

TO OUR SHAREHOLDERS AND EMPLOYEES:

Since the beginning of 1978 management has been engaged in continuous efforts to restructure the debt and capital of Talcott National Corporation and its operating finance subsidiary, James Talcott, Inc. We are pleased to report that the Restructuring Plan announced in November, 1978 for the comprehensive refinancing of certain outstanding debt and preferred shares was successfully completed on April 30, 1979.

The Restructuring Plan, as consummated, resulted in the payment by James Talcott of \$99,694,000 to debtholders and preferred shareholders in satisfaction of \$127,126,000 of debt and preferred stock, at redemption value. James Talcott also has called for the redemption, at par, on June 5, 1979, of its 5½% Senior Notes due December 1, 1979 and its 5½% Senior Notes due June 1, 1980 totaling \$3,700,000. The cash required for these payments was generated, in substantial part, from sales, basically at book value, of the assets of James Talcott's Business Finance Division.

These payments, coupled with other transactions resulting from the Restructuring Plan, increased James Talcott's net worth, which was \$56,600,000 at December 31, 1978, by approximately \$6,700,000 and increased National's net worth, which was \$1,000,000 at December 31, 1978, by approximately \$26,700,000.

James Talcott's bank revolving credit arrangement which under the previous agreement permitted maximum borrowings of \$240,000,000, with interest at 120% of prime, now provides for borrowings of up to \$188,400,000 through May 31, 1982, with interest at 125% of prime, and with no compensating balances required under either credit agreement. The agreement provides that the revolving credit arrangement on that date will be extended annually or be converted to a five-year revolving term loan with 5% quarterly reductions of the original commitment.

James Talcott also now has outstanding \$963,000 of senior notes due 1979-85; \$1,229,000 subordinated and capital notes due 1983-89; and \$757,000 of preferred stock, at redemption value, subject to mandatory redemption in 1985-90. The amounts outstanding on these notes and preferred shares prior to the restructuring aggregated approximately \$100,000,000. James Talcott's Series A Junior Preferred Shares scheduled for redemption in 1980-82, an aggregate of \$1,200,000, are not affected by the Restructuring Plan.

National's senior debt of \$6,300,000 has been reduced to \$2,900,000 and the maturity extended to the years 1985 to 1991. National's 6% Convertible Subordinated Debentures due 1994, amounting to \$25 million, were not changed by the Restructuring Plan but, as announced on April 12, 1979, National intends to make an exchange offer to these holders. Under the proposed exchange offer, which will only be made by means of a prospectus or offering circular as required by applicable securities laws, holders of outstanding 6% Debentures would be offered an opportunity to exchange such debentures for a new issue of National debt which would be non-convertible, senior to the outstanding 6% Debentures and subordinated to the senior debt of National. Although the terms of the exchange offer have not been completed, it is presently intended to offer approximately \$600 of principal amount of new debt in exchange for each \$1,000 face amount of outstanding 6% Debentures with a coupon rate consistent with current market yield on comparable securities and with maturity dates yet to be determined. Management estimates this offer will probably be made later in 1979. The closing price of the 6% Debentures on the New York Stock Exchange on April 11, 1979 was \$490 per \$1,000 principal amount.

In addition, National intends to offer its Series C preferred shareholders the opportunity to exchange their shares, which had an aggregate redemption value of \$7,090,000 and accrued dividends of \$1,385,000 at December 31, 1978, for 7½% Junior Subordinated Notes payable over 3 years in the aggregate amount of \$3,360,000.

The remaining continuing businesses of Talcott National Corporation are consumer finance and factoring. James Talcott's Factoring Division has been separately incorporated as an independent subsidiary to be known as James Talcott Factors, Inc. Its shares, along with those of City Finance Company, James Talcott's consumer finance subsidiary, are being pledged as security for the revolving credit arrangement and for the other senior debt. The assets of James Talcott Factors, Inc. and City Finance Company have not been pledged. An additional \$20,000,000 line of credit has been arranged for James Talcott Factors to provide for its periodic needs.

A report on City Finance Company's 1978 performance by Robert P. Brock, chairman, appears on page 5.

A report on The Factoring Division's 1978 performance by William R. Gruttemeyer, chairman and president of James Talcott Factors, Inc., is on page 4.

For the year 1978 Talcott National Corporation reported income from continuing operations, exclusive of an extraordinary tax credit of \$639,000, or \$.09 per common share. This compares to a 1977 loss from continuing operations of \$198,000, or \$.19 per common share.

After giving effect to discontinued operations and the extraordinary tax credit, Talcott National Corporation in 1978 had a net loss of \$1,846,000, or \$.74 per common share, compared to a net loss of \$7,995,000, or \$2.79 per common share in 1977.

For the fourth quarter ended December 31, 1978, Talcott National Corporation showed a loss of \$584,000, or \$.23 per common share as against a net loss of \$2,326,000, or \$.81 per common share for the same period of 1977.

The fourth quarter 1978 results included a loss from continuing operations of \$186,000 or \$.09 per common share, exclusive of an extraordinary tax credit of \$165,000, or \$.05 per common share, compared to a gain of \$507,000 or \$.13 per common share for the same period in 1977.

The company's wholly-owned subsidiary, James Talcott, Inc., for the year 1978 had income from continuing operations, exclusive of the extraordinary credit, of \$3,846,000, as against \$2,830,000 for 1977. Net income in 1978 amounted to \$1,361,000, including the extraordinary tax credit of \$734,000, compared to a 1977 net loss of \$4,968,000.

James Talcott's income from continuing operations exclusive of extraordinary item for the fourth quarter of 1978 was \$649,000 versus \$1,255,000 for the comparable period of 1977. Fourth quarter 1978 net income was \$251,000, including an extraordinary tax credit of \$165,000. For the fourth quarter of 1977, James Talcott, Inc., had a net loss of \$1,578,000. The loss on discontinued operations for the fourth quarter of 1978 was \$563,000, as against \$2,833,000 for the same period of 1977.

In the accompanying financial statements, the Company has treated its real estate portfolio and Business Finance Division as discontinued operations.

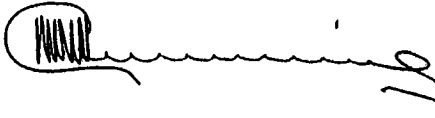
Substantial progress was made during 1978 in the management of the Company's real estate assets. During the past year, the positive net cash flow from real estate assets was \$9,000,000 as against \$6,700,000 in the preceding year. During the year \$7,000,000 was provided in additional allowances for losses and estimated future holding costs for the non-earning real estate finance receivables and owned properties held for sale. This compares with \$10,500,000 provided in 1977 for this purpose.

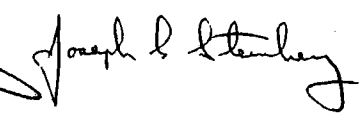
The net investment in real estate in 1978 declined by \$12,600,000. While significant reductions in real estate investment have been accomplished during the past two years, it must be noted that satisfactory resolution of the real estate problems will require an extended period of time and is dependent, to a great extent, upon market conditions and the outcome of pending litigation.

During 1978 several management changes took place. Ian M. Cumming was elected chairman of the Board of Directors and president of Talcott National Corporation in June, 1978, and chairman of the Board of Directors and president of James Talcott, Inc. in August, 1978. In December, 1978, Joseph S. Steinberg was elected to the Board of Directors of Talcott National Corporation and James Talcott, Inc., and in January, 1979 was named president of both Talcott National Corporation and James Talcott, Inc.

Effective May 16, 1979, John W. Jordan, II, vice president, Carl Marks & Co., Inc. and Lawrence D. Glaubinger, chairman, Stern & Stern Textiles, Inc. were elected directors of Talcott National Corporation and James Talcott, Inc. Messrs. Jordan and Glaubinger are associated with Marks Investing Corporation, which together with Messrs. Cumming and Steinberg, indirectly acquired 1,600,000 shares of Talcott National Corporation on April 30, 1979.

We wish to thank our clients, creditors, employees and shareholders for their loyalty and support.


Ian M. Cumming
Chairman of the Board


Joseph S. Steinberg
President

The recent successful closing of the Restructuring Plan has had an important effect on our factoring operations and offers new opportunity and increased potential for improving performance in the years ahead.

Under terms of the Plan, the factoring business, which has been operating as a division of James Talcott, Inc., has been incorporated as a separate company to be known as James Talcott Factors, Inc. One immediate direct benefit of this move is the establishment of one of the strongest balance sheets in the factoring industry.

This, along with other advantages derived from the restructuring, considerably strengthens our position and gives tacit assurance to present and prospective clients of our ability to provide more and better services.

James Talcott Factors, Inc., is a unique new company that is actually 125 years old in terms of its history, tradition and experience. 1979 marks the Silverterennial anniversary of the founding of our factoring business which was begun in 1854.

In 1978 The Factoring Division enjoyed one of the best years in our long, proud history, and achieved an increase, over 1977, of \$1.8 million in pretax income, exclusive of a \$1.4 million non-recurring insurance recovery related to a Swiss factoring office which was discontinued in 1976.

Our stated pretax profit objective for 1978 was to exceed 4% of average funds employed. Actual 1978 pretax earnings, excluding the insurance recovery, amounted to 5.7% of average investment.

The high profit yield was attained as the result of several contributing elements but was due principally to substantially reduced purchased receivable losses and an increase in average investment of approximately \$9 million.

Net purchased receivable write-offs in 1978 were .05% of factored volume, compared to .18% of factored volume in 1977, a reduction of 72%. This substantial improvement was directly attributable to three major causes.

First, most customers improved inventory control and reduced purchase commitments which enabled them to maintain better financial positions. Second, we continued to improve the performance of our customer credit administration. And lastly, recoveries from amounts written off in prior years increased as a percentage of gross write-offs.

The provision for client losses increased 50% in 1978 to .3% of average funds employed from .2% in 1977. This increase, while anticipated, is still well under the accepted industry standard of approximately .5% of average funds employed. This lower than normal incidence of client losses reflects the effective client administration and sound marketing standards and practices of our account executives.

Direct expenses rose approximately 9% in 1978 as against a pretax earnings increase of 49%. The increase in direct costs was attributable, in part, to inflationary pressures and had been anticipated. A considerable amount of these higher costs related to the development of new data processing systems. This expenditure is regarded as an investment which will help to increase our operating efficiencies in the years ahead by providing improved on-line application systems which are, and will continue to be, among the most advanced in the industry.

Over the past several years we have been able to substantially and consistently improve our earnings. Our average factored investment has grown steadily each year since 1975 and in 1978 rose 10.1% over the previous year. James Talcott Factors, Inc.'s return on funds employed is believed to be among the highest in the industry. We have been able to achieve these results while also furnishing responsive, timely, innovative and liberal financial and credit related services to our clients and their customers.

Our goals for 1979 are for moderate increases in volume and average investment and for pretax earnings to again exceed 4% of average funds employed. In the coming year we expect an increase in purchased receivable losses to a moderate level of about .15% of factored sales volume. Fractional increases are also anticipated in client losses and direct expenses.

The added benefits to our factoring business resulting from the restructuring give us encouragement for attaining both our short-term and long-term objectives.

Further, the substantial increase in the net worth of Talcott National Corporation and James Talcott, Inc., should enable James Talcott Factors, Inc. to obtain funding in amounts adequate to service its existing portfolio and to provide for planned growth.

Additionally, as a result of the successful completion of the restructuring, the executives and operating personnel of James Talcott Factors, Inc., are now free to devote their full attention to the expansion and refinement of our factoring services.

Throughout the recent period of uncertainty, we managed to retain our reputation for integrity, quality of performance and profitability. We are now better geared to move forward. With the continued support of our factored clients and traditional referral sources such as accountants, attorneys and bankers, we are confident that we will regain our position of eminent leadership in the field.

Our Financial Statements begin on page 34.


William R. Gruttemeyer
Chairman and President
James Talcott Factors, Inc.

For 1978 receivables, representing cash instalment loans made directly to customers and retail instalment contracts purchased from dealers, were at a record high \$102,615,000. This represents an increase of \$17,158,000, or 20% over the 1977 receivables. The volume of receivables for 1978 also rose to \$120,618,000 which is an increase of 25% over the previous year.

As a result of only limited funds being available for expansion, City Finance Company continued to conduct its consumer finance operation from 102 branch offices located in eight states, primarily in the Southeastern part of the country.

In 1978, pretax income was \$3,583,483, a decrease of 26% from the record \$4,853,200 of 1977. 1978 net income represented a 4.9% return on average net receivables, compared to 7% for 1977. The decline in net income was attributable principally to three factors. First, interest expense increased due to a higher prime rate by \$1,422,000, or 34%, on an increase in average net receivables of 5%. Second, provision for losses increased \$842,000 over 1977, though actual net credit losses were reduced. Third, a reduction in gross income of approximately \$1,000,000 was caused by an adverse Tennessee Supreme Court decision limiting the interest charged on Tennessee originated loans to 10% per year. City operating expenses as a percentage of gross income were reduced. Despite the negative factors, income before taxes and interest expense stated as a percentage of average net receivables was 12.6% in 1978, the second highest return in recent years.

The high quality of City's receivables was again very evident. The ratio of net credit losses to average outstanding loan receivables was 1.11% and net credit losses to liquidations on dealer contracts was .78% compared to 1.23% and .86%, respectively, in 1977. Delinquencies continue favorable. Loans delinquent 60 days or more on a contractual basis were 1.66% in 1978 compared to 1.85% in 1977 and on a recency of payments basis, 1.70% in 1978 compared to 1.74% in 1977. At December 31, unearned interest on pre-computed loans receivable as a percentage of gross outstandings at year-end 1978, increased by 15% to 21.4%. The

unearned premium on credit related insurance increased by more than \$1,000,000. These two deferred items represent revenues which will be reflected in future earnings.

As noted above, financial and operating results for 1978 were affected by our Tennessee operations. Because of a Tennessee Supreme Court decision in August, 1977 declaring parts of the State Loan Act to be unconstitutional, City suspended its lending activities in that state from August, 1977 to April, 1978. However, an amendment to the State Constitution was passed in March, 1978, allowing all provisions of existing statutes regulating rates of interest and other charges to remain in full force and effect until July 1, 1980. Following that amendment, City once again became active in making consumer loans in Tennessee. At the time of the August, 1977 Supreme Court decision, City had \$27,257,000 in Tennessee loan receivables. Suspending lending activities for the seven-month period resulted in a reduction to \$16,585,000 by April, 1978 when we reactivated operations in Tennessee. An active solicitation program to regain the lost loan receivables was successful and, at the 1978 year end, Tennessee loan receivables had increased to \$28,397,000.

New legislation was recently enacted in Tennessee to be effective July 1, 1979, which permits the same interest and loan charge rates as contained in the loan act under which we are now operating and with a permitted increase in maximum maturities. This law removes one of the uncertainties affecting our future operations.

Continued high interest cost will adversely affect 1979 profits. However, with the increase in deferred revenues, enactment of the aforementioned Tennessee legislation, a portfolio of high quality receivables and a commitment to cost control, we are optimistic that 1979 will be a good year.

Our Financial Statements begin on page 40.



Robert P. Brock
Chairman
City Finance Company

TO OUR SHAREHOLDERS AND EMPLOYEES:

The year 1979 saw substantial progress in management's continuing efforts to restructure the debt and capital of Talcott National Corporation and its operating finance subsidiary, James Talcott, Inc. (Talcott).

The Restructuring Plan as ultimately consummated on April 30, 1979, resulted in the payment by the Company of \$131,624,000 to debtholders and preferred shareholders in satisfaction of \$160,750,000 of debt and preferred stock. The cash required for these payments was generated primarily from the sale of the assets of Talcott's Business Finance Division. As a result of the Restructuring Plan, the Company's common shareholder's equity was increased by approximately \$26,700,000. Further increases in common shareholders' equity subsequently resulted (a) in the amount of \$5,408,000 from the exchange of 7½% Junior Subordinated Instalment Notes for 96.5% of the then outstanding Series C Preferred Shares and (b) in the amount of \$5,004,000 from the exchange of \$8,185,000 principal amount of 13¾% Senior Subordinated Debentures for \$13,641,000 (54.6%) of the Company's then outstanding 6% Convertible Subordinated Debentures.

These transactions placed the Company and Talcott in a much stronger financial position than at any time in recent years although the high cost of bank borrowings and the provisions related to

these borrowings substantially limited the ability of the Company to finance the growth of both the factoring and consumer finance businesses. With this background, an agreement to sell the factoring business conducted by a subsidiary, James Talcott Factors, Inc., was entered into by management in October 1979 with Lloyds and Scottish Limited. Stockholders approved this sale at a special meeting held on February 13, 1980. Detailed information about the sale can be found in the proxy statement relating to that meeting. The sale was consummated in late May 1980. As a result, the Company has changed its name to Leucadia National Corporation and Talcott has changed its name to Leucadia, Inc. The new symbol on the New York Stock Exchange for the Company's common shares is "LUK".

The proceeds from the sale have been used to reduce Talcott's senior debt. The senior debt remaining after the sale has been successfully refinanced with a smaller number of banks at a lower interest rate and with the elimination of certain restrictive covenants.

For the year ended December 31, 1979, the Company reported net income of \$19,310,000 or \$5.81 per common and dilutive common equivalent share (\$5.02 on a fully diluted basis). Included in this amount was an extraordinary credit of \$25,644,000 or \$7.72 per common and dilutive common

equivalent share (\$6.26 on a fully diluted basis) resulting from the settlement of debt described above. This compares with a net loss for 1978 of \$1,846,000 or \$.74 per common share. The Company, for 1979, reported a loss from continuing operations of \$1,347,000 or \$.41 per common and dilutive common equivalent share (\$.02 on a fully diluted basis). Losses from discontinued operations for 1979 were \$4,987,000 or \$1.50 per common and dilutive common equivalent share (\$1.22 on a fully diluted basis) compared to income in 1978 of \$742,000 or \$.25 per share.

Talcott reported net income for the year ended December 31, 1979 of \$15,157,000, including an extraordinary credit resulting from settlement of debt of \$18,936,000. This compared with net income in 1978 of \$1,361,000, including an extraordinary tax credit of \$734,000. Income from continuing operations amounted to \$669,000 in 1979 compared with \$364,000 for 1978. Talcott's discontinued operations in 1979 reported a loss of \$4,447,000 in contrast to income of \$263,000 in 1978.

City Finance Company, Talcott's wholly-owned consumer finance subsidiary, reported income before income taxes of \$4,154,000 in 1979 compared with \$3,583,000 in 1978. Revenues for 1979 were \$25,407,000, an increase from \$20,782,000 in 1978 or an increase of more than 22%.

A report on City Finance Company's 1979 perfor-

mance by Robert P. Brock, Chairman appears on page 42.

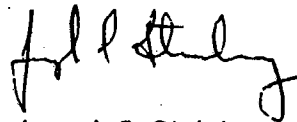
In spite of additional provisions for losses and future holding costs of \$5,271,000 in 1979, continued progress has been made in the management of the Company's real estate assets. Realization on the real estate portfolio produced a net positive cash flow of \$8,000,000 in 1979 and \$9,000,000 in 1978. Management expects the orderly liquidation of the real estate portfolio to continue during the coming year.

Although we are heartened by 1979's progress, it must be noted that we are affected to a considerable degree by market conditions and high interest costs. A continuation of these historically high interest rates could adversely affect our results of operations and financial position—particularly in the consumer finance business where increased borrowing costs are not readily passed along. Furthermore these high interest costs coupled with a depressed economy could result in increased credit losses.

We wish to thank the many lending institutions, employees and shareholders who have continued to provide their support to the Company and its management.



Ian M. Cumming
Chairman



Joseph S. Steinberg
President

**MESSAGE FROM THE CHAIRMAN OF THE
BOARD AND PRESIDENT:**

The 126th year of our Company was a busy one which included significant changes in our businesses. We entered the year with an agreement to sell our factoring subsidiary, James Talcott Factors, Inc., to Lloyds and Scottish Limited. The closing of the sale occurred later than anticipated due to delays in obtaining regulatory approval. Unfortunately, the period from year-end to the sale date was a period of high interest rates and an unfavorable economy, particularly in the industries served by the factoring operations. The deterioration in the financial condition of several factoring clients resulted in our establishing substantial provisions for losses prior to the sale. However, on May 27, 1980, the sale was consummated. We sincerely miss our friends at James Talcott Factors and are very appreciative of the support of their employees and management throughout the years. One result of that sale was the elimination of the James Talcott name under which the Company had operated since its inception.

Another major development, on December 3, 1980, we acquired American Investment Company (AIC), a holding company engaged in consumer financing and insurance activities. Through City Finance Company we have been actively engaged in consumer financing for some years; however, insurance not related to consumer financing is a new business to us. We are very pleased with the Insurance operations. The comments of Lawrence

L. Hoffman, Chief Operating Officer of the insurance operations, are included in this portion of the annual report.

Our consumer finance operations are headed by Robert P. Brock, Chairman of City Finance Company since 1978. City Finance, which is now part of AIC, had an outstanding year in 1980. The depth of experienced management at City Finance enabled us to begin to integrate the operations of City Finance and AIC and to eliminate duplications. We have found in AIC an experienced, dedicated and very able consumer lending group and look forward to the results of integrated operations. A report by Mr. Brock on the consumer finance operations is also included in this section of the annual report.

In 1980, and in 1981 to date, substantial litigation related to our real estate has been resolved. The resolution of one potential problem enabled our independent auditors to render an unqualified opinion on our financial statements for the first time since 1975.

For the year ended December 31, 1980, the Company had income from continuing operations of \$662,000 or \$.21 per common and dilutive common equivalent share; income from discontinued operations of \$477,000 or \$.15 per common and dilutive common equivalent share; an extraordinary credit from use of net operating loss carryforwards of

\$753,000 or \$.23 per common and dilutive common equivalent share and net income of \$1,892,000 or \$.59 per common and dilutive common equivalent share. The 1980 results include AIC's operating results since its acquisition on December 3, 1980.

For 1979, the Company had a loss from continuing operations of \$1,347,000 or \$.41 per common and dilutive common equivalent share (\$.02 on a fully diluted basis); loss from discontinued operations of \$4,987,000 or \$1.50 per common and dilutive common equivalent share (\$1.22 on a fully diluted basis); extraordinary credits from implementation of the Restructuring Plan and the debt exchange offer of \$25,644,000 or \$7.72 per common and dilutive common equivalent share (\$6.26 on a fully diluted basis) and net income of \$19,310,000 or \$5.81 per common and dilutive common equivalent share (\$5.02 on a fully diluted basis).

In December 1980, management announced that it was exploring the feasibility of and various techniques to accomplish a transaction or series of transactions that might result in its common stockholders being afforded the opportunity to receive approximately \$9 in cash or preferred stock, the terms of which had not yet been determined, in exchange for each share of common stock. Management currently is exploring the feasibility of an exchange offer that would afford holders of up to 1,400,000 shares of its common stock the opportunity to receive preferred stock of

the Company, the terms of which have not yet been determined, in exchange for their shares. Such exchange offer would be made only by means of a prospectus as required by applicable securities laws. We will keep you informed as to decisions taken in this regard.

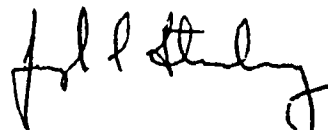
The accomplishments of 1980 required a tremendous effort on the part of our officers and employees. We sincerely thank them for their unselfish efforts and the many sacrifices made on behalf of the Company.

We also are very appreciative of the support of our lenders. We made many requests of them, often on short notice, and they invariably responded in a positive and constructive manner.

This year, for the first time, we are including the annual report filed with the Securities and Exchange Commission on Form 10-K as an integral part of our shareholders' report. This presentation will provide our shareholders with more detailed descriptions of our business, statistical data and financial statements than previously were available in our annual reports.



Ian M. Cumming
Chairman



Joseph S. Steinberg
President

REPORT ON CONSUMER FINANCE OPERATIONS:

The 1980 year proved to be a very challenging but rewarding one for City Finance Company which, until the acquisition of AIC on December 3, 1980, comprised the Company's consumer finance operations. During the first half of the year, we restricted the growth of our receivables, due to the federal government's credit restraint program. This was followed by management's decision to continue the restriction, due to limited availability of funds and the record-high cost of borrowed funds. We concluded the year with a great deal of our energy directed toward the closing of the acquisition of AIC with its very large receivable base.

In spite of the above restraints, the diversion of attention to the AIC acquisition and a depressed economy, City Finance Company had record earnings for the year. Net income amounted to a record \$2,865,000, a gain of 33% over 1979 net income of \$2,152,000. These figures do not include the results of AIC's operations which are included in the financial statements of Leucadia National Corporation from December 3, 1980 to the end of calendar 1980.

City Finance's income before income taxes and interest expense expressed as a percentage of average net receivables also set a record high, at 15.03%. This compares to 14.43% in 1979. This percentage return continues to be unusually high for the consumer finance industry.

Income and expense items are also best analyzed by relating them to average net receivables. On this basis, net revenues were 28.7% of average net receivables in 1980, compared to 28.9% of average net receivables in 1979 and operating expenses decreased to 10.4% of average net receivables in 1980 from 10.9% in 1979.

City Finance's contractual delinquency of 60 days or more was 2.19% of outstanding receivables, an increase from 1.78% in 1979. Net credit losses to average net direct consumer loans outstanding

were 1.90% in 1980, compared to 1.22% in 1979. Credit losses on dealer instalment contracts were .90% of liquidations as compared to 1.06% in 1979. The increase in our delinquency and charge-off rates were a direct result of the depressed economy with its accompanying heavy unemployment, and the increased use of the liberalized exemptions offered in the new bankruptcy code. Although the above delinquency and charge-off ratios show an increase for 1980, they are still among the lowest in the industry.

Although AIC has not experienced earnings on its receivables as favorable as has City Finance, we believe the profile of the average AIC customer is essentially similar to a City Finance customer. Accordingly, I am very optimistic about the great potential offered by the AIC acquisition, and the addition of its experienced personnel, who after several years of an uncertain future with other potential AIC merger partners, are eager to return to the normal routine of the consumer finance business. With AIC's large receivable customer base to work with, our future growth appears to be most promising.

Our management team feels very confident in its ability to improve both the quality of the receivables and earnings. We will, assuming the availability of reasonably priced money, direct our attention to expanding our receivables in those states offering the best gross income yields and strive to continue to decrease our direct costs as a percentage of the net receivables employed.

On balance, 1981 should be a good year for the consumer finance operations.



Robert P. Brock
Chairman of City Finance Company and
Chief Operating Officer of the Consumer
Finance Operations.

REPORT ON INSURANCE OPERATIONS:

The purchase of AIC resulted in Leucadia National Corporation entering the non-credit related insurance business through AIC's subsidiary, Charter National Life Insurance Company, and its subsidiary, Charter American Insurance Company. In addition, City Life Insurance Company, a former subsidiary of City Finance Company, became a subsidiary of Charter American and these three companies now comprise the insurance operations of Leucadia National Corporation.

The purpose of this report is to acquaint you with these companies. The figures mentioned below reflect amounts for all of 1980's operations, though, except for City Life, the earnings of the insurance operations are included only in Leucadia National's consolidated financial statements from December 3, 1980.

CHARTER NATIONAL LIFE INSURANCE COMPANY

During the past decade, a handful of the more than 1,800 life insurance companies in the United States and Canada have effectively reshaped the insurance marketplace and have established

themselves as an important part of the insurance industry. Charter National Life is one of these companies, and is recognized as one of the country's most innovative insurance marketers, operating in the highly competitive life brokerage market and specializing in the underwriting of impaired risk or hard to insure cases, and in the development of innovative life insurance products. The company is licensed in 49 states, the District of Columbia, Canada, and Puerto Rico.

Its most recent product innovations include Single Premium Interest Adjustable Life (SPIAL), a paid-up life insurance policy which utilizes today's high interest rates to produce a lower cost for the consumer. Under this program, Charter may adjust benefits upward or downward every five years, depending upon changes in interest rates. First introduced in late 1979, SPIAL accounted for 44.1% of the Company's new ordinary business written in 1980.

Another new program is the Retired Lives Reserves ("RLR"), a product which provides the equivalent of paid-up group life insurance at retirement to employees of small to medium-size corporations. Charter National offers several versions of this program, one of which was unique to the industry

when first offered by Charter National in late 1978. The Company has pioneered other aspects of RLR, including lifetime funding and excess interest crediting. RLR accounted for 21.5% of the Company's new business in 1980.

The balance of Charter's business results from aggressive underwriting of impaired risk or rated business. The Company uses a highly skilled team of professional underwriters and medical personnel, together with access to domestic and international reinsurance markets, to arrive at an acceptable price for the buyer. This insurance specialty is confined to only a few companies, and Charter National has been in this business since 1967.

Credit insurance operations of Charter National Life have been conducted in two parts, captive and non-captive. The captive credit business is written for customers of the AIC consumer finance operations and the non-captive business is written for non-related parties. Leucadia is not new to the captive business, since City Life has been involved in captive credit insurance for a number of years.

CHARTER AMERICAN INSURANCE COMPANY

Charter American is the property and casualty subsidiary of Charter National Life, and is licensed to operate in 33 states. Except for its credit property lines (household goods and lenders' collateral protection), most other major lines have been historically unprofitable. In 1979, the Company began a planned program of curtailing and/or discontinuing major lines of business which were unprofitable, due to high claim reserves and extraordinary losses. This program should be completed as of May 31, 1981. Charter American expects to eventually confine its activities primarily to credit property lines as a reinsurer.

We in the Charter group look forward to contributing to the operations of Leucadia and believe we will make an important contribution to its future earnings.



Lawrence L. Hoffman, CLU
President of Charter National Life Insurance Company and Charter American Insurance Company and Chief Operating Officer of the Insurance Operations

1981

**MESSAGE FROM THE CHAIRMAN
OF THE BOARD AND PRESIDENT:**

1981 was another year of continuing improvement in your Company's financial condition.

During the year the capitalization of the Company was substantially changed by (i) the retirement, at discount, of the Company's 8-¾ % Senior Note, (ii) the Exchange Offer whereby 656,301 Series E \$1.85 Cumulative Preferred Shares were issued in exchange for an equal number of common shares, (iii) the cash tender offer for 6% Convertible Subordinated Debentures which was started in 1981 and completed in 1982 and (iv) the substantial reductions in bank and short-term debt more fully described below. Perhaps most importantly, we have fully digested the acquisition of American Investment Company ("AIC"), which took place on December 3, 1980, and have positioned the Company to take advantage of opportunities as they appear.

Shortly after the AIC acquisition was consummated, we concluded that it was not desirable to finance consumer finance receivables (which are essentially long-term, fixed rate obligations) with bank borrowings (which are essentially volatile, variable rate obligations). Accordingly, we determined to reduce the investment in consumer finance receivables by approximately \$125,000,000. This was principally accomplished by sales of receivables completed in March and April 1981 and the recently completed sale to an affiliate of Manufacturers Hanover Trust Company. Since completion of that sale, our consumer finance operations have been essentially free of variable rate indebtedness and principally financed by long-term indebtedness that had an average stated interest rate of 6.58%. We are also very pleased that during 1981 AIC, for the first time

in many years, was able to sell a substantial amount of commercial paper. This form of temporary financing is much less expensive than bank borrowings. Although AIC has no current need to issue commercial paper, we believe it has the ability to issue commercial paper at any time if desired.

As you know, prior to the acquisition of AIC we were not involved in non-credit related insurance operations. During 1981, we studied the industry in detail, had actuarial studies pertaining to our insurance operations prepared and engaged an investment banker to advise us. We then concluded that the potential sales value of the life insurance operations was sufficiently attractive for us to pursue a sale. To date, no sales agreement has been entered into and no assurance can be given that any sale will result.

We also determined to sell the casualty insurance operations since the risks inherent in that type of business are greater than we care to assume. The sale of these operations, which is scheduled to close in early April, will result in a gain which will be reflected in 1982 results of operations.

Our real estate operations, which are classified for financial reporting purposes as a discontinued operation, had an operating loss in 1981. However, we did receive over \$11,000,000 in proceeds from the sale of properties. We also reinvested over \$7,200,000 in a New York City commercial office building which we have been involved with for many years and which, because of the booming New York City commer-

cial real estate market, has increased in value. We are now in the process of leasing available space in that building which should further increase its value. To date in 1982 we have sold properties which had a book value of \$1,900,000 for \$9,300,000. The gain on these sales will be reflected in 1982 results of discontinued operations.

Consolidated net income for the year ended December 31, 1981 was \$7,835,000 compared to net income for the year ended December 31, 1980 of \$1,892,000. Income from continuing operations in 1981 was \$5,056,000 compared to \$662,000 in 1980. The 1981 results include AIC for the entire year but for 1980 AIC is only included for approximately one month. Discontinued operations had a loss of \$1,700,000 in 1981 and income of \$477,000 in 1980. The 1980 discontinued operations include the gain on the sale of James Talcott Factors, Inc. Extraordinary credits totaled \$4,479,000 in 1981 and \$753,000 in 1980. The 1981 extraordinary credits included a gain of \$1,021,000 on repurchase of the Company's Senior Note and \$1,100,000 representing a portion of the gain resulting from the cash tender offer for 6% Convertible Subordinated Debentures. In 1982, the Company will report an additional extraordinary gain resulting from that offer. Other extraordinary items result from utilization of tax loss carryforwards.

We are very optimistic about the future of our Company. We believe that the consumer finance operations are efficiently managed and, in this period of record high interest rates, properly financed; that our insurance operations should, if

not sold, continue to be profitable and to offer innovative products; and that the Company is prepared to take advantage of opportunities.

Further, in March 1982, we acquired, principally through a cash tender offer, 57% of the outstanding common shares of TFI Companies, Incorporated ("TFI"). TFI is an American Stock Exchange listed company primarily engaged in the manufacture and distribution of building materials and the processing and distribution of meat products. Although, we are just becoming familiar with TFI, we believe we have made a wise investment in that company.

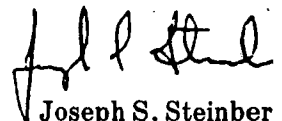
The comments of our chief operating officers are included in this portion of our annual report. We have also included the Form 10-K as filed with the Securities and Exchange Commission, which includes the annual audited consolidated financial statements and statistical and other data.

During the year we again made many requests of our bankers, often on very short notice. Again, they responded in a timely, efficient and positive manner. Many of our accomplishments would not have happened without their support.

The demands made on our officers and employees during 1981 were extreme and we cannot thank them enough for their efforts on behalf of our Company.



Ian M. Cumming
Chairman



Joseph S. Steinber
President

REPORT ON CONSUMER FINANCE OPERATIONS:

In looking back at the operations of the consumer finance group in 1981, one thing becomes crystal clear—it will not be quickly forgotten by this writer.

The acquisition of AIC on December 3, 1980 increased our consumer finance operation from 103 offices operating in 8 states with net receivables of approximately \$124 million at December 31, 1979 to 358 offices operating in 25 states with approximately \$427 million in receivables at December 31, 1980. Moreover, the consumer finance group entered 1981 operating from two home office locations, with different operating and financial reporting staffs and different operating procedures and philosophies.

As we entered 1981, we became convinced that we could no longer make consumer loans (which have long-term maturities and fixed rates) by funding them with bank loans particularly in a period of extremely volatile interest rates. From this conclusion our operating policy for 1981 was developed. That was to reduce our dependence upon expensive debt through a reduction in our outstanding receivables. Additionally, we determined to reduce our home office operating expenses by consolidating the two separate home office locations under City Finance and to implement the operating policies throughout all our operations that had made City Finance so successful in the past.

To achieve the reduction in such debt, we immediately set upon a program that would reduce receivables by approximately \$125 million. This reduction was accomplished primarily through the sale of receivables to four different companies in a program which has only recently been completed. Upon the completion of the sale of our West Coast offices to Manufacturers Hanover Consumer Services, Inc. on February 1, 1982, our consumer finance receivables had been reduced from \$427 million at the beginning of 1981 to \$199 million.

Consolidation of the two home offices was accomplished in two stages. First, in early 1981, operational control of consumer finance offices in several Southeastern states was transferred from Saint Louis to City Finance in Memphis. Then, in July, the remaining operations were transferred to Memphis. The consolidation resulted in a substantial reduction in home office

personnel and overhead expenses. Of at least equal importance, this consolidation enabled us to blend the operations and achieve greater uniformity and improved operating control.

Our operating and financial results for 1981 are difficult to compare to 1980 due to the acquisition of AIC; however, the following should be noted:

- ☐ contractual delinquency of 60 days or more stated as a percentage of outstanding receivables was down 30%, from 8.00% in 1980 to 5.56% in 1981,
- ☐ credit losses increased from 2.11% in 1980 to 3.35% in 1981 and
- ☐ earnings in the acquired AIC offices increased substantially.

The heavy credit losses are continued evidence of a depressed economy with an ever increasing percentage of unemployed in our nation's work force. Also adversely affecting our credit losses is the continuing high number of bankruptcies filed as a result of the liberal exemptions allowed under the bankruptcy code.

We will continue to reduce receivables principally through liquidations in our generally less profitable Northeastern offices. The remaining receivables will be used as a solid base for our ongoing operations. New growth through acquisitions will be pursued as opportunities arise provided we obtain acceptable financing.

With the reduction in receivables, with some recovery in our economy and with encouragement that the abuses permitted by the bankruptcy code will be corrected I am optimistic about the potential improvement in all phases of our operations for 1982. We should then be positioned to enter 1983 with receivables of excellent quality and high yields and should produce an outstanding profit contribution for the Company.

Our efforts will be dedicated toward that end.


Robert P. Brock
Chairman of the Board
City Finance Company

Message from The Chairman of The Board and The President:

The 1982 year was an outstanding year in the 128 year history of your Company. Many events, the foundation for which had been laid during the last few years, came to fruition in 1982. In addition, the Company took advantage of other opportunities as they arose to improve the Company's financial condition and to lay the foundation for future growth.

Although the 1982 consolidated results of operations reflect several significant transactions recorded as extraordinary or non-recurring items in the consolidated income statement, perhaps the most significant transaction was the sale in early February of approximately \$65,000,000 of such receivables. This sale completed the planned \$125,000,000 reduction of consumer finance receivables. The funds from this sale were utilized to retire substantially all of the American Investment Company ("AIC") variable rate indebtedness and ultimately to acquire a portion of AIC's long-term indebtedness at a substantial discount. After completing this sale, the Company's consumer finance operations were principally located in those states where City Finance Company has historically operated most successfully.

We are committed to the consumer finance industry and believe there is a substantial opportunity for growth and future profits. Our consumer finance operations are headed by Robert Brock and supported by a highly competent and experienced staff. His report on the consumer finance operations is separately included.

During 1982 we had discussions with several potential buyers for Charter National Life Insurance Company ("Charter") our life insurance subsidiary. However, we have decided not to sell Charter. We determined that its profitability was being substantially reduced by excessive overhead. David Cumming, Vice President and General Counsel of your Company, was elected Chairman and President of Charter with instructions to reduce the excessive overhead and develop new life insurance products. We are happy to report that progress is being made in that regard.

In 1982, Charter introduced its TAPLAN product, which is discussed in more depth in David Cumming's report on the insurance operations. In summary, sales of TAPLAN in 1982 were approximately \$63,971,000. However, as much as TAPLAN has characteristics substantially different from that of other insurance products sold by Charter, we have decided to defer recognition of all income related

to TAPLAN until we have had more experience with it. Our experience to date has been satisfactory and we believe it is likely that TAPLAN and other similar products will add substantially to our future profits.

We see Charter as a provider of specialty insurance products that include increasing cash value features and hope to significantly expand this area of our business.

In the spring of 1982 we perceived an opportunity to retire AIC's low rate long-term indebtedness at a substantial discount from principal amount principally using cash generated from the sale of the consumer finance receivables. We believed that interest rates were declining from historically high levels and that AIC would be able to borrow in the future at lower rates—particularly in light of the substantial improvement in AIC's operations and capitalization. Cash tender offers for AIC and the Company's debt resulted in an aggregate \$42,036,000 principal amount of indebtedness being acquired for approximately \$30,161,000.

The 1982 results of operations include extraordinary credits aggregating \$24,192,000 and non-recurring credits including a gain from settling a long-outstanding federal income tax matter. Discontinued operations include gains of \$7,200,000 from the sale of certain real estate properties and approximately \$1,600,000 from the sale of the casualty insurance subsidiary. In 1983, we expect, AIC's dividends and earnings will enable the Company to reduce a substantial portion of the Company's outstanding bank indebtedness.

The Company was involved in several acquisitions in 1982. It acquired 57% of the outstanding common shares and certain convertible and non-convertible debt of Cardiff Equities Corporation ("Cardiff"), formerly TFI Companies, Incorporated, an American Stock Exchange company with remaining interests in building materials distribution and manufacturing. As we expected at the time of the tender, Cardiff has not operated profitably since acquisition, principally because of the depressed economy. Since Cardiff was purchased at less than the reported book value and is independently financed, our financial exposure is limited to our relatively modest remaining investment. We ultimately expect Cardiff to be a positive contributor to earnings and a vehicle for growth in the non-financial area. Cardiff has required a disproportionate amount of management's time and attention and in retrospect, our timing of this acquisition could have been better.

In mid-December, the Company acquired Terracor, a company which had been in chapter 11 bankruptcy proceedings and formerly controlled by your Company's Chairman. Prior to approving the acquisition, the Board of Directors appointed a committee of independent directors and engaged real estate appraisers and independent investment bankers to review the transaction. We believe we acquired Terracor's assets at less than fair value and ended litigation that was occupying substantial management time. We also became a partner with John W. Jordan II, a Director of the Company, in The Jordan Company, a firm specializing in structuring leveraged buy-outs. As a result during 1982, we became a 22-30% equity owner in four companies. These companies have operated profitably since acquisition and the Company recorded its portion of their earnings in results of operations.

AIC terminated its bank credit agreement early in 1983 and in related transactions (i) entered into a \$25,000,000 7½ year credit agreement with a bank and (ii) participated in a relatively new form of financing called an "interest rate swap". These related transactions have the effect of converting the variable rate credit agreement borrowings into a 12.2%

maximum fixed rate financing. The Company also called for redemption, on March 1, 1983, its 6% Convertible Subordinated Debentures.

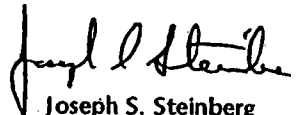
On March 10, 1983, the Board of Directors declared a two-for-one stock split to be effective in the form of a 100% stock dividend payable on April 6, 1983 to stockholders of record on March 23, 1983.

We are very appreciative of the support of our bank lenders who have again responded to our frequent requests in a constructive and innovative manner, often on very short notice. We are also thankful for our very capable employees and professional advisors of whom we often make unreasonable requests, but who always fulfill such requests in an unfailing manner while continuing to perform their more routine assignments in an extraordinary fashion.

1982 was an extraordinary year which we cannot expect will soon be repeated. It has provided a strong financial foundation which will be a basis for future earnings growth. It was a year our loyal shareholders deserved.



Ian M. Cumming
Chairman



Joseph S. Steinberg
President

Message from The Chairman of The Board and the President

1983

Your Company finished its 129th year, with its common shareholders' equity at an all-time high of \$73,498,000. The Company's capital base (common shareholders' equity, preferred shares and subordinated indebtedness) was strengthened by the successful completion of two public offerings of preferred stock: \$30,000,000 of Series F \$2.00 Convertible Exchangeable Preferred Stock in May 1983 through Merrill Lynch White Weld Capital Markets Group; and \$50,000,000 of Series G Adjustable Rate Cumulative Preferred Stock in December 1983 through Drexel Burnham Lambert Incorporated. This gives us \$179,622,000 of capital base. The capital base is particularly important to finance companies since lenders generally permit senior indebtedness to be a multiple of the capital base.

The 1983 consolidated results of operations reflected improvement in continuing operations. Income from continuing operations in 1983 was \$15,596,000 or \$2.41 per common share as compared to \$10,455,000 or \$1.75 per common share in 1982. 1983 extraordinary credits and discontinued operations were \$5,126,000 or \$.96 per common share. Extraordinary credits and discontinued operations include utilization of tax loss carryforwards and gains on sale of the discontinued real estate finance assets.

A number of other significant events occurred in 1983 and early in 1984:

We have paid off all debt remaining from the 1979 restructuring plan.

A two-for-one stock split in the form of a 100% stock dividend was effected in April 1983.

Our subsidiary, American Investment Company ("AIC"), terminated its bank credit agreement early in 1983 and entered into a \$25,000,000 7½ year credit agreement with a bank and participated in a relatively new form of financing called an "interest rate swap". A second \$25,000,000 "interest rate swap" was entered into in November and a second \$25,000,000 credit agreement was entered into in March 1984. The effect of the interest rate swap agreements and related credit agreements is to effectively convert variable rate debt to a fixed rate which is designed to more appropriately finance our consumer finance operations.

Our Board of Directors authorized the purchase of up to 300,000 common shares. Through March 12, 1984 we have acquired 250,215 common shares at an average cost of \$18.47 per share. We consider this an excellent investment for the Company.

On April 2, 1984, our Utah based industrial loan and thrift company was converted into a national bank which will take money market and other non-demand deposits insured by the Federal Deposit Insurance Corporation ("FDIC").

On March 23, 1984, we placed an \$18,300,000 non-recourse mortgage on our New York City headquarters building. We also have received several offers, which we are currently evaluating, to sell the building for approximately \$18,000,000 in excess of its book value.

On March 29, 1984, we announced that a letter of intent had been signed to acquire Columbia National Life Insurance Company for \$18,000,000. Completion of the acquisition is subject to certain conditions.

We continue to be committed to the consumer finance industry and believe that there is a substantial opportunity for growth and future profits. The report of Robert Brock, Chairman of City Finance Company, who leads our consumer finance operations is separately included.

Our life insurance operations are principally conducted through Charter National Life Insurance Company ("Charter"). As we indicated last year, our strategy was to create new life insurance products and to reduce the excessive overhead at Charter. Progress has been made in both areas as is reflected in the report of Charter's chief executive officer, David Cumming, also included separately. In 1983 we continued to defer recognition of all income related to our TAPLAN product, a single premium increasing whole life insurance product. Premiums from TAPLAN were \$63,971,000 in 1982 and \$57,697,000 in 1983. Experience to date has been satisfactory and we presently expect to consider recognizing income with respect to TAPLAN during 1984.

As reported last year, the Company acquired a majority interest in Cardiff Equities Corporation ("Cardiff"), an AMEX company whose continuing operations are principally in the manufacturing of vanities and electrical cord sets. Our efforts to restructure Cardiff and have it contribute to Leucadia's future profits were significantly advanced in 1983 and should be completed in 1984.

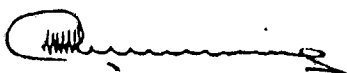
The 1983 year profited from two other bright spots:

Through our partnership in The Jordan Company we have acquired interests sufficient to permit the Company to record our investments under the equity method of accounting in eight companies engaged in various businesses. The Jordan Company is a firm managed by one of our directors, John Jordan II, that specializes in structuring leveraged buy-outs in which we become equity participants with only a modest cash investment. The Company's share of the earnings of those companies included in results of operations was \$2,606,000 for 1983 compared to \$700,000 for 1982. In addition, included in the 1983 results is a non-cash, non-operating pre-tax gain of \$1,350,000 as a result of the successful public offering of its common shares by one of these companies, Bench Craft, Inc., in December 1983.

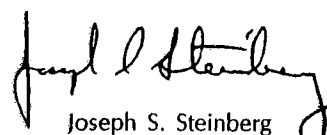
Terracor was acquired late in 1982 by the Company furnishing the \$5,932,000 required to fund its chapter 11 bankruptcy plan. During 1983, Terracor realized proceeds of \$5,308,000 from the sale of properties and the collection of instalment notes receivable. Terracor has substantial assets remaining which should provide profits from time to time. In late December, Terracor acquired a small consumer finance company, Town Enterprises, Inc., for \$2,500,000.

We remain appreciative of our lenders, capable employees and professional advisors who again performed yeoman service in 1983.

1982 was a year of extraordinary gains. 1983 in many ways was even better because our profits from continuing operations again improved. We are pleased for our loyal shareholders and we hope that our shareholders are pleased as well.



Ian M. Cumming
Chairman


Joseph S. Steinberg
President

Report on Consumer Finance Operations

It is with a great deal of pleasure that I report to you on the record results of our operations during the 1983 year.

Highlights of our year were:

Record financial results

Increased gross income

Reduced operating expenses

Increased investment in receivables

Receivables increased 26% in operating branches

Seven new offices were opened

Town Enterprises, Inc. was acquired on December 30, 1983

Reduced delinquency and losses

a 34% reduction in the percentage of direct loans contractually delinquent by 60 days or more

a 42% reduction in the loss ratio

a 30% reduction in the provision for bad debt losses

In my report to you last year, I stated that we were entering 1983 with receivables of excellent quality and high yields, which should result in an outstanding profit contribution for the Company. Our results were even better than anticipated. Based on operating data we use in the management of the business, earnings before deducting interest expense and income taxes stated as a percentage of average gross receivables was 16.1% in 1983 compared to 13.25% in 1982, a 22% increase, and a record percentage return on our investment for the Company. This was accomplished by increasing our gross income and by reducing both operating expenses and bad debt losses.

Consumer finance receivables increased by \$49,100,000 in 1983. This represents an increase of \$55,508,000 in the operating branches and a reduction of \$6,408,000 in the liquidating branches. We added 7 operating branches during the year and now conduct business in 157 locations in 16 states. Our average net receivable per operating branch was \$1,822,000 at December 31, 1983 compared to \$1,485,000 at December 31, 1982.

Continued improvement in delinquency resulted in increased collections which improved gross income. Contractual delinquency on direct loans 60 days or more past due continued to show improvement from 4.68% in 1982 to 3.09% in 1983. These ratios are considerably better than industry averages and once again show that we continue to maintain excellent quality receivables. We hope to have continued low bad debt write-offs and high yields.

Bad debt charge-offs were lower in 1983 than in 1982, going from 2.9% to 1.7%, for a 42% reduction. We hope for continued improvement in this ratio in 1984.

The consumer finance business made a strong showing in 1983. The consumer regained confidence in the future of the economy and re-entered the marketplace in increased numbers. As a result, our volume of sales finance and direct loan business increased, which led to the increase in our receivables. I do not anticipate any slowdown in 1984, as bargains in the marketplace continue to appeal to the consumer. We intend to actively solicit consumers in our servicing areas and hope to continue the growth achieved in 1983. We believe growth is the key to continued reduction in operating expense through the handling of more dollars in earning assets in each branch location.

As I see it, the biggest challenge facing us in 1984 is to maintain the spread between gross income and the cost of funds. Competition in the form of reduced rates has been widely noted during the last half of 1983 and will likely expand further in 1984 if the lower cost of short-term funds continues. We, however, will continue to exercise careful judgement in properly matching both the pricing and the maturity of our loans with the cost and term of borrowed funds.

Despite the problem of a possible squeeze on gross income in 1984, we are very optimistic of our continued ability to show additional improvements in our financial results as well as in our operating ratios. With increased receivables and reduced delinquency, we are positioned for additional record profits in 1984 and look forward with a great deal of enthusiasm to being a major contributor to the profits of Leucadia.

A handwritten signature in black ink, reading "Robert P. Brock". The signature is fluid and cursive, with the first name "Robert" and last name "Brock" clearly legible.

Robert P. Brock
Chairman of the Board
City Finance Company

Report on Insurance Operations

The non-captive insurance business of Leucadia is principally conducted through Charter National Life Insurance Company, which is licensed in all states (except New York), the District of Columbia, Puerto Rico and in seven provinces of Canada.

Life insurance as a business has been dramatically changed over the last decade by external events. The marketplace has shown increasing sensitivity to the investment elements of life insurance products as interest rates have fluctuated. Life insurance products have become much more flexible as computer software and hardware have been created to administer complex contracts.

The combination of high interest rates and automated administration has permitted smaller companies such as Charter to compete effectively with the very large companies; the general level of competition has become very intense. Charter has responded to these changes in several ways though none of these changes are designed to put Charter in direct competition with the largest companies for the mass market.

TAPLAN, our single premium increasing whole life product, was the major new business producer in 1983 as it was in 1982. Premium revenues were \$57,697,000 for 1983. TAPLAN combines increasing death benefits with significant cash values which increase at rates competitive with other tax-deferred investments.

For financial reporting purposes, Charter has continued to defer recognition of all operating income applicable to TAPLAN. Though we have been pleased with TAPLAN's experience, we can not yet be certain what profits will be because of uncertainties as to future interest rates, mortality and, particularly, persistency. We intend to reevaluate our TAPLAN experience in 1984 and may then begin to recognize profits.

Proposed tax legislation makes it likely that TAPLAN will not be sold in the future. In order to provide a saleable contract to satisfy demands for a TAPLAN like policy, CHART-A-PLAN was introduced in January 1984. This is a flexible premium life policy with significant cash values, designed to meet the requirements of the proposed new law.

In addition to TAPLAN and CHART-A-PLAN, Charter has continued to be innovative and to introduce new products.

In 1983 Charter began marketing immediate and structured settlement annuities. These types of products produced \$6,477,000 in premium revenues. Our modest result has made it clear that success in this area will require a more effective marketing effort.

Credit insurance is generally issued with little or no regard for the health of the insured. It is therefore very expensive and essentially unsaleable to sophisticated consumers obtaining large loans. Charter is developing an inexpensive decreasing term contract for larger size loans which would justify the underwriting effort. Charter hopes to market the contract initially through tax shelter syndicators. Charter, has in the past and in 1984, will market traditional credit insurance, primarily through small banks in conjunction with consumer loans.

Charter has commenced selling inexpensive term insurance with annual commissions. The Company hopes to market this product through broker-dealers.

During 1983, Charter continued to have significant success in decreasing overhead. General expenses in 1983 were 25% less than in 1982. The Company anticipates further decreases though they will be less dramatic. Despite the decrease in overhead, the Company continues to improve its performance and service standards.

The 1983 results reflect significant progress toward establishing Charter as a profitable company with innovative products. We are also actively seeking to acquire other life insurance companies. The expected benefits of such acquisitions are (1) purchase of life insurance contracts at a cost lower than that of obtaining new business in traditional ways (2) efficiencies created by eliminating duplication of policy maintenance costs and (3) new product opportunities.

We hope to make Charter a stronger and more profitable company in 1984.

A handwritten signature in black ink, appearing to read 'David Cumming', with a long horizontal line extending to the right.

David Cumming
President

Message From the Chairman of the Board and the President

Our Company completed its 131st year with common shareholders' equity at a record high of \$151,033,000 and book value per common share at a record high of \$19.88.

The year saw a number of notable transactions, including the significant expansion of our manufacturing operations and our entry into the field of equipment leasing.

In January, we received an additional payment of approximately \$39,800,000 related to our 1984 investment in Avco Corporation.

In March, Cardiff Equities Corporation, then our majority-owned subsidiary, completed the acquisition of Conwed Corporation for a total purchase price of approximately \$45,350,000. Conwed is engaged in manufacturing industrial products, including proprietary plastic netting, for various uses. Two of its other operations were sold during 1985 for a total of approximately \$42,500,000 and part of the proceeds of these sales were used to retire substantially all bank debt incurred for the acquisition. Because of the increased significance of the manufacturing operations following the acquisition of Conwed, the Company's financial statements were restated in 1985 to reflect Cardiff as a consolidated subsidiary. The Company recently acquired the balance of the equity interest in Cardiff by means of a tender offer and a merger.

In April, we sold our equity interest in one of the Associated Companies in which we have acquired interests by virtue of our partnership interest in The Jordan Company. We received aggregate consideration valued at approximately \$16,000,000 and reported a pre-tax gain of approximately \$12,000,000 from this sale. We also entered into another partnership agreement with the partners of The Jordan Company for leveraged buy-outs generally smaller than those currently being done by The Jordan Company.

In September, we entered into an agreement with National Intergroup, Inc. ("NII") pursuant to which, on January 2, 1986, NII purchased 75% of our

NII common stock for \$32,819,400 in cash plus warrants to purchase the same number of NII shares as were sold. As a result, the Company significantly reduced its cash investment in NII while retaining the opportunity to participate in appreciation in the market value of NII common stock. Because the cash consideration received and the value of the warrants approximated the cost of the NII shares sold, no pre-tax gain or loss will be recognized. However, the transaction will result in certain tax benefits that will be reflected in 1986 results of operations. The agreement with NII also contains certain standstill provisions. During 1985 the Company had conducted two proxy solicitations in opposition to NII's Board of Directors and had proposed a business combination with NII, subject to certain conditions, which the NII Board rejected.

In September, the Company also commenced equipment leasing operations when a subsidiary became a co-general partner of a partnership formed to lease aircraft and aircraft equipment. In November, we acquired O.P.M. Leasing Services, Inc. following its reorganization under Chapter 11 of the Bankruptcy Code. This subsidiary, which has been renamed AIC Leasing Services, Inc., is engaged in computer leasing and remarketing. We subsequently acquired 48% of the outstanding common stock of Brae Corporation, a public company principally engaged in the leasing and management of railcars. Executive officers of the Company now serve as directors of Brae.

During 1985, we made significant acquisitions of both equity interest in other companies and of our own equity securities. At present, we beneficially own more than 5% of the outstanding common stock of the following public companies: Minstar, Inc. (10.5%), GATX Corporation (8.9%), NII (7.8%), Brae (48%), British Petroleum of America (16.5%) and Prudential Financial Services Corporation (19.8%). Shareholders who have been following our involvement with GATX are referred to the discussion beginning on page 1 of the accompanying Form 10-K. During the year, we acquired, directly and indirectly, an aggregate of 1,098,108 of our own Common Shares at an average cost of approximately \$19.37 per share,

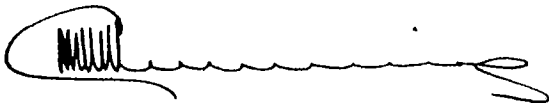
which is less than book value per share at year-end. In addition, we repurchased substantially all of our Series G Adjustable Rate Cumulative Preferred Stock and called for redemption all of our Series F \$2.00 Convertible Exchangeable Preferred Stock. Substantially all the Series F Preferred Shares were converted into a total of 1,426,131 Common Shares.

During 1985 and early 1986, we also completed a number of financings designed to increase our financial resources. These included public offerings of \$75,000,000 principal amount of 14% Senior Subordinated Notes, \$30,000,000 principal amount of 7¾% Convertible Subordinated Debentures and \$37,100,000 principal amount of Subordinated Swiss Franc Bonds that (after giving effect to a hedging transaction) bear interest at an effective annual rate of 10.8%. In addition, we added a third \$25,000,000 bank revolving credit agreement and entered into

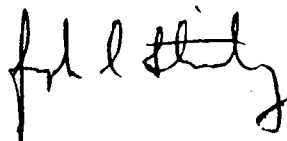
amendments that permit subordinated debt to be treated as capital for certain ratio purposes.

The many transactions mentioned above tend to obscure the achievements of our basic operations — consumer finance, life insurance and manufacturing. Each had a very successful year and we are including separate reports from the executives with primary responsibility for them. We believe these businesses are properly financed and conservatively managed and we are proud of their achievements.

Once again we wish to express our appreciation to our employees, lenders, investment bankers and professional advisors who, in a challenging yet fruitful year, assisted us in creating further value for our shareholders.



Ian M. Cumming
Chairman



Joseph S. Steinberg
President

Report on Consumer Finance Operations

The year 1985 was one of continued progress for our Company. We accomplished record earnings, expansion of our branch network, and an increase in finance receivables.

During 1985, we continued to follow our policy of orderly expansion, adding 12 locations and ending the year with 173 operating branches located in thirteen states, primarily in the Southeastern part of the country. The development costs for these new locations whose earnings level has not yet attained that of our established offices is included in results of operations.

Principally due to the increases in the number of offices, the Company's gross receivables continued to grow. During 1985, consumer finance receivables increased \$34,200,000 to \$363,600,000 compared to \$222,800,000 at the 1982 year end for a 63% increase in this three year period.

Income before income taxes for the consumer finance operations (including related credit insurance) increased in 1985 by approximately 17% from the 1984 level. Income from consumer operations before interest and taxes also reached record levels. We believe the most important measure and the principal measure used in the management of the business is net income before interest and taxes stated as a percentage of average outstanding consumer finance receivables ("NIBIT"). The NIBIT was 17.2% in 1985 and continued to place us at the top of our industry among those companies with outstanding net receivables of our size or larger. A primary reason for our continued success has been our ability to maintain our gross income percentage while reducing our operating expenses as a percentage of funds employed.

City Finance is exclusively in the consumer finance business. Ninety-one percent of our receivables are in loans made direct to the consumer and the remaining nine percent are in dealer acquired sales finance contracts (primarily of a non-automobile variety). At December 31,

1985, forty-five percent of the direct loan receivables were secured by either a first or second mortgage on real estate, with the remainder primarily secured by automobiles and/or miscellaneous consumer goods.

A very important part of the finance business is the sale of credit related insurance, including credit life, credit disability, and various types of property insurance designed to protect the collateral used as security for the loan. Approximately 12% of our total gross income originated from commissions and premiums earned from the sale of this insurance.

Our operating strategy in 1985 was affected by a tremendous increase beginning in the last quarter of 1984 in the amount of lendable funds being offered to the consumer, primarily through unsolicited credit cards. This has led to a concern that the consumer may be overloaded with debt. Also, some of our competition began offering unrealistically low rates of interest.

As a result, during 1985 we directed our personnel to use caution in our loan granting, paying particular attention to those individuals with excessive obligations. In addition, we continued to price our interest charge on extended term real estate loans to realistically match our long-term cost of funds. We were determined not to price our interest charge on loans, which are essentially long-term in nature, by reference to short-term rates.

Market conditions and competition created a difficult operating environment which had a negative impact on the volume of new real estate loans that we were able to generate during the year and increased bankruptcy filings throughout the country had a negative impact on delinquency and bad debt charge-off ratios. In addition, the reduced rates offered by some of our competitors resulted in retirement of an unusual number of our existing loans. In spite of this, we were successful in maintaining a high percentage of real estate secured loans and, in fact, had a gain of \$6,200,000 in this category of receivable during the year. Sixty day contractual delinquency increased from 3.01% at December 31, 1984 to 3.25% at December 31, 1985 and the

loss ratio (write-offs less recoveries) was 1.44% in 1985 up from .94% in 1984. Both of these ratios are still well in line with industry average and are better than our Company's historical averages.

As we look forward to 1986, we have mixed emotions. On the one hand, we continue to believe that excessive funds in the consumer marketplace will result in a greater number of individuals becoming over-obligated, bringing about higher delinquency and a subsequent rise in personal bankruptcies. Also, rate competition may possibly become even more aggressive and make it more difficult to maintain an increased level of realistically priced consumer finance loans. On the other hand, the over-obligation by consumers will also offer opportunities to work with individuals in restructuring their debts by more properly matching their debt to their incomes. This should be an excellent source of new business if properly qualified and adequately secured.

We have initiated a training program which will educate our loan personnel to look for and recognize these opportunities. They will be

trained to give professional counseling to the consumer, urging awareness of their indebtedness and, where advisable, recommend a restructure of their payment schedule to obtain current payment performance.

With our expanding branch network and increased portfolio of receivables, we are in an extremely good position for a continued increase in our gross income and a reduction in our operating expense as percentage of funds employed. This should enable us to once again show improvement in our profit contribution.

We are proud of our consistent earnings performance and of the high quality of our assets. Our employees are dedicated and hard-working and are determined to be tops in their industry. We will continue to train them for new opportunities that arise in today's competitive and complex consumer finance market. Again, we are most appreciative of the unfailing encouragement that we receive from our parent company and, with their ongoing support, we are committed toward enhancing the quality of our assets while continuing to make a significant profit contribution.



Robert P. Brock
Chairman of the Board
City Finance Company

Report on Insurance Operations

The insurance business of Leucadia is principally conducted through Charter National Life Insurance Company, which is licensed in all states (except New York), the District of Columbia, Puerto Rico and seven provinces of Canada.

Charter's major line of business since 1982 has been investment oriented life insurance ("IOL") products. These policies have varying characteristics but are similar in that they have significant cash values and are sold principally on the basis of the tax deferral of the increases in their cash values.

After a lackluster year in 1984 (\$23.6 million of new IOL premium) Charter determined in the spring of 1985 to change its marketing approach. Marketing of IOL products had been through independent wholesaling organizations. Representation by these organizations was not exclusive which created chronic problems for the Company. In May 1985, Charter hired a national sales manager for the IOL products. The effect of this change in strategy was quickly evident as our 1985 new premium production from these products was \$69.0 million, the highest annual production to date.

A significant ongoing problem for the Company with the IOL products has been changes in the tax laws which have required changes in the products. In 1985, further changes in the tax code affecting these products were proposed but were ultimately not adopted in the tax reform bill which was passed by the House of Representatives. The Company does not expect that provisions which materially affect IOL products will be introduced into the bill in the Senate.

Charter has recognized no income on its IOL products although experience to date has been satisfactory. It seemed clear to us when we first started to sell IOL products that the then prevailing accounting treatment (recognition of the present value of all anticipated future profits at the time the premium is received) was not prudent and did not properly reflect the economic realities of the product. In the last four

years the financial troubles of companies which have reported substantial income on similar products have done much to change acceptable accounting procedures. As of early 1986, the Financial Accounting Standards Board was considering new accounting methods which would require recognition of income as it is realized through interest margins, mortality and expense margins and surrender charges. This is in accord with our view of a sensible method of accounting for this product. We will begin to recognize income on certain of our IOL products starting in 1986 utilizing a method which will reflect the earnings over time.

Overhead, which decreased significantly at Charter in 1982 and 1983, remained essentially level in 1984 and increased slightly in 1985. The 1985 increase was a result of substituting in-house expenses for the outside commission expense of the third party wholesalers. We expect that overhead will be level or increase very slightly in 1986 despite what we hope will be another year of substantial new business.

Competition has increased markedly over the last year. The number of companies selling products essentially similar to Charter's has increased roughly four-fold in 1985 and there are now approximately fifty companies selling similar products. Many of these companies have attempted (some with success) to capture market share by selling policies with artificially high rates. Our success in 1985 indicates that we can be successful in this market with sensible rates as long as we provide good marketing and service.

In February 1986, Charter introduced new IOL products which permit additional premium payments after the first year, add an option to index interest credits to Treasury paper, and add a policy with an optional additional death benefit.

During 1986, Charter expects to begin marketing variable life insurance through its existing distribution channels. Premiums from variable life insurance policies will be invested through a "separate account" of Charter in unaffiliated mutual funds. Gains and losses from mutual fund investments will be for the account of the policyholders.

At the end of 1984, Leucadia wrote off \$16 million of value of life insurance in force because of unsatisfactory experience with the block of traditional life insurance policies which Charter had at the time it was acquired by Leucadia. Actuarial studies at the end of 1985 indicate that this block has stabilized.

We hope that our reorganized marketing and sales effort will make 1986 another successful year for Charter.

A handwritten signature in black ink, appearing to read 'David Cumming', with a stylized, looping flourish.

David Cumming
President
Charter National Life Insurance Company

Report on Manufacturing Division

The manufacturing operations of Leucadia are conducted through Cardiff Equities Corporation, which was acquired in March of 1982. Since that time we have continuously evaluated the operations applying our long established criteria in regards to market share, margins, and return on investment.

In 1984, after several poor earnings years, Cardiff determined it should concentrate its resources in the manufacturing portion of its business which had historically been profitable. Accordingly, in mid-1984, Cardiff sold the last non-manufacturing subsidiary that it owned. In late 1984, Cardiff began an acquisition of Conwed Corporation which was completed in March 1985 for a purchase price of \$45.4 million. The acquisition of Conwed added four manufacturing businesses to the two that Cardiff already owned. It also was the main factor in Cardiff's achieving record operating results in 1985 as pre-tax income from continuing operations before income taxes and minority interest rose to \$6.7 million.

The six manufacturing operations consist of the following product lines: Plastic Netting, Bonded Fiber Products, Hydraulic Mulch, Office Partitions and Workstations, Power Cord Sets, and Bathroom Vanities and Cultured Marble Tops.

After completing the acquisition, Cardiff applied the same criteria to each of the Conwed businesses as it had in the past. As a result, two businesses whose margins and returns were inadequate were sold, allowing Cardiff to reduce bank debt by \$19.1 million.

Our plastics business, part of Conwed, manufactures proprietary plastic netting for various industrial and agricultural uses. 1985 was an excellent year with operating profit up 33% on a sales increase of 13% compared to pre-acquisition 1984. We are a significant force in the markets in which we compete, and we expend substantial research dollars to both improve market positions and to develop new markets. While we do anticipate greater competition in 1986, we are looking at certain alternative

production techniques which will allow us to supplement our existing product lines.

Two of our other Conwed businesses, Bonded Fibers Products and Hydraulic Mulch, consolidated production from two manufacturing facilities into one during 1985. Bonded Fibers manufactures insulated pads for sale to, among others, the bedding and automotive industries. The Mulch division produces hydraulic mulch for use in turf establishment markets. This production consolidation was necessitated by the sale of a facility in northern Minnesota which had contained production for several different businesses including these two. The consolidation of production caused us to curtail sales efforts in certain geographic regions, as these products are freight sensitive and would no longer be competitive. Sales in these two divisions fell 8% from pre-acquisition 1984 levels with operating profits down 14%. The disruption caused by the move of certain Bonded Fibers production equipment had a detrimental effect on margins. In both divisions we are industry leaders and have a commanding market position, particularly in the bedding and turf establishment markets. In 1986, we are committing substantial effort to the development of new products for the Bonded Fibers automotive market.

Our office partition business, acquired with Conwed, manufactures and markets freestanding office partitions and workstations to office furniture wholesalers and dealers. Workstation systems and panels for open-office design is the largest and fastest growing segment of the office furniture business. New products designed to target the commodity segment of the market are expected to improve 1986 operating results.

Our cord set business produces electric power cord sets sold to manufacturers of a wide range of products from small tools to personal computers. This business services a highly competitive market and experienced a decline in sales and margins during 1985. Foreign competition had a particularly adverse effect on this business, which we expect to continue until the dollar reaches a more competitive level.

Cardiff's vanity business manufactures bathroom vanities (hardwood cabinets and cultured marble tops) for sale to home improvement centers and other retailers specializing in the do-it-yourself market. We hold a strong position in the bathroom vanity market which is a market served by several national and many regional suppliers. During 1985, this business added a second production facility which will help to counteract strong regional competition in future years. In 1985, operating income declined from the prior year despite sales remaining unchanged.

Competition from both domestic and foreign suppliers had a negative impact on margins as did certain start-up costs associated with the new facility. The substantial increase in production capabilities will improve operating results in the near future.

We believe that each of our businesses has excellent growth and earnings potential. We hope that, during 1986, emphasis on new product development and return on investment will produce another fine year for Cardiff.



Thomas E. Mara
Chief Operating Officer
Manufacturing Division

Message from the Chairman of the Board and the President

Your Company completed its 130th year with its common shareholders' equity at an all time high. The net income achieved for 1984 was also a record. Though the April 30, 1979 restructuring seems ancient history today fewer than six years have actually passed. At the time of the restructuring we had a common shareholders' deficit of approximately \$7,680,000 compared to our positive common shareholders' equity of \$126,097,000 at December 31, 1984. The book value per common share at April 30, 1979 was a negative of approximately \$.85 compared to a positive book value per common share of \$17.70 at December 31, 1984, or an increase of \$18.55 per common share.

Clearly the most significant event that occurred during the year was our \$77,475,000 investment in the undervalued equity securities of Avco Corporation. Prior to our entering into commitments for financing sufficient to seek control of Avco, Avco offered to buy our position at the existing market price, which was substantially above our cost, plus reimbursement of expenses. We accepted the offer subject to a provision in the repurchase agreement that if Avco were acquired within a specified period we would receive an additional payment measured by the difference between the price at which our Avco shares were repurchased and the acquisition price. As you are aware, Avco was subsequently acquired by Textron Inc. and we received the additional payments called for by the repurchase agreement. As a result of our Avco investment we realized pre-tax income in 1984 of about \$61,000,000, exclusive of interest and other related costs.

The success of the Avco transaction should not hide the many other important events of 1984 and early 1985, most of which were positive:

Our consumer finance operations had the finest year in their history. Almost all measures of operating performance were at record levels. This was particularly true of the "NIBIT" discussed in Robert Brock's report, which was at a record high 17.74% of average investment in consumer finance receivables. We also increased our average investment in consumer finance receivables by 24%. We believe there is no company of comparable size in the consumer finance industry which can match our performance. Your attention is directed to the report of Robert Brock for more details.

Since the beginning of 1984 we have added bank credit facilities of over \$150,000,000, including \$75,000,000 at the parent company level. Consistent with our policy of properly matching interest rates and maturities, during the year we had in place interest rate "swap" and interest rate "cap" agreements covering over \$110,000,000.

During 1984 we sold our headquarters building at 315 Park Avenue South in New York City, and realized a pre-tax gain of approximately \$16,000,000.

During 1984 and continuing into 1985 we made investments in equity securities of a number of companies we believed represented undervalued situations. We currently hold equity positions of more than 5% in the following companies: Bench Craft, Inc. (OTC), British Land of America (NYSE), Minstar, Inc. (OTC), National Intergroup, Inc. (NYSE) and Prudential Financial Services, Inc. (OTC). The investment in Bench Craft, Inc., results from our partnership interest in The Jordan Company and the investment in British Land of America results from the sale of our headquarters building.

During 1984 we looked at many potential acquisitions. While none were completed during 1984, our unconsolidated subsidiary, Cardiff Equities Corporation, recently completed the acquisition of Conwed Corporation. Conwed, which has headquarters in St. Paul, Minnesota, manufactures coordinated ceiling and furniture products for commercial interiors as well as various industrial products.

As of February 14, 1985, our common shares were split three-for-two. This was effected by means of a 50% stock dividend distributed to holders of our common shares.

Among the investments we made during 1984 were investments in our own common stock. During the year we acquired directly or indirectly 964,958 common shares at an average price of \$12.00.

During 1984 we redeemed all our outstanding Series E \$1.85 Cumulative Preferred Shares and acquired an aggregate of 272,400 Series F Convertible Exchangeable Preferred Shares for \$6,262,000. In March 1985 we called for redemption all remaining Series F Preferred Shares; we expect substantially all such shares to be converted into common shares prior to redemption. In early 1985 we also began to acquire Series G Adjustable Rate Cumulative Preferred Shares. The acquisitions and redemptions of preferred shares were done in large part because of our changed tax situation due to the succession of profitable years. When our tax loss carryforwards were available we were not concerned about the non-deductibility of the dividends. On an after-tax basis, however, the preferred dividends became too costly.

During 1984 our sales of investment oriented insurance products declined from the 1983 levels. We believe the decline is explained in part by the well publicized financial difficulties of two single premium insurance issuers. We also believe the favorable stock market conditions and lower interest rates of 1984 had a negative effect on sales of these products.

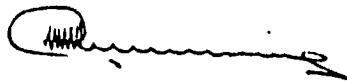
At the end of 1984 we determined to reduce the carrying value of Charter to reflect the unfavorable experience of certain traditional life insurance products sold by Charter principally prior to our acquisition of the Company at the end of 1980. These write-downs, which approximated \$16,000,000, should have a favorable effect on future results since Charter will not bear the expense that arises when insurance policies are terminated earlier than expected.

It should be noted that the experience on our investment oriented insurance products such as TAPLAN, CHART-A-PLAN, Competitor and Competitor II, has been satisfactory and we expect to begin to recognize profits on these policies in 1985. It should also be noted that the amount of reserves and investments should compound every year if the business is retained, and therefore provide an increasing amount of future income. The report of David Cumming on the insurance operations is included as a separate section of this report.

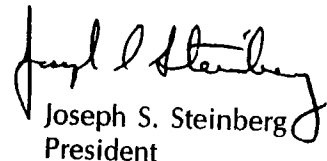
We are pleased to note that during 1984 The Jordan Company partnership agreement was extended through 1986. The amended agreement provides for increased cash contributions and lower profit participations by the Company. In addition to the earnings from the ten companies in which we have equity interests as a result of our interest in The Jordan Company, we also receive investment banking and management fees. During 1984 our share of the profits of these companies was \$4,807,000 and our share of the fees earned in 1984 was approximately \$415,000. As reported last year one of these companies went public in 1983. Discussions are in progress for our sale at a substantial profit of our interest in another of the companies.

We are again appreciative of our lenders, investment bankers, employees and professional advisors who have continued to perform in an extraordinary way to help us achieve more for our loyal shareholders.

We do not promise that 1985 will be better—or even as profitable—as 1984, but we do believe our consumer finance and life insurance operations are properly and conservatively managed. The Company also has the financial resources and management ability to take advantage of opportunities as they arise.



Ian M. Cumming
Chairman



Joseph S. Steinberg
President

Report on Consumer Finance Operations

I am pleased to report continued progress in our operation during the 1984 year. Record high yields were obtained on our invested funds. This, coupled with greater control of our operating expenses and record-low bad debt losses, resulted in record earnings, both in dollars and as a percentage of average net receivables before interest expenses and income taxes.

Progress was made both in increasing our total receivables and in opening new branch locations. Gross receivables were up 21% over the previous year, to \$329,400,000 at year end. Delinquency on direct loans, 60 days and over, as reported on original contractual terms, showed continued improvement, reducing to 3.01% at year end. Net bad debts charged off for the year were at a record low .94% of average net receivables during the year.

Our receivables at the end of 1981 were \$339,800,000, reduced to \$222,800,000 at December 31, 1982 principally as a result of the sale of certain selected receivables to reduce dependence on short-term variable rate debt. Having achieved that reduction, we then had an increase in 1983 to \$271,900,000, which continued during 1984. As a result, our total gross receivables which were \$222,800,000 at December 31, 1982 had increased 48% to \$329,400,000 at the end of 1984. Our receivable base at the end of 1981 listed 34% of our receivables in loans secured by real estate. This has increased to 48% at the 1984 year end. Also, our dealer retail sales contracts, which were 5% of total receivables in 1981 are now 9%.

Contractual delinquency on direct loans has shown continued improvement, starting at 5.56% at the 1981 year end and steadily dropping to 3.01% at the 1984 year end.

Also showing great improvement was the bad debt loss ratio, going from 3.4% in 1981 to a record low .94% in 1984. The provision for bad debts, of course, is in part controlled by the receivable base and is generally higher when receivables are growing and lower when receivables are declining.

The final and most important measure, and the principal measure used in the management of the business, is net income before interest and taxes ("NIBIT") stated as a percentage of average net receivables. The NIBIT was 10.91% in 1981, our first year with the AIC receivables, and has improved steadily to its present 17.74%, a record high for our Company, and the best percentage return on invested funds that I have seen in any consumer finance company of comparable size!!!

Forecasts for 1985 continue to project a moderate expansion in our economy. Our charge is to make certain that we obtain our fair share of this business and increase the size of our receivable base for continued increase in our earnings. Even under this optimistic projection, we will still be tested in using our expertise. I am convinced that credit grantors will be tested in our loan approval guidelines during the year, which will require keeping a watchful eye on overloading of debt by consumers. It is no secret that the present availability and reduced cost of funds have made vast amounts of funds available to the consumer.

Plastic cards, with very generous credit lines attached, are being received, unsolicited, by a very large number of average consumers. If these consumers become liberal users of these sources of credit, we will be faced with notable increases in our delinquency and quite possibly, an increase in bankruptcy and bad debt losses. This would also reduce the presence of these individuals in the consumer retail market, with its adverse effect on sales. We will be aware of this in our loan approval guidelines and will seek to further strengthen our loans with added security to protect us from those debtors who over-obligate themselves after we have closed our loan with them.

Another area of concern for 1985 is the March 1 effective date of the FTC Trade Regulation Rule on Credit Practices, which among other things, limits our ability to take certain non-purchase liens on household goods furnishings. We have surveyed a cross section of our customers regarding their reaction to a substitution of household goods items that are not in the restricted area and the response from our customers has been most encouraging. Substitution of collateral could enable us to continue uninterrupted our present method of making small size consumer loans that have historically been secured by household goods furnishings that are exempt under the new rule.

An expansion of our office network, increasing the receivables within the existing branches and maintaining gross yields will be our main objectives in 1985. This will require a concerted effort toward training the necessary employees to staff the management positions of these new locations. We realize that increasing receivables in the branches is the answer to controlling operating expenses in the branch as a percentage of funds employed, and we are determined to see that this is done. This, coupled with the added earnings from growth of our receivables, should give us the added earnings that we hope to generate in 1985.

We are very proud of our accomplishments in 1984. Our employees are hard-working and dedicated to the best interests of the Company. We feel they are exceptionally well trained and capable of competing successfully with any credit grantor in the consumer finance market. With their fine efforts and the continued support that we have enjoyed from our corporate headquarters, I am very optimistic about our ability to continue to show progress in 1985.



Robert P. Brock
Chairman and Chief Executive Officer
City Finance Company
Memphis, Tennessee

Report on Insurance Operations

In 1984, the non-captive insurance business of Leucadia was conducted through Charter National Life Insurance Company, which is licensed in all states (except New York), the District of Columbia, Puerto Rico, and seven provinces of Canada.

Charter National's core business is in single premium life insurance which has been principally sold through securities brokers. Over the last few years there have been a series of changes in the tax treatment of life insurance. In addition, the public's awareness of the financial troubles of several deferred annuity companies have focused attention on the fact that the GAAP basis financial statements are sometimes not useful in determining whether a life insurance company is solvent. Since most securities brokers have a limited ability to do due diligence based on statutory financial statements, many of them have adopted a very cautious attitude toward the insurance industry. This change in attitude has been bad for sales for life insurance through broker dealers for Charter National and virtually all other companies. Only at the very end of 1984 was there any sign of a return of the stock brokers to life insurance sales.

During 1984, Charter developed a strategy to respond to the changes in the market-place. We had only moderate success. Charter's new single and flexible premium production was \$23,641,000 in 1984 compared to \$57,697,000 for 1983. Indeed, the change is more dramatic than initially appears since the 1984 production from securities dealers was down nearly 90% from the 1983 level.

We see early signs that Charter's production in the securities dealer market will increase again in 1985. The amount of that production will depend on two factors. The first is the amount of adverse publicity the insurance industry receives as a result of insolvencies. The second is the strength of the stock and bond markets, since securities dealers generally turn more to insurance products when their primary markets are slack.

Charter National continues to have excellent experience with the single premium block of business it has written. A comprehensive review of our persistency and mortality experience has been made, and we expect to begin recognizing GAAP income on this block of business during 1985. When Charter instituted its policy of deferring income on single premium business, it was virtually alone in an industry which preferred to recognize future income in the greatest amount possible in the year in which a policy was issued. Since that time, the instability of companies which followed this accounting procedure has caused a major shift in accounting policy so that many companies now defer earnings to one degree or another.

After a significant drop in overhead in 1983, expenses remained constant in 1984. With a reorganization of our staff and continued automation, we hope for renewed reduction of our expense levels in 1985.

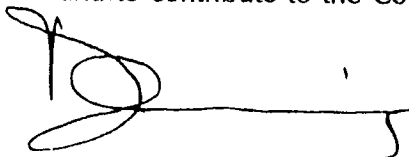
As in the last few years, competition in life insurance is very intense. Many companies, in search of dramatic increases in sales volume, are selling life insurance products with inadequate profit margins. Charter has consciously decided not to pursue sales unless the profits appear to be adequate. Because of this decision, we frequently do not match our competition when they make what we view as ill-advised pricing decisions. In turn, this fact will tend to make Charter's growth slower than it would otherwise be and somewhat irregular. One beneficial effect of this slower pattern of growth is that Charter's statutory capital and surplus will be less strained by the volume of new business. In addition, our profitability should improve steadily as we accumulate a larger and larger block of business.

During 1984, Charter and Leucadia reviewed many possible acquisitions in the life insurance industry. In particular we were looking for companies which could be consolidated with Charter to create a significant benefit by decreasing aggregate overhead expense. Although there were no acquisitions in 1984, we will continue to review potential companies while keeping in mind that it is more important to avoid mistakes than to complete a transaction.

In addition to single premium whole life, Charter continues to market immediate annuities, structured settlement annuities, and 10-year level term insurance and intends to market pure endowments in 1985. We have achieved only moderate success in these lines to date, and they will require greater effort in 1985.

The experience on certain traditional life insurance policies principally written prior to the acquisition of Charter by Leucadia has not been satisfactory. Accordingly, during 1984, based on actuarial studies which reflect the adverse experience of recent years, we decided to write-off value of life insurance in force related to this line of business amounting to \$16,000,000. We expect that earnings in the next few years will benefit, since the excess lapses and unfavorable mortality related to this line of business should no longer adversely affect our earnings.

We confidently expect to return to higher levels of new premium production and to contribute to the Company's profitability.



David Cumming
President
Charter National Life Insurance Company
St. Louis, Missouri

1706
1986

Message from the Chairman and President

We are pleased to report that we finished our 132nd year with common shareholders' equity at \$214,587,000, an all time high. We are pleased with this achievement because our goal is to increase shareholders' equity and to invest that equity in assets which will increase it further in the future.

The market price of our common stock began the year at \$11.63 and finished at \$17.00. During 1986, the Board of Directors authorized a 2-for-1 stock split effective in January 1987. Share prices included in this report reflect this split.

The most significant event during 1986 was the sale of our consumer finance operations for a pre-tax gain of \$72 million. We believed that increased participation in the consumer finance business by large financial institutions was increasing the competitive pressure on interest rates resulting in decreased interest spreads and decreased profitability. There is a time to sow and a time to reap. The price was irresistible. The management of City Finance concurred in our judgement; we will miss them.

During 1986, we made substantial investments in the common shares of Enron Corporation and Minstar, Inc. We sold all or a substantial portion of those investments and realized pre-tax gains of \$32 million. Subsequently we acquired additional shares of Minstar, Inc. and presently hold about 7.2%. During 1986, we also sold our investment in Bench Craft, Inc. and, in an initial public offering, sold one-third of our interest in Carmike Cinemas, Inc. We realized pre-tax gains of \$4.2 million from these two sales. The interests in Bench Craft and Carmike Cinemas were acquired

as a result of our participation as a partner in The Jordan Company.

Not all investments, however, are completely successful. In January 1986, we acquired a 45% interest (49% at December 31, 1986) in BRAE Corporation for about \$26 million. Since that time, BRAE has not operated as we had expected, and we currently believe the prospects for BRAE, particularly as they relate to its electronic sign manufacturing subsidiary, are considerably less favorable than they appeared when we made that investment. Accordingly, in the 1986 financial statements, we wrote down the investment by approximately \$15,607,000.

During 1985, we made a merger proposal to National Intergroup, Inc. ("NII") and engaged in two unsuccessful proxy contests. As previously reported, we then agreed to sell a substantial portion of our investment to NII for cash and warrants. We made a decision to maintain an interest in NII common stock and warrants because we believed there was potential for substantial appreciation. Unfortunately, NII made several business decisions that have adversely impacted its operating results and stock price. The loss in market value, which we recognized in the 1986 financial statements, was largely offset by tax benefits related to the transaction.

During 1986, we also made a merger proposal to GATX Corporation. The merger was never consummated and we sold our stock investment at an amount that approximated its cost. We did, however, incur costs of about \$1.7 million.

Our insurance operations, which are conducted through Charter National Life Insurance Company of St. Louis, had a very good year. We started to recognize earnings on the Single Premium Whole Life ("SPWL") products we have been selling

since 1982 using a conservative accounting method that should provide increasing amounts of income in future years. Premiums on SPWL products were \$99.5 million in 1986 compared to \$69 million in 1985. In 1986, Charter introduced a variable life product. We are very optimistic about this product and believe it is likely to result in substantial future sales. A report on the insurance operations by David Cumming, President of Charter National, follows.

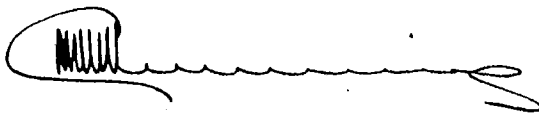
Our manufacturing operations also had a fine year. During 1986, we acquired the minority interest in Cardiff Equities Corporation, our manufacturing subsidiary. A report on the manufacturing operations by Thomas Mara is also included.

In November, we acquired claims from certain claimants in the reorganization proceedings of Baldwin-United Corporation for about \$107 million. Upon effectiveness of the reorganization plan, Baldwin-United changed its name to PHLCORP, Inc. For our claims we received 39% of PHLCORP's common shares, two series of

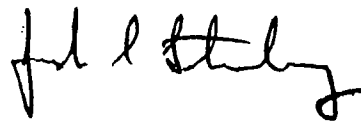
zero coupon bonds and a 57% interest in a liquidating trust. Leucadia's nominees were recently elected as PHLCORP's Board of Directors and the Company's Chairman and President as well as other officers of the Company were elected to similar positions at PHLCORP. We believe we have made a good investment in PHLCORP.

As we start into 1987, we are a somewhat different Company than when we entered 1986. However, our fundamental goal of increasing shareholder values remains unchanged. We will continue to work hard to increase the value of our existing assets and to look for new opportunities in both the financial and non-financial areas. We believe we have the support of our commercial and investment bankers that will permit us to take advantage of any opportunities that might appear.

Our 1986 year made heavy demands on our officers, employees, bankers and professional advisors. We thank them for their efforts on your behalf.

A handwritten signature in dark ink, appearing to read 'Ian M. Cumming', with a stylized, elongated flourish at the end.

Ian M. Cumming
Chairman

A handwritten signature in dark ink, appearing to read 'Joseph S. Steinberg', with a stylized, elongated flourish at the end.

Joseph S. Steinberg
President

Report on Insurance Operations

In 1986, the insurance business of Leucadia was conducted through Charter National Life Insurance Company, which is licensed in all states (except New York), the District of Columbia, Puerto Rico and seven provinces of Canada. During 1986, the captive credit business was terminated in connection with Leucadia's sale of the consumer finance operations.

Charter's major business since 1982 has been investment oriented life insurance ("IOL"), principally Single Premium Whole Life ("SPWL") products. These policies have varying characteristics but all have significant cash values and are sold principally on the basis of the tax deferral of increases in life insurance cash values.

Charter's production of SPWL in 1985 was \$69 million of premium, which was the best production year to date. In 1986, production of these products increased by 44% to \$99.5 million. The increase in production has resulted from a successful program, initiated in 1985, to market through national and regional sales managers who represent Charter exclusively.

During 1986, Charter introduced Life inVest, a flexible premium variable life policy. Policyholders' cash values are invested in mutual funds managed by Scudder, Stevens & Clark. Production was \$2.7 million for 1986, \$8 million of this in December. Charter hopes to sell large volumes of this product in the next few years.

After several years in which new tax rules were enacted every year, we had no change in the tax treatment of life insurance during 1986. There

are, however, early indications that this issue will receive attention in the Congress again in 1987.

From 1982 until 1986, Charter did not recognize income on SPWL business because it felt that it did not have sufficient experience with the product. Beginning in 1986 Charter has recognized income on the earliest policies written. Charter will recognize income on an as-earned basis although it will continue to defer earnings in the first three years after a policy is issued. Acquisition costs will be written-off over a ten-year period. As more policies age, the existing block of SPWL policies should contribute increasing amounts to the earnings of Charter.

Competition in the SPWL market has become very intense as this product has become more and more common. Charter makes no effort to compete on crediting rates because it does not believe that the companies offering the highest rates are writing profitable business. We endeavor to offer a sensible rate and we work hard on marketing and customer service. Our 1986 production shows that this is a viable strategy.

Variable life products are not as competitive as IOL products. While our competitors in IOL number in the hundreds, there are still fewer than a dozen companies writing comparable variable life policies and even fewer than that attempting to sell the product through the same channels we are trying to cultivate. For this reason, we have decided to place a heavy emphasis in 1987 on building our variable life business.

Overhead expense remained essentially the same from 1985 to 1986. In 1986, Charter simplified its business by reinsuring its health insurance

and juvenile paid-up term business with another carrier. It is Charter's intention to continue to simplify its business and products and to offer a narrow range of products. By following this course, we believe that we can greatly increase our productivity and continue to make significant strides in increasing our production without materially increasing overhead.

A handwritten signature in black ink, appearing to read 'David T. Cumming', with a stylized, looping initial 'D'.

David T. Cumming
President
Charter National
Life Insurance Company

Report on Manufacturing Division

The manufacturing division of Leucadia is comprised of six manufacturing businesses consisting of the following product lines: plastic netting, bonded fiber products, hydraulic mulch, office partitions and workstations, power cord sets and bathroom vanities (including cultured marble tops). Prior to 1986 these operations were conducted through Cardiff Equities Corporation, a publicly-held company, in which Leucadia owned a majority interest. During 1986, after evaluating the growth and earnings potential of these operations, we acquired the remainder of Cardiff held by the public.

1986 was a strong year for the manufacturing business with pre-tax income improving to \$8.5 million on revenues of \$83.1 million. In 1985 Cardiff completed the acquisition of Conwed Corporation, which ultimately added four manufacturing operations to the two Cardiff already owned. Subsequent to the acquisition, we began to restructure Conwed's operations and decentralize its corporate administrative functions. This reorganization, which was completed in 1986, is expected to reduce administrative expenses by approximately \$750,000 annually.

Our plastics business manufactures proprietary plastic netting for various industrial and agricultural uses. This business experienced another excellent year in 1986 with annual sales and operating profit both increasing compared to 1985. In December 1986, we acquired manufacturing equipment and other related assets from a company which produces plastic netting products primarily for the citrus and poultry markets. We are currently adding 60,000 square feet of manufacturing space to our Athens, Georgia facility to house the equipment and support this business.

We believe future sales and earnings will be significantly improved by this acquisition.

The bonded fibers business manufactures fiber insulator pads for sale to, among others, the bedding and automotive industries. In 1986, annual sales declined although operating earnings increased from annual 1985 levels. The increase was, however, below our expectations as we continued to have difficulties with manufacturing equipment moved from a Minnesota facility which we had sold in 1985. We are confident we have now solved our production problems and look forward to a significant improvement in operating performance in 1987. In 1986 we developed several new products, primarily for the automotive market. In 1987, in addition to continuing our new product development efforts, we are investigating several different production techniques which would offer us new market opportunities altogether. The vanity business manufactures bathroom vanities (hardwood cabinets and cultured marble tops) for sale to home improvement centers and other retailers specializing in the do-it-yourself market. Our operating profit in 1986 rose significantly on a modest sales increase. Gross margins improved during 1986 as production efficiencies at our Hornell, New York plant, opened in 1985, rose to expected levels. Additionally, the reduction of waste generated in the production process at both manufacturing locations was a significant factor in our increased profitability. We are presently involved in expanding our manufacturing capability to produce some of the more costly raw material components for our cabinets. In addition, we are investigating the feasibility of purchasing certain automated production equipment to improve product quality and to better control costs.

Our cord set business produces power cord sets sold to manufacturers of a wide range of products

from small tools to personal computers. Foreign competition continues to have an adverse impact on this business which we expect will continue until the dollar reaches a more competitive level. We are presently looking to automate certain aspects of our production process to improve product quality and reduce costs.

In our mulch business, which produces hydraulic mulch for use in turf establishments and juice processing markets, we committed significant dollars to refurbishing our manufacturing equipment to improve plant production.

Our office partition business, which manufactures freestanding office partitions and workstations which it sells to office furniture wholesalers and dealers, is continuing to develop new products

targeted primarily to the commodity segment of the market.

We continue to evaluate our businesses on the basis of market share, margins and return on investment. In 1987 we hope to continue a steady growth in sales and earnings by emphasizing new product development, improved product quality and reduced production costs. Investment in "state-of-the-art" production equipment will be an important ingredient in reaching our goals. If successful, we should enjoy another fine year in 1987.



Thomas E. Mara
President

Message from the Chairman and President

1987 was a disappointing year for your Company. Although total revenues increased by approximately \$47 million from 1986 to 1987, we had a net loss of \$18.1 million compared to net income of \$78.2 million in 1986 and \$25.9 million in 1985. The reasons for the loss are explained later in this letter.

Since this management acquired its interest in Leucadia in April 1979, your Company has evolved from a financially troubled factoring and finance concern to its present form as a holding company with more than \$1 billion in assets. Our subsidiaries are engaged principally in life insurance, manufacturing and other financial services (banking, real estate and equipment leasing). Through our 63% interest in PHLCORP, Inc., we are also engaged in trading stamps, motivation services, life insurance and property and casualty insurance and, through our 74% interest in BRAE Corporation, we are engaged in leasing and management of railcars and the manufacture and leasing of electronic visual displays. In addition, your Company has equity interests in a number of other publicly and privately held companies.

Although considerable income is generated from operations of our subsidiaries, a large portion of our net income in recent years has been derived from the sale of investments, and, in some cases, assets. We did not dispose of any major assets in 1987 and consequently did not generate significant income from such sales. However, we have never managed the Company with an emphasis on reported quarterly or annual earnings. By and large, we are pleased with our accomplishments to date. It is, however, an unpredictable enterprise from one year to the next.

Several factors contributed to the 1987 results. Unlike 1986, when Leucadia sold its consumer finance business, there were no sales of significant assets in 1987. At year end, as a result of the October 19 market collapse, we determined to write down our equities portfolio by \$9.1 million (as of today, the market value has increased to more than the written down amount). A substantial portion of our assets are invested in assets which are currently non-earning or earning at a low rate. Much of that amount is invested in Phlcorp, and we remain excited and optimistic about its future. (For more on Phlcorp, consult its annual report).

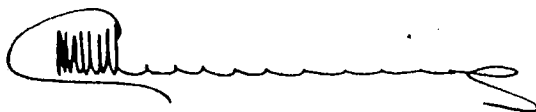
Our manufacturing companies had a fine year earning 27% on net invested capital. We expect solid growth and performance in the years to come. A report by Thomas E. Mara, Executive Vice President of Leucadia who is responsible for these operations, is included in the next few pages.

Our life insurance operations are principally conducted by Charter National Life Insurance Company of St. Louis. Our sales of investment oriented life insurance increased substantially from 1986, although sales of a newly introduced variable life insurance product, while substantial, were disappointing. A report on Charter National Life by David Cumming is also separately presented.

We also had substantial growth in our banking/lending operations. Our customer banking deposits, all of which are FDIC insured, increased from \$40.6 million at December 31, 1986 to \$118.3 million a year later. Most of these funds are invested in loans to individuals, including a \$42 million portfolio acquired during the year. Earnings have not yet followed the increase in

deposits; we are investing heavily in the growth and expansion of the bank which is compromising current earnings.

As mentioned, we spent a significant amount of time on our investment in Phlcorp. We owned 39% of its common shares throughout 1987, and in February 1988, we increased our ownership to 63% of Phlcorp's common shares as a result of a tender offer. In 1988, Phlcorp converted its holdings in surplus notes of Empire Insurance Company into 70% of the outstanding common shares of Empire (which was converted into a stock company from a mutual company on January 1, 1988). Empire is a New York domiciled property and casualty insurer. We are optimistic about Empire's prospects. The Company received a cash distribution of \$24 million from its interest in the Phlcorp liquidating trust and a cash payment of approximately \$18 million upon the retirement by Phlcorp of all of its outstanding zero coupon notes. Starting in 1988, Phlcorp will be a consolidated subsidiary and we believe a positive contributor to operations.



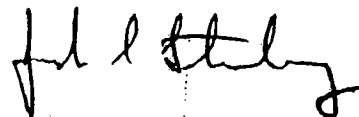
Ian M. Cumming
Chairman

In April 1988 we invested an additional \$10 million in BRAE Corporation which increased our ownership to 74%. As a result, Brae will become a consolidated subsidiary in 1988. Brae has restructured its manufacturing operations and will be a positive contributor to our earnings.

During 1987 (mostly after the October market decline) we acquired 828,602 common shares at an average price of \$11.85 per common share. We believe this is a good investment for your Company.

We have sought to keep our balance sheet strong and conservative and believe that is true today. Our operations are sound and conservatively managed and we believe have the ability to continue to grow profitably.

As usual, we thank our officers and loyal employees, our bankers, and our professional advisors for their efforts. We also thank you, our loyal stockholders, for your continued support.



Joseph S. Steinberg
President

Report on Insurance Operations

During 1987, Charter National Life Insurance Company continued to make solid progress despite some disappointments. We continued to control costs by simplifying our product offerings and increasing volume in a limited portfolio of products. During 1987, sales advanced to another record. On the other hand, the company's sales of its variable life product, although substantial, fell short of our goals.

We believe that small to medium sized life insurance companies can operate efficiently only if they concentrate on a narrow range of products. By offering a limited range of similar and relatively simple products, Charter expects to continue rapid growth of its assets and earnings without a significant increase in overhead expenses. In 1987, sales of investment oriented life insurance ("IOL") increased by 68% to \$171.5 million, while overhead expenses increased moderately.

Our business is to sell insurance policies which are purchased as much for their investment characteristics as for the death benefits. Charter's profit results from the spread between our investment earnings and the rate which we credit to policyholders. The fixed costs of doing this business are fairly high and the marginal costs, once a company is in the business, are quite low. For this reason, many companies have followed a strategy of offering very high crediting rates in order to write large volumes of business and decrease their unit costs. We believe that many of our competitors have, through this strategy, decreased their spread more than they have decreased their costs. Charter insists upon maintaining a satisfactory spread and therefore sells less than it otherwise might; it accordingly benefits somewhat less than its competitors from

reduced unit costs. As we see it, if a product is priced with little or no profit, the company will be hard pressed to "make it up in volume."

We began selling a variable life product in 1986 and the sales volume in the product, although substantial, has been lower than we had hoped to achieve. Sales of variable life were \$2.7 million in 1986 and \$33.4 million in 1987. Charter had hoped to produce \$100 million or more in variable premium in 1987. In 1988, we will try several new approaches to selling variable products. At the same time, we will continue to trim our expense structure.

An on-going problem for the life insurance industry has been frequent changes in the tax law. Congress is again considering changes which may require changes in Charter's business. These changes are sometimes expensive and occasionally cause interruptions in our marketing momentum. This is an uncertainty which appears to have become a permanent part of Charter's business.

We continue to account conservatively for IOL business, writing off acquisition expense more rapidly than most companies and deferring earnings for three years on most of our business. While these accounting policies reduce current earnings, they benefit the company by providing earnings which are unlikely to be reversed by future events.

Charter's pre-tax earnings decreased from \$15.4 million in 1986 to \$5.6 million in 1987. Pre-tax income in 1986 included \$8 million of realized investment gains compared to only \$0.2 million in 1987. Exclusive of securities gains, pre-tax income increased from \$5.4 million in 1986 to \$7.4 million in 1987. A major factor determining such earnings has been the company's practice of deferring

earnings for three years on new single premium life business. As the block of business which is more than three years old grows, significant improvements in earnings should result.

We have sold increasing volumes of business each year while maintaining adequate margins. Each successful year not only increases our block of profitable business but drives down our unit costs of administering policies. We look forward to another successful year in 1988.

A handwritten signature in black ink, appearing to read 'David T. Cumming', with a stylized, looping initial 'D' and a horizontal line extending to the right.

David T. Cumming
Chairman and President
Charter National Life Insurance Company

Report on Manufacturing Division

Leucadia's six manufacturing companies make the following products: bathroom vanities (with cultured marble tops), plastic netting, bonded fiber products, power cord sets, hydraulic mulch, and office partitions and furniture.

In 1987 the Manufacturing Division enjoyed a fine year with pre-tax income of \$11.9 million on revenues of \$94.2 million. For 1986, pre-tax income was \$8.5 million and revenues were \$83.1 million. We began the year emphasizing improvements in product quality and reduction of production costs. Investment in new plant and equipment was an integral part of our plan to improve quality and lower cost.

During 1987, acquisitions for both our bathroom vanity and plastic netting businesses affected our results. The bathroom vanity acquisition, completed in November, allows us to produce vanity cabinet doors, one of the more costly material components of our bathroom vanity products. This acquisition will help improve product quality and reduce cost. Our plastic netting product line was expanded as a result of a December 1986 acquisition for which a new facility came on stream in 1987. The plastic netting products are used in the citrus and poultry packaging industries. Both acquisitions provide us with additional product development opportunities.

The vanity business manufactures hardwood cabinets and cultured marble tops for sale to home improvement centers and other retailers specializing in the do-it-yourself market. Both sales and operating profits rose dramatically over 1986 levels. We were successful in attracting several large home improvement center chains as new customers. With existing customers, we increased our share of their vanity programs.

During 1988 we plan to develop several new products.

Our plastic netting business manufactures proprietary plastic netting for various industrial and agricultural uses. Although 1987 sales were significantly ahead of the prior year, operating profits were flat. Start-up losses relating to the new acquisition were a significant factor in reduced gross margins, as was a 30% increase in the cost of our primary raw material. We believe that raw material prices have stabilized for 1988 and price increases will gain back some of our lost margin. New product opportunities in highway construction and maintenance hold promise for 1988.

The bonded fibers business produces fiber insulator pads for sale to, among others, the bedding and automotive industries. During 1987, we eliminated business with high freight costs which resulted in lower gross margins than we were willing to accept. As such, sales were below those of the previous year. However, operating profit was substantially improved over 1986, as new products enjoyed high margins. In 1988, we intend to develop several products for markets other than bedding and automotive.

The power cord set business produces power cord sets for manufacturers of a wide variety of consumer and industrial products. During the past several years, this business has suffered from strong foreign competition as a result of a strong dollar overseas. This situation has eased somewhat and the business was more profitable in 1987. We are continuing to automate certain aspects of our production process to improve quality and reduce costs.

In our mulch business we manufacture hydraulic mulch for use in turf establishment and juice

processing markets. During the last two years, we have significantly refurbished much of our manufacturing equipment. This has resulted in improved plant production and operating profitability in 1987.

Our office partition business manufactures freestanding office partitions, workstations and furniture products which it sells to office furniture wholesalers and dealers. During 1987, a major product line was redesigned and a new office furniture line was created. This new product development effort, targeted mainly to the commodity segment of the market, will continue in the coming year.

We continue to be alert to growth opportunities while being diligent in monitoring our market

shares, gross margins and investment returns. For 1988, we are emphasizing the development of new products and markets as well as continuing to work towards ever higher quality and service. We are prepared to make capital investments where necessary to achieve our goals. We will continue to be prudent in our decision-making, especially in view of a risk of recession in the near future. However, if the overall economy does not stumble in 1988, we look forward to another fine year.



Thomas E. Mara

President

Manufacturing Division

Message from the Chairman and President

We are pleased to report an earnings recovery in 1988 as compared with our 1987 loss. Income before a change in accounting for income taxes was \$23,733,000 in 1988 (\$1.80 per common share or \$1.75 per fully diluted share) compared to a loss of \$18,144,000 (\$1.32 per common share) in 1987. This past year securities gains were a major factor with recorded net pre-tax gains of \$21,099,000 from securities transactions compared to net losses of \$3,848,000 in 1987. The increased earnings also reflect the effects of our additional investments in PHLCORP, Inc. ("Phlcorp") and BRAE Corporation ("Brae") which in 1988 became consolidated subsidiaries. At December 31, 1988 consolidated assets exceeded \$2 billion.

During 1988 many significant transactions occurred. In February we completed a tender offer for additional Phlcorp common shares and Leucadia's interest in Phlcorp increased from 39% at December 31, 1987 to 64% at December 31, 1988. We invested additional funds in Brae and increased our ownership from 49% at December 31, 1987 to 74% (79% if certain warrants are exercised) at December 31, 1988. As a result of the conversion of the Empire Insurance Company ("Empire") from a mutual company to a stock company and other transactions, Leucadia had an effective interest in Empire of 58% at the end of 1988. During 1988 Leucadia also sold at a profit all or a portion of its interests in the common stock of Minstar, Inc., Oxford First Corp. and several of the companies we had interests in as a result of our association with The Jordan Company. We also entered into an agreement to sell our interest in certain properties located in San Luis Obispo County, California for \$22,000,000; we expect the sale to close in the second quarter of 1989 for a pre-tax gain in excess of \$16,000,000.

During 1989 we acquired additional shares in Cambrian & General Securities p.l.c. ("Cambrian") which, when added to our holdings at December 31, 1988 represent approximately 74% of Cambrian's voting interest. Funding for this

investment was through a special purpose bank facility. We believe that our investment in Cambrian will prove to be profitable.

The Annual Report on Form 10-K filed with the SEC is a part of this report. You are referred there for additional information. However, certain comments on each of our operating divisions follows.

Life Insurance:

Our life insurance operations are principally conducted through Charter National Life Insurance Company of St. Louis ("Charter"), which sells a variety of tax advantaged life insurance products. The tax treatment of Charter's most successful product was changed during the year on a prospective basis. In anticipation of such change, we emphasized the sale of another product which was not subject to this tax uncertainty. The net result was a small decrease in premium revenues from 1987 levels. We account for our insurance products on a very conservative basis and will continue to do so when new accounting principles, which are required for 1989, are implemented. Including a subsidiary, Charter now writes business in all 50 states. In 1989 Charter expects to market a tax advantaged policy which will meet the requirements of the new tax law.

Property And Casualty Insurance:

During 1988 Empire became a consolidated subsidiary. Empire writes personal and commercial lines of insurance almost exclusively in New York. Empire is an unusual casualty company in that it does not sacrifice profitability for market share; in addition, it has been very successful at controlling operating costs. While earnings in 1988 were excellent, the casualty insurance business has historically been very cyclical. Nevertheless, we are cautiously optimistic about the future.

Manufacturing:

The Manufacturing Division produces a variety of products including bathroom vanities, bonded fiber products, plastic netting products, insulation

products, electrical cord sets, bulk wood fiber, office divider panels and electronic signs. Brae's subsidiary, American Sign & Indicator Corporation, joined the group in 1988. Although the Manufacturing Division had lower profits in 1988 (due to higher raw material costs and start up costs of new equipment and facilities resulting in manufacturing inefficiencies) we remain encouraged by the division's excellent return on investment and this years prospects.

Banking, Real Estate and Leasing:

This division includes our Salt Lake City based national bank and thrift operations, the railcar leasing business, principally conducted through Brae, and computer leasing. The national bank had a higher average investment in loans during 1988 and also opened a new branch and several loan production offices. During 1989 the bank intends to expand by making automobile financing loans to individuals with prior credit problems. We believe this business, properly controlled, can be successful. We also invested additional funds in owned railcars and, as a result of the additional investment in Brae, increased our interest in its railcars.

Trading Stamps:

The trading stamps business is conducted by The Sperry and Hutchinson Company, Inc. ("S&H"), a subsidiary of Phlcorp. Although the trading stamps industry has been in a declining trend for a number of years, and S&H has reduced its operations in response, 1988 operating results were good. In 1989 S&H was informed that its largest customer would discontinue the distribution of trading stamps in the second quarter. S&H believes it will

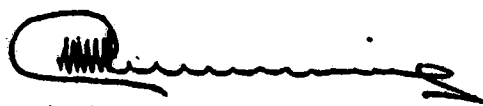
be able to develop plans which will reduce, but not eliminate, the effect of this lost business.

Motivation Services:

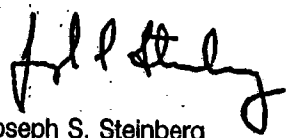
The motivation services business is conducted through S&H Motivation, Inc., a subsidiary of Phlcorp. This segment operated at a break-even in 1988 after instituting a cost cutting program. New management has implemented plans which we believe will lead to future growth and profitability.

A frequent comment concerning Leucadia is that our financial statements and reports are complicated and difficult to understand. We agree, but unfortunately this complexity follows from our business strategy. We tend to be buyers of companies that are troubled or out of favor and as a result are selling substantially below the values which we believe are there. We then work at improving the acquired operations with a view to increasing cash flow and profitability. From time to time we sell parts of these operations when prices available in the market reach what we believe to be advantageous levels. While we are not perfect in executing this strategy, we are proud of our long term track record. We are not income statement driven and do not run your Company with an undue emphasis on either quarterly or annual earnings. We believe that we are conservative in our accounting practices and policies and that our balance sheet is conservatively stated.

The accomplishments of this year required great effort on the part of many. We thank our employees and advisors for the work they have done on behalf of our shareholders. We also thank our bank lenders for their continuing support. We continue to be optimistic about the future of your Company.



Ian M. Cumming
Chairman



Joseph S. Steinberg
President

Message from the Chairman and President

Net income for 1989 was \$64,311,000. This is a 31% return on the December 31, 1988 shareholders' equity. We are pleased with this result.

During the last ten years our shareholders' equity has increased at a compounded annual rate of 27.4%. We are obviously also pleased with that. We would, however, caution against any extrapolation. Every year the hurdle gets higher. We will, however, continue to try. Our shareholders' equity increased by \$50,823,000 during the year. The changes in shareholders' equity are shown on page F-6 of the Form 10-K for the year ended December 31, 1989, which is included elsewhere in this Annual Report.

A frequent comment concerning Leucadia is that our financial statements and reports are complicated and difficult to understand. We agree. Mixing the balance sheets of insurance companies—both life and casualty—banking, six different manufacturing operations, trading stamps and motivation services makes for a confusing financial stew. What follows is an attempt to look at the balance sheet in a different way. This somewhat unorthodox presentation is based on the segment data included on page 3 of the Form 10-K and is designed to approximate the net investment in our different activities. It is how we look at our balance sheet. We hope it is helpful and illuminating to you.

Segments:

Life Insurance	\$ 106.3
Property and Casualty Insurance	60.9
Banking, Real Estate and Leasing	55.2
Manufacturing	52.1
Trading Stamps	(27.5)
Motivation Services	4.1
Corporate and Other	122.0
	<u>373.1</u>

Corporate Debt:

Bank Debt	-0-
14% Senior Subordinated Notes	(67.3)
6% Subordinated Swiss Franc Bonds ..	(43.1)
Other Debt	(5.0)
Total Corporate Debt	<u>(115.4)</u>
Shareholders' Equity	<u>\$ 257.7</u>

What follows are comments on each of our businesses.

Life Insurance:

Our life insurance operations are conducted through Charter National Life Insurance Company of St. Louis, which sells a variety of tax advantaged life insurance and annuity products. Charter, directly and through a subsidiary, writes business in all fifty states. The tax treatment of Charter's most successful product was changed in 1988 and Charter experienced reduced premium receipts as it emphasized alternative products. By the end of 1989 new products were introduced, including a life insurance product designed to meet the current definition of life insurance for federal income tax purposes. In 1989 Charter implemented, on a very conservative basis, the accounting required by FASB 97. Segment results for 1989 reflect the negative effect on earnings of (a) securities losses of \$3.8 million compared to gains of \$2.8 million in 1988 and \$.5 million in 1987, (b) implementation on a conservative basis of FASB 97 and (c) reduced investment income resulting from increased investments in cash equivalents. At year end the cost and market value of Charter's investment portfolio were approximately the same. At the present time, we do not believe the life insurance business is particularly attractive.

Property and Casualty Insurance:

The Company's property and casualty insurance business is conducted by the Empire Insurance Group, a subsidiary of our 66% owned subsidiary, PHLCORP, Inc. Empire writes personal and commercial lines of insurance almost exclusively in New York. Empire had superb financial results for the year. During 1989, Empire took the opportunity to dispose of a substantial portion of its municipal bond portfolio resulting in a loss for statutory accounting purposes and a profit for financial accounting purposes. At December 31, 1989 the market value of the Empire Group's bond portfolio exceeded the carrying value.

The property and casualty insurance business has been treacherously cyclical. Ollie Patrell, Empire's Chairman, and his excellent management team continue to do a superb job of managing this business. In spite of the industry's historic difficulties we are cautiously enthusiastic about Empire's future.

Banking, Real Estate and Leasing:

The Company's banking operations are conducted through our national bank subsidiary, American Investment Bank, N.A. and several other wholly and partially owned subsidiaries. Consolidated instalment loans outstanding were \$135,624,000 at December 31, 1989, an increase of \$18,194,000 from last year. These subsidiaries specialize in making consumer loans and have 27 offices in Oklahoma, Tennessee, Mississippi, South Carolina, Oregon and Virginia. We expect to open another 20 offices in 1990.

The cost of opening new offices plus the cost of setting up adequate loan loss reserves, which stood at 3.8% of net outstanding loans at year end, has depressed earnings and will continue to do so. We are investing in future growth and, hopefully, profits.

In April of 1989, we completed the sale of our 90% interest in land in San Luis Obispo County, California and a related condominium project. As a result, during 1989 we realized profits of \$18,295,000.

Manufacturing:

The manufacturing division produces a variety of products including bathroom vanities, bonded fiber products, plastic netting products, insulation products, electric cord sets, bulk wood fiber and office dividers. We have been working hard for the last several years at improving the gross margins of these businesses by investing in manufacturing efficiencies. 1989 reaped the fruits of these efforts and this division provided excellent earnings. We will continue to concentrate on gross margin while adding a special effort to get

closer to our customers. Hopefully, thereby we will learn how to further improve our products and be better competitors.

We are aggressively seeking to grow these businesses and have added several employees whose primary responsibility is to find profitable acquisitions for the manufacturing operations. If you know of any attractive acquisition candidates please contact Blake Winchell at (415) 677-1700.

Trading Stamps:

The trading stamp business is conducted by The Sperry and Hutchinson Company, Inc., a subsidiary of Phlcorp. The traditional trading stamp business continues to decline. We are attempting to manage the decline so as to minimize the adverse financial impact. S&H is attempting to expand its business through the development of an electronic database marketing program. It is too early to comment on its likely success.

Motivation Services:

The motivation services business is conducted through S & H Motivation Inc., another Phlcorp subsidiary. This is a very competitive business and our subsidiary is struggling towards profitability. We have encouraged further investment in an expanded marketing effort in hopes of increasing volume and profitability.

Corporate Assets and Other Things:

In October 1989, the Company sold its railcar leasing and management operations, principally conducted through BRAE Corporation and in December 1989 sold Brae's only other operation which had no continuing value. As a result of these sales the Company realized a net pre-tax gain of \$47,300,000. In 1990 Leucadia acquired all the common shares of Brae that it did not already own.

At December 31, 1988 the Company owned approximately 31% of Cambrian & General Securities, then a United Kingdom investment trust. During 1989, we acquired substantially all of the

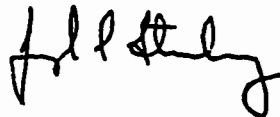
remaining equity interest in Cambrian. At December 31, 1989 the Company's investment in Cambrian was approximately \$27,700,000 less than Cambrian's net assets. In addition, we received \$12,500,000 in January related to a prior Cambrian investment which is not reflected in the excess amount referred to above. As stated in the financial statements the Company will reflect this excess in future earnings.

During 1989 and early 1990 several transactions resulted in the reduction of 1,371,000 of the Company's outstanding common shares and warrants to acquire 786,000 of the Company's common shares. The aggregate cost of these transactions was approximately \$37,000,000, equivalent to an average cost of \$19.21 per common share.

A handwritten signature in black ink, appearing to read 'Ian M. Cumming', with a stylized, elongated tail.

Ian M. Cumming
Chairman

We tend to be buyers of companies that are troubled or out of favor and as a result are selling substantially below the values which we believe are there. We then work at improving the acquired operations with a view to increasing cash flow and profitability. From time to time, we sell parts of these operations when prices available in the market reach what we believe to be advantageous levels. In 1989 we did all of these things. With the help of our hard working employees, advisers and the continued support of our bankers we had a good year. We hope you are pleased. We are cautiously optimistic about the future in spite of the uncertain economic times.

A handwritten signature in black ink, appearing to read 'Joseph S. Steinberg', with a stylized, elongated tail.

Joseph S. Steinberg
President

Message from the Chairman and President

Net Income for 1990 was \$47,340,000, an 18% return on average equity. During the preceding eleven year period of 1980 to 1990, we have increased our shareholders' equity from \$22,945,000 to \$268,567,000 and our book value per common share from \$1.27 to \$23.64, which represents a 30.4% annual compounded rate of return. During this period, when opportunity, the Company repurchased 8,539,997 shares of common stock for \$95,569,000 (an average price of \$11.19 per share).

In an ongoing effort to keep hubris at bay, we would like to point out the following: Rising tides raise all boats. The economy was buoyant. Money was easy to come by. To this we added energy, enthusiasm and some perspicacity, and our boat, buoyant in the rising tide produced the aforementioned results.

However, we are reminded of Pharoah's dream interpreted by Joseph to mean that seven years of famine will surely follow seven years of plenty. Unfortunately, the previous seven years of plenty have been largely financed by debt which the nation cannot over time sustain. In the coming years, a correction is inevitable.

A wise man once said that you become more conservative when you have something to conserve. We view our job as having become more difficult. We will continue to endeavor to compound our shareholders' equity at an attractive rate, but with considerable caution.

Last year we included a table, presented again below, which attempts to look at our balance sheet in a comprehensible manner. This presentation is based on the segment data included on page 3 of the Form 10-K and is designed to approximate the net investment in our different activities. Our consolidated balance sheet is a very confusing financial stew, mixing as it does many different businesses. We have \$463.9 million invested in our various business segments financed by \$195.3 million of borrowed money and \$268.6 million of shareholders' money.

Segments:	(In millions)
Life Insurance	\$ 88.8
Property and Casualty Insurance	118.8
Banking, Real Estate and Leasing	65.2
Manufacturing	54.6
Trading Stamps	(31.9)
Motivation Services	2.9
Corporate and Other	165.5
	463.9
Corporate Debt:	
Bank Debt	(94.0)
14% Senior Subordinated Notes	(45.8)
6% Subordinated Swiss Franc Bonds	(41.0)
Other Debt	(14.5)
Total Corporate Debt	(195.3)
Shareholders' Equity	\$ 268.6

What follows are comments on each of these segments. We recommend the attached Form 10-K for a more detailed discussion.

Life Insurance:

Our life insurance operations are principally conducted through Charter National Life Insurance Company of St. Louis, Missouri.

For the last several years, Charter has sold various investment oriented products. Certain of these products have become difficult to sell as their design has become contorted because of frequently changing tax requirements. In the marketplace, competitors have underpriced these products to gain cash or market share. As this mispricing caught up with one company, others entered the market to take their place. We learned that the net spread between money earned on investments and money credited to the policyholder left no room for an expensive sales effort. Recently, we have ceased selling these products and will concentrate on servicing our existing customers and marketing "variable" annuities through unaffiliated mutual fund management companies.

Charter, unlike many insurance companies, does not rely on non-investment grade debt to support its liabilities. In retrospect we were both lucky and smart.

During 1990, Charter determined that it would be in its best interest to dispose of a very old block of traditional life insurance business. It had not sold similar products for many years. The Company recorded a loss of \$16,857,000 on the sale. This was not Charter's finest hour.

Charter has a very capable back office operation and hopes to buy blocks of investment oriented policies which will utilize the same fixed overhead to efficiently service more policies.

Property and Casualty Insurance:

Our property and casualty insurance operations are conducted by The Empire Group, a subsidiary of Phlcorp. Empire writes personal and commercial insurance principally in the New York metropolitan area. Empire enjoyed another year of excellent operating results in 1990. Earned premiums were up and losses were acceptable. Empire is very conservatively managed and has tight control of its costs. Empire's focus on urban insurance provides expertise in risk management that many other companies do not have. In addition, Empire, unlike many insurers in this cyclical industry, declines to write business when adequate profit margins are not obtainable. Substantially all of Empire's investments are in U.S. government issued or guaranteed securities and investment grade debt obligations.

Banking and Lending:

The Company's banking and lending operations are conducted through American Investment Bank, N.A., two other F.D.I.C. Insured industrial banks located in Salt Lake City, Utah and other subsidiaries involved in consumer lending. At December 31, 1990, the banking and lending operations had outstanding loans (net of unearned finance charges) of \$202,781,000 compared to \$135,624,000 at December 31, 1989.

The Company expanded its consumer lending operations in 1990 by opening 30 new offices for a total of 57 offices located in Alabama, Kentucky, Mississippi, Oklahoma, Oregon, South Carolina, Tennessee and Virginia. Opening new offices is expensive and will burden the banking and lending operations' profitability until each office reaches maturity in several years. We plan to open 20 additional offices in 1991. Loan loss reserves stood at \$6,782,000 or

3.3% of outstanding loans at December 31, 1990.

Manufacturing:

During 1990, the earnings of the manufacturing companies were depressed by expenditures for new products, market development costs and the general economic slowdown in the second half of the year. However, the return on investment was still excellent.

We also purchased three small companies which manufacture electrical cable, folding doors and bathroom medicine cabinets.

Trading Stamps:

The trading stamp business is conducted by a Phlcorp subsidiary, The Sperry and Hutchinson Company, Inc. The traditional Green Stamp business continued its decline which began in 1969. Barring a miraculous change, we expect this trend to continue.

During 1990, we noted that the liability for unredeemed trading stamps at December 31, 1989 may be approximately \$34,000,000 in excess of the amount that ultimately will be required to redeem outstanding trading stamps and determined to recognize the apparent excess over five years. A more complete discussion of this complicated subject occurs in the Form 10-K.

Motivation Services:

Motivation services are provided by another Phlcorp subsidiary, S&H Motivation, Inc. ("SHM"). Fifty-three percent of SHM's sales in 1990 were to the automobile industry. The automobile industry had a bad year, which adversely affected SHM, as did the Gulf crisis which reduced motivational travel programs.

Other Items:

During the year we recognized income resulting from our prior acquisition of Cambrian & General Securities in the amount of \$43,000,000. As a result of certain recent legal proceedings we are hopeful that additional income will be recorded in 1991.

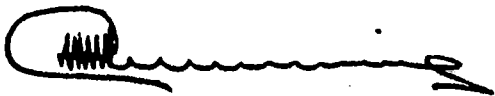
Also during 1990, the long pending rehabilitation of the various Wisconsin insurance companies owned by Phlcorp moved forward including the return of certain of these companies. As a result, we recorded income of \$9,696,000 in 1990. It is possible that further assets will be returned in 1991.

During 1990, we acquired approximately 46.6% of the outstanding ordinary shares of Molins PLC, a United Kingdom company engaged in manufacturing, for approximately \$63,115,000. In spite of our large minority position, we have been unable to exercise any significant influence on Molins' management. At December 31, 1990 the quoted market price for Molins' shares exceeded our cost. We are considering our future course of action.

On March 7, 1991, Leucadia made a proposal to Phlcorp's Board of Directors that Phlcorp acquire all of Leucadia's outstanding common shares in a merger transaction in which Leucadia shareholders would receive two common shares of Phlcorp for each Leucadia common share. Consequently, Leucadia's present equity securityholders would own, as a result of the proposed merger, approximately 81% of Phlcorp's then outstanding common shares on a fully diluted basis. Phlcorp has formed a special committee of independent directors unaffiliated with Leucadia to consider the proposal.

On April 5, 1991, as we are writing this to you, Leucadia announced the execution of an agreement to acquire the Colonial Penn Insurance Group. The purchase price consists of \$100,000,000 in cash and a \$50,000,000 ten year 12% subordinated Leucadia note, which may be retired for \$30,000,000 up to one year after the transaction closes. We believe it will take several months to receive the necessary regulatory approvals before this transaction can be concluded.

We are often asked to describe our corporate strategy and long-term goals for Leucadia. Amended by the caution we noted earlier, the best explanation we are able to give is to repeat what we said in our 1988 letter to shareholders:



Ian M. Cumming
Chairman

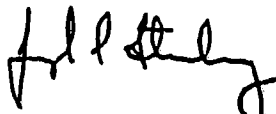
We tend to be buyers of companies that are troubled or out of favor and as a result are selling substantially below the values which we believe are there. We then work at improving the acquired operations with a view to increasing cash flow and profitability. From time to time we sell parts of these operations when prices available in the market reach what we believe to be advantageous levels. While we are not perfect in executing this strategy, we are proud of our long-term track record. We are not income statement driven and do not run your Company with an undue emphasis on either quarterly or annual earnings. We believe that we are conservative in our accounting practices and policies and that our balance sheet is conservatively stated.

Our operating companies are decentralized. We believe that our businesses should operate without undue interference from the owners. We, therefore, depend on the excellent management teams that run these companies. They do a superb job. We are available to help solve problems which inevitably arise, to allocate capital and to plan for the future.

We continue to look for acquisitions that are reasonably priced. If you know of anything of interest please call Larry Hershfield or Blake Winchell at (415) 677-1700.

1991 will be a busy year completing the Colonial Penn acquisition. It is our largest acquisition to date. We will be relying again on our hard working and dedicated employees and advisors. A special thanks to our bankers, some of whom have had their own business travails during 1990, but who have continued to be very supportive.

Last year we were cautiously optimistic about the future in spite of the uncertain economic times. This year we are more cautious and less optimistic, but there are still opportunities to be pursued.



Joseph S. Steinberg
President

Message from the Chairman and President

To Our Shareholders,

1991 was a successful year for Leucadia. We reported \$94,380,000 (\$7.89 per share) in earnings from continuing operations after income taxes, a 35.1% return on last year's ending equity and the highest earnings since this management took over thirteen years ago. In those same thirteen years, our common shareholders' equity has gone from a negative \$7,657,000 (\$.43 per share) to \$365,495,000 (\$31.77 per share) at year end 1991.

On December 31, 1978, the stock was selling for \$0.32 a share (adjusted for subsequent stock splits) and at December 31, 1991 it was quoted at \$36.88 a share, a 44% compounded rate of appreciation.

1991 was, in addition, a very important year for our future. But first, let us explain how we got to where we are. In the 1988 report to stockholders, we elucidated a strategy repeated below, which has been responsible for the above mentioned results.

We tend to be buyers of companies that are troubled or out of favor and as a result are selling substantially below the values which we believe are there. From time to time, we sell parts of these operations when prices available in the market reach what we believe to be advantageous levels. While we are not perfect in executing this strategy, we are proud of our long-term track record. We are not income statement driven and do not run your Company with an undue emphasis on either quarterly or annual earnings. We believe we are conservative in our accounting practices and policies and that our balance sheet is conservatively stated.

In pursuit of that strategy, on August 16, 1991, we purchased Colonial Penn Insurance Group for \$127,863,000 in cash. The Colonial Penn Insurance Group had a prepurchase GAAP net worth of approximately \$391,000,000. More about the financial effect of this below. After working diligently for the last eight months at restructuring Colonial Penn, we have had no significant unpleasant surprises and believe we have made an outstanding acquisition.

Our future results will be assisted by strong recurring earnings from our much enlarged insurance groups. The addition of Colonial Penn Life, with the life business of Charter National, will form the Life Insurance Group with just over \$2.0 billion in assets employed. Empire Insurance Group, wholly owned by Phlcorp (our 63% owned subsidiary), and Colonial Penn Insurance Company constitute the Casualty Insurance Group which have just under \$2.0 billion in assets employed.

The prospect of significant recurring earnings will be a joy and a significant relief. Your management sometimes feels like gerbils running around the inside of a revolving cage. Although enjoyable, it will be nice to occasionally get off for a rest. Nonetheless, we will continue to look for more undervalued opportunities, as well as tending to the businesses we already own.

What follows are more details on the Colonial Penn acquisition and comments on the state of our other businesses.

The Acquisition of Colonial Penn

At the date of acquisition, Colonial Penn had a GAAP net worth of \$390,878,000 for which we paid \$127,863,000, leaving \$263,015,000 to be allocated. This "Bargain" results in the following changes in Colonial Penn's historical balance sheet.

	(In thousands)	
Colonial Penn Group GAAP net worth at acquisition ..	\$390,878	
Less cost of acquisition	<u>127,863</u>	
"Bargain" to be allocated	<u>\$263,015</u>	
First, intangible and depreciable assets are written off:		
Deferred policy acquisition costs	\$139,809	
Insurance in force	20,064	
Fixed assets	<u>24,915</u>	\$184,788
Next, provisions are recorded for restructuring costs:		
Severance costs	9,277	
Costs of getting out of unnecessary leases	19,855	
Relocation costs	1,438	
Post employment benefits	<u>7,000</u>	37,570
Next, increases in policy reserves, mostly belt and suspenders reserve strengthening:		
Annuities	5,800	
Accident and health	10,000	
Property and casualty	<u>33,005</u>	48,805
Finally, taxes not required because of indemnification from the seller and other write offs, net	<u>(8,148)</u>	
	<u>\$263,015</u>	

The result of all this is that costs and expenses going forward will be substantially reduced (see page 5 of the attached 10-K) from Colonial Penn's past. An analogous situation would be a manufacturing company with no depreciation. In fact, we have written off all fixed assets and the unamortized balance (\$160,000,000) Colonial Penn spent to create its existing business. If what we believe is true comes to pass, Leucadia will recover the "Bargain" in future income.

Life Insurance Group

This group is composed of the Colonial Penn Life companies and Charter National Life. These companies sell a number of different life and health products, which are described in greater detail in the attached 10-K. Our plans for these products will continue to be driven, as they have been in the past, by persistency and profitability and not by premium growth. Profitability will be monitored continually and if the requisite profits are not available in the marketplace, sales will cease and attention turned to preservation of existing policies and premium flows. You will recall that several years ago we ceased new sales of Single Premium Whole Life (SPWL) at Charter when competition drove profitability from that line of product. We have been successful at preserving that block of business while not writing new business. The combining of the operations of these two companies is underway.

Property and Casualty Group

Empire Group, the property and casualty insurer, owned by Phlcorp, our 63% subsidiary, had an excellent year. It is a niche company specializing in risks in the Boroughs of New York. Empire does what it does very well and, hopefully, will continue to do so. They too are dedicated to profitability and will not sacrifice profit for premiums or market share.

Colonial Penn Property and Casualty has two parts. A special risk portfolio with a madcap assortment of risks, which is being liquidated and which, in our opinion is adequately reserved. By far the larger business segment, which we believe has an exciting future, is the direct response automobile insurance business.

Much appears these days in the business press about automobile insurance. Various states are at odds with the industry and have mandated lower rates. Many states have had plebiscites seeking to roll back rates. All this we think begets an opportunity—the opportunity to be among the low cost producers. Colonial Penn provides such an opportunity. It is a direct marketer without the costs of a sales force. The direct marketing operation has been successful in the past. Sophisticated procedures and equipment are in place. The senior management which we have installed is cautiously optimistic that over the next five years Colonial Penn can become a significant player in its market place. We share their enthusiasm for these prospects.

The investment portfolios of both the life and casualty groups, which total \$3.1 billion, are almost entirely invested in U.S. government and agencies and investment grade bonds. There are no real estate loans, real estate owned or other problem assets. We intend to continue to conservatively manage the portfolio. At December 31, 1991, these portfolios had a market value of \$3.2 billion (\$115,000,000 in excess of their book value). The well reported asset problems of the insurance industry do not apply to us.

Banking and Lending

In 1984, we obtained from the Controller of the Currency a national banking license. These licenses were available to corporations engaged in general commerce. The resulting banks are called Consumer Banks, or Non-Bank Banks. For several years after the issuance of the license, we went about developing a consumer lending business in our consumer bank. Shortly thereafter, we acquired Utah industrial loan corporations with FDIC insurance to do more of the same business. The banking and lending operations have done well on balance. Several of the product lines are doing extremely well—two not so well. One of those has been discontinued and one is being trimmed back. We do not expect any significant losses and when mature, we expect these product lines will result in a very profitable operation.

Manufacturing

The manufacturing division lost a small amount of money last year. There were three reasons: The economy is slow (particularly in our markets), we have a large plant under construction and management problems.

The new plant is a few months from coming on line. The manufacturing division has a new structure and a full-time general manager and, if the economy recovers, the companies should return to profitability and, we are hopeful, to the high return on invested assets from whence they came.

Incentive Services

Incentive services are conducted by Phlcorp's subsidiaries, Sperry and Hutchinson Green Stamps and S&H Motivation. The Green Stamp business continues to shrink, but shrink profitably. The Motivation business made a tiny profit. We have discontinued our efforts to develop an electronic database marketing and incentive program. All costs of that mistaken effort have been expensed. Results from the latest statistical study of redemptions indicate that at December 31, 1990, there may be approximately \$55,000,000 in excess stamp reserves. Because the amount of the excess may be different than indicated by the study, we are amortizing the apparent excess to income over a five year period.

Other Matters

After three years of attempting to take over Molins PLC, a United Kingdom based engineering company, we accepted an offer for our shares arranged by Molins and recognized a \$18,437,000 profit.

We were able to recognize another \$9,359,000 in income from Cambrian & General as a result of settlement of certain litigation, elimination of reserves no longer required and receipt of cash distributions on a related prior investment.

After four long years of negotiation, a settlement was reached with El Salvador on the expropriation of our power company, CAESS, 44% owned by Phlcorp. President Cristiani has conducted the negotiations in a businesslike fashion and legislation authorizing payment of \$35,340,000 to CAESS shareholders over the next four years has recently been approved by the Legislative Assembly of El Salvador. If a closing occurs, Phlcorp's ultimate share will be approximately \$4,000,000 in cash in 1992, and the balance in \$12,000,000 6% U.S. dollar denominated Government of El Salvador 4-year bonds. The gains will be recorded as cash is received.

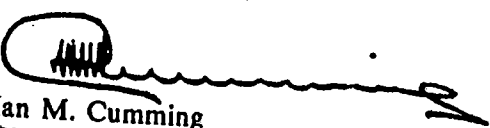
The accounting profession has been busy. The Statement of Financial Accounting Standards (SFAS No. 106) "Employers' Accounting for Postretirement Benefits Other Than Pensions" must be adopted no later than 1993. The Company's liability for benefits to retired persons that we will recognize (net of minority interest) amounts to approximately \$6.5 million and that amount will be recognized in 1992. We feel it is best to recognize this liability in one year rather than amortize it over the 20 years that the rules optionally permit.

SFAS 109 "Accounting for Income Taxes" was issued in February 1992. This requires that accounting and tax loss carryforwards be calculated and recorded as an asset. For those of you who have waded through the tax section of the 10-K for the past number of years, you will recognize that we have significant tax loss carryforwards. We are trying as best we can to comply with SFAS 109. It requires, among other things, that we determine whether we will have sufficient earnings in the future. We are trying very hard given the uncertainties inherent in the process to come up with the best estimate consistent with our conservative bent towards our balance sheet. This is not an accounting exercise, but some form of alchemy and should have been relegated to the notes to the financial statements and not to the financial statements themselves. At this writing, it appears the number will be substantial. It will be recognized in 1992 as an item of income.

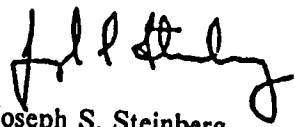
1991 was a watershed year. Our insurance groups should provide a firm foundation for a more certain future. Our balance sheet is strong and conservatively presented. The problems we have identified in the other operating businesses are being addressed. We hope satisfactorily.

Although optimistic about Leucadia and its future, we are greatly concerned about the domestic economy. Most worrisome of all is seeing our inability as a nation to address our problems in a coherent fashion and move in some rational way toward solving them. Hopefully, we will muddle through without any financial accidents more severe than hundreds of congressmen writing checks on each other's balances.

Many thanks again to employees, advisors, banks and all others who have worked very hard to accomplish this record year. It could not have been achieved without them.



Ian M. Cumming
Chairman



Joseph S. Steinberg
President

Letter from the Chairman and President

To Our Shareholders,

Shareholders' equity at December 31, 1992 was a positive \$618,161,000. Shareholders' equity at December 31, 1978 was a deficit of \$7,657,000. This date is important because your Chairman became chairman the previous June and your President became president in January of 1979. During the 14 years from 1978-1992, book value per share (adjusted for stock splits) was increased from a negative \$.22 to a positive \$22.12. The stock price (adjusted for stock splits) for that same period went from \$.16 to \$39.50, a compound rate of 47.8% per annum.

Earnings for the year were \$130,607,000, or \$5.33 per share. This is a 36% return on last year's ending equity. Obviously, as book value increases, obtaining similar returns will become increasingly difficult. But, we will continue to try, consistent with prudence and with a heightened concern about the economic environment, about which more later.

At the year end 1992, we had \$4,330,580,000 of assets employed in the following fashion:

	(In millions)
Property and Casualty Insurance	\$1,843.3
Life Insurance	1,857.0
Banking and Lending	268.9
Incentive Services	41.2
Manufacturing	105.8
Corporate and Other*	214.4
	<u>\$4,330.6</u>

* Principally consists of cash, investments and receivables.

As mentioned in our letter to shareholders last year, and as is borne out by the numbers above, we are now an insurance group. "The prospect of significant recurrent earnings will be a joy and a significant relief", we said last year. Thankfully, it has become true.

Before describing what went on in 1992 in the segments above, a brief update on the August 1991 acquisition of Colonial Penn Group. The Colonial Penn assets are included above in the Property and Casualty and Life Insurance numbers. We paid \$128,000,000 for Colonial Penn and between August 16, 1991 and December 31, 1992, it earned pre-tax \$191,752,000, which included \$39,866,000 of securities gains. This is a remarkable result that we may never repeat.

Property and Casualty Insurance Group

Colonial Penn's direct response automobile insurance group, under the superb direction of Ollie Patrell, is aggressively pursuing an inexpensive way to acquire new business. The direct marketing operations of Colonial Penn, prior to our acquisition, were too expensive and during 1992 we adopted a new, lower cost marketing strategy. Although this resulted in a decrease in premium volume for 1992, we are pleased with the new cost structure and with the increasingly profitable premium volume that we hope will result. We cautiously expect to generate sufficient volume by the end of 1993 to replace lapses and to produce significant growth in the future. Our objective on an ongoing basis is a combined ratio of less than 100%. For 1992, it was about 103%, which includes the effect of Hurricane Andrew.

Hurricane Andrew cost the Company about \$36,000,000, of which \$30,000,000 was reinsured to other insurers, so the net result was tolerable. Ollie, sensing the market for catastrophe insurance would tighten, scurried off to Europe for a week and replaced our catastrophe coverage, albeit more expensively and with a higher retention level. Hurricane Andrew also initiated a detailed study of our auto and homeowners exposure in certain geographic areas where these storms occur and we have introduced procedures to avoid dangerous geographic concentrations. Our goal for this segment is to be the low cost producer in our market.

The Colonial Penn special risks portfolio continues to be liquidated and is in our opinion adequately reserved. There may even be a reserve recovery somewhere in the distant future. We believe we are also adequately reserved for the well known problems in California and New Jersey.

The Empire Insurance Group is a property and casualty insurer primarily in the Boroughs of New York. It specializes in small residential and commercial real estate, automobile and taxi cab insurance. Empire is a niche player and has been in the same niche for many years and does its business well. In addition, the Empire Group does a considerable amount of service work for other insurers. This includes administration services, including processing, underwriting and collection activities for the New York Public Automobile Pool and assigned risk business from other insurers. This service work helps amortize back office expenses and does not generally involve the assumption of underwriting risk. Under the very capable direction of Andy Attivissimo, Empire has experienced management at all levels and is growing nicely.

Life Insurance Group

As we described in last year's report, the life operations of Charter National Life and the various life companies of the Colonial Penn Group have been combined under one management ably lead by Rich Pettitt. Rather than discuss the life companies themselves it will be clearer to discuss the life product lines.

Graded Benefit Life

Graded Benefit Life is a guaranteed issue, modified benefit policy offered without medical exams or evidence of insurability in amounts of \$350 to \$10,000 to persons between 50 and 80 years of age by direct response, principally generated by television advertisements. Those of you with insomnia may recognize the television ads featuring Ed McMahon that often play late at night. There are over 900,000 policies in force, which have a low lapse rate and an extremely predictable mortality experience.

Consistent with the policies described above for Property and Casualty, during 1992 we revamped the marketing effort in order to lower costs and to increase profitability. We hope to soon generate premiums sufficient to maintain the size of the book. Perhaps by next year, we will have developed techniques sufficient to show modest growth.

This is a predictable, low risk, useful and profitable product line. We like this business very much.

Investment Oriented Products

The only significant product offered in 1992 was a no-load variable annuity product. This is a tax deferred life product where the premiums are invested, at the direction of the policyholder, in a choice of mutual funds offered by Scudder, Stevens & Clark. The policyholder bears the entire investment risk. We like the product very much, but have been unable to figure out a way to sell it in significant volume. Premium receipts for 1992 were only \$58,207,000. We are continuing to investigate ways to increase volume.

Until 1991, we profitably sold other tax advantaged life products, mainly single premium whole life (SPWL) and single premium deferred annuities (SPDA). Given our conservative investment bent, the potential volatility of interest rates, the expected new rules about marking to market "trading" portfolios (as the SEC defines them) and the willingness of competitors to offer crediting rates that imply investments at very high rates, we found ourselves unable to compete prudently. During 1992, after lowering crediting rates, the Company began a program of selling these blocks and asking policyholders to consider moving to another company. At the date of this writing, if the SPWL block that is currently subject to a letter of intent closes, we will have reduced our assets employed in the life group by about \$900,000,000. It is a difficult and unpleasant task to reduce the size of a business, with the inevitable disruption to the lives of the hard working and loyal employees.

All of the above notwithstanding, in the years ahead when tax rates will be considerably higher, these tax deferred and, in the case of death, tax sheltered products will continue to be attractive to consumers. We may not be at the end of this tale.

Investments

The investment portfolio is managed by several investment advisors. We carefully monitor their efforts and provide clear strategic direction. As a result, at year end 97% of the insurance operations investment portfolio was in U.S. Government, investment grade fixed income securities and policyholder loans. This portfolio had an approximate 7.3% yield to maturity and an estimated remaining life for the bonds of 6 years and a market value of approximately \$54.7 million above book value. Thanks to our substantial tax loss carryforwards, we were able to harvest substantial capital gains from our investment portfolios, which fits very well with our worries about future interest rate increases.

Guiding Principles

We thought it might be helpful to list some of the principles that guide our approach to the insurance business.

1. We are driven by a search for profitability, not for volume or market share and, as a result, sometimes the best strategy is to retreat.
2. We would rather reserve conservatively and be required to release reserves than to underreserve and be required belatedly to report losses.
3. We search for niches, not dominance, on the theory that the world can tolerate many mice but few elephants.
4. We invest the portfolios conservatively. We are willing to give up marginal yield for predictability, safety and a good night's sleep. This general conservatism helped us survive the '80s. There is no such thing as a free lunch: Either it isn't lunch or it isn't free.
5. We face the responsibility of managing so much of other people's money with constant vigilance and trepidation. The insurance reserves do not belong to the shareholders, only the capital does.

Banking and Lending

The Company has three small banking and lending operations in Salt Lake City, Utah. American Investment Bank, N.A. (AIB) is a national bank primarily regulated by the Comptroller of the Currency and insured by the Federal Deposit Insurance Corporation (FDIC). American Investment Financial (AIF) and Governor Financial (GF) are two Utah State chartered industrial loan companies, whose deposits are also insured by the FDIC.

GF was in the business of making difficult first and second mortgages at above market rates. This business did not meet our expectations and is being wound down. Under the capable direction of Leonard Sebesta, our continuing lending operations are in the business of making unsecured loans by mail to doctors, investors and executives and automobile loans to less credit worthy borrowers. These businesses are doing very well and have above average returns on equity and total assets after conservative loan loss provisions. Until the latter part of 1992, the banking and lending operations were also in the consumer finance business, financing consumer paper generated by affiliated loan development offices in the southeastern United States. We determined that this business was not sufficiently profitable and sold all of the receivables and related offices for a \$12,100,000 profit.

AIB and AIF had the following ratios for and at the end of 1992 (exclusive of gain from sale of the consumer loan offices): Tier I Capital as a percentage of risk weighted assets—20.5% and 37.1%; net income as a percent of total average assets—3.0% and 3.2%; net income as a percent of average equity—25.7% and 21.7%; and, loan loss reserves as a percent of total loans—3.5% and 1.9%.

AIF is in a fight with the FDIC. They insist that the borrowers are not fit borrowers from a federally insured institution and that the institution is unsafe and unsound. We do not agree. The numbers and results to date do not bear these assertions out and we are going to resist the threatened supervisory

action to the fullest extent possible. We believe the FDIC's position is not borne out by the facts. They suffer from S&L induced post-trauma syndrome.

If we are unsuccessful in defending our position and give up the licenses of AIF and GF, we will fund these businesses from other sources.

Incentive Services

Incentive services are conducted by The Sperry and Hutchinson Company, Inc. (S&H) and S&H Motivation, Inc. (SHM). Early in 1993 we contributed the net assets of SHM to a joint venture with an unrelated motivation services company in exchange for a 45% equity interest in the joint operation. This may be an instance where one and one is more than two, but we will see. In any event, our investment is not large.

The Green Stamp business conducted by S&H continues to shrink, but shrink profitably under the management of Joe Orlando. The liability for unredeemed trading stamps on the balance sheet at December 31, 1992 was \$74,964,000. The latest statistical studies of redemption patterns show that approximately \$29,203,000 may be excess at December 31, 1992. Because the ultimate excess may be different than indicated by these studies, we are amortizing the apparent excess into income over the remaining two-three year period. We will continue to operate this business as long as it makes an operating profit.

Manufacturing Group

The manufacturing business, we hope, will be profitable this year. Whether it can make an adequate return on our invested capital remains to be seen.

Other Matters

On June 10, 1992, we sold \$125,000,000 of 10 $\frac{3}{4}$ % Senior Subordinated Notes due in 2002. These notes were subsequently rated as "Investment Grade" by Standard & Poors and Duff & Phelps. Somewhat wistfully, we leave the realm of junk bond issuers.

On February 8, 1993, we sold \$100,000,000 of newly authorized 5 $\frac{1}{4}$ % Convertible Subordinated Debentures due in 2003. The debentures are convertible into common shares at \$57.50 per share. The proceeds from this issue were added to working capital and are currently invested in a spread of 1-5 year treasuries. These debentures were rated as "Investment Grade" by Standard & Poors.

On December 31, 1992, we finally completed the merger of Phlcorp into a wholly owned subsidiary of Leucadia. As part of this transaction, on January 8, 1993, the Company effected a 2 for 1 stock split in the form of a stock dividend. This last split means that if you bought one share in 1979 when we took over, you now have 12 shares.

In connection with the Phlcorp merger, the Company paid a \$.20 per share dividend on the split shares. We further agreed to consider future dividends. Late this year, when results for the year become apparent, we will give consideration to another annual dividend.

On March 30, 1993 we received the \$5,300,000 in cash and \$12,000,000 6% U.S. dollar denominated Government of El Salvador bonds. This ends a long saga that began with the expropriation of the electric utility, CAESS, 44% owned by Phlcorp, on November 15, 1986. Many thanks are due to the U.S. State Department and the congressmen and senators who were consistently helpful. Special thanks also to our attorney, J.A. Uribe of MacArthur & Uribe and to Vice President Mark Hornstein, both of whom have been to El Salvador on our behalf many, many frustrating times.

At December 31, 1992, the Company had aggregate minimum tax loss carryforwards of \$344,000,000.

We told you in our last report that the SFAS 109 "Accounting for Income Taxes" would be adopted in 1992. We did not adopt it in 1992, but will adopt it in the first quarter of 1993, recording an asset of \$170,000,000. It will be reported as \$128,000,000 of income from a change in accounting principles, a

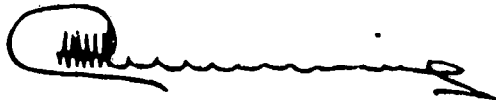
\$9,000,000 direct increase in shareholders' equity and the elimination of \$33,000,000 of intangibles. We are confused too.

1992 was a good year for Leucadia. We had record earnings and made significant progress in our insurance operations that we hope will grow and become increasingly profitable. Some of the problem businesses outside the main thrust of our operations were satisfactorily resolved. Our balance sheet is strong and conservatively stated and we have sufficient cash and credit to take advantage of future opportunities.

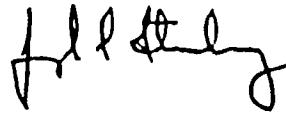
We are, however, worried about the U.S. economy. We have as a national family been living far beyond our means. For years we have had inadequate savings, investment and productivity growth. We borrowed to support our standard of living. The good times for the past 10-12 years were accomplished by both lowering taxes and increasing spending. We must pay the piper and balance our budget. The current plan is to do that by raising taxes and cutting spending a little. Can these opposite fiscal policies provide both growth and abundance? We doubt it. We believe that this nation must give up its profligate ways and live more within its means, but we worry that the process of getting there will be painful, for it will require our national standard of living to fall.

It is with these concerns in mind that we will go forward and attempt to design strategies first to protect and secondly to increase shareholders' wealth.

Many thanks again to our employees, advisors, bankers and all those who have worked very hard to accomplish this record year. It could not have been achieved without them.

A handwritten signature in black ink, appearing to read 'Ian M. Cumming', with a stylized, elongated flourish extending to the right.

Ian M. Cumming
Chairman

A handwritten signature in black ink, appearing to read 'Joseph S. Steinberg', with a stylized, elongated flourish extending to the right.

Joseph S. Steinberg
President

Letter from the Chairman and President

To Our Shareholders,

1993 was a good year for Leucadia. Earnings were \$245,454,000, or \$8.09 per share, a 40% return on last year's ending equity. Net worth was \$907,856,000 or \$32.54 per share. This compares with a negative \$.22 per share at December 31, 1978, when the present management took over. The stock price (adjusted for stock splits) for that same period went from \$.16 to \$41.00 per share, a compound rate of 44.7% per annum over those 15 years. We are pleased with this achievement; we hope you are. We doubt we will do as well in 1994.

The results for 1993 require some special explanation. The accounting elves have been working overtime again this year and, as a result, our report to you includes an inordinate number of accounting changes, some of which are quite complicated, but none of which change the excellent results. First, we will attempt to explain why the numbers appear as they do so that you can understand what actually happened to our businesses.

There are various components to the \$245.5 million of earnings. To reconcile that number to the increase in net worth requires an explanation to show the effect of all the accounting changes on the income statement and the balance sheet.

	<u>1993</u>	<u>1992</u>	<u>1991</u>
	(In millions)		
Income before taxes.....	\$176.9	\$143.5	\$95.0
Provision for taxes currently payable.....	25.3	12.9	.2
Applied to deferred taxes.....	35.3	—	—
Income before accounting changes.....	116.3	130.6	94.8
Accounting changes.....	129.2	—	—
Net income.....	<u>\$245.5</u>	<u>\$130.6</u>	<u>\$94.8</u>

Several comments are in order. Pre-tax operating income is progressing quite nicely. The \$129.2 million of income from accounting changes is, for the most part, the result of capitalizing our tax loss carryforwards (NOLs) and other future tax deductions as required by SFAS 109. "Taxes Currently Payable" are, for the most part, taxes payable in cash and include state income taxes, federal minimum taxes and tax sharing payments to the I.R.S. (resulting from the use of Phlcorp NOLs). The \$35.3 million of deferred tax expense, which is not a cash expense, is applied to reduce the deferred tax asset account which appears on the balance sheet.

For those of you interested in a more detailed explanation of SFAS 109, you may get some satisfaction from reading Note 13 to the financials. We have disparaged this accounting change in our letters to you in the past and our attitude remains the same. The attempt of SFAS 109 to improve precision in accounting has rendered the results inexplicable to all but the most sophisticated readers of financial statements. In a very imprecise way, SFAS 109 requires that the future benefit of our NOLs and other tax deductions be estimated and put on the balance sheet as an asset called "Deferred Income Taxes." In 1993, this estimation and capitalization increased our earnings significantly. In the future, for as long as we have NOLs, we will report income tax expense far greater than we pay, and will reduce the previously capitalized deferred tax asset. To make matters even more confusing, every year we must re-estimate the usability of our remaining NOLs and other tax deductions and, if necessary, adjust the deferred tax asset. We preferred the pre-SFAS 109 reporting in 1991 and 1992. We reported paying very little tax and disclosed in a note to the financial statements that we had NOLs. Simple. Too much complexity robs simplicity and thus understanding.

Here in simplified form is the effect on net income and shareholders' equity of all of the accounting changes. Additional information on the accounting changes may be found in Note 1 to the financials.

<u>Accounting Change</u>	<u>P&L at 1/1/93</u>	<u>Direct Equity</u> (In millions)	<u>Total Equity</u>	<u>Future Impact</u>
SFAS 109 "Accounting for Income Taxes"	\$127.2	\$ 9.4	\$136.6	Confusion and annual readjustments
SFAS 106 "Employers' Accounting for Postretirement Benefits other than Pensions"	(4.5)	-	(4.5)	Minimal
SFAS 112 "Employers' Accounting for Postemployment Benefits"	(3.2)	-	(3.2)	Minimal
SFAS 115 "Accounting for Certain Investments in Debt and Equity Securities"	-	49.5	49.5	Changes with market
EITF 93-6 "Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises"	9.7	-	9.7	Less conservative balance sheet
	<u>\$129.2</u>	<u>\$58.9</u>	<u>\$188.1</u>	

The \$49.5 million increase directly to equity is the accounting elves at work again. Heretofore debt securities were generally held at amortized cost on our balance sheet and current market value stated in a footnote. Under SFAS 115, changes in market value will go through net worth. This is a change that enlightens no one and will have the unintended consequence of encouraging financial institutions to change investment strategy in not necessarily beneficial ways. Why this is a good thing is beyond our understanding.

The \$9.7 million equity increase comes about through the release of insurance reserves. The accountants do not share our conservatism.

To summarize, the \$289.7 million increase in net worth from December 31, 1992 to December 31, 1993 is composed of the following (in millions):

Income before accounting changes	\$116.3
Accounting changes	188.1
Purchase of stock for treasury	(10.8)
Dividends paid	(7.0)
Exercise of options	2.3
Other	.8
Total	<u>\$289.7</u>

The responsibility for explaining our corporate accounting now belongs to Joe Orlando in our New York office. He has replaced Norman Kiken as our principal accounting officer. Norman, clutching the gains from his many years of faithful service, has escaped to California to start a winery. From accounting to farming, Norman does love a challenge! Through all the late nights, the impossible deadlines, truculent tax lawyers, opaque accounting rules, and junk food at the printers, Norman never lost his good cheer, improved his penmanship or remembered his calculator! We wish him the very best for the successful fulfillment of his dream. He will be greatly missed.

Property and Casualty Insurance Group

The Property and Casualty Insurance Group has two operating companies—Colonial Penn Insurance and the Empire Insurance Group. Colonial Penn, headquartered in Valley Forge,

Pennsylvania, is licensed in all 50 states and provides private passenger automobile and homeowners insurance to the age 50+ population. Colonial Penn, as a direct marketer, does not sell through agents and strives to be the lowest cost provider to this market segment. Colonial Penn had total net earned premiums of \$452.6 million in 1993.

The Empire Insurance Group, headquartered in New York City, operates in the New York metropolitan area. Through a network of independent agents and brokers, Empire provides both personal and commercial insurance products and continues to be successful in identifying and developing niche programs. In addition, Empire's expertise in its market has allowed it to secure a considerable amount of service work which complements its voluntary insurance operations. Empire had total net earned premiums of \$259.4 million in 1993.

In our property and casualty operations, we strive for profitability, not market share or volume. To that end, we emphasize high quality underwriting, expense containment and careful claims control. The ratios below illustrate the results of our property and casualty operations as compared to the industry as a whole:

	Combined Ratio		
	1993	1992	1991 ¹
GAAP (Generally accepted accounting principles)	96.9%	101.7%	102.1%
SAP (Statutory accounting principles)	93.7%	102.8%	103.3%
Industry (SAP basis)	106.9%	115.7%	108.8%

¹Includes Colonial Penn from date of acquisition.

Our goal, which we have stated before, is to have a combined ratio of no more than 100%. A combined ratio of 100% means that premiums equal the sum of claims, related expenses and underwriting expenses. Thus, if the combined ratio is 100% or less the shareholders keep the after tax earnings on the invested reserves and equity, which can be quite substantial on \$1.7 billion of investments. We exceeded that goal in 1993, as the severity of claims were down and prior years' claims were settled under our new procedures at less than the reserved amounts. Unusual catastrophic losses will make it difficult to achieve our combined ratio goal of 100%.

As we also mentioned in the past, we discontinued Colonial Penn's marketing operations shortly after the acquisition because it was too expensive. When we resumed marketing in 1992, with new, lower cost programs, new premiums were not sufficient to maintain the size of the company. However, at this writing, we have significantly narrowed the gap and the volume generated from new premiums is nearly replacing lapses. We hope to report absolute growth in 1994.

Prior to our acquisition of Colonial Penn, the company wrote certain commercial lines of insurance. This closed block of business continues its satisfactory liquidation. We believe it is adequately reserved. Some day there may be a recovery.

1993 was a far gentler year than 1992 when Hurricane Andrew and other storms in the Northeast strained the world's catastrophic reinsurance capacity. Property and casualty earnings were impacted by winter storms in the first quarter but subsequent months sailed by without major incident. In 1993, no deductibles were breached giving our reinsurers a breather to recover from the shellacking they took in 1992.

Catastrophe insurance renewals for 1994 were negotiated in the latter part of last year and were oversubscribed at essentially the same rates. Colonial Penn continued its \$11 million deductible program in light of continuing high rates for lower retentions. Our statutory surplus at Colonial Penn is much higher after two years of solid earnings and therefore a higher retention limit makes sense.

Life Insurance Group

We conduct our life insurance business through Colonial Penn Life headquartered in Philadelphia, Pennsylvania, Charter National Life in St. Louis, Missouri, and Intramerica Life Insurance in New York, New York. The principal life insurance product is a guaranteed issue policy sold directly to persons age 50 to 80 in face amounts of \$350 to \$10,000, issued without a medical examination or evidence of insurability. We have over 900,000 policies in force. This is a predictable and profitable block of business where the laws of large numbers operate in our favor. Ed McMahon is a spokesperson on television and via direct mail.

In 1992, we sold \$10.9 million of new annualized premium (NAP). In 1993, we sold \$16.9 million of NAP. At approximately \$15 million in NAP, the business starts to grow. We are hoping to do better in 1994.

Critical to the success of this business is the cost of acquiring new business. We have managed to reduce our costs to about one-half of the costs previously incurred, which is a credit to the perspicacity of Colonial Penn Life's management.

Charter sells a no-load variable annuity product. Premiums from variable annuity products are invested at the direction of the policyholder in a series of unaffiliated mutual funds (managed by Scudder, Stevens and Clark) where the policyholder bears the entire investment risk. This no-load/no sales charge product is an excellent retirement savings vehicle. It allows the policyholder to choose from a variety of investment vehicles and have the gains accrue without taxation. The investment performance, for which we are not responsible, has been excellent. Premium receipts were \$81.5 million in 1993 versus \$58.2 million in 1992. We are hopeful that further growth will occur in 1994. One of the few benefits of higher taxes is that this product becomes more appealing. This was a tiny business which has now become a small business. Total assets related to this product have grown from zero in 1986 to \$262.9 million at the end of 1993.

Investments

As we mentioned above, if you astutely manage a casualty company, the earnings on invested reserves and equity belong to the shareholders. In the life insurance business, we earn a profit after death claims, crediting rates and expenses are paid. In our life and casualty operations we have \$2.4 billion of investments, of which 96% is invested in U.S. Government and agency paper and other investment grade investments. The portfolio had a 6.2% average yield and estimated average remaining life of 4.7 years and a duration of 2.9 as of December 31, 1993. We have been managing the portfolio for some time with higher rates in mind. We were prepared for the current uptick in interest rates. Our outside investment advisors have done a magnificent job. Our boat is stable, on course, and in no foreseeable danger of sinking.

Last year we included a list of guiding principles. We are repeating these here again and adding some others.

1. We are driven by a search for profitability, not for volume or market share and, as a result, sometimes the best strategy is to retreat.
2. We would rather reserve conservatively and be required to release reserves than to under reserve and be required belatedly to report losses.
3. We search for niches, not dominance, on the theory that the world can tolerate many mice but few elephants.
4. We invest the portfolios conservatively. We are willing to give up marginal yield for predictability, safety and a good night's sleep. This general conservatism helped us survive the '80s. There is no such thing as a free lunch—either it isn't lunch or it isn't free.

5. We face the responsibility of managing so much of other people's money with constant vigilance and trepidation. The insurance reserves do not belong to the shareholders, only the capital does.

To the above, we add the following:

6. We invest in shorter maturity bonds. In the long run, stocks do better but over shorter periods of time they are not predictable. The obligations to our insureds are predictable. We best fulfill our obligations by investing in bonds.

7. We are afraid of long-term bonds.

8. We do not invest the insurance portfolios in uninsured real estate loans, junk bonds or exotic securities.

9. We do not reinsure other insurers risks. Our plate is full with our own risks.

10. We increase our shareholders' wealth by buying businesses at the right price—not by speculating in portfolio securities.

Banking and Lending

The Company's banking and lending operations are conducted through its national bank subsidiary, American Investment Bank, N.A. (AIB), and a wholly owned industrial loan corporation, American Investment Financial (AIF). These institutions have deposit insurance from the Federal Deposit Insurance Corporation (FDIC). Our relationship with the FDIC has improved and is satisfactory. Loans receivable were \$188 million at year end, pre-tax earnings were \$12 million, pre-tax return on assets was 4.48% and pre-tax return on equity was 26.32%.

These institutions are continuing to grow in 1994. AIB was a startup in 1980 and is developing into a significant source of our earnings. The principal businesses are executive lending by mail and auto lending to borrowers with prior credit problems.

Incentive Service

The Company's incentive services are carried on by The Sperry and Hutchinson Company, Inc. (S&H). Since 1969 when the annual sales peaked, the stamp business has been steadily declining. S&H manages the shrinkage of its business profitably.

At December 31, 1993, the liability for unredeemed trading stamps was \$58.5 million. Because the business is shrinking, the historical stamp redemption patterns may have changed—this amount may be in excess of what is required. The latest statistical studies indicate that approximately \$17.1 million may be excess at December 31, 1993, which we continue to amortize into income.

For those of you who are old enough to remember collecting green stamps, licking and sticking them into book after book all in aid of a new toaster, the decline of S & H will feel like the loss of an old friend. "The old order changeth, yielding place to new..."²

Manufacturing Group

The manufacturing companies continue making progress on their return to profitability.

Other Matters

During 1993 interest rates came down to levels where it was advantageous to replenish our coffers. In February 1993, we sold \$100 million principal amount of 5¼% Convertible Subordinated Debentures

²Alfred, Lord Tennyson

due 2003. In August 1993, the Company sold \$100 million principal amount of 7¼% of Senior Notes due 2013. At this writing, most of this money is available. Although it is invested at a slightly negative spread, it is, in our opinion, a modest price to pay for increased liquidity, which along with \$150 million in unused bank lines gives us the ability to take advantage of opportunities.

On June 23, 1993, we completed the sale of certain tax advantaged life products to John Hancock Mutual Life Insurance Company. We reported a pre-tax gain of \$16.7 million. As we mentioned last year, these products were unattractive to us in an environment where competition was willing to take interest rate risks that we found unacceptable.

At the end of 1993, we declared a \$.25 per share annual dividend up from \$.20 per share in 1992. Towards the end of the year, as the results from 1994 become apparent, we will again consider a dividend.

Latin America

On March 30, 1993, the Company received cash of \$5.3 million and \$12 million principal amount of 6% U.S. dollar denominated El Salvador Government bonds, due in instalments through 1996. This ended a long saga that began with the expropriation of the electric utility, Compañía de Alumbrado Eléctrico de San Salvador (CAESS). At this writing, we have sold the remaining bonds in the market at a modest discount. In the first quarter of 1994, the Company will report a pre-tax gain of approximately \$8.5 million on this transaction.

In November of 1993, the Bolivian Power Company was listed on the New York Stock Exchange and sold 1,250,000 shares of newly issued stock for \$28.3 million to finance future growth. This is the first company operating principally in Bolivia to be listed on the New York Stock Exchange. Leucadia sold 750,000 of its shares in the same offering for \$17 million and reported a \$13 million pre-tax gain. We still own 719,206 shares representing 17% of the outstanding common shares. Our holdings in the Barbados Light and Power Company remain unchanged.

During 1994, we acquired 30% of Caja de Ahorro y Seguro, S.A. (the "Caja") for \$46 million along with a local partner who also purchased 30% on the same terms. The "Caja" is Argentina's largest insurance company with 55 branches and an important presence throughout the country. It is the major direct writer of group life insurance and an important automobile insurer. It also operates a small bank.

The Argentine economy is revitalizing. The "Caja" is a household name with a tremendous market share. We are hopeful that, together with our local partners, newly hired senior management and our Leucadia insurance staff, the "Caja" can be developed into a profitable growing business. Time will tell. To date, we have realized through hard work and good luck \$45 million of value from our other Latin American investments.

Our shareholders should not conclude from the last few paragraphs that we plan to report to you next year in Spanish, though one of us will study Spanish for three weeks this summer. Our investments in Latin America came about either by happenstance, as in the case of Bolivia, El Salvador and Barbados, or in our usual opportunistic way, as in Argentina.

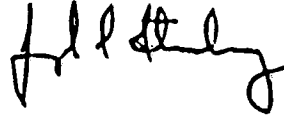
1993 was a year of accounting changes, of increased liquidity and continued improvements in our insurance operations and banking business. One of the undersigned is more pessimistic than the other, seeing as he does, higher taxes, higher interest rates and potential financial accidents around every corner. The other's point of view is that the globalization of the world's economy and the desire of peoples all over the world to partake in the higher standard of living, as advertised on CNN, presents an opportunity for the United States to profitably provide the capital, goods and services necessary for improving education, health and industrialization worldwide.

The optimism of one, however, is greatly cautioned by the gloom of the other. We have collected a large pile of coconuts and our job is in no small part conservation as well as growth. First, we will endeavor to keep the coconuts we have then add to the pile. As in the past, we debate endlessly but proceed cautiously.

We are exceptionally well assisted by our employees, advisors, bankers and all those who work hard in our common enterprise. We are most grateful.

A handwritten signature in black ink, appearing to read 'Ian M. Cumming', with a stylized, elongated flourish at the end.

IAN M. CUMMING
Chairman

A handwritten signature in black ink, appearing to read 'Joseph S. Steinberg', with a stylized, elongated flourish at the end.

JOSEPH S. STEINBERG
President

Letter from the Chairman and President

To Our Shareholders,

1994 was a difficult year. We successfully avoided the major potholes. We suffered no derivative disasters or mortgage backed security fiascos. Interest rates, however, rose sharply and that had a significant effect on our ability to realize security gains. With a bond portfolio accounting for 96% of our investments, we are a reluctant hostage to the bond market. Fortunately, good portfolio management by our investment advisors and staff enabled us to escape almost unscathed from rising rates. As you will see from the chart and discussion below, security gains accounted in great measure for the difference in earnings from 1993. After tax earnings were \$70,836,000, or \$2.41 a fully diluted share, which does not reflect the benefit of our net operating loss carryforwards. This is only an 8% after tax return on last year's ending equity. Not adequate by itself, but when taken in the context of the 1994 bond market and averaged with the 15 previous years, it is satisfactory. Net worth, adjusted for splits, was a negative \$.22 per share 16 years ago, and at December 1994 net worth was \$31.44 per share. The stock price adjusted for splits during the same period went from \$.16 to \$44.50 per share, a compound rate of return of 42% per annum over those 16 years.

Below is a list of earnings of our various business units. We remind everyone that we are highly decentralized. These numbers include all the costs up to and including those of the Presidents and Chairmen of the business units. There are no allocated costs for the undersigned or the other 43 people in the Corporate and Executive headquarters (see Corporate and Other below). Corporate expenses include interest, results of corporate security transactions, as well as overhead associated with accounting, portfolio management, taxes and the significant costs associated with pursuing new opportunities. We refer to this chart throughout this letter. Income (loss) by business segment is as follows (in thousands):

	<u>1994</u>	<u>1993</u>	<u>Prospects</u>
Property & Casualty Insurance:			
Operations	\$ 99,840	\$113,431	
Net securities gains (losses)	(3,448)	14,563	<i>Showing signs of growth</i>
Life Insurance:			
Operations	53,052	30,168	
Net securities gains (losses)	(3,941)	31,867	<i>Growing</i>
Banking and Lending:			
Operations	16,302	12,542	
Net securities gains (losses)	(2)	46	<i>Growing</i>
Incentive Services:			
Operations	10,335	13,121	
Net securities gains (losses)	0	776	<i>Hanging on</i>
Manufacturing	(11,758)	(2,239)	<i>Broken</i>
Corporate and Other:			
Operations	(55,449)	(42,078)	
Net securities gains (losses)	(4,613)	4,671	<i>Tomorrow's opportunities</i>
Subtotal income before tax:			
Operations	112,322	124,945	
Net securities gains (losses)	(12,004)	51,923	
Total pre-tax	100,318	176,868	
Tax provision ¹	(29,482)	(60,609)	
Total after tax	<u>\$ 70,836</u>	<u>\$116,259</u>	

¹Does not reflect the benefit of net operating loss carryforwards. See Note 13 of Notes to Consolidated Financial Statements for an explanation of our net operating loss carryforwards.

Although we are not happy with last year's results, there is a time to reap and a time to sow. Rising interest rates made the harvest difficult last year, but we were able to invest in several opportunities for the future, about which more later.

In late 1993 we became convinced that interest rates would increase in 1994. Subsequently, the Federal Reserve increased the discount rate six times, from 3.0% to 5.5% and the long bond lost 15% of its value. To illustrate the magnitude of this movement, if you took our investment portfolio at January 1, 1994 and froze it, buying nothing and selling nothing, by December 31, 1994 the portfolio would have lost \$187 million in value. Since we lacked the courage to go into cash on January 1, 1994, during the year we shortened the average life of the \$2.4 billion portfolio from 4.7 to 3.6 years. By reinvesting the proceeds of sales, the yield to maturity increased from 6.2% at December 31, 1993 to 6.4% at December 31, 1994. The increase in yield will recoup the realized losses within two years. The total return on our portfolio was a negative .58% last year compared to the Salomon 5-year treasury index of a negative 4.05%. Furthermore, since we are not certain that rates will remain at present levels for the foreseeable future, the current portfolio is defensively postured against another increase in interest rates. The interest rate sword has two edges; in 1993 we benefited from one edge and in 1994 we suffered from the other. 1995 will be a challenge. It is a lot more fun taking gains as rates fall than preserving capital as rates rise.

On the financing front, things were quiet in 1994. We purchased an option for \$2.6 million, exercisable in August 1996, to fix an interest rate of 8.39% on \$50 million of borrowings for an eight year term.

Property and Casualty Insurance Group

The Property and Casualty Insurance Group has two operating groups, Colonial Penn and Empire. Colonial Penn, headquartered in Valley Forge, Pennsylvania, is licensed in all 50 states and provides private passenger automobile and homeowners insurance to the mature adult population. Colonial Penn, as a direct marketer, deals directly with the public and endeavors to be the lowest cost provider to this market segment.

Empire, headquartered in New York City, operates in the New York metropolitan area. Through a network of independent agents and brokers, Empire provides both personal and commercial insurance products and continues to be successful in identifying and developing niche programs. Empire's expertise in its market has allowed it to secure a considerable amount of service work, which complements its voluntary insurance operations.

In property and casualty operations we strive for profitability not market share or volume. To that end, we emphasize high quality underwriting, expense containment and careful claims control. The ratios below illustrate the results of our property and casualty operations as compared to the industry as a whole:

	<u>1994</u>	<u>Combined Ratio</u> <u>1993</u>	<u>1992</u>
GAAP (Generally accepted accounting principles)	99.1%	96.9%	101.7%
SAP (Statutory accounting principles)	98.8%	93.7%	102.8%
Industry (SAP Basis)	N/A	106.9%	115.7%

Our goal, which we have stated before, is to have a combined ratio of no more than 100%. A combined ratio of 100% means that premiums equal the sum of claims, administrative expenses and underwriting expenses. Thus, if the combined ratio is 100% or less, the shareholders keep the after tax earnings on the invested reserves and the equity, which can be quite substantial on \$1.6 billion of investments. We exceeded that goal in 1994 and 1993 with a combined ratio of under 100%.

From the segment data you will note that the Property and Casualty operations' profitability was \$113.4 million in 1993 and \$99.8 million in 1994. This needs further explanation. From experience we estimate the claims and expenses so that the aggregate reserves will be sufficient to pay over time for all the crumpled fenders and bumped heads. Keep in mind that insurance only works if you have a large number of policies over which individual claims can be averaged. In 1993, as in 1991 and 1992, we

concluded that too much had been previously reserved as a result of our advantageous purchase of Colonial Penn in 1991. Excess claim reserves were released and operating earnings were higher. As all good things end, the "bargain" associated with the purchase of Colonial Penn is over.

In 1994, the casualty companies' total net losses and expenses, after reinsurance, from earthquakes and storms were \$18.3 million. In 1993, similar events cost us \$10.9 million. The most spectacular loss in 1994 was from the Northridge, California earthquake which cost the industry \$11 billion. Several major companies found their surplus impaired. Colonial Penn fared better than most with a net loss of \$11.7 million. Our losses have not significantly increased from earlier estimates because we reserve conservatively. California is a remarkable place. In spite of the fact that it burns, slides, shakes and floods, it is the seventh² largest economy in the world.

Starting with the devastation of Hurricane Andrew in 1992, the cost and availability of catastrophe reinsurance has gone up or is no longer available³. Nevertheless, we have been able to complete our reinsurance treaties over the last three years but at a higher cost. As our surplus has grown, we have increased retentions and used the savings to increase reinsurance at upper levels.

Colonial Penn and Empire are also in the business of servicing other insurance companies' policies. Empire was one of the first companies in New York State to do so. Servicing companies assume assigned risk business from other insurance companies and receive a fee in addition to policyholder premiums. At present we service approximately \$200 million of annualized premium of this type business, all with insurance risk. Empire also performs administrative services for the New York Public Automobile Pool without insurance risk. This activity is profitable in its own right and absorbs fixed costs.

For 1993 (the latest data available) Colonial Penn, GEICO, Liberty Mutual and USAA had the lowest expense ratios among national automobile insurers. In 15 states, our new business rates are 30% below our largest competitors. There is, however, a conundrum here: Why are we not growing faster? If we have built a better mouse trap, where are the mice? The answer is that we have faith in financial gravity. If we are 30% cheaper, as we are in 15 states, we believe the customers will eventually find their way to us past the downfield blocking of commission salesmen and higher advertising budgets. Our competition is not other direct response companies but rather insurance agents whom we can profitably underprice. The results are beginning to show. As of this writing we are adding more auto policies than are lapsing. We remain enthusiastic about the auto insurance business. The success of no load mutual funds and discount brokers is comforting. Keep the faith.

New York City and its Boroughs, where Empire lives and works, is an interesting and appealing place. So many people in so little space is a siren song to aggressive insurers. Inevitably bruised by the tough urban milieu, poorer and wiser, some of them leave. Empire knows this pattern well. We do not chase price. We pleasantly say good-bye when prices go down and expect to see the clients again when the market tightens. In 1994, several competitors decided they had had enough and withdrew. Empire profitability grew by 19%.

We have settled our obligations to the New Jersey Joint Underwriting Association within the amount we reserved. We expect a similar result in regard to Proposition 103 in California. We are encouraged that state regulators are seeming to realize that when a car runs into a tree it costs money to adjust the claim, fix the car and settle third-party claims. By and large, the marketplace is pretty good at allocating these costs and prices. Neither irresponsible political rhetoric nor propositional dicta can change these facts.

When we acquired Colonial Penn, we inherited a batch of difficult commercial lines and reinsurance receivables which we continue to satisfactorily resolve. There may be a recovery some day.

²World Bank Atlas 1994.

³For example, Barbados Light and Power Company has been unable to get any catastrophe insurance on its distribution assets. 37.4% of Barbados Light and Power's common stock is owned by Canadian International Power Liquidating Trust. Leucadia National Corporation owns 57.3% of the Trust which is recorded at \$2 million at December 31, 1994.

Life Insurance Group

We conduct our life insurance business through Colonial Penn Life headquartered in Philadelphia, Pennsylvania; Charter National Life in St. Louis, Missouri; and Intramerica Life Insurance in Pearl River, New York. Our principal life insurance product is a guaranteed issue policy sold directly to persons age 50 to 80 in face amounts of \$350 to \$10,000. We have over 900,000 policies in force. This is a predictable and profitable block of business where the laws of large numbers operate in our favor. Ed McMahon is our spokesperson on television and through direct mail.

In 1992, we sold \$12.7 million of new annualized premium (NAP), \$17 million in 1993 and \$20.5 million in 1994. At approximately \$15 million in NAP, the business grows. Critical to success is the cost of acquiring new business. Since 1991, we have managed to reduce acquisition costs by almost 50%. This growth was achieved by adhering, with religious fervor, to a pre-defined acquisition cost structure. We are pleased with the 1994 result.

Charter sells a no-load variable annuity product. Premiums are invested at the direction of the policyholder in a series of unaffiliated mutual funds (managed by Scudder, Stevens and Clark) where the policyholder bears the entire investment risk. Total assets are \$295 million.

Banking and Lending

The Company's banking and lending activities are conducted through its national bank subsidiary, American Investment Bank, N.A., (AIB); a Utah State chartered industrial loan corporation, American Investment Financial (AIF); and a New York based SSBIC, Transportation Capital Corp. (TCC).

During 1994, these companies produced \$16 million in pre-tax earnings with outstanding loans receivable of \$264 million. Pre-tax return on assets was 6.2%, pre-tax return on equity was 31%. AIB paid a \$5.8 million dividend to Leucadia.

AIB and AIF offer executive and professional loans primarily by mail. AIB also offers auto loans to people with less than sterling credit. We operate the auto loan program in ten states and continue to cautiously expand. There is significant competition coming into this market. We intend to maintain our concentration on careful underwriting to avoid losses. TCC makes loans secured by taxicab medallions in New York, Boston and Chicago. AIB and AIF deposits are insured by the FDIC, with whom, for the time being, we are at peace.

Incentive Services

Leucadia's incentive services are carried on by The Sperry and Hutchinson Company, Inc. (S&H). Since 1969, when annual sales peaked, the stamp business has been declining. S&H has managed to shrink profitably. By adding a new, much less expensive computer system and by utilizing a third-party fulfillment operator (they mail the toasters to the customers), we will generate further expense savings in 1995. As long as our customers continue to buy stamps, S&H will continue to redeem them through the catalog.

At December 31, 1994, the liability for unredeemed stamps was \$42 million. Latest statistical studies indicate that approximately \$5.4 million of this liability will not be required; it will be amortized into income next year.

Manufacturing

In 1994, manufacturing was a disaster. More precisely, one company, our bathroom vanity division, was a self-inflicted, unmitigated disaster. The other manufacturing companies did reasonably well. Here is the story.

This division makes bathroom vanities and cultured marble (i.e., plastic) sinks for the top of the vanities. In 1991, we decided to consolidate several facilities into one and install new semi-automated

production equipment in the hopes of increasing efficiency. Two bad things happened; one strategic, one tactical. The market is moving away from solid wood, fully assembled cabinets to paper and wood veneer, home-assembled cabinets. The new plant presently makes the former, not the latter. The implementation of this flawed strategy was also atrocious. As a result, we have a new President of the Manufacturing Group and have, we hope, written off all of our past mistakes. We are paying close attention. Our apologies to the shareholders. Hopefully, better news next year.

Real Estate

Until recently our real estate interests came about as a result of other acquisitions whereby we ended up with surplus property. Recently, however, this has changed. "We tend to be buyers of assets that are troubled or out of favor, and as a result, are selling at substantially below the values which we believe are there."⁴ Our theory is that a well located property bought in a bad market will, in a good market, appreciate to at least replacement cost. Here is what we have done.

We purchased for \$50.8 million in cash a 615,000 square foot building at 685 Third Avenue in New York City, which formerly was the corporate headquarters of American Home Products. 405,000 square feet are available for rent, of which 355,000 square feet are contiguous. Empire Insurance will very shortly be in need of 200,000 square feet. With Empire as a tenant, the building has sufficient cash flow, after expenses, to justify a long-term mortgage in excess of the purchase price. Other potential tenants will probably pay more rent for space near Grand Central where the availability of large blocks of contiguous space is shrinking. This will have an even better financial outcome. If another tenant appears, Empire can move to the Wall Street area where there are also many interesting opportunities.

We purchased, out of bankruptcy, two 41-story luxury San Diego condominium towers known as The Harbor Club, located across the street from the Convention Center, with expansive views of the harbor! The buildings have 350,000 square feet, of which 42,000 is commercial, and 202 residential units. We purchased the buildings for \$120 a square foot and are marketing the 180 remaining residential units at an average price of \$345 per square foot, before the cost of models, management and sales. If the reader is interested in a beautiful San Diego condominium, please call!⁵

We are conditionally committed to purchase (again, out of bankruptcy) a 3,400 lot subdivision in Southern California in an area where home builders are in need of lots. We are working with the City of San Marcos to finalize details of the entitlement process before moving forward. We may end up with a national home builder as a partner.

In another complicated bankruptcy transaction, we invested \$21 million in HomeFed Corporation bonds (the parent of HomeFed Bank, which was seized by the RTC). Under the bankruptcy reorganization plan, we expect to receive approximately 40% of HomeFed as well as a convertible note that would allow us to increase our ownership to approximately 89% in three years. HomeFed owns several single family developments which will be completed.

We also purchased a 46% interest in 30 North LaSalle Street in Chicago. The building cost \$63.8 million, \$16 million in cash and the balance with excellent non-recourse financing. The building has 926,000 square feet and shortly will be fully leased.

During 1994, Colonial Penn Life took advantage of the soft real estate market in Philadelphia and acquired a 127,000 square foot office building in the Philadelphia historic section for \$4.2 million or \$33 per square foot. On March 20, 1995, the company occupied 60% of the space with expansion room for the future as the current tenants' leases expire. Colonial Penn Property and Casualty also purchased a 104,000 square foot building in Valley Forge, Pennsylvania for \$6 million for its own use.

⁴Report to the shareholders 1988, 1990 and 1991.

⁵Our goofy lawyers insist we state that this sentence does not constitute an offer, which can only be made through a written prospectus.

Latin America

In the first quarter of 1994, we completed the sale of the bonds we received from the expropriation of the Compania de Alumbrado Electrico de San Salvador in 1986. We reported an \$8.5 million gain.

In the fourth quarter of 1994, we completed the sale of our remaining interest in the Bolivian Power Company and reported a \$14.5 million gain. The Government of Bolivia is pursuing policies in the electric sector with which we disagree. This was clearly a time to reap. Since 1986, we have realized value of \$63.7 million from our Latin American investments.

During 1994 we were, along with local partners, the successful bidder in the privatization of Caja de Ahorro y Seguro, S.A. ("Caja"), a company with insurance and banking operations formerly owned by the Argentine government. We purchased 30% for \$46 million, our local partner purchased 30% for the same amount, and the government retained the remaining 40%. Caja is Argentina's largest insurance company with 55 branches located throughout the country. The restructuring is proceeding nicely. Hopefully, 1995 will report profits.

Argentina is being buffeted by the back wash from the Mexican financial crisis. They call it the "tequila effect" in Buenos Aires. There is likely to be tough sailing. Bank liquidity is tight and Argentina owes a lot of money abroad.

Since we are already in the Argentine boat, we look on the bright side. There is not a lot of money moving South and we are already committed. It is unlikely that much foreign competition will appear this year. This is good for Caja, as we will be able to complete the planned restructuring, move to new headquarters, and solidify our market share. Caja has revenues of \$535 million, insures approximately 311,000 automobiles and has group life insurance policies covering 4 million lives. Not a small company.

Russia

In June of 1994 we went to the world's largest garage sale. Russia put 15,000 companies up for privatization. We invested \$25 million and are accounting for this on a cost recovery basis. We have taken \$5.4 million out and our year-end book value is \$19.6 million invested in 32 companies.

As previously reported, we are drilling for oil in Siberia and supplying raw materials to an aluminum smelter in Tajikistan.

As a result of this activity, we have opened an office in Moscow to look after these investments and to look for other opportunities. Larry Hershfield, Executive Vice President, has moved to Moscow with his family to head up this operation.

Time and space preclude us from telling you much about our attitude toward the future of Russia or the former Soviet Union. It is, however, the sixth largest population on the globe. The technical and engineering education is first-rate. Many factories have up-to-date western equipment. What is missing is the legal, financial and marketing infrastructure necessary for a functioning free market. It is reminiscent of the Wild West. Companies are extremely inexpensive compared to similar companies in the West. There is little working capital available. If there is political stability, the market will flourish and we will do very well. High risk, high reward. If not, the losses will be tolerable.

A vignette: each Russian citizen was given a voucher, which looks like a small stock certificate. Vouchers were the only currency allowed in the privatization auctions. A voucher market developed whereby people like us purchased vouchers for between \$15 and \$25 U.S. each. We visited the voucher auction market in downtown Moscow one day and on the way out noticed an older lady wearing a babushka trying to sell one voucher. We negotiated the purchase of her voucher. When the transaction was complete, she said to us with great conviction: "There are two things Russia will never be without, bad roads and fools."⁶ We have been warned!

⁶Attributed to Nikolai Gogol, a Russian author born on April 1, 1809.

Other Things

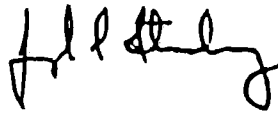
1994 was both a difficult and a successful year. Interest rate increases are the nemesis of bond portfolios and we have a big one. The bathroom vanity division is a problem and an embarrassment. Our other operating companies are doing well and most are showing signs of growth. We made several investments which should bear fruit in the future.

In Genesis, Chapter 41, Joseph interpreted Pharaoh's dream of the lean cows eating the fat cows to mean that seven lean years would follow seven fat years. There has been an almost continuous bull market since 1980, 15 fat years! We worry that the bears are out there somewhere and they must be very hungry! We hope we are prepared for their arrival. There are opportunities in bear markets, too.

Thanks to our loyal employees, advisors, and banks for their hard work and good cheer in a difficult year.



IAN M. CUMMING
Chairman



JOSEPH S. STEINBERG
President

Letter from the Chairman and President

To Our Shareholders,

Earnings for 1995 were \$107,503,000 or \$1.81 per share after taxes, a 12.2% return on last year's ending equity. Net worth was \$1,111,491,000 or \$18.47 per share. This compares with a negative net worth of (\$7,657,000) or (\$.11) per share at December 31, 1978, when we began managing the Company. The stock price for the same period (adjusted for stock splits) went from \$.08 to \$25.00 per share, a compound rate of 40.2% per annum for those 17 years.

In annual reports in years past we have taken great delight in occasionally reporting after tax rates of return on prior year's ending equity in the 30% plus range (see below). At the same time, we have warned that these high rates of return were not sustainable over time.

Leucadia's After Tax Rates of Return

<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>
18.4%	35.3%	35.7%	39.7%	7.8%	12.2%

There are several factors which affect the up and down nature of these returns. With the increasing size of our net worth, given what we do and how we do it (more later), it becomes ever harder for us to maintain very high rates of return. The chart below demonstrates that all asset classes have trouble managing high returns over time. As the amount of our capital increases, the returns will inevitably tend to regress to the averages. This is a law of nature. The second reason is that we have significant assets invested in future opportunities. These assets have little or no returns during their incubation. When they hatch, if we have done a good job, the progeny will sell at a good price or have high rates of return. Lastly, some of our operating companies are worth significantly more than book value, which has not been realized.

Market Rates of Return

	<u>70 Years 1926-95</u>	<u>Recent Decade 1986-95</u>	<u>1980s</u>	<u>1990s 1990-95</u>
Leucadia Stock Price.....	(a)	21.8%	31.0%	29.3%
S&P 500	10.5%	14.8%	17.5%	13.0%
Small Company	12.5%	11.9%	15.8%	15.3%
Long-Term Corporates	5.7%	11.3%	13.0%	11.3%
Long-Term Government	5.2%	11.9%	12.6%	11.9%
Short-Term Government	5.3%	9.1%	11.9%	9.0%
Treasury Bills	3.7%	5.6%	8.9%	4.9%
Inflation	3.1%	3.5%	5.1%	3.4%

(a) Leucadia's stock price since our tenure began (1978) has grown at a compound annual rate of 40.2%.

Further complicating the business of investing, is the fact that since 1980 there has been significant inflation in the price of financial assets. Mutual fund assets have grown from \$135 billion to \$2,162 billion, U.S. Government securities from \$1 trillion to \$5 trillion and the S&P 500 Market Cap from \$926 billion to \$4,588 billion. There was \$27 billion of funds raised last year which was invested in leveraged buyouts (LBO) and private equity transactions¹. In 1980 no one had heard of an LBO fund. There is too much money chasing too few opportunities which has driven down returns. However, this is not all bad, even truffle hunters need a rest.

Our corporate strategy explains what we do.

"We tend to be buyers of companies that are troubled or out of favor and as a result are selling substantially below the values which we believe are there. From time to time, we sell parts of these operations when prices available in the market reach what we believe to be advantageous levels. While we are not perfect in executing this strategy, we are proud of our long-term track record. We are not income statement driven and do not run your company with an undue emphasis on either quarterly or annual earnings. We believe we are conservative in our accounting practices and policies and that our balance sheet is conservatively stated."²

Because we buy "companies that are troubled or out of favor..." when these companies are acquired they may provide no or very low rates of return until they become profitable or are sold. Because "we are not income statement driven and do not run your company with an undue emphasis on either quarterly or annual returns," the annual returns are often erratic. Since we have not realized substantial gains from sales of operating companies in the last few years, nor have we had significant increases in operating income from incubator assets, human nature is such that we are slightly embarrassed by 8% and 12% annual returns.

One of us will soon be 56 years of age, the other just turned 52. We are too young to quit, and too old to change our ways. Therefore, we will proceed doing what we know best—buying assets cheap and selling them when someone else wants them more than we do. If asset valuations remain unrealistically high in the United States and other suitable investments, such as foreign investments, do not become available, we will keep our money in the bank or conclude that we have too much capital and should return some of it to the shareholders. A mechanism more tax efficient than doubling the dividend, as we did last year, would be appropriate. Both of us think, however, that this era of overly generous asset prices will pass. When there is the inevitable correction, people will think truffles are but a fungus and we will be in the truffle business again.

We think of Leucadia as two companies: a group of Operating Companies and a collection of opportunistic investments in the future, i.e., Work in Progress assets, as shown below.

¹ *Return on Investment* magazine, January/February 1996.

² Originally reported in the 1988 annual report.

Leucadia's Return on Investment

	Investment 12/31/95	Pre-tax Results 1995	1995 Return on 1994 Investment (b)
	(Dollars in thousands)		
Operating Companies:			
Colonial Penn P&C	\$ 342,005	\$ 68,851	26.28%
Empire P&C	231,205	10,091	5.04%
Life Insurance	159,590	53,647	35.12%
Subtotal, Insurance	732,800	132,589	21.56%
Banking and Lending (a)	62,481	16,736	26.59%
Manufacturing	58,497	(18,044)	(27.75%)
Subtotal, Operating Companies	853,778	131,281	17.67%
Corporate Assets:			
The WMAC Companies	48,648	41,030	257.45%
Work in Progress assets	411,712	16,263	5.74%
Other Corporate (including deferred taxes and cash)	298,300	(17,400)	(7.07%)
Corporate Debt	(500,947)	(38,992)	(9.59%)
Subtotal, Corporate	257,713	901	0.65%
Consolidated	<u>\$1,111,491</u>	<u>\$132,182</u>	14.99%

(a) Banking and Lending investment at December 31, 1995 excludes \$55,301,000 invested by non-bank subsidiaries in auto loans, but pre-tax results include the profits from such loans.

(b) We ask you to pay attention here; these return percentages are based on the year end 1994 investment balance.

The assets under Subtotal, Operating Companies are mature Operating Companies. In spite of the fact that one of them, Manufacturing, is still broken (more later), and Empire had a hiccup in 1995 (more later), these companies in total did well. When these two problems are resolved, they should do even better. The Operating Companies are completely decentralized and in the hands of managers of our choosing, who on most occasions do an outstanding job.

The second "company" is represented by the \$411,712,000 invested in Work in Progress assets. These assets are in two categories: working assets and incubator assets. Some of the working assets are for sale, but not until we get a price which we believe represents their intrinsic value, others are being held because we believe their value will improve. The WMAC Companies are a good example of working assets. On the chart above they are reported separately for illustrative purposes. These two insurance companies were under the control of the Wisconsin Insurance Commissioner since we bought them with the Baldwin-United acquisition in 1986. We worked for nine years to get them liberated. In 1995 the Wisconsin Insurance Commissioner returned them to us and we reported a \$41 million gain, which is not taxable.

The balance of the Work in Progress assets are incubator assets. These are assets which we think will grow over time; we give them attention and tender loving care. The real estate, Argentina, Russian and Jordan Company investments fit in this category as do occasional stock and bond investments, such as our holdings in the Rockefeller Center REIT, which is mentioned later.

In summary, our Operating Companies have high rates of return. Occasionally someone offers us a price significantly in excess of book value, which results in a very high return in the year this occurs, and is hopefully sheltered from tax by our net operating loss carryforwards and other tax attributes. We have Work in Progress assets which have low rates of return. Sometimes they are sold at a profit or metamorphose into high yielding Operating Companies; sometimes we sell them at a loss. These phenomena have resulted in annual rates of return which vary year to year but have over time produced satisfactory results. Hopefully this process will go on unabated.

Below is a chart of our earnings by business unit and following the chart, a discussion of each unit. There are no allocated costs for interest, accounting, portfolio management or for the 48 people in the corporate and executive headquarters which include the undersigned. These costs and the net costs associated with Work in Progress assets are accounted for in the Corporate section.

	1995	1994
	(Dollars in thousands)	
Property and Casualty Insurance:		
Colonial Penn:		
Operations	\$ 65,724	\$ 62,897
Net securities gains (losses)	3,127	(1,021)
Empire Insurance Company:		
Operations	10,543	36,943
Net securities gains (losses)	(452)	(2,427)
Total Property and Casualty Insurance:		
Operations	76,267	99,840
Net securities gains (losses)	2,675	(3,448)
Life Insurance:		
Operations	51,848	53,052
Net securities gains (losses)	1,799	(3,941)
Banking and Lending:		
Operations	16,736	16,302
Net securities gains (losses)	0	(2)
Manufacturing	(18,044)	(11,758)
Corporate and Other:		
Operations	(14,652)	(45,114)
Net securities gains (losses)	15,553	(4,613)
Subtotal, Income before tax:		
Operations	112,155	112,322
Net securities gains (losses)	20,027	(12,004)
Total pre-tax	132,182	100,318
Tax provision (a)	(24,679)	(29,482)
Total after tax	<u>\$107,503</u>	<u>\$ 70,836</u>

(a) Does not reflect the benefit of net operating loss carryforwards. See Note 14 of Notes to Consolidated Financial Statements for the excruciating explanation of our net operating loss carryforwards.

Property and Casualty Insurance Group

The Property and Casualty Insurance Group has two operating groups: Colonial Penn and Empire. Colonial Penn, headquartered in Valley Forge, Pennsylvania, is licensed in all 50 states and provides private passenger automobile and homeowners insurance to the mature adult population. Colonial Penn, as a direct marketer, deals directly with the public and endeavors to be the lowest cost provider to this market segment.

Empire, headquartered in New York City, operates in the New York metropolitan area. Through a network of independent agents and brokers, Empire provides both personal and commercial insurance products and continues to be successful in identifying and developing niche programs. Empire's expertise in its market has allowed it to secure a considerable amount of service work from other insurers which complements its voluntary insurance operations.

Property and Casualty Insurance Group Combined Ratio

	<u>1995</u>	<u>1994</u>	<u>1993</u>
Colonial Penn Group:			
Statutory accounting principles.....	97.3%	97.1%	89.7%
Generally accepted accounting principles	97.0%	96.1%	92.2%
Empire Group:			
Statutory accounting principles.....	107.4%	101.3%	101.4%
Generally accepted accounting principles	113.0%	103.5%	104.9%
Property and Casualty Insurance Group:			
Statutory accounting principles.....	101.2%	98.8%	93.7%
Generally accepted accounting principles	103.5%	99.1%	96.9%
Industry:			
Statutory accounting principles.....	N/A	108.5%	106.9%

Our goal, which we have stated before, is to have a combined ratio of no more than 100%. A combined ratio of 100% means that premiums equal the sum of claims, administrative expenses and underwriting expenses. Thus, if the combined ratio is 100% or less, the shareholders keep the after tax earnings on the invested reserves and the equity, which can be quite substantial on \$1.9 billion of investments. Colonial Penn accomplished this goal for all three years while Empire struggles toward achieving the same goal. Normally, the industry as a whole does not do as well as either Colonial Penn or Empire.

Colonial Penn Property and Casualty

Colonial Penn Property and Casualty had a good year. A.M. Best upgraded the company to an A-. California did not fall into the Pacific Ocean and our part of Florida did not blow away, thus the year was relatively free of any major catastrophes which cost

\$4.5 million for 1995, \$17.4 million for 1994 and \$7.2 million for 1993. The reinsurers had fewer losses in 1995 and we have reduced our exposures somewhat. As a result, we were able to buy more catastrophic coverage in 1996 for less money! We settled the California Proposition 103 litigation for an amount that was within our reserves.

Total written premiums have grown by 9%. Most importantly, voluntary auto reached crossover. At the end of the year we had 1% more voluntary auto policies than at the beginning of the year, with premium volume up 5.7%. Volume was up more than policyholder count because we are insuring slightly younger drivers with newer or more cars. This is a good thing. 1996 is an important year for Colonial Penn. The restructuring is complete. Harry Wulsin and his team have demonstrated their ability to grow the portfolio inexpensively. During 1996, their challenge is to increase the rate of growth without disrupting the excellent expense structure.

Empire

Empire had a dyspeptic year; here is what happened. For the last four years, Empire's premium volume has increased at a 10% average annual rate from \$243.1 million in 1992 to \$326.1 million in 1995. This caused an undue strain on our people and some of the systems proved to be antiquated. This is an old story in the P&C business and, with 20/20 hindsight, we might have known better and caught it sooner. Early in the year the New York State Insurance Department finalized a market conduct review which brought to light problems in our claims department. Further investigation verified these findings and corrective action was taken. In addition to paying a fine, Empire was required to reopen closed claim files. Significant additional claim amounts were paid and charged to expense. All this resulted in operating earnings of \$10.5 million in 1995, as opposed to \$36.9 million in 1994.

Given what had happened, we asked our actuaries what these difficulties implied about our level of reserves for existing claims and what it implied about the likely occurrence of future claims. Both of these questions are of vital interest to us and to them. It is central to the accuracy of our accounting.

Actuaries predict the future, not with a crystal ball, but rather by looking out the rear window of a fast moving car. If the car gets to its destination safely everything is fine. If it crashes, it's not their fault. Someone else was the driver. Three actuaries participated: our new actuary (the old one became a lawyer) and two actuarial consultants. It was reminiscent of the first act of *A Midsummer Night's Dream*. Actuaries are mathematical types, they are peculiarly inarticulate (think of the combination of Forrest Gump and the Rain Man) and their language is impenetrable to a lay person. After many meetings they agreed with one another that the reserve strengthening which ran through the income statement in 1995, along with the extra claims expense, has left Empire adequately reserved. We will watch very closely and hope to return to being so conservatively reserved that the other merry band of back seat drivers, the accountants, will complain! Rich Pettitt has been named Chairman and Chief Executive of Empire. He has done a splendid job leading the Life Insurance Companies to profitability and growth. We are confident that Rich will do a similar job at Empire.

Life Insurance Group

We conduct our life insurance business through Colonial Penn Life headquartered in Philadelphia, Pennsylvania; Charter National Life in St. Louis, Missouri; and Intramerica Life Insurance in Pearl River, New York. Our principal life insurance product is a guaranteed issue policy sold directly to persons age 50 to 80 in face amounts of \$350 to \$10,000. We have over 900,000 policies in force. This is a predictable and profitable block of business.

In 1992, we sold \$10.9 million of new annualized premium, \$17 million in 1993, \$20.5 million in 1994 and \$21.8 million in 1995. At approximately \$15 million per annum, the business grows. Critical to success is the cost of acquiring new business. Since our purchase of Colonial Penn in 1991, we have been able to add new premiums at half the previous acquisition cost. Business in 1995 produced 90,000 new policies.

Ed McMahon and Alex Trebeck are our spokesmen on television and through direct mail. Television is our primary source of leads.

The Life Insurance Group sells a no-load variable annuity product. Premiums are invested at the direction of the policyholder in a series of unaffiliated mutual funds (managed by Scudder, Stevens and Clark), where the policyholder bears the entire investment risk. Total assets were \$323.2 million at the end of 1994 and \$374.7 million at the end of this year.

Banking and Lending

The Company's banking and lending activities are conducted through its national bank subsidiary, American Investment Bank, N.A. (AIB); a Utah State chartered industrial loan corporation, American Investment Financial (AIF); and Transportation Capital Corp. (TCC), a New York based SSBIC.

AIB and AIF make auto, executive and professional loans primarily by mail. TCC makes loans secured by taxicab medallions in New York, Boston, Cambridge and Chicago. AIB and AIF deposits are insured by the FDIC.

AIB primarily offers auto loans to people with bad credit reports. We have done quite well with the program over the years and offer this service in 14 states throughout the country. In the last couple of years, significant competition began to enter the market. Several large, well financed financial institutions entered the market or bought competitors (at very large premiums) and several initial public offerings were funded. The competition has become increasingly intense, rates have fallen in the market and loan losses are up. From the borrowers point-of-view the choice is simple, go with the lower rate. We have decided not to lower rates but to let the business shrink. As a result, our volumes have fallen significantly. We have seen the arrival of inexperienced money before. This is a difficult business. Higher rates are required to make money. Over the next few years we hope that the competition will dwindle and our volumes will slowly return. If not, we will go on to something else. We have no desire to be a slender lender, a lender at inadequate rates.

This segment earned \$16.7 million in 1995. We do not expect to do as well in 1996. Warren Mino and his team have their work cut out for them, for these may be the beginning of seven lean cow years.

Manufacturing

We have done very poorly with the manufacturing operations for the last several years and to our chagrin they have lost a lot of money. Operations were better in 1995 than the numbers suggest, as we explain below. Stephen C. Perry is the President of the Manufacturing Division with one year's tenure. So far, in spite of the dreadful results which he inherited from us, he is doing a superior job of returning these companies to profitability or selling them. This effort is continuing.

We have learned an expensive lesson in the last few years. We purchased these manufacturing companies inexpensively. We worked on them until they were in the aggregate making high returns on net invested assets. They performed admirably for a number of years. We were off doing other things. The scent of truffles is intoxicating. Then we made a series of disastrous personnel choices and a poorly executed facilities expansion, which we believe are now behind us. If you take our explanation with a grain of salt, we won't mind.

General Marble is the largest operating unit and the cause of much of the problems in recent years. Its primary product lines are cabinets and cultured marble sinktops for the bathroom sold primarily by home centers. For the first time since 1991, General Marble achieved profitability at the end of 1995, but incurred a loss for the year. Steve expects General Marble to be profitable in 1996. Our fingers are crossed.

The other large manufacturing unit is Conwed Plastics which makes plastic netting in configurations which allow it to be used for bagging, wrapping, bird and trellis netting, filtration, carpet backing, fencing, padding and various other products. Conwed Plastics enjoys a strong position in a number of its markets. It has been profitable for a number of years and is expected to remain so. It provides a satisfactory return on investment.

While the Manufacturing Division as a whole incurred a substantial loss once again in 1995, more than half of the loss was associated with Conwed Fibers, including \$6 million related to the fire and closure of a plant in Riverside, New Jersey. Late in 1995, we decided to close the facility, pay the shutdown costs and sell the building and equipment. It made little sense to us to take what little insurance proceeds were left after the building was repaired and invest it in an operation with a suspect future. Several other units showed improvements in 1995; nevertheless, some declined in performance and will require Steve's increased attention in 1996. One of the small units, Designscape, was sold at a loss of \$1.1 million.

Incentive Services

Leucadia's incentive services are offered by The Sperry and Hutchinson Company, Inc. (S&H). Since 1969, when annual sales peaked, the stamp business has been declining. It continues to do so profitably. As long as people continue to buy stamps and we can sell them profitably, we will continue to do so. Redemption of stamps is by mail or

through redemption centers. Incentive services is now reported as part of Work in Progress assets. There it will live out its remaining years with other relics from previous acquisitions.

Real Estate

Last year we reported the acquisition of significant real estate investments. Since then prices have risen and we are no longer finding attractive purchases. We are concentrating on renovating, developing and marketing these properties for sale into what we hope will be a rising market. The condominiums on Harbor Drive in San Diego are selling reasonably well and the renovation of 685 Third Avenue in New York City is complete and marketing of the building will begin shortly.

Our last foray into real estate was Rockefeller Center Properties, Inc. We thought it was a good value up to \$5.00 per share. We purchased 2.7 million shares at an average price of approximately \$4.70 per share before the market went over \$5.00 per share at which time we quit buying. An offer was made by a group headed by Goldman Sachs and David Rockefeller for \$8.00 per share. We voted yes.

Most of the real estate projects are proceeding acceptably and hopefully will provide pleasant surprises in the future. Because real estate values can be so fickle, we are recognizing income conservatively. Real estate assets totaling \$144 million live with the Work in Progress assets.

Russia

We have modified our strategy in Russia. When we began investing we bought positions in 31 companies for \$25.0 million. Our book value of investments at year end is \$39.7 million, accounted for on the cost recovery basis. Our intention was to investigate these companies, decide which were the most interesting, perhaps invest more, and give them help in obtaining access to western capital and expertise. The strategy was that of a merchant banker.

We are now investing in a larger opportunity with a more active operational responsibility (discussed below). We intend to reduce the number of portfolio investments to a smaller number of positions in larger companies that we expect to do well as the Russian economy grows. We are cheered by the prospects of investing in emerging markets and cautioned by the obvious risks.

We signed a letter of intent to become a 75% partner with PepsiCo, Inc. to become the Pepsi bottler for a large portion of central and eastern Russia plus Kazakhstan and Kyrgyzstan in Central Asia. This territory contains 92.0 million, hopefully thirsty people. This will be a significant investment for us (\$79 million) and an exciting opportunity. Larry Hershfield will head this enterprise from his base in Moscow. We will keep you informed of our progress.

We own a significant position in Bratsky LPK, a large pulp and forestry operation in Siberia. At full output this facility can produce 2% of the world pulp demand with adequate forestry reserves to supply it. We would like to team up with an industry

partner who would take a similar stake in the company and help them raise debt financing to upgrade the facilities. The facilities in question have a replacement cost of approximately \$1.5 billion not including the forest reserves. We paid a modest amount for our stock.

Our 50% interest in Symaskaya Exploration, Inc., a joint venture with Equity Oil Company (EQTY)³, continues to drill its first exploratory well on a 1,100,000 acre license in the Karasnoyarsk region of Siberia. The well, to be drilled to 14,000 feet, is nearing total depth. We are drilling on a huge closed anticline. Logs and cores show the presence of hydrocarbon. We have not yet obtained evidence that we have discovered a commercial well. For a wildcat well in a wildcat basin, so far so good.

Our general attitude about Russia, which we expressed in last year's Report to Shareholders, has not changed. Russia is a place that is "out of favor" with companies "that are troubled" and are "selling substantially below the values which we believe are there." We may be a minority in believing that the current politics will not significantly change the ultimate transformation of Russia to a market economy. Time will tell if we are correct. Our Russian investments are in Work in Progress assets.

Latin America

We own a 30% investment in La Caja de Ahorro y Seguro, the largest insurance company in Argentina, and an over 23% position in Barbados Light and Power (not technically in Latin America, but close). Barbados provides about \$500,000 in dividends on a \$2 million investment.

La Caja has been completely restructured and during 1996 should contribute a decent return on our \$45 million investment. Growth prospects for La Caja are attractive. We have maintained our 50% market share in the life business and have increased our auto business by \$13 million per annum (approximately 7% growth) which puts us in the top three in market share. La Caja is starting a workers' compensation company in a joint venture with an experienced Chilean partner. Total revenues for 1995 were approximately \$550 million. We did not report any earnings during the restructuring period. Argentina is just beginning to recover from a severe recession and the outlook is positive. These investments are in the Work in Progress assets category.

Other

Our investment portfolio of the insurance subsidiaries remain very defensively positioned with 94.2% in governments and investment grade credits with a duration of 3.2 years. The recent runup in interest rates reminds us that interest rates do not fall forever as they have been tending to do consistently since 1982. On balance, we prefer caution. In our investment portfolio, as in the truffle hunting business, there is too much money chasing too little yield.

We purchased 46.4% of MK Gold for \$22.5 million or \$2.50 per share. MK Gold has ownership interests in two gold mines in California. We are delighted that Frank Joklik,

³ Our fellow Director, Paul Dougan, is President/Chief Executive of Equity Oil Co.

recently retired Chief Executive of Kennecott Copper Corporation, has become Chief Executive of MK Gold. Frank is an energetic and gifted executive. We hope that under his leadership we can expand MK Gold's horizons geographically and metallurgically; although one of us is a gold bug and would be content to stay with gold.

In June of 1995 we sold \$100,000,000 of 8.25% ten year senior subordinated notes.

Our relationship with the Jordan Company entities continues profitably.

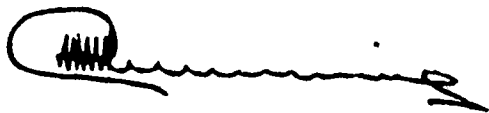
In September of 1995 the Company netted \$43.7 million, after expenses, from the exercise of warrants held by the undersigned and the sale of 478,200 shares by the Company. This transaction also resulted in a \$20.1 million tax benefit to the Company.

On November 15, 1995 the Company split its common stock two-for-one and the \$.25 per share dividend remained the same, thereby doubling it. Though our cash dividends only slightly affects overall return, many shareholders (including the two of us) love them.

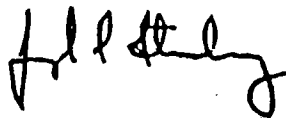
Ollie Patrell, our P&C mentor and friend, retired at the end of the year. Ollie engineered a turnaround at Empire in 1982, before we purchased Baldwin-United. He was a key player in the acquisition and restructuring of Colonial Penn and La Caja. Ollie will remain a director of the P&C companies. We wish him and his wife Kay well in retirement.

To those of you who have read these missives for the last several years, we must appear to be genetically gloomy about the future. We are unreconstructed. We fear for the diminishment of our capital. Our government in Washington is disheveled. We observe with wonder and amazement the longest bull market in this century. Our investment advisor guru calculated the S&P 500's fifty year averages for price/dividends, price/book, price/earnings and price/cash flow ratios. At year end 1995, the S&P would have to fall anywhere from 21% to 52% to return to these historic averages. How high can up be? When will the business cycle bicycle in the other direction? We are greatly assisted in these deliberations by Leucadia's hard working employees and our patient advisors.

More next year.



IAN M. CUMMING
Chairman



JOSEPH S. STEINBERG
President

Letter from the Chairman and President

To Our Shareholders,

We are writing to you at the beginning of September. In prior years we would have held our annual meeting by this time. We delayed the annual meeting and this report to the shareholders due to the pending sales of the Colonial Penn companies.

In 1996, we earned \$48,677,000 after tax, or \$.80 per share, an anemic 4.4% return on 1995's ending equity. Net worth was \$1.118 billion or \$18.51 per share. The stock price at the end of the year was \$26.75. This represents a 27.0% return per annum on book value per share since December 31, 1979, shortly after this management took over, and a 28.8% return per annum on the stock price since December 31, 1979. (The net worth on December 31, 1978 was a negative \$7.7 million; it is impossible to calculate a compounding rate of return on a negative number.)

While the return for 1996 was less than we would have liked, we are still satisfied with the long-term results. We have been following the same strategy for six months shy of 20 years. We repeat that strategy below. To our long-term shareholders we apologize for the endless repetition of the explanation of Leucadia's strategy, but it best explains what we do.

"We tend to be buyers of companies that are troubled or out of favor and as a result are selling substantially below the values which we believe are there. From time to time, we sell parts of these operations when prices available in the market reach what we believe to be advantageous levels. While we are not perfect in executing this strategy, we are proud of our long-term track record. We are not income statement driven and do not run your company with an undue emphasis on either quarterly or annual earnings. We believe we are conservative in our accounting practices and policies and that our balance sheet is conservatively stated."¹

We have been single-minded in the implementation of this strategy. When we have strayed from this philosophy, more often than not, we have regretted it.

The chart which follows chronicles the results since we began. Some years are good and some years are terrible, but we hope you are pleased with the overall results. We are.

¹ Originally reported in the 1988 annual report. Subsequently repeated in 1990, 1991 and 1995 annual reports.

	Book Value Per Share	Book Value % Change	Market Price Per Share	Market Price % Change	Equity	Annual Return on Beginning Equity	Net Income (Loss)
(Dollars in thousands, except per share amounts)							
Historical:							
1978.....	\$(0.11)	NA	\$ 0.08	NA	\$ (7,657)	NA	\$ (2,225)
1979.....	0.32	NM	0.36	350.0 %	22,945	NM	19,058
1980.....	0.34	6.3 %	0.28	(22.2)%	24,917	8.2 %	1,879
1981.....	0.42	23.5 %	0.55	96.4 %	23,997	30.2 %	7,519
1982.....	1.07	154.8 %	0.97	76.4 %	61,178	153.6 %	36,866
1983.....	1.28	19.6 %	1.42	46.4 %	73,498	29.4 %	18,009
1984.....	2.22	73.4 %	2.39	68.3 %	126,097	82.8 %	60,891
1985.....	2.49	12.2 %	2.91	21.8 %	151,033	18.6 %	23,503
1986.....	3.79	52.2 %	4.25	46.0 %	214,587	51.7 %	78,151
1987.....	3.34	(11.9)%	2.44	(42.6)%	180,408	(8.5)%	(18,144)
1988.....	3.84	15.0 %	3.59	47.1 %	206,912	11.8 %	21,333
1989.....	4.92	28.1 %	5.34	48.7 %	257,735	31.1 %	64,311
1990.....	5.91	20.1 %	5.69	6.6 %	268,567	18.4 %	47,340
1991.....	7.95	34.5 %	9.22	62.0 %	365,495	35.3 %	94,830
1992.....	11.06	39.1 %	19.75	114.2 %	618,161	35.7 %	130,607
1993.....	16.27	47.1 %	20.50	3.8 %	907,856	39.7 %	245,454
1994.....	15.72	(3.4)%	22.25	8.5 %	881,815	7.8 %	70,836
1995.....	18.47	17.5 %	25.00	12.4 %	1,111,491	12.2 %	107,503
1996.....	18.51	0.2 %	26.75	7.0 %	1,118,107	4.4 %	48,677
Pro Forma							
June 30, 1997 (a)	29.60	59.9 %	30.94	15.7 %	1,822,153	60.8 %	680,052
CAGR							
(1979-96) (b)(c)		27.0 %		28.8 %		25.7 %	
CAGR							
(1979-Pro Forma							
June 30, 1997)							
(a)(b)(c)		29.5 %		29.0 %		28.4 %	

- (a) The pro forma amounts shown above for June 30, 1997 (other than market price per share) reflect the pending sale of the Colonial Penn Life Group and the proposed sale of the Colonial Penn P&C Group as if such transactions had been consummated on June 30, 1997.
- (b) A negative number cannot be compounded; therefore, we have used 1979.
- (c) Compounded Annual Growth Rate (CAGR)

The line in the chart above, "Pro Forma June 30, 1997," requires an explanation. On April 2, 1997, we issued a press release stating that we were in discussions with potential purchasers of one or more of our insurance companies. These negotiations resulted in the signing of contracts for the sale of both of the Colonial Penn companies for proceeds in excess of \$1.4 billion. The Pro Forma June 30, 1997 line reflects information as if these sales would have been recorded on June 30, 1997. It shows net income of \$680 million and a 60.8% increase in beginning equity to \$1.822 billion. Both sales are currently expected to close by the end of October or early November.

Since we bought the Colonial Penn companies in the summer of 1991 for \$127.9 million, they have been ably managed by Ollie Patrell, Harry Wulsin, Rich Petitt, Greg Barstead, and others. Together we have all worked very hard to make these entities more profitable. The companies have paid to Leucadia tax-sharing payments, management fees, interest, and dividends totaling \$300 million. This, plus the proceeds from the sales, adds up to approximately \$1.77 billion pre-tax. In addition, we retain ownership of a small

insurance company with a \$33 million GAAP net worth at June 30, 1997. This is a remarkable result and a significant return on investment, approximately 75% per annum.

In the venture capital business, where we began our careers, we developed the belief that the science is in investing and the art is in selling. Art in the sense of the ineffable human ability to collect and integrate vast amounts of unrelated information and in some mysterious way arrive at an opinion as to whether to hold or to sell. Over the years, we have learned to depend upon this process.

In deciding whether or not to sell the Colonial Penn companies, we availed ourselves to both science and art. We hired Jefferies & Company to provide a fairness opinion on one of these transactions. The results of their analysis can be found in the proxy statement.

Our personal thinking went something like this. Colonial Penn Property & Casualty sells auto insurance direct to the consumer. Current conventional wisdom is that direct marketing of insurance is the wave of the future. Direct marketing companies are much in demand and lots of money is pouring into the business. GEICO, General Electric, Progressive, and others will become ferocious competitors. When the giants start to rumble, price pressure cannot be far behind. Large marketing expenses in the hope of establishing large market share and increased profitability is not our forte. Several times we have participated in market segments into which large amounts of new capital flowed. The first time was when we owned James Talcott Factors in the early 1980s. The big banks decided to go into factoring and the business became less profitable. The current example is the substandard credit auto lending business. Too much capital flowing into market niches makes for a miserable, frustrating experience.

Since auto insurance is not a particularly growing market, the only place to get new customers is from a competitor. We are afraid that in the future making money in the auto insurance business will be like picking up pennies in front of a steamroller—dangerous and not significantly rewarding. For a total of over one billion dollars, 2.6 times GAAP book, 3.2 times statutory book, and 24.1 times after-tax earnings, a sale was the better part of valor.

Colonial Penn Life has one principal product line, Graded Benefit Life, which is a guaranteed issue, modified whole life policy offered to individuals 50 to 80 years of age, principally in face amounts of \$350 to \$10,000. The target market is small, price sensitive, and over the last five years has grown slowly. In 1996, new premium was \$22 million; it takes \$15 million per year just to maintain the book of business. Without new products and a massive investment in marketing, against the significant headwind from already better established competitors, we did not think we could make the life company grow in a meaningful way. We are finders of undervalued investments and fixers of things, not great marketers. \$460 million is 3.1 times GAAP book, 5.8 times statutory book, and 14.7 times 1996 earnings after tax. Looks good to us.

After analyzing the marketplace to compare prices paid for similar companies and gazing into the future as best we could, we decided that prices had reached advantageous levels and thus decided to sell. The ugly ducklings had become swans.

The chart which follows shows, on a pro forma basis, the effect of the sales on the balance sheet, followed by a review of our remaining companies and assets.

Unaudited Pro Forma Consolidated Balance Sheet
June 30, 1997

	Historical (a)	Adjustments for Colonial Penn Life Sale	Adjustments for Colonial Penn Property & Casualty Sale	Pro Forma After Both Sales
	(In thousands)			
Assets:				
Investments	\$3,011,487	\$(660,568)	\$(997,279)	\$1,353,640
Cash and cash equivalents	361,106	(41,798)	928,885	1,248,193
Reinsurance receivable, net	265,242	(18,585)	(61,811)	184,846
Conseco notes secured by letters of credit		400,000		400,000
Trade, notes and other receivables, net ..	569,379	(3,836)	(151,241)	414,302
Prepays and other assets	195,254	(1,131)	(10,655)	183,468
Property, equipment and leasehold improvements, net	99,384	(9,992)	(19,595)	69,797
Deferred policy acquisition costs	112,112	(69,591)	(15,372)	27,149
Separate and variable accounts	622,022	(114,419)		507,603
Investments in associated companies	207,874		(3,842)	204,032
Total assets	\$5,443,860	\$(519,920)	\$(330,910)	\$4,593,030
Liabilities:				
Customer banking deposits	\$ 200,170			\$ 200,170
Trade payables and expense accruals	201,975	\$ (30,423)	\$ (41,564)	129,988
Other liabilities	139,184	(9,942)	(39,173)	90,069
Income taxes payable	51,536	14,067	166,978	232,581
Deferred income taxes	(99,137)	95,020	58,487	54,370
Policy reserves	1,934,592	(683,473)	(582,353)	668,766
Unearned premiums	463,978	(8,301)	(304,113)	151,564
Separate and variable accounts	622,022	(114,419)		507,603
Debt, including current maturities	581,653	(2,269)	(3,135)	576,249
Total liabilities	4,095,973	(739,740)	(744,873)	2,611,360
Minority interest	9,517			9,517
Company-obligated mandatorily redeemable preferred securities of subsidiary trust holding solely subordinated debt securities of the Company	150,000			150,000
Shareholders' equity:				
Common shares	61,553			61,553
Additional paid-in capital	190,674			190,674
Net unrealized (loss) on investments	(5,030)			(5,030)
Retained earnings	941,173	219,820	413,963	1,574,956
Total shareholders' equity	1,188,370	219,820	413,963	1,822,153
Total	\$5,443,860	\$(519,920)	\$(330,910)	\$4,593,030

- (a) The "Historical" column has been adjusted as if the Colonial Penn Life Group were a continuing operation; this is not in accordance with generally accepted accounting principles.
- (b) As in the past, this report to you is accompanied by a copy of our 1996 Form 10-K which we issued in March 1997. The Proxy Statement also incorporates a copy of our 1996 Form 10-K, as well as a set of restated 1996 financial statements that reflect the sale of the Colonial Penn Life Group as a discontinued operation. In the near future, we will restate the restated 1996 financial statements to reflect the sale of the Colonial Penn Property & Casualty Group as a discontinued operation. All of these sets of numbers are required by SEC rules in order to keep our shareholders well informed. If you feel more confused than informed, we understand.

Empire Insurance Company

Last year we told you Empire had dyspepsia and explained what we thought had happened. We reported that in 1995, we added \$35 million to reserves and that such an adjustment would be sufficient. Regrettably, this year we are reporting we were wrong. We have added an additional \$28 million to reserves and, as a result, Empire reported only \$11 million of operating earnings.

In March 1996, Rich Petitt, a long-time Leucadia executive was asked to run Empire and turn over day-to-day supervision of Colonial Penn Life to others. He and his new team initiated a thorough review of the company, paying particular attention to why there had been a need for such extensive reserve strengthening.

Are the problems behind us? The new management has done a detailed file review to ascertain if the amount of claim reserves are at realistic levels. Reserves were increased when found to be inadequate. Another step was to accelerate claim handling. Settlements are now being made through more efficient use of personnel, innovative evaluation and disposition techniques, and better supervision. Early 1997 indications are that adverse claim development in primarily 1995 and older accident years continues. By the end of 1997, however, things should be clearer. Will further reserve strengthening be necessary? Until the majority of these old claims with inadequate reserves are worked through the system we will not know for sure.

In addition to the above, and adding to the difficulties, was a woefully inadequate management information system. New software has been ordered and is being installed. More competent MIS management has been hired.

All of the above dishevelment and change has been difficult. We are grateful to Rich Petitt and his team for the long, frustrating hours of digging, diagnosing and designing the cure. The necessary changes and improvements are well underway.

Empire is in a specialized market: Manhattan and the other boroughs of New York City. If we can become the most efficient and lowest cost producer in that huge market, we will do very well. Time will tell—we have been sorely disappointed and embarrassed.

Banking and Lending

The Company's banking and lending operations are conducted through its national bank subsidiary, American Investment Bank, N.A. (AIB), and a Utah state chartered industrial loan corporation, American Investment Financial (AIF). AIB and AIF both make executive and professional loans primarily by mail. Subprime auto loans make up about one-third of AIB's assets. AIF has shifted its attention to boat and recreation vehicle loan products, in addition to beginning to cautiously make Small Business Administration (SBA) guaranteed loans. Conway Hansen has joined our organization with 16 years of experience in this field. We are optimistic that this will be a profitable addition to our niche banking activities.

One depressing tangible illustration, however, of the current state of consumer banking is the number of mailers each of us receives offering credit cards, home equity loans, and unsecured lines of credit. In our view, the consumer lending business has become overly competitive and the returns do not warrant the risks. Lenders are in a

bidding war to convince customers at virtually every income level to borrow more and more. This easy access to credit allows borrowers to control their own debt ratios to an unprecedented degree. Not surprisingly, we now read of skyrocketing delinquencies and bankruptcies.

These trends have hit our subprime auto program especially hard. In keeping with the plan we announced last year, we are shrinking the portfolio rather than chase after business with inadequate rates and excessive losses. Most of our competition securitizes their loans. As capital markets respond to the poor performance of the loans backing these securities, we expect funds available in the market to dwindle and rates to rise. Until then, we intend to approve loans cautiously, make prudent program changes, increase our loan loss reserves, closely monitor the debt ratios of our borrowers, and pay even more attention to servicing and collecting our existing portfolio. This will reduce earnings in the short run but will position our lending operations to take advantage of opportunities arising from the inevitable shakeout in the industry. These same problems are evident, but to a lesser degree, in our executive loan programs. We persevere by keeping rates and underwriting standards where they need to be, even if it means shrinking the portfolios. We don't expect any improvement in the auto loan business in 1997. Three large auto competitors have gone bankrupt, but there is still no shortage of silly money about. Wall Street has yet to feel the pain; when it does, the business will improve. We maintain the perhaps naive hope that this Alice in Wonderland substandard lending market will return to economic rationality.

Our banking and lending operations had operating earnings of \$14.5 million in 1996. We do not expect to do as well in 1997.

We changed management at American Investment Bank. H.E. Scruggs is the new CEO. He and his new team have their work cut out for them.

Manufacturing

Since 1991, we have been making excuses for the manufacturing companies. We promised that if we couldn't make them sufficiently profitable we would sell or liquidate them. There used to be nine companies, now there are three and they are profitable. In 1996, this division made a tiny profit. Stephen C. Perry, president of the manufacturing division, continues to do yeoman service cleaning up a mess not of his making. The problems are not all behind us.

Conwed Plastics, a maker of plastic netting, while adequately profitable, is not growing fast enough. General Marble was bestowed a "Partner of the Year Award" by The Home Depot, our largest customer. General Marble's hardworking management is to be commended. They have come a long way in producing a quality product with fast and responsive delivery, but we must continue to improve and broaden our customer base. It is, however, akin to being given a prize by a scorpion. Prizes today, and then ruthless demands for price reduction tomorrow. Electri-Cord, albeit profitable, is not predictably so. Management is currently negotiating to purchase the company.

Steve has also taken on responsibility for what remains of the Sperry and Hutchinson Company and the wineries (more later). He has become a valuable addition to our executive ranks.

Wineries

Several years ago we made a small investment in a winery purchased from the FDIC. Over the years our investment has grown and we are now the proud principal owners, together with Gary and Nancy Andrus, of Pine Ridge Winery located in Napa Valley, California. We are also developing a new winery, Archery Summit, in Dayton, Oregon. Both wineries produce premium wines. Pine Ridge produces 75,000 cases per year and has sufficient capacity, in a theoretically perfect year, to produce up to 100,000 cases of Cabernet, Merlot, Chardonnay, and Chenin Blanc. Archery Summit, when at full production, will produce 15,000 cases of very expensive, exquisite Pinot Noir.

We have been buying land and shortly will have enough of our own grapes to meet all our needs. We made a small operating profit in 1996 which we expect will increase. There is a shortage of premium wine in the market and Pine Ridge has been able to raise prices. Our managing partner Gary Andrus is a gifted winemaker and his wife Nancy, when not on her motorcycle, is a very effective head of marketing.

We encourage our shareholders to entreat your favorite restaurant and wine store to carry these delicious wines! If you cannot find the wine locally, telephone the winery at 1-800-486-0503, or stop by and visit the beautiful tasting rooms and caves.

Russia

Our participation in the Russian economy is in two parts. We have an investment portfolio of traded equity securities intended to track the hoped for improvements in the Russian economy. We account for these securities on a cost recovery basis, i.e., on a sale no profit is recognized, if there be one. Instead, when securities are sold, the proceeds are applied to the cost of the portfolio, thereby reducing our carrying value. At June 30, 1997, our net cost in the portfolio was \$22.3 million and its approximate market value was \$83.4 million. These are chickens we don't count before they hatch.

In April 1996, we formed a joint venture with the Pepsi Cola Company. We have 75% and have expended \$79.5 million. Pepsi has 25% and has invested \$26.5 million in our joint company, Pepsi International Bottlers. In July 1997, Leucadia, PepsiCo and Pepsi International Bottlers entered into loan agreements with third-party lenders, primarily the European Bank for Reconstruction and Development and the International Finance Corporation (a subsidiary of the World Bank), to provide \$90 million in additional financing.

Larry Hershfield is putting together an excellent team in Russia. The difficulties, however, of installing a manufacturing and distribution operation that spans nine time zones, from just east of Moscow to Vladivostok, cannot be underestimated. For 70 years this was a centrally-planned economy. Now it has opened itself up to the rough and tumble of the free market. Old regulations die a slow death and don't apply to the current realities. By and large, the Russian bureaucracy recognizes the need to change—they just don't know what to do while they wait. New laws and regulations are desperately needed but are painfully slow in coming. These problems, not to mention Coke, make life interesting, albeit frustrating. At June 30, 1997, our investment was \$44.7 million, net of operating losses to date. We expect to invest further in this venture. Per capita soft drink consumption is only 35 servings in our market area versus 850 in the

United States and 270 in Hungary. As the economy improves, we expect the consumer to become thirstier.

Argentina

The Company owns a 30% interest in La Caja de Ahorro y Seguro S.A. ("La Caja"), a holding company for a life insurance company, a property and casualty insurance company, and a bank. Our Argentine partners, the Werthein family, also hold a 30% interest.

La Caja, from its offices nationwide, distributes auto and life insurance on a direct basis (not paying commissions to agents) and is a leader in its markets. The company has total annual premiums of \$500 million and total assets of \$640 million. La Caja was acquired in 1995 in a privatization in which the government of Argentina retains 30% and the employees 10%. Much work has been done by La Caja's excellent management to improve all aspects of the company's operations, including strengthening insurance reserves. At December 31, 1996, the investment was carried on our books at \$44.3 million. Leucadia's equity in La Caja's results of operations since acquisition is not material. We expect significant progress in the next few years.

Real Estate

In July 1996, we committed to invest \$25 million in a mixed use project known as Renaissance Plaza in Brooklyn, New York. We own a 57.5% equity interest in the 809,000 square foot office building and garage, and a 16% interest in the 384 room Marriott Hotel. Completion is scheduled for 1998. The Empire Insurance Group and the City of New York will be the major tenants in the building. Empire will receive \$36 million in present value benefits, primarily from New York City, plus a very favorable long-term lease.

In 1994, we purchased for \$50.8 million a 615,000 square foot building at 685 Third Avenue in New York City. We invested in a new lobby and reskinned the outside of the building. On June 30, 1997, the building was sold for \$100 million and a \$35.6 million pre-tax gain was recorded.

Also in 1994, we purchased out-of-bankruptcy two 41-story condominium towers across from the convention center in San Diego, California, known as The Harbor Club. Of the 201 residential units in the building, 127 have been sold or are under contract for sale. Of the 42,000 square feet of commercial space, 7,500 square feet is leased. It now appears that when this project is complete, the return will be in the single digits. We paid too much!

Our 46% interest in 30 North LaSalle in Chicago, Illinois, was sold for a pre-tax profit of \$8 million which is a 30% return per annum on our investment.

Several small parcels of land have been sold. A large land development project, again purchased out-of-bankruptcy, in San Diego County, California, with 3,400 lots, is perilously close to the completion of entitlements. When entitlements are final, we will determine whether to sell the project or to partially develop it for sale to builders. There is a shortage of entitled lots in San Diego.

Real estate prices are high and going higher—we are sellers. We have approximately \$99 million invested in real estate at June 30, 1997.

Money

In October 1996, the Company sold \$135 million of 7½% Senior Subordinated Notes, due in 2006. This money was used to purchase \$102.7 million of the Company's 10¾% Senior Subordinated Notes, due in 2002. This redemption resulted in a fourth quarter 1996 loss of \$6.8 million, net of income tax. The remaining 10¾% Notes were redeemed or bought in the open market by June 1997. This refinancing will result in an annual expense savings of \$2.6 million. In January 1997, the Company sold \$150 million of 8.65% trust issued preferred securities, due in January 2027, of its wholly-owned subsidiary Leucadia Capital Trust I. The Company fully and unconditionally guarantees the Trust's obligations.

In March 1997, the Company called for redemption all of its outstanding \$100 million 5¼% Convertible Subordinated Debentures due 2003, at a redemption price of 102.625%. We issued 3,258,145 new shares and \$6.3 million par value we redeemed for cash. We wish to welcome those of you who are new shareholders.

Our relationship with The Jordan Company and its affiliates has been renewed for three more years and continues harmoniously and successfully. Thank you Jay Jordan and David Zalaznick.

MK Gold, of which we own 46%, has one gold mine in operation at present and is prospecting for opportunities. Gold prices are down, which makes new developments more difficult.

During 1996, the Company did not use its \$150 million credit agreement. In February 1997, we replaced this credit facility with a new contractual bank credit facility of \$200 million, bearing interest at prime or LIBOR, which will mature in February 2002. When both insurance company transactions close, we will need to renegotiate our bank lines.

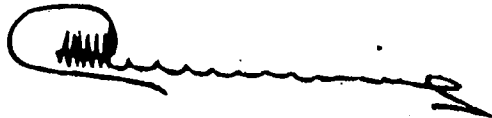
We have been asked several times whether success has dampened our enthusiasm and motivation to continue. We have both become vastly more successful (politically correct-speak for richer) than we ever dreamed. We have smart employees, energetic advisors, capital galore, companies, real estate, Barbados Power, Argentine investments, banks and insurance companies, vineyards, gold mines, bottling plants, and unprecedented opportunities. We are in a period of global expansion, free market economics are in vogue and we are enthusiastic practitioners thereof. The global sand pile is an interesting place and, until slowed by the vicissitudes of old age, the current plan is to continue. Why not, this is fun! If we decide to stop, you will be told immediately.

A note of caution to the above enthusiasm is in order. Valuations of almost everything are at an all time high or thereabouts. The investing we do is difficult in times like these. After the sale transactions close, we will be a company with piles of cash, credit availability, and various operating businesses and investments. We will not let the money burn a hole in our pockets. Circumstances may dictate inaction for a considerable period. We are prepared for that—you should be, too.

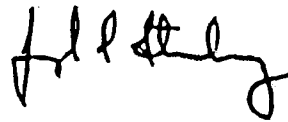
A very special thank you to the hardworking, intelligent and dedicated employees of the Colonial Penn companies. They are largely responsible for making these companies so valuable. We wish them well. Usually at the end of this report to you we discuss our attitude toward the economy, interest rates, and price levels. This year our actions speak louder than words.

We regret to report the recent death of our Vice President and Corporate Secretary, Ruth Klindtworth. Ruth joined the Company in 1960, long before either of us. She was loyal, capable, and hardworking. In our early days at Talcott one of us, in a moment of poor judgment, tried to fire Ruth. She indignantly refused to be fired and put the offender in his proper place—thank goodness. She was our historian and friend. We will miss her.

As we approach our twentieth anniversary of directing Leucadia's affairs, a special thanks to all those who help with long hours, weekend interruptions, and holiday cancellations. Without them, it would not have been possible.



IAN M. CUMMING
Chairman



JOSEPH S. STEINBERG
President

Letter from the Chairman and President

1447
1997

To Our Shareholders

In 1997, the Company earned \$661.8 million after tax, or \$10.64 per share, an extraordinary 59% return on 1996 ending equity. Net worth at year end was \$1.9 billion or \$29.17 per share. The stock price as of this writing is \$38.38 per share, compared with \$26.75 per share at the end of 1996.

We are writing to you in early April this year, back to the old rhythm of a spring shareholders' meeting which was pleasantly disrupted by the pending sales last year of the Colonial Penn Life and Colonial Penn Property & Casualty companies. The good fortune of these sales, which were discussed in last year's report, are recapped on page 1 of the 10-K, which is attached to this report.

We are reminded that current senior management started this adventure in 1978; one of us in June and the other in December; it is our twentieth anniversary at the helm of Leucadia. What follows is a chart which reviews those twenty years. Since December 1979, equity has compounded from \$22.9 million to \$1.9 billion, a 27.7% compounded annual rate of return. The stock price, adjusted for stock splits, increased from \$0.08 to \$34.50, a 37.6% compounded return (see chart below). Some of those years were lean and others fat; we are pleased with the overall results and hope you are as well. We doubt we can do as well in the future; this engenders some interesting questions, which we will discuss later.

(Dollars in thousands, except per share amounts)

	Book Value Per Share	Book Value % Change	Market Price Per Share	Market Price % Change	Equity	Annual Return on Beginning Equity	Net Income (Loss)
1978	\$ (0.11)	NA	\$ 0.08	NA	\$ (7,657)	NA	\$ (2,225)
1979	0.32	NM	0.36	350.0 %	22,945	NM	19,058
1980	0.34	6.3 %	0.28	(22.2)%	24,917	8.2 %	1,879
1981	0.42	23.5 %	0.55	96.4 %	23,997	30.2 %	7,519
1982	1.07	154.8 %	0.97	76.4 %	61,178	153.6 %	36,866
1983	1.28	19.6 %	1.42	46.4 %	73,498	29.4 %	18,009
1984	2.22	73.4 %	2.39	68.3 %	126,097	82.8 %	60,891
1985	2.49	12.2 %	2.91	21.8 %	151,033	18.6 %	23,503
1986	3.79	52.2 %	4.25	46.0 %	214,587	51.7 %	78,151
1987	3.34	(11.9)%	2.44	(42.6)%	180,408	(8.5)%	(18,144)
1988	3.84	15.0 %	3.59	47.1 %	206,912	11.8 %	21,333
1989	4.92	28.1 %	5.34	48.7 %	257,735	31.1 %	64,311
1990	5.91	20.1 %	5.69	6.6 %	268,567	18.4 %	47,340
1991	7.95	34.5 %	9.22	62.0 %	365,495	35.3 %	94,830
1992	11.06	39.1 %	19.75	114.2 %	618,161	35.7 %	130,607
1993	16.27	47.1 %	20.50	3.8 %	907,856	39.7 %	245,454
1994	15.72	(3.4)%	22.25	8.5 %	881,815	7.8 %	70,836
1995	18.47	17.5 %	25.00	12.4 %	1,111,491	12.2 %	107,503
1996	18.51	0.2 %	26.75	7.0 %	1,118,107	4.4 %	48,677
1997	29.17	57.6 %	34.50	29.0 %	1,863,531	59.2 %	661,815
CAOR (1978-1997) (a)				37.6%			
CAOR (1979-1997) (a) (b)	28.5%						
						27.7%	

(a) Compounded Annual Growth Rate (CAOR)

(b) A negative number cannot be compounded; therefore, we have used 1979.

Empire Insurance Company

In 1995, we told you Empire had dyspepsia and we reported having to strengthen reserves by \$35 million. In 1996, we reported we were again strengthening reserves by \$28 million. This year we are reporting the addition of another \$27 million to reserves. As you might suppose, adding to reserves reduces reported income by a like amount. At this point, you ought to be exasperated at our inability to get this right! We are also exasperated and embarrassed. What follows is a progress report.

For the last three years at Empire, when the actuaries looked at current results versus what we and they had expected, claims were higher and the costs associated with settling the claims higher as well. This result has a nasty two-pronged effect. Not only must reserves for past years be revised upward, but it also calls into question the accuracy of the reserves being established on current business and the pricing of that business. What caused this to happen?

Empire's earned premiums grew from \$211 million in 1991 to \$326 million in 1995. Rapid growth is a good thing only if people, systems and procedures are in place to handle the increasing volume and, most importantly, only if appropriate prices are charged. In retrospect, we were chasing unprofitable business and our systems and people were not up to the challenge. Without realizing it, Empire was having a sale. Not surprisingly, customers took advantage. To make matters worse, a few of our less than faithful agents, sensing weakness and wanting to take advantage of our inadequate pricing, sent us business that we should have turned down, but did not.

We are improving all the working parts of Empire. Are we making progress—yes. Are we there—we don't know. Tomorrow's settlements will provide statistical fodder to test the accuracy of current pricing, underwriting, etc. In the midst of these problems, Empire eked out a small profit in 1997 of \$1.4 million pre-tax. Rich Pettit and his team continue working long hours to complete the task; there are signs of progress and we are cautiously optimistic. More next year.

Banking and Lending

The Company's banking and lending operations, with assets of \$265 million at the end of 1997, are conducted through its national bank subsidiary, American Investment Bank, N.A. (AIB) and a Utah-State chartered Industrial Loan Corporation, American Investment Financial (AIF).

AIB and AIF are in semi-hibernation. In the past, in addition to other products, both made executive and professional loans by mail. While these programs were very profitable for many years, the huge number of credit offers which flood your mail box should give a clue as to why we have discontinued this business; too much money chasing too many over-borrowed borrowers. Subsequent to the end of 1997, substantially all of the executive and professional loans were sold at a premium. With these sales, subprime auto loans now make up the bulk of AIB's outstandings. AIB must struggle to reduce overhead without rendering itself incapable of growing if the market justifies expansion.

There may be some good news. AIB is in a strong position to maximize its opportunities arising from the shakeout underway in the subprime auto lending industry. In last year's report, we declared our hope that this Alice in Wonderland substandard lending market would return to economic rationality. Early indications suggest our hope was well placed and our strategy well timed. Volume is increasing and losses are under control. We did not surrender good judgment when the market was running away and we do not intend to do so now that it is heading in our direction. As other subprime auto lenders have faltered, we have been bidding on portfolios of loans. Reality is coming slowly to this market; we have not yet been successful bidders. Substandard auto portfolios looking for a new home, call Bud Scruggs at (801) 297-1040. Bud and his new team are doing a good job.

The largest threat to both banks is a rapid deterioration in the credit climate. With 1.4 million bankruptcies filed in 1997, and 1998 on pace to exceed that record, anyone involved in consumer lending must keep an eye on the courthouse.

The biggest disappointment in 1997 was the settlement of a lawsuit against AIB, related to loans AIB purchased from a real estate syndicator who proved to be a crook and now resides in jail. We expected to be protected by our holder-in-due-course status. However, our lawyers were overly optimistic; the litigation went poorly enough so that we decided to settle rather than trust our fate to a class action lawsuit and a jury trial. The settlement and related legal expenses reduced AIB's 1997 pre-tax earnings by 38%. Our combined banking earnings for 1997 were \$5.8 million pre-tax.

Manufacturing

Once there were nine small companies; now there is one: Conwed Plastics. All the other manufacturing companies have been sold or liquidated since they did not produce an adequate return on equity. Steve Perry, who competently managed these sales, has decided to pursue other career interests. We are grateful for his help.

Conwed Plastics earned \$8.9 million pre-tax last year, a 38.4% return on equity. Our challenge is to increase Conwed's growth rate. Such challenges have not been our forte, but hope springs eternal! We are ably assisted by John Rosenberger and his experienced team.

Wineries

The wineries, Pine Ridge in Napa Valley, California, and Archery Summit in the Willamette Valley of Oregon, performed according to plan. Five years ago, cows grazed where now Archery Summit vineyards produce glorious Pinot Noir. Pine Ridge is continuing vineyard development to reach its planned capacity of 100,000 cases of high quality Cabernet and Chardonnay from our own vineyards. Though profitable, one juvenescent and one expanding winery are hard on earnings and cash flow in the short term.

Our wines offer extraordinary taste and value. We hope you will encourage your local restaurants and liquor stores to carry both wines. If you are in Napa Valley or Western Oregon, please call 1-800-486-0503 to arrange a visit to the caves and tasting rooms, or to locate availability in your area. You will surely enjoy the visit and the wine.

Gary and Nancy Andrus make the wine, sell the wine and create the buzz, which keeps our caves almost empty.

Russia

In April 1996, we formed a 75%/25% joint venture with the Pepsi Cola Company, called Pepsi International Bottlers, to manufacture and distribute Pepsi products in Russia, east of Moscow. This was a disappointing investment for us. Together with Pepsi, we determined that a merger with Pepsi's Moscow region made more sense than proceeding independently. The investment required for the future was beyond our willingness to participate.

Pepsi has an option to buy our remaining interest for a sum which exceeds our remaining book value by \$25.3 million at December 31, 1997. We have a similar put right exercisable in 2000.

Our other Russian investments are shares in publicly traded companies and Russian government and corporate bonds. At December 31, 1997, the securities had a book value of \$36 million and a market value of \$85.5 million. These securities are a bet on the future of Russia and we remain cautiously optimistic.

Larry Hershfield, our Executive Vice President, has been living in Moscow since February 1995. He will continue on in Russia for the time being searching for new investments and minding the current ones.

Argentina

The Company owns a 30% interest in La Caja de Ahorro y Seguro S.A. (La Caja), a holding company for life insurance, property and casualty insurance, workers' compensation insurance and a bank.

We, along with our Argentine partners, the Wertheim family, who also own 30%, were the successful bidders in the 1994 privatization of the government owned La Caja. The government retained 30% ownership and the employees 10%.

From its offices nationwide, La Caja distributes auto and life insurance on a direct basis (not paying commissions to agents) and is the leader in the Argentine market. A reminder, the Colonial Penn companies were also direct marketers.

In 1997, La Caja had total annual premiums of \$586 million and total assets of \$692 million, including banking operations. This investment is carried on our books at \$45 million. In the three years since the privatization of this previously government-managed enterprise, La Caja has been subjected to a complete renovation. The initial head count was cut by 50%, systems and procedures overhauled, new accounting systems installed, new computer systems installed, and the main office moved from antiquated offices on Plaza de Congreso to new office space which was converted from industrial space to award-winning functional offices.

Ever mindful of the problems discussed in the Empire section of this report, at La Caja we are concentrating on efficient claims' handling and building reserves. We are not eager to recognize income until we and the actuaries are highly confident that the reserving practices are conservative and profits real.

Real Estate

As we mentioned last year, 685 Third Avenue in Manhattan, which we purchased in 1994, was sold on June 30, 1997 for \$100 million. We recorded a \$35.6 million pre-tax gain.

In 1994, we purchased out of bankruptcy two forty-one story condominium towers across from the convention center in San Diego, California. Of the 201 residential units in the building, at this writing 168 have been sold or are under contract for sale. Morton's of Chicago is our first commercial tenant. Our recent sellout rate has been faster than we expected. Kudos to Paul Borden and his team.

San Elijo Ranch, a very large land development project in San Diego County, California, purchased out of bankruptcy with 3,400 single family lots, is almost fully entitled. Lot sales should begin this year. The sooner the better—there is a shortage of single family lots in this particular part of California, interest rates are low, etc. After location, location—timing is everything.

Last year we told you of our commitment in July 1996 to invest up to \$25 million in a mixed use project known as Renaissance Plaza, located in downtown Brooklyn, New York. The project consists of an 809,000 square foot office building, a 384 room Marriott Hotel, and an 1,100 space parking garage. We own 57.5% of the office building and garage and 16% of the hotel. Empire Insurance and the City of New York are the major tenants. Empire, to date, has received approximately \$8 million of the approximately \$36 million of present value benefits to which it is entitled for relocating to this site.

The project is on schedule for completion in September 1998. The parking garage is open, the hotel is scheduled for a July 4th grand opening, the City has started moving in, and Empire will relocate in September 1998. Barring unforeseen circumstances, this should be an excellent investment. Josh Muss, Luis Medeiros, Zalman Jacobs, Tom Mara and Mark Hornstein dreamed it, schemed it, and executed it!

Early in 1998, in another bankruptcy transaction, we purchased two buildings in Washington, D.C., hard by the U.S. Capitol, with approximately 630,000 square feet of office space for \$23 million. The District of Columbia has committed to a ten-year lease and substantial renovation work will begin shortly. Our partner in this transaction is our old friend Chip Akridge, a surviving Washington real estate developer.

A lot development program on the beach in Rosemary Beach, Florida, ably managed by Patrick Bienvenue, is about to reach the magical cash break-even. Money will roll in from here on. We bought this real estate at a time when prices were advantageous—we are now sellers. And so the wheel turns.

At December 31, 1997, Leucadia's total investment in real estate was \$93 million compared to \$142 million at December 31, 1996.

Money and Other Things

In March 1997, we called the 5 $\frac{1}{2}$ % debentures. \$94 million was converted to 3,258,145 of common shares and \$6 million was redeemed.

In January 1997, the Company sold \$150 million aggregate liquidation amount of 8.65% trust issued preferred securities (TRUPS) of its wholly-owned subsidiary, Leucadia Capital Trust I, the dividends on which are tax deductible to the Company. These securities have an effective maturity date of January 15, 2027.

In February 1998, we agreed to reinsure our remaining life insurance business to Allstate Life Insurance Company for a premium of \$30 million. The transaction should close in the second quarter of 1998. Under the accounting rules, we will not show any profit when the transaction closes. The profit will be reflected in the income statement over a number of years.

Our relationship with The Jordan Company was again very successful and extends through 1999. Jay Jordan and David Zalaznick manage a very successful LBO business, in which we participate.

At the time of this writing, the parent company had about \$1.6 billion in cash, cash equivalents, and marketable liquid securities, plus \$411 million of notes issued by Conesco, Inc. due in 2003, backed by bank letters of credit. A simplified way to look at Leucadia National at this time would be (in millions):

Corporate cash, cash equivalents and marketable securities	\$ 1,579
Conesco notes receivable backed by bank letters of credit	411
Operating companies and other investments, net of certain liabilities	367
Total	2,357
Less: Debt	343
TRUPS	150
Net Worth	\$ 1,864

(Actual at December 31, 1997 with certain pro forma adjustments.)

The investment in operating companies and other investments listed above are at cost, adjusted for earnings and dividends since acquisition. If the world doesn't change significantly, there are potential gains therein.

The Future Conundrum

For the past twenty years, we have done the same thing over and over again: purchased assets or companies which we thought to be undervalued and then worked hard to improve their cash flows and to realize the inherent value. If someone came along and offered us more than we felt those assets were worth in our hands, we sold, e.g., Colonial Penn.

The process has worked well for 20 years. Even through the boisterous '80s, when money was abundant and prices were rising, we still found nuggets of value. During the '90s, mining for value has become increasingly difficult. Prices are higher still and more money is created every day as the markets of the world continue to rise. An undervalued asset is like finding the proverbial needle in a haystack. We are going blind.

Higher prices inevitably mean lower returns. The consequences of miscalculation or mistake become more deadly as prices increase. Extreme caution is in order.

Since we are inherently curious and peripatetic, in the last few years, in search of higher returns, we have been to Russia, Guyana, Argentina, South Korea, Angola, the Kyrghyz Republic, Germany, Panama, the Congo, Holland, and other places. The story is much the same. On a risk-adjusted basis, returns are generally too low to justify investment. There is a vast amount of money sloshing around the world. As hard as we run, the hot money has beat us there. One of us predicts a very unhappy ending to this exuberance; the other doesn't know what to think.

Thus is our conundrum. Several alternatives are available.

- Do nothing. Keep our cash short and safe and wait until the old world returns. In the meantime, low returns are guaranteed.
- Do the above, but give the shareholders back a significant portion of their money. Perhaps individually you can do better than we think we can. At least we will worry less.
- Stop the merry-go-round and give all the money back on the theory that a 20-year run is a good one; the old world is unlikely to return soon, but for certain it will not be in exactly the same form. These dogs may be too old for new tricks.
- Some combination of the above.

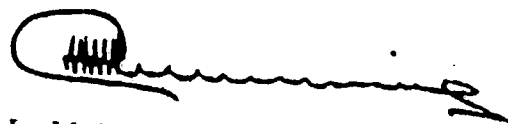
We have been ruminating much about this of late. We are dithering; we will continue our ruminations. As soon as we have arrived at a conclusion, we will let you know. Call us if you have an opinion. A note of caution—if the right rabbit jumped in front of us, we might be singing a very different tune.

The past 20 years have been exhilarating and at times exhausting, but always fun and interesting, and our friendship goes on unabated. Without the constant loyalty and hard work of our employees and advisors, it would not have been possible nor as much fun. Our lawyer, trusted friend and advisor, Steve Jacobs, has blown retreat on his silver bugle many times and we have listened more often than not. For the above and much more, we are thankful.

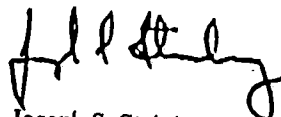
Leucadia's stock price has enabled our fellow stockholder, friend and 14-year veteran, Rich Pettit, to leave Leucadia as soon as we find his replacement as CEO of Empire Insurance. He plans to go into business with his children, to build with them something he can leave with them. He richly deserves to pursue his dreams—we wish him much success and thanks.

Also, a special thank you this year to Assunta Leto, our long-suffering, multilingual assistant in New York who is the Leucadia employee with the greatest seniority. Since she is younger than her years, we won't mention exactly when she joined the Company.

Thanks also to our shareholders, many of you have been around since the beginning.



Ian M. Cumming
Chairman



Joseph S. Steinberg
President

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters.

(a) Market Information.

The Common Shares of the Company are traded on the New York Stock Exchange and Pacific Stock Exchange under the symbol LUK. The following table sets forth, for the calendar periods indicated, the high and low sales price per Common Share on the consolidated transaction reporting system, as reported by the Dow Jones Historical Stock Quote Reporter Service.

	Common Share	
	High	Low
<u>1997</u>		
First Quarter.....	\$29.00	\$25.75
Second Quarter.....	31.88	27.38
Third Quarter.....	34.75	31.00
Fourth Quarter.....	36.63	33.00
<u>1998</u>		
First Quarter.....	\$41.13	\$33.56
Second Quarter.....	40.13	32.81
Third Quarter.....	34.75	27.63
Fourth Quarter.....	32.38	26.25
<u>1999</u>		
First Quarter (through March 12, 1999).....	\$33.06	\$29.50

(b) Holders.

As of March 12, 1999, there were approximately 3,685 record holders of the Common Shares.

(c) Dividends.

The Company paid a cash dividend of \$.25 per Common Share on December 31, 1997. The payment of dividends in the future is subject to the discretion of the Board of Directors and will depend upon general business conditions, legal and contractual restrictions on the payment of dividends and other factors that the Board of Directors may deem to be relevant.

The HomeFed Dividend. The Company acquired a 41.2% interest in HomeFed in 1995. HomeFed is a publicly traded real estate development company (OTC (Non-NASDAQ): "HFDC") with its principal office at 1903 Wright Place, Suite 220, Carlsbad, California 92008 (telephone number 760-918-8200).

In 1998, the Company distributed to its shareholders of record on August 25, 1998 (the "HomeFed Dividend Holders") a pro rata dividend of all of the beneficial interests in a trust that holds 41.2% of the common stock of HomeFed and contracts to increase that ownership to 89.6% of HomeFed. This dividend resulted in 1998 dividend income to the HomeFed Dividend Holders of \$.1426 for each Common Share of the Company held on August 25, 1998, even though no physical distribution was made because the trust interests are uncertificated. A Form 1099-DIV was sent to HomeFed Dividend Holders reflecting this distribution.

The Company anticipates that, following effectiveness of a registration statement to be filed with respect to the HomeFed shares, the HomeFed Dividend Holders will receive 1.0 share of HomeFed

Leucadia National Corporation

Corporate Office

315 Park Avenue South
New York, New York 10010-3607
(212) 460-1900

Executive Office

529 East South Temple
Salt Lake City, Utah 84102-1089
(801) 521-1000

Operating Companies

Telecommunications

WilTel Communications Group, Inc.
One Technology Center
Tulsa, Oklahoma 74103-2807
Ian M. Cumming, Chairman
Jeff K. Storey, President
(918) 547-6000

Health Services

Symphony Health Services, LLC
11350 McCormick Road, Suite 600
Executive Plaza IV
Hunt Valley, Maryland 21031-1002
Sally N. Weisberg, Chairman and President
(443) 886-2200

Manufacturing

Conwed Plastics
2810 Weeks Avenue, SE
Minneapolis, Minnesota 55414-2898
H.E. Scruggs, Chairman
Mark E. Lewry, President
(612) 623-1700

Banking

American Investment Bank, N.A.
200 East South Temple
Salt Lake City, Utah 84111-1241
H.E. Scruggs, Chairman
Justin R. Wheeler, President
(801) 297-1000

Real Estate

Leucadia Financial Corporation
529 East South Temple
Salt Lake City, Utah 84102-1089
Patrick D. Bienvenue, President
(801) 521-5400

Winery

Pine Ridge Winery
5901 Silverado Trail
Napa, California 94558-9749
George J. Scheppler, President
(707) 253-7500

Copper Mine Development

MK Gold Company
Eagle Gate Tower
60 East South Temple, Suite 1225
Salt Lake City, Utah 84111-1033
G. Frank Joklik, Chairman
Thomas E. Mara, President
(801) 297-6900

Counsel

Weil, Gotshal & Manges LLP
767 Fifth Avenue
New York, New York 10153-0119
Stephen E. Jacobs, Esq.
Andrea A. Bernstein, Esq.
(212) 310-8000

Registrar and Transfer Agent

American Stock Transfer & Trust Company
59 Maiden Lane
New York, New York 10038-4502
(800) 937-5449

Auditors

PricewaterhouseCoopers LLP
1177 Avenue of the Americas
New York, New York 10036-2798

The Common Stock is listed for trading on the New York and Pacific Stock Exchanges under the symbol "LUK."

The 7¼% Senior Notes due 2013, the 7¼% Senior Subordinated Notes due 2006 and the 8¼% Senior Subordinated Notes due 2005 are listed for trading on the New York Stock Exchange under the symbol "LUK."

The trademark is registered in the United States Patent and Trademark office.

Financial Highlights

	1998	1997	1996
Revenues	\$ 530,506,000	\$ 630,737,000	\$ 670,443,000
Net securities gains (losses)	\$ (60,871,000)	\$ 3,249,000	\$ 24,117,000
Income (loss) from continuing operations before income taxes, minority expense of trust preferred securities and extraordinary loss	\$ 29,377,000	\$ (24,238,000)	\$ (48,187,000)
Income tax benefit	\$ (25,073,000)	\$ (9,891,000)	\$ (19,326,000)
Minority expense of trust preferred securities, net of taxes	\$ (8,248,000)	\$ (7,942,000)	\$ —
Income (loss) from continuing operations before extraordinary loss	\$ 46,202,000	\$ (22,289,000)	\$ (28,861,000)
Income from discontinued operations, net of taxes	\$ 8,141,000	\$ 58,516,000	\$ 84,376,000
Gain on disposal of discontinued operations, net of taxes	\$ —	\$ 627,645,000	\$ —
Income before extraordinary loss	\$ 54,343,000	\$ 663,872,000	\$ 55,515,000
Extraordinary loss from early extinguishment of debt, net of taxes	\$ —	\$ (2,057,000)	\$ (6,838,000)
Net income	\$ 54,343,000	\$ 661,815,000	\$ 48,677,000
Earnings (loss) per common share:			
Basic:			
Income (loss) from continuing operations before extraordinary loss	\$.73	\$ (.36)	\$ (.48)
Income from discontinued operations	\$.13	\$.94	\$ 1.40
Gain on disposal of discontinued operations	\$ —	\$ 10.09	\$ —
Extraordinary loss	\$ —	\$ (.03)	\$ (.11)
Net income	\$.86	\$ 10.64	\$.81
Diluted:			
Income (loss) from continuing operations before extraordinary loss	\$.73	\$ (.36)	\$ (.48)
Income from discontinued operations	\$.13	\$.94	\$ 1.40
Gain on disposal of discontinued operations	\$ —	\$ 10.09	\$ —
Extraordinary loss	\$ —	\$ (.03)	\$ (.11)
Net income	\$.86	\$ 10.64	\$.81
Total assets	\$ 3,958,951,000	\$ 3,745,336,000	\$ 2,776,591,000
Cash and investments	\$ 2,229,895,000	\$ 2,453,555,000	\$ 1,246,220,000
Common shareholders' equity	\$ 1,853,159,000	\$ 1,863,531,000	\$ 1,118,107,000
Book value per common share	\$ 29.90	\$ 29.17	\$ 18.51

Letter from the Chairman and President

To Our Shareholders

In 1998, the Company earned \$54.3 million after tax, or \$.86 per share, a 2.9% return on ending equity. Net worth ended the year at \$1.85 billion or \$29.90 per share. This represents a 27% return per annum of book value per share since December 31, 1979, shortly after this management took over. Market price of the stock was \$31.50 at December 31, 1998 versus \$34.50 at year-end 1997. During the waning months of 1998, and up until March 17, 1999, the Company purchased 3,734,970 Leucadia common shares in the open market at an average price of \$29.50. Since 1978, and as of December 31, 1998, we have repurchased 37,316,491 shares (adjusted for splits), at an average price of \$4.65. In addition to the repurchase of these shares, we have decided to dividend to the shareholders 44% of the 1998 year ending net worth as a capital gain. More about that, and plans for the future, after reviewing recent developments and current operations.

Empire Insurance Company

Empire Insurance has become our *bête noir*. Beginning in 1995, we have strengthened reserves by \$131.5 million. It reminds us of the street in front of Empire's former office on Fifth Avenue in New York. A huge pothole appeared due to a large water main break. It took days and days to stop the flow of water and many tons of fill and asphalt to repair the street. We have periodically filled our pothole with money called reserves, but we are not sure the repair is going to hold. Empire, if nothing else, is a testimony to our persistence, if not our competence.

For the last four years, when the actuaries looked at current results and compared them with our previous predictions, they found more claims than expected, with the cost of settling the claims higher as well. These adverse developments have a nasty result. Reserves must be adjusted upward for past business and the loss predictions being used for current business are put in doubt.

Actuaries are naturally conservative folks. They are not interested in optimistic forecasts. This means that Empire will not be reporting earnings until we and they are sure the reserving problems are behind us. We hope that the understandable conservatism of our current reserving practices will have happier results in the future.

We continue to work on improving all the moving parts at Empire. To that end, we have hired Robert Toppi as the CEO. He has 30 years of insurance experience, a considerable amount of it in the New York City market. He is working hard to stabilize, reengineer and lower costs to fit a smaller sized operation, which will be the inevitable result of proper reserving and profitable pricing of our insurance products. Empire has in the past covered some of its overhead by acting as a servicing carrier for others and by purchasing assigned risk business. These opportunities have been dramatically reduced and are slowly disappearing. Empire's restructuring is made more difficult by the excess of capital in the property and casualty industry. As a result, many competitors are reaching for the incremental premium dollar hoping it will be marginally profitable. All of us involved in the Empire restructuring hope we are nearing the end of these difficult times. Let us pray!

Banking and Lending

The Company's banking and lending operations are conducted by its national bank subsidiary, American Investment Bank, N.A. (AIB), and a Utah state chartered Industrial Loan Corporation, American Investment Financial (AIF). This segment at December 31, 1998, had total assets of \$269.3 million and total capital of \$49.5 million.

AIB and AIF have been hibernating for the past several years. AIB's largest market segment, sub-prime auto lending, became inundated with competitors making substandard loans at standard interest rates, with, as you might expect, disastrous consequences. When this phenomenon began four years ago, AIB retreated and waited. During 1998, two things happened. The most irrational participants either withdrew from the market or were carried off by their creditors; those who remain have been pricing more sensibly. During this interregnum, AIB has improved its collection methods and has added a three-tiered risk-based pricing structure, installed new technology, paid great attention to static pool analysis (business is tracked every quarter throughout its life), and improved operating procedures. By the end of 1998, AIB and AIF were able to double their monthly loan volume. Preliminary review indicates the results are adequate and improving—the good economy has helped. Also during 1998, AIB acquired at a discount a \$37 million portfolio of subprime auto loans, which will increase yield on assets and help amortize fixed costs. AIF's boat and recreational vehicle programs reached profitability. The Small Business Administration lending program is advancing slowly.

We have spoken before about the state of consumer banking. It has become overly competitive and over-loaned to already financially burdened consumers. In response to this problem, AIB and AIF made a timely exit from their executive and professional loan programs by selling in 1998 substantially all of their portfolios for a pre-tax gain of \$6.5 million. In preparation for the meeting to consider the sale of executive and professional loan portfolios, AIB's chairman, H.E. "Bud" Scruggs, was overheard mumbling something about "credit Armageddon." Leucadia's general caution, conservatism, and fear for the future of financial assets is alive and well.

The banking entities posted pre-tax earnings of \$13.9 million for 1998. Management, ably led by Bud Scruggs, maintained credit quality and managed risks, while taking advantage of windows of opportunity.

Manufacturing

Having sold all of our other manufacturing companies, Conwed Plastics is our only remaining manufacturing company. Its sales were up 11% year-over-year and profitability was up 10%. Lower raw material prices have provided an offset for higher depreciation costs resulting from needed plant expansions. Several new products have been introduced and we hope to increase efficiencies as Conwed continues to grow moderately. Congratulations to John Rosenberger and his team.

Winery

Our wineries, Pine Ridge in Napa Valley, California, and Archery Summit in the Willamette Valley of Oregon, performed according to plan. We continue to reinvest all of their cashflow in the improvements and expansion necessary to get to our target of about 115,000 cases of estate-bottled wine per year. At these levels, we believe there is an effective utilization of fixed assets. Last year we sold 62,000 cases of primarily estate-bottled wine. Estate-bottled wine, for you non-wine "geeks," is defined as wine made by the winery from grapes grown on vineyards farmed by the winery.

We are proud that the Pine Ridge 1996 Carneros Merlot was featured on the March 1999 cover of *Wine Enthusiast*, along with several other world-class wines, including Petrus. Call 1-800-486-0503 to arrange a visit to either winery or to locate suppliers in your area. Our wines are exceptional and you will bring glory to your name by encouraging your local restaurant and liquor store to carry both brands!

Gary and Nancy Andrus and their extraordinary staff continue to make, sell and improve the wine. The cellars are almost bare.

Argentina

Until March 18, 1999, the Company owned a 30% interest in Caja de Ahorro y Seguro, S.A. (La Caja), a Buenos Aires based holding company for life insurance, property and casualty insurance, workers' compensation insurance and a small bank. We acquired this interest for \$46 million in 1994 along with our Argentine partner, the Wertheim family, who also purchased a similar interest.

We have sold our interest to the Italian insurance company, Assicurazioni Generali Group, for \$166 million, which includes cash and a \$40 million secured note from our Argentine partner, due April 2001. In 1999, we will report a pre-tax gain of \$120 million on this sale. Our experiences in Argentina were altogether pleasant, except for the commute, which leaves something to be desired. Tom Mara, our executive vice president and 20-year colleague, has been to Argentina more times than either he or his family cares to remember. He did an outstanding job supervising this investment.

Real Estate

At December 31, 1998, the carrying value of the Company's real estate investments totaled \$397 million versus \$93 million at year-end 1997. We have previously reported that we are sellers of real estate. As fast as we sell, other good opportunities have appeared. What follows is a description of the largest of these investments.

Of the \$397 million, \$246 million is represented by our new consolidated 95.4% French subsidiary, Compagnie Fonciere FIDEI (Fidei). The assets of Fidei consist of 150 buildings, and condominium interests in buildings, located primarily in Paris, France, and its environs, which aggregate more than 3,500,000 square feet. We paid \$62.3 million for this equity stake and we have put all of Fidei's real estate holdings up for sale in an orderly manner. So far, most sale prices have been at or greater than were projected. So far so good!

In 1994, we purchased out of bankruptcy two 41-story condominium towers across from the convention center in San Diego, California. All but two of the 201 residential units have been sold or are under contract, and a portion of the commercial space is rented to the splendid restaurant Morton's of Chicago, at which we are two regular patrons. We paid too much for this property, but thanks to the efforts of Paul Borden and many others, the investment has a high single-digit return. All of our bad deals should be so good!

We have distributed to our shareholders of record as of August 25, 1998, a pro rata dividend of beneficial interests in a trust that holds 41.2% of the common stock of HomeFed Corporation and contracts which will increase that ownership to 89.6%. This dividend resulted in 1998 income of \$.1426 for each common share of Leucadia held by you on August 25, 1998, even though there has been no physical distribution of shares. The effective date of a Securities and Exchange Commission registration statement with respect to HomeFed shares is expected to occur later this year. Once that occurs, Leucadia shareholders as of the record date of August 25, 1998 will receive 1.0 share of HomeFed common stock for each 1.26 common shares of Leucadia. By the time you read this, shareholders of record as of August 25, 1998 should have received a Form 1099-DIV for the amount of this dividend. However, as of this writing, it has come to our attention that several financial institutions have not yet sent out these forms. You may want to contact your broker.

HomeFed is a real estate development company based in San Diego County, California. Its main project is San Elijo Hills, a fully entitled 3,400 single-family home development located in San Marcos, California. Grading and infrastructure construction are underway, and hopefully the first 750 homesites will be sold to builders during 1999.

In October of 1998, HomeFed purchased 4,800 acres in the Otay Ranch south and east of San Diego, in Chula Vista, California, for \$19.5 million. Now begins the long, arduous, difficult and frustrating process of getting the land zoned and permitted. In the future, you will hear about HomeFed from the HomeFed management.

Last year, in another bankruptcy transaction, Leucadia purchased 630,000 square feet of empty office space in Washington, D.C., for \$23 million. Renovations are all but complete and the City of Washington, D.C. has leased this space and is currently moving in. The opportunity and land exists to build another 250,000 square foot building on this site. Several offers to purchase the property for a handsome return are being considered. Our vice president, Mark Hornstein, and our old friend and partner in this venture, Chip Akridge, have done a great job.

Renaissance Plaza, which was completed in 1998, is located in downtown Brooklyn, New York. It is a mixed-use project consisting of 809,000 square feet of office space, a very successful 384 room Marriott Hotel, and 1,100 indoor parking spaces. We own 57.5% of the office building and garage and 16% of the hotel. Empire Insurance has moved into its beautiful new quarters along with the other tenant, the City of New York. Leucadia is obligated to invest up to \$25 million in the project and to date has invested \$5 million.

Our community development project in Rosemary Beach, Florida, continues to do well. Sales to date have returned substantially all of our investment and sales in the future will, after costs and expenses, contribute profits. The Home and Garden cable channel recently purchased one of the lots on which they built a house to give away in its March lottery. Kudos to Patrick Bienvenue and his crew.

With our partner and old friend, Denis Sullivan, we have developed and are beginning to sell a 372-lot subdivision surrounding a golf course near San Luis Obispo, California. For the time being, we are keeping and operating the golf course. Again, this project is expected to have a very satisfactory return. This will be the second successful partnership we have done with Denis. We hope there will be more, if we can pry him away from the golf course.

Russia

We first went to Russia in 1994. We purchased \$25 million in common shares of a wide-range of companies by participating in the voucher auctions. We still hold most of these shares. We have sold some, bought others, and our current book value of this portfolio is \$8.5 million. During 1998, the Company recorded a \$75 million pre-tax write down of its Russian and Polish debt and equity securities. Ouch!

We just recently completed our sale of Pepsi International Bottlers back to PepsiCo. In 1999, we will report a \$29.5 million pre-tax gain on the sale. On a cash basis, however, we lost \$40 million in our attempt to become the Pepsi bottler for two-thirds of Russia. When at bat, sometimes you strike out!

Larry Hershfield has moved back to the United States and will continue to monitor Russia from home. Our remaining \$8.5 million portfolio of securities is mainly concentrated in larger Russian companies such as the telephone company, the national electrical utility, and several oil and gas companies. Our theory is that if Russia succeeds, this is a bet with a very large upside. As we write this, there are no immediate signs that cause us to be optimistic. It is, however, a large country with abundant resources and an educated workforce.

Money and Other Things

In a remarkable windfall, the Company was able to repurchase for \$42.2 million, \$51.8 million liquidation amount of 8.65% trust issued preferred securities of Leucadia Capital Trust I (TRUPS) as a result of the demise of an unfortunately over-leveraged hedge fund. The difference between the book value and the amount paid was added directly to shareholders' equity.

Under its \$100 million bank credit facility, the Company borrowed \$62.3 million to finance the acquisition of Fidei. The Company entered into a currency swap to hedge most of this currency exposure.

During 1998, the Company bought 1,996,400 of its common shares for \$58.1 million, and in 1999 bought an additional 1,738,570 shares for \$52.1 million as of March 17, 1999. These share purchases were funded from cash on the balance sheet.

In December of 1998, the Company entered into an agreement to sell its remaining life insurance subsidiaries to Allstate for statutory capital, plus \$3.6 million. The expected pre-tax gain from this transaction is approximately \$20 million, which is expected to close in 1999, after receiving regulatory approval.

In February of 1999, the Company sold the S & H Green Stamps Company back to its founder's family, the Beineckes, who have their own plans for its rebirth. The Company will recognize a \$19 million pre-tax gain on the sale.

We believe the year 2000 problem is under control.

The Future

Last year in these ruminations we described to you some of the frustrations we felt in trying to keep the large amount of shareholders' money to work at above average rates of return in these crazed economic times. We have concluded that for us this is impossible.

Our mail room manager, on the other hand, is a day trader in high tech stocks and has done very well—he thinks we are crazy for working so hard. E-Bay and amazon.com are not our forte (see below). In the process of deciding what to do, not surprisingly, we rediscovered our history. As we have told you many times, what we do is:

We tend to be buyers of companies that are troubled or out of favor and as a result are selling substantially below the values which we believe are there. From time to time, we sell parts of these operations when prices available in the market reach what we believe to be advantageous levels. While we are not perfect in executing this strategy, we are proud of our long-term track record. We are not income statement driven and do not run your company with an undue emphasis on either quarterly or annual earnings. We believe we are conservative in our accounting practices and policies and that our balance sheet is conservatively stated.¹

We have stuck with this strategy single-mindedly, and we hope you would agree, successfully. Most importantly, we have enjoyed it, prospered doing it, and don't want to quit. We have, however, too much money to effectively invest for you and for us!

Therefore, as we write this letter, we expect to return to the shareholders a dividend of \$812 million, or \$13.48 per share, and, for the foreseeable future, we will continue to manage Leucadia. The Company has received a ruling from the I.R.S. providing that any gain realized on such a dividend will be treated as a capital gain. After the dividend and certain 1999 first quarter asset sales, the Company will have a \$1.13 billion net worth and \$900 million in cash, marketable securities and collateralized notes. Under some of our bond covenants, this distribution will require the Company to tender at 101% for its 8¼% and 7¾% Senior Subordinated Debt with an aggregate principal amount of \$235 million. This may leave the Company with less cash, depending on the number of bonds tendered. With all of the activity that has occurred so far in 1999, which we have reported herein, this year has the potential to be a good one. Whether it will continue, we knoweth not! If opportunities do not present themselves, we intend to consider other alternatives to benefit shareholders.

¹ Originally reported in the 1988, and repeated in 1990, 1991, 1995 and 1996 annual reports.

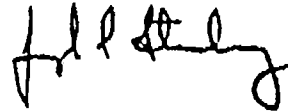
As we head off for our second 20 years together, one of us is excited and energized by the opportunities at hand, the other is hunkered down for fear a tsunami resulting from the next Kondratief Long Cycle² will wash us all into poverty. Hopefully, somewhere in between lies the truth. We have enjoyed this journey and each other and plan to continue until one of us doesn't enjoy one or the other!

This year, Andrea Bernstein deserves special thanks. She has labored long and hard as an associate at Weil, Gotshal & Millionaire working on our legal affairs. She is a newly minted partner and it is richly deserved. Almost twenty years ago on April 29, 1979, we purchased our interest in Leucadia (then Talcott National Corporation), with Andrea's mentor, Steve Jacobs, at our side then, as he is now. They are an extraordinary team!

For the first time, in the last year we hired a number of new people who didn't come with acquired businesses. We welcome them and commend to them our long-serving colleagues for advice and comfort. Many at Leucadia work long hours and sacrifice much. To our senior colleagues, we thank you. Without you and our advisors, none of this is possible.



Ian M. Cumming
Chairman



Joseph S. Steinberg
President

² Russian economist Nikolai Kondratief pioneered the concept of long wave cycles in 1926.

Financial Highlights

	1999	1998	1997
Revenues	\$ 706,632,000	\$ 530,506,000	\$ 630,737,000
Net securities gains (losses)	\$ 10,885,000	\$ (60,871,000)	\$ 3,249,000
Income (loss) from continuing operations before income taxes, minority expense of trust preferred securities and extraordinary loss	\$ 243,471,000	\$ 29,377,000	\$ (24,238,000)
Income tax provision (benefit)	\$ 44,521,000	\$ (25,073,000)	\$ (9,891,000)
Minority expense of trust preferred securities, net of taxes	\$ (5,521,000)	\$ (8,248,000)	\$ (7,942,000)
Income (loss) from continuing operations before extraordinary loss	\$ 193,429,000	\$ 46,202,000	\$ (22,289,000)
Income from discontinued operations, net of taxes	\$ 8,619,000	\$ 8,141,000	\$ 58,516,000
Gain on disposal of discontinued operations, net of taxes	\$ 15,582,000	\$ —	\$ 627,645,000
Income before extraordinary loss	\$ 217,630,000	\$ 54,343,000	\$ 663,872,000
Extraordinary loss from early extinguishment of debt, net of taxes	\$ (2,588,000)	\$ —	\$ (2,057,000)
Net income	\$ 215,042,000	\$ 54,343,000	\$ 661,815,000
Earnings (loss) per common share:			
Basic:			
Income (loss) from continuing operations before extraordinary loss	\$ 3.26	\$.73	\$ (.36)
Income from discontinued operations	\$.14	\$.13	\$.94
Gain on disposal of discontinued operations	\$.26	\$ —	\$ 10.09
Extraordinary loss	\$ (.04)	\$ —	\$ (.03)
Net income	\$ 3.62	\$.86	\$ 10.64
Diluted:			
Income (loss) from continuing operations before extraordinary loss	\$ 3.26	\$.73	\$ (.36)
Income from discontinued operations	\$.14	\$.13	\$.94
Gain on disposal of discontinued operations	\$.26	\$ —	\$ 10.09
Extraordinary loss	\$ (.04)	\$ —	\$ (.03)
Net income	\$ 3.62	\$.86	\$ 10.64
Total assets	\$ 3,070,227,000	\$ 3,958,951,000	\$ 3,745,336,000
Cash and investments	\$ 1,466,551,000	\$ 2,229,895,000	\$ 2,453,555,000
Common shareholders' equity	\$ 1,121,988,000	\$ 1,853,159,000	\$ 1,863,531,000
Book value per common share	\$ 19.75	\$ 29.90	\$ 29.17
Cash dividends per common share	\$ 13.58	\$ —	\$.25

Letter from the Chairman and President

To Our Shareholders

In 1999, the Company earned \$215 million after tax, or \$3.62 per share, which is a 19.2% return on ending equity of \$1.1 billion. In May and December, the Company distributed to shareholders an aggregate capital gains distribution of \$13.58 per share totaling \$811.9 million, 43.8% of our December 31, 1998 net worth.

As major shareholders, we are happy to have some of our personal money off the table and invested in mostly munis, which by today's standards are mundane and somnolent. Does anyone else remember municipal bonds? On a risk adjusted basis, munis feel good to us. Shareholders now have the proceeds from the two dividends to pursue otherthings.com!

Presented with the opportunity to return money to our shareholders in a tax-advantaged way, blessed by the I.R.S., we could not imagine a better thing to do. These aging dogs didn't believe they could keep \$2 billion in equity effectively invested, let alone employ the additional funds available to Leucadia in the capital markets. With our net worth of \$1.1 billion and substantial liquidity, we remain hard at work foraging in the financial ecology for the sweet smell of undervalued assets! More about this later.

For the past several annual meetings, shareholders have asked why we missed the bull market in the S&P 500, and the roiling and boiling internet and biotech markets on the NASDAQ. Our answer has been that is not what we do. For new shareholders, here is what we do:

We tend to be buyers of assets and companies that are troubled or out of favor and as a result are selling substantially below the values which we believe are there. From time to time, we sell parts of these operations when prices available in the market reach what we believe to be advantageous levels. While we are not perfect in executing this strategy, we are proud of our long-term track record. We are not income statement driven and do not run your company with an undue emphasis on either quarterly or annual earnings. We believe we are conservative in our accounting practices and policies and that our balance sheet is conservatively stated.¹

To mutilate a hackneyed phrase, we are old dogs and we can't learn new tricks—we believe the ones we learned over the last 30 years continue to work just fine.

A few words now about the Company's operations and then some thoughts about the future.

Empire Insurance Company

Between 1991 and 1995 Empire's annual earned premiums increased from \$210.7 million to \$326.1 million. This undue growth brought to light significant deficiencies in personnel, systems, underwriting, claims and reserves. In 1995, we added \$34.5 million to reserves and began the slow, arduous and often disheartening process of examining the deficiencies and correcting them. That process continues today and is far from complete.

From 1995 to 1999 earned premiums decreased from \$326.1 million per annum to \$145.2 million per annum, almost a round trip. During this period, as we were tightening underwriting and increasing prices, the market was lowering prices as competition became fiercer. This is an industry with too much capital chasing too little business. A catastrophe or two would be good for the industry, although not for society.

¹ Originally reported in the 1988, and repeated in the 1990, 1991, 1995, 1996 and 1998 annual reports.

When we began restructuring Empire, we did not foresee such a precipitous drop in volume; which ballooned overhead out of proportion to revenues. This will take time to fix. Most importantly, the Internet is hanging like the sword of Damocles over all property and casualty companies as Internet-based "virtual" companies edge closer to reality. We hope the Internet will make our agents more effective, but time will tell whether agent-based companies will provide enough value to customers. We are working hard to merit their business.

If this sounds depressing, it sometimes feels that way. We are, however, making some progress and fortunately have sufficient capital to see the problem through to the end. Since 1995, we have added \$149.8 million to reserves and reported \$3.8 million in GAAP pre-tax losses.

This has been a difficult and thankless task for Bob Toppi and his crew. They have done, and continue to do, yeoman service fixing a problem not of their making.

Banking and Lending

The Company's banking and lending operations are principally conducted through American Investment Bank, N.A. (AIB), a national bank subsidiary, and American Investment Financial (AIF), an industrial loan corporation. AIB and AIF are insured by the FDIC. AIB's largest market segment is sub-prime auto loans, making loans to individuals to buy a car who are not the best credit risks. For taking this risk, AIB charges a higher rate of interest. AIF is a small lender to sub-prime boat and recreational vehicle buyers and also makes Small Business Administration guaranteed loans.

Up until 1995, the sub-prime auto business had been very profitable for AIB. In 1995, money poured into this challenging market and some competitors cut interest rates to unacceptable levels. AIB believed the better part of valor was not to reduce rates, but to retire from the field in good order. As a result, volume fell and AIB went into a prolonged hibernation while working on collections, underwriting and improving the electronic platforms from which the business is controlled.

By 1998, rationality began to return to the sub-prime automobile market. Several players who thought they could defy financial gravity ended up in bankruptcy. The acquisition in late 1998 of a \$36.9 million portfolio of sub-prime auto loans, purchased at a discount, jumpstarted AIB's return to the market.

In 1999, AIB acquired Tranex Credit Corp., a sub-prime auto lender based in Indianapolis, along with its \$67.9 million portfolio. Another subsidiary of Leucadia purchased from Tranex \$44.2 million of residual interests and excess servicing assets of related securitized trusts and \$12 million of other assets. Gary Levine, the Chairman/President of Tranex, has joined the bank as an Executive Vice President to manage AIB's auto program. As a result of all of this, banking and lending operations had loans outstanding of \$339.8 million at December 31, 1999 versus \$185.2 million at the end of the previous year.

AIB is actively back in the sub-prime business and generating nearly \$300 million in loans per annum from 29 states with an anticipated average life of 22 months. While these loans are not as profitable as in the pre-1995 era, the risk/reward relationship makes sense. Operating results for 1999 decreased due to provisions for loan losses on the growing portfolio of loans and because there were no earnings from the executive and professional loan portfolio which was sold in 1998 resulting in a non-recurring gain of \$6.5 million. We will continue to keep in mind the lessons of the past, and should events warrant, AIB will go back into its cave.

H.E. "Bud" Scruggs and Randy Jenson, who joined Leucadia in 1997 after graduating from Harvard Business School, have orchestrated this resurrection. Recently, in recognition of his accomplishments, Randy was promoted to President of AIB, Bud Scruggs remains as Chairman. Congratulations are due to both of them and their staffs who have assisted them through a difficult period.

Manufacturing

Conwed Plastics manufactures and markets proprietary plastic netting for a variety of industrial uses including construction, agriculture, packaging, carpet padding and filtration. Conwed has plants in Minneapolis, Minnesota and in Athens, Georgia. Results are below:

(In millions)	1997	1998	1999
Sales	\$50.9	\$56.6	\$64.0
Pre-tax profits	8.9	10.1	11.9
Return on net invested assets	32.5%	29.5%	31.9%
Return on average equity	37.8%	39.7%	42.2%

Business has been great under the bright skies of a long expanding business cycle—rising tides lift all boats.

Although this is a mundane old-economy business, it provides a very high return on net invested assets (total assets minus current liabilities) and has some internal growth potential.

Our worries are everybody's: when the new economy stumbles for whatever reason, will it bring down the old economy as well? An added worry, Conwed's raw material is polypropylene and polypropylene prices are rising as they must unavoidably do when petroleum prices rise. Not good.

John Rosenberger and his crew have done a remarkable job of increasing productivity in both plants and have given us a banner year. Had they not applied their innovative minds to the problems, we would have had capacity constraints before now. Kudos to all for working smart!

Winery

The Company has a 90% interest in two wineries: Pine Ridge Winery in Napa Valley, California, which was acquired in 1991, and Archery Summit located in the Willamette Valley, Oregon, which the Company started from scratch in 1993. These wineries primarily sell super-ultra-premium wines (wines that sell at retail from \$25 to \$125 per bottle).

During 1999, the wineries sold 76,300 9-liter equivalent cases versus 62,000 cases in 1998. As a result of our investments over the past few years in land and facilities, we are closer to our target of producing approximately 100,000 cases per year. At this level, we will balance our sales, grape production and winery capacity to produce all estate bottled wine. (Estate bottled wines are made from grapes farmed on vineyards owned by the winery.) At December 31, 1999, our combined investment in these wineries was \$51.9 million. We believe our purchases of land to implement this plan were made at attractive prices.

Our partners, Gary and Nancy Andrus are extraordinary. They have the knowledge and enthusiasm to make and sell great wine. Call (800) 486-0503, if you would like to visit the wineries or to find out where you can buy Pine Ridge or Archery Summit near where you live. Depending upon your state's liquor laws, wine may be ordered through the mail at (800) 575-9777 or through the Internet store at www.pineridgewinery.com or www.archerysummit.com. Remember, in moderate quantities, wine is a medicinal food!

MK Gold

We have increased our stake in MK Gold to 72.5% through the purchase of additional shares for \$15.8 million. During 1999, these funds, plus a \$20 million loan from Leucadia and \$6.2 million of their own money, were used to acquire Cobre Las Cruces S.A., a Spanish company that holds the mineral rights to the Las Cruces copper deposit in the pyrite belt of Spain. Two hundred seventy-nine drill holes totaling 272,000 feet have indicated the existence of a 15.2 million metric ton resource containing approximately 6.1% copper overlain by 150 meters of unconsolidated overburden. Actual mining will be subject to significant financing, permitting, engineering and construction. An unaffiliated company has a one-year option to purchase 35% of Cobre Las Cruces at MK Gold's cost plus interest. Assets at historically low prices are investments we like best.

MK Gold has a 25% equity interest in, and the mining contract for, a small California gold mine. MK Gold is actively looking for further opportunities to do contract mining and make equity investments in the mining sector.

Frank Joklik and his team of very experienced mining executives ably lead MK Gold.

Fidei

Fidei is a 100% owned French subsidiary, which was found and acquired for Leucadia by our esteemed colleagues Zalman Jacobs and Luis Medeiros. Its head office is in Paris.

When we acquired it, the Company had over 150 investments in real estate, mostly in Paris and its environs. Since acquisition, Fidei has had all of its real estate holdings for sale, and during 1999 sold 62 properties for a pre-tax gain of \$37.9 million. At December 31, 1999, there were 88 properties remaining available for sale, representing 2,100,000 square feet, with a book value of \$87.6 million. Our net investment in Fidei at December 31, 1999, was \$38.1 million, after reporting profits of \$33 million and receiving a return of capital of \$41.4 million. Fidei has cash of \$125.6 million and long-term debt of \$214.6 million as of the end of 1999. We are currently looking at further opportunities in Europe for Fidei. This was and is a good investment.

Real Estate

At December 31, 1999, we had domestic real estate investments totaling \$196.5 million versus \$151.5 million at December 31, 1998.

Renaissance Plaza, completed in 1998, is located in downtown Brooklyn, New York. It is 809,000 square feet of office space, a 376 room Marriott Hotel and 1,100 indoor parking spaces. After all our investment is returned, together with a 12.5% per annum preferred return, we own 57.5% of the office building and parking spaces and 16% of the hotel. The hotel is enjoying a 92% occupancy rate and the office space is 100% leased. Consideration is being given by the partners to add approximately 280 additional hotel rooms.

The Rosemary Beach, Florida community development continues to do well. The project is cash positive with more to sell. We have a property management company to rent the homes when the owners wish. This horizontal hotel will eventually have approximately 2,000 beds. Rosemary Beach is a gorgeous community on a beautiful white beach on the Florida panhandle. Contact Patrick Bienvenue at (801) 521-5400, who has ably guided this project from the beginning, if you would like a brochure.

Union Square in Washington, D.C., not far from the U.S. Capitol Building, is 630,000 square feet of office buildings we purchased out of bankruptcy and completely renovated. It is leased to the District of Columbia. We have \$76.5 million invested with a net operating income of \$11.4 million. Mark Hornstein and our partner Chip Akridge did a great job of untangling, renovating and leasing this project.

At Cypress Ridge, near San Luis Obispo, California, our partner Denis Sullivan is struggling to get final approval for the sale of 378 completed lots. One hundred of these lots are under contract for sale. The golf course is approaching its second year and is wonderful. If you would like to play Cypress Ridge, call the Pro Shop at (805) 474-7979. If you want to retire to a beautiful central California climate, call Denis at (805) 489-2781.

One Harbor Drive in San Diego, California, is complete. The last commercial unit is in escrow. In 1994, we paid too much, \$42 million, to buy the project out of bankruptcy. We have realized an 11% return—all of our bad deals should go so well!

A reminder to our shareholders of record on August 25, 1998, you should have received your shares of HomeFed Corporation, which were distributed as a special dividend in October 1999. If you did not receive those shares, please contact Laura Ulbrandt at (212) 460-1900.

HomeFed is a real estate company in Carlsbad, California, which manages San Elijo Hills, a fully entitled master-planned community of 3,400 homes and apartments located in San Marcos, California, which owes Leucadia \$71.4 million including its preferred return. HomeFed also purchased (in partnership with Leucadia) 4,800 acres in the Otay Ranch master-planned community southeast of San Diego for \$19.5 million. Leucadia provided financing for this project and is owed \$11.2 million including its preferred return. If you haven't sold your shares in HomeFed, you will hear more about these projects from them. Contact Paul Borden, President of HomeFed, at (760) 918-8200, if you would like more information about this project.

Money and Other Things

Investment and other income in 1999 included the gains on the sale of La Caja of \$120.8 million (our formerly 30% owned Argentina insurance company), The Sperry and Hutchinson Company, Inc., \$18.7 million, and Pepsi International Bottlers, \$29.5 million; Fidei rental income and gains on sales of properties, \$60.4 million; corporate investment income, \$77.9 million; and the gain on sale of an equity interest in an associated company, \$8.7 million.

The increase in selling, general and other expense is related to Fidei's expenses, higher provisions for loan losses at AIB on the growing portfolio of loans and the inevitable legal and other expenses from developing the plan to pay the \$811.9 million dividend.

Income taxes for 1999 reflect a benefit of \$40.1 million from the use of capital loss carryforwards.

Payment of the \$811.9 million dividend to the shareholders required the Company to make an offer to repurchase all of its Senior Subordinated Notes, with an aggregate principal outstanding of \$235 million, plus accrued interest. We purchased \$194.2 million of these bonds.

In previous years we wrote down our ill-fated investments in Russian and Polish securities to \$10 million, the current book value. At December 31, 1999, these investments had a value of \$36.4 million—subject to change without notice! For the time being, we are leaving this long-term bet on the table, primarily in basic industries of those two countries.

During 1999, we repurchased 5,182,958 Leucadia shares for \$125.5 million (8.4% of the shares outstanding). From January 1, 2000 to March 13, 2000, we repurchased 1,505,000 shares for \$32.1 million (2.6% of the shares outstanding). We invest in Leucadia stock when shareholders want to sell and we think the price is attractive. After all, of all possible investments, we know Leucadia best.

In the first quarter of 2000, Leucadia will record a \$24.6 million gain from the sale of certain securities of Jordan Telecommunication Products, Inc., and may receive \$7.5 million more, subject to resolution of certain contingencies. A long, pleasurable and profitable relationship with Jay Jordan and David Zalaznick continues unabated. They are very gifted investors.

Earlier this year we made an arrangement with our old friends and advisors at Jefferies & Company to share with them some of their adventures in the junk bond markets. (High yield bonds to those with delicate ears.) The junk bond market is in disarray and presents opportunities.

We invested in shares of Fidelity National Financial, Inc. (FNF) and Chicago Title Corporation during and after the pendency of their merger, which created a position in the combined company, FNF, of 9.9% of the shares. We view this position as an interesting investment.

The Future

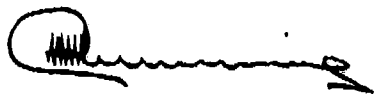
1999 was a good year. In fact, it was the second best since we began this journey in 1979. The distribution to the shareholders was the right thing to do; we are properly sized for our appetites. However, as long as the madness in the public markets persists, it will be difficult to invest. Some companies are trading at market capitalizations that suggest they will become more valuable than the GDP of most Western economies. We say this realizing the enormous wealth that has been created for others and the opportunities we may have missed, but we are sticking to our knitting. Several people have pointed out that the market is bifurcated—new economy stocks are high, everything else is low. What worries us is that when the bubble bursts, every boat, large or small, will sink regardless of its intrinsic value. These are perilous times. Taking into account the distribution of \$811.9 million to our shareholders and the repurchase of Leucadia stock, since 1979 we have compounded Leucadia's equity at 21.5%. This used to be a respectable record!

Over the past several years we have added several freshly-minted MBAs. They are leavening the loaf and looking at things with new eyes while adding to the corporate vigor, soaking up our eccentric culture and, most importantly, collecting frequent flyer miles on young bottoms! One, Randy Jensen, graduated into an important operating position at American Investment Bank.

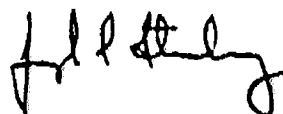
We found Thomas Mara, our Executive Vice President, at Talcott National (Leucadia's predecessor) when we arrived in 1978. He has been a constant force for order in our ever-changing environment. We appreciate him greatly and thank his family for their forbearance during his 74 round trips to Buenos Aires over the last five years, let alone trips to Israel, Japan, Croatia and many other exotic and not so exotic destinations. Without him, these past 21 years would not have been possible.

As usual, we are ably assisted by our staff and advisors also without whom none of this would have been possible!

One of us had a dream.



Ian M. Cumming
Chairman



Joseph S. Steinberg
President

Financial Highlights

	2000	1999	1998
Revenues	\$ 715,487,000	\$ 706,632,000	\$ 530,506,000
Net securities gains (losses)	\$ 123,225,000	\$ 10,885,000	\$ (60,871,000)
Income from continuing operations before income taxes, minority expense of trust preferred securities and extraordinary gain (loss)	\$ 193,302,000	\$ 243,471,000	\$ 29,377,000
Income tax provision (benefit)	\$ 72,756,000	\$ 44,521,000	\$ (25,073,000)
Minority expense of trust preferred securities, net of taxes	\$ (5,521,000)	\$ (5,521,000)	\$ (8,248,000)
Income from continuing operations before extraordinary gain (loss)	\$ 115,025,000	\$ 193,429,000	\$ 46,202,000
Income from discontinued operations, net of taxes	\$ -	\$ 8,619,000	\$ 8,141,000
Gain on disposal of discontinued operations, net of taxes	\$ -	\$ 15,582,000	\$ -
Income before extraordinary gain (loss)	\$ 115,025,000	\$ 217,630,000	\$ 54,343,000
Extraordinary gain (loss) from early extinguishment of debt, net of taxes	\$ 983,000	\$ (2,588,000)	\$ -
Net income	\$ 116,008,000	\$ 215,042,000	\$ 54,343,000
Earnings (loss) per common share:			
Basic:			
Income from continuing operations before extraordinary gain (loss)	\$ 2.07	\$ 3.26	\$.73
Income from discontinued operations	\$ -	\$.14	\$.13
Gain on disposal of discontinued operations	\$ -	\$.26	\$ -
Extraordinary gain (loss)	\$.02	\$ (.04)	\$ -
Net income	\$ 2.09	\$ 3.62	\$.86
Diluted:			
Income from continuing operations before extraordinary gain (loss)	\$ 2.07	\$ 3.26	\$.73
Income from discontinued operations	\$ -	\$.14	\$.13
Gain on disposal of discontinued operations	\$ -	\$.26	\$ -
Extraordinary gain (loss)	\$.02	\$ (.04)	\$ -
Net income	\$ 2.09	\$ 3.62	\$.86
Total assets	\$ 3,143,637,000	\$ 3,070,227,000	\$ 3,958,951,000
Cash and investments	\$ 1,612,576,000	\$ 1,466,551,000	\$ 2,229,895,000
Common shareholders' equity	\$ 1,204,241,000	\$ 1,121,988,000	\$ 1,853,159,000
Book value per common share	\$ 21.78	\$ 19.75	\$ 29.90
Cash dividends per common share	\$.25	\$ 13.58	\$ -

Letter from the Chairman and President

To Our Shareholders

In 2000, Leucadia earned \$116 million after tax, or \$2.09 per diluted common share, which is a 10% return on average equity or a 9.6% return on ending equity of \$1.2 billion.

The following chart reflects the results of this management's efforts beginning 22-plus years ago. We clutched Talcott National Corporation and its subsidiaries (founded in 1854) from the brink of bankruptcy and transformed it into Leucadia National Corporation. The pro forma compound annual growth rate ("CAGR") line at the bottom adds back, for comparison purposes, the effect of the \$811.9 million capital gain dividends distributed in 1999.

(Dollars in thousands, except per share amounts)

	Book Value Per Share	Book Value % Change	Market Price Per Share	Market Price % Change	Equity	Net Income (Loss)	Return on Average Equity
Historical:							
1978	\$ (0.11)	NA	\$ 0.05	NA	\$ (7,657)	\$ (2,225)	NA
1979	0.32	NM	0.21	320.0%	22,945	19,058	249.3%
1980	0.34	6.3%	0.16	(23.8%)	24,917	1,879	7.9%
1981	0.42	23.5%	0.32	100.0%	23,997	7,519	30.7%
1982	1.07	154.8%	0.56	75.0%	61,178	36,866	86.6%
1983	1.28	19.6%	0.82	46.4%	73,498	18,009	26.7%
1984	2.22	73.4%	1.39	69.5%	126,097	60,891	61.0%
1985	2.49	12.2%	1.69	21.6%	151,033	23,503	17.0%
1986	3.79	52.2%	2.47	46.2%	214,587	78,151	42.7%
1987	3.34	(11.9%)	1.42	(42.5%)	180,408	(18,144)	(9.2%)
1988	3.84	15.0%	2.09	47.2%	206,912	21,333	11.0%
1989	4.92	28.1%	3.11	48.8%	257,735	64,311	27.7%
1990	5.91	20.1%	3.31	6.4%	268,567	47,340	18.0%
1991	7.95	34.5%	5.36	61.9%	365,495	94,830	29.9%
1992	11.06	39.1%	11.48	114.2%	618,161	130,607	26.6%
1993	16.27	47.1%	11.92	3.8%	907,856	245,454	32.2%
1994	15.72	(3.4%)	12.94	8.6%	881,815	70,836	7.9%
1995	18.47	17.5%	14.53	12.3%	1,111,491	107,503	10.8%
1996	18.51	0.2%	15.55	7.0%	1,118,107	48,677	4.4%
1997	29.17	57.6%	20.06	29.0%	1,863,531	661,815	44.4%
1998	29.90	2.5%	18.31	(8.7%)	1,853,159	54,343	2.9%
1999	19.75 ^(b)	(33.9%)	23.13	26.3%	1,121,988 ^(b)	215,042	14.5%
2000	21.78	10.3%	35.44	53.2%	1,204,241	116,008	10.0%
Pro forma 2000	37.32 ^(c)				2,063,812 ^(c)		
CAGR (1978–2000)			34.8%				
CAGR (1979–2000) ^(a)	22.3%				20.8%		
Pro forma CAGR (1979–2000) ^{(a)(c)}	25.4%				23.9%		

(a) A negative number cannot be compounded; therefore, we have used 1979.

(b) Reflects a reduction resulting from dividend payments in 1999 totaling \$811.9 million or \$13.58 per share.

(c) Pro forma to add back dividend payments in 1999 totaling \$811.9 million plus estimated after tax interest on dividend of \$.86 per share.

The preceding chart raises the question, why have Leucadia's returns gone down over the last several years? First, it is more difficult to compound large amounts of money at high rates than smaller amounts. Back in the early years, Leucadia's net worth was so miniscule that almost any successful investment would produce a very high return. Second, as we mentioned in previous letters, Leucadia has been almost in hibernation for the last few years, not seeing the kind of opportunities where the upside potential and the downside risk made sense. And lastly, we have probably gotten more risk adverse over the years. Back in 1979, there wasn't much to risk.

2000 was a tumultuous year for the United States financial markets. The "irrational exuberance" pronounced several years ago by Federal Reserve Chairman Greenspan has turned into a virus causing much pain in 2000. Between first uttering these words and the continued implacable rise in equity valuations, even Dr. Greenspan became a reluctant believer in the new economy.

Pontification is not our normal line of work. We must, however, express a certain satisfaction from having steadfastly argued over the last many years that we were witness to an old-fashioned financial frenzy that would not and could not continue. Economics has its own gravitation-like forces that work over time and can only be ignored at the investors' peril.

So that our shareholders might know how we think about such things, here is what we think happened and what is likely to happen in the future.

In the early 1980s, the U.S. economy found itself increasingly uncompetitive and inefficient. The Japanese miracle was much heralded in the financial press. The U.S. auto industry blamed Japan for all of its troubles—imagine, better quality cars at a lower price! Eventually American industry woke up. Rather than cursing the darkness, the mantra became: productivity! Not unexpectedly, in this boisterous, robust, self-renewing country of ours, when the national ethos is infused with a common goal, great things can happen. Productivity replaced Japan-bashing as corporate America's preoccupation. No more sucking our thumbs in the corner blaming the Japanese miracle for all of our economic troubles.¹

At about the same time, a huge new innovation was coming of age. It was, and is, of revolutionary proportions. It began with the discovery of the transistor and continues today as the Digital Age. At the same time, as industry and commerce were looking for ways to be more efficient, Tim Berners-Lee² was thinking away at CERN, the European Particle Physics Laboratory, in Geneva, Switzerland. At the time, there was an Internet; it was a physical thing, a bunch of fiber optic cables connecting a bunch of computers at universities and research labs around the world. These computers had no way of looking for information on any of the other computers and, even if they did, had no standard way to send the information in a form that could be interpreted. Tim Berners-Lee had a vision—the WWW (World Wide Web) and the first search engine, "Enquire Within Upon Everything" was born. Now computers could communicate; we had the Internet and all that has flowed to this date.

¹ Incidentally, the Japanese have their own problems. Their stock market peaked in 1989 and has stubbornly remained moribund since then. Japan's banks, even after writeoffs in the many billions, are loaded with nonperforming or underperforming loans. Real estate prices are estimated to be down 90% from their peak and bankruptcies are at an all time high. The long delayed and ever expected restructuring of Japan, Inc., has still not taken place. Based on the Japanese experience, our reading of U.S. history post the 1929 crash and our own biases, we believe that our homegrown irrational exuberance virus will work slowly and that a quick and painless recovery is unlikely.

² For further information on Tim Berners-Lee, read *Weaving the Web* by Tim Berners-Lee with Mark Fischetti, published by Harper San Francisco.

Information is like inventory—the more turns you get, the more productive you are. With this new Internet tool, the whole world sped up and time and space shrunk. So, at the same time the American economy was focused on becoming more efficient, along came this world-shrinking, timesaving communication device. The digital economy races ahead at lightning speed. New concepts, products, ideas, software, hardware, glass transmission, and telecommunication advances are born and continue to evolve to this day. The whole of the American economy was being reshaped and retooled at the speed of Internet communication. The confluence of these two events: efficiency-driven American industry and the advent of the Digital Age, gave new meaning to synergy. The exuberant markets reacted to the new age with unlimited enthusiasm and for ten-plus years we had a boom.

Although this analysis is incomplete, our belief is that these two phenomena were major drivers of the boom. Booms lead to busts, and we got one of those as well. In 2000, the air started to come out of the over-inflated equity markets, particularly in the NASDAQ, home of the Digital Age.

Currently, the price earnings ratio ("P.E.") for the Dow Jones Industrial Average is 20, for the NASDAQ it is 167 and for the S&P 500 it is 24. Historically, the mean P.E. for the DOW is 17 (from 1930 to the present date); the NASDAQ is 53 (from December 1985 to present), and the S&P 500 is 15 (from 1935 to present). Over time there will be a recovery, but when speculation becomes a frenzy and markets are pushed far beyond their historical mean, the correction can be very sudden and cause much financial pain. Making the collapse even more painful, after a speculative period stocks often fall considerably below their historical mean. Exacerbating the pain, they usually stay below the mean for an extended period of time. And for the highfliers, we doubt that many of those will be around to enjoy the recovery when it does come. We hold these truths to be self-evident, that all speculative bubbles end up the same way—with a bust. This is financial gravity—to be ignored at our peril.

Leucadia's management wakes up every morning with several hundred million dollars invested in risk free treasury bills. Think of us as groundhogs with a daily habit. We pop out of our holes each and every morning and look around the marketplace for investment opportunities. The first question we ask is: "Do we see anything that can earn more than the risk free rate, adjusted for risk?" When the markets are as high as they have been in the last many years, we saw very little of interest and went back down our holes. In fact, we successfully offered most of our assets for sale to others at what we felt were irrationally exuberant prices. After distributing \$811.9 million to shareholders, Leucadia is left with plenty of liquidity, the same old overhead and small recurring earnings. Our job for the next few years is to buy recurring earnings and prepare those assets for the next frenzy. Patience is required for this process, but it is not complicated!

Adventures in the Insurance Game and Empire

Over time Leucadia has owned a number of insurance companies. In 1980, Leucadia bought American Investment Company, which was a small loan company on the NYSE, headquartered in St. Louis, Missouri. Charter National Life, a credit life company, was resident therein. In the late 1980s, Charter got into the tax-advantaged single premium whole life business. Several years later, while we were being hypnotized by the theoretical potential of single premium whole life and the testosterone-driven forecasts of Charter's marketing department, we received an offer of \$150 million. We tried to get more and drove off the buyer. Five or six years later we managed to get almost as much money as we had been offered years before. A lucky save, but an expensive lesson in our own irrational exuberance.

In 1986, Leucadia purchased the residue of Baldwin-United Corporation from the Bankruptcy Court. Empire Insurance Company was one of the many assets resident therein. When Leucadia gained control of Empire in the first quarter of 1988, Empire had a statutory net worth of \$63.2 million. That statutory net worth peaked at \$180.2 million on December 31, 1997. At the end of 2000, statutory net worth at Empire had fallen to \$76.9 million, and first quarter developments indicate it is continuing to shrink in 2001. What happened?

Empire Insurance Company started out life as a "subway" mutual company, so described because nearly all the customers could be reached by subway in the boroughs of New York. By year end 1995, net earned premiums had grown to \$326.1 million from \$140.2 million in 1986. We now realize that this increase overwhelmed the back office, the information systems and the management, while at the same time price competition became fierce in the New York area. What resulted was a death spiral that Empire could not get ahead of. Raising prices, competition and poor customer service lowered volume, lower volume reduced contribution margin, which overwhelmed Empire's ability to cut costs in a timely manner, cutting costs disrupted day-to-day operations and the spiral continued inexorably downward. This has been our worst setback in 22 years. While it cost no cash, it was a desperate loss of opportunity, hopefully not to be repeated.³

In the summer of 1991, Leucadia bought the Colonial Penn Life and Colonial Penn Casualty companies for approximately \$128 million. These companies had been for sale a long time and the selling price had come down to an attractive level. The problem was a portfolio of casualty insurance risks in niche markets that appeared very scary. The seller strengthened reserves several times. After exhaustive due diligence, we determined that it was most likely properly reserved and made the purchase. We worked very hard over the next six years to make these companies more profitable. During those six years, Leucadia received approximately \$300 million in management fees, interest, dividends and tax sharing payments, and in 1997, sold both companies for \$1.5 billion. Now that is the way it is supposed to work!

Our last adventure in the insurance game was the 1994 purchase for \$46 million of a 30% interest in Caja de Ahorro y Seguro S.A. (La Caja), a Buenos Aires based insurance holding company, in a privatization sale by the Argentine government. Many trips later from New York and Salt Lake City to Buenos Aires, entailing a complete restructuring of La Caja, resulted in the sale of our interest for \$166 million in 1999.

Colonial Penn was a grand slam, La Caja a home run, Charter a base hit, and Empire a strike out. You might wonder why we spend so much time regurgitating history. It is out of fear that we will repeat it. It is cathartic and educational to have to explain mistakes!

Banking and Lending

Leucadia's banking and lending operations are principally conducted through American Investment Bank, N.A. (AIB), a national banking subsidiary, and American Investment Financial (AIF), an industrial loan corporation. AIB and AIF deposits are insured by the FDIC. Together AIB and AIF have deposits of \$526.2 million at December 31, 2000. Consolidated loans of the two entities at December 31, 2000, were \$515.8 million. AIB's largest market segment is sub-prime auto loans, making loans to individuals who have difficulty obtaining credit with the principal secured by used and moderately priced automobiles. For taking this risk, AIB charges higher rates of interest.

AIF is a small lender to non-prime boat and recreational vehicle buyers and also makes loans guaranteed by the Small Business Administration.

³ You can read all of the gory details in the 10-K.

The operations of Tranex Credit Corp., also a sub-prime lender, acquired by AIB in September 1999, have now been integrated. It has been a difficult transition. Our forecasts were too ambitious, we executed too slowly and we have been adversely affected by a slowing economy. The \$67.9 million portfolio purchased as part of the transaction has performed below our expectations. This experience has provided a valuable reminder that conservative assumptions are often not conservative enough.

Beginning in the second half of 2000, we noticed an increase in losses and delinquency in the auto portfolio. This increase, we think, can be partially explained by the deteriorating economic conditions in the United States. Customers who are at the bottom of the economic ladder have little protection in the face of a slowing economy and their behavior represents a leading indicator of things to come. In response, we will reduce loan originations significantly by tightening underwriting standards and eliminating marginal auto dealer relationships and territories. We anticipate that AIB's assets will be flat in 2001, after growing 55% to \$544 million in 2000. We have been working hard to reduce overhead expenses to accommodate a smaller operation. We believe the economic slowdown will create opportunities for AIB to do business with more credit-worthy customers at more sensible prices. Some of AIB's competitors who are addicted to growth and have chosen to price sub-prime credit risks unrealistically will have a difficult time surviving. We have confidence that we can profitably weather the storm, but we remain mindful of the lessons of the past, and should events warrant, we will hasten our retreat. AIB's after tax return on assets for the year 2000 was 0.15% and the return on average equity was 1.0%. AIF's return on assets for the same year was 2.35% and its return on average equity was 12.26%.

Manufacturing

Through Conwed Plastics, Leucadia manufactures and markets proprietary lightweight plastic netting used for a variety of purposes including, among other things, construction, agriculture, packaging, carpet padding, filtration and consumer products. Fifteen percent of its 2000 sales were exported to Europe, Latin American, Japan and Australia. Results are below:

(In millions)	1997	1998	1999	2000
Sales	\$50.9	\$56.6	\$64.0	\$65.0
Pre-tax profits	8.9	10.1	11.9	11.3
Return on net invested assets	32.5%	29.5%	31.9%	23.3%
Return on average equity	37.8%	39.7%	42.2%	28.7%

Operating at capacity, and in order to meet product demand, Conwed is constructing an \$18.5 million manufacturing facility in Belgium, which is expected to be operational in the third quarter of 2001. The Belgium facility will service customers in the European and Asian markets, which are currently being supplied by Conwed's domestic manufacturing facilities. It turns out it is cheaper to ship to Asia from Europe than from the United States. When fully operational, the facility is expected to increase capacity by approximately 20%.

During the second half of last year, volume fell and orders slowed down as the economy began to weaken. Raw material prices rose with oil prices, which has made things worse. Conwed is now scrambling to prepare for a further slowdown and, as is likely to become apparent, Leucadia will suffer from an unfortunately timed, but necessary in the long run, increase in capital committed to this business.

Conwed is Leucadia's old economy canary! Miners used to take canaries in small cages with them into mines. If their singing stopped and their feet pointed upward, it was a sign of poisonous gas; the feet pointed the way to the surface!

Winery

Leucadia has a 90% interest in two wineries: Pine Ridge in Napa Valley, California and Archery Summit in the Willamette Valley, Oregon. Pine Ridge was acquired in 1991 and Archery Summit was started from dense Oregon forest in 1993. These wineries produce and sell super-ultra-premium wines—wine talk for expensive. During 1999, these wineries sold 75,900 nine-liter equivalent cases of wine for \$12.5 million, and during 2000, sold 79,300 cases for \$14.4 million.

Since acquisition, Leucadia has invested \$53.2 million, principally to fund the acquisition of land for new vineyards, vineyard development and winemaking equipment. About \$16.7 million of that is related to Archery Summit, whose production is only at about one-half design capacity and will still be in the development stage for the next several years.

In 2000, earnings before interest and taxes ("EBIT"), was \$3.7 million or a return on ending equity of about 7%. If prices and demand don't collapse, EBIT will continue to increase as the vineyards mature and production increases.

Despite the pleasures of owning wineries, during 2000 Leucadia engaged an investment banking firm to put the wineries up for sale. We did not receive offers which we considered adequate and don't intend to sell the wineries at this time. To assure shareholders of the integrity of Leucadia's balance sheet, the offers were considerably in excess of its investment.

Our partners, Gary and Nancy Andrus, continue to make and sell great wines! Thus, the great prices for super-ultra-premium wines: \$25–\$135 per bottle. Call 800-486-0503, if you care to visit the wineries or find out where you can buy the wine near where you live. Depending on your state liquor laws, you may order wine through the mail or through the Internet at www.pineridgewinery.com or www.archerysummit.com. Remember, moderate use of wine—one glass each of Pine Ridge and Archery Summit per day—extends life, reduces stress and makes your fellow shareholders happy.

MK Gold

MK Gold is traded on the NASD OTC Bulletin Board; Leucadia owns 72.9%. MK Gold has a 25% equity interest in, and the mining contract for, a small gold mine in California. MK Gold also owns Cobre Las Cruces, S.A., a Spanish company that holds the exploration and mineral rights to the Las Cruces copper deposit in the Pyrite Belt of Spain. A feasibility study has been completed by Bechtel International, Inc., which reports proven and probable reserve estimates of 15.8 million metric tonnes grading 5.94% copper that are overlain by a gold-bearing gossan (which has not been evaluated). This reserve calculation was based upon the analysis of approximately 280 drill holes totaling over 82,000 meters. The feasibility study estimates the capital cost will be approximately \$290 million to bring the mine into production. Mining will be subject to permitting (currently underway), obtaining both debt and equity financing for the project, engineering and construction. A mining concession application, accompanied by the feasibility study and environmental impact studies, was submitted to the applicable Spanish and Andalusian governmental agencies during the first quarter of 2001. We shall see; nothing ventured, nothing gained!

Frank Joklik, MK Gold's very experienced chairman, leads this able team. We are grateful for their efforts.

Real Estate

FIDEI is a 100%-owned French subsidiary headquartered in Paris. When acquired, FIDEI had over 150 investments in real estate, mostly in Paris and its environs. In 1999, FIDEI sold 62 properties for a pre-tax gain of \$37.9 million, and in 2000, sold 38 properties for a pre-tax gain of \$27.1 million. At December 31, 2000, 53 properties remain for sale aggregating approximately 1,300,000 square feet. FIDEI has certain pleasant tax attributes and is looking for further opportunities in Europe.

At December 31, 2000, Leucadia had \$166.5 million invested in domestic real estate. This represents investments in office buildings, shopping centers, residential real estate projects, and unimproved land, all in various stages of development and all doing fine.

During 2000, Leucadia received \$94.3 million in proceeds on a non-recourse loan from a third party lender on an office complex in Washington, D.C., not far from the U.S. Capitol, which when added to the amounts previously received fully repaid Leucadia's investment, plus a 17.5% preferred return. Leucadia retains a 50% interest in the complex and additional land for further development.

Real estate values may fall in the economic downturn ahead, but Leucadia is well positioned to weather the storm and to purchase additional assets.

FINOVA

We are encouraged that opportunities may once again be coming our way. The first may be the arrival of an investment opportunity in The FINOVA Group Inc. FINOVA, based in Scottsdale, Arizona, is a lender to middle market companies with \$12 billion of assets at book value.⁴ FINOVA had been funding itself in the commercial paper market, and as a result of a loss of market confidence, its access to the commercial paper market evaporated. Ultimately, FINOVA ended up in default on its \$11.3 billion of borrowings, which included over 55 financial institutions providing bank credit facilities and countless owners of bonds.

Last year, Larry Hershfield, one of Leucadia's executives, brought this opportunity to our attention several times during FINOVA's search for either a purchaser or an investor. We conducted considerable due diligence following which we negotiated a transaction whereby Leucadia would have invested up to \$350 million in new equity subject to the approval of creditors. After several meetings with creditors, it became apparent that the creditors were not interested in this particular proposal and the transaction was mutually terminated.

Not to let sleeping groundhogs lie, we continued to think about various possibilities for restructuring FINOVA's debts. Finally, in February 2001, Leucadia and Berkshire Hathaway Inc. formed a jointly owned company, Berkadia LLC, and agreed with FINOVA that Berkadia would lend it \$6 billion on a senior secured basis to facilitate a Chapter 11 reorganization. The balance of FINOVA's debt would be paid in the form of new debt. The commitment to lend expires August 31, 2001 and is subject to numerous usual conditions, including confirmation of the Chapter 11 plan approved by Berkadia.

Berkadia's commitment is 90% guaranteed by Berkshire Hathaway and 10% by Leucadia, with Berkshire Hathaway guaranteeing Leucadia's portion. In consideration for making the loan, Berkadia will also receive 51% of the stock of FINOVA and will designate a majority of its directors. In conjunction with the commitment, FINOVA paid to Berkadia a fee of \$60 million. Leucadia also entered into a ten-year management agreement with FINOVA, for which a non-refundable \$8 million fee was paid to the Berkadia partners as compensation for the first year's services.

⁴ This investment is really going back to our roots. Talcott National, from which Leucadia evolved, was in the same business as FINOVA and had many of the same problems.

Under the direction of FINOVA's board, Larry Hershfield spends all of his time at FINOVA working on the development of the Chapter 11 plan and advising FINOVA's new CEO, Bill Hallinan. Tom Mara and Joe Orlando, Leucadia's EVP and CFO, respectively, also are devoting a considerable amount of their time to FINOVA as well. The Chapter 11 reorganization plan will have been filed by the time you read this and we are hopeful the plan will be confirmed this summer.

For those of you unfamiliar with Federal bankruptcy procedures, it is an orderly process, guided by a Federal judge, who weighs the interests of stockholders as well as creditors. In most cases, the approval of creditors is required to confirm a plan of reorganization. The process is often full of sound and fury, but usually results in a sensible outcome. Lawyers, accountants and investment bankers make a lot of money. We are hopeful that FINOVA's plan will be confirmed. At the present time, it is the only plan before the court and has the endorsement of FINOVA's Board of Directors. However, it is possible other bidders may arrive on the scene or the creditors may choose to go in a different direction.

Working with Warren Buffett has been a delight for both of us. Berkshire's lawyers, led by Bob Denham and his team, equally so.

Money and Other Things

At December 31, 2000, excluding amounts held by regulated subsidiaries, Leucadia had cash, cash equivalents and marketable securities of \$643.4 million, plus \$156.8 million in marketable securities collateralizing letters of credit, plus \$183.1 million of cash, cash equivalents and marketable securities held by FIDEI.

In late 1999 and 2000, Leucadia purchased \$89 million of securities of Fidelity National Financial, Inc., a publicly traded title insurance company and later in the year sold the stock for \$179.9 million.

The outstanding promissory note due to Leucadia by Consec, Inc., for \$250 million, was paid in full in the third quarter of 2000, plus a \$7.5 million prepayment penalty.

In June 2000, Leucadia replaced its bank credit facility of \$100 million with a new facility of \$152.5 million. At December 31, 2000, no amounts were outstanding. Total parent company debt, which excludes non-recourse debt of subsidiaries, was \$147.1 million.

During 2000, Leucadia invested \$100 million in JPOF II, a limited liability company that is a registered broker-dealer. JPOF II is managed and controlled by Jefferies & Company, and is a market maker in high yield debt ("junk bonds"). For the year ended December 31, 2000, Leucadia recorded \$17.3 million in pre-tax income from this investment.

In January 2000, Leucadia's 10% equity interest in Jordan Telecommunication Products, Inc. was sold for a pre-tax gain of \$24.8 million. Plus Leucadia may receive additional contingent payments in the future.

In October 2000, Leucadia committed to invest \$75 million in convertible preferred shares of White Mountains Insurance Group, Ltd. (WTM-NYSE), representing approximately 4% of the common stock when converted. WTM is buying the property and casualty insurance company CGU Corporation, the U.S. portion of the English company CGNU plc. This acquisition should close later this year. WTM is controlled and directed by Jack Byrne, an able and experienced insurance executive, long admired by the undersigned.

During 2000, Leucadia repurchased 1,505,000 of its common shares for \$32.1 million at an average price of \$21.33 per share.

The Future

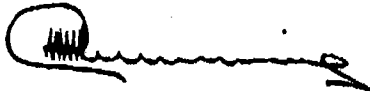
The year 2000 was, we think, a transitional year. In the euphoria of the last several years, we were able to sell many of Leucadia's assets at advantageous prices. This has left us in a position we have not experienced since the late 1980s where Leucadia's recurring earnings barely cover its overhead and must rely on deals and investments for earnings. Hopefully, this problem will rectify itself as declining prices allow us to sniff out value and purchase good companies at attractive prices.

We think equity markets will continue to fall toward or below their historical means and that this process will take considerable time. Falling markets, financial sorrow and woe, perhaps not good for the nation, are the garden in which these groundhogs thrive!

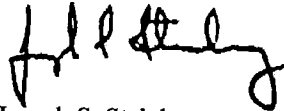
We will continue to work hard, hopefully continue to be lucky and be ably assisted by the same staff and advisors who have been around for many, many years, and without whom, none of this would have been possible.

When we first arrived at Talcott National in 1978, the company was in financial extremis. Our now friend, Stephen E. Jacobs, Head of the Corporate Department of Weil, Gotshal & Manges, was on the scene and has been present at every take off and crash landing that the two of us have conceived of since then. After 38 years in the New York office of Weil, Gotshal & Manges, Steve is taking his act to his firm's London office. We will miss his intense day-to-day involvement in our affairs. Rest assured we will consult with him on anything important and will continue to rely on his more than capable partner, Andrea Bernstein, and on his trusty trumpet to blow the sound of retreat as he has so many times in the past.

We wish Steve and wife Sherry the best and intend to drop in for tea from time to time.



Ian M. Cumming
Chairman



Joseph S. Steinberg
President

Quid quid bonum pro Leucadia bonum est!

Letter from the Chairman and President

2001

To Our Shareholders

In 2001, Leucadia lost \$7.5 million, the third loss in the 24 years we have been managing this enterprise. We have an explanation, which does not excuse the loss. It involves the arcane intricacies invented by the accounting profession to supposedly make financial reporting more realistic. In 2001, the fruits of their efforts resulted in our only picking up as income a small portion of the \$60 million in cash we received from the FINOVA transaction (described in our SEC filings) and requiring us to write off \$94.4 million of investment in FINOVA stock we got for free and never thought was worth much to begin with. To further complicate matters (which are not the accountants' doing) we wrote off our remaining investment in Empire Insurance Group, about which more later. Empire resulted in an after-tax loss of \$72.7 million. On the plus side was the release of \$36.2 million of previously accrued tax contingencies that are no longer necessary. Happily the \$60 million and the \$94.4 million from the FINOVA transaction are being recognized in income as FINOVA repays its loan. The detailed footnotes are on pages F-12 through F-14. The chart below attempts to explain the P & L in greater detail.

Here is what happened.

(In millions)	
Revenues ^(a) ^(b)	\$375.3
Expenses	(321.6)
Income	53.7
Taxes, net ^(c)	16.6
Income after tax	70.3
Other:	
Minority expense	(5.5)
Empire losses ^(d)	(72.7)
Accounting changes	.4
Net Loss as reported (GAAP)	\$(7.5)
Earnings to be reported in future periods as the Berkadia loan is repaid:	
FINOVA stock loss	\$82.1
Accrued FINOVA cash fees	52.2
Taxes at 35%	(47.0)
After-tax future earnings	\$87.3

(a) Includes a loss of \$94.4 million on 25% of FINOVA's common stock, acquired for no additional consideration in connection with Berkadia's loan to FINOVA, which will be amortized back into income as the Berkadia loan is paid down by FINOVA. \$12.3 million of this amount was amortized into income in 2001.

(b) Includes just \$7.8 million of the \$60 million of cash fee (points) paid to Leucadia for Berkadia's loan to FINOVA. The balance was deferred and will be amortized into income as the FINOVA loan is repaid.

(c) Includes \$36.2 million release of previously accrued tax contingencies.

(d) This is all related to Empire, which is being discontinued. See Empire below.

Empire

First, a mercifully short history of the rise and fall of the Empire Insurance Group. We obtained control of Empire in early 1988, it had a statutory net worth of \$63.2 million. By December 31, 1997, its statutory net worth peaked at \$180 million. A good portion of the increase in net worth resulted from redundant reserves (which means we paid less in claims than we had originally expected to pay). The redundancies began to evaporate in 1995, but we did not realize the importance of this fact at the time. A couple of years earlier we had made what became the fatal decision. We dramatically expanded our private passenger auto book of business in New York City, the Bermuda Triangle for insurance companies. We believed we could underwrite bad drivers at high prices and make money. We were wrong. Looking through the rear view mirror, our prices were not high enough to overcome bad drivers, endemic medical fraud, poor systems and equally overconfident competitors. At December 31, 2001, the statutory net worth was \$23.2 million and shrinking. Our decision to discontinue Empire's operations and Empire's operating loss resulted in a total loss of \$72.7 million for the year. If there is a recovery at the end of this saga, it will be a tiny one and a miracle. The best thing about this unfortunate journey is that it is over.

This difficult job has been accomplished under the leadership of Bud Scruggs and a remarkable group of young executives he has recruited and mentored. Bud has been heard to muse: "This job feels like following elephants in a parade!"

Bermuda

You are being asked at the shareholders' meeting to consider changes to allow Leucadia to move its domicile to Bermuda. The proxy statement has a detailed description of what needs to be done to accomplish this. There is also an explanation of how the move will affect shareholders.

Why are we advocating this? Over the years, we have made successful investments not only in the United States, but also in England, France, Argentina, Barbados, Bolivia and El Salvador. We currently have ongoing investments in Barbados, France, Spain and Russia; in Russia we have lost money so far. When the successful investments were realized, we would have paid tax on the gain, were it not for our net operating loss carryforwards. Those loss carryforwards are gone now and are irreplaceable. As a Bermuda company, Leucadia would be able to reinvest these profits without an intervening U.S. corporate level tax. This resulting benefit is at the heart of what we are paid to do—increase shareholder value. The United States is almost alone in taxing corporate worldwide income even if earned outside the United States. Putting this in dollars and cents means that if we make a good investment from Bermuda and sell the investment at a gain, there will be no corporate level tax due on the profit. If, for example, as a Bermuda company we were to make a profit of \$500 million on the sale of a particularly successful investment, Leucadia would save more than \$175 million in corporate level taxes (at current U.S. rates), or over \$3.00 per share. Shareholders will continue to be liable for taxes on dividends and capital gains. Leucadia will continue to pay taxes on its U.S. operations.

If approved at our shareholders meeting in May, the move to Bermuda may not take place immediately. There is a U.S. tax to be paid by the Company at the time of the move to Bermuda that is dependent on the price of our stock versus the value of our assets. We do not intend to implement the move unless the tax cost is reasonable. Furthermore, the move to Bermuda will also impose some additional restrictions on stockholders owning more than 1% of the shares of the Company (currently 553,000 shares equals one percent). Existing shareholders will not be required to sell any stock. The purpose of these additional restrictions also has to do with taxes. The proxy statement goes into this in greater detail. Please read it carefully before voting. We're voting "yes".

Recently, there has been much sound and fury about Bermuda from several politicians, both Republican and Democrat. They claim that such moves are in some way nefarious and even un-American. We strenuously disagree.

The United States is a nation of laws. Our elected representatives make the laws and we obey them. We don't make laws, they do, and we don't interpret laws, judges do. In 1947, Judge Learned Hand wrote, "Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich and poor, and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions."¹

Even before Judge Hand's learned opinion, Justice George Sutherland delivered an opinion of the U.S. Supreme Court which in part read, "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted."²

Banking and Lending

Leucadia's banking and lending operations are principally conducted through American Investment Bank, N.A. (AIB), a national bank subsidiary, and American Investment Financial (AIF), an industrial loan corporation. AIB and AIF deposits are insured by the FDIC. Together AIB and AIF had deposits of \$476.5 million at December 31, 2001. Consolidated loans of the two entities at December 31, 2001, were \$521.2 million. AIB's largest market segment is sub-prime auto loans, consisting of loans to individuals who have difficulty obtaining credit, with the principal secured by used and moderately priced automobiles. For taking this risk, AIB charges higher rates of interest. In 2001 the average initial loan balance was \$12,250 and the yield was 21.5%; in an earlier day competition allowed 24%.

AIF is a small lender to non-prime boat and recreational vehicle buyers and also, until recently, made loans guaranteed by the Small Business Administration.

Beginning in the second half of 2000, we noticed an increase in losses and delinquencies in the auto portfolio. This increase, we thought, could be explained by the deteriorating economic conditions in the United States. Customers who are at the bottom of the economic ladder have little protection in the face of a slowing economy and their behavior represents a leading indicator of things to come. In response, we reduced loan originations significantly by tightening underwriting standards and eliminated marginal auto dealer relationships and territories. We managed the business so that AIB's assets would be flat in 2001, after growing 55% to \$544 million in 2000. Caution was in order.

However, the adverse trends continued during 2001, and despite our efforts of cutting costs and being more selective in underwriting loans, profitability continued to deteriorate.

As a result, in September 2001, AIB stopped originating new sub-prime automobile loans. At year-end 2001, additional reserves were added to account for the closing of the Indianapolis collection office. This has not been a bad business, just not good enough for the current risks versus the rewards.

We continue to service our existing loan portfolios. We will also seek to acquire loan portfolios that meet our credit criteria. If over the next several years these institutions cannot find profitable lending niches, or portfolio purchases, the invested capital should be repatriated to Leucadia.

¹ COMMISSIONER V. NEWMAN, 159 F.2D 848, 850-851 (CA2 1947)

² GREGORY V. HELVERING, Commissioner of Internal Revenue, 293 U.S. 465, 468 (1935)

Manufacturing

Conwed Plastics is a leading manufacturer of proprietary lightweight plastic netting used for a variety of purposes including construction, agriculture, packaging, carpet padding, filtration and consumer products. The products are primarily used to add strength to other materials as in carpet padding, or to act as a barrier as in warning fences, or as crop protection from birds. This is a business where Conwed's netting is engineered into 1000's of other manufacturers' products.

Conwed markets its products both domestically and internationally, with approximately 13% of its 2001 sales exported to Europe, Latin America, Japan and Australia. The Company primarily sells its products through an employee sales force, which is located in the United States and Europe.

Results are as follows.

(In millions)	1997	1998	1999	2000	2001
Sales	\$50.9	\$56.6	\$64.0	\$65.0	\$53.7
Pre-tax profits	8.9	10.1	11.9	11.3	7.8
Return on net invested assets	32.5%	29.5%	31.9%	23.3%	13.8%
Return on average equity	37.8%	39.7%	42.2%	28.7%	16.5%

Conwed is our old economy thermometer. As you can see from the chart above, it tracks what is going on in the real economy, not to be confused with the enthusiast's economy, which resides on Wall Street.

Conwed continues to be profitable and is working on being more so—dedicated to the proposition that being a low cost producer is great in good times and bad. Some of the erosion in the return on average equity and return on net invested assets is the result of our increased investment in the Belgium plant. We decided, probably prematurely, to build a European plant in 1999. It is up and running, but does not yet have enough business to be profitable. We think it was the right decision, which will eventually pay off.

There is a recent small but measurable increase in our sales to carpet cushion manufacturers over same period sales to this segment last year. This might indicate a slight uptick in the old economy or might indicate that new carpeting is an affordable luxury in a down economy.

Kudos to Conwed for leading the way in the fight to keep as many costs variable and to exact more productivity from the costs that are not!

Winery

Leucadia owns two wineries: Pine Ridge in Napa Valley, California and Archery Summit in the Willamette Valley, Oregon. Pine Ridge was acquired in 1991 and Archery Summit was started from scratch in 1993. The wineries produce and sell ultra-premium and luxury wines, \$25–\$135 per bottle. Archery Summit's case sales are less than its production capacity. To date, Archery Summit has been able to sell all its production at very high prices. The challenge will be to continue to do so as production continues to increase.

In 2001, Gary and Nancy Andrus, our partners and founders of Pine Ridge, decided they wanted to sell out. Leucadia agreed to buy their interest and now owns 100%. Gary is going to pursue other interests and we wish him well. Nancy will continue on at Pine Ridge in marketing.

During 2000, these wineries sold 79,300 9-liter equivalent cases for \$14.4 million. During 2001, 68,900 9-liter equivalent cases were sold for \$12.8 million. The fourth quarter is usually a large revenue period for our wineries, and the events of 9/11 certainly resulted in lower wine sales, which has continued in 2002.

George Scheppler has joined us as the new President and CEO of the wineries. George's entire career has been spent in the wine business. For sixteen years, George has been working for the wine interests of the Baron Philippe de Rothschild, with the last 10 of those years as co-CEO of Opus One, a French/American joint venture winery and preeminent luxury goods wine brand. We welcome him and look forward to the implementation of his exciting plans for the future. In the meantime, wines of both Pine Ridge Winery and Archery Summit Winery continue to receive great reviews by the wine press.

Remember—wine is food; it has biblical antecedents. One glass each day of Pine Ridge or Archery Summit wine extends life and makes your fellow shareholders happy.

Depending upon your state liquor laws, you may order wine through the mail or on the Internet at www.pineridgewinery.com or www.archerysummit.com. Both wineries are quite beautiful from spring through the fall grape crush. Come visit and taste! Call Pine Ridge at (800) 575-9777 or Archery Summit at (800) 732-8822 and tell them you are a shareholder and ask for a tour.

MK Gold

MK Gold is traded on the NASD OTC Bulletin Board; Leucadia owns 72.8%. MK Gold owns Cobre Las Cruces, S.A., a Spanish company that owns the Las Cruces copper deposit in the Pyrite Belt of Spain. As a result of approximately 280 drill holes totaling over 82,000 meters, proven and probable reserves are estimated at 15.8 million metric tonnes grading 5.94% copper. A feasibility study completed by Bechtel International, Inc., estimates the capital cost will be approximately \$290 million to bring the mine into production. Operating costs are estimated at \$.33/lb of copper. Mining will be subject to permitting and obtaining both debt and equity financing for the project. A mining concession application, accompanied by the feasibility study and an environmental impact study, was submitted to the applicable governmental agencies during the first quarter of 2001. As of this writing at the end of March 2002, the process of obtaining the permits continues. There is no reason to believe it will not be issued, but we knoweth not when. Prayers for high copper prices are also in order.

FINOVA

FINOVA, a financial services holding company that emerged from bankruptcy in August 2001, is 50% owned by Berkadia, a joint company owned by Berkshire Hathaway Inc. and Leucadia. Berkadia made FINOVA a \$5.6 billion loan to finance FINOVA's chapter 11 plan. Leucadia has guaranteed 10% of Berkadia's borrowings to fund the FINOVA loan. Leucadia has a ten-year management agreement with FINOVA and Larry Hershfield, a Leucadia employee, is the chief executive of FINOVA.

Leucadia owns, through Berkadia, 25% of FINOVA's common stock, receives \$4 million of the management fee yearly, plus interest received on 10% of the Berkadia loan, less 10% of Berkadia's cost of funds. Leucadia also received \$60 million of the \$120 million in fees charged to FINOVA for the loan.

Since its chapter 11 restructuring, FINOVA's business activities have been limited to the orderly collection and liquidation of its assets and is not engaged in any new lending activities. Cash generated by these activities is used to pay operating expenses and interest on all the FINOVA debt and then the principal of the Berkadia loan. As of this writing, the loan is paid down to \$3.9 billion.

The bulk of FINOVA's loans were to less than prime credits. After 9/11, significant additional reserves for impairment were taken, mainly on the hospitality and transportation portfolios. It is Leucadia's belief that the Berkadia loan will be paid in full, but FINOVA's other outstanding debt is substantially impaired and there will be nothing left for FINOVA's shareholders.³

Real Estate

FIDEI is a 100%-owned French subsidiary headquartered in Paris. When acquired, the Company had over 150 properties:

1999: 62 properties sold for pretax gain of \$37.9 million

2000: 38 properties sold for pretax gain of \$27.1 million

2001: 26 properties sold for pretax gain of \$8.2 million

At December 31, 2001, 27 properties aggregating 858,000 square feet remain, with a book value of \$28.7 million. These remaining properties should be sold during 2002. While the real estate is being liquidated, we are investigating selling the company, which has some French tax attributes. So far we have enjoyed a return of 19.7% on our original investment of \$67 million. Our thanks to Zalmie Jacobs, Luis Medeiros, Jean-François Delepouille and Jean-Frédéric Lambert.

At December 31, 2001, the Company's domestic real estate had a book value of \$146 million. The most significant real estate investments are:

- A loan to and a residual equity interest in a master-planned community in San Diego County with 3,400 entitled residential units that are being developed by HomeFed Corporation. We also have a loan to HomeFed and a preferred equity interest in one of their projects.
- A 719-room hotel located on Waikiki Beach, called the Aston Waikiki Beach Hotel, which is being renovated. Rooms are available from \$65 to \$95 per night on Expedia.com and are selling briskly.
- Several small shopping centers that we are in the process of selling.
- Partial interest in the Brooklyn Marriott Hotel and an adjoining office building and parking structure. Empire profitably sublet its space in the office building to the United States Secret Service, who needed the space subsequent to 9/11, and to the New York City Board of Education.

We believe that these properties are worth something more than their carrying value.

Money and Other Things

At December 31, 2001, excluding amounts held by regulated subsidiaries, Leucadia has cash, cash equivalents and marketable securities of \$805 million, plus \$163.8 million in cash and securities collateralizing letters of credit. At December 31, 2001, Leucadia had credit facilities of \$152.5 million, of which none was drawn. Total parent company debt, which excludes non-recourse debt of subsidiaries, was \$194.5 million. Except for our investment in Berkadia described above, we are not responsible for the indebtedness of any of the partnerships and other companies in which we have investments.

During 2001, we repurchased none of our common stock.

³ The stock is on our books for zero.

In 2000, Leucadia invested \$100 million in JPOF II, a limited liability company that is a registered broker-dealer. JPOF II is managed and controlled by Jefferies & Company, and makes markets in high yield bonds. For the year ended December 31, 2001, Leucadia recorded \$27.1 million of pretax income from this investment. Our thanks to the team.

In 2001, we invested \$75 million in White Mountains Insurance Group, Ltd. (WTM-NYSE), for 375,000 common shares or about 4% of this Bermuda-domiciled financial services holding company. At December 31, 2001, these shares had a market value of \$130.5 million.

In 2001, the Company invested \$127.5 million for approximately 25% of the common stock in Olympus Re Holdings, Ltd., a newly formed Bermuda reinsurance company, primarily engaged in property excess, marine and aviation reinsurance. Joe Steinberg is its Chairman. This company was formed with the intention of benefiting from the expected increase in reinsurance pricing subsequent to 9/11. At the end of two years each shareholder has an option to withdraw if the shareholder believes prices for reinsurance are headed south as they seemingly always do. Though prices are definitely up, this investment is exposed to the usual risks reinsurance companies subject themselves to. Olympus' reinsurance contracts generally do not cover losses resulting from terrorist attacks, except for certain personal lines contracts. We will be carefully watching the Weather Channel beginning in late August.

Since 1982, we have invested an aggregate of \$105 million in various entities owned or controlled by Jay Jordan and David Zalaznick. As of December 31, 2001, we have received \$166.1 million back. Also at December 31, 2001, we hold interests in 45 Jordan/Zalaznick companies, carried at \$59 million on our books, of which \$43.8 million relates to public companies carried at market value.

The Future

2001 was a confusing year. It began with equity prices in the markets falling toward their historical means. We do better when markets are below their historical means, but we do little when they are far above. To our surprise, earlier this year there was a reversal of the downward trend towards the mean. Prices in the markets strengthened and the Federal Reserve and others announced the recession to be over. Time will tell whether this turns out to be true.

Our personal view is that there is a disconnect. The real economy is still in a period of readjustment whereby the ebullient speculative economy, i.e., the stock markets, are struggling mightily to maintain prices that suggest continued high growth rates that we do not think are sustainable.

Meanwhile, we continue to forage for undervalued or underappreciated investments. For what it is worth, we are busier this year than last, and although we usually are not high bidders, recently we have been closer to winning than losing and have bought a few small investments. We started at Leucadia together in 1978, with \$53,000 which we borrowed on our credit cards. We have been enormously fortunate for which we are grateful beyond words. But we are 24 years older, richer and probably a bit lazier (at least one of us) and undoubtedly more conservative. We hope our shareholders find themselves in the same situation.

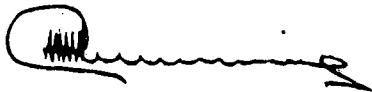
In the past Leucadia has occasionally invested a large percentage of its net worth in the purchase of a single investment. (For example, Avco in 1984, Baldwin United in 1986 and Colonial Penn in 1991.) It is hard to imagine investing the same percentage again in a single investment with our net worth today of \$1.2 billion. We are intuitively most comfortable with investments in the \$100-\$200 million range. What that means is that we must not only find and manage good investments, but also multiples of them. To this end we are developing, successfully we think, several executives and teams who have the talent for sniffing out the extraordinary investment opportunity. If we cannot invest in compelling values, we prefer to leave Leucadia's money in the bank.

Complicating our efforts is the fact that there is more competition for the good deal than ever before. Traditional private equity funds have veered into our areas of expertise as well as hedge funds. An enormous amount of money has been raised for investing in distressed assets. All of this continues to make our job harder.

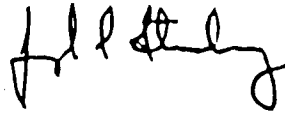
The "when are you going to slow down" bell has rung several times this year in one of our households! For the time being we are ignoring the peal.

We and our able staff and advisors will continue the search for attractive, safe investments that, over time, will return higher yields than those generally available in the market. If we are unsuccessful in our search, we and our fellow shareholders ought to give the money to someone else to manage.

After 24 years, this is still fun!

A handwritten signature in black ink, appearing to read 'Ian M. Cumming', with a stylized, wavy underline.

Ian M. Cumming
Chairman

A handwritten signature in black ink, appearing to read 'Joseph S. Steinberg', with a stylized, wavy underline.

Joseph S. Steinberg
President

Letter from the Chairman and President

To Our Shareholders

In 2002, Leucadia reported \$161.6 million in after tax income or \$2.88 per fully diluted share, which is a 10.5% return on ending equity. This return is slightly distorted by \$150 million which was added to equity from the sale of stock late in the year, about which more later.

Since 1998 we have been the shrinking Leucadia, with assets of \$2.9 billion at the end of 1998 and \$2.5 billion at the end of 2002. Most of this decrease came as the result of sales of companies or earning assets to others who wanted them more than we. In retrospect, these were well-timed sales, achieved without payment of substantial taxes (more about that later), but leaving us with a few operating businesses, a number of investments in what we call "associated companies," a considerable cash and investment balance and, unfortunately, few opportunities, until recently. The various investments we did make have worked out pretty well and shareholders' equity has grown from \$1.12 billion at the end of 1999 to \$1.39 billion¹ at the end of 2002. This return is not too bad when compared with a return on an investment in the S&P 500, which peaked in early 2000 and has had three down years since then, not to mention the NASDAQ 100, which is down 73% over the same period. While we feel badly for the individual investors who suffered from the bursting of the bubble, we applaud these declines as they may indicate that rationality is returning to the investment world.

Before going on to a detailed review of the year with its successes, failures, opportunities and risks, this chart² shows the reader how we think about our year end assets and liabilities (in millions).

Assets		Liabilities and Net Worth	
Subsidiary Operating Companies	\$ 347.1	Corporate Debt and TRUPS	\$ 288.4
Associated Companies	\$ 665.5	Other Corporate, net	\$ 65.9
Corporate Cash and Investments	\$ 876.2	Net Worth	\$1,534.5

We have never spent much time worrying about our income statement. For the most part, it is indecipherable anyway given the arcane and constantly changing rules of GAAP. It seems many accountants have been spending all of their time writing new rules. In the future, we hope they will give as much effort to auditing to make sure their clients are not crooks and that their financial statements actually comply with the rules.

We follow our own few rules. First, don't overpay. Second, don't overstate earnings or the balance sheet. Third, pay as little tax as the law allows. Fourth, don't break the rules. Following these principles has led to satisfactory growth in shareholders' equity and peace of mind.

Bermuda

We didn't go to Bermuda—not for the lack of trying, but because our stock price was too high and tax costs unbearable. The shareholder resolution approving the move to Bermuda was approved resoundingly and remains in effect until the 2005 shareholder meeting.

¹ This number excludes the \$150 million in new equity, which we raised by selling stock in December 2002.

² These are unconsolidated figures on an equity method basis rather than the consolidated numbers that you can see on our audited year end balance sheet. The SEC says we can't report these to you without presenting at the same time the most directly comparable GAAP measures. So "Subsidiary Operating Companies" represents \$820.2 million of assets net of \$473.1 million of liabilities and "Other Corporate, net" represents \$80.1 million of assets net of \$146 million of liabilities on our consolidated balance sheet.

Banking and Lending

Leucadia's banking and lending operations are principally conducted through American Investment Bank, N.A. (AIB), a national bank subsidiary, and American Investment Financial (AIF), a Utah industrial loan corporation. The FDIC insures the deposits of both AIB and AIF. Together, AIB and AIF had deposits of \$392.9 million at December 31, 2002. Consolidated loans of the two entities at December 31, 2002, were \$373.6 million. At December 31, 2002, 55% were loans to individuals generally collateralized by automobiles; 38% were loans to individuals, substantially all of which were collateralized by real or personal property; 4% were loans to small businesses; and 3% were unsecured loans. Most of the individuals are considered by us and our regulators to be "sub-prime borrowers," which means they either don't pay their bills on time or have too much debt.

Though profitable for many years, in September of 2001, in response to negative trends in delinquencies and losses, AIB exited its largest market segment, sub-prime auto. It was the right decision. During 2002, we witnessed the struggling economy push losses to extremely high levels in that portfolio. In response, we increased our loan loss reserve by \$10 million in September 2002 and believe that we are adequately reserved for losses. The Bank remains very well capitalized.

In 2002, the same troubling trends we saw in auto appeared in the rest of our portfolios. Given these trends and the fact that we do not see any signs of a recovering economy, we have decided to take a break from consumer lending. The possible rewards of lending to consumers do not justify to us the current levels of risk—at least at this time.

With no lending activities, our primary focus is on servicing or selling our existing loan assets and efficiently winding down our consumer-based operations. While we continue to search for opportunities to leverage our banking charters, we will not sacrifice profitability for the honor of owning a national bank or the privilege of borrowing with the full faith and credit of Uncle Sam.

Our regulators are very concerned about all sub-prime institutions and, notwithstanding our good intentions by exiting these businesses, they insisted we sign an agreement memorializing our exit from the sub-prime market.

Manufacturing

Conwed Plastics is a leading manufacturer of proprietary lightweight plastic netting used for a variety of purposes including construction, agriculture, packaging, carpet padding, filtration and consumer products. The products are primarily used to add strength to other materials, as in carpet padding, or to act as a barrier, as in warning fences, or as crop protection from birds. Conwed's netting is engineered into thousands of other manufacturers' products.

Conwed markets its products both domestically and internationally with approximately 16% of its sales in Europe, Latin America, Japan and Australia. Conwed primarily sells its products through an employee sales force located in the U.S. and Europe.

Results are as follows:

(In millions)	1998	1999	2000	2001	2002
Sales	\$56.6	\$64.0	\$65.0	\$53.7	\$50.7
Pretax profits	\$10.1	\$11.9	\$11.3	\$7.8	\$3.1
Return on average equity	39.7%	42.2%	28.7%	16.5%	7.8%

Conwed's profits and returns were negatively impacted in 2002 by a charge of \$1.25 million related to the write down of assets resulting from the loss of business with a single consumer products company and the poor performance of our new European manufacturing operation.

John Rosenberger, Conwed's CEO for the last 18 years, retired at the end of 2002. During John's long tenure, he built a fine company and turned in sterling returns on equity. We thank John for his years of effort and for the \$82 million of lovely cash he generated for Leucadia! John has been succeeded by Mark Lewry. Our hope is that Mark can create a similar record over the next 18 years!

A slow economy and competitive pressures kept revenue on a downward trend in 2002. Price reductions of \$1.7 million were given in key market segments to maintain market share. This along with the loss of business in the consumer products area accounted for the revenue reduction compared to last year. Significant reductions in variable costs and overhead totaling \$2.9 million helped improve operating income by \$.6 million for the year. The European plant was operational for the first full year in 2002, but results did not meet expectations. Efforts are ongoing to improve cost efficiencies and increase capacity utilization. The goal is to generate positive cash flow in 2003 from this plant. Building and starting up a new plant contemporaneously with an economic downturn was not smart!

The economy does not show signs of dramatic improvement in the near future. The cost of Conwed's primary raw material rose 50% in 2002 and is expected to go higher in the coming year. These are challenging times for Conwed. Continuing and redoubled efforts to further reduce fixed and variable overhead, regain desirable margins in existing markets, and focus efforts on new business development opportunities are the keys to getting revenues back into a growth pattern and returning profitability to past levels! This is going to be a difficult job and we wish Mark and his team good fortune!

Winery

The Company owns two wineries: Pine Ridge in Napa Valley, California and Archery Summit in the Willamette Valley, Oregon. Pine Ridge, which was acquired in 1991, was born in 1978. Archery Summit was built from scratch in 1993. These wineries primarily sell wine in the luxury segment of the premium table wine market, \$25–\$135 retail per bottle. During 2002, the wineries sold approximately 77,700 9-liter equivalent cases of wine for \$15.7 million.

Leucadia has invested \$60.9 million in the wineries, mostly in vineyard development in Napa Valley and the Willamette Valley. At the present time, absent a large acquisition, we do not see the necessity for further investment. The wineries are generating sufficient cash internally and so far the economic downturn seems not to have hit our segment.

The 2002 year end issue of the *Wine Spectator*, the premier commentator on wines and the wine business, included an annual list of the 100 best wines in the world. To our great pleasure, #4 on said list is 1999 Pine Ridge Stags Leap Cabernet Sauvignon and #46 is the 2000 Pine Ridge Carneros, Dijon Clones Chardonnay.³ A spectacular result—congratulations to Stacy Clark, our wine maker, and the rest of the staff. George Scheppler, who just celebrated his one year incumbency as President and CEO, is our oenological rabbit's foot!

Remember—wine is food, and has been since Homer imagined the voyage of Odysseus across the “wine-dark seas.” A glass of Pine Ridge or Archery Summit wine each day is good for your health, your good cheer, and makes your fellow shareholders happy!

Depending upon your state liquor laws, you may order wine through the mail or on the Internet at www.pineridgewinery.com or www.archerysummit.com. Both wineries are quite beautiful from spring through the fall grape crush. Come visit and taste! Call Pine Ridge at (800) 575-9777 or Archery Summit at (800) 732-8822 and tell them you are a Leucadia shareholder, ask for a tour and become a member of our wine club.

³ Sadly, both of these wines are sold out.

MK Gold

MK Gold is traded on the NASD OTC Bulletin Board (Symbol: MKAU.OB); Leucadia owns 72.8%. MK Gold owns Cobre Las Cruces, S.A., a Spanish company that owns the Las Cruces copper deposit in the Pyrite Belt of Spain. As a result of approximately 280 drill holes totaling over 82,000 meters, proven and probable reserves are estimated at 15.8 million metric tonnes grading 5.94% copper. A feasibility study completed by Bechtel International, Inc. estimates the capital cost will be approximately \$290 million to bring the mine into production, excluding interest and other financing costs. Cash operating costs are estimated at \$.33/lb of copper. Opening the mine will be subject to permitting and obtaining both debt and equity financing for the project. A mining concession application, accompanied by the feasibility study and an environmental impact study, was submitted to the applicable governmental agencies during the first quarter of 2001. As of this writing at the end of March 2003, the process of obtaining permits continues. There is no reason to believe they will not be issued, but we knoweth not when. Prayers for high copper prices and friendly bankers are also in order.

FINOVA

FINOVA, a financial services holding company that emerged from bankruptcy in August 2001, is 50% owned by Berkadia, a company jointly owned by Berkshire Hathaway Inc. and Leucadia. On August 21, 2001, Berkadia made FINOVA a \$5.6 billion loan to finance FINOVA's chapter 11 plan. Leucadia has guaranteed 10% of Berkadia's borrowings to fund the FINOVA loan. Leucadia has a ten-year management agreement with FINOVA.

Larry Hershfield, our long-time Leucadia colleague was the Chief Executive of FINOVA until his departure in September of 2002. Larry has gone to seek his fortune doing transactions for his own account. After 17 years with us, he will be missed and we wish him great success.

Tom Mara, our long-time Executive Vice President, has become the new CEO and Glenn Gray, a FINOVA executive, was promoted to COO. Together they are a formidable team and are doing a splendid job.

Leucadia owns, through Berkadia, 25% of FINOVA's common stock and shares the \$8 million annual management fee equally with Berkshire, plus receives interest on 10% of the Berkadia loan, less 10% of Berkadia's cost of funds.⁴ Leucadia also received in 2001 \$60 million of the \$120 million in fees charged to FINOVA for the loan.

Since emergence from bankruptcy in August 2001, FINOVA's business activities have been limited to the orderly collection and liquidation of its assets. FINOVA is not engaged in any new business development activities, except to honor existing customer commitments and to restructure financing relationships with existing customers in an effort to maximize their value. As a result, FINOVA's workforce has been restructured to focus exclusively on these activities and staffing levels have been reduced in a manner that is consistent with the reduction in assets.

Management does not expect that there will be sufficient funds to fully repay FINOVA's New Senior Notes, which get paid after the Berkadia loan, and if so, there will not be a return to the FINOVA stockholders—both results are consistent with our expectations subsequent to 9/11.

For further details, we recommend you read the FINOVA 10-K.

⁴ Through December 31, 2002, these payments totaled \$17.8 million.

WilTel Communications

In the fourth quarter of 2002, Leucadia acquired 44% of the 50 million shares of outstanding common stock of WilTel Communications Group, Inc. for an aggregate purchase price of \$330 million. The WilTel stock was acquired under the chapter 11 restructuring plan of Williams Communications Group, Inc. In October 2002, in a private transaction, we purchased an additional 1,700,000 shares of WilTel common stock for \$20.4 million. Together, these transactions resulted in Leucadia acquiring 47.4% of the outstanding common stock of WilTel for an aggregate purchase price of \$350.4 million. After the bankruptcy, the company changed its name to WilTel Communications Group, Inc., and is now a publicly traded telecommunications company that owns or leases and operates a nationwide inter-city fiber optic network extended locally and globally to provide Internet, data, voice and video services. WilTel is listed on the NASDAQ (Symbol: WTEL).

Some WilTel facts:

- Nearly 30,000 miles of fiber optic cable, of which 28,554 is currently in use;
- Local fiber optic cable networks within 20 of the largest U.S. cities;
- 120 network centers located in 107 U.S. cities;
- Operational border crossings between the U.S. and Mexico, via California and Texas, and between the U.S. and Canada, via Washington, Michigan and New York;
- Capacity on five major undersea cable systems connecting the continental U.S. with Europe, Asia, Australia, New Zealand and Hawaii.
- WilTel's principal customers are other carriers and its largest customer is SBC Communications, which accounts for approximately 40% of its revenues under a long-term contract.

For a more detailed description of WilTel and its operations, we recommend interested shareholders consult the WilTel 10-K, a copy of which we are including with our annual report. The complexity and distress of the telecommunications industry is fully described therein and we thought that given our large investment you ought to have an opportunity to read it. WilTel is a work in progress. There has been much accomplished but there is much more to do. When we made the investment, we were aware that the telecommunications industry was experiencing great instability and therein was the opportunity. We were not aware that the company was as organizationally disheveled as it turned out to be. This fact has not changed our long-term enthusiasm for the investment, but has put significant pressure on cash and survivability in the short term. WilTel will likely need to raise additional capital in the next several years.

When we first became involved with WilTel the directors planned to undertake a national search for a CEO, but quickly decided that given the essential need for a quick restructuring the best candidate was in our midst. Jeff Storey, then Vice President and General Manager of Operations, although not yet CEO-hardened, was the obvious choice. His promotion was well received in the bankruptcy-battered company. Jeff is significantly responsible for WilTel's best trait—a national wholesale fiber optic network that we believe is best in its class. Bud Scruggs and the Leucadia Asset Management Group he heads have provided Jeff lots of fingers to stick in leaking dikes whilst he remakes the company.

Accomplishments To Date:

- In the last eight months, head count has been reduced from 3,000 to 2,200. In the past six months, 53 vice presidents have been reduced to 15. The previous organizational structure looked like a wedding cake. It has been collapsed and currently resembles a blueberry pancake!
- In spite of the turmoil of bankruptcy and the significant downsizing, the world class operational performance of WilTel's network has remained best in class. (The Atlantic-ACM "Wholesale Carrier Report Card" ranked WilTel first overall among wholesale carriers.)
- Refocused the organization from internal product-centric focus to external customer focus.
- Reduced run rate costs between January 2002 and 2003 by \$18.7 million or \$224 million per annum.
- Hired an experienced senior sales manager from outside the company. We wish Pete Bell and WilTel a profitable, energetic sales-driven future together.

Challenges That Remain:

- The biggest challenge continues to be growing profitable revenue in the face of declining prices occasioned by overcapacity and bankruptcy of our competitors who are pricing for short-term cash development. WilTel is winning business and expanding whilst it restructures its marketing, but it is slow going. There are signs that price erosion may be ebbing.
- Becoming the low *cost* provider.
- Carefully husband WilTel's cash. Carefully control capital expenditures and aggressively manage working capital.
- Put a plan in place for future funding when it becomes necessary.

We remain confident that our investment over the long term will be a good one.⁵

A special thank you to our "anchor tenant" and largest customer, SBC. WilTel did them a great disservice by stumbling into bankruptcy. SBC's senior management has been tough, demanding and helpful. SBC's and WilTel's original concept of outsourcing carriers' networks was brilliant strategically and saved SBC substantial capital investment. It is the newly emergent WilTel's job to deliver the goods for SBC and its other customers.

From an income statement point of view, Leucadia is required to record its share of WilTel's profits or losses. This will mean that while WilTel may be progressing nicely, we could be showing losses until our investment is reduced to zero. We will explain this all again in next year's annual report.

WebLink

On the last day of 2002, we purchased 80% of the common stock of WebLink Wireless, including its \$21 million in unrestricted cash, 100% of its \$18.8 million of Senior Secured notes, and 89% of its \$20.5 million of PIK notes, all for \$19 million. WebLink had revenues of \$160.3 million for 2002, having fallen from a peak of \$324.4 million in 1999. WebLink is a paging and 2way messaging company, whose fortunes along with all its competitors have fallen on hard times due to the march of technology, where cell phones have supplanted the pager for most users. At one time there were

⁵ Our fingers are crossed.

about 38 million pagers, today maybe 15 million. The market cap of the industry has fallen from about \$4 billion to almost zero. We don't expect a rebound but believe that a consolidation of the survivors will produce an attractive cash flow, as there seems to be a base demand for paging and 2way messaging from business users who need to communicate with their employees, but who do not want to pay for chatting on cell phones to Granny and surfing the net. This is a classic "cigar butt" investment, a term which an investor we admire coined referring to an industry with one or two puffs left. Though we are agnostic on the point, the management of WebLink believes that new attractively priced 2way devices which hopefully will be available later this year and telemetry products offer upside potential. We hope they are right and will encourage their efforts.

Real Estate

During 2002 we sold our interest in Compagnie Fonciere FIDEL, our French real estate subsidiary, and recorded an increase to equity of \$12.1 million. This sale winds up a successful investment brought to us through the efforts of Zalman Jacobs and Luis Medeiros.

At year end, we had \$85.2 million invested in domestic real estate. These properties include residential land developments, commercial properties and land in various stages of development. The final sell-out of our property in Rosemary Beach, Florida is almost complete. Kudos to Patrick Bienvenue for a successful project.

During the fourth quarter of 2002, we sold CDS Holding, one of our domestic real estate subsidiaries, to HomeFed Corporation for \$25 million, paid with \$1 million in cash and 24,742,268 shares of HomeFed's common stock, representing 30.3% of the outstanding shares. Many of our long-term shareholders are HomeFed shareholders (both of us own substantial stock in HomeFed and are directors), having received the shares through a 1998 dividend. HomeFed trades on the NASD OTC Bulletin Board (Symbol: HFDC.OB).

Maryland Jockey Club

In November 2002, the Company sold its 40% interest in a thoroughbred racetrack business in Maryland for net proceeds of \$28 million and recorded a pretax gain of \$14.3 million. We retained for 20 years an approximate 15% profits interest in gaming opportunities other than horse racing developed by the buyer. Zalman Jacobs and Luis Medeiros also engineered this successful investment. Luis regrets that he no longer has a good excuse for spending time at the track.

Empire

From a financial perspective, the sad story of Empire Insurance Company is behind us since our remaining equity was written off last year; from an operating perspective, it is not. During 2002 the significant downsizing of Empire continued. Under the general direction of Bud Scruggs, Rocco Nittoli continues the important but thankless task of escorting Empire to the doors of the hereafter! Asked recently, what's up, here is what Rocco said:

"Every time we make some progress, we are quickly reminded about marketplace events that continue to exhaust our very limited capital—auto fraud, increasing settlement values for claims in litigation, and inadequate rates for the coverage being provided. During 2002, net earned premiums totaled \$13.9 million, a decline of \$50.2 million from 2001. This decline was not pain-free, and at December 31, 2002, the Empire Group's statutory surplus totaled \$16.4 million, a decline of \$6.8 million from the prior year.

The road ahead remains bumpy and the statutory surplus is critically low. Frequent downsizing and restructuring is necessary to minimize the inefficiencies that result from running off an insurance operation and we must find ways to put an end to Empire's surplus erosion. Given the extended period of time to report and settle liability claims, many years will expire before we know if any value from Empire can ever be reclaimed. We are hopeful, but not optimistic."

Rocco is doing a great job!

Money and Other Things

As mentioned previously, one of our rules is to pay as little tax as the law allows. In 2002, the Internal Revenue Service completed the audit of Leucadia's consolidated federal income tax returns for the years 1996-1999, without any material tax payments required. The 2002 results reflect a reversal of approximately \$120 million of tax accruals arising from good tax planning and the use of net operating loss carryforwards from acquired companies. Our thanks especially go to Joe Orlando, our CFO; Phil Cannella, Director of Taxes and Mark Hoenig of Weil, Gotshal & Manges.

Leucadia owns 25% of the common stock of Olympus Re Holdings, Ltd, a Bermuda reinsurance company primarily engaged in the property excess, marine and aviation reinsurance business. For 2002, we recorded \$24.1 million in pretax income for this investment that had a book value of \$155.7 million at the end of the year. There were no catastrophes related to weather to speak of in 2002, which provided the high return. Reinsurance rates remain high for the time being, which augur well for the near future. Again, we will start watching the weather channel in August.

In 2002, we recorded \$15.2 million of pretax income from our \$100 million investment in JPOF II, an investment which mirrors the high yield trading desk of and is managed and controlled by Jefferies & Company, Inc.

Leucadia owns 4.5% of White Mountains Insurance Group, a publicly traded Bermuda-domiciled financial services holding company. The market value of our holding at December 31, 2002 was \$121.1 million against a cost of \$75 million.

Since 1982 we have had a very pleasant and successful partnership with The Jordan Company and Jordan/Zalaznick Capital Company. These entities specialize in structured leverage buyouts. During 2002, The Jordan Company raised a \$1.5 billion fund to conduct these future operations. Leucadia committed to invest \$10 million in the general partner of the fund. Since 1982, this relationship has been very profitable for both sides but now the former partnership comes to an end, as all future transactions will be done in their new fund.⁶

Jay Jordan came into our lives shortly after business school, when the undersigned were learning their trade at Carl Marks & Co. under the tutelage of Robert Davidoff and Ed Marks.

Jay is a smart, energetic, sparkly-eyed Notre Dame Irish linebacker type. Our first encounter was listening to him explain with great conviction that we should ignore the fact that he hadn't graduated "officially" from the Columbia Business School because he refused to take physical education. He was hired at Carl Marks in the summer of 1971 and our lives have been intertwined ever since. He is our brother!

We wish Jay and David Zalaznick great success in the new chapter of their business life.

⁶ Leucadia has earned \$110.9 million since inception of its relationship with The Jordan Company and carries 40 investments on our books for \$62 million, which will eventually be sold.

During 2002, we acquired an additional 15% of Barbados Light and Power, raising our ownership percentage to 36%. We urge all shareholders to visit Barbados frequently and keep their lights on and the room temperature set to very cool.

In December 2002, the Company completed a private placement of approximately \$150 million of Leucadia common stock at \$35.25 per share to the mutual fund clients of Franklin Mutual Advisers, LLC. The price was satisfactory to us, and in the business environment ahead there will be no such thing, for Leucadia, as too much liquidity.

At December 31, 2002, Leucadia had readily available cash and marketable securities of \$680 million, excluding amounts held by regulated subsidiaries and \$170.1 million of cash and securities collateralizing letters of credit.

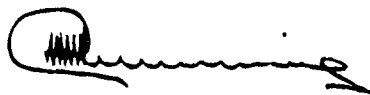
The Future

As we write this, the ground war in Iraq has just begun. This has produced, in at least one of us, a miasma over what would have otherwise been outright enthusiasm for investment opportunities as asset prices deflate to more sensible levels after 15 years in the stratosphere.

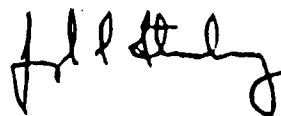
No matter what, wars are expensive, disruptive and bring unintended consequences. At least two of our fellow hardworking employees have been called to active duty and perhaps into harm's way. We pray for their safe return. We are in a very cautious mood. We will, however, persevere in the work for which the shareholders compensate us so handsomely.

Lastly we want to pay tribute to our friend and colleague, Barry Burris who died on May 10, 2002. When we first became involved in the enterprise which has become Leucadia, Barry was the second partner on the account from Coopers & Lybrand. Shortly thereafter, he became the partner in charge of the Leucadia account. In many ways Barry was our mentor, teaching us the arcane and sometimes silly rules of GAAP, warning us away from transactions where our enthusiasm did not match the numbers uncovered by due diligence and most of all by being a good friend. He was an important influence in the lives of our key executives including Jane Goldman, Joe Orlando, Tom Mara and, most of all, our retired CFO, Norm Kiken. In semi-retirement, Barry could most often be found on his boat, but was always available to be hauled ashore for a consultation. In several battles over accounting issues, Barry forcefully advocated our position to victory. But as much as he fought for us when we were right, he was equally effective in fighting with us when we were wrong. And for that we are grateful and will miss him very much. In this age of Enron and discredited accounting firms Barry was the exact opposite, bringing credit to his chosen profession.

Thanks to one and all of our employees and advisors who have assisted our efforts this last year.



Ian M. Cumming
Chairman



Joseph S. Steinberg
President

Letter from the Chairman and President

2003

To Our Shareholders

In 2003, Leucadia reported \$97 million in after tax income or \$1.57 per fully diluted share. Included in this calculation are 11,156,460 shares issued in November 2003 for the remainder of WiTel we did not already own. WiTel is now a wholly-owned consolidated subsidiary. In 2003, Leucadia earned an anemic 4.5% return on ending equity.

Since December 31, 1978, shareholders' equity has grown from a deficit of \$7.7 million, when this management took over, to equity of \$2.13 billion at December 31, 2003. From December 31, 1979¹ to December 31, 2003, book value has compounded at 20.85% per annum and the market price of Leucadia common stock has compounded by 25.19%. During the same period, the S&P 500 compounded at 10.21%. In addition, not included in this calculation are dividend payments of \$945.2 million including the special dividend paid in 1999. Also during the same period, we repurchased 44,010,684 split-adjusted Leucadia shares for \$331.2 million, at an average price of \$7.53 per share.

Financial assets remain very expensive and markets frothy. Prospects for the economy seem neutral at best, but the prices of financial assets are predicting a rosy future. Here are the things we worry about which point in the opposite direction:

Interest rates are at a historical low point. If the economy falters there is not much room for stimulation. Can short term rates go much lower than 1%? (Japan's experience is not encouraging, but we hasten to add that we do not know much about Japan.)

The steep yield curve has encouraged Wall Street's love affair with the "Carry Trade" which will come to tears when interest rates rise, not only causing the speculators to lose money, but seriously disrupting financial markets. ("Carry Trade" means buying, for example, a batch of United States ten year bonds yielding 4%, financed by overnight borrowings at 1% and hoping nothing changes.)

The current account deficit continues to be stubbornly negative and continues to grow.

We sell less and less to the rest of the world. Foreign grown agricultural commodities have become more competitive and plentiful, worldwide manufacturing is moving to China and the outsourcing of labor to foreign lands is becoming more practical due to advances in communications. (Will all our children be hedge fund managers and bond traders?)

Due to the war in Iraq and the costs related to combating terrorism, the Federal government will run large budget deficits for the foreseeable future. State and local governments are in the same pickle. Higher taxes will be needed to fund these deficits.

Since our domestic savings rate is very low, we rely on the kindness of strangers, i.e., foreign investors and governments to fund our deficits by buying Treasuries. Japan has been buying billions per month during 2003. When Japan finally gets its house in order won't it need money to invest in its own economy?

The Dollar has depreciated so sharply against other major currencies, causing foreign investors to lose a lot of money, and, at least in the short run, making us a risky place to invest. At the beginning of 2003 there were .97 Euros to the Dollar. It is now .81 Euros. The same slice of pizza in Rome at the end of the year was either 16.5% smaller in size or cost 19.7% more in dollars than at the beginning of the year. Our fall trip to Italy is going to cost BIG BUCKS.

Housing prices have gone through the roof. The housing lots of our affiliate, HomeFed Corporation, and our lot developments in Florida are in great demand and have appreciated greatly in price,

¹ We can't use 1978 year end because the ending equity was negative.

funded, we believe, by the availability of low or no down payment mortgage financing. Our anecdotal experience is that homebuyers are buying bigger houses, taking on the maximum allowable debt, financed by variable rate mortgages? What happens when variable rates double from 2% to 4% is anybody's guess, but the housing and construction markets will certainly not benefit. Chairman Greenspan suggested recently that homebuyers finance with variable rate mortgages and forego the security of higher cost, fixed rate financing. To our mind this is the "Carry Trade" comes to Main Street.

Oil and energy prices have risen dramatically in the last year. At the beginning of 2003 domestic crude oil was \$31.85 per barrel. At March 30, 2004 it was \$36.25. As might be expected, coal and gas prices have similarly risen. As citizens we seem to have no or little interest in curbing consumption.

Lastly, there seems to be meager growth in employment with many formerly well paid workers being either laid off or forced to take pay cuts.

So why is the Dow Jones over 10,000 and the NASDAQ 100 over 1,400? We don't know why, but have concluded that this is a good time to husband our readily available cash and marketable securities, which were \$1.2 billion at year end.

Now for the good news. Several interesting and profitable businesses and transactions came to our attention this year, more about them later. We remind ourselves and our shareholders of a few principles guiding our acquisitions and business conduct.

1. Don't overpay.
2. Buy companies that make products and services that people need and want and provide them as cheaply as possible with consistently high quality. Search out candidates in out-of-favor industries that have turn-around potential. Our record as midwives to resuscitating disorganized, unprofitable, bedridden and moribund companies is pretty good.
3. Earnings sheltered by net operating loss carryforwards (NOLs) are more valuable than earnings that are taxed by the IRS.
4. Pay employees for performance and expect hard work and honesty in return.
5. Don't overpay.

Our long term hope is to compound equity per share at a better than average rate. If we succeed, our shareholders will be well served. When we see few attractive opportunities we stay out of the market.

Before going on to a detailed review of the year with its successes, failures, opportunities and risks, this chart³ shows the reader how we think about our year end assets and liabilities (in millions).

Assets		Liabilities and Net Worth	
Subsidiary Operating Companies	\$ 1,000.5	Corporate Debt	\$ 560.3
Associated Companies	\$ 430.9	Net Worth	\$ 2,134.2
Other Corporate, net	\$ 25.4		
Corporate Cash and Investments	\$ 1,237.7		

² On March 20th, we sent reservation letters to prospective purchasers of lots at Draper Lake, our new 95-lot development project in Walton County, Florida. We received nearly 190 expressions of interest from the owners at our other development project, Rosemary Beach, also in Walton County, Florida. Binding contracts are expected soon. An extraordinary sellout, if it happens.

³ These are unconsolidated figures on an equity method basis rather than the consolidated numbers that you can see on our audited year end balance sheet. The SEC says we can't report these to you without presenting at the same time the most directly comparable GAAP measures. So "Subsidiary Operating Companies" represents \$2,499.3 million of assets net of \$1,498.8 million of liabilities and "Other Corporate, net" represents \$178.8 million of assets net of \$153.4 million of liabilities on our consolidated balance sheet.

WilTel Communications Group

In the fourth quarter of 2002, Leucadia acquired 44% of the 50 million shares of outstanding common stock of WilTel (formerly Williams Communications Group, Inc.), for an aggregate purchase price of \$330 million. The WilTel stock was acquired pursuant to the chapter 11 restructuring plan of Williams Communications Group, Inc. In October 2002, in a private transaction, we purchased an additional 1,700,000 shares of WilTel common stock for \$20.4 million. Together, these transactions resulted in Leucadia acquiring 47.4% of the outstanding common stock of WilTel for an aggregate purchase price of \$350.4 million.

In November 2003, Leucadia purchased the balance of the WilTel common stock it did not already own in an exchange offer for 11,156,460 Leucadia common shares, which were recorded at a value of \$422.8 million. WilTel is now a wholly-owned, consolidated subsidiary of Leucadia.

For a more detailed description of WilTel and its operations we recommend that interested shareholders consult the 10-K attached, pages 5-18. The complexity and distress of the telecommunications industry is described in detail therein and we think that, given our large investment, you should read it. This is by far the largest investment Leucadia has made to date. WilTel is a work in progress. Much has been accomplished but much more remains to be done. When we made the investment, we were aware that the telecommunications industry was experiencing great trauma and therein was the opportunity. We were not aware that the Company was as organizationally disheveled as it turned out to be. The dishevelment has been remedied.

Last year we reported the battlefield promotion of Jeff Storey from Vice President and General Manager of Operations to CEO. WilTel's shining jewel and best competitive advantage is its modern efficient network. Jeff and his team are our kind of people—moderate respect for authority and a dedication to excellence and truth! We now have a battle-hardened CEO building a team selling the advantages of a high quality, reliable, low-cost network.

What follows is a list of facts, accomplishments and challenges as we and Jeff see them.

WilTel Facts:

- Nearly 30,000 miles of fiber-optic cable, of which 28,627 is currently in use.
- Local fiber optic cable networks within 36 of the largest U.S. cities.
- 118 network centers located in 107 U.S. cities.
- Fiber-optic cable connecting the U.S. and Mexico in California and Texas; and the U.S. and Canada in Washington, Michigan and New York.
- Capacity on five major undersea cable systems connecting the continental U.S. with Europe, Asia, Australia, New Zealand, Guam and Hawaii.
- A long term contract with SBC, its largest customer, which accounts for approximately 52% of WilTel's total 2003 revenues under a long-term contract. SBC's business with WilTel is growing.

Accomplishments To Date:⁴

- Since the beginning of 2002, headcount has been reduced from 3,900 to 1,970. This included dropping from fifty-five vice presidents to nine.
- Segment operating performance⁵ has turned around from a \$45 million loss in 2002 to income of \$79 million in 2003.
- 2003 revenue grew by 13%, improved gross margin by 11% and reduced operating expenses (excluding depreciation and amortization expenses) by 24% in 2003 versus 2002.
- WilTel's voice business grew, carrying 3.3 billion minutes per month. (3.3 billion minutes/month is 100 million minutes/day, 4,166,166 minutes/hour and 69,444 minutes/minute—a lot of people talking all at once!) This is up from about 1.7 billion/month in January of 2003.
- The Atlantic-ACM "Wholesale Carrier Report Card" ranked WilTel first overall among wholesale carriers for the third year in a row. WilTel ranked first in five of the six categories in the survey: customer service, provisioning, billing, pricing and products⁶.
- Turned its Vyvx business profitable by shutting down non-profitable lines of business and reestablishing the market leadership in technology and customer relationships. Vyvx is the premiere provider of broadcast quality video transmission.
- Demonstrated courage, commitment, competence and flawless execution by launching for the first time High Definition TV transport over an IP infrastructure for the 2004 Super Bowl, one of the world's most watched sporting events.
- Met the operational needs of our largest customer, SBC, in an efficient and timely manner.

Challenges That Remain:

- The biggest challenge continues to be growing revenue in the face of declining prices, occasioned by continued overcapacity. WilTel is winning new business and expanding whilst it restructures its marketing, but it is slow going. There are feeble signs that price erosion may be ebbing, but more slowly than we had hoped.
- Sorting out the future of Internet telephone calls, Voice Over Internet Protocol (VOIP) and its effect, positive or negative, on WilTel.
- Continuing to serve the needs of WilTel's largest customer, SBC, at mutually agreeable prices.
- Carefully husbanding WilTel's cash and aggressively managing working capital.
- Carefully controlling capital expenditures to include only projects where the return on investment makes sense.
- Developing new products and services for data customers.
- A net operating tax loss carryforward of \$3.4 billion as of year end offers a tantalizing opportunity to shelter future profits and examine sensible merger/acquisition opportunities. WilTel's other tax attributes provide future tax deductions that will be partially available to shelter a portion of Leucadia's other earnings.

⁴ WilTel became a consolidated subsidiary of Leucadia in November 2003. The amounts below include amounts reported by WilTel for periods both before and after it became a consolidated subsidiary.

⁵ Segment operating performance is income before income taxes, interest expense, investment income, depreciation and amortization expense and other non-operating income and expense.

⁶ WilTel's goal is to rank first in the sixth category, network, next year.

We remain confident that our investment over the long term will be a good one. Some good luck and a few prayers will help!

Healthcare Services-Symphony Health Services

In September 2003, Leucadia acquired Symphony Health Services which is primarily engaged in physical, occupational, speech and respiratory therapy. The purchase price was \$36.7 million including expenses, of which approximately \$29.2 million was provided by non-recourse secured financing. Revenues for the four months ended December 31, 2003 were \$71 million.

Symphony currently operates in 40 states, providing services at 2,000 locations, with a workforce of 4,900 employees, some part-time. Their services are offered under the following brands: RehabWorks, Symphony Respiratory Services, NurseWorks and Polaris Group.

Symphony offers the opportunity to healthcare providers to outsource some of their patient's treatment needs. Some nursing homes, for instance, don't need a full-time physical therapist but are required to have the service available on demand. Symphony's employees can work part-time during the hours of their choice. This need for services and this desire for work mesh nicely. Fortunately for Symphony, as the population ages, the demand for healthcare professionals grows. Recruiting therapists as well as customers are the major factors in Symphony's successful business model.

The management is provided by one Sally Weisberg. Sally was originally a therapist who, in 1987, founded the predecessor to Symphony and several years later sold it for a nice profit. The buyer, also in the healthcare industry, ended up with its whole collection of companies in bankruptcy, much to Sally's chagrin. Working diligently, Zalman Jacobs and Luis Medeiros (of FIDEL, Maryland Jockey Club and Waikiki hotel fame) convinced Sally that we would be satisfactory partners and together they extracted Symphony from the bankruptcy process. After three years of bankruptcy trials and tribulations, Symphony joined the Leucadia family.

Sally has set a challenge for all new Leucadia company investments. Her target is to pay back our investment this year! If accomplished, it will be formally named "The Weisberg Maneuver".

We are optimistic about future growth both organic and through possible mergers. If you know of any candidates, call Sally at (443) 886-2200.

Manufacturing

Conwed is a leading manufacturer of lightweight plastic netting used for a variety of purposes, mostly to provide barriers or to strengthen other materials in industries such as construction (plastic fencing), agricultural (bird net and sod net), carpet padding, packaging (reinforced shipping paper) and consumer products (strengthening mop pads and industrial hand wipes). Our netting ends up in thousands of products that are sold throughout the world. Our products are manufactured in Minneapolis, Minnesota; Athens, Georgia; and Ghent, Belgium. In 2003, 16% of the revenues resulted from sales outside the U.S.

This company has good and bad attributes. The bad ones are lots of price competition, ever unstable raw material prices and product substitution by other materials. It must constantly reinvent itself with new product offerings. In 2004, we launched a new biodegradable product which is being sold into the erosion control market. We spend between 2% and 5% of sales on the reinvention effort.

The good attributes are that the company rides the waves of the U.S. economy and gives us advance warning of market softness. Over all the years, good and bad since March 1985, Conwed has given us a very high return on investment. Some might call Conwed a cash cow, but we prefer to call it a cash gazelle!

(In millions)	1999	2000	2001	2002	2003
Sales	\$ 64.0	\$ 65.0	\$53.7	\$50.7	\$53.3
Pretax profits	\$ 11.9	\$ 11.3	\$ 7.8	\$ 3.1	\$ 4.4
Return on average equity	42.2%	28.7%	16.5%	7.8%	12.6%

Our management team, under the able leadership of Mark Lewry, does a great job of orchestrating profitability through all these problems. We are currently facing underutilized capacity, the result of building a plant in Europe at the wrong time, for which the undersigned accept responsibility. There have also been several missteps in getting the Belgium management right and the decline in the value of the Dollar relative to the Euro has not helped either.

MK Gold

Leucadia has \$64.3 million invested in 72.5% of MK Gold, a public company trading on the NASD OTC Bulletin Board (Symbol: MKAU). MK Gold owns Cobre Las Cruces, S.A., a Spanish company which holds the exploration and mineral rights to the Las Cruces copper deposit in the Pyrite Belt of Spain. For history buffs, this belt of mineralization has been exploited since Roman times.

During 2003, three important water permits and the mining concession were received, including environmental approvals from Spanish and Andalusia government agencies. Land acquisition is in full swing. Other permits are required and should be obtained this year. Detailed engineering may begin soon.

Since January 1, 2003, and as of March 9, 2004, capital costs in U.S. Dollars to develop the mine have escalated to \$346.4 million (€281 million), excluding interest during construction and other financing costs. This escalation is due to depreciation of the Dollar from \$1.05 per Euro at December 31, 2002 to \$1.26 per Euro at December 31, 2003. Construction and operating costs are mostly in Euros and revenues in Dollars. The good news is that copper prices have risen from \$.70 to \$1.05 per pound in the same period. If the ratio between the Dollar and the Euro remains what it is today, we will be fine. The status quo, however, is unlikely and the relationship between the Euro, the Dollar and copper prices will provide excitement in bringing this project to fruition.

The financing efforts have begun under the direction of Frank Joklik, Chairman of MK Gold, a long-time copper miner who is wise in the vagaries of mining and metal markets, and Tom Mara, President of MK Gold and Leucadia's highly regarded long-term Executive Vice President and Treasurer. If it can be done, they will get it done.

Wineries

Leucadia owns two wineries: Pine Ridge in Napa Valley, California, born in 1978, and acquired by us in 1991, and Archery Summit in the Willamette Valley, Oregon (on Archery Summit Road), which we founded and constructed in 1993. These wineries sell 76% of their production into the luxury segment of the premium table wine market, which is defined as over \$25 retail per 750 ml bottle, and 24% of its production (9% of revenue) into the "we the people" segment of the market, into which we sell a delicious Chenin Blanc made from purchased grapes. Our wineries' President, George Scheppeler, hates the Chenin Blanc since it takes a place on restaurant wine lists that he wants reserved for estate wines, but his CFO, David Workman, and we like it for the gross profit and contribution.

In 2002, we sold 77,700 9-liter equivalent cases total, in 2003 only 63,500. We managed to avoid the economic downturn in the luxury segment in 2002, but last year it found us. We had too much Merlot to sell and it took us several additional months to sell the Merlot inventory. As fashion trends change, so do wine fashions; Merlot is out, Cabernet is in. Thus is the fate of many luxury consumer products.

The 2003 harvest at Pine Ridge was exceptionally good. Just before it was time to pick the grapes, however, a heat wave appeared with extremely low humidity. The grapes perspired and got smaller resulting in a reduced tonnage harvested. Early returns are that the juice is of a higher quality. We wait patiently for the 2003 vintage of Cabernet, which will be released in 2006, to see what we have! The wine reviews for the 2001 Archery Summit wines were great and our all women team of winemaker and viticulturist is making great wine.

Remember—wine is food, and in moderation is good for vascular upkeep. Wine has been our friend in times of woe and celebration since mankind lounged around the Tigris and Euphrates rivers in the Fertile Crescent, inventing agrarian and urban culture. But, not a pleasant place to be these days!

Depending upon your state liquor laws, you may order wine through the mail or on the Internet (www.pineridgewinery.com or www.archerysummit.com), or join our Wine Club and thereby keep track of this management's labors on a monthly basis!

Both wineries are beautiful from spring through the fall grape crush. Come visit, join our Wine Club, announce you are a Leucadia shareholder and ask for a tour. The tasting rooms are open seven days a week. When you identify yourself as a Leucadia shareholder (the honor system) you will be given the shareholder 20% discount.

Call Pine Ridge at (800) 575-9777 or Archery Summit at (800) 732-8822.

Real Estate

In December 2002, we had \$85.2 million invested in real estate. In December 2003, we had \$144.3 million invested and reported earnings of \$18.1 million. The real estate operations include a mixture of commercial properties, residential land development projects and other unimproved land.

During the year we purchased a 90% interest in eight acres of unimproved land in Washington, D.C. for \$53.8 million. This land is near the U.S. Capitol building and across the street from the new headquarters of the Bureau of Alcohol, Tobacco and Firearms. The land is zoned for a minimum of 2,000,000 square feet of commercial space.

Leucadia owns 30% of the common stock of HomeFed, a publicly-traded company spun off from Leucadia in 1998. The stock trades on the NASD OTC Bulletin Board (Symbol: HOFD) at \$34.80 per share as of this writing. HomeFed principally develops residential lots in the San Diego area. The undersigned together own an additional 18.1% of HomeFed stock and one of us is its Chairman.

We own a 718-room hotel located on Waikiki Beach in Hawaii with a book value of \$41.6 million. Following an extensive renovation, the hotel's performance has been improving as rates have been increased and occupancy has held steady. Subject to availability, for the rest of the year the hotel is offering a discounted special Leucadia shareholder rate (again, the honor system) starting at \$109 per night, including breakfast. The hotel's reservation number is 800-877-7666 and the hotel's website is www.astonwaikiki.com.

Banking and Lending

Leucadia's banking and lending operations are principally conducted through American Investment Bank, N.A. (AIB), our nationally chartered bank, and American Investment Financial (AIF), a Utah industrial loan corporation. AIB and AIF take money market and non-demand deposits that are eligible for FDIC insurance.

"Honey, I Shrunk the Bank"⁷ **Banking and Lending Operations** **Consolidated Balance Sheets**

As of December 31, 2003, 2002 and 2001

Assets	12/31/03	12/31/02	12/31/01
Cash and short-term investments	\$ 7,089,333	\$ 18,551,340	\$ 17,884,817
Investment in marketable securities	57,918,958	113,836,765	80,001,809
Loan receivables	205,451,897	373,604,451	521,241,470
Allowance for loan losses	(24,235,698)	(31,849,330)	(35,695,756)
Receivables from affiliates	1,400	7,032	133,144
Other assets	7,830,637	20,502,478	29,451,366
	\$ 254,056,527	\$ 494,652,736	\$ 613,016,850
Liabilities and Stockholder's Equity			
Time deposits	\$ 145,517,048	\$ 392,914,895	\$ 476,513,063
Accounts payable and other liabilities, net	21,905,069	5,599,822	25,512,249
	167,422,117	398,514,717	502,025,312
Equity (includes advances from parent classified as equity)	86,634,410	96,138,019	110,991,538
	\$ 254,056,527	\$ 494,652,736	\$ 613,016,850

Leucadia began making consumer automobile loans to individuals with bad credit in 1988, through AIB and AIF. For several years this was a very lucrative business. America is, for the most part, only one story high and, except for major metropolitan areas, people need cars to get to work. Lending rates then were high and loan losses around 2%.

As interest rates dropped, competitors were drawn like bees to honey by the opportunity to lend at what seemed to be high rates. Massive amounts of less cautious money poured into what became known as sub-prime lending. Competitors reduced rates by 30%, business boomed and loan losses went straight up, stinging us as well as the newcomers.

In September 2001, we decided to stop originating sub-prime automobile loans. (See chart above.) The Company's other consumer lending products were suffering similarly. In January 2003, we stopped writing loans altogether.

We decided to attack in the opposite direction, known to those with less imagination as a retreat. Money not lost is money earned. Later this year we hope to surrender our banking licenses. Someday we may return to consumer lending when the risk/reward ratio returns to rationality. R.I.P., AIB and AIF.

⁷ "Honey, I Shrunk the Kids", Walt Disney Pictures, 1989.

We are grateful to Justin Wheeler and his staff for their dedication and hard work. It is, after all, much more fun to be attacking in the conventional direction.

FINOVA

FINOVA, a financial services holding company that emerged from bankruptcy in August 2001, is 50%-owned by Berkadia, a company jointly owned by Berkshire Hathaway Inc. and Leucadia. On August 21, 2001, Berkadia made FINOVA a senior secured \$5.6 billion loan to finance FINOVA's chapter 11 plan. Leucadia guaranteed 10% of Berkadia's borrowing to fund the FINOVA loan and receives 10% of its interest income, less interest expense. Berkshire and Leucadia also share an annual \$8 million management fee. Since 2001, Leucadia has received \$88.2 million in cash from this investment, which was all profit.

Tom Mara is FINOVA's CEO, and Glenn Gray, a FINOVA executive, is COO. Together they are a formidable team and are doing a splendid job.

Since emergence from bankruptcy in August 2001, FINOVA's business activities have been limited to the orderly collection and liquidation of its assets. FINOVA is not engaged in any new business development activities except to honor existing customer commitments and to restructure financing relationships with existing customers in an effort to maximize their value. As a result, FINOVA's workforce has been reduced to focus exclusively on these activities.

In February 2004, two years ahead of schedule, FINOVA paid off the Berkadia loan and Berkadia, in turn, paid off its bank loan, which extinguished Leucadia's 10% guarantee. Our future income from this investment is expected to be limited to our share of the management fee.

FINOVA does not believe there will be sufficient funds to fully repay FINOVA's outstanding public debt and therefore there will not be a return to the FINOVA stockholders—both results are consistent with the expectations we developed for this business subsequent to 9/11.

Empire

In December 2001, Empire was set upon the task of an orderly liquidation, and we wrote off our investment. Rocco Nittoli and his team are executing the plan very well and soon will have time to do more things at Leucadia. We maintain a cooperative relationship with the New York Insurance Department Commissioner.

WebLink

On the last day of 2002, we purchased 80% of the common stock of WebLink Wireless, a paging and two-way messaging company (which at the time had \$21 million of unrestricted cash on its balance sheet), 100% of its \$18.8 million Senior Secured notes and \$17.8 million of a \$20 million PIK note, all for \$19 million. The \$18.8 million Senior Secured notes have been paid off with interest! In 1999 revenues peaked at \$324.4 million and 2002 revenue was \$160.3 million.

There were 38 million pagers in service at the top of the market, now less than 15 million. Industry market capitalization at its high was \$4 billion; today it is about \$1 billion for independent companies. Cell phones have made pagers obsolete for most users.

Roll-ups of the remaining paging companies seem the only path to survival. The question was: would we be the "roll-uppee" or the "roll-upor?" The answer follows.

In the fourth quarter of 2003, WebLink sold substantially all of its operating assets to a subsidiary of Metrocall Holdings, Inc. for 500,000 shares of Metrocall common stock and warrants to purchase 125,000 shares of Metrocall common stock at \$40 per share. We got rolled-up!

At this writing, Metrocall stock is trading at about \$70 per share, indicating a potential cash profit from our paging investment of approximately \$32 million, if we sold the shares at that price. Also Metrocall and its major competitor have announced a merger.

Money and Other Things

In December 2003, Leucadia purchased all the senior secured debt obligations of ATX Communications, Inc. and certain of its affiliates for \$25 million. ATX is an integrated communications provider (known as a CLEC) that offers local phone service, long distance service, internet high-speed data and other communications services to its business and residential customers throughout the Mid-Atlantic and Midwest regions of the U.S. ATX is publicly traded on the NASD OTC Bulletin Board (Symbol: COMMQ).

In January 2004, ATX filed a chapter 11 bankruptcy petition in order to reorganize its financial affairs. Under certain conditions, Leucadia will convert its \$25 million investment into 100% of the equity of a reorganized ATX following the confirmation of a plan of reorganization.

At December 31, 2003, the book value of the Company's investment in Olympus Re Holdings, Ltd. (Olympus) was \$116 million. In June 2003, we sold 567,574 of our Olympus common shares back to the company for \$79.5 million and recognized a \$1.5 million gain. For the year we recognized \$40.4 million of pre-tax income from this investment under the equity method of accounting. We remain with a 16% interest.

We have a \$100 million investment in JPOF II, a registered broker dealer managed by Jefferies and Company. In 2004, the \$14.8 million of 2003 earnings from this investment was distributed to our exchequer.

We own 4.2% of White Mountains Insurance Group at December 31, 2003. This investment had a market value of \$172.5 million, for which we paid \$75 million.

The Company owns 36% of Barbados Light and Power Holdings Ltd., the parent company of Barbados Light and Power Company Ltd. Shareholders are encouraged to holiday in Barbados and not to turn off the lights and air conditioners!

During 2003, we sold \$275 million principal amount of 7% Senior Notes due in 2013. During 2004, to date we sold another \$100 million of the same issue.

In 2003, the Company recognized a tax benefit of \$24.4 million for the favorable resolution of certain federal and state income tax contingencies.

At December 31, 2003, readily available cash and marketable securities totaled \$1.2 billion. In the world ahead we think liquidity is good.

The Future

We commented earlier on our concerns about the uncertain world. Uncertainty breeds concern, concern breeds a lack of courage and hopefully asset undervaluation. In the resulting confusion, we hope to put the \$1.2 billion we have on hand to work at a better than average rate of return. Time will tell.

2003 was the 25th year the undersigned have been at the helm of Leucadia. It remains fun and interesting. One of us will be 65 in a year and a bit. He thinks the earliest retirement date should be 70! (Think of the delight that will bring to the Social Security Administration.)

Our friend and colleague Stephen Jacobs, Esq., of Weil, Gotshal & Millionaire has been at our side for 25 years (except for a two-year junket to the London office), and is ably assisted by his partner Andrea Bernstein. Steve is not only a good lawyer but an astute adviser. He carries an allegorical silver bugle in his pocket. When our ardor overcomes good sense, we hear the crystal clear sound of his bugle sounding retreat. He has blown it several times and the stockholders have been well served.

Tom Mara has also been with us since the beginning. He is a friend and an excellent executive up to any task, no matter how difficult. He is determined, focused and a self-starter! Our occasional histrionics never deter him from his duly appointed rounds. He is indispensable!

As the years roll on there are many others who have been with us a long time. In our view it is a remarkably intelligent, curious and effective bunch of people in whom we have great faith and to whom as shareholders we are grateful.

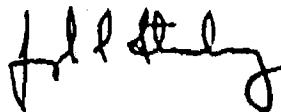
Mark Hornstein, who had been with us 22 years, retired in January 2004. He is missed but deserves the travel he so much enjoys.

Our friend, Edwin Marks, who gave us our start in the investment business and helped us acquire control of Leucadia, passed away in 2003. He was the President of Carl Marks and Company, our first employer after business school, and where we learned our trade. Edwin set an example which we admire and we cherish his memory.

Thanks to one and all!

A handwritten signature in black ink, appearing to read 'Ian M. Cumming', with a stylized, elongated tail.

Ian M. Cumming
Chairman

A handwritten signature in black ink, appearing to read 'Joseph S. Steinberg', with a stylized, elongated tail.

Joseph S. Steinberg
President

Financial Highlights

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2004

	2004	2003	2002
Revenues and other income	\$ 2,262,111,000	\$ 548,971,000	\$ 235,157,000
Net securities gains (losses)	\$ 142,936,000	\$ 9,953,000	\$ (37,066,000)
Income (loss) from continuing operations before income taxes, minority expense of trust preferred securities and equity in income of associated companies	\$ 55,285,000	\$ (31,753,000)	\$ (39,144,000)
Income tax benefit	\$ (20,192,000)	\$ (43,442,000)	\$ (144,075,000)
Minority expense of trust preferred securities, net of taxes	\$ —	\$ (2,761,000)	\$ (5,521,000)
Equity in income of associated companies, net of taxes	\$ 76,479,000	\$ 76,947,000	\$ 54,712,000
Income from continuing operations	\$ 151,956,000	\$ 85,875,000	\$ 154,122,000
Income (loss) from discontinued operations, net of taxes	\$ (8,269,000)	\$ 3,681,000	\$ 2,989,000
Gain on disposal of discontinued operations, net of taxes	\$ 1,813,000	\$ 7,498,000	\$ 4,512,000
Net income	\$ 145,500,000	\$ 97,054,000	\$ 161,623,000
Earnings (loss) per common share:			
Basic:			
Income from continuing operations	\$ 1.42	\$.94	\$ 1.85
Income (loss) from discontinued operations	\$ (.08)	\$.04	\$.04
Gain on disposal of discontinued operations	\$.02	\$.08	\$.05
Net income	\$ 1.36	\$ 1.06	\$ 1.94
Diluted:			
Income from continuing operations	\$ 1.40	\$.93	\$ 1.83
Income (loss) from discontinued operations	\$ (.08)	\$.04	\$.04
Gain on disposal of discontinued operations	\$.02	\$.08	\$.05
Net income	\$ 1.34	\$ 1.05	\$ 1.92
Total assets	\$ 4,800,403,000	\$ 4,397,164,000	\$ 2,541,778,000
Cash and investments	\$ 2,320,052,000	\$ 1,602,495,000	\$ 1,043,471,000
Common shareholders' equity	\$ 2,258,653,000	\$ 2,134,161,000	\$ 1,534,525,000
Book value per common share	\$ 20.99	\$ 20.09	\$ 17.16
Cash dividends per common share	\$.25	\$.17	\$.17

Letter from the Chairman and President

To Our Shareholders

In 2004, Leucadia reported \$145.5 million in after tax income or \$1.34 per fully diluted share. This is a 6.4% return on ending equity. Our returns on ending equity for the last five years were 6.4%, 4.5%, 10.5%, (0.6%) and 9.6%, averaging 6.1%. Thankfully, since we began in 1978, we have compounded our equity at 20.2%.¹ This calculation ignores dividend payments of \$972.1 million (including the special dividend paid in 1999 as a capital gain distribution), stock repurchases and the 1998 distribution of HomeFed shares to our shareholders. We are not pleased with the results over the last two years.

In the late 1990s there was a tremendous run-up in the value of assets. We concluded that prices were unsustainable and, therefore, sold most of our assets at significant gains. Last year it looked like values might return to more sensible levels. Competition for investment opportunities, however, roared back in the form of 35-year old hedge fund managers — private equity firms who have never known a bear market — and other investors willing to invest at high prices in risky assets with seemingly cheap money. These unguided optimists are ably assisted by the existence of an ebullient junk bond market and the hot potato bank loan market, where banks make loans sending them out the door before the ink has barely dried, disappearing into an amorphous market where credit is at best secondary and mostly forgotten. We wonder who buys these loans. All this speculation casts a familiar shadow and reminds us of 1988, and the time immediately before the demise of Drexel Burnham. But, every speculative era is different and ends in a new way. We are particularly struck by the fact that four of the twelve or so AAA companies listed on the New York Stock Exchange are all under investigation for alleged financial shenanigans (MBIA, AIG, Fannie Mae & Freddie Mac). It may be that it will take some time for the natural workings of capitalism to correct its own excesses, but the process in the end could get pretty ugly.

One of us had a conversation recently with the head of bank loan syndications at an eminent bank. The banker complimented us on our patience and allowed that many deals will likely blow up. He and his competitors have annual plans and budgets to meet and credit quality has succumbed to competitive pressures. While we thank the banking community for creating future inventory for future investments, it is difficult to remain disciplined and on the sidelines in a game we love. We are reminded of the picture of Sewell Avery, Chairman of Montgomery Ward during World War II, being carried out of his office in his chair for refusing to adapt to the times. Perhaps that is the fate in store for us.

Leucadia remains liquid with approximately \$1.8 billion available for investment without any further financial leverage. It is painful having money in the bank earning about 2%. Our investment philosophy is bimodal, either we invest in high returning opportunities or have the money in the bank or under our mattresses.

In the past, we have described what we do as buying assets that are out of favor and, therefore, cheap or disheveled in one way or another which makes them inexpensive. We then work very hard at improving their performance until they are the most efficient and productive in their market segment. But for now there are too many indiscriminant investors competing for the same opportunities.

¹ Since ending 1978 equity was a negative number, we used ending 1979 equity for the start of this calculation.

WilTel Communications Group

WilTel was a disheveled company when we came upon it. It had all the classic attributes of investments we like. It was distressed and in bankruptcy; had poor management that could be improved; had newly acquired assets that cost \$7 billion; had key customers needing its services; and as an extra bonus, had great tax attributes enabling Leucadia to eliminate its tax liabilities for many years to come. On the negative side, it was a participant in a highly competitive and rapidly changing industry where technology plays an important role. Further, although working diligently to expand its customer base, WilTel sells a commodity product in an oversupplied market to a few big customers who utilize their buying power to reduce prices.

By far, WilTel's largest customer is SBC. We are their key supplier of voice and data transport. With the pending acquisition of AT&T by SBC, we are working together with SBC to continue to provide high quality dependable service during the governmental approval process, which is likely to take a year or more, and the subsequent delicate transfer of this traffic to the AT&T network. In total this process will take no less than two and up to three or four years.

We currently believe WilTel will receive sufficient revenue during the transition period to pay off its bank debt and restructure its business. We will also be considering opportunities for consolidation. We do not believe that WilTel will become roadkill on the telecom highway. However, as of this writing we don't know whether the loss of SBC will result in the recognition of an impairment loss related to WilTel's property and equipment.

WilTel's future lies in a number of areas. Vyvx, its wholly-owned subsidiary, is the premier transport of content for broadcasters. Vyvx transports major news stories for the networks, ads for radio and television broadcasts, and athletic events. Last year, for the second time, we back-hauled (from the stadium to the network operations center) the Super Bowl in HDTV format on internet protocol — lots of hand wringing in our Network Operations Center but the transmission was carried off flawlessly.

WilTel recently became an approved supplier to the Federal Government and obtained its first contract. We expect this aspect of our business to grow.

Our current contract with SBC has restricted our ability to provide a comprehensive set of services for Enterprise Customers which are large organizations or governmental entities that contract their telecom needs for data and voice transmission. MCI and AT&T are the major suppliers of these services and together with their potential suitors may have nearly 80% of the market. In most cases these customers need highly engineered solutions that require a customer-centered and responsive organization. This market is part of our future. We believe many of these customers will prefer to deal with nimble WilTel for part or all of their telecom needs.

"Diversity" is a word used in the telecom world to describe the need for redundancy in the movement of voice and data traffic. With SBC swallowing AT&T and MCI disappearing into Verizon or Qwest the number of alternatives available to Enterprise Customers, carriers or governments for obtaining diversity is shrinking dramatically. Even the biggest competitors in the telecom market need diversity for the purpose of maintaining redundancy for their customers. We think there may be a place for WilTel living off the crumbs from the plates of these elephants, as long as we are ever watchful of their feet!

In a previous letter we reported on the battlefield promotion of Jeff Storey to CEO of WilTel. Jeff is now battle hardened and he and his team have accomplished much in improving the financial performance of WilTel as set forth below.

(In millions)	2001	2002	2003	2004
Operating revenues	\$1,185.5	\$1,191.7	\$1,343.3	\$1,582.9
Cost of sales	746.5	820.2	930.8	1,129.2
Operating expenses, net	548.7	416.7	333.4	305.6
Segment profit (loss) from operations	\$ (109.7)	\$ (45.2)	\$ 79.1	\$ 148.1
Headcount	3,887	2,354	1,967	1,889

A famous investor, who we both much admire, is reputed to have explained that he did not invest "outside his circle of competence." In purchasing WilTel we believed we were investing within "our circle of competence." Time will tell if we were right. One of us is skeptical that WilTel will ever be a successful investment; the other continues to believe that there will be future riches on the wings of broadband! We are, however, in complete agreement on who we hope is right! Come what may, even if the skeptic is right, we do not believe that this adventure will jeopardize Leucadia's overall well being.

See the end of this letter for a depiction of life in the Telecom Boardroom.

Symphony Health Services

In September 2003, Leucadia acquired Symphony Health Services which is primarily engaged in physical, occupational, speech and respiratory therapy. Symphony currently operates in 46 states, providing services at 2,000 locations, with a workforce of 3,200 employees, some part-time.

Symphony offers healthcare providers the opportunity to outsource some of their patients' treatment needs. Some nursing homes, for instance, don't need a full-time physical therapist but are required to have the service available on demand. Symphony's employees can work part-time during the hours of their choice. This need for services and this desire for flexible work hours mesh nicely. Fortunately for Symphony, as the population ages, the demand for healthcare professionals grows. Attracting and retaining therapists as well as customers are the major factors in Symphony's successful business model.

In last year's letter we celebrated the possibility that Symphony might repay our investment in the first full year under Leucadia ownership. After all these years, you would think we would know better than to be celebrating possibilities rather than performance! We under-estimated the challenges management faced to quickly return our investment. Symphony suffered from organizational atrophy induced by languishing for three years in bankruptcy. It had postponed long overdue investments and had not fully integrated a number of hastily assembled acquisitions.

In October of 2004, we brought in a new CEO, R. Scott Jones. Scott is an energetic and seasoned health industry executive with a track record of operating success and who is off to a strong start in rehabilitating Symphony. While we do not want to jinx his performance, early indications suggest Scott will prove to be as effective a fiscal therapist as his colleagues are physical therapists.

With 2004 revenues exceeding \$258 million, the company barely managed \$5 million in pre-tax income. Given the cost and time devoted to complete the current rehabilitation, we expect 2005 to be better. We are satisfied that the patient is back on its feet and making good progress.

The business of providing therapy to patients mostly covered by Medicare and Medicaid is highly regulated. Our well-trained therapists do an excellent job of providing quality care under a complex set of rules and regulations. The threat to Symphony is not government regulation, but rather the government's willingness and ability to pay for services rendered. As part of the Balanced Budget Act of 1997 (back in the good old days when our national leaders at least pretended to care about the impact of deficits), outpatient therapy was capped at \$1,590 per patient per year, but the implementation of the cap has been delayed a number of times through legislation. Implementation of the cap would reduce our revenues and profits and, more importantly, substantially reduce the health and well-being of patients. Absent specific action by Congress, the benefit cap will become effective on January 1, 2006. We are hopeful our elected officials will craft a more creative and less draconian method of dealing with health care costs for this vulnerable segment of our population. A letter to your congressional delegation is in order.

Manufacturing

Conwed is a leading manufacturer of lightweight plastic netting made for a variety of purposes, most often to provide a barrier or to strengthen other materials. It is used for construction (plastic fencing), agricultural (bird net and sod net), carpet padding, packaging (to reinforce shipping paper) and also for consumer products (strengthening mop pads and industrial hand wipes). Our netting ends up in hundreds of products sold throughout the world. Our products are manufactured in Minneapolis, Minnesota; Athens, Georgia; and Genk, Belgium. In 2004, 16% of the revenue resulted from sales outside the U.S.

This company has its share of challenges. There is lots of price competition among its competitors, ever-unstable plastic raw material prices and the constant possibility of product substitution through the use of other materials. Conwed must continually reinvent itself with new product offerings. For example, in 2004, we launched six new products including a new biodegradable product that is being sold into the erosion control market. We spend between 2% and 5% of sales on the reinvention effort.

Conwed rides the waves of the U.S. economy, giving us an early warning outlook on business prospects. Over all the years, good and bad, since its acquisition in March 1985, Conwed has given us a very high return on investment. Some might call Conwed a cash cow; we prefer to call it a cash gazelle!

(In millions)	2000	2001	2002	2003	2004
Sales	\$ 65.0	\$ 53.7	\$ 50.7	\$ 53.3	\$ 64.1
Pre-tax profits	\$ 11.3	\$ 7.8	\$ 3.1	\$ 4.4	\$ 7.9
Return on average equity	28.7%	16.5%	7.8%	12.6%	25.1%

Mark Lewry took over as CEO at the end of 2002. We hope the most recent results above are forerunners of future growth in sales, pre-tax profit, and return on average equity. Mark and his excellent team are customer centric, and concentrate on new product offerings, the endless pursuit of manufacturing efficiencies and the well being of its employees, all the while watching and learning from the competition.

The future looks bright. In February 2005, Conwed purchased NSW, LLC U.S., which manufactures produce and packaging nets, header label bags (think onions), case liners and heavy weight netting for drainage and erosion control. NSW has a manufacturing and distribution facility in Roanoke, Virginia. For the year ending December 31, 2004, its sales were over \$20 million. The purchase price was \$28 million.

MK Resources

Leucadia has \$88 million invested in 72.1% of MK Resources, a public company trading on the NASD OTC Bulletin Board (Symbol: MKRR). MK Resources owns Cobre Las Cruces, S.A., a Spanish company which holds the exploration and mineral rights to the Las Cruces copper deposit in the Pyrite Belt of Spain. For history buffs, this belt of mineralization has been exploited since Roman times.

The mining concession was received in 2003, and the four principal water permits were received during 2003 and 2004. Additional permits relating to emissions and land use were received in early 2005. Approximately 98% of the land necessary for the operation of the mine and related processing facilities has been acquired. Detailed engineering may begin soon.

As of March 4, 2005, capital costs in U.S. Dollars to develop the mine have escalated to \$372 million (€281 million), excluding interest and other financing costs during construction. This escalation is due to depreciation of the Dollar from \$1.06 per Euro at September 1, 1999 (when Las Cruces was purchased) to \$1.36 per Euro at December 31, 2004. Construction and operating costs are mostly in Euros and revenues in Dollars. The good news is that copper prices have risen from \$.78 to \$1.48 per pound in the same period. If the ratio betwixt the Dollar, the Euro and copper remains what it is today, we will be fine. The status quo, however, is unlikely and the relationship between the Dollar, the Euro and copper prices will provide excitement in bringing this project to fruition.

MK Resources continues to review its financing options for Las Cruces, which, in addition to debt financing, could include a joint venture, sale of the project, merger and/or other transaction. We are hopeful that MK Resources' future plans will become clearer soon.

Frank Joklik, MK Resources' experienced Chairman, and Fernando Fernandez, President of Cobre Las Cruces, S.A., continue to manage the development of the project in difficult and trying international fiscal times.

Bull Durham, former Chairman of Phelps Dodge Corporation, is an experienced miner who brings his knowledge and expertise to the MK board. He also serves on the FINOVA board.

Wineries

Leucadia owns two wineries: Pine Ridge in Napa Valley, California, born in 1978 and acquired by us in 1991, and Archery Summit in the Willamette Valley, Oregon (on Archery Summit road), which we founded and constructed in 1993. The company controls 224 acres of vineyards in Napa Valley, California in the well regarded appellations of Stags Leap, Carneros, Rutherford, Oakville and Howell Mountain and 115 acres in the Willamette Valley of Oregon. Substantially all of this acreage is producing grapes.

At December 31, 2004, the combined investment in these wineries was \$58 million.

During 2004 the wineries sold approximately 63,600 9-liter equivalent cases of wine generating wine revenue of \$13.2 million. 81% of case sales and 93% of wine revenue are in the luxury segment of premium table wine market, which is defined as over \$25 retail per 750 ml bottle.

The wine industry is becoming ever more competitive. Robert Parker, a noted wine commentator, in an address last year to a large group of wine aficionados, put forth the proposition that wine quality throughout the world has increased so dramatically through improved viticulture and winemaking techniques that no one area, excepting the French Grand Cru, can expect to have a significant advantage. At the same time the interest and consumption of wine continues to grow both in the United States and around the world.

In the face of these competitive pressures we continue to improve our viticulture and winemaking techniques. Several of our wines received high ratings from leading wine publications, though never as high as we think they deserve. Last year we mentioned that we had an oversupply of Merlot production that is being solved through a replanting and re-budding program. "Merlot Madness" of the past has succumbed to the movie "Sideways." We are having success in building our Wine Clubs and with retail sales made at the wineries.

The distribution of wine in the United States is archaic. It is a three-level system in most states. We sell to wholesalers, who sell to retailers, restaurants and hotels, who all sell to consumers. In many states the system is protected and monopolistic. There is a case before the U.S. Supreme Court that may perhaps, in some states, lead to the simplification of some of these archaic laws. Even over the protests of some participants, the Internet-era is here to stay.

Depending upon your state liquor laws, you may order wine on the Internet (www.pineridgewinery.com or www.archerysummit.com) or join our Wine Club and receive delicious libations monthly.

Visit the wineries and enjoy the tasting room experience. Shareholders of Leucadia receive a 20% discount — on the honor system. Call Pine Ridge at (800) 575-9777 or Archery Summit at (800) 732-8822.

Banking and Lending

During 2004, the bank sold substantially all its outstanding loans plus certain loan portfolios that had been previously written off. Pre-tax income for 2004 was \$22 million primarily as a result of the release of loan reserves from sold assets. AIB intends to file a plan with the regulators that will ultimately result in the surrender of its bank charter.

Justin Wheeler, Marc Fuller and Brad Merrill have expertly negotiated through a regulatory thicket and accomplished a peaceful and profitable end to our adventure in sub-prime lending.

FINOVA

FINOVA is 50% owned by Berkadia, a joint venture between Berkshire Hathaway Inc. and Leucadia. We have earned substantial fee income managing the liquidation of FINOVA. Tom Mara, our long-serving Executive Vice President and Treasurer is FINOVA's CEO, and Glenn Gray, its COO. Together they have done a masterful job of winding down this business. Glenn is leaving FINOVA during 2005, with our thanks and best wishes.

ATX

In December 2003, we purchased all the debt obligations of ATX Communications and its affiliates for \$25 million. Year-end December 31, 2004, ATX reported \$251 million of total revenue.

ATX is an integrated telecom provider that offers local exchange carrier and inter-exchange carrier telephone, Internet, high-speed data and other communications services to business and residential customers in target markets in the Mid-Atlantic and Midwestern regions of the U.S.

In January 2004, ATX commenced a voluntary Chapter 11 bankruptcy in order to reorganize its affairs. We provided \$5 million of debtor in possession financing secured by liens on most of the assets. In March 2005, ATX filed its second amended Plan of Reorganization. The Plan contemplates that Leucadia, in exchange for its \$25 million, will receive 95% of the new common stock and a new \$25 million note which bears interest at 10%. In addition, we will provide \$25 million of exit financing to fund the Reorganization Plan, which was confirmed by the bankruptcy court in April 2005. ATX is a small player in a very fragmented industry. There will be consolidation opportunities in the years ahead, which we intend to pursue.

David Larsen authored this opportunity as well as our investment in WebLink which we refer to later. He is looking for new investment opportunities. His telephone number is (801) 524-8541.

Sarbanes Oxley and 404

By now most of our shareholders have probably heard something about the new rules that apply to public companies and its reporting requirements called Sarbanes-Oxley and 404, known fondly as SOX. These rules came about as a result of the financial scandals surrounding Enron and WorldCom, among others. In short, the rules require that we and our CFO certify, to our knowledge, that the financial statements we publish and file are correct, which is something that we think we have been doing all along anyway. In addition, following extensive procedures, we had to convince ourselves and our outside auditors, PricewaterhouseCoopers LLP, that our internal controls over financial reporting were effective. This effort was cheerfully led by Rocco Nittoli to a satisfactory conclusion. It makes us happy that there were no reportable shortfalls in our internal controls. This effort involved many additional hours of work by internal and external personnel and cost over \$4 million. We doubt it was worth the money, but since the law required it be done, we complied.

Money and Other Things

- On December 31, 2004, the Company effected a three-for-two stock split of the Company's common shares in the form of a 50% stock dividend. The stock dividend was paid to holders of record of the Company's common shares at the close of business on December 23, 2004. A cash dividend of \$.25 per share was paid on all the post split shares, which effectively raised the dividend by 50%.
- During 2004, the Company sold \$100 million principal amount of 7% Senior Notes due in 2013.
- During 2004, the Company sold \$350 million principal amount of 3¾% Convertible Senior Subordinated Notes due 2014, convertible into the Company's common shares at \$45.93 per share at any time before their maturity, subject to certain restrictions, at a conversion rate of 21.7707 shares per each \$1,000 principal amount of notes, subject to adjustment (an aggregate of 7,619,745 shares).
- As of December 31, 2004, Leucadia's readily available cash, cash equivalents and marketable securities, excluding amounts held by a regulated subsidiary and non-regulated subsidiaries that are parties to agreements which restrict the payment of dividends, totaled \$1.76 billion. This amount includes a \$242.3 million investment at market value in the common equity of White Mountains Insurance Group (WMIG), a publicly traded Bermuda-based property, casualty and reinsurance group, (representing 3.5% of WMIG for which the Company paid \$75 million).
- We recognized \$91.5 million of pre-tax income in 2004 from equity investments in associated companies; a detailed list of the components is on page 48 of the 10-K included herein.
- One of us is Chairman of Olympus Re, a Bermuda-based reinsurer of which we own approximately 19%, which has a quota share arrangement with a subsidiary of WMIG. Olympus Re was conceived as a virtual company to take advantage of a hard market for reinsurance, post 9/11, and has only two employees. Almost all of our premiums come through WMIG subsidiaries. Results have been outstanding. Leucadia earned 22%, 26% and 7% on its investment in each of the last three years (excluding cash received from selling shares back to Olympus), the last return having been achieved in the face of four major hurricanes in the last half of 2004.

Unfortunately, these storms did not scare reinsurers or new participants (mostly 35-year old hedge fund managers barely out of college around the time of Hurricane Andrew), and there is a definite softening in the cost of reinsurance. Olympus will exit the business if pricing gets too unattractive.

- Leucadia owns 2,474,226 common shares of HomeFed (about 30%), a publicly traded stock on the NASD OTC Bulletin Board (Symbol: HOFD) of which one of us is its Chairman. The undersigned together also own an additional 18.9% of HomeFed stock as a result of a distribution to all Leucadia shareholders in 1998. HomeFed principally develops residential lots in the San Diego area. Leucadia's investment in HomeFed shares is carried at \$39.5 million as an investment in an associated company. When we distributed the stock of HomeFed in 1998 the shares traded at \$1.80, adjusted for a subsequent stock split. As of March 31, 2005, the share price was \$53.
- We own 36% of the Barbados Light and Power Company. At December 31, 2004, the company was on our books for \$12.1 million.
- WebLink, a paging company we acquired in December 2002 while it was in bankruptcy, was sold to Metrocall in November 2003, which merged with Arch in November 2004, which changed its name and became USA Mobility, Inc. right after the merger. This was a classic rollup of a fragmented and declining industry. At December 31, 2004 our investment in the shares of USA Mobility were carried at their market value of \$25.8 million; all were sold during 2005. Since December 2002 we have received \$48.4 million in cash and securities for our \$19 million WebLink investment.
- At December 31, 2004, the Company's real estate assets had a book value of \$131.2 million. During 2004, we sold 92 lots of a 95-lot development project in South Walton County, Florida for approximately \$50 million. We recognized \$15.8 million in pre-tax profits and will recognize additional pre-tax profits of \$10.2 million this year. Patrick Bienvenue conceived and executed this project from a twinkle in his eye to \$50 million in cash in our bank account within one year. If you have interesting development parcels from \$5-50 million, call him at (801) 521-5400.²
- In 2004, the Company exercised an option to sell two of its older corporate aircraft for total proceeds of \$38.8 million and reported a pre-tax gain of \$11.3 million. The option was received in connection with the purchase of two new corporate aircraft during 2003.
- Net securities gains for 2004 aggregated \$142.9 million, substantially all of which reflect realized gains from the sale of publicly traded debt and equity securities. Many of these gains came through our association with Jay Jordan and David Zalaznick of the Jordan Company who provided these investment opportunities and who we thank.
- In 2004, the Company recognized a tax benefit of \$27.3 million for the favorable resolution of certain income tax contingencies and a tax benefit of \$3.9 million to record a federal income tax carryback refund.

² We do not consider ourselves as being in the real estate business. We look at real estate as we look at junk bonds—opportunistically.

The Future

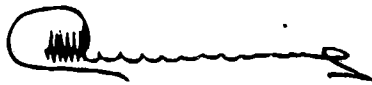
The future of our country and our currency is very troubling. Thinking about it makes us morose. Currently, our nation's fiscal, monetary and economic policies are hastening the end of the American hegemony that began at the end of World War II. Though we surely live in one of the most free, fairest, energetic and democratic societies ever developed on this globe our future economic position relative to the rest of the world is in peril.

If we compare the financing of our own families and our businesses to that of our country, we indeed have reason to be concerned. Unless our nation's profligate ways are moderated, we are going to end up with a run on the dollar. What the consequences of that might be, other than we will all be poorer, is hard for us to contemplate or predict.

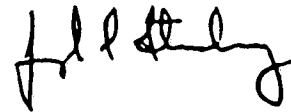
We plan to continue to search for undervalued or out-of-favor assets that we can buy and improve. The pickings are slim, but our enthusiasm is unabated. If we run out of ideas or steam we will let you know and develop a plan to return money to our shareholders.

Our long-term friend and consigliere, Stephen Jacobs, retired from his endless 42 year service at Weil, Gotshal & Manges, to devote his full time efforts to Leucadia as counsel. We are delighted!

To all our hard working, diligent and smart employees, we offer boundless thanks and affection.

A handwritten signature in black ink, appearing to read 'Cumming', with a stylized, elongated tail.

Ian M. Cumming
Chairman

A handwritten signature in black ink, appearing to read 'J. S. Steinberg', with a stylized, elongated tail.

Joseph S. Steinberg
President

Financial Highlights

2005

	2005	2004	2003
Revenues and other income	\$ 1,041,147,000	\$ 637,962,000	\$ 313,679,000
Net securities gains	\$ 208,816,000	\$ 136,564,000	\$ 9,928,000
Income (loss) from continuing operations before income taxes, minority expense of trust preferred securities and equity in income (losses) of associated companies	\$ 138,163,000	\$ 111,878,000	\$ (8,218,000)
Income tax benefit	\$(1,131,082,000)	\$ (20,192,000)	\$ (35,174,000)
Minority expense of trust preferred securities, net of taxes	\$ —	\$ —	\$ (2,761,000)
Equity in income (losses) of associated companies, net of taxes	\$ (45,133,000)	\$ 76,479,000	\$ 76,947,000
Income from continuing operations	\$ 1,224,112,000	\$ 208,549,000	\$ 101,142,000
Income (loss) from discontinued operations, net of taxes	\$ 111,557,000	\$ (64,862,000)	\$ (11,586,000)
Gain on disposal of discontinued operations, net of taxes	\$ 300,372,000	\$ 1,813,000	\$ 7,498,000
Net income	\$ 1,636,041,000	\$ 145,500,000	\$ 97,054,000
Earnings (loss) per common share:			
Basic:			
Income from continuing operations	\$ 11.36	\$ 1.95	\$ 1.10
Income (loss) from discontinued operations	\$ 1.03	\$ (.61)	\$ (.12)
Gain on disposal of discontinued operations	\$ 2.79	\$.02	\$.08
Net income	\$ 15.18	\$ 1.36	\$ 1.06
Diluted:			
Income from continuing operations	\$ 10.71	\$ 1.90	\$ 1.09
Income (loss) from discontinued operations	\$.96	\$ (.58)	\$ (.12)
Gain on disposal of discontinued operations	\$ 2.60	\$.02	\$.08
Net income	\$ 14.27	\$ 1.34	\$ 1.05
Total assets	\$ 5,260,884,000	\$ 4,800,403,000	\$ 4,397,164,000
Cash and investments	\$ 2,687,846,000	\$ 2,080,309,000	\$ 1,403,619,000
Common shareholders' equity	\$ 3,661,914,000	\$ 2,258,653,000	\$ 2,134,161,000
Book value per common share	\$ 33.90	\$ 20.99	\$ 20.09
Cash dividends per common share	\$.25	\$.25	\$.17

Letter from Chairman and President

To Our Shareholders

In 2005 Leucadia reported \$1,636 million in after tax income, or \$15.18 per share, \$14.27 fully diluted. These record earnings require an explanation: \$505.7 million is pre-tax operating earnings from our various businesses and investments, and \$1,135.1 million is a result of capitalizing the non-present value of our net operating tax loss carryforward (NOL) remaining after the sale of WilTel. It resides on the balance sheet as a "Deferred Tax Asset." We will explain a bit more about this accounting labyrinth later.

Here is the Leucadia scorecard for the past 28 years since we took the helm.

(Dollars in thousands, except per share amounts)

	Book Value Per Share	Book Value % Change	S&P 500 % Change— Dividends Included	Market Price Per Share	Market Price % Change	Shareholders' Equity	Net Income (Loss)	Return on Average Equity
1978	(\$0.07)	NA	NA	\$0.03	NA	(\$7,657)	(\$2,225)	NA
1979	0.21	NM	18.2%	0.14	366.7%	22,945	19,058	249.3%
1980	0.23	9.5%	32.3%	0.11	(21.4%)	24,917	1,879	7.9%
1981	0.28	21.7%	(5.0%)	0.21	90.9%	23,997	7,519	30.7%
1982	0.71	153.6%	21.4%	0.38	81.0%	61,178	36,866	86.6%
1983	0.85	19.7%	22.4%	0.55	44.7%	73,498	18,009	26.7%
1984	1.48	74.1%	6.1%	0.93	69.1%	126,097	60,891	61.0%
1985	1.66	12.2%	31.6%	1.13	21.5%	151,033	23,503	17.0%
1986	2.53	52.4%	18.6%	1.65	46.0%	214,587	78,151	42.7%
1987	2.23	(11.9%)	5.1%	0.94	(43.0%)	180,408	(18,144)	(9.2%)
1988	2.56	14.8%	16.6%	1.39	47.9%	206,912	21,333	11.0%
1989	3.28	28.1%	31.7%	2.07	48.9%	257,735	64,311	27.7%
1990	3.94	20.1%	(3.1%)	2.20	6.3%	268,567	47,340	18.0%
1991	5.30	34.5%	30.5%	3.57	62.3%	365,495	94,830	29.9%
1992	7.37	39.1%	7.6%	7.65	114.3%	618,161	130,607	26.6%
1993	10.85	47.2%	10.1%	7.94	3.8%	907,856	245,454	32.2%
1994	10.48	(3.4%)	1.3%	8.62	8.6%	881,815	70,836	7.9%
1995	12.31	17.5%	37.6%	9.69	12.4%	1,111,491	107,503	10.8%
1996	12.34	0.2%	23.0%	10.37	7.0%	1,118,107	48,677	4.4%
1997	19.45	57.6%	33.4%	13.37	28.9%	1,863,531	661,815	44.4%
1998	19.93	2.5%	28.6%	12.21	(8.7%)	1,853,159	54,343	2.9%
1999	13.17 ^(a)	(33.9%)	21.0%	15.42	26.3%	1,121,988 ^(a)	215,042	14.5%
2000	14.52	10.3%	(9.1%)	23.63	53.2%	1,204,241	116,008	10.0%
2001	14.41	(0.8%)	(11.9%)	19.25	(18.5%)	1,195,453	(7,508)	(0.6%)
2002	17.16	19.1%	(22.1%)	24.87	29.2%	1,534,525	161,623	11.8%
2003	20.09	17.1%	28.7%	30.73	23.6%	2,134,161	97,054	5.3%
2004	20.99	4.5%	10.9%	46.32	50.7%	2,258,653	145,500	6.6%
2005	33.90	61.5%	4.9%	47.46	2.5%	3,661,914 ^(a)	1,636,041	55.3%
CAGR								
(1978-2005) ^(a)			10.0%	31.4%				
CAGR								
(1979-2005) ^(a) 21.6%			9.9%	25.1%	21.5%			

(a) CAGR stands for compound annual growth rate. Since negative numbers cannot be compounded, we also show CAGRs with 1979 as a starting point. These calculations do not reflect the benefit of any cash dividend payments or the spin-off of HomeFed in 1998.

(b) Reflects a reduction resulting from dividend payments in 1999 totaling \$811.9 million or \$9.05 per share.

(c) Reflects the recognition of \$1,135.1 million of the deferred tax asset or \$10.51 per share.

We have been unhappy with the GAAP reporting of tax assets mentioned above for some time. Early in the 1990's, the accountants adopted a rule, SFAS 109. Under this rule, which we disparaged back then, companies are required to recognize the non-present value of their NOLs and put them on the balance sheet as something called a Deferred Tax Asset. For up to the next twenty years, or as long as we have NOLs, we will report an income tax expense and the Deferred Tax Asset will be reduced by the same amount, but we will not pay cash taxes.¹ This large asset may not become a reality until sometime in the future and we cannot begin to project when that will be. We long for the pre-SFAS 109 days when the NOLs rested peacefully in the footnotes until sometime in the future when they would be called upon to deflect taxation. Too much complexity robs simplicity and thus, understanding.

As much as we dislike the required accounting treatment, owning this Deferred Tax Asset and NOL is a good thing. As of December 31, 2005, Leucadia has approximately \$5.1 billion of NOLs that are available to eliminate the regular federal income taxes that would otherwise be payable on that amount of pre-tax income in the future (a potential federal tax savings of approximately \$1.8 billion). The amount and availability of the NOLs are subject to certain qualifications, limitations and uncertainties as discussed in Note 16 of Notes to Consolidated Financial Statements and Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

For those who want more explanation, please call Joe Orlando, our CFO, at (212) 460-1900. Please be understanding that the alchemy required to construct the Deferred Tax Asset is complex, requires lots of assumptions and is difficult to explain. Joe shares our dissatisfaction.

Below is a simplified breakdown of the earnings for 2005, including the Deferred Tax Asset. Later in the letter we will discuss various components of the earnings.

	(In thousands)
Pre-tax income (loss) amounts:	
Continuing operations	\$ 138,163
Associated companies	(44,403)
Discontinued operations	111,568
Gains on sales of discontinued operations	300,372
Subtotal, pre-tax income	505,700
Income tax (provision) benefit amounts:	
Continuing operations before associated companies	
Current	(4,018)
Deferred	1,135,100
Associated companies	(730)
Discontinued operations	(11)
Subtotal, income taxes	1,130,341
Net income	\$ 1,636,041

¹ We will still have to pay federal alternative minimum tax, state and local income taxes and foreign income taxes, as applicable.

WilTel Communications Group

In December 2005, we sold WilTel to Level 3 Communications for \$460.3 million in cash; 115 million shares of Level 3 common stock (which we sold in 2006 for \$376.6 million); and we retained the right to receive \$236 million of cash from SBC Communications (WilTel's largest customer, now AT&T), of which \$104.7 million has been paid at the date of this writing with the balance due later this year.

In the aggregate, Leucadia received net value of \$870.8 million from the sale of WilTel, including the cash received from the sale of the Level 3 stock, cash paid by Level 3, and the net book value of the retained assets and liabilities. In addition, we retained the NOL, which will rest on the balance sheet as a Deferred Tax Asset. In 2005, WilTel accounted for \$116 million of earnings from discontinued operations and \$243.8 million of gain on sale. Adding the proceeds from the sale of WilTel plus the current and future tax savings adds up to a satisfactory deal. For more information, see Note 5 of Notes to Consolidated Financial Statements.

Our trip through Telecom Broadband Land was at times frightening and at times exhilarating. We were fortunate to find in WilTel three extraordinary executives who rose, like a trout to a fly, to accept their greatly expanded responsibilities. Jeff Storey, a newly-minted CEO; Ed McLaughlin, Chief of Operations; and Mardi DeVerges, a likewise new CFO, enthusiastically attacked the challenge of reviving WilTel after the confusion and uncertainty of a major bankruptcy and the chaos which resulted, to produce a best-in-class, award winning national wholesale broadband supplier! They and their excellent teams continuously delivered great service to our customers in spite of a supportive but demanding major customer and the industry's endlessly falling prices which required them to continuously downsize over a three-year plus period of time to meet ever changing financial realities. They are to be greatly admired!

We are also very grateful to the Leucadia people who assisted the WilTel teams—Bud Scruggs, Jimmy Hallac, Joe Orlando, Tom Mara and many others.

ATX Communications

In December 2003, Leucadia purchased all of ATX's debt obligations under its senior secured credit facility for \$25 million, and ATX commenced a voluntary Chapter 11 case to reorganize its financial affairs shortly thereafter. The bankruptcy plan (the "Plan") of ATX was confirmed by the Bankruptcy Court for the Southern District of New York and became effective on April 22, 2005. As contemplated by the Plan, in exchange for its investment in the credit facility, Leucadia received approximately 90% of the new common stock of the reorganized ATX, a new \$25 million senior secured 10% note, and provided ATX with \$30 million of additional financing. The aggregate purchase price for ATX was \$56.3 million. Leucadia has consolidated ATX into its financial statements since the effective date of the Plan.

ATX is an integrated telecom provider that offers local and long distance telephone services, Internet, high-speed data and other communications services to business and residential customers in the Mid-Atlantic region of the U.S. These types of companies are known by their jargon name CLEC ("Competitive Local Exchange Carrier").

David Larsen is the midwife of this transaction and he is working diligently to renovate ATX following its emergence from bankruptcy. David is joined in this effort by ATX's management, led by Jeff Coursen, and by Jeff Storey, who we spoke of earlier as the CEO of WilTel. We are delighted that Jeff remains with Leucadia. They and the ATX team have:

- sold an out-of-region business to another CLEC for \$6 million
- sold ATX's Internet dial-up business for \$9.2 million
- reduced headcount by 15%
- established a plan to double EBITDA in 2006
- rolled out the next generation of services such as VoIP and managed services

With further consolidation of the old Bell companies to AT&T/Bell South and Verizon, plus a wounded Qwest, the future of the CLEC phenotype will be challenged. Efficient operations, good customer service and attractive pricing will be essential to be a survivor. ATX is concentrating on these aspects of its operations. In the short term there will be opportunities for consolidation in which we hope to participate. We expect to see the development of several strong regional CLECs and perhaps the development of a few national competitors as well.

It remains to be seen in the coming consolidation of this orphan species whether we will be the "consolidator" or the "consolidatee." Either way, we expect to come out just fine.

TeleBarbados

With our partner, Barbados Light & Power, we together invested \$30 million in bringing broadband capacity to that small island. A glass fiber cable has been laid in the ocean from Barbados to St. Croix. From St. Croix, the cable connects to several other cable systems and then to the rest of the world. Leucadia owns 36% of BL&P and one of the undersigned is its Chairman.

Jeff Storey will manage our investment in TeleBarbados. We hope this small company will have a very high return on its investment.

Conwed Plastics

Conwed is a leading manufacturer of lightweight plastic netting made for a variety of purposes, most often to provide a barrier or to strengthen other materials. It is used for construction (plastic fencing), agricultural (bird net and sod net), carpet padding, packaging (for produce) and also for consumer products (strengthening mop pads and industrial hand wipes). Our netting ends up in hundreds of products sold throughout the world. Our products are manufactured in Minneapolis, Minnesota; Athens, Georgia; Roanoke, Virginia; and Genk, Belgium. In 2005, 11% of the revenue resulted from sales outside the U.S. and positive cash flow was achieved for the first time at our European facility.

(In millions)	2001	2002	2003	2004	2005
Sales	\$ 53.7	\$ 50.7	\$ 53.3	\$ 64.1	\$ 93.3
Pre-tax profits	\$ 7.8	\$ 3.1	\$ 4.4	\$ 7.9	\$ 14.2
Return on average equity	16.5%	7.8%	12.6%	25.1%	33.4%

Mark Lewry took over as CEO at the beginning of 2003. The above chart speaks volumes about his abilities, energy and leadership skills. He has built a remarkable team. Go Mark go!

Mark's own words:

"Acquisitions fueled much of the growth as Conwed looked at a number of opportunities and completed three deals acquiring the assets of NSW and ADPI in the U.S. and the industrial netting business from Tensar Group Limited in the U.K. These acquisitions give Conwed a strong base in the packaging industry and the ability to grow business in the filtration markets."

Revenues for Conwed's base business in the U.S. also increased 19% from organic growth related to new customers, new product development efforts and selling price increases. Conwed has focused on developing products for the building and construction markets during the last few years. Revenues from these efforts accounted for approximately 10% of Conwed's total revenues in 2005.

Capacity improvements were made in 2005 by enhancing two key production lines in the U.S. to increase the output rates. This, along with leveraging our Europe operations to support U.S. demand, gave Conwed the ability to meet customer demand in 2005 and beyond, while minimizing the capital investment needed.

Conwed's Europe operations achieved positive cash flow in 2005. Europe revenues in 2006 are expected to double with the acquisition of Tensar's industrial business late in 2005, new customers and the continued utilization of Europe production capacity to supply U.S. needs.

Resin costs continued to rise for the third straight year. High utilization rates in the polypropylene industry and high oil and gas prices along with the impact of hurricane Katrina increased our costs by more than 20% for the third year in a row. The ability to pass some of the cost increases along to customers and keep our overhead cost structures in check helped operating margins improve from 2004.

Overall 2005 was an active year for Conwed as efforts to grow the business profitably through acquisition and organic growth efforts were successful. For 2006, Conwed expects to continue its growth strategies by looking for additional add-on acquisitions and new product development opportunities."

Idaho Timber Corporation

In May 2005, we acquired Idaho Timber for \$133.6 million in cash. We want to thank Bill Reid and Mike Shein and their colleagues at Chartwell Investments who brought us this transaction and have a participation in its profits.

Idaho Timber is headquartered in Boise, Idaho and remanufactures dimension lumber, a business with which we were not familiar. We asked Ted Ellis, Idaho Timber's young and energetic president, "What does that mean?" As Ted explained, remanufacturing in the lumber business means cutting less than perfect lumber as it comes from the sawmill and turning it into higher grade lumber. Lumber is primarily graded into three groups: #2 and better, #3, and Economy. Economy and #3 lumber is defective in some way. It has knot holes, is twisted or has other defects of one sort or another. It is sold in bulk by the sawmills and is a commodity. Idaho Timber buys this lower grade defective lumber and remanufactures it by cutting out the defective parts and turning the pieces into higher grade, shorter or narrower lumber.

Idaho Timber also bundles and barcodes home center boards for large retailers and produces pine decking and other specialty wood products.

Idaho Timber acquires lumber from sawmills in United States, Canada, South America and Europe. From time to time, international trade politics, i.e., duties and quotas can affect this business either positively or negatively.

For the 8 months ending December 31, 2005, Idaho Timber had operating income of \$14.8 million before depreciation and amortization expenses.

We are very pleased with this acquisition. Capex is low and taxable income is high; therefore we shelter Idaho Timber pre-tax earnings with our NOL and reduce our Deferred Tax Asset, the perfect outcome.

The bad news is the lumber business is cyclical and subject to the mercy of housing starts, the economy and lumber prices, which means its earnings will fluctuate year to year. That is fine with us, as it is a well-managed company and best in class! Ted is a fine leader and runs a tight ship and sticks to his knitting.

Symphony Health Services

In September 2003, Leucadia acquired Symphony Health Services which primarily provides physical, occupational and speech therapy, healthcare staffing and Medicare consulting services. Symphony currently operates in 46 states at approximately 1,650 locations, with a workforce of approximately 2,900 employees, many of whom are part-time.

Symphony offers healthcare providers the opportunity to outsource some of their patient's treatment needs. Some nursing homes, for instance, don't need a full-time physical therapist but are required to have the services available. Symphony's employees can work full-time or part-time at one or more facilities. As the population ages, the demand for healthcare professionals will continue to grow. Attracting and retaining therapists as well as customers are the major challenging factors in Symphony's business model. As you might imagine, this business can be a personnel nightmare!

In October 2004, we brought onboard a new CEO, R. Scott Jones, an energetic and seasoned health industry executive with a track record of operating success to makeover the company. This makeover of Symphony turned out to be a much harder job than Scott and we expected. Low morale, inadequate IT systems, badly priced contracts with some customers, plus the complexities of managing and recruiting therapists working all over the country has kept Scott very busy for the last 15 months solving all the problems at once. He has done a remarkable job restoring Symphony to good order and profitability and we are pleased.

However, there are several endemic problems with its business model. Services are provided over a very large geographic area to many customers. Some employees work part-time and some full-time. Together, this mix makes a difficult management problem with so many moving parts. Last but not least, it is a highly regulated business being managed by the U.S. Congress!

Throughout last year Symphony devoted a tremendous amount of time lobbying Congress against the implementation of "caps" on the dollar amount of therapy each patient could receive under Medicare. Our clients are a frail, elderly population living in long-term care facilities, most likely for the rest of their days. They have little political clout to plead their case for the comfort and benefits provided by therapy in their last days in their veil of tears.

Congress, in its never-ending search for money to spend, often takes the path of least resistance by eliminating programs where the beneficiaries are not powerful. Caps were implemented on January 1, 2006; however, an exception process has been adopted by which some patients who need more therapy may still be able to get it. We expect the implementation of these caps will negatively impact earnings during 2006.

Under Scott's leadership, we have been looking at other opportunities and whether a roll-up strategy may provide the possibility for a more successful business model. We shall see. Scott has a difficult job, but he never complains!

What Used to be MK Gold

In August 2005, Leucadia consummated a merger with its then 72.1% owned subsidiary, MK Resources Company ("MK"), acquiring 100% ownership of MK. The acquisition cost was \$12.8 million, consisting of approximately 216,000 of Leucadia's common shares and cash. As a result of the merger, MK is now a wholly-owned subsidiary of Leucadia, and MK's securities are no longer publicly traded.

As part of the same transaction, immediately following the merger Leucadia sold to Inmet, a Canadian-based global mining company traded on the Toronto stock exchange (Symbol: IMN), a 70% interest in Cobre Las Cruces ("CLC"), a Spanish company that holds the exploration and mineral rights to the Las Cruces copper deposit in the Pyrite Belt of Spain, not far from Sevilla. Inmet acquired their interest in CLC in exchange for 5.6 million newly issued Inmet common shares, representing approximately 11.7% of the outstanding Inmet common shares immediately following completion of the transaction. Leucadia retains a 30% interest in CLC. The Inmet shares were recorded at their fair value of approximately \$78 million, and we recorded a pre-tax gain on the sale of \$10.5 million. As of March 27, 2006, those shares had a market value of approximately \$173 million.

CLC subsequently entered into an agreement with third party lenders for project financing consisting of a ten year senior secured credit facility for up to \$240 million, and a senior secured bridge credit facility of up to €69 million to finance subsidies of €53 million (which are approved by the European Union but not yet received) and expected rebates of VAT taxes. Leucadia and Inmet have guaranteed 30% and 70%, respectively, of the obligations outstanding under both facilities until completion of the project. At December 31, 2005, no amounts were outstanding under the facilities. Leucadia and Inmet have also committed to provide financing to CLC which is estimated to be \$159 million, of which Leucadia's share will be 30%.

A May 2005 technical report prepared by Pincock, Allen & Holt, an independent engineering company, indicated proven and probable reserves at the Las Cruces deposit of approximately 16 million metric tons of copper ore at an average grade of 6.6% copper. The capital costs to build the project have been estimated at €290 million (\$345 million at the exchange rate in effect on February 13, 2006), including working capital, land purchases, and contingencies, but excluding reclamation bonding requirements, inflation, interest during construction, cost overruns and other financing costs.

CLC expects to reach full mine production by the middle of 2008. Cash operating costs per pound of copper produced are expected to average € .33 per pound (\$.39 per pound) of copper produced at current exchange rates. The project's capital and operating costs will be paid for in euros, while copper revenues during the life of the mine are currently based on the U.S. dollar. In order to minimize its exposure to currency fluctuations, CLC has entered into an agreement to swap €171 million of Euro denominated debt into \$215 million of U.S. dollar denominated debt once construction of the mine is complete.

All of the project's capital and operating costs are currently being reestimated and are likely to increase. Copper prices are presently at an all-time high but we do not know what the future holds for this commodity.

Wineries

Leucadia owns two wineries: Pine Ridge Winery in Napa Valley, California, born in 1978 and acquired by us in 1991, and Archery Summit in the Willamette Valley, Oregon (on Archery Summit Road), which we founded and constructed in 1993. The wineries control 224 acres of vineyards in Napa Valley, California, in the well regarded appellations of Stags Leap, Carneros, Rutherford, Oakville and Howell Mountain, and 115 acres in the Willamette Valley of Oregon. Substantially all of this acreage is producing grapes. At December 31, 2005, the combined investment in these wineries was \$71 million.

During 2005, the wineries sold approximately 81,200 9-liter equivalent cases of wine generating wine revenue of \$17.8 million.

The luxury segment of the wine industry is intensely competitive. Our wines compete with small and large producers in the U.S. as well as with imported wines. Demand for wine in the luxury market segment can rise and fall with general economic conditions, and is also significantly affected by available supply. The demand for our wine is largely affected by the ratings given the wines in industry and consumer publications. Wines are rated on a 1-to-100 numerical scale for each vintage and type of wine. The scores provided by *The Wine Spectator* and by Robert Parker can make or break a vintage of wine.

Several years ago, in an effort to improve the quality of our wines and achieve better scores, we decided to change the way we planted, pruned, picked and sorted the grapes and made the wine. We hired a very gifted French winemaker and viticulturist to guide us. The process was expensive and intense. The 2003 wines made by our winemakers Stacy Clark and Anna Matzinger, with his assistance, are appearing this year. Hopefully we will see the results in the scores and the wine will fly out of the wineries at increased prices! Hope springs eternal.

Lest you forget, wine is a consumer product. We recommend you see the movie *Sideways*. Subsequent to its theatrical release, our Merlot sales at Pine Ridge plummeted and our Pinot Noir sales at Archery Summit soared!

One of the nice things that we have noted about our winery investments is that buying land in first class winegrowing regions, planting grapes and farming using the best techniques not only produces good wine, but also produces an asset the value of which has outstripped inflation and provides a good real estate investment, especially in Napa Valley.

We have given considerable thought to the future of our wine business and have preliminarily decided to expand our presence in this market segment. We are in the midst of these deliberations—more next year.

Depending upon your state liquor laws, you may order wine on the Internet (www.pineridgewinery.com or www.archerysummit.com) or join our Wine Club and receive delicious libations monthly.

Visit the wineries and enjoy the tasting room experience. Shareholders of Leucadia receive a 20% discount—on the honor system. Call Pine Ridge at (800) 575-9777 or Archery Summit at (800) 732-8822.

Remember, wine is food and we think leads to longevity!

FINOVA

FINOVA is 50% owned by Berkadia, a joint venture between Berkshire Hathaway Inc. and Leucadia. Since acquiring our interest in FINOVA, Leucadia has recorded \$95.2 million of income from this investment. Our long time Executive Vice President and Treasurer, Tom Mara, is FINOVA's CEO. He has done a masterful job winding down the business. This year or next we expect FINOVA to return what's left of the remaining cash and assets to FINOVA's creditors.

Real Estate

After two very successful projects in the Florida panhandle, Patrick Bienvenue and his real estate group have purchased two pieces of land in Maine. A 115 acre parcel in Rockport with 5,500 feet of waterfront on Penobscot Bay, and a 76 acre parcel located on Islesboro, a 9,100 acre island accessible from the mainland by a 15 minute ferry ride.

Under Patrick's direction, we are beginning to construct two small oceanfront office buildings on Carlisle Bay in Bridgetown, Barbados, in a joint venture with Barbados Light & Power. We are examining other real estate projects in Barbados and many other places in the U.S. and other countries.

Patrick is constantly looking for new projects, especially in Florida in the winter! Please call him at (801) 521-5400, if you see something you think would be of interest.

In May 2005, Leucadia sold its 716-room Waikiki Beach hotel for net cash proceeds of approximately \$73 million and a pre-tax gain of \$56.6 million. From acquisition of a note in June 2000 to the sale, Zalman Jacobs traveled incessantly from New York to Hawaii for countless court hearings, endless negotiations with our truculent ground lessor and the eventual sale.

During 2005, we sold our equity interest in an office complex located on Capitol Hill in Washington, D.C. Leucadia's share of the net proceeds was \$73.2 million with a pre-tax gain of \$72.3 million.

In the fourth quarter of 2005, we agreed to sell our 90% interest in eight acres of land in Washington, D.C. for aggregate cash consideration of \$121.9 million for which we paid \$53.8 million. The sale closed in February 2006. We received net cash proceeds of \$75.7 million and expect to report a pre-tax gain of \$48.9 million.

At December 31, 2005, domestic real estate assets had a book value of \$166.2 million.

White Mountains and Olympus Re

During the course of 2005 we disposed of our interest in White Mountains Insurance Group for a gain of \$146 million on our original investment in 2001 of \$75 million. White Mountains was founded and capably led for many years by our good friend Jack Byrne. Our investment in White Mountains partially funded its acquisition of One Beacon Insurance Company which was in need of a turn around. Having accomplished that goal, which the stock market appreciated, White Mountains stock price increased from \$200 per share to over \$550 per share. We decided to take our profits and move on. We want to thank Jack and all the other members of the White Mountain team for a job well done.

Our investment in Olympus Insurance did not have such a happy outcome. Several years ago, we invested in the startup of a new reinsurance company to participate with White Mountains in the catastrophe reinsurance market that offers protection to primary insurance companies for weather-related extreme losses, mainly hurricanes, typhoons, tornadoes, tsunamis, etc. Pricing of the insurance is based on computer models which estimate total maximum losses under various scenarios. Premiums seemed high relative to the risks and for the first few years we patted ourselves on the back for our investment acumen. In retrospect, we did not appreciate the true risks of our investment and the shortcomings of the models.

During the 2005 hurricane season, Olympus was hit with a one-two-three punch and an eventual knockout by the lasses Katrina, Wilma and Rita. The models were wrong. The underwriters were too optimistic and drastically underestimated the maximum possible loss. As the estimates of losses from these storms soared upward over several months our entire remaining investment was blown away, resulting in a loss of \$120.1 million for 2005. Taking into account our original investment of \$127.5 million, on which we received back cash of \$79.5 million, our total loss on this investment was \$48 million.

There is great debate as to whether weather patterns around the globe have changed. We are not sure of the answer to this question, but we voted with our feet by not participating in the recapitalization of Olympus and one of us who was Chairman has resigned.

Sarbanes Oxley and 404

After the financial scandals of several years ago, the Congress passed several laws now collectively known by the acronym "SOX", which sounds just like what are on your feet. We have diligently worked on complying with these rules and have successfully passed two years of required tests. We test ourselves, PricewaterhouseCoopers LLP ("PwC") tests our tests, PwC tests again, and so this very expensive process, which adds little utility, becomes busy work, but we must comply to be a public company. Joe Orlando, his staff, subsidiary finance departments and Rocco Nittoli have accomplished this successfully and surmounted inordinate frustrations.

We unhappily note that relationships between public accounting firms and their clients have changed for the worse under SOX. They are no longer advisors, or coaches, or a group of experts available for consultation in implementing an ever greater number of accounting rules that are difficult to understand, no matter how dedicated we are to full compliance. Public accounting firms have become just another unhelpful regulator.

Money and Other Things

- Leucadia owns approximately 30% of HomeFed Corporation, a real estate development company that was spun off to our shareholders in 1998. It is traded on the NASD OTC Bulletin Board and its ticker symbol is HOFD. At the time of the spin-off to Leucadia's shareholders, the stock was valued at \$1.79 per share. Subsequently, in 2002, Leucadia purchased additional shares giving it a 30% stake at \$9.70 per share. At the end of 2005, HomeFed shares were trading at \$67.00 per share. The undersigned each own 7.7% and 9.5%, respectively, of HomeFed as a result of the spin-off. Leucadia and the undersigned are very pleased with HomeFed's progress.
- During 2005, the Company's banking and lending operations sold its remaining customer deposits and surrendered its National Bank Charter.
- During 2005, we wrote down \$12.2 million of investments in certain available for sale securities.

- In June 2005, the 8¼% Senior Subordinated Notes were redeemed at their term for \$19.1 million.
- At December 31, 2005, Leucadia had a liability of \$102.8 million on its balance sheet for its unfunded pension plan obligations. Benefits in these plans have been frozen. We intend to substantially fund this liability in the foreseeable future. Most of this amount had been previously recorded in our balance sheets.
- At December 31, 2005, we had \$85.1 million of letters of credit and guarantees outstanding.
- As of this date, we have approximately \$2.5 billion available for new investments—\$1.9 billion of which is cash, United States Treasuries and securities of Government-Sponsored Entities, and \$600 million is various corporate debt, equities and other securities.

The Future

We worry about the profligate ways of our country's fiscal policy. The trade deficit is huge and growing and represents debt to foreigners. We will do fine until the day our little green markers, our dollar bills, printed at little cost and which represent our promises to pay, become less attractive to our creditors. If these creditors decide precipitously or all at the same time to exchange these markers for other countries' markers, our big strong bustling nation is in big trouble. One of us is very worried.

As there is nothing we can do about this problem, we will continue to work with our large pile of low yielding cash to put it to higher and better use! We have many things in the hopper that look interesting and hopefully by next year at this time we will have a measurable reduction in cash and an increase in higher yielding investments.

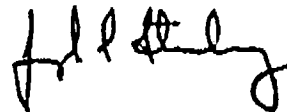
We have been seriously considering the future of Leucadia and its management. One of us is 62 and the other will be 66 this summer. We are both in good health and have nine years left to go on our new ten-year employment contracts. Our enthusiasm is unabated for deals and investments, but we do recognize our responsibility to ensure management continuity and are working on the problem. We don't have anything specific to report but we want to make sure that our \$5.1 billion NOL is used up and our Deferred Tax Asset reduced to zero.

The undersigned get most of the credit for what goes on in Leucadia but we should not—just some of it. We have a large group of dedicated hard working people who do most of the work and it is they who should get most of the credit. We are the orchestra conductors—we don't play a note but we stand in front of everybody and wave a stick.

More next year.



Ian M. Cumming
Chairman



Joseph S. Steinberg
President

Letter from the Chairman and President

To Our Shareholders

In 2006, Leucadia recognized \$289.5 million in pre-tax income and \$189.4 million in after tax income which is \$.85 per share fully diluted.¹ Ending December 2006, net worth was \$3,893.3 million or a return of 5%. This anemic return is the result of what we do. Investing for the long-term and fixing troubled companies results in lumpy outcomes. Over the long-term, however, we are pleased with the results and happy to have participated in the wealth created for our shareholders.

Below is Leucadia's scorecard for the last 29 years since we took over the management.

Leucadia National Corporation Scorecard

	Book Value Per Share	Book Value % Change	% Change in S&P 500 with Dividends Included	Market Price Per Share	Market Price % Change	Equity	Net Income (Loss)	Return on Average Equity
(Dollars in thousands, except per share amounts)								
1978	(\$0.04)	NA	NA	\$0.01	NA	(\$7,657)	(\$2,225)	NA
1979	0.11	NM	18.2%	0.07	600.0%	22,945	19,058	249.3%
1980	0.12	9.1%	32.3%	0.05	(28.6%)	24,917	1,879	7.9%
1981	0.14	16.7%	(5.0%)	0.11	120.0%	23,997	7,519	30.7%
1982	0.36	157.1%	21.4%	0.19	72.7%	61,178	36,866	86.6%
1983	0.43	19.4%	22.4%	0.28	47.4%	73,498	18,009	26.7%
1984	0.74	72.1%	6.1%	0.46	64.3%	126,097	60,891	61.0%
1985	0.83	12.2%	31.6%	0.56	21.7%	151,033	23,503	17.0%
1986	1.27	53.0%	18.6%	0.82	46.4%	214,587	78,151	42.7%
1987	1.12	(11.8%)	5.1%	0.47	(42.7%)	180,408	(18,144)	(9.2%)
1988	1.28	14.3%	16.6%	0.70	48.9%	206,912	21,333	11.0%
1989	1.64	28.1%	31.7%	1.04	48.6%	257,735	64,311	27.7%
1990	1.97	20.1%	(3.1%)	1.10	5.8%	268,567	47,340	18.0%
1991	2.65	34.5%	30.5%	1.79	62.7%	365,495	94,830	29.9%
1992	3.69	39.2%	7.6%	3.83	114.0%	618,161	130,607	26.6%
1993	5.43	47.2%	10.1%	3.97	3.7%	907,856	245,454	32.2%
1994	5.24	(3.5%)	1.3%	4.31	8.6%	881,815	70,836	7.9%
1995	6.16	17.6%	37.6%	4.84	12.3%	1,111,491	107,503	10.8%
1996	6.17	0.2%	23.0%	5.18	7.0%	1,118,107	48,677	4.4%
1997	9.73	57.7%	33.4%	6.68	29.0%	1,863,531	661,815	44.4%
1998	9.97	2.5%	28.6%	6.10	(8.7%)	1,853,159	54,343	2.9%
1999	6.59 ^(b)	(33.9%)	21.0%	7.71	26.4%	1,121,988 ^(c)	215,042	14.5%
2000	7.26	10.2%	(9.1%)	11.81	53.2%	1,204,241	116,008	10.0%
2001	7.21	(0.7%)	(11.9%)	9.62	(18.5%)	1,195,453	(7,508)	(0.6%)
2002	8.58	19.0%	(22.1%)	12.44	29.3%	1,534,525	161,623	11.8%
2003	10.05	17.1%	28.7%	15.37	23.6%	2,134,161	97,054	5.3%
2004	10.50	4.5%	10.9%	23.16	50.7%	2,258,653	145,500	6.6%
2005	16.95	61.4%	4.9%	23.73	2.5%	3,661,914 ^(c)	1,636,041	55.3%
2006	18.00	6.2%	15.8%	28.20	18.8%	3,893,275	189,399	5.0%
CAGR								
(1978-2006) ^(a)			10.1%	32.8%				
CAGR								
(1979-2006) ^(a)	20.8%		10.0%	24.9%		20.9%		

(a) CAGR stands for compound annual growth rate. Since negative numbers cannot be compounded, we also show CAGRs with 1979 as a starting point. These calculations do not reflect the benefit of any cash dividend payments or the spin-off of HomeFed in 1998.

(b) Reflects a reduction resulting from dividend payments in 1999 totaling \$811.9 million or \$4.53 per share.

(c) Reflects the recognition of \$1,135.1 million of the deferred tax asset or \$5.26 per share.

¹You will note a large asset on our balance sheet (page F-3 of the 10-K) called "Deferred tax asset, net". As we explained last year, this is the non-present value of some of the taxes that we will not pay in the future as a result of a large NOL (net operating loss carryforward). During 2006, the pre-tax income was substantially sheltered from taxes due to this NOL.

What We Do

We tend to be buyers of assets and companies that are troubled or out of favor and as a result are selling substantially below the values which we believe are there. From time to time, we sell parts of these operations when prices available in the market reach what we believe to be advantageous levels. While we are not perfect in executing this strategy, we are proud of our long-term track record. We are not income statement driven and do not run your company with an undue emphasis on either quarterly or annual earnings. We believe we are conservative in our accounting practices and policies and that our balance sheet is conservatively stated.²

Rules of the Road

1. Don't overpay, no matter what the madding crowd³ is up to.
2. Buy companies that make products and services that people need and want and provide them as cheaply as possible with consistently high quality. Lower cost and higher quality is a relentless and never-ending task.
3. Earnings sheltered by NOLs are more valuable than earnings that are taxed!
4. Compensate employees for performance and expect hard work and honesty in return.
5. Don't overpay!

A Bit about Commodities, Globalization and China

We have been thinking a lot about China, but not doing much about it. We observed from the sidelines its tremendous growth and are believers in its continuing potential. One of us has been there several times, the other not. However, China is very far away, and we have a well founded skepticism towards investments in places where the rule of law is not well developed. We have successfully invested in some difficult and strange places, among them Bolivia, Argentina, El Salvador and Russia, as well as some pleasant places such as Barbados, Spain and Australia.

Prior to the emergence of China as a turbocharged economic growth engine commodity prices were pretty much in the doghouse during the latter part of the last century. In our readings it came to our attention (and to many other investors, some sooner and smarter than we) that China is consuming an ever increasing amount of the world's resources. Some analysts and pundits think China is the country version of the old Pac-Man® video game and will devour the marginal production of all commodities, which will, for the foreseeable future, push up prices as China demands more and a greater share of the world's commodities. It is also not surprising that China, an economy with 1.3 billion people who are beginning to discover the delights of a consumer society, wants and has the ability to consume more and more every year. Its demand for everything is likely to increase, both consumer goods and raw materials. In the meantime, as a low cost manufacturer of all the things that we no longer make here in the U.S.A., China has assembled an unspent cash hoard of over a trillion dollars and is busy spending part of this vast sum on soy beans from Argentina and Brazil, oil from the Middle East and iron ore and copper from Australia and other places. China is also in the midst of building a new infrastructure, i.e., railroads, highways, factories, etc., all of which requires lots of copper, iron ore and energy. Prices for all of these commodities has risen dramatically over the last ten years, with copper going from \$1.09 per pound to \$3.00 per pound, Australian lump iron ore

²Originally reported in the 1988, and repeated in the 1990, 1991, 1995, 1996, 1998 and 1999 annual reports.

³Thomas Hardy's 4th novel, published 1895, "*Far From the Madding Crowd*."

from \$.37085 per dry metric tonne unit to \$1.0264 per dry metric tonne unit and gas from \$2.60 per mcf to \$7.53 per mcf. With our investments in copper, iron ore and oil and gas drilling, we are riding the wave of commodity price inflation and vicariously enjoying the roller coaster ride of China's booming economy. Certainly we can expect a bust one day, but we hope not too soon. Details are below.

Cobre Las Cruces

In August of 2005, our wholly-owned subsidiary, MK Resources, sold a 70% interest in its Las Cruces copper deposit to Inmet Mining Corporation (TSX:IMN) in exchange for 5.6 million of Inmet's common shares – we retained the remaining 30%. The Las Cruces copper deposit is located 20 kilometers outside Seville in the Andalucía region of Spain. Las Cruces is a high-grade copper deposit with a current projected development budget of €380 million, of which €53 million will be funded by national and regional grants by Spain and the European Community.

The mine will produce 72,000 tonnes per year of copper cathode with an expected life of at least 15 years. We will own 30% of the production directly, and an interest in the balance through our stock ownership in Inmet. An independent 2005 reserve study indicated reserves of 16 million tonnes of ore with an average grade of 6.6% copper. Extraction will be via open pit with the exception of 740,000 tonnes of ore, which will be removed by underground methods. Actual production of LME⁴ copper cathode is scheduled to commence in early 2008 with a projected life of mine cash operating cost of €39 per pound. The dewatering and re-injection system is up and running, plant construction is underway, and management is in place. As happens with projects of this nature, costs have substantially increased above initial estimates and the unknown is to be expected.

Cobre Las Cruces expects 2007 to be a very busy year and anticipates spending an additional €260 million, including €180 million to complete detailed engineering, procurement and construction. A large part of their efforts in 2007 will be focused on the hiring and training of operational staff in anticipation of an early 2008 production start up.

To fix some of its costs, Cobre Las Cruces has hedged \$215 million of its foreign exchange exposure at \$1.25 to the Euro for the period of the construction. Cobre Las Cruces has also fixed its interest rate exposure on its debt at 5.2%, plus the loan margin, for the period 2008 to 2014, by which time we expect the loan to be repaid. Cobre Las Cruces has not sold forward any of the copper, the price of which continues to remain buoyant. At some point we may revisit this subject.

Cobre Las Cruces has been excellently supervised by Tom Mara, our Executive Vice President and Treasurer, and by Frank Joklik, our veteran miner. Tom joined Leucadia 30 years ago before the undersigned, and we hope and expect he will be around for the next 30.

Fortescue Metals Group Ltd

In August 2006, Leucadia invested \$400 million in Fortescue Metals Group Ltd ("FMG"). We received 26.4 million common shares of FMG stock (9.99% of the total outstanding shares) and a \$100 million 13-year subordinated note that receives, in lieu of a fixed coupon, payments equal to 4% of revenues (net of government royalties) over the term of the note. FMG is traded on the Australian Stock Exchange (ASX:FMG).

FMG has approximately 35,500 square kilometers of mining tenements. Tenement is Australian speak for mineral leases. Two of the tenements, called Christmas Creek and Cloud Break, contain over one billion tonnes of proven and probable iron ore reserves. These reserves will be the first to be mined and are the only tenements subject to our 4% of revenue payments.

⁴London Metal Exchange

In addition to our \$400 million investment, FMG borrowed in the international markets \$2.05 billion at a weighted-average rate of just over 10%. These funds and ours are being used to dredge the ship channels, to build a port facility to load ore on ships, to construct a 260-kilometer railroad to transport the ore to the port, and to build the mines at the sites mentioned above. Check FMG's website <http://www.fmg1.com.au> for pictures of the ongoing construction and a further description of this enormous undertaking.

First ore loaded on ship is planned for the end of the first quarter 2008; thereafter payments to Leucadia will follow. So far, the project is on schedule and on budget. FMG is the creation of a hyperactive, smart, energetic Australian entrepreneur named Andrew Forrest; imagine the Energizer Bunny®. Andrew's roots in Western Australia go back many generations. His forbearers include, among others, the founding Premier of Western Australia and some of the country's early explorers. Andrew himself was brought up in the Outback on a sheep station – the Australian equivalent of a ranch. This ranch had few people, 50,000 sheep and several thousand cows. Hard work and survival are in his DNA.

Andrew is an inspiring leader, a visionary and a knowledgeable executive and miner. We are fond of him and his delightful family. We are very happy with this investment. One of us serves on the FMG board (where our suggestions are welcomed) and the other is an alternate.

In 2006, iron ore prices increased 19%. The price of iron ore for the coming year (April 2007 through March 2008) has been reset 9.5% higher than last year. Analysts predict the price will go up again next year. Since prices do not go up forever, we did our initial investment arithmetic on declining iron ore prices.

At December 31, 2006, FMG stock traded at \$10.46 per share giving our 26.4 million shares a market value of \$276 million. As of this writing, March 28, 2007, the shares are trading at \$18.60 per share and our stake has a market value of \$491 million.

Goober Drilling

Before discussing our investment in Goober⁵ Drilling, let us digress. Several years ago most of the boxcar manufacturers in the U.S. had disappeared. There was a surfeit of boxcars selling at \$10,000 or less. Replacement costs were running \$30,000 to \$40,000 plus, depending upon the type. Twenty-five thousand boxcars were being retired every year due to old age and misadventure. We drew a supply and demand curve and we believed the two would cross in the not too distant future. We bought lots of boxcars and sent them out to forage on the railroads of North America, where they collected per diem money, and sent it home. Demand for boxcars rose higher and higher and we eventually submitted to a suitor and sold the fleet in 1989 at a significant profit.

Similarly at the peak in 1982, there were 5,139 oil and gas land-based drilling rigs in the U.S. with average day rates of \$5,770. Late in the first quarter of 2006, there were only 1,582 oil and gas rigs and average day rates had risen to \$14,100. Fortuitously, at that time into our offices came, from Stillwater, Oklahoma, the hard working owners of Goober Drilling, Chris McCutchen and John Special.

These successful fellows ran a drilling business in the Mid-Continent Region of the U.S., mainly in Oklahoma and Texas. They, too, understood supply/demand curves, resulting from the upwardly escalating oil and gas prices. Being adventurous and optimistic souls (but without enough financing),

⁵Goober also gouber. The peanut, *Arachis hypogaea*. 1833 Louisville Publ. Advt. 7 Nov., A few bags of Gouber Pea, or Ground Pea [for sale]. 1834 *Cherokee Phoenix* (New Echota, Ga.) 24 May 3/4 But he so seam I frade of he, I guess he steal my goober. –*The Oxford English Dictionary*, Volume VI, page 668.

they ordered 18 brand new rigs to add to their existing fleet of 11 rigs. These new rigs were high horsepower and most were equipped with top-drives. High horsepower and top-drives are required for horizontal drilling, which allows re-drilling of certain difficult but potentially productive formations. Horizontal drilling drills to a targeted depth then turns to drill horizontally to the surface of the land. They can pull up the drill string then go back and drill in another direction. (Imagine a daddy-long-legs spider with many legs up to one mile long.)

Day rates for new high horsepower rigs were then in the low \$20,000 per day with an operating cost of approximately \$9,000. The new rigs were about to be delivered and Goober needed money.

So in 2006, Leucadia acquired a 30% limited liability company interest in Goober for \$60 million and agreed to lend Goober \$126 million secured by all of its rigs. In January 2007, the loan was increased with an additional secured credit facility of \$45 million. For an additional \$25 million, we increased our equity interest to 42%.

At December 31, 2006, Goober had 21 operating drilling rigs, ten of which were new and financed by Leucadia. In addition, Goober has 13 rigs under construction and has committed to buy two more rigs. By the middle of 2007, all these rigs (36 in all) should be operational. Assuming current rig rates and 90% utilization, these rigs would generate annual billings of \$240 million. Between the interest on our debt and our share of the earnings we expect a very satisfactory investment return.

Rig day rates and the tenor of the contracts with the lease owners fluctuate with oil and gas prices. If gas prices stay at \$6 per mcf, we will prosper. If they stay over \$7 per mcf for three years, we will do very well! We hope for high gas prices, copper prices and iron ore prices.

Goober is growing rapidly and our Asset Management Group ("AMG") is helping them expand their back office to better monitor costs and institute Sarbanes-Oxley rules.

Our friends from Chartwell initiated this investment.

Symphony Healthcare

Last year we told you about the successes, trials and tribulations of Symphony—1,650 locations in 46 states, populated by 2,900 employees, many of whom are part-time. Attracting and retaining full or part-time therapists and keeping them trained became a major pain and was becoming evermore expensive.

We concluded that the business model could be improved by combining with other physical and occupational therapist providers. To this end, we went in search of possible roll-ups, and blessedly, got rolled up. We recorded a pre-tax gain of \$53.3 million on the sale. Luck helps!

Our colleagues, Zalman Jacobs and Luis Medeiros, found this company and executed the sale.

ATX Communications

ATX is a CLEC (Competitive Local Exchange Carrier) which we purchased in 2003 and reorganized through a Chapter 11 bankruptcy in 2005. Following its emergence from bankruptcy we went on another hunt to buy other CLECs or be bought. We are not convinced that there is a long-term future for small CLECs among the two remaining national telecommunications companies and the cable companies, and as a result ATX was purchased by the greater optimist. Thanks to David Larsen, Jeff Storey and the ATX team for the investment and the \$41.6 million pre-tax gain on sale.

Conwed Plastics

Conwed Plastics manufactures and markets lightweight plastic netting for a variety of purposes: building and construction, erosion control, packaging, sod backing, agricultural, carpet padding, filtration and consumer products. Conwed is a market leading company in lightweight netting products used in carpet cushion, turf reinforcement, erosion control and packaging. Leucadia's investment in Conwed Plastics was \$65.5 million at December 31, 2006. See pages 7-8 of the 10-K for a more detailed description of Conwed Plastics.

Conwed's products are manufactured in Minneapolis, Minnesota; Athens, Georgia; Roanoke, Virginia and Genk, Belgium and sold throughout the world.

(In millions)	2002	2003	2004	2005	2006
Sales	\$ 50.7	\$ 53.3	\$ 64.1	\$ 93.3	\$ 106.3
Pre-tax profits	\$ 3.1	\$ 4.4	\$ 7.9	\$ 14.2	\$ 17.9
Return on average equity	7.8%	12.6%	25.1%	33.4%	29.5%

A summary of 2006 in the words of Mark Lewry, President of Conwed:

"In 2006, Conwed celebrated 40 years in business and continues to be successful with a strategy to grow the business both organically and through acquisition. Revenues grew 14%, exceeding \$100 million for the first time, while pre-tax profits grew to 17% of sales. Resin price increases, for the first time in three years, began to moderate. While still up 92% from 2002, with continued diligence around cost and price management, the company's gross profit continued to improve.

Conwed's European operation, which represents approximately 14% of Conwed's sales, continues to deliver positive cash flow. The acquisition of Netlon from Tensar Group Limited in the U.K. in 2005 doubled our European operation and has enabled us to significantly upgrade the management team.

We looked at a number of acquisition opportunities during the year. Polynet Inc. was acquired in May 2006. The equipment and business were integrated into our Roanoke, Virginia facility.

During 2006, we also pursued Etiquetas Y Empaques (E&E) in Guadalajara, Mexico, closing the deal in early 2007. This company will expand our packaging business on the west coast and provide a platform to grow production in a lower cost operating environment.

Including E&E, Conwed has acquired and integrated six companies since 2004. During this time frame our revenues and return on equity have doubled while profits have grown over 300%.

2006 was a good year for Conwed as the twin engines of organic and acquisitive growth combined to deliver strong financial results. The strategy in 2007 will be the same and we certainly hope for similar results."

Idaho Timber

Idaho Timber is headquartered in Boise, Idaho, and remanufactures dimension lumber and produces other wood products. Idaho Timber was acquired in May 2005. For the eight months of 2005, pre-tax income was \$8.2 million, and for 2006 was \$12 million. See pages 4-7 of the 10-K for a more detailed description of Idaho Timber.

When we purchased Idaho Timber, we knew the earnings would porpoise as it is buffeted by the economic winds of commodity lumber prices and the housing market. These risks were built into the purchase price and as a result we own a well managed company with low capex and high taxable income using up our NOLs.

Ted Ellis is a fine manager who runs a tight ship and leads a band of effective people. He sticks to his knitting.

2006 in Ted's own words:

"In 2006 Idaho Timber was faced with a multitude of challenges. First, there was a continuation of a global over-supply of timber. Second, a complicated trade issue with Canada encouraged additional supply to come into the U.S. market in anticipation of a settlement of the dispute, which occurred last year. Third, there was a sharp downturn in housing as the year progressed.

All of this created a depressed lumber market and much lower prices for the industry. During this difficult time, Idaho Timber endeavored to maximize its volume and maintain a profitable result, outperforming the industry during this very difficult period of time.

Also during 2006, Idaho Timber finalized construction of its first new plant in several years. This plant is the second located in North Carolina and is designed to complement Idaho Timber's presence in key Eastern markets and to take advantage of the supply of lumber from a multitude of sources. This facility was completed in 2006 and has reached profitability much earlier than expected. The addition of the Chadbourn, North Carolina operation brings Idaho Timber to a total of eleven strategically located and diversified operations throughout the United States.

The Idaho Timber team has managed to control expenses in an ever-increasing cost environment, i.e., freight, labor and supplies.

Though year-over-year revenues were down due to the reduction of prices in the commodity lumber market, market share increased by expanding our customer base positioning the Company well for the future when the market improves.

The people at Idaho Timber are a family of hard working entrepreneurial individuals, constantly searching for ways to improve all aspects of our business. We hope the over-supply of lumber and the housing slow down resolve in the near future to allow us to achieve a result reflective of our efforts."

Gaming Entertainment

The Company's gaming interest is held through a controlling interest in Premier Entertainment Biloxi, LLC, which owns the Hard Rock Hotel & Casino Biloxi located in Biloxi, Mississippi. Hard Rock Biloxi was scheduled to open to the public on August 31, 2005. Two days prior to that, Hurricane Katrina struck the Mississippi Gulf Coast. The casino portion of the project was built on a floating barge located just offshore. During the storm, Katrina's winds peeled back the roof like a can of sardines, collapsing the roof and sinking the barge. The hotel portion located onshore, although structurally intact, was damaged by torrents of rain washing through the shattered windows.

We acquired our controlling interest (thanks to an introduction by our former colleague, Larry Hershfield) for \$90.8 million and own approximately 46% of the common stock and all of the preferred stock, which accrues dividends at 17% per annum. We also own a Premier \$13.4 million 15% junior subordinated note due in 2012, and made an \$8.1 million 12% loan to Premier which matures in May 2007, plus we are committed to provide up to \$40 million of construction financing (\$11.3 million was outstanding at December 31, 2006). All of Premier's equity interests are pledged to secure repayment of Premier's outstanding \$160 million principal amount of 10 3/4% First Mortgage Notes due February 1, 2012.

Prior to Hurricane Katrina, Premier had purchased \$181.1 million of insurance coverage for the wind damage to its real and personal property and for business interruption. To date, Premier has received \$160.9 million in insurance payments with an additional \$12.9 million being litigated with a silly insurer. Some insurance companies love premiums but detest payouts!

As a result of a dispute with the Premier note holders, who for some pernicious reason refused to release the insurance proceeds for the rebuilding of the hotel and casino, Premier and its subsidiaries filed voluntary petitions before the United States Bankruptcy Court for the Southern District of Mississippi for reorganization under the Bankruptcy Code. Premier continues to operate the company as debtors in possession.

The Bankruptcy Court has authorized the rebuilding and has to date released \$44.2 million of the insurance proceeds. Upon reconstruction, the resort will have a hotel with 318 rooms and suites, retail space, five restaurants, 1,500 slot machines and 50 gaming tables. This time, the casino will be built on pilings in the Gulf of Mexico, but not on a barge, though we will still worry about hurricanes. Leucadia has committed to provide up to \$180 million to finance the reorganization which would principally be used to pay off the Premier notes. When it leaves bankruptcy, Premier's available funds should be sufficient to repay our construction financing, and could also enable Premier to repay some of our other loans. A Confirmation Hearing for the Bankruptcy reorganization is expected to occur in May 2007.

The Casino and Hotel will hopefully have its grand opening July 7, 2007. Shareholders who gamble are encouraged to come visit Biloxi and leave some money behind! As always the odds favor the house but in this case you own the house.

Antilles Crossing

Leucadia (75%) and Light & Power Holdings Ltd. (25%) invested in a \$30 million glass fiber cable laid on the ocean floor from St. Croix to Barbados to provide residential and commercial data and voice services. From St. Croix, the cable connects with a cable, owned by others, to the U.S. and beyond to the rest of the world. A spur connection has been run to St. Lucia. Leucadia owns approximately 38% of Light and Power and one of the undersigned is its chairman.

The going has been difficult. Cable & Wireless, who has had a choke hold on Barbados telephone calls for decades, has been uncooperative by causing endless delays for endless reasons. The Barbados Government was helpful in issuing the necessary licenses. Since the money has been spent and the cable landed, the Barbados Government regulators have not been helpful. We shall overcome.

Brian Harvey is the manager of Antilles Crossing and is doing a splendid job.

Wineries

Leucadia owns two wineries: Pine Ridge Winery in Napa Valley, California, born in 1978 and acquired by us in 1991, and Archery Summit in Dayton, Oregon (on Archery Summit Road), which we founded and constructed in 1993. The wineries control 345 acres of vineyards: 229 acres in Napa Valley, California, in the well regarded appellations of Stags Leap, Carneros, Rutherford, Oakville and Howell Mountain, and 116 acres in the Willamette Valley of Oregon. Substantially all of this acreage is producing grapes. During 2006, the wineries sold approximately 81,000 9-liter equivalent cases of wine generating wine revenue of \$19.5 million. At December 31, 2006, the combined investment in these wineries was \$69.9 million.

We have purchased 611 acres of ground in the wine producing area of Eastern Washington State, hard by the Columbia River, from which we have rights to 2.5 acre feet of water. An acre foot describes the amount of water which, if piled up, would be one foot deep over the entire acreage. We are now planting a 90-acre test vineyard with several varieties of grapes. After this year's harvest is in, we plan to gain some experience as to climate and *terroir*⁶ by making some wine from purchased grapes.

The luxury segment of the wine industry is intensely competitive. Our wines compete with small and large producers in the U.S. as well as with imported wines. Demand for wine in the luxury market segment can rise and fall with general economic conditions, and is also significantly affected by available supply. The demand for our wine is largely affected by the ratings given the wines in industry and consumer publications. Wines are rated on a 1-to-100 numerical scale for each vintage and type of wine. The scores provided by *The Wine Spectator* and by Robert Parker can and do make or break a vintage of wine. We make it sometime.

As we mentioned, in an effort to improve the quality of our wines and achieve better scores, we decided to change the way we planted, pruned, picked and sorted the grapes and made the wine. We hired a very gifted French winemaker and viticulturist to guide us. The process was expensive and intense. With his assistance, the 2003 wines made by our talented winemakers Stacy Clark and Anna Matzinger have, in our opinion, improved.

Last year we mentioned we were contemplating some changes. We have added and will continue to add very experienced personnel to guide us into the future. Although the making and selling of wine is complex and difficult, we are making progress and the value of our vineyard and wineries continue to go up.

Depending upon your state liquor laws, you may order our wine on the Internet (www.pineridgewinery.com or www.archerysummit.com) or join our Wine Clubs and receive delicious libations monthly.

Visit the wineries in person and enjoy the tasting room experience. Shareholders of Leucadia receive a 20% discount—on the honor system. Call Pine Ridge at (800) 575-9777 or Archery Summit at (800) 732-8822.

Remember, wine is food and we think red wine leads to longevity!

⁶ *Terroir* (terwar/in French) can be very loosely translated as "a sense of place" which is embodied in certain qualities, and the sum of the effects that the local environment has had on the manufacture of a product; a group of vineyards (or even vines) from the same region, belonging to a specific appellation. —*Wikipedia, the free encyclopedia.*

Medical Product Development

Sangart

At December 31, 2006, Leucadia owned 69% of Sangart, having invested \$49.2 million since 2003. Sangart is a biopharmaceutical company engaged in the development of a blood substitute for oxygen transport. We invested an additional \$48.5 million in March 2007, which increased our ownership to 87%. We also have a warrant to invest an additional \$48.5 million on the same terms, but voluntarily. This recent investment plus the warrant funds, if exercised, are expected to finance the company through completion of its Phase III trials and commercialization. Sangart has commenced two Phase III trials in Europe that are designed to demonstrate the product's safety and effectiveness in preventing and treating low blood pressure during surgery, and in reducing the incidence of operative and postoperative complications.

Phase III trials are done on a large number of volunteer humans, are expensive and take a long time; Sangart expects to enroll over 800 patients in its trials. If the trials are successful, it should lead to commercialization of the product in a few years. We own a facility capable of producing 250,000 units per year. Regulators, including the FDA (Federal Drug Administration), who are charged with approving such products for human consumption, are notoriously cautious about what constitutes a "successful" Phase III trial.

Blood substitutes have had a rocky road to commercialization. No other products have been successful. We are hopeful the Phase II trial results foretell successful Phase III trials.

For a more expansive explanation of this journey, see pages 11-13 of the 10-K.

Chakshu⁷

In August 2005, Leucadia made a \$10 million investment for a 20% stake in an early stage, specialty pharmaceutical company called Chakshu Research. Chakshu is currently developing prescription eye drops to address the symptoms of early stage cataracts. Hopefully, this research will result in stopping cataract growth and perhaps recidivism. With baby boomers increasingly growing older, we believe a product that addresses age-related vision loss is attractive. Studies have indicated that approximately 90 million Americans suffer from cataracts but less than 40 million have been diagnosed. Since only mature cataracts are recommended for surgery, just 1.4 million Americans had cataract surgery in 2005.

FDA Phase I/II clinical trials commenced in January 2006 and enrollment (105 patients) was completed during the fourth quarter of 2006. Unmasking the results of the trials is expected to take place in April 2007. Undoubtedly, more money will be needed to complete pivotal Phase III trials and begin the process of product commercialization. We are cautiously optimistic.

⁷ "Bye" in Sanskrit.

Real Estate

At December 31, 2006, real estate properties had a book value of \$176.7 million. The company owns:

- 15-story 740,000-square foot office building in Tulsa, Oklahoma, formerly WilTel's headquarters. We have signed a term sheet to sell the building.
- In Myrtle Beach, South Carolina, a 112-acre fully entitled mixed use development project, consisting of 397,000 square feet of retail/commercial space (almost all leased) and 1,441 residential units of which 555 are under contract for sale to builders.
- 196 acres of land in two parcels undergoing residential entitlement in mid-coast Maine.
- A 15-acre unentitled air rights parcel over the train tracks behind Union Station in Washington, D.C. Entitlement is just beginning. This is one for the grandkids.
- An operating shopping center in Long Island, New York that has 71,000 square feet of retail space and is being expanded.
- 540-acre parcel bordering Telluride, Colorado. We are attempting to have it rezoned for estate lots, cabins and a lodge site.
- 2,005 acres of land close by Moab, Utah, which is going through the development approval process.
- Leucadia owns approximately 30% of the outstanding stock of HomeFed Corporation (NASDAQ OTC BB:HOFD). HomeFed is a successful real estate company in Southern California which was previously spun off to Leucadia shareholders. Carrying value is \$45.7 million. December 31, 2006 market value is \$163.3 million. Along with Leucadia, the undersigned are the largest shareholders.
- In February 2006, Leucadia completed the sale of 8 acres of unimproved Washington, D.C. land for net cash proceeds of \$75.7 million and recorded a pre-tax gain of \$48.9 million.

The real estate development business requires great patience and patient money to wait out long laborious entitlement processes and real estate downturns. Leucadia's approach to real estate is completely tactical; when we can't find succulent morsels, we hibernate.

Money and Other Things

In February 2007, our seven year investment in JPOF II came to an end. JPOF II was managed by Jefferies & Company, Inc., a full service investment bank to middle market companies and the trading of high yield securities. Over the seven years, Leucadia has enjoyed a weighted average return on the investment of approximately 20% per year, which was annually distributed. Thanks to Rich Handler, Andrew Whittaker and their great team. We are very pleased with that investment and have renewed it in another form.

A new six-year joint venture with Jefferies was fashioned whereby we will invest \$600 million and Jefferies a matching \$600 million. The new venture will be a registered broker-dealer engaged in the secondary sales and trading of high yield securities and special situation securities, including bank debt, post-reorganization equity, equity, equity derivatives, credit default swaps and other

financial instruments. The venture will commit capital to the market by making markets in high yield and distressed securities and will invest in and provide research coverage on these types of securities. We are hopeful that when credit is not as plentiful as it is today opportunities will abound.

On March 6, 2007, Leucadia raised \$500 million in the public market at 7 1/8% for ten years. The purpose of this financing was to match fund the new Jefferies investment and for general corporate purposes.

At December 31, 2006, Leucadia had approximately \$2.2 billion available for new investing, \$738 million of which is cash and U.S. Government and agency bonds. Please call us with ideas.

Exodus

In June 1995, H.E. Scruggs, known to one and all as Bud, came to work at Leucadia, he wanted to learn about business. H.E. is Herbert Eugene, which explains "Bud".

Bud had a long and successful career prior to joining Leucadia: a law degree, partner in a political consulting firm, long surviving Chief of Staff to the Governor of Utah and professor of Political Science at Brigham Young University.

Over the ensuing years, Bud made himself very valuable to Leucadia and rose to become one of the five or six principal executives of Leucadia National Corporation. He helped formulate the AMG. While the undersigned and others are out chasing rabbits, the AMG fellows stay home and mind the assets on a daily basis.

Bud and his wife Shirley are active members of The Church of Jesus Christ of Latter-day Saints, the "Mormons". Sensing his Leucadia years were the perfect preparation for the ministry, the Church drafted him up along with his delightful spouse Shirley for three years of service as Mission President, which supervises 100-200 missionaries between the ages of 19 and 22. Bud has been assigned to the Sydney, Australia North Mission. We were hoping it would be closer so we could continue to tap his secular advice. Our prediction is the Mormon population of Sydney North will flourish and multiply.

Bud is hard-working, creative and smart, with a vast and eclectic sense of humor. We will miss him very much, but wish him well.

The Future

These are confusing economic times. There are galvanic economic and political power shifts in the world. China, India and the rest of Southeast Asia are roiling. The U.S. had an economic and political hegemony from the end of World War II until the end of the last century. We are now bogged down in a senseless war in Iraq, the House and Senate are constantly bickering and getting even, and are not able to manage our country. Education, healthcare, Social Security, Medicare, Medicaid, immigration policy, among others, are all difficult issues. We need the best and the brightest, patriots all, to hammer out the thoughtful compromises necessary to assure a prosperous and full future. Will the world ever again look at us as a bright light on top of the mountain? Asia rises and we flounder, where this leads, we know not.

One of us thinks the sky is falling and the Dollar on the edge of debasement. One of us thinks the efforts of half the global population who struggle towards the western standard of life and liberty will cause a global bull market that could last a long, long time.

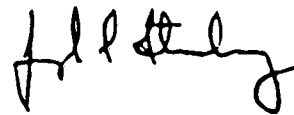
Meanwhile, we have committed over \$1 billion in the last twelve months and have added a few very experienced deal folk to join our team. The beat goes on.

We have a two-pronged approach to our succession problem—merge or acquire a large company not dependent on our investment skills and/or/also find and nurture talented investment types who have good deal skills—whether inside or outside the Company. The two of us hope to be around for a long time. We enjoy each other and what we do. We shall overcome this problem!

We may be the lead dogs on this dogsled, but we couldn't possibly pull it alone. We are eternally grateful to our experienced hard working colleagues.

A handwritten signature in dark ink, appearing to read 'Ian M. Cumming', with a long, horizontal, wavy line extending to the right.

Ian M. Cumming
Chairman

A handwritten signature in dark ink, appearing to read 'Joseph S. Steinberg', with a stylized, cursive script.

Joseph S. Steinberg
President