

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

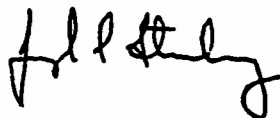
remaining equity interest in Cambrian. At December 31, 1989 the Company's investment in Cambrian was approximately \$27,700,000 less than Cambrian's net assets. In addition, we received \$12,500,000 in January related to a prior Cambrian investment which is not reflected in the excess amount referred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



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.



Joseph S. Steinberg
President