

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.

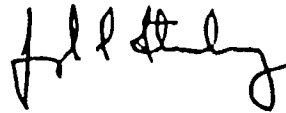
We are, however, worried about the U.S. economy. We have as a national family been living far beyond our means. For years we have had inadequate savings, investment and productivity growth. We borrowed to support our standard of living. The good times for the past 10-12 years were accomplished by both 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.



Ian M. Cumming
Chairman



Joseph S. Steinberg
President