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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 irresistable. 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.

Ian M. Cumming
Chairman

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.

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