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.

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.

Ian M. Cumming
Chairman

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.

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