1991

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		127,863
"Bargain" to be allocated		$263,015
First, intangible and depreciable assets are written off:		
Deferred policy acquisition costs	$139,809	
Insurance in force	20,064	
Fixed assets	24,915	$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	7,000	37,570
Next, increases in policy reserves, mostly belt and suspenders reserve strengthening:		
Annuities	5,800	
Accident and health	10,000	
Property and casualty	33,005	48,805
Finally, taxes not required because of indemnification from the seller and other write offs, net		(8,148)
		$263,015

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