Letter from the Chairman and President

To Our Shareholders,

1993 was a good year for Leucadia. Earnings were $245,454,000, or $8.09 per share, a 40% return on last year's ending equity. Net worth was $907,856,000 or $32.54 per share. This compares with a negative $.22 per share at December 31, 1978, when the present management took over. The stock price (adjusted for stock splits) for that same period went from $.16 to $41.00 per share, a compound rate of 44.7% per annum over those 15 years. We are pleased with this achievement; we hope you are. We doubt we will do as well in 1994.

The results for 1993 require some special explanation. The accounting elves have been working overtime again this year and, as a result, our report to you includes an inordinate number of accounting changes, some of which are quite complicated, but none of which change the excellent results. First, we will attempt to explain why the numbers appear as they do so that you can understand what actually happened to our businesses.

There are various components to the $245.5 million of earnings. To reconcile that number to the increase in net worth requires an explanation to show the effect of all the accounting changes on the income statement and the balance sheet.

	1993	1992	1991
		(In millions)	
Income before taxes	$176.9	$143.5	$95.0
Provision for taxes currently payable	25.3	12.9	.2
Applied to deferred taxes	35.3	–	–
Income before accounting changes	116.3	130.6	94.8
Accounting changes	129.2	–	–
Net income	$245.5	$130.6	$94.8

Several comments are in order. Pre-tax operating income is progressing quite nicely. The $129.2 million of income from accounting changes is, for the most part, the result of capitalizing our tax loss carryforwards (NOLs) and other future tax deductions as required by SFAS 109. "Taxes Currently Payable" are, for the most part, taxes payable in cash and include state income taxes, federal minimum taxes and tax sharing payments to the I.R.S. (resulting from the use of Phlcorp NOLs). The $35.3 million of deferred tax expense, which is not a cash expense, is applied to reduce the deferred tax asset account which appears on the balance sheet.

For those of you interested in a more detailed explanation of SFAS 109, you may get some satisfaction from reading Note 13 to the financials. We have disparaged this accounting change in our letters to you in the past and our attitude remains the same. The attempt of SFAS 109 to improve precision in accounting has rendered the results inexplicable to all but the most sophisticated readers of financial statements. In a very imprecise way, SFAS 109 requires that the future benefit of our NOLs and other tax deductions be estimated and put on the balance sheet as an asset called "Deferred Income Taxes." In 1993, this estimation and capitalization increased our earnings significantly. In the future, for as long as we have NOLs, we will report income tax expense far greater than we pay, and will reduce the previously capitalized deferred tax asset. To make matters even more confusing, every year we must re-estimate the usability of our remaining NOLs and other tax deductions and, if necessary, adjust the deferred tax asset. We preferred the pre-SFAS 109 reporting in 1991 and 1992. We reported paying very little tax and disclosed in a note to the financial statements that we had NOLs. Simple. Too much complexity robs simplicity and thus understanding.

1993

Here in simplified form is the effect on net income and shareholders' equity of all of the accounting changes. Additional information on the accounting changes may be found in Note 1 to the financials.

Accounting Change	P&L at 1/1/93	Direct Equity	Total Equity	Future Impact
	(In millions)			
SFAS 109 "Accounting for Income Taxes"	$127.2	$ 9.4	$136.6	Confusion and annual readjustments
SFAS 106 "Employers' Accounting for Postretirement Benefits other than Pensions"	(4.5)	–	(4.5)	Minimal
SFAS 112 "Employers' Accounting for Postemployment Benefits"	(3.2)	–	(3.2)	Minimal
SFAS 115 "Accounting for Certain Investments in Debt and Equity Securities"	–	49.5	49.5	Changes with market
EITF 93-6 "Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises"	9.7	–	9.7	Less conservative balance sheet
	$129.2	$58.9	$188.1	

The $49.5 million increase directly to equity is the accounting elves at work again. Heretofore debt securities were generally held at amortized cost on our balance sheet and current market value stated in a footnote. Under SFAS 115, changes in market value will go through net worth. This is a change that enlightens no one and will have the unintended consequence of encouraging financial institutions to change investment strategy in not necessarily beneficial ways. Why this is a good thing is beyond our understanding.

The $9.7 million equity increase comes about through the release of insurance reserves. The accountants do not share our conservatism.

To summarize, the $289.7 million increase in net worth from December 31, 1992 to December 31, 1993 is composed of the following (in millions):

Income before accounting changes	$116.3
Accounting changes	188.1
Purchase of stock for treasury	(10.8)
Dividends paid	(7.0)
Exercise of options	2.3
Other	.8
Total	$289.7

The responsibility for explaining our corporate accounting now belongs to Joe Orlando in our New York office. He has replaced Norman Kiken as our principal accounting officer. Norman, clutching the gains from his many years of faithful service, has escaped to California to start a winery. From accounting to farming, Norman does love a challenge! Through all the late nights, the impossible deadlines, truculent tax lawyers, opaque accounting rules, and junk food at the printers, Norman never lost his good cheer, improved his penmanship or remembered his calculator! We wish him the very best for the successful fulfillment of his dream. He will be greatly missed.

Property and Casualty Insurance Group

The Property and Casualty Insurance Group has two operating companies—Colonial Penn Insurance and the Empire Insurance Group. Colonial Penn, headquartered in Valley Forge,

Pennsylvania, is licensed in all 50 states and provides private passenger automobile and homeowners insurance to the age 50+ population. Colonial Penn, as a direct marketer, does not sell through agents and strives to be the lowest cost provider to this market segment. Colonial Penn had total net earned premiums of $452.6 million in 1993.

The Empire Insurance Group, headquartered in New York City, operates in the New York metropolitan area. Through a network of independent agents and brokers, Empire provides both personal and commercial insurance products and continues to be successful in identifying and developing niche programs. In addition, Empire's expertise in its market has allowed it to secure a considerable amount of service work which complements its voluntary insurance operations. Empire had total net earned premiums of $259.4 million in 1993.

In our property and casualty operations, we strive for profitability, not market share or volume. To that end, we emphasize high quality underwriting, expense containment and careful claims control. The ratios below illustrate the results of our property and casualty operations as compared to the industry as a whole:

	Combined Ratio		
	1993	1992	1991[1]
GAAP (Generally accepted accounting principles)	96.9%	101.7%	102.1%
SAP (Statutory accounting principles)	93.7%	102.8%	103.3%
Industry (SAP basis)	106.9%	115.7%	108.8%

[1]Includes Colonial Penn from date of acquisition.

Our goal, which we have stated before, is to have a combined ratio of no more than 100%. A combined ratio of 100% means that premiums equal the sum of claims, related expenses and underwriting expenses. Thus, if the combined ratio is 100% or less the shareholders keep the after tax earnings on the invested reserves and equity, which can be quite substantial on $1.7 billion of investments. We exceeded that goal in 1993, as the severity of claims were down and prior years' claims were settled under our new procedures at less than the reserved amounts. Unusual catastrophic losses will make it difficult to achieve our combined ratio goal of 100%.

As we also mentioned in the past, we discontinued Colonial Penn's marketing operations shortly after the acquisition because it was too expensive. When we resumed marketing in 1992, with new, lower cost programs, new premiums were not sufficient to maintain the size of the company. However, at this writing, we have significantly narrowed the gap and the volume generated from new premiums is nearly replacing lapses. We hope to report absolute growth in 1994.

Prior to our acquisition of Colonial Penn, the company wrote certain commercial lines of insurance. This closed block of business continues its satisfactory liquidation. We believe it is adequately reserved. Some day there may be a recovery.

1993 was a far gentler year than 1992 when Hurricane Andrew and other storms in the Northeast strained the world's catastrophic reinsurance capacity. Property and casualty earnings were impacted by winter storms in the first quarter but subsequent months sailed by without major incident. In 1993, no deductibles were breached giving our reinsurers a breather to recover from the shellacking they took in 1992.

Catastrophe insurance renewals for 1994 were negotiated in the latter part of last year and were oversubscribed at essentially the same rates. Colonial Penn continued its $11 million deductible program in light of continuing high rates for lower retentions. Our statutory surplus at Colonial Penn is much higher after two years of solid earnings and therefore a higher retention limit makes sense.

Life Insurance Group

We conduct our life insurance business through Colonial Penn Life headquartered in Philadelphia, Pennsylvania, Charter National Life in St. Louis, Missouri, and Intramerica Life Insurance in New York, New York. The principal life insurance product is a guaranteed issue policy sold directly to persons age 50 to 80 in face amounts of $350 to $10,000, issued without a medical examination or evidence of insurability. We have over 900,000 policies in force. This is a predictable and profitable block of business where the laws of large numbers operate in our favor. Ed McMahon is a spokesperson on television and via direct mail.

In 1992, we sold $10.9 million of new annualized premium (NAP). In 1993, we sold $16.9 million of NAP. At approximately $15 million in NAP, the business starts to grow. We are hoping to do better in 1994.

Critical to the success of this business is the cost of acquiring new business. We have managed to reduce our costs to about one-half of the costs previously incurred, which is a credit to the perspicacity of Colonial Penn Life's management.

Charter sells a no-load variable annuity product. Premiums from variable annuity products are invested at the direction of the policyholder in a series of unaffiliated mutual funds (managed by Scudder, Stevens and Clark) where the policyholder bears the entire investment risk. This no-load/no sales charge product is an excellent retirement savings vehicle. It allows the policyholder to choose from a variety of investment vehicles and have the gains accrue without taxation. The investment performance, for which we are not responsible, has been excellent. Premium receipts were $81.5 million in 1993 versus $58.2 million in 1992. We are hopeful that further growth will occur in 1994. One of the few benefits of higher taxes is that this product becomes more appealing. This was a tiny business which has now become a small business. Total assets related to this product have grown from zero in 1986 to $262.9 million at the end of 1993.

Investments

As we mentioned above, if you astutely manage a casualty company, the earnings on invested reserves and equity belong to the shareholders. In the life insurance business, we earn a profit after death claims, crediting rates and expenses are paid. In our life and casualty operations we have $2.4 billion of investments, of which 96% is invested in U.S. Government and agency paper and other investment grade investments. The portfolio had a 6.2% average yield and estimated average remaining life of 4.7 years and a duration of 2.9 as of December 31, 1993. We have been managing the portfolio for some time with higher rates in mind. We were prepared for the current uptick in interest rates. Our outside investment advisors have done a magnificent job. Our boat is stable, on course, and in no foreseeable danger of sinking.

Last year we included a list of guiding principles. We are repeating these here again and adding some others.

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 under reserve 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.

To the above, we add the following:

6. We invest in shorter maturity bonds. In the long run, stocks do better but over shorter periods of time they are not predictable. The obligations to our insureds are predictable. We best fulfill our obligations by investing in bonds.

7. We are afraid of long-term bonds.

8. We do not invest the insurance portfolios in uninsured real estate loans, junk bonds or exotic securities.

9. We do not reinsure other insurers risks. Our plate is full with our own risks.

10. We increase our shareholders' wealth by buying businesses at the right price—not by speculating in portfolio securities.

Banking and Lending

The Company's banking and lending operations are conducted through its national bank subsidiary, American Investment Bank, N.A. (AIB), and a wholly owned industrial loan corporation, American Investment Financial (AIF). These institutions have deposit insurance from the Federal Deposit Insurance Corporation (FDIC). Our relationship with the FDIC has improved and is satisfactory. Loans receivable were $188 million at year end, pre-tax earnings were $12 million, pre-tax return on assets was 4.48% and pre-tax return on equity was 26.32%.

These institutions are continuing to grow in 1994. AIB was a startup in 1980 and is developing into a significant source of our earnings. The principal businesses are executive lending by mail and auto lending to borrowers with prior credit problems.

Incentive Service

The Company's incentive services are carried on by The Sperry and Hutchinson Company, Inc. (S&H). Since 1969 when the annual sales peaked, the stamp business has been steadily declining. S&H manages the shrinkage of its business profitably.

At December 31, 1993, the liability for unredeemed trading stamps was $58.5 million. Because the business is shrinking, the historical stamp redemption patterns may have changed—this amount may be in excess of what is required. The latest statistical studies indicate that approximately $17.1 million may be excess at December 31, 1993, which we continue to amortize into income.

For those of you who are old enough to remember collecting green stamps, licking and sticking them into book after book all in aid of a new toaster, the decline of S & H will feel like the loss of an old friend. "The old order changeth, yielding place to new. . . ."[2]

Manufacturing Group

The manufacturing companies continue making progress on their return to profitability.

Other Matters

During 1993 interest rates came down to levels where it was advantageous to replenish our coffers. In February 1993, we sold $100 million principal amount of 5¼% Convertible Subordinated Debentures

[2]Alfred, Lord Tennyson

due 2003. In August 1993, the Company sold $100 million principal amount of 7¾% of Senior Notes due 2013. At this writing, most of this money is available. Although it is invested at a slightly negative spread, it is, in our opinion, a modest price to pay for increased liquidity, which along with $150 million in unused bank lines gives us the ability to take advantage of opportunities.

On June 23, 1993, we completed the sale of certain tax advantaged life products to John Hancock Mutual Life Insurance Company. We reported a pre-tax gain of $16.7 million. As we mentioned last year, these products were unattractive to us in an environment where competition was willing to take interest rate risks that we found unacceptable.

At the end of 1993, we declared a $.25 per share annual dividend up from $.20 per share in 1992. Towards the end of the year, as the results from 1994 become apparent, we will again consider a dividend.

Latin America

On March 30, 1993, the Company received cash of $5.3 million and $12 million principal amount of 6% U.S. dollar denominated El Salvador Government bonds, due in instalments through 1996. This ended a long saga that began with the expropriation of the electric utility, Compañia de Alumbrado Eléctrico de San Salvador (CAESS). At this writing, we have sold the remaining bonds in the market at a modest discount. In the first quarter of 1994, the Company will report a pre-tax gain of approximately $8.5 million on this transaction.

In November of 1993, the Bolivian Power Company was listed on the New York Stock Exchange and sold 1,250,000 shares of newly issued stock for $28.3 million to finance future growth. This is the first company operating principally in Bolivia to be listed on the New York Stock Exchange. Leucadia sold 750,000 of its shares in the same offering for $17 million and reported a $13 million pre-tax gain. We still own 719,206 shares representing 17% of the outstanding common shares. Our holdings in the Barbados Light and Power Company remain unchanged.

During 1994, we acquired 30% of Caja de Ahorro y Seguro, S.A. (the "Caja") for $46 million along with a local partner who also purchased 30% on the same terms. The "Caja" is Argentina's largest insurance company with 55 branches and an important presence throughout the country. It is the major direct writer of group life insurance and an important automobile insurer. It also operates a small bank.

The Argentine economy is revitalizing. The "Caja" is a household name with a tremendous market share. We are hopeful that, together with our local partners, newly hired senior management and our Leucadia insurance staff, the "Caja" can be developed into a profitable growing business. Time will tell. To date, we have realized through hard work and good luck $45 million of value from our other Latin American investments.

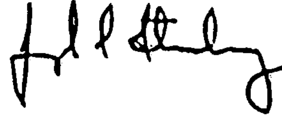
Our shareholders should not conclude from the last few paragraphs that we plan to report to you next year in Spanish, though one of us will study Spanish for three weeks this summer. Our investments in Latin America came about either by happenstance, as in the case of Bolivia, El Salvador and Barbados, or in our usual opportunistic way, as in Argentina.

1993 was a year of accounting changes, of increased liquidity and continued improvements in our insurance operations and banking business. One of the undersigned is more pessimistic than the other, seeing as he does, higher taxes, higher interest rates and potential financial accidents around every corner. The other's point of view is that the globalization of the world's economy and the desire of peoples all over the world to partake in the higher standard of living, as advertised on CNN, presents an opportunity for the United States to profitably provide the capital, goods and services necessary for improving education, health and industrialization worldwide.

The optimism of one, however, is greatly cautioned by the gloom of the other. We have collected a large pile of coconuts and our job is in no small part conservation as well as growth. First, we will endeavor to keep the coconuts we have then add to the pile. As in the past, we debate endlessly but proceed cautiously.

We are exceptionally well assisted by our employees, advisors, bankers and all those who work hard in our common enterprise. We are most grateful.

IAN M. CUMMING
Chairman



JOSEPH S. STEINBERG
President