

---

---

# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

---

## FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2006

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-5721

## LEUCADIA NATIONAL CORPORATION

(Exact name of registrant as specified in its Charter)

New York  
(State or other jurisdiction of  
incorporation or organization)

13-2615557  
(I.R.S. Employer  
Identification Number)

315 Park Avenue South, New York, New York  
(Address of principal executive offices)

10010-3607  
(Zip Code)

(212) 460-1900  
(Registrant's telephone number, including area code)

N/A  
(Former name, former address and former fiscal year, if changed since last report)

---

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

APPLICABLE ONLY TO CORPORATE ISSUERS: Indicate the number of shares outstanding of each of the issuer's classes of common stock, at November 1, 2006: 216,329,442.

---

---

## PART I—FINANCIAL INFORMATION

### Item 1. Financial Statements.

LEUCADIA NATIONAL CORPORATION AND SUBSIDIARIES

#### Consolidated Balance Sheets

September 30, 2006 and December 31, 2005

(Dollars in thousands, except par value)

	September 30, 2006 <small>(Unaudited)</small>	December 31, 2005
<b>Assets</b>		
Current assets:		
Cash and cash equivalents .....	\$ 301,019	\$ 386,957
Investments .....	980,144	1,323,562
Trade, notes and other receivables, net .....	100,005	377,216
Prepays and other current assets .....	173,165	140,880
Total current assets .....	1,554,333	2,228,615
Restricted cash .....	18,262	27,018
Non-current investments .....	1,272,382	977,327
Notes and other receivables, net .....	29,801	22,747
Intangible assets, net and goodwill .....	61,293	85,083
Deferred tax asset, net .....	972,876	1,094,017
Other assets .....	369,576	213,583
Property, equipment and leasehold improvements, net .....	236,095	237,021
Investments in associated companies .....	709,815	375,473
Total .....	<u>\$5,224,433</u>	<u>\$5,260,884</u>
<b>Liabilities</b>		
Current liabilities:		
Trade payables and expense accruals .....	\$ 103,327	\$ 259,778
Other current liabilities .....	5,633	23,783
Debt due within one year .....	184,079	175,664
Income taxes payable .....	10,978	15,171
Total current liabilities .....	304,017	474,396
Other non-current liabilities .....	109,655	121,893
Long-term debt .....	972,637	986,718
Total liabilities .....	<u>1,386,309</u>	<u>1,583,007</u>
Commitments and contingencies		
Minority interest .....	<u>13,513</u>	<u>15,963</u>
<b>Shareholders' Equity</b>		
Common shares, par value \$1 per share, authorized 300,000,000 shares; 216,326,442 and 216,058,016 shares issued and outstanding, after deducting 56,875,963 and 56,874,929 shares held in treasury .....	216,326	216,058
Additional paid-in capital .....	517,783	501,914
Accumulated other comprehensive loss .....	(113,132)	(81,502)
Retained earnings .....	3,203,634	3,025,444
Total shareholders' equity .....	<u>3,824,611</u>	<u>3,661,914</u>
Total .....	<u>\$5,224,433</u>	<u>\$5,260,884</u>

See notes to interim consolidated financial statements.

## LEUCADIA NATIONAL CORPORATION AND SUBSIDIARIES

**Consolidated Statements of Operations**

For the periods ended September 30, 2006 and 2005

(In thousands, except per share amounts)

(Unaudited)

	For the Three Month Period Ended September 30,		For the Nine Month Period Ended September 30,	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
<b>Revenues and Other Income:</b>				
Manufacturing .....	<b>\$105,375</b>	\$115,066	<b>\$343,180</b>	\$ 223,991
Investment and other income .....	<b>48,609</b>	47,503	<b>243,706</b>	111,899
Net securities gains .....	<b>16,259</b>	85,706	<b>99,391</b>	132,732
	<u><b>170,243</b></u>	<u>248,275</u>	<u><b>686,277</b></u>	<u>468,622</u>
<b>Expenses:</b>				
Manufacturing cost of sales .....	<b>91,909</b>	98,019	<b>290,698</b>	189,140
Interest .....	<b>22,843</b>	16,203	<b>61,541</b>	49,240
Salaries and incentive compensation .....	<b>19,971</b>	13,256	<b>62,042</b>	33,216
Depreciation and amortization .....	<b>5,855</b>	4,296	<b>16,187</b>	13,675
Selling, general and other expenses .....	<b>35,707</b>	29,641	<b>108,570</b>	85,223
	<u><b>176,285</b></u>	<u>161,415</u>	<u><b>539,038</b></u>	<u>370,494</u>
Income (loss) from continuing operations before income taxes and equity in income (losses) of associated companies.....	<b>(6,042)</b>	86,860	<b>147,239</b>	98,128
Income taxes .....	<u><b>(8,709)</b></u>	<u>(24,885)</u>	<u><b>48,871</b></u>	<u>(1,131,809)</u>
Income from continuing operations before equity in income (losses) of associated companies.....	<b>2,667</b>	111,745	<b>98,368</b>	1,229,937
Equity in income (losses) of associated companies, net of taxes .....	<u><b>1,073</b></u>	<u>(66,531)</u>	<u><b>24,336</b></u>	<u>11,962</u>
Income from continuing operations.....	<b>3,740</b>	45,214	<b>122,704</b>	1,241,899
Income (loss) from discontinued operations, net of taxes .....	<b>(2,717)</b>	58,770	<b>(3,870)</b>	81,231
Gain on disposal of discontinued operations, net of taxes .....	<u><b>59,454</b></u>	<u>130</u>	<u><b>59,356</b></u>	<u>54,708</u>
Net income.....	<u><b>\$ 60,477</b></u>	<u>\$104,114</u>	<u><b>\$178,190</b></u>	<u>\$ 1,377,838</u>
Basic earnings (loss) per common share:				
Income from continuing operations .....	<b>\$ .02</b>	\$.21	<b>\$ .57</b>	\$5.77
Income (loss) from discontinued operations..	<b>(.01)</b>	.27	<b>(.02)</b>	.38
Gain on disposal of discontinued operations .	<b>.27</b>	-	<b>.27</b>	.25
Net income.....	<u><b>\$ .28</b></u>	<u>\$.48</u>	<u><b>\$ .82</b></u>	<u>\$6.40</u>
Diluted earnings (loss) per common share:				
Income from continuing operations .....	<b>\$ .02</b>	\$.21	<b>\$ .56</b>	\$5.42
Income (loss) from discontinued operations..	<b>(.01)</b>	.26	<b>(.02)</b>	.35
Gain on disposal of discontinued operations .	<b>.26</b>	-	<b>.26</b>	.24
Net income.....	<u><b>\$ .27</b></u>	<u>\$.47</u>	<u><b>\$ .80</b></u>	<u>\$6.01</u>

See notes to interim consolidated financial statements.

LEUCADIA NATIONAL CORPORATION AND SUBSIDIARIES

**Consolidated Statements of Cash Flows**

For the nine months ended September 30, 2006 and 2005

(In thousands)

(Unaudited)

	<u>2006</u>	<u>2005</u>
<b>Net cash flows from operating activities:</b>		
Net income .....	\$ 178,190	\$ 1,377,838
Adjustments to reconcile net income to net cash provided by operations:		
Deferred income tax provision (benefit).....	96,344	(1,135,100)
Depreciation and amortization of property, equipment and leasehold improvements .....	28,171	142,374
Other amortization .....	(9,936)	2,132
Share-based compensation .....	12,390	-
Excess tax benefit from exercise of stock options .....	(376)	-
Provision for doubtful accounts.....	1,005	3,951
Net securities gains.....	(99,391)	(135,009)
Equity in income of associated companies.....	(38,792)	(12,692)
Distributions from associated companies .....	74,209	89,293
Net gains related to real estate, property and equipment, and other assets .....	(99,344)	(36,968)
Gain on disposal of discontinued operations.....	(94,616)	(56,708)
Investments classified as trading, net .....	(3,885)	19,472
Net change in:		
Restricted cash.....	8,625	(9,152)
Trade, notes and other receivables.....	156,384	31,860
Prepays and other assets .....	(1,394)	(14,743)
Trade payables and expense accruals.....	(127,152)	(17,133)
Other liabilities .....	(15,900)	(28,823)
Income taxes payable .....	(4,179)	(1,634)
Other.....	8,288	(673)
Net cash provided by operating activities .....	<u>68,641</u>	<u>218,285</u>
<b>Net cash flows from investing activities:</b>		
Acquisition of property, equipment and leasehold improvements .....	(33,659)	(109,559)
Acquisitions of and capital expenditures for real estate investments .....	(57,398)	(20,353)
Proceeds from disposals of real estate, property and equipment, and other assets ..	179,985	27,579
Proceeds from sale of discontinued operations, net of expenses and cash of operations sold .....	115,304	101,360
Collection of Premier's insurance proceeds .....	109,383	-
Acquisitions, net of cash acquired .....	(105,282)	(172,622)
Net change in restricted cash .....	(91,640)	(2,415)
Advances on notes and other receivables.....	(23,588)	(100)
Collections on notes, loan and other receivables.....	21,790	3,015
Investments in associated companies.....	(267,273)	(6,241)
Distributions from associated companies.....	2,040	2,619
Investment in Fortescue Metals Group Ltd.....	(408,030)	-
Purchases of investments (other than short-term).....	(3,010,495)	(2,342,929)
Proceeds from maturities of investments.....	893,339	977,805
Proceeds from sales of investments .....	<u>2,483,093</u>	<u>1,417,222</u>
Net cash used for investing activities.....	<u>(192,431)</u>	<u>(124,619)</u>
<b>Net cash flows from financing activities:</b>		
Net change in customer banking deposits.....	-	(24,565)
Issuance of long-term debt .....	61,739	70,765
Reduction of long-term debt.....	(34,042)	(58,978)
Issuance of common shares.....	3,404	1,584
Purchase of common shares for treasury.....	(33)	-
Excess tax benefit from exercise of stock options.....	376	-
Other.....	6,364	(664)
Net cash provided by (used for) financing activities.....	<u>37,808</u>	<u>(11,858)</u>
Effect of foreign exchange rate changes on cash.....	44	(880)
Net increase (decrease) in cash and cash equivalents .....	<u>(85,938)</u>	<u>80,928</u>
Cash and cash equivalents at January 1, .....	<u>386,957</u>	<u>486,948</u>
Cash and cash equivalents at September 30, .....	<u>\$ 301,019</u>	<u>\$ 567,876</u>

See notes to interim consolidated financial statements.

LEUCADIA NATIONAL CORPORATION AND SUBSIDIARIES

**Consolidated Statements of Changes in Shareholders' Equity**

For the nine months ended September 30, 2006 and 2005

(In thousands, except par value)

(Unaudited)

	Common Shares \$1 Par Value	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total
<b>Balance, January 1, 2005</b> .....	\$215,201	\$490,903	\$ 136,138	\$1,416,411	<u>\$2,258,653</u>
Comprehensive income:					
Net change in unrealized gain (loss) on investments, net of taxes of \$0.			(95,818)		(95,818)
Net change in unrealized foreign exchange gain (loss), net of taxes of \$0 .....			(14,802)		(14,802)
Net change in unrealized gain (loss) on derivative instruments, net of taxes of \$0 .....			2,395		2,395
Net income .....				1,377,838	<u>1,377,838</u>
Comprehensive income .....					<u>1,269,613</u>
Issuance of common shares on acquisition of minority interest in MK Resources Company .....	668	12,191			12,859
Exercise of options to purchase common shares .....	<u>192</u>	<u>1,392</u>			<u>1,584</u>
<b>Balance, September 30, 2005</b> .....	<u>\$216,061</u>	<u>\$504,486</u>	<u>\$ 27,913</u>	<u>\$2,794,249</u>	<u>\$3,542,709</u>
<b>Balance, January 1, 2006</b> .....	\$216,058	\$501,914	\$ (81,502)	\$3,025,444	<u>\$3,661,914</u>
Comprehensive income:					
Net change in unrealized gain (loss) on investments, net of taxes of \$18,163 .....			(32,009)		(32,009)
Net change in unrealized foreign exchange gain (loss), net of taxes of \$298 .....			526		526
Net change in unrealized gain (loss) on derivative instruments, net of taxes of \$84 .....			(147)		(147)
Net income .....				178,190	<u>178,190</u>
Comprehensive income .....					<u>146,560</u>
Share-based compensation expense ....		12,390			12,390
Exercise of options to purchase common shares, including excess tax benefit .....	269	3,511			3,780
Purchase of common shares for treasury .....	<u>(1)</u>	<u>(32)</u>			<u>(33)</u>
<b>Balance, September 30, 2006</b> .....	<u>\$216,326</u>	<u>\$517,783</u>	<u>\$(113,132)</u>	<u>\$3,203,634</u>	<u>\$3,824,611</u>

See notes to interim consolidated financial statements.

**Notes to Interim Consolidated Financial Statements**

1. The unaudited interim consolidated financial statements, which reflect all adjustments (consisting of normal recurring items or items discussed herein) that management believes necessary to present fairly results of interim operations, should be read in conjunction with the Notes to Consolidated Financial Statements (including the Summary of Significant Accounting Policies) included in the Company's audited consolidated financial statements for the year ended December 31, 2005, which are included in the Company's Annual Report filed on Form 10-K, as amended by Form 10-K/A, for such year (the "2005 10-K"). Results of operations for interim periods are not necessarily indicative of annual results of operations. The consolidated balance sheet at December 31, 2005 was extracted from the audited annual financial statements and does not include all disclosures required by accounting principles generally accepted in the United States of America ("GAAP") for annual financial statements.

On June 14, 2006, a two-for-one stock split was effected in the form of a 100% stock dividend that was paid to shareholders of record on May 30, 2006. The financial statements (and notes thereto) give retroactive effect to the stock split for all periods presented.

In June 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109" ("FIN 48"), which prescribes the accounting for and disclosure of uncertainty in income tax positions. FIN 48 defines the criteria that must be met before any part of the benefit of a tax position can be recognized in the financial statements, provides guidance for the measurement of tax benefits recognized and guidance for classification and disclosure. FIN 48 is effective for fiscal years beginning after December 15, 2006, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The Company is currently evaluating the impact of adopting FIN 48 on its consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("SFAS 157"), which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of adopting SFAS 157 on its consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)" ("SFAS 158"), which requires companies to recognize on their balance sheet a net liability or asset for the funded status of their defined benefit pension and other postretirement plans, recognize changes in funded status through comprehensive income and provide additional footnote disclosures. SFAS 158 is effective for publicly traded calendar year-end companies as of December 31, 2006. In addition, SFAS 158 requires companies to measure the funded status of their plans as of the date of its fiscal year-end, with limited exceptions, effective for fiscal years ending after December 15, 2008. The Company is currently evaluating the impact of adopting SFAS 158 on its consolidated financial statements, but does not believe it will have a material impact.

Certain amounts for prior periods have also been reclassified to be consistent with the 2006 presentation, and to reflect as discontinued operations WilTel Communications Group, LLC ("WilTel"), which was sold during the fourth quarter of 2005, Symphony Health Services, LLC ("Symphony"), which was sold in July 2006, and ATX Communications, Inc. ("ATX"), which was sold in September 2006. For more information concerning the sales, see Note 9.

2. Results of operations for the Company's segments are reflected from the date of acquisition. The primary measure of segment operating results and profitability used by the Company is income (loss) from continuing operations before income taxes and equity in income (losses) of associated companies. As a result of the classification of Symphony and ATX as discontinued operations, the

**Notes to Interim Consolidated Financial Statements, continued**

Company no longer has a healthcare services segment or a telecommunications segment; for information about the Company's new gaming entertainment segment, see Note 17.

Certain information concerning the Company's segments for the three and nine month periods ended September 30, 2006 and 2005 is presented in the following table (in thousands).

	For the Three Month Period Ended September 30,		For the Nine Month Period Ended September 30,	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
<b>Revenues and other income (a):</b>				
Manufacturing:				
Idaho Timber .....	\$ 77,614	\$ 90,887	\$261,895	\$154,419
Plastics .....	27,944	24,500	82,175	69,943
Gaming Entertainment .....	1,599	-	2,441	-
Domestic Real Estate .....	4,951	4,824	76,836	22,116
Other Operations.....	12,474	31,421	30,151	49,614
Corporate (b).....	<u>45,661</u>	<u>96,643</u>	<u>232,779</u>	<u>172,530</u>
Total consolidated revenues and other income ..	<u>\$170,243</u>	<u>\$248,275</u>	<u>\$686,277</u>	<u>\$468,622</u>
<b>Income (loss) from continuing operations before income taxes and equity in income (losses) of associated companies:</b>				
Manufacturing:				
Idaho Timber .....	\$ 335	\$ 4,463	\$ 11,871	\$ 4,112
Plastics .....	5,150	4,344	15,374	12,289
Gaming Entertainment .....	(830)	-	(217)	-
Domestic Real Estate .....	(2,353)	1,034	48,445	1,576
Other Operations (c).....	(8,856)	15,403	(22,657)	10,832
Corporate (b).....	<u>512</u>	<u>61,616</u>	<u>94,423</u>	<u>69,319</u>
Total consolidated income (loss) from continuing operations before income taxes and equity in income (losses) of associated companies .....	<u>\$ (6,042)</u>	<u>\$ 86,860</u>	<u>\$147,239</u>	<u>\$ 98,128</u>

- (a) Revenues and other income for each segment include amounts for services rendered and products sold, as well as segment reported amounts classified as investment and other income and net securities gains on the Company's consolidated statements of operations.
- (b) Includes net securities gains of \$16,300,000 and \$75,800,000 for the three month periods ended September 30, 2006 and 2005, respectively, and \$99,400,000 and \$123,500,000 for the nine month periods ended September 30, 2006 and 2005, respectively. Net securities gains include provisions of \$9,700,000 and \$4,000,000 for the three month periods ended September 30, 2006 and 2005, respectively, and \$12,300,000 and \$7,300,000 for the nine month periods ended September 30, 2006 and 2005, respectively, to write down investments in certain available for sale securities due to declines in market value determined to be other than temporary.
- (c) Losses in other operations for the 2006 periods principally relate to research and development expenses and operating expenses of the Company's medical product development subsidiary.

For the three month periods ended September 30, 2006 and 2005, income from continuing operations has been reduced by depreciation and amortization expenses of \$10,400,000 and \$8,300,000, respectively; such amounts are primarily comprised of Corporate (\$2,900,000 and \$2,700,000, respectively), manufacturing (\$4,400,000 and \$4,000,000, respectively) and other operations (\$1,700,000 and \$1,500,000, respectively). For the nine month periods ended September 30, 2006 and 2005, income from continuing operations has been reduced by depreciation and amortization expenses of \$29,300,000 and \$24,000,000, respectively; such amounts are primarily comprised of Corporate (\$8,800,000 and \$8,000,000, respectively), manufacturing (\$13,000,000 and \$9,900,000,

**Notes to Interim Consolidated Financial Statements, continued**

respectively) and other operations (\$4,200,000 and \$4,500,000, respectively). Depreciation and amortization expenses for other segments are not material.

For the three month periods ended September 30, 2006 and 2005, income from continuing operations has been reduced by interest expense of \$22,800,000 and \$16,200,000, respectively; such amounts are primarily comprised of Corporate (\$18,100,000 and \$15,900,000, respectively), gaming entertainment (\$4,700,000 in 2006) and other operations (\$300,000 in 2005). For the nine month periods ended September 30, 2006 and 2005, income from continuing operations has been reduced by interest expense of \$61,500,000 and \$49,200,000, respectively; such amounts are primarily comprised of Corporate (\$53,100,000 and \$47,000,000, respectively), gaming entertainment (\$8,000,000 in 2006) and other operations (\$1,200,000 in 2005). Interest expense for other segments is not material.

3. The following tables provide summarized data with respect to significant investments in associated companies accounted for under the equity method of accounting for the periods the investments were owned by the Company. The information is provided for those investments whose relative significance to the Company could result in the Company including separate audited financial statements for such investments in its Annual Report on Form 10-K for the year ended December 31, 2006 (in thousands).

	<u>September 30, 2006</u>	<u>September 30, 2005</u>
EagleRock Capital Partners (QP), LP (“EagleRock”):		
Total revenues .....	<b>\$10,200</b>	\$(16,800)
Income (loss) from continuing operations before extraordinary items ..	<b>9,600</b>	(18,000)
Net income (loss) .....	<b>9,600</b>	(18,000)
The Company’s equity in net income (loss) .....	<b>7,100</b>	(13,500)
Jefferies Partners Opportunity Fund II, LLC (“JPOF II”):		
Total revenues .....	<b>\$37,900</b>	\$ 31,600
Income from continuing operations before extraordinary items .....	<b>36,300</b>	29,300
Net income .....	<b>36,300</b>	29,300
The Company’s equity in net income .....	<b>23,900</b>	19,500

4. A summary of investments at September 30, 2006 and December 31, 2005 is as follows (in thousands):

	<u>September 30, 2006</u>		<u>December 31, 2005</u>	
	<u>Amortized Cost</u>	<u>Carrying Value and Estimated Fair Value</u>	<u>Amortized Cost</u>	<u>Carrying Value and Estimated Fair Value</u>
Current Investments:				
Investments available for sale .....	<b>\$ 859,198</b>	<b>\$ 862,373</b>	\$1,206,973	\$1,206,195
Trading securities .....	<b>103,445</b>	<b>102,975</b>	103,978	105,541
Other investments, including accrued interest income .....	<b>14,796</b>	<b>14,796</b>	11,826	11,826
Total current investments .....	<b><u>\$ 977,439</u></b>	<b><u>\$ 980,144</u></b>	<b><u>\$1,322,777</u></b>	<b><u>\$1,323,562</u></b>
Non-current Investments:				
Investments available for sale .....	<b>\$1,094,480</b>	<b>\$1,101,478</b>	\$ 762,178	\$ 825,716
Other investments .....	<b>170,904</b>	<b>170,904</b>	151,611	151,611
Total non-current investments .....	<b><u>\$1,265,384</u></b>	<b><u>\$1,272,382</u></b>	<b><u>\$ 913,789</u></b>	<b><u>\$ 977,327</u></b>

During the first quarter of 2006, the Company sold all of its 115,000,000 shares of Level 3 Communications, Inc. common stock that it had received in connection with the sale of WilTel for total proceeds of \$376,600,000 and recorded a pre-tax gain of \$37,400,000.



**Notes to Interim Consolidated Financial Statements, continued**

5. A summary of intangible assets, net and goodwill at September 30, 2006 and December 31, 2005 is as follows (in thousands):

	<u>September 30, 2006</u>	<u>December 31, 2005</u>
Intangibles:		
Customer relationships, net of accumulated amortization of \$9,980 and \$6,686 .....	<b>\$48,621</b>	\$58,911
Trademarks and tradename, net of accumulated amortization of \$192 and \$268.....	<b>1,662</b>	4,140
Software, net of accumulated amortization of \$0 and \$701 .....	-	4,399
Patents, net of accumulated amortization of \$259 and \$142 .....	<b>2,071</b>	2,188
Other, net of accumulated amortization of \$1,583 and \$1,488 .....	<b>788</b>	1,446
Goodwill.....	<b><u>8,151</u></b>	<u>13,999</u>
	<b><u>\$61,293</u></b>	<b><u>\$85,083</u></b>

During the nine months ended September 30, 2006, the Company recorded \$4,200,000 of new intangible assets, principally customer relationships, resulting from acquisitions by the plastics manufacturing segment and the other operations segment. Intangible assets, net at December 31, 2005 included \$16,500,000 related to ATX, which was sold in September 2006.

Amortization expense on intangible assets was \$2,000,000 and \$1,500,000, respectively, for the three month periods ended September 30, 2006 and 2005, and \$5,700,000 and \$3,900,000, respectively, for the nine month periods ended September 30, 2006 and 2005. The estimated aggregate future amortization expense for the intangible assets for each of the next five years is as follows: 2006 (for the remaining three months)–\$2,000,000; 2007–\$7,100,000; 2008–\$6,600,000; 2009–\$6,100,000; and 2010–\$5,800,000.

At September 30, 2006 and December 31, 2005, goodwill included \$8,200,000 within the plastics manufacturing segment; at December 31, 2005, goodwill also included \$5,800,000 related to ATX.

6. A summary of accumulated other comprehensive income (loss), net of taxes at September 30, 2006 and December 31, 2005 is as follows (in thousands):

	<u>September 30, 2006</u>	<u>December 31, 2005</u>
Net unrealized losses on investments .....	<b>\$ (54,390)</b>	\$(22,381)
Net unrealized foreign exchange losses .....	<b>(2,364)</b>	(2,890)
Net unrealized losses on derivative instruments.....	<b>(1,155)</b>	(1,008)
Net minimum pension liability.....	<b><u>(55,223)</u></b>	<u>(55,223)</u>
	<b><u>\$(113,132)</u></b>	<b><u>\$(81,502)</u></b>

7. Investment and other income includes changes in the fair values of derivative financial instruments of \$(900,000) and \$1,600,000 for the three month periods ended September 30, 2006 and 2005, respectively, and \$900,000 and \$1,500,000, for the nine month periods ended September 30, 2006 and 2005, respectively.

8. In February 2006, Square 711 Developer, LLC (“Square 711”), a 90% owned subsidiary of the Company, completed the sale of 8 acres of unimproved land in Washington, D.C. for aggregate cash consideration of \$121,900,000. The land was acquired by Square 711 in September 2003 for cash consideration of \$53,800,000. After satisfaction of mortgage indebtedness on the property of \$32,000,000 and other closing payments, the Company received net cash proceeds of approximately \$75,700,000, and recorded a pre-tax gain of \$48,900,000.

9. In July 2006, the Company sold Symphony to RehabCare Group, Inc. for aggregate cash consideration of approximately \$107,000,000. After satisfaction of Symphony’s outstanding credit agreement (\$31,700,000 at date of sale) and other sale related obligations, the Company realized net

**Notes to Interim Consolidated Financial Statements, continued**

cash proceeds of \$62,300,000 and recorded a pre-tax gain on sale of discontinued operations of \$53,300,000 (\$33,500,000 after tax). Results of operations for Symphony for the three month period ended September 30, 2005 and for the nine month periods ended September 30, 2006 and 2005 are as follows (in thousands):

	For the Three Month Period Ended September 30,	For the Nine Month Period Ended September 30,	
	<u>2005</u>	<u>2006</u>	<u>2005</u>
Revenues and other income:			
Healthcare revenues.....	\$54,376	<b>\$110,370</b>	\$182,791
Investment and other income.....	<u>208</u>	<u>225</u>	<u>751</u>
	<u>54,584</u>	<u><b>110,595</b></u>	<u>183,542</u>
Expenses:			
Healthcare cost of sales .....	46,308	<b>95,628</b>	154,100
Interest.....	674	<b>1,195</b>	2,143
Salaries.....	3,483	<b>5,835</b>	9,968
Depreciation and amortization .....	280	<b>708</b>	895
Selling, general and other expenses.....	<u>3,667</u>	<u><b>7,013</b></u>	<u>14,059</u>
	<u>54,412</u>	<u><b>110,379</b></u>	<u>181,165</u>
Income from discontinued operations before income taxes.....	172	<b>216</b>	2,377
Income taxes .....	<u>(3)</u>	<u><b>107</b></u>	<u>(11)</u>
Income from discontinued operations .....	<u>\$ 175</u>	<u><b>\$ 109</b></u>	<u>\$ 2,388</u>

The Company has not classified Symphony's assets and liabilities as discontinued operations because the balances are not material. Summarized information for Symphony's assets and liabilities is as follows (in thousands):

	December 31, 2005
Current assets.....	\$52,470
Non-current assets .....	<u>3,165</u>
Total assets.....	<u><b>\$55,635</b></u>
Current liabilities .....	\$45,262
Non-current liabilities.....	<u>280</u>
Total liabilities .....	<u><b>\$45,542</b></u>

At December 31, 2005, current assets principally consisted of trade receivables and current liabilities principally consisted of trade payables and amounts due under Symphony's credit agreement.

In September 2006, the Company sold ATX to Broadview Networks Holdings, Inc. for aggregate cash consideration of approximately \$85,700,000, subject to working capital adjustments, and recorded a pre-tax gain on sale of discontinued operations of \$41,600,000 (\$26,100,000 after tax).

**Notes to Interim Consolidated Financial Statements, continued**

Results of operations for ATX for the three and nine month periods ended September 30, 2006 and 2005 are as follows (in thousands):

	For the Three Month Period Ended September 30,		For the Nine Month Period Ended September 30,	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Revenues and other income:				
Telecommunication revenues .....	\$39,377	\$40,402	\$118,987	\$70,995
Investment and other income .....	<u>172</u>	<u>4</u>	<u>1,275</u>	<u>66</u>
	<u>39,549</u>	<u>40,406</u>	<u>120,262</u>	<u>71,061</u>
Expenses:				
Telecommunication cost of sales .....	25,007	24,149	72,231	43,490
Interest .....	38	35	126	64
Salaries .....	8,585	6,456	21,054	11,539
Depreciation and amortization .....	2,223	2,412	7,374	4,179
Selling, general and other expenses .....	6,869	6,403	20,629	11,557
	<u>42,722</u>	<u>39,455</u>	<u>121,414</u>	<u>70,829</u>
Income (loss) from discontinued operations before income taxes .....	(3,173)	951	(1,152)	232
Income taxes .....	<u>(707)</u>	<u>5</u>	<u>749</u>	<u>101</u>
Income (loss) from discontinued operations .....	<u>\$ (2,466)</u>	<u>\$ 946</u>	<u>\$ (1,901)</u>	<u>\$ 131</u>

The Company has not classified ATX's assets and liabilities as discontinued operations because the balances are not material. Summarized information for ATX's assets and liabilities is as follows (in thousands):

	December 31, 2005
Current assets .....	\$40,308
Non-current assets .....	<u>48,550</u>
Total assets .....	<u>\$88,858</u>
Current liabilities .....	\$32,479
Non-current liabilities .....	<u>2,001</u>
Total liabilities .....	<u>\$34,480</u>

At December 31, 2005, current assets principally consisted of cash and trade receivables, non-current assets principally consisted of property and equipment and intangible assets and goodwill, and current liabilities principally consisted of trade payables.

For the three and nine month 2006 periods, gain on disposal of discontinued operations also reflects \$700,000 and \$600,000, respectively, of pre-tax gains (\$500,000 and \$400,000, respectively, after tax) principally for the resolution of certain sale-related contingencies and obligations and working capital adjustments related to WilTel, which was sold in the fourth quarter of 2005. In addition, gain on disposal of discontinued operations for the 2006 periods includes a pre-tax loss of \$900,000 (\$600,000 after tax) from the sale of the Company's gas properties during the third quarter. Income (loss) from discontinued operations for the nine month 2006 period includes \$2,900,000 of pre-tax losses (\$2,100,000 after tax) related to these gas properties; amounts for the comparable period in 2005 as well as for the three month 2006 and 2005 periods were not material.

**Notes to Interim Consolidated Financial Statements, continued**

10. Pension expense charged to operations for the three and nine month periods ended September 30, 2006 and 2005 related to the defined benefit pension plan (other than WilTel's plan) included the following components (in thousands):

	For the Three Month Period Ended September 30,		For the Nine Month Period Ended September 30,	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Interest cost .....	\$ 479	\$ 511	\$1,446	\$1,534
Expected return on plan assets .....	(263)	(222)	(795)	(679)
Actuarial loss .....	226	220	697	636
Amortization of prior service cost .....	1	1	2	3
Net pension expense .....	<u>\$ 443</u>	<u>\$ 510</u>	<u>\$1,350</u>	<u>\$1,494</u>

Employer contributions to the defined benefit pension plan (other than WilTel's plan) were \$7,000,000 during the first nine months of 2006.

WilTel's defined benefit pension plan expense charged to operations for the three and nine month periods ended September 30, 2006 and 2005 included the following components (in thousands):

	For the Three Month Period Ended September 30,		For the Nine Month Period Ended September 30,	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Interest cost .....	\$ 2,487	\$ 2,954	\$ 7,463	\$ 7,057
Service cost .....	-	1,528	-	3,459
Expected return on plan assets .....	(1,766)	(2,229)	(5,299)	(4,882)
Actuarial loss .....	397	2,327	1,190	2,350
Net pension expense .....	<u>\$ 1,118</u>	<u>\$ 4,580</u>	<u>\$ 3,354</u>	<u>\$ 7,984</u>

As more fully discussed in the 2005 10-K, WilTel was sold in December 2005 but its defined benefit pension plan was excluded from the sale. The defined benefit pension plan expense for periods prior to the sale is classified as discontinued operations; expenses subsequent to the sale have been charged to continuing operations.

Employer contributions to WilTel's defined benefit pension plan were \$42,800,000 during the first nine months of 2006; as disclosed in the Company's 2005 10-K such contributions were estimated to aggregate \$29,100,000 for all of 2006. Additional contributions were made during 2006 to reduce the underfunded status of the plan which has the effect of reducing the cost of government charged variable insurance premiums.

Several subsidiaries provide certain healthcare and other benefits to certain retired employees under plans which are currently unfunded. The Company pays the cost of postretirement benefits as they are incurred. Amounts charged to expense were not material in each of the three and nine month periods ended September 30, 2006 and 2005.

11. Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123R, "Share-Based Payment" ("SFAS 123R"), using the modified prospective method. SFAS 123R requires that the cost of all share-based payments to employees, including grants of employee stock options and warrants, be recognized in the financial statements based on their fair values. The cost is recognized as an expense over the vesting period of the award. Prior to adoption of SFAS 123R, no compensation cost was recognized in the statements of operations for the Company's share-based compensation plans; the Company disclosed certain pro forma amounts as required.

The fair value of each award is estimated at the date of grant using the Black-Scholes option pricing model. As a result of the adoption of SFAS 123R, compensation cost increased by \$3,000,000 and \$12,400,000, respectively, for the three and nine month 2006 periods and net income decreased by

**Notes to Interim Consolidated Financial Statements, continued**

\$2,000,000 and \$8,100,000, respectively, for the three and nine month 2006 periods. Had the Company used the fair value based accounting method for the three and nine month 2005 periods, compensation cost would have been higher by \$400,000 and \$1,400,000, respectively, and primary and diluted earnings per share would not have changed. As of September 30, 2006, total unrecognized compensation cost related to nonvested share-based compensation plans was \$29,500,000; this cost is expected to be recognized over a weighted-average period of 1.7 years.

As of September 30, 2006, the Company has two share-based plans: a fixed stock option plan and a senior executive warrant plan. The fixed stock option plan provides for grants of options or rights to non-employee directors and certain employees up to a maximum grant of 450,000 shares to any individual in a given taxable year. The maximum number of common shares that may be acquired through the exercise of options or rights under this plan cannot exceed 2,519,150. The plan provides for the issuance of stock options and stock appreciation rights at not less than the fair market value of the underlying stock at the date of grant. Options granted to employees under this plan are intended to qualify as incentive stock options to the extent permitted under the Internal Revenue Code and become exercisable in five equal annual instalments starting one year from date of grant. Options granted to non-employee directors become exercisable in four equal annual instalments starting one year from date of grant. No stock appreciation rights have been granted. As of September 30, 2006, 2,495,150 shares were available for grant under the plan. During the nine month period ended September 30, 2006, 24,000 options at \$30.78 per share were granted; during the nine month period ended September 30, 2005, 12,000 options at \$18.03 per share were granted.

The senior executive warrant plan provides for the issuance, subject to shareholder approval, of warrants to purchase up to 2,000,000 common shares to each of the Company's Chairman and President at an exercise price equal to 105% of the closing price per share of a common share on the date of grant. On March 6, 2006, the Company's Board of Directors approved, subject to shareholder approval, the grant of warrants to purchase 2,000,000 common shares to each of the Company's Chairman and President at an exercise price equal to \$28.515 per share (105% of the closing price per share of a common share on that date). In May 2006, shareholder approval was received and the warrants were issued. The warrants expire in 2011 and vest in five equal tranches with 20% vesting on the date shareholder approval was received and an additional 20% vesting in each subsequent year.

The following summary presents the weighted-average assumptions used for grants made during the 2006 and 2005 periods:

	2006		2005
	Options	Warrants	Options
Risk free interest rate.....	4.92%	4.95%	3.77%
Expected volatility .....	22.78%	23.05%	23.58%
Expected dividend yield.....	.81%	.41%	.69%
Expected life.....	4.3 years	4.3 years	4.3 years
Weighted average fair value per grant .....	\$7.75	\$9.39	\$4.29

The expected life assumptions were based on historical behavior and incorporated post-vesting forfeitures for each type of award and population identified.

**Notes to Interim Consolidated Financial Statements, continued**

The following table summarizes information about outstanding stock options at September 30, 2006 and changes during the nine months then ended:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at January 1, 2006.....	1,955,260	\$17.60		
Granted .....	24,000	\$30.78		
Exercised .....	(269,460)	\$12.63		<u>\$ 4,000,000</u>
Forfeited .....	—	\$ —		
Outstanding at September 30, 2006..	<u>1,709,800</u>	<u>\$18.56</u>	<u>3.5</u>	<u>\$13,100,000</u>
Exercisable at September 30, 2006..	<u>556,900</u>	<u>\$14.88</u>	<u>2.8</u>	<u>\$ 6,300,000</u>

At September 30, 2006, 4,000,000 warrants were outstanding and 800,000 were exercisable but had no aggregate intrinsic value as the exercise price exceeded the market value. Both the outstanding and exercisable warrants had a weighted-average remaining contractual term of 4.4 years. No warrants were exercised or forfeited during the nine month 2006 period.

12. For the 2006 periods, the Company's effective income tax rate is lower than the federal statutory rate because of the reversal of \$6,000,000 of state income tax reserves due to the favorable resolution of certain contingencies. The income tax provisions for the three and nine month 2005 periods reflect credits of \$25,100,000 and \$1,135,100,000, respectively, as a result of the reversal of a portion of the valuation allowance for the deferred tax asset. The Company adjusted the valuation allowance in 2005 since it believed it was more likely than not that it will have future taxable income sufficient to realize that portion of the net deferred tax asset.
13. Basic earnings (loss) per share amounts are calculated by dividing net income by the sum of the weighted average number of common shares outstanding. To determine diluted earnings (loss) per share, the weighted average number of common shares is adjusted for the incremental weighted average number of shares issuable upon exercise of outstanding options and warrants, unless the effect is antidilutive. In addition, the calculations of diluted earnings (loss) per share assume the 3¾% Convertible Notes are converted into common shares and earnings increased for the interest on such notes, net of the income tax effect, unless the effect is antidilutive. The number of shares used to calculate basic earnings (loss) per share amounts was 216,291,000 and 215,595,000 for the three month periods ended September 30, 2006 and 2005, respectively, and 216,202,000 and 215,387,000 for the nine month periods ended September 30, 2006 and 2005, respectively. The number of shares used to calculate diluted earnings (loss) per share amounts was 231,906,000 and 231,328,000 for the three month periods ended September 30, 2006 and 2005, respectively, and 231,875,000 and 231,132,000 for the nine month periods ended September 30, 2006 and 2005, respectively.
14. Cash paid for interest and income taxes (net of refunds) was \$70,200,000 and \$6,400,000, respectively, for the nine month period ended September 30, 2006 and \$83,900,000 and \$3,900,000, respectively, for the nine month period ended September 30, 2005.
15. Debt due within one year includes \$149,600,000 and \$92,100,000 as of September 30, 2006 and December 31, 2005, respectively, relating to repurchase agreements. These fixed rate repurchase agreements have a weighted average interest rate of approximately 5.28%, mature at various dates through March 2007 and are secured by non-current investments with a carrying value of \$153,300,000.
16. In April 2006, the Company acquired a 30% limited liability company interest in Goober Drilling, LLC, ("Goober Drilling") for aggregate consideration of \$60,000,000, excluding expenses, and agreed to lend to Goober Drilling, on a secured basis, up to \$80,000,000 to finance new equipment

**Notes to Interim Consolidated Financial Statements, continued**

purchases and construction costs, and to repay existing debt. In June 2006, the Company agreed to increase the secured loan amount to an aggregate of \$126,000,000 to finance additional equipment purchases and construction costs. As of September 30, 2006, the outstanding loan amount was \$93,100,000. Goober Drilling is an on-shore contract oil and gas drilling company based in Stillwater, Oklahoma that provides drilling services to exploration and production companies. The Company's investment in Goober Drilling is classified as an investment in an associated company.

17. During the second quarter of 2006, the Company indirectly acquired a controlling voting interest in Premier for an aggregate purchase price of \$90,800,000, excluding expenses. The Company owns approximately 46% of the common units of Premier and all of Premier's preferred units, which accrue an annual preferred return of 17%. The Company also acquired Premier's junior subordinated note due August 2012, with an outstanding balance at acquisition of \$13,400,000, and has made an \$8,100,000 12% loan to Premier that matures in May 2007. Premier is the owner of the Hard Rock Hotel & Casino Biloxi ("Hard Rock Biloxi"), located in Biloxi, Mississippi, which was severely damaged prior to opening by Hurricane Katrina and which, pending receipt of insurance proceeds, is to be rebuilt. All of Premier's equity interests are pledged to secure repayment of Premier's outstanding \$160,000,000 principal amount of 10<sup>3</sup>/<sub>4</sub>% First Mortgage Notes due February 1, 2012 (the "Premier Notes"). In addition, the Company agreed to provide up to \$40,000,000 of construction financing to Premier's general contractor by purchasing the contractor's receivables from Premier if the receivables are more than ten days past due. At acquisition, the Company consolidated Premier as a result of its controlling voting interest.

On September 19, 2006, Premier and its subsidiary filed voluntary petitions for reorganization under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"), before the United States Bankruptcy Court for the Southern District of Mississippi, Southern Division (the "Court"). Premier is seeking the Court's assistance in gaining access to Hurricane Katrina-related insurance proceeds which has been denied to Premier by its pre-petition secured bondholders. Premier will continue to operate its business as "debtors in possession" under the jurisdiction of the Court and in accordance with the applicable provisions of the Bankruptcy Code and orders of the Court. Premier believes that its insurance proceeds and permitted equipment financing are sufficient to pay its creditors in full and to rebuild the Hard Rock Biloxi.

The Company has deconsolidated Premier effective with the filing of the voluntary petitions, and has classified its net investment in Premier as an investment in an associated company (\$116,900,000 as of September 30, 2006, including all loans and equity interests). The bankruptcy filings were made solely to allow Premier access to the insurance proceeds, the proceedings are not expected to last for an extended period and creditors are expected to receive the amounts owed to them. For these reasons, the Company believes that the application of the equity method of accounting during the pendency of the bankruptcy proceedings is appropriate.

Summarized financial information for Premier is as follows (in thousands):

	<u>September 30, 2006</u>
Assets:	
Current assets .....	\$ 9,358
Non-current assets (a) .....	<u>315,588</u>
Total assets.....	<u>\$324,946</u>
Liabilities:	
Current liabilities (b) .....	\$196,051
Non-current liabilities.....	<u>11,962</u>
Total liabilities .....	<u>208,013</u>
Shareholders' equity .....	<u>116,933</u>
Total liabilities and shareholders' equity.....	<u>\$324,946</u>

## Notes to Interim Consolidated Financial Statements, continued

- (a) Includes \$11,900,000 of intangible assets, \$148,500,000 of net property and equipment and \$152,600,000 of restricted cash for amounts held by the indenture trustee of the Premier Notes.
- (b) Includes bonds and notes payable of \$165,300,000.

Premier has filed a motion with the Court seeking approval for \$180,000,000 debtor in possession financing to be provided by a subsidiary of the Company. If approved, proceeds from the financing would be used by Premier to pay the Premier Notes in full, to pay for post-petition operating expenses including the repair, reconstruction and eventual operation of the Hard Rock Biloxi, and to pay certain other costs and expenses to be determined. The financing would bear interest at 10<sup>3</sup>/<sub>4</sub>% per annum, would have a scheduled maturity of February 1, 2012, and would be subject to the satisfaction of certain conditions at the Company's discretion.

Prior to Hurricane Katrina, Premier purchased a comprehensive blanket insurance policy providing up to \$181,100,000 in coverage for damage to real and personal property, including business interruption coverage. Premier has received payments from various insurance carriers aggregating \$160,800,000 with respect to \$168,100,000 face amount of coverage; the remaining \$13,000,000 face amount of coverage has not been settled and is currently in litigation. All insurance settlements have been placed on deposit into restricted accounts under the control of the indenture trustee of the Premier Notes.

Hurricane Katrina completely destroyed the Hard Rock Biloxi's casino, which was a facility built on floating barges, and caused significant damage to the hotel and related structures. The threat of hurricanes remains a significant risk to the existing facilities and to the new casino, which will be constructed over water on concrete pilings that are expected to greatly improve the structural integrity of the facility. In July 2006, Premier purchased a new insurance policy providing up to \$149,300,000 in coverage for damage to real and personal property and up to the lesser of six months or \$30,000,000 of business interruption and delayed opening coverage. The coverage is syndicated through several insurance carriers, each with an A.M. Best rating of A- (Excellent) or better. The policy provides coverage for the existing structures, as well as for the repair and rebuild of the hotel, low rise building and parking garage and the construction of the new casino.

Although the insurance policy is an "all risk" policy, weather catastrophe occurrence ("WCO"), which is defined to include damage caused by a named storm, is limited to \$50,000,000 with a deductible equal to the greater of \$7,000,000 or 5% of total insured values at risk. WCO coverage is subject to mandatory reinstatement of coverage for an additional pre-determined premium.

Since the WCO coverage purchased by Premier is substantially less than the coverage in place prior to Hurricane Katrina, Premier has more exposure to property damage resulting from similar catastrophic storms. However, Premier's assessment of the probability of a similar type of loss occurring during the remainder of this year's hurricane season is remote, an assessment based in large part on the less severe damage sustained to the non-casino facilities from Hurricane Katrina last year, and the amount of new construction that will be at risk during the balance of the 2006 hurricane season. Premiums for WCO policies have increased dramatically as a result of Hurricane Katrina, and the amount of coverage that can be purchased has also been reduced as insurance companies seek to reduce their exposure to such events.

18. In June 2006, the Company entered into a new credit agreement with various bank lenders for a \$100,000,000 unsecured credit facility that matures in five years and bears interest based on the Eurocurrency rate or the prime rate. The Company's existing credit agreement was terminated. At September 30, 2006, no amounts were outstanding under this bank credit facility.
19. In August 2006, pursuant to a subscription agreement with Fortescue Metals Group Ltd ("Fortescue") and its subsidiary, FMG Chichester Pty Ltd ("FMG"), the Company invested an aggregate of \$408,000,000, including expenses, in Fortescue's Pilbara iron ore infrastructure project in Western Australia. In exchange for its cash investment, the Company acquired 26,400,000 common shares of Fortescue, representing approximately 9.99% of the outstanding Fortescue common stock, and a 13 year, \$100,000,000 note of FMG. Interest on the note is calculated as 4%



**Notes to Interim Consolidated Financial Statements, continued**

of the revenue, net of government royalties, invoiced from the iron ore produced from the project. The note is unsecured and subordinate to the project's secured debt. Fortescue is a publicly traded company on the Australian Stock Exchange, and the shares acquired by the Company may be sold without restriction. At the date of acquisition, the Company's investment in Fortescue's common shares was recorded at an aggregate fair value of \$202,100,000, based on the closing price of Fortescue's common shares on that date. The Company has classified the Fortescue common shares as a non-current available for sale investment.

For accounting purposes, the Company bifurcated its remaining \$205,900,000 investment into a 13 year zero-coupon note and a prepaid mining interest. The zero-coupon note was recorded at an estimated initial fair value of \$21,600,000, representing the present value of the principal amount discounted at 12.5%. The prepaid mining interest of \$184,300,000 has been classified with other non-current assets, and will be amortized to expense as the 4% of revenue is earned.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Interim Operations.**

The following should be read in conjunction with the Management's Discussion and Analysis of Financial Condition and Results of Operations included in the 2005 10-K. As more fully discussed in the 2005 10-K, reported cash flows from operating, investing and financing activities do not generally follow any particular pattern or trend, and reported results in the most recent period should not be expected to recur in any subsequent period.

### **Liquidity and Capital Resources**

Net cash provided by operating activities decreased by \$149,600,000 in 2006 as compared to the same period in 2005, due principally to no 2006 cash flows from WilTel, which was sold in December 2005, reduced distributions of earnings from associated companies, reduced funds generated from activity in the trading portfolio and payment of incentive compensation and pension plan contributions. During 2006, cash provided by operating activities reflect the collection of \$179,800,000 of certain receivables from AT&T Inc. (as more fully discussed in the 2005 10-K) and increased cash flow from the Company's operating units, principally the manufacturing businesses. WilTel's 2005 cash flow from operating activities for the nine month period ended September 30, 2005 was \$119,000,000. The increased cash flow from the Company's manufacturing units reflects Idaho Timber, which was acquired during the second quarter of 2005, and increased operating income at the plastics manufacturing segment resulting from increased revenues. In 2006, distributions from associated companies principally include earnings distributed by EagleRock, which is discussed below. In 2005, distributions from associated companies principally resulted from the sale of Union Square.

Net cash flows used for investing activities increased by \$67,800,000 in 2006 as compared to 2005. During the 2006 period, proceeds from the disposal of discontinued operations net of expenses and cash sold were \$115,300,000, principally reflecting the sale of Symphony and ATX and the resolution of WilTel's working capital adjustment, as compared to \$101,400,000 in the 2005 period, principally reflecting the sale of the Waikiki Beach hotel. During 2006, funds provided by the disposal of real estate and other assets include the sales of Square 711 and certain associated companies, and funds used for investing activities include the investment in Fortescue; these transactions are discussed in greater detail below. Premier's obligation to place insurance proceeds in restricted accounts (see below) is the principal reason for the net change in restricted cash during 2006. The use of funds during 2006 for acquisitions (net of cash acquired) principally reflects the acquisition of Premier. The use of funds during 2005 for acquisitions (net of cash acquired) totaled \$172,600,000 for the acquisitions of NSW, ATX and Idaho Timber. Funds used for WilTel's acquisition of property, equipment and leasehold improvements totaled \$79,100,000 in 2005; as a result of the sale of WilTel the Company's use of funds for property, equipment and leasehold improvements declined significantly. The use of funds for investments in associated companies increased by \$261,000,000 in 2006 as compared to 2005, principally reflecting the investment in Safe Harbor Domestic Partners L.P. ("Safe Harbor") and Goober Drilling, which are discussed below.

During 2006, net cash provided by financing activities was \$37,800,000, as compared to net cash used for financing activities of \$11,900,000 in 2005. During 2005, funds were used to retire customer banking deposits of the banking and lending operations as they became due and the remaining deposits were sold. Issuance of long-term debt during the 2006 and 2005 periods principally relates to repurchase agreements. The reduction of long-term debt during 2006 includes the repayment of \$32,000,000 of debt of Square 711, which was sold. The reduction of long-term debt during 2005 includes the repayment of \$22,100,000 of debt of operations sold (Waikiki Beach hotel) and the maturity of the Company's 8¼% Senior Subordinated Notes.

As reflected on the Company's September 30, 2006 consolidated balance sheet, the sum of the Company's cash and cash equivalents, investments classified as current assets and non-current investments aggregated \$2,553,500,000. However, since \$400,000,000 of this amount is pledged as collateral pursuant to various agreements, represents investments in non-public securities or is held by subsidiaries that are party to agreements which restrict the Company's ability to use the funds for other

purposes, the Company does not consider those amounts to be readily available to meet the Parent's liquidity needs. The \$2,153,500,000 that is readily available is comprised of cash and short-term bonds and notes of the United States Government and its agencies of \$808,000,000 (37.5%), U.S. Government-Sponsored Enterprises of \$300,700,000 (14.0%) and other publicly traded debt and equity securities aggregating \$1,044,800,000 (48.5%), including the Company's investment in Fortescue's common stock. The investment income realized from the Parent's readily available cash, cash equivalents and marketable securities is used to meet the Parent company's short-term recurring cash requirements, which are principally the payment of interest on its debt and corporate overhead expenses.

As of September 30, 2006, the Company had outstanding \$149,600,000 of fixed rate repurchase agreements (an increase of \$57,500,000 from December 31, 2005). These repurchase agreements, which are reflected in debt due within one year, have a weighted average interest rate of approximately 5.28%, mature at various dates through March 2007 and are secured by non-current investments with a carrying value of \$153,300,000.

In January, April and July 2006, the Company received \$16,600,000, \$20,100,000 and \$11,500,000, respectively, as distributions from its investment in EagleRock. The amount received in January was included in current trade, notes and other receivables, net in the Company's December 31, 2005 consolidated balance sheet. In October 2006, the Company informed EagleRock that it does not intend to redeem its remaining interest at this time. At September 30, 2006, the book value of the Company's investment in EagleRock was \$51,000,000.

In January 2006, the Company invested \$50,000,000 in Safe Harbor, a limited partnership which will principally invest in the securities of Japanese public companies. Although the general partner is permitted to invest directly in securities, the general partner expects that substantially all funds will be invested in a master fund managed by the general partner.

In February 2006, Square 711 completed the sale of 8 acres of unimproved land in Washington, D.C. for aggregate cash consideration of \$121,900,000. The land was acquired by Square 711 in September 2003 for cash consideration of \$53,800,000. After satisfaction of mortgage indebtedness on the property of \$32,000,000 and other closing payments, the Company received net cash proceeds of approximately \$75,700,000.

During the first quarter of 2006, the Company received aggregate cash proceeds of \$56,400,000 from the sale of its equity interest in and loan repayment by two associated companies and recorded a pre-tax gain totaling \$27,500,000, which is reflected in investment and other income for the nine month period ended September 30, 2006.

In the second quarter of 2006, the Company acquired a 30% limited liability company interest in Goober Drilling for aggregate consideration of \$60,000,000, excluding expenses, and agreed to lend to Goober Drilling, on a secured basis, up to \$126,000,000 to finance new equipment purchases and construction costs, and to repay existing debt. As of September 30, 2006, the outstanding loan amount was \$93,100,000. Goober Drilling is an on-shore contract oil and gas drilling company based in Stillwater, Oklahoma that provides drilling services to exploration and production companies.

As discussed above, during the second quarter of 2006, the Company indirectly acquired a controlling voting interest in Premier for an aggregate purchase price of \$90,800,000, excluding expenses. The Company owns approximately 46% of the common units of Premier and all of Premier's preferred units, which accrue an annual preferred return of 17%. The Company also acquired Premier's junior subordinated note due August 2012, with an outstanding balance at acquisition of \$13,400,000, and has made an \$8,100,000 12% loan to Premier that matures in May 2007. All of Premier's equity interests are pledged to secure repayment of Premier's outstanding \$160,000,000 principal amount of 10¾% First Mortgage Notes due February 1, 2012 (the "Premier Notes"). In addition, the Company agreed to provide up to \$40,000,000 of construction financing to Premier's general contractor by purchasing the contractor's receivables from Premier if the receivables are more than ten days past due.

On September 19, 2006, Premier and its subsidiary filed voluntary petitions for reorganization under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"), before the United States

Bankruptcy Court for the Southern District of Mississippi, Southern Division (the “Court”). Premier is seeking the Court’s assistance in gaining access to Hurricane Katrina-related insurance proceeds which has been denied to Premier by its pre-petition secured bondholders. Premier will continue to operate its business as “debtors in possession” under the jurisdiction of the Court and in accordance with the applicable provisions of the Bankruptcy Code and orders of the Court. Premier believes that its insurance proceeds and permitted equipment financing are sufficient to pay its creditors in full and to rebuild the Hard Rock Biloxi.

The Company has deconsolidated Premier effective with the filing of the voluntary petitions, and has classified its net investment in Premier as an investment in an associated company (\$116,900,000 as of September 30, 2006, including all loans and equity interests). The bankruptcy filings were made solely to allow Premier access to the insurance proceeds, the proceedings are not expected to last for an extended period and creditors are expected to receive the amounts owed to them. For these reasons, the Company believes that the application of the equity method of accounting during the pendency of the bankruptcy proceedings is appropriate.

Premier has filed a motion with the Court seeking approval for \$180,000,000 debtor-in-possession financing to be provided by a subsidiary of the Company. If approved, proceeds from the financing would be used by Premier to pay the Premier Notes in full, to pay for post-petition operating expenses including the repair, reconstruction and eventual operation of the Hard Rock Biloxi, and to pay certain other costs and expenses to be determined. The financing would bear interest at 10¾% per annum, would have a scheduled maturity of February 1, 2012, and would be subject to the satisfaction of certain conditions at the Company’s discretion.

Prior to Hurricane Katrina, Premier purchased a comprehensive blanket insurance policy providing up to \$181,100,000 in coverage for damage to real and personal property, including business interruption coverage. Premier has received payments from various insurance carriers aggregating \$160,800,000 with respect to \$168,100,000 face amount of coverage; the remaining \$13,000,000 face amount of coverage has not been settled and is currently in litigation. All insurance settlements have been placed on deposit into restricted accounts under the control of the indenture trustee of the Premier Notes.

Hurricane Katrina completely destroyed the Hard Rock Biloxi’s casino, which was a facility built on floating barges, and caused significant damage to the hotel and related structures. The threat of hurricanes remains a significant risk to the existing facilities and to the new casino, which will be constructed over water on concrete pilings that are expected to greatly improve the structural integrity of the facility. In July 2006, Premier purchased a new insurance policy providing up to \$149,300,000 in coverage for damage to real and personal property and up to the lesser of six months or \$30,000,000 of business interruption and delayed opening coverage. The coverage is syndicated through several insurance carriers, each with an A.M. Best rating of A- (Excellent) or better. The policy provides coverage for the existing structures, as well as for the repair and rebuild of the hotel, low rise building and parking garage and the construction of the new casino. Although the insurance policy is an “all risk” policy, weather catastrophe occurrence (“WCO”), which is defined to include damage caused by a named storm, is limited to \$50,000,000 with a deductible equal to the greater of \$7,000,000 or 5% of total insured values at risk. WCO coverage is subject to mandatory reinstatement of coverage for an additional pre-determined premium.

Since the WCO coverage purchased by Premier is substantially less than the coverage in place prior to Hurricane Katrina, Premier has more exposure to property damage resulting from similar catastrophic storms. However, Premier’s assessment of the probability of a similar type of loss occurring during the remainder of this year’s hurricane season is remote, an assessment based in large part on the less severe damage sustained to the non-casino facilities from Hurricane Katrina last year, and the amount of new construction that will be at risk during the balance of the 2006 hurricane season. Premiums for WCO policies have increased dramatically as a result of Hurricane Katrina, and the amount of coverage that can be purchased has also been reduced as insurance companies seek to reduce their exposure to such events.

In June 2006, the Company entered into a new credit agreement with various bank lenders for a \$100,000,000 unsecured credit facility that matures in five years and bears interest based on the

Eurocurrency rate or the prime rate. The Company's existing credit agreement was terminated. At September 30, 2006, no amounts were outstanding under this bank credit facility.

In July 2006, the Company sold Symphony to RehabCare Group, Inc., for aggregate cash consideration of approximately \$107,000,000. After satisfaction of Symphony's outstanding credit agreement (\$31,700,000 at date of sale) and other sale related obligations, the Company realized net cash proceeds of \$62,300,000 and recorded a pre-tax gain on sale of discontinued operations of \$53,300,000.

In August 2006, pursuant to a subscription agreement with Fortescue and FMG, the Company invested an aggregate of \$408,000,000, including expenses, in Fortescue's Pilbara iron ore infrastructure project in Western Australia. In exchange for its cash investment, the Company acquired 26,400,000 common shares of Fortescue, representing approximately 9.99% of the outstanding Fortescue common stock, and a 13 year, \$100,000,000 note of FMG. Interest on the note is calculated as 4% of the revenue, net of government royalties, invoiced from the iron ore produced from the project. The note is unsecured and subordinate to the project's secured debt. Fortescue is a publicly traded company on the Australian Stock Exchange, and the shares acquired by the Company may be sold without restriction. At the date of acquisition, the Company's investment in Fortescue's common shares was recorded at an aggregate fair value of \$202,100,000, based on the closing price of Fortescue's common shares on that date. The Company has classified the Fortescue common shares as a non-current available for sale investment.

For accounting purposes, the Company bifurcated its remaining \$205,900,000 investment into a 13 year zero-coupon note and a prepaid mining interest. The zero-coupon note was recorded at an estimated initial fair value of \$21,600,000, representing the present value of the principal amount discounted at 12.5%. The prepaid mining interest of \$184,300,000 has been classified with other non-current assets, and will be amortized to expense as the 4% of revenue is earned.

In September 2006, the Company sold ATX to Broadview Networks Holdings, Inc. for aggregate cash consideration of approximately \$85,700,000, subject to working capital adjustments and recorded a pre-tax gain on sale of discontinued operations of \$41,600,000.

### **Critical Accounting Estimates**

The Company's discussion and analysis of its financial condition and results of operations are based upon its consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these financial statements requires the Company to make estimates and assumptions that affect the reported amounts in the financial statements and disclosures of contingent assets and liabilities. On an on-going basis, the Company evaluates all of these estimates and assumptions. The following areas have been identified as critical accounting estimates because they have the potential to have a material impact on the Company's financial statements, and because they are based on assumptions which are used in the accounting records to reflect, at a specific point in time, events whose ultimate outcome won't be known until a later date. Actual results could differ from these estimates.

*Income Taxes*—The Company records a valuation allowance to reduce its deferred tax asset to the amount that is more likely than not to be realized. If in the future the Company were to determine that it would be able to realize its deferred tax asset in excess of its net recorded amount, an adjustment would increase income in such period. Similarly, if in the future the Company were to determine that it would not be able to realize all or part of its deferred tax asset, an adjustment would be charged to income in such period. The determination of the amount of the valuation allowance required is based, in significant part, upon the Company's projection of future taxable income at any point in time. The Company also records reserves for contingent tax liabilities based on the Company's assessment of the probability of successfully sustaining its tax filing positions.

During 2005, the Company's projections of future taxable income enabled it to conclude that it is more likely than not that it will have future taxable income sufficient to realize a portion of the Company's net deferred tax asset; accordingly, \$1,135,100,000 of the deferred tax valuation allowance was reversed as a credit to income tax expense (principally during the second quarter of 2005). The Company's conclusion that a portion of the deferred tax asset was more likely than not to be realizable is strongly influenced by its historical ability to generate significant amounts of taxable income. The Company's

estimate of future taxable income considers all available evidence, both positive and negative, about its current operations and investments, includes an aggregation of individual projections for each material operation and investment, and includes all future years that the Company estimated it would have available net operating losses. Over the projection period, the Company assumed that its readily available cash, cash equivalents and marketable securities would provide returns generally equivalent to the returns expected to be provided by the Company's existing operations and investments, except for certain amounts assumed to be invested on a short-term basis to meet the Company's liquidity needs. The Company believes that its estimate of future taxable income is reasonable but inherently uncertain, and if its current or future operations and investments generate taxable income greater than the projected amounts, further adjustments to reduce the valuation allowance are possible. Conversely, if the Company realizes unforeseen material losses in the future, or its ability to generate future taxable income necessary to realize a portion of the deferred tax asset is materially reduced, additions to the valuation allowance could be recorded. At September 30, 2006, the balance of the deferred valuation allowance was approximately \$911,600,000.

*Impairment of Securities*—Investments with an impairment in value considered to be other than temporary are written down to estimated fair value. The write-downs are included in net securities gains in the consolidated statements of operations. The Company evaluates its investments for impairment on a quarterly basis.

The Company's determination of whether a security is other than temporarily impaired incorporates both quantitative and qualitative information; GAAP requires the exercise of judgment in making this assessment, rather than the application of fixed mathematical criteria. The Company considers a number of factors including, but not limited to, the length of time and the extent to which the fair value has been less than cost, the financial condition and near term prospects of the issuer, the reason for the decline in fair value, changes in fair value subsequent to the balance sheet date, and other factors specific to the individual investment. The Company's assessment involves a high degree of judgment and accordingly, actual results may differ materially from the Company's estimates and judgments. The Company recorded impairment charges for securities of \$9,700,000 and \$4,000,000 for the three month periods ended September 30, 2006 and 2005, respectively, and \$12,300,000 and \$7,300,000 for the nine month periods ended September 30, 2006 and 2005, respectively.

*Business Combinations*—At acquisition, the Company allocates the cost of a business acquisition to the specific tangible and intangible assets acquired and liabilities assumed based upon their relative fair values. Significant judgments and estimates are often made to determine these allocated values, and may include the use of independent appraisals, consider market quotes for similar transactions, employ discounted cash flow techniques or consider other information the Company believes relevant. The finalization of the purchase price allocation will typically take a number of months to complete, and if final values are materially different from initially recorded amounts adjustments are recorded. Any excess of the cost of a business acquisition over the fair values of the net assets and liabilities acquired is recorded as goodwill which is not amortized to expense. Recorded goodwill of a reporting unit is required to be tested for impairment on an annual basis, and between annual testing dates if events or circumstances change that would more likely than not reduce the fair value of a reporting unit below its net book value.

Subsequent to the finalization of the purchase price allocation, any adjustments to the recorded values of acquired assets and liabilities would be reflected in the Company's consolidated statement of operations. Once final, the Company is not permitted to revise the allocation of the original purchase price, even if subsequent events or circumstances prove the Company's original judgments and estimates to be incorrect. In addition, long-lived assets like property and equipment, amortizable intangibles and goodwill may be deemed to be impaired in the future resulting in the recognition of an impairment loss; however, under GAAP the methods, assumptions and results of an impairment review are not the same for all long-lived assets. The assumptions and judgments made by the Company when recording business combinations will have an impact on reported results of operations for many years into the future.

## Results of Operations

### *The 2006 Periods Compared to the 2005 Periods*

#### *Manufacturing—Idaho Timber*

For the three and nine months ended September 30, 2006, revenues and other income for Idaho Timber were \$77,600,000 and \$261,900,000, respectively; gross profit was \$4,200,000 and \$25,500,000, respectively; and pre-tax income was \$300,000 and \$11,900,000, respectively. Results of operations for the three and nine months ended September 30, 2006 include salaries and incentive compensation expenses of \$1,900,000 and \$7,100,000, respectively, and depreciation and amortization expenses of \$1,200,000 and \$3,700,000, respectively. For the three months ended September 30, 2005 and for the period from acquisition (May 2005) through September 30, 2005, revenues and other income were \$90,900,000 and \$154,400,000, respectively; gross profit was \$9,100,000 and \$12,600,000, respectively; and pre-tax income was \$4,500,000 and \$4,100,000, respectively. Results of operations for the three months ended September 30, 2005 and for the period from acquisition through September 30, 2005 include salaries and incentive compensation expenses of \$3,000,000 and \$4,200,000, respectively, and depreciation and amortization expenses of \$1,100,000 and \$2,900,000, respectively.

Idaho Timber's revenues for the third quarter of 2006 declined as compared to the prior quarters of 2006 due to lower average selling prices and reduced shipment volume. This decline was principally due to weakening demand resulting from reductions in housing starts and the abundant supply of lumber in the marketplace. In October 2006, the trade dispute between the U.S. and Canada over Canadian lumber imports was resolved and a new Softwood Lumber Agreement became effective that restricts and imposes a tax on Canadian lumber imports. During the third quarter, imports from Canada increased in anticipation of the implementation of the new agreement adding to the oversupply in the market.

While raw material costs (the largest component of its cost of sales) declined slightly in the third quarter of 2006 due to the continued decline in market conditions and the diminished uncertainty concerning the impact of the Softwood Lumber Agreement, this reduction lagged behind the reduction in selling prices. Gross profit and pre-tax results for the third quarter of 2006 reflect this compression. Pre-tax results for the third quarter of 2006 also reflect a reduction in salaries and incentive compensation as compared to the prior quarters of 2006 principally due to lower incentive compensation as a result of Idaho Timber's decreased profitability.

#### *Manufacturing—Plastics*

Pre-tax income for the plastics division was \$5,200,000 and \$4,300,000 for the three month periods ended September 30, 2006 and 2005, respectively, and \$15,400,000 and \$12,300,000 for the nine month periods ended September 30, 2006 and 2005, respectively. The plastics division's revenues and other income were \$27,900,000 and \$24,500,000 for the three month periods ended September 30, 2006 and 2005, respectively, and \$82,200,000 and \$69,900,000 for the nine month periods ended September 30, 2006 and 2005, respectively. Gross profits were \$9,200,000 and \$7,900,000 for the three month periods ended September 30, 2006 and 2005, respectively, and \$27,000,000 and \$22,300,000 for the nine month periods ended September 30, 2006 and 2005, respectively. Revenues for the nine months ended September 30, 2006 reflects \$3,900,000 of increased revenues from NSW (which was acquired in February 2005). In addition, revenues in the three and nine month 2006 periods reflect increases in the carpet cushion and erosion control markets, partially reduced by a decline in the consumer products market due to lower demand for certain products. These revenue changes result from a variety of factors including increased road construction and the impact of price increases implemented in 2005. While the carpet cushion market continued to benefit from the previously strong housing market through the first half of 2006, it has begun to experience a reduction in sales volume resulting from a slowdown in housing starts. Gross margins for the three and nine month 2006 periods also reflect an increase in the cost of polypropylene, the principal raw material used and a byproduct of the oil refining process whose price tends to fluctuate with the price of oil. In addition, gross margin for the nine month 2006 period reflects \$1,000,000 of greater amortization expense on intangible assets resulting from

acquisitions and depreciation expense as compared to the same period in 2005. Pre-tax results for the three and nine month 2006 periods also reflect \$400,000 and \$1,400,000 of higher salaries and incentive compensation expense than for the comparable periods in 2005.

#### *Gaming Entertainment*

For the three month period and the period from date of acquisition to September 30, 2006, Premier had pre-tax losses of \$800,000 and \$200,000, respectively. Such amounts reflect Premier's interest expense of \$4,700,000 and \$8,000,000, respectively, all other expenses of \$3,600,000 and \$6,800,000, respectively, insurance recoveries and charges for minority interests. As more fully discussed above, the Company has deconsolidated Premier as a result of its filing voluntary petitions with the Bankruptcy Court; during the pendency of the bankruptcy, Premier's results will be reflected as equity in income (losses) of associated companies. Until such time as the Hard Rock Biloxi reopens, Premier's operating results will consist primarily of overhead costs, interest expense, charges or credits for minority interests and remaining insurance recoveries.

#### *Domestic Real Estate*

Pre-tax income (loss) for the domestic real estate segment was \$(2,400,000) and \$1,000,000 for the three month periods ended September 30, 2006 and 2005, respectively, and \$48,400,000 and \$1,600,000 for the nine month periods ended September 30, 2006 and 2005, respectively. Pre-tax income for this segment for the nine month period ended September 30, 2006 principally reflects the sale by Square 711, which resulted in a pre-tax gain of \$48,900,000. In addition, the Company recognized pre-tax profit related to its 95-lot development project in South Walton County, Florida of \$100,000 and \$1,800,000 for the three month periods ended September 30, 2006 and 2005, respectively, and \$3,600,000 and \$4,200,000 for the nine month periods ended September 30, 2006 and 2005, respectively. Such amounts principally result from the completion of certain required improvements.

#### *Corporate and Other Operations*

Investment and other income increased in the three and nine month periods ended September 30, 2006 as compared to the same periods in 2005 primarily due to greater interest income of \$12,100,000 and \$50,100,000, respectively, reflecting a larger amount of invested assets and higher interest rates, and for the nine month 2006 period, \$27,500,000 of gain from the sales of two associated companies and \$7,100,000 from the recovery of a bankruptcy claim. Investment and other income for the three and nine month 2005 periods includes a gain of \$10,500,000 on the sale of 70% of the Company's interest in Cobre Las Cruces, S.A. to Inmet Mining Corporation. Investment and other income also reflects income (charges) of \$(900,000) and \$1,600,000 for the three month periods ended September 30, 2006 and 2005, respectively, and \$900,000 and \$1,500,000 for the nine month periods ended September 30, 2006 and 2005, respectively, related to the accounting for mark-to-market values of Corporate derivatives.

Net securities gains for Corporate and Other Operations aggregated \$16,300,000 and \$85,700,000 for the three month periods ended September 30, 2006 and 2005, respectively, and \$99,400,000 and \$132,700,000 for the nine month periods ended September 30, 2006 and 2005, respectively. Included in net securities gains for the nine month 2006 period is a gain of \$37,400,000 from the sale of 115,000,000 shares of Level 3 common stock for \$376,600,000. Included in net securities gains for the 2005 periods is a gain of \$70,000,000 from the sale of 175,000 shares of White Mountain Insurance Group, Ltd. common stock. Net securities gains include provisions of \$9,700,000 and \$4,000,000 for the three month periods ended September 30, 2006 and 2005, respectively, and \$12,300,000 and \$7,300,000 for the nine month periods ended September 30, 2006 and 2005, respectively, to write down the Company's investments in certain available for sale securities. The write-down of the securities resulted from a decline in market value determined to be other than temporary.

The increase in interest expense during the 2006 periods as compared to the same periods in 2005 primarily reflects interest expense relating to fixed rate repurchase agreements.



Salaries and incentive compensation expense increased by \$6,600,000 and \$23,200,000, respectively, in the three and nine month periods ended September 30, 2006 as compared to the same periods in 2005 principally due to share-based compensation expense recorded as a result of the adoption of SFAS 123R. For the three and nine month 2006 periods, salaries and incentive compensation expense included \$3,000,000 and \$12,400,000, respectively, relating to grants made under the Company's senior executive warrant plan and the fixed stock option plan. Salaries and incentive compensation also increased in the three and nine month 2006 periods as compared to the same periods in 2005 due to greater Corporate bonus expense, compensation expense of a subsidiary that was acquired in the fourth quarter of 2005 that is engaged in the development of a new medical product, and for the nine month 2006 period, greater compensation expense for the winery operations.

The increase in selling, general and other expenses of \$6,200,000 and \$20,300,000 in the three and nine month periods ended September 30, 2006 as compared to the same periods in 2005 primarily reflects research and development costs and operating expenses of the medical product development subsidiary, greater employee benefit costs including pension costs relating to WilTel's retained plan (which were classified with discontinued operations in 2005 for periods prior to the sale of WilTel), and higher professional fees, which largely relate to potential and existing investments. The 2006 periods also reflect increased corporate aircraft expenses. In addition, selling, general and administrative expenses for the three and nine month 2005 periods include \$2,400,000 and \$4,500,000, respectively, related to Indular, an Argentine shoe manufacturing company that was sold in the fourth quarter of 2005.

For the three and nine month periods ended September 30, 2006, the Company's effective income tax rate is lower than the federal statutory rate primarily because of the reversal of \$6,000,000 of state income tax reserves due to the favorable resolution of certain contingencies. The income tax provisions for the three and nine month periods ended September 30, 2005 reflect credits of \$25,100,000 and \$1,135,100,000, respectively, as a result of the reversal of a portion of the valuation allowance for the deferred tax asset. The Company adjusted the valuation allowance in 2005 since it believes it is more likely than not that it will have future taxable income sufficient to realize that portion of the net deferred tax asset.

#### *Associated Companies*

Equity in income (losses) of associated companies for the three and nine month periods ended September 30, 2006 and 2005 includes the following (in thousands):

	For the Three Month Period Ended September 30,		For the Nine Month Period Ended September 30,	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Olympus Re Holdings, Ltd.....	\$ -	\$(81,700)	\$ -	\$(69,700)
EagleRock .....	(4,900)	6,100	7,100	(13,500)
JPOF II.....	4,200	8,400	23,900	19,500
HomeFed Corporation.....	300	800	1,200	1,300
Union Square .....	-	-	-	72,300
Safe Harbor.....	(3,800)	-	(7,300)	-
Other .....	5,400	(100)	13,900	2,800
Equity in income (losses) before income taxes .....	1,200	(66,500)	38,800	12,700
Income tax expense.....	100	-	14,500	700
Equity in income (losses), net of taxes ....	<u>\$ 1,100</u>	<u>\$(66,500)</u>	<u>\$24,300</u>	<u>\$ 12,000</u>

In early 2006, Olympus Re Holdings, Ltd. raised a significant amount of new equity to replace some, but not all of the capital that was lost as a result of the 2005 hurricanes. Since the Company did not invest additional capital in Olympus, its equity interest was diluted (to less than 4%) such that it no longer applies the equity method of accounting for this investment subsequent to December 31, 2005. The Company wrote down the book value of its remaining investment in Olympus to zero in 2005.

In May 2005, Union Square sold its interest in an office complex located on Capitol Hill in Washington, D.C. During the second quarter of 2005, the Company received its share of the net proceeds totaling \$71,800,000 and received an additional \$1,000,000 in the fourth quarter for its share of escrowed proceeds. The Company recognized a pre-tax gain on the sale, including the escrowed proceeds, of \$71,900,000.

## **Discontinued Operations**

### *Healthcare Services*

As discussed above, in July 2006 the Company sold Symphony and classified its historical operating results as a discontinued operation during the second quarter. Pre-tax income of the healthcare services segment was \$200,000 for the three month period ended September 30, 2005 and \$200,000 and \$2,400,000 for the nine month periods ended September 30, 2006 and 2005, respectively. Gain on disposal of discontinued operations for the 2006 periods includes a pre-tax gain on the sale of Symphony of \$53,300,000 (\$33,500,000 after tax).

### *Telecommunications-ATX*

As discussed above, in September 2006 the Company sold ATX and classified its historical operating results as a discontinued operation during the third quarter. Pre-tax income (loss) of ATX was \$(3,200,000) and \$1,000,000 for the three month periods ended September 30, 2006 and 2005, respectively, and \$(1,200,000) and \$200,000 for the nine month periods ended September 30, 2006 and 2005, respectively. Gain on disposal of discontinued operations for the 2006 periods includes a pre-tax gain on the sale of ATX of \$41,600,000 (\$26,100,000 after tax).

### *Real Estate*

In May 2005, the Company sold its 716-room Waikiki Beach hotel and related assets for an aggregate purchase price of \$107,000,000, before closing costs and other required payments. The Company recorded a pre-tax gain of \$56,600,000 (\$54,600,000 after tax), which is reflected in gain on disposal of discontinued operations for the nine month period ended September 30, 2005.

### *WilTel*

Gain on disposal of discontinued operations for the three and nine month 2006 periods includes \$700,000 and \$600,000, respectively of pre-tax gains (\$500,000 and \$400,000, respectively, after tax) principally for the resolution of certain sale-related contingencies and obligations and working capital adjustments related to WilTel, which was sold in the fourth quarter of 2005. WilTel's pre-tax income classified as a discontinued operation was \$57,300,000 and \$78,300,000 for the three and nine month periods ended September 30, 2005, respectively.

### *Other*

In the third quarter of 2006, the Company sold its gas properties and recorded a pre-tax loss on disposal of \$900,000 (\$600,000 after tax). Income (loss) from discontinued operations for the nine month 2006 period includes \$2,900,000 of pre-tax losses related to these gas properties; amounts for the comparable period in 2005 as well as for the three month 2006 and 2005 periods were not material.

## **Cautionary Statement for Forward-Looking Information**

Statements included in this Report may contain forward-looking statements. Such statements may relate, but are not limited, to projections of revenues, income or loss, development expenditures, plans for growth and future operations, competition and regulation, as well as assumptions relating to the

foregoing. Such forward-looking statements are made pursuant to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995.

Forward-looking statements are inherently subject to risks and uncertainties, many of which cannot be predicted or quantified. When used in this Report, the words “estimates,” “expects,” “anticipates,” “believes,” “plans,” “intends” and variations of such words and similar expressions are intended to identify forward-looking statements that involve risks and uncertainties. Future events and actual results could differ materially from those set forth in, contemplated by or underlying the forward-looking statements.

Factors that could cause actual results to differ materially from any results projected, forecasted, estimated or budgeted or may materially and adversely affect the Company’s actual results include but are not limited to the following: potential acquisitions and dispositions of our operations and investments could change our risk profile; dependence on certain key personnel; economic downturns; changes in the U.S. housing market; changes in telecommunications laws and regulations; risks associated with the increased volatility in raw material prices and the availability of key raw materials; compliance with government laws and regulations; changes in mortgage interest rate levels or changes in consumer lending practices; a decrease in consumer spending or general increases in the cost of living; proper functioning of our information systems; intense competition in the operation of our businesses; our ability to generate sufficient taxable income to fully realize our deferred tax asset; weather related conditions and significant natural disasters, including hurricanes, tornadoes, windstorms, earthquakes and hailstorms; our ability to insure certain risks economically; reduction or cessation of dividend payments on our common shares. For additional information see Part I, Item 1A. Risk Factors in the 2005 10-K and Part II, Item 1A. Risk Factors contained herein.

Undue reliance should not be placed on these forward-looking statements, which are applicable only as of the date hereof. The Company undertakes no obligation to revise or update these forward-looking statements to reflect events or circumstances that arise after the date of this Report or to reflect the occurrence of unanticipated events.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

Information required under this Item is contained in Item 7A of the Company’s Annual Report on Form 10-K for the year ended December 31, 2005, and is incorporated by reference herein.

### **Item 4. Controls and Procedures.**

Evaluation of disclosure controls and procedures

- (a) The Company’s management evaluated, with the participation of the Company’s principal executive and principal financial officers, the effectiveness of the Company’s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)), as of September 30, 2006. Based on their evaluation, the Company’s principal executive and principal financial officers concluded that the Company’s disclosure controls and procedures were effective as of September 30, 2006.

Changes in internal control over financial reporting

- (b) There has been no change in the Company’s internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the Company’s fiscal quarter ended September 30, 2006, that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

## PART II—OTHER INFORMATION

### Item 1. Legal Proceedings.

Reference is made to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2006 and the disclosure contained in such Report with respect to litigation concerning The Thaxton Group, Inc. (together with its subsidiaries, "Thaxton"). On September 12, 2006, Thaxton and the Company's affiliate, The FINOVA Group Inc. and its subsidiaries (collectively, "Finova") reached a preliminary settlement to resolve all outstanding claims in the ongoing litigation involving Thaxton and Finova (the "Settlement"). As part of the Settlement, the previously disclosed lawsuit pending in the United States District Court for the District of South Carolina, Anderson Division in which the Company and one of its executive officers were named as defendants is also being settled without any payment by or adverse finding against the Company and its executive. An agreement reflecting the Settlement has been signed by the parties and is subject to the satisfaction of certain conditions, including (i) approval of the District Court and the Thaxton and Finova bankruptcy courts and (ii) final District Court approval of the fairness of the Settlement.

For additional information concerning Finova and Thaxton-related litigation, reference is made to the Form 10-K for the year ended December 31, 2005 filed by The FINOVA Group Inc. and its Form 10-Q for the quarter ended September 30, 2006.

### Item 1A. Risk Factors.

As a result of the chapter 11 filing of Premier in September 2006, the Company is adding to its risk factors the item listed below that is specific to the Premier investment.

**As a debtor in possession, Premier must obtain bankruptcy court approval for the conduct of its business.** Premier is currently operating under bankruptcy court supervision as a debtor in possession, and the bankruptcy court will need to approve its access to financing and any other transactions outside the ordinary course of business. If the court does not authorize Premier to enter into the \$180,000,000 debtor in possession financing offered by an affiliate of the Company (to repay the Premier Notes), or if the court does not otherwise provide Premier access to insurance proceeds already paid to Premier but held under the control of Premier's pre-petition bondholders, Premier would not have sufficient funds to repair and rebuild the Hard Rock Biloxi and fund its pre-opening expenses. Risks and uncertainties related to Premier's chapter 11 filing also include those related to the actions of Premier's creditors and other third parties with an interest in Premier's chapter 11 proceedings.

### Item 6. Exhibits.

- 10.1 Form of Subscription Agreement, dated as of July 15, 2006, by and among FMG Chichester Pty Ltd, the Company, and Fortescue Metals Group Ltd.
- 10.2 Form of Amending Agreement, dated as of August 18, 2006, by and among FMG Chichester Pty Ltd, the Company, and Fortescue Metals Group Ltd.
- 31.1 Certification of Chairman of the Board and Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of President pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.3 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chairman of the Board and Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of President pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.3 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**LEUCADIA NATIONAL CORPORATION**  
(Registrant)

Date: November 9, 2006

By: /s/ Barbara L. Lowenthal

Barbara L. Lowenthal  
Vice President and Comptroller  
(Chief Accounting Officer)