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Leucadia's Unmined Potential

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Leucadia has savvy management and cheap assets -- an enviable combo.

LEUCADIA NATIONAL MAY BE THE CLOSEST THING to what Berkshire Hathaway was 20 years ago, before Berkshire became so large that Warren Buffett needed investments of several billion dollars to move the needle.

AFP/Getty Images
Above, a western Australia mine run by Fortescue Metals, a company in which Leucadia has a big stake.

Run for 30 years by a secretive duo, Ian Cumming and Joseph Steinberg, Leucadia has invested in a wide variety of stocks and a diverse group of businesses. It has generated impressive returns and developed a cult-like following among value-oriented investors who like its investment style -- and results. Buffett is a fan of Leucadia, although Berkshire doesn't own the stock. Leucadia's book value, which stood at $23 a share on Sept. 30, is up from just 11 cents in 1979, an annual growth rate of more than 20%.

Leucadia (ticker: LUK), however, has fallen 60% since Sept. 30, to about 17, leaving it way below its May peak of 57 and slashing its market value to $4.3 billion. Investors fear that Cumming, 68, and Steinberg, 64, have lost their touch, owing to declines in many of Leucadia's key equity holdings, including Australian iron-ore producer **Fortescue Metals Group** (FMG.Australia), securities firm Jefferies (JEF), Canada's **Inmet Mining** (IMN.Canada) and auto-finance outfit AmeriCredit (ACF).

MANY OF THE COMPANY'S OTHER investments are suffering, including Cresud (CRESY), an Argentine agricultural and real-estate company, and Leucadia's 10% stake in a hedge fund run by William Ackman of Pershing Square that owns a single stock, retailer Target (TGT). Leucadia probably has lost half of the $200 million it put in the fund last year.

Fans argue that Leucadia is oversold, noting that it rarely has traded below book in the past decade and in recent years typically has commanded 1.5 to two times book. The stock could hit $30 in the next year if the company's equity holdings turn around and if Steinberg and Cumming take advantage of the current financial distress to display their old stock-picking magic. Says one Leucadia holder: "I don't think that they suddenly took stupid pills." Given market declines since Sept. 30, Leucadia's book value has now probably fallen closer to $20 a share.

Steinberg and Cumming, who couldn't be reached for comment, focus on minimizing Leucadia's tax bill. The company now has $1.6 billion of deferred tax assets, indicating that it expects to shield some $5 billion of future profits from federal income taxes. Strip out that tax asset to reflect no future gains, and estimated book falls to around $14 a share. "That's a worst-case assumption. You're not paying much above that for the stock," says a recent Leucadia investor.

Book value also may be understated because of conservative valuations for real estate and other assets the company owns, plus a potentially lucrative agreement with Fortescue that pays Leucadia 4% of net revenues from its Australian iron-ore mine for more than a decade. The deal could produce more than $100 million of annual profits for Leucadia, assuming ore prices don't collapse.

Leucadia Nat'l (LUK - NYSE)
Weekly close on Dec. 4

Recent Price	$17.10
YTD Change	–64%
Market Value	$4.3 (bil)
Book Value*	$23.40
Price/Book Value	0.73
Key Shareholders: **Joseph Steinberg (President)**	11%
Ian Cumming (Chairman)	10%

*As of Sept. 30.
Sources: Thomson Reuters; company reports

Leucadia's operating businesses, including plastics, wood products, pre-paid phone cards, as well as a Napa Valley winery and the Hard Rock Hotel & Casino in Biloxi, Miss., don't generate much profit. Investors tend to value the company on book value, rather than earnings, because most of its worth lies in investments.

LEUCADIA ALSO HAS INVESTED about $100 million for an 87% stake in a medical start-up called Sangart, which is developing a blood substitute now in clinical trials. There have been many failures in this field, but Leucadia hopes that Sangart's product, Hemospan, is a winner.

Many holders simply view Leucadia as a play on Cumming and Steinberg's investment acumen. Both intend to stay on the job for a while; their employment contracts run into 2015. Some Leucadia watchers believe the company will be liquidated or sold when Cumming and Steinberg leave the scene.

Like Buffett, Cumming and Steinberg believe in a strong balance sheet. As of Sept. 30, Leucadia's $8.4 billion in assets significantly exceeded its $2.6 billion in debt and other liabilities. Leucadia had about $500 million of cash and equivalents on Sept. 30, down from $1.4 billion on Dec. 31. Dividends certainly aren't a drain on its cash. This year, there will be none; last year, the payout was only 25 cents a share.

Unlike Berkshire, Leucadia lacks significant operating businesses; its focus tends to be on more speculative companies. It has paid $405 million for 32 million shares -- a 28%

stake -- in AmeriCredit, which provides auto loans to those with weak credit. Reflecting a tough economy and tightness in the credit markets, AmeriCredit shares are 40% below Leucadia's cost.

Cumming, Leucadia's chairman, and Steinberg, its president, may be the lowest-profile leaders of any sizable public company. Outside of their annual shareholder letter and appearance at the annual meeting, they stay out of public view. There are no earnings conference calls, no investor presentations and no financial guidance. There are no photographs of Cumming or Steinberg in the annual report. Hardly any analysts cover the company because of its complexity and minimal communications.

LEUCADIA INVESTED IN FORTESCUE in 2006, when founder and CEO Andrew Forrest needed money to build a giant mine in a remote area that would compete with Australian iron-ore titans Rio Tinto and BHP Billiton to supply the voracious Chinese steel industry. Leucadia, which initially invested $400 million, now owns 9.9% of Fortescue. The miner's shares got as high as A$13.15 in May, at the height of the commodity boom, making Leucadia's stake worth $3 billion and pushing up Leucadia stock. Since then, Fortescue has slid to A$2.50 still more than double Leucadia's cost.

The Bottom Line

Leucadia is trading near 17, versus a book value now estimated at 20. If Leucadia's two top managers haven't lost their investment touch, the stock could hit 30 in a year.

Leucadia also has a close relationship with investment firm Jefferies, reflecting in part Steinberg's friendship with CEO Rich Handler. Last year, Leucadia took a 50% stake in Jefferies junk-bond trading unit, in return for $350 million, even though securities firms rarely sell outsiders parts of their trading operations. This year, Leucadia has accumulated a 30% stake -- 48.6 million shares -- in Jefferies itself, at an average cost of $16. But the stock has dropped to around 10, less than 80% of book value.

Jefferies isn't immune to Wall Street's troubles -- it laid off about 10% of its staff last week -- but its losses have been relatively modest because it doesn't take big trading positions. Still, its high-yield trading business has lost more than $80 million this year. Jefferies, a scrappy niche firm, focuses on equity trading and junk bonds, as well as investment banking.

Leucadia now looks like an attractive play on its depressed investments and on the ability of Cumming and Steinberg to find new opportunities. Unless the pair has indeed taken "stupid pills," investors could do well taking a ride with them.