Great Lakes Dredge & Dock CORP
Form 10-K
March 09, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2011

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: 001-33225

Great Lakes Dredge & Dock Corporation

(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of** **incorporation or organization)**	**20-5336063** **(I.R.S. Employer** **Identification No.)**
2122 York Road, Oak Brook, IL	**60523**

(Address of principal executive offices) (Zip Code)

(630) 574-3000

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Class	Name of each exchange on which registered
Common Stock, (Par Value $0.0001)	Nasdaq Stock Market, LLC

Securities registered pursuant to section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The aggregate market value of voting stock held by non-affiliates of the Registrant was $316,516,845 at June 30, 2011. The aggregate market value was computed using the closing price of the common stock as of that date on the Nasdaq Stock Market. (For purposes of a calculating this amount only, all directors and executive officers of the registrant have been treated as affiliates.)

As of March 5, 2012, 58,999,404 shares of Registrant s Common Stock, par value $.0001 per share, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part of 10-K	Documents Incorporated by Reference
Part III	Portions of the Proxy Statement to be filed with

the Securities and Exchange Commission in connection

with the 2012 Annual Meeting of Stockholders.

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Cautionary Note Regarding Forward-Looking Statements

Certain statements in this Annual Report on Form 10-K may constitute forward-looking statements as defined in Section 27A of the Securities Act of 1933 (the Securities Act), Section 21E of the Securities Exchange Act of 1934 (the Exchange Act), the Private Securities Litigation Reform Act of 1995 (the PSLRA) or in releases made by the Securities and Exchange Commission (SEC), all as may be amended from time to time. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements of Great Lakes Dredge & Dock Corporation and its subsidiaries (Great Lakes), or industry results, to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Statements that are not historical fact are forward-looking statements. Forward-looking statements can be identified by, among other things, the use of forward-looking language, such as the words plan, believe, expect, anticipate, intend, estimate, project, may, would, could, s scheduled to, or other similar words, or the negative of these terms or other variations of these terms or comparable language, or by discussion of strategy or intentions. These cautionary statements are being made pursuant to the Securities Act, the Exchange Act and the PSLRA with the intention of obtaining the benefits of the safe harbor provisions of such laws. Great Lakes cautions investors that any forward-looking statements made by Great Lakes are not guarantees or indicative of future performance. Important assumptions and other important factors that could cause actual results to differ materially from those forward-looking statements with respect to Great Lakes, include, but are not limited to, risks and uncertainties that are described in Item 1A of this Annual Report on Form 10-K for the year ended December 31, 2011, and in other securities filings by Great Lakes with the SEC.

Although Great Lakes believes that its plans, intentions and expectations reflected in or suggested by such forward-looking statements are reasonable, actual results could differ materially from a projection or assumption in any forward-looking statements. Great Lakes future financial condition and results of operations, as well as any forward-looking statements, are subject to change and inherent risks and uncertainties. The forward-looking statements contained in this Annual Report on Form 10-K are made only as of the date hereof and Great Lakes does not have or undertake any obligation to update or revise any forward-looking statements whether as a result of new information, subsequent events or otherwise, unless otherwise required by law.

Availability of Information

You may read and copy any materials Great Lakes files with the SEC at the SEC s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Copies of such materials also can be obtained at the SEC s website, www.sec.gov or by mail from the Public Reference Room of the SEC, at prescribed rates. Please call the SEC at 1-800-SEC-0330 for further information on the Public Reference Room. Great Lakes SEC filings are also available to the public, free of charge, on its corporate website, www.gldd.com as soon as reasonably practicable after Great Lakes electronically files such material with, or furnishes it to, the SEC.

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Part I

Item 1. Business

The terms we, our, ours, us, Great Lakes and Company refer to Great Lakes Dredge & Dock Corporation and its subsidiaries. The term refers to our subsidiary NASDI, LLC and the term Yankee refers to our subsidiary Yankee Environmental Services, LLC.

Organization

Great Lakes is the largest provider of dredging services in the United States. The Company was founded in 1890 as Lydon & Drews Partnership and performed its first project in Chicago, Illinois. The Company changed its name to Great Lakes Dredge & Dock Company in 1905 and was involved in a number of marine construction and landfill projects along the Chicago lakefront and in the surrounding Great Lakes region. Great Lakes now provides dredging services in the East, West, and Gulf Coasts of the United States and worldwide. The Company also owns NASDI, a demolition services provider located in the Boston, Massachusetts area. The Company has a 50% interest in Amboy Aggregates, a sand dredging operation in New Jersey and a 50% interest in TerraSea Environmental Solutions, (TerraSea) an environmental remediation services business.

On December 31, 2010 the Company acquired the assets of L.W. Matteson, Inc. (Matteson), a maintenance and environmental dredging and levee construction company located in Burlington, Iowa for $45 million plus cash earnout payments if certain earnings criteria are met. The acquisition was funded with $37.5 million in cash and a seller note of $7.5 million. The Matteson acquisition expanded the Company s service offering into lake and river dredging, inland levee and construction dredging, environmental restoration and habitat improvement and other marine construction.

The Company operates in two reportable segments: dredging and demolition. These reportable segments are the Company s operating segments and the reporting units at which the Company tests goodwill for impairment. Financial information about the Company s reportable segments and operating revenues by geographic region is provided in Note 15 to the Company s consolidated financial statements.

Dredging Operations (approximately 83% of 2011 total revenues)

Dredging generally involves the enhancement or preservation of navigability of waterways or the protection of shorelines through the removal or replenishment of soil, sand or rock. The U.S. dredging market consists of three primary types of work: capital, beach nourishment and maintenance. The Company s bid market is defined as the aggregate dollar value of domestic projects on which the Company bid or could have bid if not for capacity constraints. The Company experienced an average combined bid market share in the U.S. of 39% over the prior three years, including 44%, 52% and 32% of the domestic capital, beach nourishment and maintenance sectors, respectively. The foregoing bid market data does not reflect rivers & lakes activities which are separately categorized. The Company s bid market share of rivers & lakes in the year of activity since the Matteson acquisition is 36%.

In addition, the Company is the only U.S. dredging service provider with significant international operations. Over the prior three years, foreign dredging operations accounted for an average of 17% of the Company s dredging revenues.

Domestic Dredging Operations

Over its 121-year history, the Company has grown to be a leader in capital, beach nourishment and maintenance dredging in the U.S.

Capital (approximately 30% of 2011 dredging revenues). Capital dredging consists primarily of port expansion projects, which involve the deepening of channels to allow access by larger, deeper draft ships and the provision of land fill used to expand port facilities. In addition to port work, capital projects also include land

reclamations, trench digging for pipelines, tunnels and cables, and other dredging related to the construction of breakwaters, jetties, canals and other marine structures. Although capital work can be impacted by budgetary constraints and economic conditions, these projects typically generate an immediate economic benefit to the ports and surrounding communities.

Beach nourishment (approximately 26% of 2011 dredging revenues). Beach nourishment projects generally involve moving sand from the ocean floor to shoreline locations where erosion threatens shoreline assets. Beach erosion is a continuous problem that has intensified with the rise in coastal development and has become an important issue for state and local governments concerned with protecting beachfront tourism and real estate. Beach nourishment is often viewed as a better response to erosion than trapping sand through the use of sea walls and jetties, or relocating buildings and other assets away from the shoreline. Generally, beach nourishment projects take place during the fall and winter months to minimize interference with bird and marine life migration and breeding patterns and coastal recreation activities.

Maintenance (approximately 22% of 2011 dredging revenues). Maintenance dredging consists of the re-dredging of previously deepened waterways and harbors to remove silt, sand and other accumulated sediments. Due to natural sedimentation, most channels generally require maintenance dredging every one to three years, thus creating a recurring source of dredging work that is typically non-deferrable if optimal navigability is to be maintained. In addition, severe weather such as hurricanes, flooding and droughts can also cause the accumulation of sediments and drive the need for maintenance dredging.

Rivers & lakes (approximately 7% of 2011 dredging revenues). Domestic rivers and lakes dredging and related operations typically consist of lake and river dredging, inland levee and construction dredging, environmental restoration and habitat improvement and other marine construction projects. With the completion of the Matteson acquisition, commencing January 1, 2011 the Company was able to target and perform additional projects along U.S. inland waterways, which includes rivers and lakes. Establishing a presence in these markets enables the Company to bid for and take advantage of opportunities that were previously generally outside of its operating scope. In recent years, Matteson worked on projects along the Mississippi river basin and in several states, including Alabama, Arizona, Arkansas, Florida, Illinois, Iowa, Louisiana, Mississippi, Missouri, Minnesota, Nebraska, Oklahoma, South Dakota, Tennessee and Texas. Generally, inland river and lake projects in the northern U.S. take place in non-winter months because frozen waterways significantly reduce the Company s ability to operate and transport its equipment in the relevant geographies.

Foreign Dredging Operations (approximately 15% of 2011 dredging revenues)

Foreign capital projects typically involve land reclamations, channel deepening and port infrastructure development. The Company targets foreign opportunities that are well suited to the Company s equipment and where it faces reduced competition from its European competitors. Maintaining a presence in foreign markets has enabled the Company to diversify its customer base. Over the last ten years, the Company has performed dredging work in the Middle East, Africa, India, the Caribbean and Central and South America. Most recently, the Company has focused its efforts on opportunities in the Middle East and South America as well as Australia, Southeast Asia and India.

Dredging Demand Drivers

The Company believes that the following factors are important drivers of the demand for its dredging services:

Deep port capital projects. Most U.S. ports have continual expansion plans that include deepening and widening in order to better compete for international trade. International trade, particularly in the intermodal container shipping business, is undergoing significant change as a result of the Panama Canal expansion. Many shipping lines have announced plans to deploy larger ships which, due to the channel dimension requirements, currently cannot use many U.S. ports. This is expected to put more pressure on

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U.S. ports such as Miami, Savannah and Charleston to deepen in order to remain competitive. In addition, the Ports of Los Angeles and Long Beach are resuming expansion efforts to remain competitive with deepened East Coast ports. The Company believes that port deepening and expansion work authorized under current and future Water Resources Development Act (WRDA) legislation will provide significant opportunities for the domestic dredging industry in the future. The annual bid market for deep port capital dredging over the prior three years averaged $148 million.

Gulf coast restoration. There has been continued focus on restoring the barrier islands and wetlands that provide natural protection from storms in the Gulf Coast area. Many restoration projects have commenced to repair coastal areas affected by Hurricane Katrina and the Deepwater Horizon oil spill. Several additional projects are being planned by state and local governments to restore natural barriers to utilize funding established following the Deepwater Horizon oil spill.

Substantial need for beach nourishment. Beach erosion is a continuous problem due to the normal ebb and flow of coastlines as well as the effects of severe storm activity. Growing populations in coastal communities and vital beach tourism are drawing attention to the importance of protecting beach front assets. Over the past few years, both the federal government and state and local entities have funded beach work. In 2011, the beach nourishment bid market was double the average bid market over the prior three years underscoring the substantial importance of these projects to individual communities. The annual bid market for beach nourishment over the prior three years averaged $127 million.

Required maintenance of U.S. ports. The channels and waterways leading to U.S. ports have stated depths on which shippers rely when entering those ports. Due to naturally occurring sedimentation and severe weather, active channels require maintenance dredging to ensure that stated depths are at authorized levels. Consequently, the need to maintain channel depth creates a recurring source of dredging work that is non-deferrable if optimal navigability is to be preserved. The U.S. Army Corps of Engineers (the Corps) is responsible for federally funded projects related to navigation and flood control of U.S. waterways. The federal government has provided an increase to the Corps budget for navigation for the 2012 fiscal year over prior years. Another increase for navigation in fiscal year 2013 has been proposed by the President s administration, although final appropriations will rely on Congressional support for final passage. The maritime industry, including the ports, continues to advocate for Congressional efforts to ensure that a fully funded, recurring maintenance program is in place. The annual bid market for maintenance dredging over the prior three years averaged $478 million.

Need to maintain safe navigability of the U.S. river system. Over 630 million tons of cargo are transported via inland waterways each year. As transportation by barge requires less energy, and therefore less cost, to move cargo than transportation by airplane, railcar or truck, many industries rely on safe navigability of U.S. inland waterways as a primary means to transport goods and commodities such as coal, chemicals, petroleum, minerals, stones, metals and agricultural products. Natural sedimentation and other circumstances require that the inland waterway system be periodically dredged so that it can be used as intended. The Corps recognizes the need to maintain the safe navigability of U.S. waterways.

Increasing requirements for environmental services. Both our dredging and demolition businesses have experienced requests for handling contaminated sediments and soils at project sites. The Environmental Protection Agency and several state agencies began to recognize the environmental hazards posed by stored industrial byproducts near waterways after a coal ash pond collapsed in Kingston, Tennessee in 2008 and sent a billion gallons of hazardous sludge into the Emory River. The release of coal combustion residues or other regulated pollutants into major waterways require the use of environmental dredging to remove the contaminated sediment. The capability to provide the environmental clean-up of not only the waterway, but also the processing of the contaminated sediment or any contaminated soil from other brownfield sites provides a targeted growth opportunity for Great Lakes.

Middle East market. In recent years, the Middle East has been one of the most dynamic markets for dredging services in the world. With the substantial income from oil revenues and real estate expansion, these countries have been undergoing extensive infrastructure expansion. While the worldwide economic

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slowdown has resulted in reduced activity levels, the Company believes that the demand for infrastructure development will resume and present attractive future opportunities that suit the Company s equipment in the region.

Australia, Southeast Asia and India. Port traffic continues to surge in the developing markets throughout Southeast Asia and India. Advances in economic output in conjunction with growing populations and greater prosperity are driving increased shipping needs. With this growth in marine traffic comes a need for additional port capacity and infrastructure improvement. Great Lakes is investing resources in these markets and expects to see an increased demand for the Company s dredging for upcoming port expansion. Within the same region, Great Lakes has committed vessels to create new berths for liquid natural gas (LNG) terminals being developed. Abundant energy resources from the west coast of Australia need dredging services to accommodate new terminals that will ship LNG to the industrial regions needing a source of clean and safe energy. Less reliance on coal and nuclear energy in Asian countries further the need for LNG. Great Lakes expects a continued source of dredging opportunities from the entire Australia, Southeast Asia and India region.

Demolition Operations (approximately 17% of 2011 total revenues)

NASDI, along with its sister company Yankee, is a major U.S. provider of commercial and industrial demolition services. Historically, the majority of NASDI s work was performed in the New England area. Through increased collaboration with Great Lakes other lines of business, NASDI recently expanded into the New York area and marine demolition markets, specifically, bridge demolition. NASDI s core business is exterior and interior demolition. Exterior demolition involves the complete dismantling and demolition of structures and foundations. Interior demolition involves removing specific structures within a building. The aforementioned bridge demolition involves dismantling and disposal of aged or failing bridges. Bridge demolition contains several complex engineering tasks such as maneuvering around existing traffic flow, containment of hazardous materials contained in the bridge materials and removal of extended spans, frequently over water. Other business activities include site development, the removal of asbestos and other hazardous materials, and the ability to remediate contaminated demolition materials. NASDI is one of a few providers in New England with the required licenses, operating expertise, equipment fleet and access to bonding to execute larger, complex industrial demolition projects.

Joint Ventures

Amboy Aggregates. The Company and a New Jersey aggregates company each own 50% of Amboy Aggregates, or Amboy. Amboy was formed in December 1984 to mine sand from the entrance channel to New York Harbor to provide sand and aggregate for use in road and building construction and for clean land fill. Amboy also imports stone from upstate New York and Nova Scotia and distributes it throughout the New York area. The Company s dredging expertise and its partner s knowledge of the aggregate market form the basis for the joint venture.

Amboy is one of the only East Coast aggregate producers to mine sand from the ocean floor. Amboy has a specially designed dredge for sand mining, de-watering and dry delivery. No other vessel of this type operates in the U.S. Amboy s ocean-based supply of sand provides a long-term competitive advantage in the Northeast as land-based sand deposits are depleted or rendered less cost competitive by escalating land values. Mining operations are performed pursuant to permits granted to Amboy by the federal government and the states of New York and New Jersey.

TerraSea Environmental Solutions. The Company and a European based remediation company each own 50% of TerraSea Environmental Solutions, a remediation business. TerraSea provides water and land based environmental services in the area of clean up and remediation of sediments, soil and groundwater for both marine and land based projects. The joint venture was established to capitalize on the expertise of the two equal partners for projects in the United States offering optimally engineered global solutions for environmental cleanup needs.

Customers

Dredging

The dredging industry s customers include federal, state and local governments, foreign governments and both domestic and foreign private concerns, such as utilities and oil companies. Most dredging projects are competitively bid, with the award going to the lowest qualified bidder. Customers generally have few economical alternatives to dredging services. The Corps is the largest dredging customer in the U.S. and has responsibility for federally funded projects related to navigation and flood control. In addition, the U.S. Coast Guard and the U.S. Navy are responsible for awarding federal contracts with respect to their own facilities. In 2011, approximately 56% of the Company s dredging revenues were generated from approximately 53 different contracts with federal agencies or third parties operating under contracts with federal agencies.

Foreign governments requiring infrastructure development are the primary dredging customers in international markets. Approximately 9% of the Company s 2011 dredging revenues were earned from contracts with the government of Bahrain or entities supported by the government of Bahrain.

Demolition

Demolition customers include general contractors, corporations that commission projects, non-profit institutions such as universities and hospitals, and local government and municipal agencies. This segment benefits from key relationships with certain customers in the general contracting and public infrastructure industries. The majority of the segment s demolition services are concentrated in New England, however approximately 22% of the segment s backlog consists of a single demolition project in New York. In 2011, one of NASDI s customers was responsible for approximately 24% and another customer was responsible for 17% of NASDI s annual revenues; however, the loss of either customer would not have a material adverse effect on Great Lakes as a whole.

Bidding Process

Dredging

Most of the Company s dredging contracts are obtained through competitive bidding on terms specified by the party inviting the bid. The types of equipment required to perform the specified service and the estimated project duration affect the cost of performing the contract and the price that dredging contractors will bid.

For contracts under its jurisdiction, the Corps typically prepares a fair and reasonable cost estimate based on the specifications of the project. To be successful, a bidder must be determined by the Corps to be a responsible bidder (i.e., a bidder that generally has the necessary equipment and experience to successfully complete the project as well as the ability to obtain a surety bid bond) and submit the lowest responsive bid that does not exceed 125% of the Corps original estimate. Contracts for state and local governments are generally awarded to the lowest qualified bidder. Contracts for private customers are awarded based on the contractor s experience, equipment and schedule, as well as price. While substantially all of the Company s dredging contracts are competitively bid, some government contracts are awarded through a sole source procurement process involving negotiation between the contractor and the government, while other projects are bid by the Corps through a request for proposal process. The request for proposal process benefits both Great Lakes and its customers as customers can award contracts based on factors beyond price, including experience and skill.

Demolition

The demolition segment negotiates the majority of its demolition contracts, but the segment is participating to a greater extent with competitively bid municipal work projects. This segment frequently receives revenues from change orders on existing contracts. NASDI has established a network of local contacts with developers and prime contractors that act as referral sources and enable NASDI to procure demolition jobs on a sole-source

basis. When the demolition segment bids on a project, it evaluates the contract specifications and develops a cost estimate to which it adds a reasonable margin. While there are numerous competitors in the demolition services market, NASDI benefits from its size, relationships and reputation. Therefore, there are occasions where NASDI is not the lowest bidder on a contract, but is still awarded the project based on its reputation and qualifications.

Bonding and Foreign Project Guarantees

Dredging

For most domestic projects and some foreign projects, dredging service providers are required to obtain three types of bonds: bid bonds, performance bonds and payment bonds. These bonds are typically provided by large insurance companies. A bid bond is required to serve as a guarantee that if a service provider s bid is chosen, the service provider will sign the contract. The amount of the bond is typically 20% of the service provider s bid, with a range generally between $1 and $10 million. After a contract is signed, the bid bond is replaced by a performance bond, the purpose of which is to guarantee that the job will be completed. If the service provider fails to complete a job, the bonding company would be required to complete the job and would be entitled to be paid the contract price directly by the customer. Additionally, the bonding company would be entitled to be paid by the service provider for any costs incurred in excess of the contract price. A service provider s ability to obtain performance bonds with respect to a particular contract depends upon the size of the contract, as well as the size of the service provider and its financial position. A payment bond is required to protect the service provider s suppliers and subcontractors in the event that the service provider cannot make timely payments. Payment bonds are generally written at 100% of the contract value.

In September 2011, Great Lakes entered into a new bonding agreement with Zurich American Insurance Company (Zurich) under which the Company can obtain performance, bid and payment bonds. Great Lakes has never experienced difficulty in obtaining bonding for any of its projects; and Great Lakes has never failed to complete a marine project in its 121 year history. Great Lakes is using Zurich for all bonding requirements. The previous bonding agreement with Travelers Casualty and Surety Company of America (Travelers) will remain in place until outstanding bonds expire as the projects underlying the bonds are completed. Pursuant to the existing bonding agreement, Travelers has been granted a security interest in a substantial portion of the Company s operating equipment as collateral for the Company s obligations to Travelers under its bonding agreement.

For most foreign dredging projects, letters of credit or bank guarantees issued by foreign banks are required as security for the bid, performance and, if applicable, advance payment guarantees. The Company obtains its letters of credit under its credit agreement or its separate facility which is supported by the Export-Import Bank of the United States (Ex-Im Bank) under Ex-Im Bank s Working Capital Guarantee Program. Foreign bid guarantees are usually 2% to 5% of the service provider s bid. Foreign performance and advance payment guarantees are each typically 5% to 10% of the contract value.

Demolition

The demolition segment contracts with both private, non-government customers and governmental entities. In general, it is not required to secure bonding for projects with non-governmental customers but is required to secure bonding for projects with governmental entities. When the demolition segment does have bonding requirements, the bonds are also provided by Zurich.

Competition

Dredging

The U.S. dredging industry is highly fragmented with approximately 250 entities in the U.S. presently operating more than 850 dredges, primarily in maintenance dredging. Most of these dredges are smaller and service the inland, as opposed to coastal, waterways, and therefore, do not generally compete with Great Lakes except in our rivers & lakes market. Competition is determined by the size and complexity of the job; equipment,

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bonding and certification requirements; and government regulations. Great Lakes and three other companies comprised approximately 78% of the Company s defined bid market related to domestic capital, beach nourishment and maintenance over the prior three years. The foregoing percentage excludes work in the rivers & lakes market. Within the Company s bid market, competition is determined primarily on the basis of price. In addition, the Foreign Dredge Act of 1906, or Dredging Act , and Section 27 of the Merchant Marine Act of 1920, or Jones Act , provide significant barriers to entry with respect to foreign competition. Together these two laws prohibit foreign-built, chartered or operated vessels from competing in the U.S. See Business Government Regulations below.

Great Lakes competes with several smaller competitors in the domestic rivers and lakes market. Competition is determined primarily based on the basis of geographic reach, project execution capability and price.

Competition in the international market is dominated by four large European dredging companies all of which operate larger equipment and fleets that are more extensive than the Company s. The Company targets opportunities that are well suited to its equipment and where it can be most competitive. Most recently, the Company has focused on opportunities in the Middle East where the Company has cultivated close customer relationships and has pursued contracts compatible with the size of the Company s vessels.

Demolition

The U.S. demolition and related services industry is highly fragmented and is comprised mostly of small regional companies. Unlike many of its competitors, NASDI is able to perform both small and larger, more complex projects. NASDI competes in the demolition and related services industry primarily on the basis of its experience, reputation, equipment, key client relationships and price.

Equipment

Dredging

Great Lakes fleet of dredges, material barges and other specialized equipment is the largest and most diverse in the U.S. The Company operates three principal types of dredging equipment: hopper dredges, hydraulic dredges and mechanical dredges.

Hopper Dredges. Hopper dredges are typically self-propelled and have the general appearance of an ocean-going vessel. The dredge has hollow hulls, or hoppers, into which material is suctioned hydraulically through drag-arms. Once the hoppers are filled, the dredge sails to the designated disposal site and either (i) bottom dumps the material or (ii) pumps the material from the hoppers through a pipeline to a designated site. Hopper dredges can operate in rough waters, are less likely than other types of dredges to interfere with ship traffic, and can be relocated quickly from one project to another. Hopper dredges primarily work on beach and maintenance projects.

Hydraulic Dredges. Hydraulic dredges remove material using a revolving cutterhead which cuts and churns the sediment on the channel or ocean floor and hydraulically pumps the material by pipe to the disposal location. These dredges are very powerful and can dredge some types of rock. Certain dredged materials can be directly pumped as far as seven miles with the aid of a booster pump. Hydraulic dredges work with an assortment of support equipment, which help with the positioning and movement of the dredge, handling of the pipelines and the placement of the dredged material. Great Lakes operates the only two large electric hydraulic dredges in the U.S., which makes the Company particularly competitive in markets with stringent emissions standards, such as California and Houston. Unlike hopper dredges, relocating hydraulic dredges and all their ancillary equipment requires specialized vessels and additional time and their operations can be impacted by ship traffic and rough waters. There is a wide distribution of hydraulic dredges from our smaller rivers & lakes vessels that use pipe sizes ranging from 10 to 22 and operate at between 365 and 3,200 total horsepower, while the Company s other hydraulic dredges use pipe sizes ranging from 18 to 36 and operate at between 1,900 and 20,300 total horsepower.

Mechanical Dredges. There are two basic types of mechanical dredges operating in the U.S.: clamshell and backhoe. In both types, the dredge uses a bucket to excavate material from the channel or ocean floor. The dredged material is placed by the bucket into material barges, or scows, for transport to the designated disposal area. The scows are emptied by bottom-dumping, direct pump-out or removal by a crane with a bucket. Mechanical dredges are capable of removing hard-packed sediments, blasted rock and debris and can work in tight areas such as along docks or terminals. Clamshell dredges with specialized buckets are ideally suited to handle material requiring environmentally controlled disposal. The Company has the largest fleet of material barges in the domestic industry, which provides cost advantages when dredged material is required to be disposed far offshore or when material requires controlled disposal. Additionally, the Company owns an electric clamshell dredge which provides an advantage in those markets with stringent emissions standards.

In addition, the Company has numerous pieces of smaller equipment that support its dredging operations. Great Lakes domestic dredging fleet is typically positioned on the East and Gulf Coasts, with a smaller number of vessels occasionally positioned on the West Coast, and with many of the rivers & lakes dredges on inland rivers and lakes. The mobility of the fleet enables the Company to move equipment in response to changes in demand. Great Lakes fleet also includes vessels currently positioned in the Middle East. The Company currently estimates the replacement cost of its entire fleet to be in excess of $1.5 billion.

The Company continually assesses its need to upgrade and expand its dredging fleet to take advantage of improving technology and to address the changing needs of the dredging market. The Company is also committed to preventive maintenance, which it believes is reflected in the long lives of most if its equipment and its low level of unscheduled downtime on jobs. To the extent that market conditions warrant the expenditures, Great Lakes can prolong the useful life of its vessels indefinitely.

Demolition

The demolition segment owns and operates specialized demolition equipment, including a fleet of excavators equipped with shears, pulverizers, processors, grapples, and hydraulic hammers that provide high-capacity processing of construction and demolition debris for recycling, reclamation and disposal. NASDI also owns and maintains a large number of skid-steer loaders, heavy-duty large-capacity loaders, cranes, recycling crushers, off-highway hauling units and a fleet of tractor-trailers for transporting equipment and materials to and from job sites. NASDI rents additional equipment on a project-by-project basis, which allows NASDI flexibility to adjust costs to the level of project activity.

Equipment Certification

Certification of equipment by the U.S. Coast Guard and establishment of the permissible loading capacity by the American Bureau of Shipping (A.B.S.) are important factors in the Company s dredging business. Many projects, such as beach nourishment projects with offshore sand borrow sites and dredging projects in exposed entrance channels or with offshore disposal areas, are restricted by federal regulations to be performed only by dredges or scows that have U.S. Coast Guard certification and a load line established by the A.B.S. The certifications indicate that the dredge is structurally capable of operating in open waters. The Company has more certified dredging vessels than any of the Company s domestic competitors and makes substantial investments to maintain these certifications.

Seasonality

Seasonality does not generally have a significant impact on the Company s dredging operations. However, many East Coast beach nourishment projects are limited by environmental windows that require work to be performed in winter months to protect wildlife habitats. The Company can mitigate the impact of these environmental restrictions to a certain extent because the Company has the flexibility to reposition its equipment to project sites, if available, that are not limited by these restrictions. In addition, rivers and lakes in the northern U.S. freeze during the winter, significantly reducing the Company s ability to operate and transport its equipment in the relevant geographies. Fish spawning and flooding can effect dredging operations as well.

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The Company s demolition operations are not significantly impacted by seasonality.

Weather

The Company s ability to perform its contracts may depend on weather conditions. Inclement weather can delay the completion of a project, thereby causing the Company to incur additional costs. As part of bidding on fixed price contracts, the Company makes allowances, consistent with historical weather data, for project downtime due to adverse weather conditions. In the event that the Company experiences adverse weather beyond these allowances, a project may require additional days to complete, resulting in additional costs and decreased gross profit margins. Conversely, favorable weather can accelerate the completion of the project, resulting in cost savings and increased gross profit margins. Typically, Great Lakes is exposed to significant weather in the first and fourth quarters, and certain projects are required to be performed in environmental windows that occur during these periods. See Business-Seasonality above.

Weather is difficult to predict and historical records exist for only the last 100-125 years. Changes in weather patterns may cause a deviation from project weather allowances on a more frequent basis and consequently increase or decrease gross profit margin, as applicable, on a project-by-project basis. In a typical year, the Company works on many projects in multiple geographic locations and experiences both positive and negative deviations from project weather allowances. Accordingly, it is unlikely that future climate change will have a material adverse effect on the Company s results of operations.

Backlog

The Company s contract backlog represents its estimate of the revenues that will be realized under the portion of the contracts remaining to be performed. For dredging contracts these estimates are based primarily upon the time and costs required to mobilize the necessary assets to and from the project site, the amount and type of material to be dredged and the expected production capabilities of the equipment performing the work. For demolition contracts, these estimates are based on the time and remaining costs required to complete the project, relative to total estimated project costs and project revenues agreed to with the customer. However, these estimates are necessarily subject to variances based upon actual circumstances. Because of these factors, as well as factors affecting the time required to complete each job, backlog is not always indicative of future revenues or profitability. In addition, a significant amount of the Company s dredging backlog relates to federal government contracts, which can be canceled at any time without penalty, subject to the Company s right, in some cases, to recover the Company s actual committed costs and profit on work performed up to the date of cancellation. In addition, the Company s backlog may fluctuate significantly from quarter to quarter based upon the type and size of the projects the Company is awarded from the bid market. A quarterly increase or decrease of the Company s backlog does not necessarily result in an improvement or a deterioration of the Company s business. The Company s backlog includes only those projects for which the Company has obtained a signed contract with the customer. The components of the Company s backlog and other related information are addressed in more detail in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Bidding Activity and Backlog.

Employees

Dredging

During 2011, the Company employed an average of 396 full-time salaried personnel in the U.S. In addition, the Company employs U.S. hourly personnel, most of whom are unionized, on a project-by-project basis. Crews are generally available for hire on relatively short notice. During 2011, the Company employed a daily average of 560 hourly personnel to meet domestic project requirements.

In addition, at December 31, 2011, the Company employed approximately 25 expatriates, 27 foreign nationals and 90 local staff to manage and administer its Middle East operations. During 2011, the Company also employed a daily average of 266 hourly personnel to meet project requirements in the Middle East.

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Demolition

At December 31, 2011, the demolition segment employed approximately 53 full-time salaried administrative employees, in addition to an average of 309 hourly employees pursuant to four union agreements. The hourly employees are hired on a project-by-project basis and are generally available for hire on relatively short notice.

Safety

Safety of its employees is one of the highest priorities of Great Lakes. The Company promotes a safety culture committed to training, awareness and mutual responsibility for the wellbeing of workers. Accident prevention, safety and environmental protection have top priority in the Company s business planning, in the overall conduct of its business, and in the operation and maintenance of its vessels and facilities.

Unions

The Company is a party to numerous collective bargaining agreements in the U.S. that govern its relationships with its unionized hourly workforce. However, four primary agreements apply to approximately 65% of such employees. The Company s three contracts with Local 25 Operators Union for the northern, southern and Gulf regions, representing approximately 43% of its unionized workforce, are set to expire in October 2012. The Company s collective bargaining agreement with Seafarers International Union expired in February 2012 and we have negotiated a new agreement which is subject to ratification by its members. The Company has not experienced any major labor disputes in the past five years and believes it has good relationships with the unions that represent a significant number of its hourly employees; however, there can be no assurances that the Company will not experience labor strikes or disturbances in the future.

Government Regulations

The Company is subject to government regulations pursuant to the Dredging Act, the Jones Act, the Shipping Act, 1916, or Shipping Act , and the vessel documentation laws set forth in Chapter 121 of Title 46 of the United States Code. These statutes require vessels engaged in dredging in the navigable waters of the United States to be documented with a coastwise endorsement, to be owned and controlled by U.S. citizens, to be manned by U.S. crews, and to be built in the United States. The U.S. citizen ownership and control standards require the vessel-owning entity to be at least 75% U.S. citizen owned and prohibit the chartering of the vessel to any entity that does not meet the 75% U.S. citizen ownership test.

Environmental Matters

The Company s operations, facilities and vessels are subject to various environmental laws and regulations related to, among other things: dredging operations; the disposal of dredged material; protection of wetlands; storm water and waste water discharges; demolition activities; asbestos removal; transportation and disposal of wastes and materials; air emissions; and remediation of contaminated soil, sediments, surface water and groundwater. The Company is also subject to laws designed to protect certain marine species and habitats. Compliance with these statutes and regulations can delay appropriation and/or performance of particular projects and increase related project costs. Non-compliance can also result in fines, penalties and claims by third parties seeking damages for alleged personal injury, as well as damages to property and natural resources.

Certain environmental laws such as the U.S. Comprehensive Environmental Response, Compensation and Liability Act of 1980, and the Oil Pollution Act of 1990 impose strict and, under some circumstances joint and several, liability on owners and operators of facilities and vessels for investigation and remediation of releases and discharges of regulated materials, and also impose liability for related damages to natural resources. The Company s past and ongoing operations involve the use and from time to time the release or discharge of regulated materials which could result in liability under these and other environmental laws. The Company has remediated known releases and discharges as deemed necessary, but there can be no guarantee that additional costs will not be incurred if for example third party claims arise or new conditions are discovered.

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The Company s projects may involve demolition, excavation, transportation, management and disposal of hazardous waste and other regulated materials. Various laws strictly regulate the removal, treatment and transportation of hazardous water and other regulated materials and impose liability for human health effects and environmental contamination caused by these materials. The Company s demolition business, for example, requires it to transport and dispose of hazardous substances and other wastes, such as asbestos. The Company takes steps to limit its potential liability by hiring qualified asbestos abatement subcontractors from time to time to remove such materials from our projects and some project contracts require the client to retain liability for hazardous waste generation.

Based on the Company s experience and available information, the Company believes that the future cost of compliance with existing environmental laws and regulations (and liability for known environmental conditions) will not have a material adverse effect on the Company s business, financial position, results of operations or cash flows. However, the Company cannot predict what environmental legislation or regulations will be enacted in the future, how existing or future laws or regulations will be enforced, administered or interpreted, or the amount of future expenditures that may be required to comply with these environmental or health and safety laws or regulations or to respond to newly discovered conditions, such as future cleanup matters or other environmental claims.

Executive Officers

The following table sets forth the names and ages of all of the Company s executive officers and the positions and offices presently held by them.

Name	Age	Position
Jonathan W. Berger	53	Chief Executive Officer and Director
Bruce J. Biemeck	62	President, Chief Financial Officer and Director
David E. Simonelli	55	President of Dredging Operations
Kyle D. Johnson	50	Senior Vice President Operations
John F. Karas	50	Senior Vice President Estimating
Stephen E. Pegg	53	Senior Vice President Business Development

The annual appointment of each executive officer expires in May 2012.

Jonathan W. Berger, Chief Executive Officer

Mr. Berger was named Chief Executive Officer in September 2010. Mr. Berger was a Partner in KPMG s Corporate Finance practice from 1991 through 1999 and was managing director and co-head of Corporate Finance for Navigant Consulting, Inc., a New York Stock Exchange-listed consulting firm, from 2001 to 2009. Currently, Mr. Berger is a Director and Chair of the Audit and Compensation Committees of Boise, Inc. He is a Certified Public Accountant and holds an M.B.A. from Emory University.

Bruce J. Biemeck, President and Chief Financial Officer

Mr. Biemeck was named President and Chief Financial Officer in September 2010. Mr. Biemeck has deep institutional knowledge of Great Lakes business, having served as the Company s Senior Vice President, Chief Financial Officer and Treasurer from 1991 to 1999. From April 1999 to September 2010, Mr. Biemeck was a private real estate investor and developer and acted as an independent consultant. He received a Bachelor of Science degree from St. Louis University and an M.B.A. from the University of Chicago. He is a Certified Public Accountant.

David E. Simonelli, President of Dredging Operations

Mr. Simonelli was named President of Dredging Operations in April 2010. Mr. Simonelli is responsible for the Operations Support Group which includes estimating, engineering, operations, plant and equipment and foreign operations. He was named a Vice President of the Company in 2002 and Special Projects Manager in

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1996. He joined the Company in 1978 as a Field Engineer. Mr. Simonelli earned a Bachelor of Science degree in Civil and Environmental Engineering from the University of Rhode Island. He is a member of the Hydrographic Society, the American Society of Civil Engineers and the Western Dredging Association.

Kyle D. Johnson, Senior Vice President Operations

Mr. Johnson was named Senior Vice President in February 2009 and has been Chief Contract Manager of the Company since 2006. He joined the Company in 1983 as a Mechanical Engineer and has since held positions of increasing responsibility in domestic and international engineering and operations, including Area Engineer, Special Projects Manager and Manager of Production Engineering. Mr. Johnson was named Vice President in 2002. Mr. Johnson earned a Bachelor of Science degree in Engineering from Purdue University and a Master s of Science degree in Construction Engineering & Management from Stanford University.

John F. Karas, Senior Vice President Estimating

Mr. Karas has been Senior Vice President of the company since February 2009. Previously, Mr. Karas served as a Vice President since 2002, and was named Chief Estimator in 1992. Mr. Karas joined the Company in 1983 as a Project Engineer in the Hopper Division. Mr. Karas earned a Bachelor s degree in Finance from the University of Notre Dame and is a member of the Western Dredging Association and the Association for the Advancement of Cost Engineering.

Stephen E. Pegg, Senior Vice President Business Development

Mr. Pegg was named Senior Vice President of Business Development in March 2011 after rejoining the Company as a consultant in October of 2010, and served as President of NASDI from March 2011 to August 2011. Mr. Pegg had previously served the Company as Assistant Controller, and Director of Planning and Development from 1988 1992. From 1992 through 2007, Mr. Pegg served as Vice President and Chief Financial Officer for various industrial product companies including, in 2007, LGL Group, Inc., a manufacturing company that produces capital equipment and custom electronic components. From 2008 until 2010, Mr. Pegg was an independent consultant. Mr. Pegg is a Certified Public Accountant, and he holds a Bachelor of Science degree from Illinois State University and an M.B.A. from Northwestern University s Kellogg Graduate School of Management.

Item 1A. Risk Factors

The following risk factors address the material risks and uncertainties concerning our business. You should carefully consider the following risks and other information contained or incorporated by reference into this Annual Report on Form 10-K when evaluating our business and financial condition and an investment in our common stock. Should any of the following risks or uncertainties develop into actual events, such developments could have material adverse effects on our business, financial condition, cash flows and results of operations.

We depend on our ability to continue to obtain federal government dredging contracts, and are therefore impacted by the amount of government funding for dredging projects. A reduction in government funding for dredging contracts can reduce our revenues and profits.

A substantial portion of our revenue is derived from federal government dredging contracts. Revenues related to contracts with federal agencies or companies operating under contracts with federal agencies and its percentage as a total of dredging revenue for the years ended December 31, 2011, 2010 and 2009 were as follows:

	Year Ended December 31,		
	2011	2010	2009
Federal government dredging revenue (in US$1,000)	$ 289,120	$ 367,320	$ 347,923
Percent of dredging revenue from federal government	56%	60%	61%

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Amounts spent by the federal government on dredging are subject to the budgetary and legislative processes. We would expect the federal government to continue to improve and maintain ports as it has for many years, which will necessitate a certain level of federal spending. However, there can be no assurance that the federal government will allocate any particular amount or level of funds to be spent on dredging for any specified period. In addition, federal government contracts can be canceled at any time without penalty to the government, subject to our contractual right to recover our actual committed costs and profit on work performed up to the date of cancellation. Accordingly, there can be no assurance that the federal government will not cancel any federal government contracts that have been or are awarded to us. A material reduction in government funding for dredging contracts could materially reduce our revenues and profits.

Most of our dredging contracts are fixed-price contracts pursuant to which we charge a fixed price per unit of material dredged. If we are unable to accurately estimate our costs to complete our projects, our profitability could suffer.

Most dredging contracts are fixed-price contracts where the customer pays a fixed price per unit (e.g., cubic yard) of material dredged. Fixed-price dredging contracts carry inherent risks, including risks of losses from underestimating costs, operational difficulties and other changes that sometimes occur over the contract period. One of the more significant factors that can adversely affect the profitability of a dredging project is inclement or hazardous weather conditions that exceed our estimates. Such an event can result in substantial delays in performance time and cause additional contract expenses. In addition, most of our demolition contracts are fixed-price contracts where the customer pays a fixed price for our performance under the contract. Fixed-price demolition contracts carry similar risks to our fixed-price dredging contracts. If we were to significantly underestimate the costs on one or more significant contracts, the resulting losses could have a material adverse effect on our business, operating results, cash flows or financial condition.

Our quarterly operating results may vary significantly.

Our quarterly results of operations have fluctuated in the past and may continue to fluctuate in the future. Accordingly, you should not rely on the results of any past quarter or quarters as an indication of future performance in our business operations or valuation of our stock. Our operating results could vary greatly from quarter to quarter due to factors such as:

- inclement or hazardous weather conditions that may result in underestimated delays in dredging and additional contract expenses;
- unplanned equipment downtime;
- environmental restrictions requiring that certain projects be performed in winter months to protect wildlife habitats; and
- equipment mobilization to and from projects.

If our results of operations from quarter to quarter fail to meet the expectations of public market analysts and investors, our stock price could be negatively impacted. See Item 7.   Management   s Discussion and Analysis of Financial Condition and Results of Operations   Primary Factors that Determine Operating Profitability.

Our use of the percentage-of-completion method of accounting could result in a change in previously recorded revenue and profit.

We recognize contract revenue using the percentage-of-completion method. The majority of our work is performed on a fixed-price basis. Contract revenue is accrued based on engineering estimates for the physical percent complete for dredging and estimates of remaining costs to complete for demolition. We use accounting principles generally accepted in the United States for accounting policies relating to our use of the percentage-of-completion method, estimating costs, revenue recognition, combining and segmenting contracts

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and change order/claim recognition. Percentage-of-completion accounting relies on the use of estimates in the process of determining income earned. The cumulative impact of revisions to estimates is reflected in the period in which these changes are experienced or become known. Given the risks associated with the variables in these types of estimates, it is possible for actual costs to vary from estimates previously made, which may result in reductions or reversals of previously recorded net revenues and profits.

We are subject to risks related to our international dredging operations.

Revenue from foreign contracts and its percentage to total dredging revenue for the years ended December 31, 2011, 2010 and 2009 were as follows:

	Year Ended December 31,		
	2011	**2010**	**2009**
Foreign revenue (in US $1,000)	$ 77,232	$ 82,898	$ 134,123
Percent of dredging revenue from foreign countries	15%	14%	23%

International operations subject us to additional potential risks, including:

uncertainties concerning import and export license requirements, tariffs and other trade barriers;

political and economic instability;

reduced Middle Eastern demand as a result of fluctuations in the price of oil, the primary export in the Middle East;

restrictions on repatriating foreign profits back to the United States;

difficulties in enforcing agreements through certain foreign legal systems;

requirements of, and changes in, foreign laws, policies and regulations;

difficulties in staffing and managing international operations without additional expense;

taxation issues;

greater difficulty in accounts receivable collection and longer collection periods;

compliance with the U.S. Foreign Corrupt Practices Act;

difficulty in enforcing our contractual rights;

currency fluctuations;

logistical and communication challenges; and

improperly insured political, cultural and economic uncertainties, including acts of terrorism, civil unrest, war or other armed conflict.
In addition, our international operations are subject to U.S. and other laws and regulations regarding operations in foreign jurisdictions. These numerous and sometimes conflicting laws and regulations include anti-competition laws, anti-corruption laws, tax laws, immigration laws and accounting requirements. Given the high level of complexity of these laws and despite the existence of our corporate compliance program, there is a risk that some provisions may be inadvertently breached, for example through fraudulent or negligent behavior of individual employees, or failure to comply with certain formal documentation requirements or otherwise. Violations of these laws and regulations could result in fines and penalties, criminal sanctions against us, our officers, or our employees, prohibitions on the conduct of our business and on our ability to operate in one or more countries, and could have a material adverse effect on our business, results of operations or financial condition.

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One customer currently accounts for a significant portion of our international revenue.

Revenue from contracts with the government of Bahrain and entities with which it does business and its percentage to total foreign dredging revenue for the years ended December 31, 2011, 2010 and 2009 were as follows:

	Year Ended December 31,		
	2011	**2010**	**2009**
Bahrain government dredging revenue (in US$ 1,000)	$ 47,311	$ 55,399	$ 126,026
Percent of foreign dredging revenue from the Bahrain government	61%	67%	94%

Revenue from foreign projects over the last three years has been concentrated in Bahrain and primarily with the government of Bahrain. The contraction in the Middle East real estate market has slowed the rate of the region s infrastructure development. If the government of Bahrain further curtails its infrastructure investment or diversifies its use of dredging vendors, our revenue from this customer could decline further.

In February and March 2011, Bahrain experienced civil unrest that could result in governmental instability. In response thereto, the government of Bahrain has instituted several measures, including a national curfew, that have impacted (although not materially to date) our ability to execute on projects in Bahrain. It is uncertain whether this civil unrest will continue, whether the current protests and other activities will lead to any meaningful government changes, and what additional restrictions, if any, the Bahrain government will establish. If the government changes, these measures are sustained, or additional restrictions are established, our Bahrain dredging operations, including the value of our assets related to such operations, may be adversely affected. In addition, it is uncertain if current events in Bahrain will alter the government s plans for infrastructure investment.

There are integration and consolidation risks associated with the Matteson acquisition. Future acquisitions may result in significant transaction expenses, unexpected liabilities and risks associated with entering new markets, and we may be unable to profitably operate these businesses.

On December 31, 2010, we acquired Matteson. As part of our growth strategy, we may acquire additional companies that expand, complement, or diversify our business. We regularly review various opportunities and periodically engage in discussions regarding possible acquisitions. The Matteson acquisition and future acquisitions may expose us to operational challenges and risks, including risks associated with entering new markets, diversion of management s attention from our existing business, failure to retain key personnel or customers of any acquired business, assumption of unknown liabilities of the acquired business for which there are inadequate reserves and potential impairment of acquired intangible assets. Although such risks and challenges have not yet arisen in connection with the Matteson acquisition, we may not have the appropriate management, financial or other resources needed to integrate any businesses that we acquire. Any future acquisitions may result in significant transaction expenses and unexpected liabilities.

The amount of our estimated backlog is subject to change and not necessarily indicative of future revenues.

Our contract backlog represents our estimate of the revenues that we will realize under the portion of the contracts remaining to be performed. For dredging contracts these estimates are based primarily upon the time and costs required to mobilize the necessary assets to and from the project site, the amount and type of material to be dredged and the expected production capabilities of the equipment performing the work. For demolition contracts, these estimates are based on the time and remaining costs required to complete the project relative to total estimated project costs and project revenues agreed to with the customer. However, these estimates are necessarily subject to variances based upon actual circumstances. Because of these factors, as well as factors affecting the time required to complete each job, backlog is not necessarily indicative of future revenues or

profitability. In addition, a significant amount of our dredging backlog (74% in 2011) relates to federal government contracts, which can be canceled at any time without penalty to the government, subject to our contractual right to recover our actual committed costs and profit on work performed up to the date of cancellation.

Below is our dredging backlog from federal government contracts as of December 31, 2011, 2010, and 2009 and the percentage of those contracts to total backlog as of the same date. The amount of our federal government dredging backlog at December 31, 2011 and 2010 includes amounts acquired in connection with the Matteson acquisition.

	Year Ended December 31,		
	2011	**2010**	**2009**
Federal government dredging backlog (in US $1,000)	$ 234,830	$ 141,411	$ 309,571
Percent of dredging backlog from federal government	74%	50%	85%

If we fail to comply with government contracting regulations, our revenue could suffer.

Our contracts with federal, state and local governmental customers are subject to various procurement regulations and other contract provisions. Serious violations of government contracting regulations could result in the imposition of civil and criminal penalties, which may include termination of contracts, forfeiture of profits, suspension of payments and fines and suspension from future government contracting. If we are suspended from government work for any reason, we could suffer a material reduction in revenue and cash flows.

In addition, we may be subject to litigation brought by private individuals on behalf of the government relating to our government contracts, referred to in this annual report as *qui tam* actions, which could include claims for up to treble damages. *Qui tam* actions are sealed by the court at the time of filing. The only parties privy to the information in the complaint are the complainant, the U.S. government and the court. Therefore, it is possible that *qui tam* actions have been filed against us and that we are not aware of such actions or have been ordered by the court not to discuss them until the seal is lifted. Thus, it is possible that we are subject to liability exposure for *qui tam* actions.

We have indebtedness, which makes us more vulnerable to adverse economic and competitive conditions.

As of December 31, 2011, we had indebtedness of $255 million consisting of $250 million of senior subordinated notes and $5.0 million for a note issued as part of the Matteson acquisition. Our debt could:

- require us to dedicate a portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital and capital expenditures, pay dividends and other general corporate purposes;
- limit our flexibility in planning for, or reacting to, changes in our business and our industries;
- affect our competitiveness compared to our less leveraged competitors;
- increase our exposure to both general and industry-specific adverse economic conditions; and
- limit, among other things, our ability to borrow additional funds.

If we are unable, in the future, to obtain bonding or letters of credit for our dredging contracts, our ability to obtain future dredging contracts will be limited, thereby adversely affecting our business.

We, like all dredging and demolition service providers and other contractors, are generally required to post bonds in connection with our domestic dredging contracts and bonds or letters of credit with our foreign dredging contracts to ensure job completion if we ever fail to finish a project. We have entered into a bonding agreement with Zurich, pursuant to which Zurich acts as surety, issues bid bonds, performance bonds

and payment bonds, and provides guarantees required by us in the day-to-day operations of our dredging business. However, under

certain circumstances as specified in the agreement, Zurich is not obligated under the bonding agreement to issue future bonds for us. Historically, we have had a strong bonding capacity but, under standard terms in the surety market, surety companies issue bonds on a project-by-project basis and can decline to issue bonds at any time or require the posting of collateral as a condition to issuing any bonds.

With respect to our foreign dredging business, we generally obtain letters of credit under our senior credit facility and a separate facility which is supported by Ex-Im under Ex-Im s Working Capital Guarantee Program. However, the amount of letters of credit under these facilities is limited. In addition, access to our senior credit facility and the Ex-Im facility may be limited by failure to meet certain financial requirements or other defined requirements. If we are unable to obtain bonds or letters of credit, our ability to take on future work would be severely limited.

Our business would be adversely affected if we failed to comply with the Jones Act provisions on coastwise trade, or if those provisions were modified or repealed.

We are subject to the Jones Act and other federal laws that restrict dredging in U.S. waters and maritime transportation between points in the United States to vessels operating under the U.S. flag, built in the United States, at least 75% owned and operated by U.S. citizens and manned by U.S. crews. We are responsible for monitoring the ownership of our common stock to ensure compliance with these laws. If we do not comply with these restrictions, we would be prohibited from operating our vessels in the U.S. market, and under certain circumstances we would be deemed to have undertaken an unapproved foreign transfer, resulting in severe penalties, including permanent loss of U.S. dredging rights for our vessels, fines or forfeiture of the vessels.

In the past, interest groups have unsuccessfully lobbied Congress to modify or repeal the Jones Act to facilitate foreign flag competition for trades and cargoes currently reserved for U.S. flag vessels under the Jones Act. We believe that continued efforts may be made to modify or repeal the Jones Act or other federal laws currently benefiting U.S. flag vessels. If these efforts are ever successful, it could result in significantly increased competition and have a material adverse effect on our business, results of operations, cash flows or financial condition.

Our common stock is subject to restrictions on foreign ownership.

We are subject to government regulations pursuant to the Dredging Act, the Jones Act, the Shipping Act and the vessel documentation laws set forth in Chapter 121 of Title 46 of the United States Code. These statutes require vessels engaged in the transport of merchandise or passengers or dredging in the navigable waters of the U.S. to be owned and controlled by U.S. citizens. The U.S. citizenship ownership and control standards require the vessel-owning entity to be at least 75% U.S.-citizen owned. Our certificate of incorporation contains provisions limiting non-citizenship ownership of our capital stock. If our board of directors determines that persons who are not citizens of the U.S. own more than 22.5% of our outstanding capital stock or more than 22.5% of our voting power, we may redeem such stock. The required redemption price could be materially different from the current price of our common stock or the price at which the non-citizen acquired the common stock. If a non-citizen purchases our common stock, there can be no assurance that he will not be required to divest the shares and such divestiture could result in a material loss. Such restrictions and redemption rights may make our equity securities less attractive to potential investors, which may result in our common stock having a lower market price than it might have in the absence of such restrictions and redemption rights.

Capital expenditures and other costs necessary to operate and maintain our vessels tend to increase with the age of the vessel and may also increase due to changes in governmental regulations, safety or other equipment standards.

Capital expenditures and other costs necessary to operate and maintain our vessels tend to increase with the age of the vessel. Accordingly, it is likely that the operating costs of our vessels will increase.

The average age of our more significant vessels as of December 31, 2011, by equipment type, is as follows:

Type of Equipment	Quantity	Average Age in Years
Hydraulic Dredges	20	35
Hopper Dredges	8	30
Mechanical Dredges	5	36
Unloaders	2	34
Drillboats	2	35
Material and Other Barges	146	31
Total	183	32

Remaining economic life has not been presented because it is not reasonably quantifiable because, to the extent that market conditions warrant the expenditures, we can prolong the vessels lives indefinitely. We operate in an industry where a significant portion of competitors equipment is of a similar age. It is common in the dredging industry to make maintenance and capital expenditures in order to extend the economic life of equipment.

In addition, changes in governmental regulations, safety or other equipment standards, as well as compliance with standards imposed by maritime self-regulatory organizations and customer requirements or competition, may require us, along with others in our industry, to make additional expenditures. For example, if the U.S. Coast Guard enacts new standards, we may be required to incur expenditures for alterations or the addition of new equipment (e.g. more fuel efficient engines). Other new standard requirements could be significant and would affect other industry participants as well. In order to satisfy any such requirement, we may need to take our vessels out of service for extended periods of time, with corresponding losses of revenues.

We may experience equipment or mechanical failures, which could increase costs, reduce revenues and result in penalties for failure to meet project completion requirements.

The successful execution of contracts requires a high degree of reliability of our vessels, barges and equipment. The average age of our fleet as of December 31, 2011 was 32 years. Breakdowns not only add to the costs of executing a project, but they can also delay the completion of subsequent contracts, which are scheduled to utilize the same assets. We operate a scheduled maintenance program in order to keep all assets in good working order, but despite this, breakdowns can and do occur.

Environmental regulations could force us to incur capital and operational costs.

Our industry, and more specifically, our operations, facilities and vessels, are subject to various environmental laws and regulations relating to, among other things: dredging operations; the disposal of dredged material; protection of wetlands; storm water and waste water discharges; demolition activities; asbestos removal; transportation and disposal of wastes and other regulated materials; air emissions; and remediation of contaminated soil, sediments, surface water and groundwater. We, and others who participate in the marine industry, are also subject to laws designed to protect certain marine species and habitats. Compliance with these statutes and regulations can delay permitting and/or performance of particular projects and increase related project costs. These delays and increased costs could have a material adverse effect on our results of operations or cash flows. Non-compliance can also result in fines, penalties and claims by third parties seeking damages for alleged personal injury, as well as damages to property and natural resources.

Certain environmental laws such as the U.S. Comprehensive Environmental Response, Compensation and Liability Act of 1980 and the Oil Pollution Act of 1990 impose strict and, under some circumstances, joint and several, liability on owners and operators of facilities and vessels for investigation and remediation of releases and discharges of regulated materials, and also impose liability for related damages to natural resources. Our past

and ongoing operations involve the use and from time to time the release or discharge of regulated materials which could result in liability under these and other environmental laws. We have remediated known releases and discharges as deemed necessary, but there can be no guarantee that additional costs will not be incurred if, for example, third party claims arise or new conditions are discovered.

Our projects may involve demolition, excavation, transportation, management and disposal of hazardous waste and other regulated materials. Various laws strictly regulate the removal, treatment and transportation of hazardous waste and other regulated materials and impose liability for human health effects and environmental contamination caused by these materials. Our demolition business, for example, requires us to transport and dispose of hazardous substances and other wastes, such as asbestos. Services rendered in connection with hazardous substance and material removal and site development may involve professional judgments by licensed experts about the nature of soil conditions and other physical conditions, including the extent to which hazardous substances and materials are present, and about the probable effect of procedures to mitigate problems or otherwise affect those conditions. If the judgments and the recommendations based upon those judgments are incorrect, we may be liable for resulting damages, which may be material. The failure of certain contractual protections to protect us from incurring such liability, such as staying out of the ownership chain for hazardous waste and other regulated materials and securing indemnification obligations from our customers or subcontractors, could have a material adverse effect on our business, operating results, cash flows or financial condition.

Environmental requirements have generally become more stringent over time, for example in the areas of air emissions controls for vessels and ballast treatment and handling. New or stricter enforcement of existing laws, the discovery of currently unknown conditions or accidental discharges of regulated materials in the future could cause us to incur additional costs for environmental matters which might be significant.

We may be affected by market or regulatory responses to climate change.

Increased concern about the potential impact of greenhouse gases (GHG), such as carbon dioxide resulting from combustion of fossil fuels, on climate change has resulted in efforts to regulate their emission. For example, there is a growing consensus that new and additional regulations concerning GHG emissions including cap and trade legislation may be enacted, which could result in increased compliance costs for us. Legislation, international protocols, regulation or other restrictions on GHG emissions could also affect our customers. Such legislation or restrictions could increase the costs of projects for our customers or, in some cases, prevent a project from going forward, thereby potentially reducing the need for our services which could in turn have a material adverse effect on our operations and financial condition. Additionally, in our normal course of operations, we use a significant amount of fossil fuels. The costs of controlling our GHG emissions or obtaining required emissions allowances in response to any regulatory change in our industry could increase materially.

Our business could suffer in the event of a work stoppage by our unionized labor force.

We are a party to numerous collective bargaining agreements in the U.S. that govern our industry s relationships with our unionized hourly workforce. Specifically, four primary agreements apply to approximately 65% of these employees. Our three contracts with Local 25 Operators Union for the northern, southern and gulf regions, representing approximately 43% of our unionized workforce, are set to expire in October 2012. Our agreement with Seafarers International Union expired in February 2012 and we have negotiated a new agreement which is subject to ratification by its members. The inability to successfully renegotiate contracts with these unions as they expire, or any future strikes, employee slowdowns or similar actions by one or more unions could have a material adverse effect on our ability to operate our business.

Our employees are covered by federal laws that may provide seagoing employees remedies for job-related claims in addition to those provided by state laws.

Substantially all of our seagoing employees are covered by provisions of the Jones Act and general maritime law. These laws typically operate to make liability limits established by state workers compensation laws inapplicable to these employees and to permit these employees and their representatives to pursue actions against

employers for job-related injuries in federal or state courts. Because we are not generally protected by the limits imposed by state workers compensation statutes with respect to our seagoing employees, we have greater exposure for claims made by these employees as compared to industries whose employees are not covered by these provisions.

Our business is subject to significant operating risks and hazards that could result in damage or destruction to persons or property, which could result in losses or liabilities to us.

The dredging and demolition businesses are generally subject to a number of risks and hazards, including environmental hazards, industrial accidents, encountering unusual or unexpected geological formations, cave-ins below water levels, collisions, disruption of transportation services and flooding. These risks could result in damage to, or destruction of, dredges, transportation vessels, other maritime structures and buildings, and could also result in personal injury, environmental damage, performance delays, monetary losses or legal liability to third parties.

Our current insurance coverage may not be adequate, and we may not be able to obtain insurance at acceptable rates, or at all.

We maintain various insurance policies, including hull and machinery, general liability and personal injury. We partially self-insure risks covered by our policies. While we reserve for such losses for accounting purposes, we are not required to, and do not, specifically set aside funds for the self-insured portion of claims. At any given time, we are subject to multiple personal injury claims and we maintain substantial loss accruals for these claims. Our insurance policies may not be adequate to protect us from liabilities that we incur in our business. We may not be able to obtain similar levels of insurance on reasonable terms, or at all. Our inability to obtain such insurance coverage at acceptable rates or at all could have a material adverse effect on our business, operating results, cash flows or financial condition.

Our demolition business includes key customer relationships and our reputation in the Massachusetts construction market, both of which have been developed and maintained primarily by our demolition employees. Loss of any of these elements could materially reduce our demolition revenues and profits.

Demolition contracts are entered into on a project by project basis, so we do not have continuing contractual commitments with our demolition customers beyond the terms of the current contract. We benefit from key relationships with certain general and construction contractors in the Massachusetts market but have transitioned these relationships to new management installed in 2011. We also benefit from our reputation in the Massachusetts market developed over years of successfully performing on projects. Both of these aspects of the business were developed and are maintained primarily by the officers of NASDI. The inability to maintain relationships with these customers or obtain new customers based on NASDI s reputation could reduce the revenue and profitability from demolition contracts. Our inability to retain certain executives could have a material adverse effect on our demolition segment s current customer relationships and reputation.

Delaware law and our charter documents may impede or discourage a takeover that you may consider favorable.

The provisions of our certificate of incorporation and bylaws may deter, delay or prevent a third-party from acquiring us. These provisions include:

- limitations on the ability of stockholders to amend our charter documents, including stockholder supermajority voting requirements;
- the inability of stockholders to call special meetings;
- a classified board of directors with staggered three-year terms;
- advance notice requirements for nominations for election to the board of directors and for stockholder proposals; and

- the authority of our board of directors to issue, without stockholder approval, up to 1,000,000 shares of preferred stock with such terms as the board of directors may determine and to issue additional shares of our common stock.

We are also subject to the protections of Section 203 of the Delaware General Corporation Law, which prevents us from engaging in a business combination with a person who acquires at least 15% of our common stock for a period of three years from the date such person acquired such common stock, unless board or stockholder approval was obtained.

These provisions could have the effect of delaying, deferring or preventing a change in control of our company, discourage others from making tender offers for our shares, lower the market price of our stock or impede the ability of our stockholders to change our management, even if such changes would be beneficial to our stockholders.

Our stockholders may not receive dividends because of restrictions in our debt agreements, Delaware law and state regulatory requirements.

Our ability to pay dividends is restricted by the agreements governing our debt, including our senior credit agreement, our bonding agreements and the indenture governing our senior unsecured notes. In addition, under Delaware law, our board of directors may not authorize payment of a dividend unless it is either paid out of our surplus, as calculated in accordance with the Delaware General Corporation Law, or, if we do not have a surplus, it is paid out of our net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year. To the extent we do not have adequate surplus or net profits, we will be prohibited from paying dividends.

The market price of our common stock may fluctuate significantly, and this may make it difficult for holders to resell our common stock when they want or at prices that they find attractive.

The price of our common stock on the NASDAQ Global Market constantly changes. We expect that the market price of our common stock will continue to fluctuate. The market price of our common stock may fluctuate as a result of a variety of factors, many of which are beyond our control. These factors include:

- changes in market conditions;
- quarterly variations in our operating results;
- operating results that vary from the expectations of management, securities analysts and investors;
- changes in expectations as to our future financial performance;
- announcements of strategic developments, significant contracts, acquisitions and other material events by us or our competitors;
- the operating and securities price performance of other companies that investors believe are comparable to us;
- future sales of our equity or equity-related securities;
- changes in the economy and the financial markets;
- departures of key personnel;

- changes in governmental regulations; and

- geopolitical conditions, such as acts or threats of terrorism, political instability, civil unrest or military conflicts.

In addition, in recent years, global stock markets have experienced extreme price and volume fluctuations. This volatility has had a significant effect on the market price of securities issued by many companies for reasons often unrelated to their operating performance. These broad market fluctuations may adversely affect the market price of our common stock, regardless of our operating results.

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Adverse capital and credit market conditions may affect our ability to meet liquidity needs, access to capital and cost of capital.

The domestic and worldwide capital and credit markets have experienced and are experiencing significant volatility, disruptions and dislocations with respect to price and credit availability. Should we need additional funds or to refinance our existing indebtedness, we may not be able to obtain such additional funds.

We need liquidity to pay our operating expenses, interest on our debt and dividends on our capital stock. Without sufficient liquidity, we will be forced to curtail our operations, and our business will suffer. The principal sources of our liquidity are cash flow from operations and borrowings under our senior credit facility. In the event these resources do not satisfy our liquidity needs, we may have to seek additional financing. The availability of additional financing will depend on a variety of factors such as market conditions, the general availability of credit, the volume of trading activities, our credit ratings and credit capacity, as well as the possibility that customers or lenders could develop a negative perception of our long- or short-term financial prospects if the level of our business activity decreased due to a market downturn. If internal sources of liquidity prove to be insufficient, we may not be able to successfully obtain additional financing on favorable terms, or at all.

The adoption and implementation of new statutory and regulatory requirements for derivative transactions could have an adverse impact on our ability to hedge risks associated with our business.

We enter into interest rate swap agreements to manage the interest rate paid with respect to our fixed rate indebtedness, foreign exchange forward contracts to hedge currency risk and heating oil commodity swap contracts to hedge the risk that fluctuations in diesel fuel prices will have an adverse impact on cash flows associated with our domestic dredging contracts. The United States Congress has passed, and the President has signed into law, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Financial Reform Act). The Financial Reform Act provides for new statutory and regulatory requirements for derivative transactions, including foreign currency hedging transactions. The Financial Reform Act requires the Commodities Futures and Trading Commission to promulgate rules relating to the Financial Reform Act. When the rules relating to the Financial Reform Act are established, we will assess the effect, if any, they will have on us. The rules adopted by the Commodities Futures and Trading Commission may in the future significantly reduce our ability to execute strategic hedges to manage our interest expense and reduce our fuel commodity uncertainty and thus protect cash flows. In addition, the banks and other derivatives dealers who are our contractual counterparties will be required to comply with the Financial Reform Act s new requirements, and the costs of their compliance will likely be passed on to customers such as ourselves, thus potentially decreasing the benefits to us of swap and hedging transactions and potentially reducing our profitability.

The current weakness in the economic environment and other factors could lead to our goodwill and other intangible assets becoming impaired, which may require us to take significant non-cash charges against earnings.

Under current accounting guidelines, we must assess, at least annually and potentially more frequently, whether the value of our goodwill and other intangible assets have been impaired. Any impairment of goodwill or other intangible assets as a result of such analysis would result in a non-cash charge against earnings, which charge could materially adversely affect our reported net income and our stock price. We test goodwill annually for impairment in the third quarter of each year, or more frequently should circumstances dictate. A significant and sustained decline in our future cash flows, a significant adverse change in the economic environment, slower growth rates or our stock price falling below our net book value per share for a sustained period could result in the need to perform additional impairment analysis in future periods. If we were to conclude that a future write-down of goodwill or other intangible assets is necessary, then we would be required to record a non-cash charge against earnings, which, in turn, could have a material adverse effect on our reported net income and the book value of our stockholders equity. See Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates.

If we are unable to attract and retain key personnel and skilled labor, our ability to bid for and successfully complete contracts may be negatively impacted.

Our ability to attract and retain reliable, qualified personnel is a significant factor that enables us to successfully bid for and profitably complete our work. This includes members of our management, project managers, estimators, supervisors, foremen, equipment operators and laborers. The loss of the services of any of our management could have a material adverse effect on us. If we do not succeed in retaining our current key employees and attracting, developing and retaining new highly-skilled employees, our reputation may be harmed and our operations and future earnings may be negatively impacted.

We may not be able to maintain an adequate skilled labor force necessary to operate efficiently and to support our growth strategy. We have from time-to time experienced, and may in the future experience, shortages of certain types of qualified equipment operating personnel. The supply of experienced engineers, project managers, field supervisors and other skilled workers may not be sufficient to meet current or expected demand. If we are unable to hire employees with the requisite skills, we may also be forced to incur significant training expenses. The occurrence of any of the foregoing could have an adverse effect on our business, operating results, financial condition and value of our common stock.

We may become liable for the obligations of our joint ventures, partners and subcontractors.

Some of our projects are performed through joint ventures and similar arrangements with other parties. In addition to the usual liability of contractors for the completion of contracts and the warranty of our work, where work is performed through a joint venture, we also have potential liability for the work performed by our joint ventures. In these projects, even if we satisfactorily complete our project responsibilities within budget, we may incur additional unforeseen costs due to the failure of our joint ventures to perform or complete work in accordance with contract specifications. In some joint ventures and similar arrangements, we may not be the controlling partner. In these cases, we may have limited control over the actions of the joint venture. In addition, these joint ventures may not be subject to the same requirements regarding internal controls and internal control over financial reporting that we follow. To the extent the controlling partner makes decisions that negatively impact the joint venture or internal control problems arise within the joint venture, it could have a material adverse impact on our business, financial condition, and results of operations.

We act as prime contractor on many of the projects we undertake. Depending on the nature of work required to complete the project, we may choose to subcontract a portion of the project. In our industry, the prime contractor is normally responsible for the performance of the entire contract, including subcontract work. Thus, when acting as a prime contractor, we are subject to the risk associated with the failure of one or more subcontractors to perform as anticipated.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The Company owns or leases the properties described below. The Company believes that its existing facilities are adequate for its operations.

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Dredging

The Company s headquarters are located at 2122 York Road, Oak Brook, Illinois 60523, with approximately 50,000 square feet of office space that it leases with a term expiring in 2019. As of December 31, 2011 the Company owns or leases the following additional facilities:

Location	Type of Facility	Size		Leased or Owned
Staten Island, New York	Yard	4.4	Acres	Owned
Morgan City, Louisiana	Yard	6.4	Acres	Owned
Baltimore, Maryland	Yard	4.2	Acres	Leased
Green Cove Springs, Florida	Yard	8.5	Acres	Leased
Norfolk, Virginia	Yard	5.0	Acres	Leased
Kingwood, Texas	Office	750	Square feet	Leased
Burlington, Iowa *	Office	10,000	Square feet	Leased
Burlington, Iowa *	Storage	4,000	Square feet	Leased
Des Moines County, Iowa	Yard	27.4	Acres	Leased
Little Rock, Arkansas	Yard	7.0	Acres	Leased

* These facilities are leased from L.W. Matteson, Inc., which is owned by members of the Matteson family, pursuant to a lease that expires in 2012 and is renewable on a year-to-year basis thereafter. See Note 13 to the Company s consolidated financial statements.

Demolition

The demolition segment leases 13,000 square feet of office, garage and maintenance facilities in Waltham, Massachusetts, from a minority interest owner in Yankee and prior to 2011, a profits interest owner in NASDI, pursuant to a lease that expires in 2016. See Note 13 to the Company s consolidated financial statements.

Item 3. Legal Proceedings

As is customary with negotiated contracts and modifications or claims to competitively bid contracts with the federal government, the government has the right to audit the books and records of the Company to ensure compliance with such contracts, modifications, or claims, and the applicable federal laws. The government has the ability to seek a price adjustment based on the results of such audit. Any such audits have not had, and are not expected to have, a material impact on the financial position, operations, or cash flows of the Company.

Various legal actions, claims, assessments and other contingencies arising in the ordinary course of business are pending against the Company and certain of its subsidiaries. These matters are subject to many uncertainties, and it is possible that some of these matters could ultimately be decided, resolved, or settled adversely. Although the Company is subject to various claims and legal actions that arise in the ordinary course of business, except as described below, the Company is not currently a party to any material legal proceedings or environmental claims. The Company accrues reserves when it is probable a liability has been incurred and the amount of loss can be reasonably estimated. The Company does not believe any of these proceedings, individually or in the aggregate, would be expected to have a material effect on results of operations, cash flows or financial condition.

The Company or its former subsidiary, NATCO Limited Partnership, was named as a defendant in approximately 251 asbestos-related personal injury lawsuits, the majority of which were filed between 1989 and 2000. The claims were filed on behalf of seamen or their personal representatives alleging injury or illness from exposure to asbestos while employed as seamen on Company-owned vessels. In these cases, the Company is typically one of many defendants, including manufacturers and suppliers of products containing asbestos, as well as other vessel owners. Following certain administrative proceedings, counsel for plaintiffs agreed to name a group of cases that they intended to pursue and to dismiss the remaining cases without prejudice. Plaintiffs have

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currently named 39 cases against the Company that they intend to pursue, each of which involves one plaintiff. The remaining cases against the Company were dismissed. Plaintiffs in the dismissed cases could file a new lawsuit if they develop a new disease allegedly caused by exposure to asbestos on board our vessels. The Company does not believe that it is probable that losses from these claims could be material, and an estimate of a range of losses relating to these claims cannot reasonably be made. Based on the foregoing, management does not believe that any of the 39 lawsuits, individually or in the aggregate, will have a material impact on our business, financial position, results of operations or cash flows.

On August 26, 2009, the Company s subsidiary NASDI received a letter stating that the Attorney General for the Commonwealth of Massachusetts is investigating alleged violations of the Massachusetts Solid Waste Act. The Company believes that the Massachusetts Attorney General is investigating illegal dumping activities at a dump site NASDI contracted with to have waste materials disposed of between September 2007 and July 2008. Per the Massachusetts Attorney General s request, NASDI executed a tolling agreement regarding the matter in 2009 and engaged in further discussions with the Massachusetts Attorney General s office in the second quarter of 2011 but has had no further contact with the Massachusetts Attorney General s office since then. The matter remains open, and, to the Company s knowledge, no proceedings have currently been initiated against NASDI. Should a claim be brought, NASDI intends to defend itself vigorously. Based on consideration of all of the facts and circumstances now known, the Company does not believe this claim will have a material impact on its business, financial position, results of operations or cash flows.

On March 27, 2011, NASDI received a subpoena from a federal grand jury in the District of Massachusetts directing NASDI to furnish certain documents relating to certain projects performed by NASDI since January 2005. The Company conducted an internal investigation into this matter and continues to fully cooperate with the federal grand jury subpoena. Based on the early stage of the U.S. Department of Justice s investigation and the limited information known to the Company, the Company cannot predict the outcome of the investigation, the U.S. Attorney s views of the issues being investigated, any action the U.S. Attorney may take, or the impact, if any, that this matter may have on the Company s business, financial position, results of operations or cash flows.

On April 6, 2011, NASDI received a subpoena from the District Attorney for Richmond County, New York in connection with a grand jury investigation. The subpoena directs NASDI to furnish certain documents relating to one project performed by NASDI and one of its subcontractors. The subpoena appears to be related to the activities of NASDI s subcontractor for this project. The Company fully complied with the production of requested documents and has engaged in routine communications with the District Attorney s office. Based on the Company s internal investigation to date, the Company does not believe that it will have any liability with respect to this matter. In addition, the Company intends to continue to fully cooperate with the New York grand jury subpoena.

The Company has not accrued any amounts with respect to these NASDI matters as the Company does not believe, based on information currently known to it, that a loss relating to these matters is probable, and an estimate of a range of potential losses relating to these matters cannot reasonably be made.

Item 4. Mine Safety Disclosures

Not applicable

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Part II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities
Market Information

Our common stock is traded under the symbol GLDD on the NASDAQ Global Market. The table below sets forth, for the calendar quarters indicated, the high and low sales prices of the common stock as reported by NASDAQ from January 1, 2010 through December 31, 2011.

	Common Stock	
	High	Low
First Quarter 2010	$ 7.18	$ 4.04
Second Quarter 2010	$ 7.05	$ 4.94
Third Quarter 2010	$ 6.46	$ 4.51
Fourth Quarter 2010	$ 8.08	$ 5.71

	Common Stock	
	High	Low
First Quarter 2011	$ 8.93	$ 7.05
Second Quarter 2011	$ 7.90	$ 5.15
Third Quarter 2011	$ 6.36	$ 3.97
Fourth Quarter 2011	$ 6.23	$ 4.02

	12/31/2007	12/31/2008	12/31/2009	12/31/2010	12/31/2011
Great Lakes Dredge & Dock Corp	135.46	65.24	103.29	118.96	90.99
Peer Average (see below)	126.72	73.28	86.10	87.77	86.46
NASDAQ Composite Index	109.09	64.87	93.33	109.12	107.15
Russell 2000 Index	96.03	62.61	78.40	98.24	92.88

The graph shows the cumulative total return to stockholders of the Company s common stock during a five year period ending December 30, 2011, the last trading day of our 2011 fiscal year, compared with the return on the NASDAQ Composite Index, a group of our peers which we use internally as a benchmark for our performance and the Russell 2000 Index. The graph assumes initial investments of $100 each on December 29, 2006, in GLDD stock (assuming reinvestment of all dividends paid during the period), the NASDAQ Composite Index, the Russell 2000 Index and the peer group companies, collectively. The Russell 2000 Index, which includes Great Lakes, is derived from companies with market capitalization similar to that of the Company. The peer group, which has not been presented in this graph in prior years, is comprised of the following member companies against which we measure our performance for compensation purposes.

Company	Ticker	Company	Ticker	Company	Ticker
Dycom Industries, Inc.	DY	MasTec, Inc.	MTZ	Primoris Services Corp	PRIM
Global Industries, Ltd. (prior to its purchase on September 9,2011 by Technip S.A.)	GLBL	Matrix Service Company	MTRX	Sterling Construction Company, Inc.	STRL
Granite Construction Inc.	GVA	MYR Group Inc.	MYRG	Team, Inc.	TISI
Aegion Corporation, successor to Insituform Technologies, Inc.	AEGN	Orion Marine Group, Inc.	ORN	Willbros Group, Inc.	WG
Layne Christensen Company	LAYN	Pike Electric Corporation	PIKE		

Given the integral nature of this peer group for compensation purposes and the fact that each peer is a capital intensive business, the Company deems it appropriate to also use this peer group for showing the comparative cumulative total return to stockholders of Great Lakes.

Holders of Record

As of March 5, 2012, the Company had approximately 36 shareholders of record of the Company s common stock. A substantial number of holders of the Company s common stock are street name or beneficial holders, whose shares are held of record by banks, brokers and other financial institutions.

Dividends

Quarterly dividends per common share for the most recent two years are as follows:

	Dividend	
	2011	2010
First Quarter	$ 0.017	$ 0.017
Second Quarter	$ 0.021	$ 0.017
Third Quarter	$ 0.021	$ 0.017
Fourth Quarter	$ 0.021	$ 0.017

The declaration and payment of future dividends will be at the discretion of Great Lakes board of directors and depends on many factors, including general economic and business conditions, the Company s strategic plans, financial results and condition, legal requirements including restrictions and limitations contained in the Company s senior credit agreement, bonding agreements and the indenture relating to the senior unsecured notes and other factors the board of directors deems relevant. Accordingly, the Company cannot ensure the size of any such dividend or that the Company will pay any future dividend.

The Company is a holding company and has no direct operations. The Company s ability to pay cash dividends depends, in part, on the ability of the Company s subsidiaries to pay cash dividends. The Company expects to cause the Company s subsidiaries to pay distributions to it to fund the Company s expected dividend payments, subject to applicable law and any restrictions contained in the Company s debt agreements.

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Item 6. Selected Financial Data

The following table sets forth selected financial data and should be read in conjunction with Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and the Company s audited consolidated financial statements and notes thereto included elsewhere in this annual report. The selected financial data presented below have been derived from the Company s consolidated financial statements; items may not sum due to rounding.

	$000,000,000	$000,000,000	$000,000,000	$000,000,000	$000,000,000
	Year Ended December 31,				
	2011	2010	2009	2008	2007
	(in millions except share and per share data)				
Income Statement Data:					
Contract revenues	$ 627.3	$ 686.9	$ 622.2	$ 586.9	$ 515.8
Costs of contract revenues	534.3	564.1	534.0	517.6	447.8
Gross profit	93.0	122.8	88.2	69.3	67.9
General and administrative expenses	50.4	54.4	46.0	43.2	39.0
Gain on sale of assets net	(11.7)				
Operating income	54.3	68.4	42.3	26.1	29.0
Interest expense net	(21.7)	(13.5)	(16.2)	(17.0)	(17.5)
Equity in earnings (loss) of joint ventures	(0.4)	(0.6)	(0.4)	(0.0)	2.0
Loss on foreign currency transactions net	(0.3)				
Loss on extinguishment of debt	(5.1)				
Income before income taxes	26.8	54.3	25.7	9.1	13.5
Income tax expense	(9.5)	(20.6)	(11.0)	(3.8)	(6.4)
Net income	17.3	33.7	14.7	5.3	7.1
Net (income) loss attributable to noncontrolling interests	(0.7)	0.9	2.7	(0.3)	(0.1)
Net income attributable to Great Lakes Dredge & Dock Corporation	$ 16.5	$ 34.6	$ 17.5	$ 5.0	$ 7.0
Basic earnings per share (1)	$ 0.28	$ 0.59	$ 0.30	$ 0.09	$ 0.14
Basic weighted average shares	58,890,780	58,646,511	58,506,608	58,469,431	48,911,491
Diluted earnings per share (1)	$ 0.28	$ 0.59	$ 0.30	$ 0.09	$ 0.14
Diluted weighted average shares	59,229,819	58,870,937	58,612,282	58,477,779	52,211,010

	$000,000,000	$000,000,000	$000,000,000	$000,000,000	$000,000,000
	Year Ended December 31,				
	2011	2010	2009	2008	2007
	(in millions)				
Other Data:					
Adjusted EBITDA (2)	$ 93.7	$ 103.0	$ 77.6	$ 55.9	$ 57.5
Net cash flows from operating activities	24.6	123.5	54.0	14.8	(6.3)
Net cash flows from investing activities	(16.7)	(62.7)	(24.9)	(26.3)	(77.8)
Net cash flows from financing activities	57.4	(15.6)	(36.4)	13.7	88.6
Depreciation and amortization	40.8	34.3	32.9	30.1	26.5
Maintenance expense	41.8	48.2	46.4	41.9	43.8
Capital expenditures (3)	30.7	29.9	27.3	44.6	111.0

(1) Refer to Note 1 in the Company s consolidated financial statements for the years ended December 31, 2011, 2010 and 2009 and above information for additional details regarding these calculations.
(2) See definition of Adjusted EBITDA in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.
(3) Capital expenditures in 2007 included the purchase of three vessels for $40.4 million. It also included the purchase of another vessel for $25.5 million, funded through a sale-leaseback transaction, as well as the buy-out of certain equipment previously under operating leases for $14.6 million.

	As of December 31,				
	2011	2010	2009	2008	2007
	(in millions)				
Balance Sheet Data:					
Cash and cash equivalents	$ 113.3	$ 48.5	$ 3.3	$ 10.5	$ 8.2
Working capital	195.3	90.2	91.3	87.7	82.3
Total assets	788.5	693.8	665.4	666.2	624.4
Long term senior debt, promissory notes and subordinated notes	255.0	182.5	186.0	216.5	196.5
Total stockholder s equity	292.0	279.0	245.8	228.1	230.4

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

Overview

The Company is the largest provider of dredging services in the United States. In addition, the Company is the only U.S. dredging service provider with significant international operations, which represented 15% of its dredging revenues for 2011.

Dredging generally involves the enhancement or preservation of the navigability of waterways or the protection of shorelines through the removal or replenishment of soil, sand or rock. The U.S. dredging market consists of three primary types of work: capital, beach nourishment and maintenance. Capital projects include large port deepenings and other infrastructure projects such as land reclamations. Beach nourishment projects include rebuilding of shoreline areas that have been damaged by storm activity or ongoing erosion. Maintenance projects include routine dredging of ports, rivers and channels to remove the regular build up of sediment.

With the acquisition of L.W. Matteson, Inc. (Matteson) assets on December 31, 2010, the Company began to provide the following rivers & lakes services in 2011: lake and river dredging, inland levee and construction dredging, environmental restoration and habitat improvement and other marine construction.

The Company s bid market is defined as the aggregate dollar value of domestic projects on which the Company bid or could have bid if not for capacity constraints (bid market). The Company experienced an average combined bid market share in the U.S. of 39% over the prior three years, including 44%, 52% and 32% of the domestic capital, beach nourishment and maintenance sectors, respectively. The foregoing bid market data does not reflect rivers & lakes activities which are separately categorized. The Company s bid market share of rivers & lakes in the year of activity since acquisition is 36%.

The Company s fleet of 33 dredges, of which eight are deployed internationally, 19 material transportation barges, two drillboats, and numerous other specialized support vessels is the largest and most diverse fleet of any U.S. dredging company. The mobility of the Company s fleet enables us to move equipment in response to changes in demand for dredging services to take advantage of the most attractive opportunities to employ our dredges. The Company estimates the replacement cost of the Company s fleet to be in excess of $1.5 billion in the current market.

The Company s largest domestic dredging customer is the U.S. Army Corps of Engineers (the Corps), which has responsibility for federally funded projects related to navigation and flood control of U.S. waterways. The advance of multi-jurisdictional cost sharing arrangements are allowing the Corps to utilize funds from

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sources other than the federal budget to prioritize additional projects where waterway infrastructure improvements can have an impact to large regions. Although some of a project s funding may ultimately be derived from multiple sources, the Corps maintains the authority over the project and is the Company s customer. In 2011, the Company s dredging revenues earned from contracts with federal government agencies, including the Corps as well as other federal entities such as the U.S. Coast Guard and the U.S. Navy, were approximately 56% of dredging revenues, down slightly from the Company s three year average of 60%.

The Company s demolition subsidiaries are headquartered in the Boston, Massachusetts area. In 2011, demolition revenues accounted for 17% of total revenues, above the prior three year average of 12%. The demolition segment s principal services consist of interior and exterior demolition of commercial and industrial buildings, salvage and recycling of related materials and removal of hazardous substances and materials. The majority of the work has historically been performed in New England; however, the primary demolition subsidiary, NASDI, LLC (NASDI) continues to expand its footprint into the New York area and the marine demolition market, and specifically into bridge demolition projects. Effective as of January 1, 2011, NASDI became a wholly owned subsidiary of the Company. See Note 1 to the Company s consolidated financial statements.

The Company also owns 50% of Amboy Aggregates (Amboy) and 50% of TerraSea Environmental Solutions (TerraSea) as joint ventures. Amboy s primary business is dredging sand from the entrance channel to the New York harbor in order to provide sand and aggregate for use in road and building construction and for clean land fill. Amboy also imports stone from upstate New York and Nova Scotia and distributes it throughout the New York area. TerraSea is engaged in the environmental services business through its ability to remediate contaminated soil and dredged sediment treatment.

The Company operates in two reportable segments: dredging and demolition.

Contract Revenues

Most of the Company s dredging contracts are obtained through competitive bidding on terms specified by the party inviting the bid. The types of equipment required to perform the specified service and the estimated project duration affect the cost of performing the contract and the price that dredging contractors will bid.

The Company recognizes contract revenues under the percentage-of-completion method, based on the Company s engineering estimates of the physical percentage completed for dredging projects and using a cost-to-cost approach for demolition projects. For dredging projects, costs of contract revenues are adjusted to reflect the gross profit percentage expected to be achieved upon ultimate completion of each dredging project. For demolition projects, contract revenues are adjusted to reflect the estimated gross profit percentage. Provisions for estimated losses on contracts in progress are made in the period in which such losses are determined. Claims for additional compensation due to the Company are not recognized in contract revenues until such claims are settled. Billings on contracts are generally submitted after verification with the customers of physical progress and may not match the timing of revenue recognition. The difference between amounts billed and recognized as revenue is reflected in the balance sheet as either contract revenues in excess of billings or billings in excess of contract revenues. Contract modifications may be negotiated when a change from the original contract specifications is encountered, necessitating a change in project scope or performance methodology and/or material disposal. Significant expenditures incurred incidental to major contracts are deferred and recognized as costs of contracts based on contract performance over the duration of the related project. These expenditures are reported as prepaid expenses.

Costs and Expenses

The components of costs of contract revenues include labor, equipment (including depreciation, maintenance, insurance and long-term rentals), fuel, subcontracts, rentals and project overhead. Hourly labor is generally hired on a project-by-project basis. Much of our domestic hourly labor force is represented by labor unions with collective bargaining agreements that expire at various dates during 2012 through 2014, which historically have been extended without disruption.

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Costs of contract revenues vary significantly depending on the type and location of work performed and assets utilized. Generally, capital projects have the highest margins due to the complexity of the projects, while beach nourishment projects have the most volatile margins because they are most often exposed to variability in weather conditions.

The Company s cost structure includes significant annual equipment related costs, including depreciation, maintenance, insurance and long-term equipment rentals, averaging approximately 21% to 22% of total costs of contract revenues over the last three years. During the year, both equipment utilization and the timing of cost expenditures fluctuate significantly. Accordingly, the Company allocates these equipment costs to interim periods in proportion to revenues recognized over the year to better match revenues and expenses. Specifically, at each interim reporting date the Company compares actual revenues earned to date on the Company s dredging contracts to expected annual revenues and recognizes equipment costs on the same proportionate basis. In the fourth quarter, any over or under allocated equipment costs are recognized such that the expense for the year equals actual equipment costs incurred during the year. As a result of this methodology, the recorded expense in any interim period may be higher or lower than the actual equipment costs incurred in that interim period.

Primary Factors that Determine Operating Profitability

Dredging. The Company s results of operations for its dredging segment for a calendar or quarterly period are generally determined by the following three factors:

Bid wins and dredge employment The Company s dredging segment generates revenues when the Company wins a bid for a dredging contract and starts that project. Although the Company s dredging equipment is subject to downtime for scheduled periodic maintenance and repair, the Company seeks to maximize its revenues by employing its dredging equipment on a full-time basis. If a dredge is idle (i.e., the dredge is not employed on a dredging project or undergoing scheduled periodic maintenance and repair), the Company does not earn revenue with respect to that dredge during the time period for which it is idle.

Project and dredge mix The Company s domestic dredging projects generally involve domestic capital, maintenance and beach nourishment work and its foreign dredging projects generally involve capital work. In addition, the Company s dredging projects vary in duration and, in general, projects of longer duration result in less dredge downtime in a given period. Moreover, the Company s dredges have different physical capabilities and typically work on certain types of dredging projects. Accordingly, the Company s dredges have different daily revenue generating capacities.

The Company generally expects to achieve different levels of gross margin (i.e., gross profit divided by revenues) for work performed on the different types of dredging projects and for work performed by different types of dredges. The Company s expected gross margin for a project is based upon the Company s estimates at the time of the bid. Although the Company seeks to bid on and win projects that will maximize its gross margin, the Company cannot control the type of dredging projects that are available for bid from time to time, the type of dredge that is needed to complete these projects or the time schedule upon which these projects are required to be completed. As a result, in some quarters the Company works on a mix of dredging projects that, in the aggregate, have relatively high expected gross margins (based on project type and dredges employed) and in other quarters, the Company works on a mix of dredging projects that, in the aggregate, have relatively low expected gross margins (based on project type and dredges employed).

Project execution The Company seeks to execute all of its dredging projects consistent with its project estimates. In general, the Company s ability to achieve its project estimates depends upon many factors including weather, variances from estimated project conditions, equipment mobilization time periods, unplanned equipment downtime or other events or circumstances beyond the Company s control. If the Company experiences any of these events and circumstances, the completion of a dredging project will often be accelerated or delayed, as applicable, and, consequently, the Company will experience project results that are better or worse than its estimates. The Company does its best to estimate for events and circumstances that are not within its control; however, these situations are inherent in dredging.

Demolition. The Company s demolition segment generates revenues when the Company is awarded a contract for demolition services and starts the project. The Company s revenues from its demolition segment increase or decrease based upon market demand. Like the Company s dredging segment, results of operations for the Company s demolition segment fluctuate based upon project mix and the Company s ability to execute its projects consistent with its estimates.

Critical Accounting Policies and Estimates

Our significant accounting policies are discussed in the Notes to the consolidated financial statements. The application of certain of these policies requires significant judgments or an estimation process that can affect the Company s results of operations, financial position and cash flows, as well as the related footnote disclosures. The Company bases its estimates on historical experience and other assumptions that it believes are reasonable. If actual amounts are ultimately different from previous estimates, the revisions are included in the Company s results of operations for the period in which the actual amounts become known. The following accounting policies comprise those that management believes are the most critical to aid in fully understanding and evaluating the Company s reported financial results.

Percentage-of-completion method of revenue recognition The Company s contract revenues are recognized under the percentage-of-completion method, which is by its nature based on an estimation process. For dredging projects, the Company uses engineering estimates of the physical percentage of completion. For demolition projects, the Company uses estimates of remaining costs-to-complete to determine the percentage of project completion. In preparing estimates, the Company draws on its extensive experience in the dredging and demolition businesses and its database of historical dredging information to ensure that its estimates are as accurate as possible, given current circumstances. Provisions for estimated losses on contracts in progress are made in the period in which such losses are determined. Claims for additional compensation are not recognized in contract revenues until such claims are settled. Cost and profit estimates are reviewed on a periodic basis to reflect changes in expected project performance.

Impairment of goodwill Goodwill is tested for impairment at the reporting unit level on an annual basis and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying value. The Company believes that this estimate is a critical accounting estimate because: (i) goodwill is a material asset and (ii) the impact of an impairment could be material to the consolidated balance sheet and consolidated statement of operations. The Company performs its annual impairment test as of July 1 each year. The Company operates in two reportable segments: dredging and demolition. These reportable segments are the Company s operating segments and the reporting units at which the Company tests goodwill for impairment.

The Company assesses the fair values of its reporting units using both a market-based approach and an income-based approach. Under the income approach, the fair value of the reporting unit is based on the present value of estimated future cash flows. The income approach is dependent on a number of factors, including estimates of future market growth trends, forecasted revenues and expenses based upon historical operating data, appropriate discount rates and other variables. The estimates are based on assumptions that the Company believes to be reasonable, but such assumptions are subject to unpredictability and uncertainty. Changes in these estimates and assumptions could materially affect the determination of fair value, and may result in the impairment of goodwill in the event that actual results differ from those estimates.

The market approach measures the value of a reporting unit through comparison to comparable companies. Under the market approach, the Company uses the guideline public company method by applying estimated market-based enterprise value multiples to the reporting unit s estimated revenue and Adjusted EBITDA. The Company analyzed companies that performed similar services or are considered peers. Due to the fact that there are no public companies that are direct competitors, the Company weighed the results of this approach less than the income approach.

At both December 31, 2011 and 2010, the dredging segment s goodwill was $76.6 million and demolition segment s goodwill was $21.5 million.

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The Company performed its most recent annual test of impairment as of July 1, 2011 for the goodwill in both the dredging and demolition segments with no indication of goodwill impairment as of the test date. As of the test date, the fair value of both the dredging segment and the demolition segment were in excess of their carrying values by approximately 35% and 8%, respectively. Given the small margin with which the demolition segment s fair value is in excess of its carrying value, a more than insignificant decline in the demolition segment s future operating results or cash flow forecasts versus the segment s current forecasts could potentially cause a goodwill impairment charge to be recognized in a future period. The Company will perform its next scheduled annual test of goodwill in the third quarter of 2012 should no triggering events occur which would require a test prior to the next annual test. No goodwill impairment test was performed in the fourth quarter of 2011 for either segment because no triggering event occurred which would require such a test.

Results of Operations Fiscal Years Ended December 31, 2011, 2010 and 2009

The following table sets forth the components of net income attributable to Great Lakes Dredge & Dock Corporation and Adjusted EBITDA (defined below) as a percentage of contract revenues for the years ended December 31:

	2011	2010	2009
Contract revenues	100.0%	100.0%	100.0%
Costs of contract revenues	(85.2)	(82.1)	(85.8)
Gross profit	14.8	17.9	14.2
General and administrative expenses	(8.0)	(7.9)	(7.4)
Gain on sale of assets net	1.9		
Operating income	8.7	10.0	6.8
Interest expense net	(3.5)	(2.0)	(2.6)
Equity in earnings of joint ventures	(0.1)	(0.1)	(0.1)
Loss on foreign currency transactions net	0.0		
Loss on extinguishment of debt	(0.8)		
Income before income taxes	4.3	7.9	4.1
Income tax expense	(1.5)	(3.0)	(1.8)
Net income	2.8	4.9	2.3
Net (income) loss attributable to noncontrolling interests	(0.1)	0.1	0.4
Net income attributable to Great Lakes Dredge & Dock Corporation	2.7%	5.0%	2.7%
Adjusted EBITDA	15.0%	15.0%	12.5%

Adjusted EBITDA

Adjusted EBITDA, as provided herein, represents net income attributable to Great Lakes Dredge & Dock Corporation, adjusted for net interest expense, income taxes, depreciation and amortization expense and debt extinguishment. Adjusted EBITDA is not a measure derived in accordance with accounting principles generally accepted in the United States of America (GAAP). The Company presents Adjusted EBITDA as an additional measure by which to evaluate the Company s operating trends. The Company believes that Adjusted EBITDA is a measure frequently used to evaluate performance of companies with substantial leverage and that the Company s primary stakeholders (i.e., its stockholders, bondholders and banks) use Adjusted EBITDA to evaluate the Company s period to period performance. Additionally, management believes that Adjusted EBITDA provides a transparent measure of the Company s recurring operating performance and allows management to readily view operating trends, perform analytical comparisons and identify strategies to improve operating performance. For this reason, the Company uses a measure based upon Adjusted EBITDA to assess performance for purposes of determining compensation under the Company s incentive plan. Adjusted EBITDA

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should not be considered an alternative to, or more meaningful than, amounts determined in accordance with GAAP including: (a) operating income as an indicator of operating performance; or (b) cash flows from operations as a measure of liquidity. As such, the Company s use of Adjusted EBITDA, instead of a GAAP measure, has limitations as an analytical tool, including the inability to determine profitability or liquidity due to the exclusion of interest and income tax expense and the associated significant cash requirements and the exclusion of depreciation and amortization, which represent significant and unavoidable operating costs given the level of indebtedness and capital expenditures needed to maintain the Company s business. For these reasons, the Company uses operating income to measure the Company s operating performance and uses Adjusted EBITDA only as a supplement. The following is a reconciliation of Adjusted EBITDA to net income attributable to Great Lakes Dredge & Dock Corporation:

	Year Ended December 31,		
	2011	2010	2009
		(in thousands)	
Net income attributable to Great Lakes Dredge & Dock Corporation	$ 16,528	$ 34,609	$ 17,468
Adjusted for:			
Loss on extinguishment of debt	5,145		
Interest expense, net	21,665	13,542	16,150
Income tax expense	9,545	20,554	10,983
Depreciation and amortization	40,838	34,301	33,023
Adjusted EBITDA	$ 93,721	$ 103,006	$ 77,624

Components of Contract Revenues

The following table sets forth, by segment and type of work, the Company s contract revenues for the years ended December 31 (in thousands):

	2011	2010	2009
Revenues			
Dredging:			
Capital U.S.	$ 156,251	$ 300,873	$ 203,147
Capital foreign	77,232	82,898	134,123
Beach nourishment	135,164	106,163	62,133
Maintenance	116,016	119,035	174,908
Rivers & lakes*	35,471		
Total dredging revenues	520,134	608,969	574,311
Demolition	107,199	77,953	47,933
Total revenues	$ 627,333	$ 686,922	$ 622,244

* Rivers & lakes was established by the Company on December 31, 2010 in connection with the Matteson acquisition, and did not operate as part of the Company prior to January 1, 2011.

Year Ended December 31, 2011 Compared to Year Ended December 31, 2010

Total revenue was $627.3 million in 2011, a decrease of $59.6 million, or 8.7%, from 2010 total revenue of $686.9 million. The majority of the decrease was due to lower domestic revenues in the capital dredging market. This was partially offset by increased revenues in the beach nourishment market and the demolition segment as well as the addition of rivers & lakes dredging from the Matteson acquisition. Highlights from the Company s primary dredging sectors are as follows:

Revenues from domestic capital dredging projects of $156.3 million in 2011 decreased $144.6 million, or 48.1%, from 2010 revenues of $300.9 million. The decrease in revenue is primarily due to $108.3 million of revenue in 2010 that did not repeat in 2011 from work on sand berm construction off the coast of

Louisiana in response to the Deepwater Horizon oil spill in the Gulf of Mexico. In addition, 2010 revenue benefited from $56 million for deepening projects in the ports of New Jersey that were not repeated in 2011.

Revenues from beach nourishment projects of $135.2 million in 2011 increased $29.0 million, or 27.3%, from $106.2 million in 2010. The Company won $198 million of beach projects in 2011, which is $143 million higher than the amount of beach projects won in 2010. The significant increase in beach nourishment awards created a larger supply of projects in backlog, of which the Company was able to convert a portion into revenue for projects worked in 2011. Additionally, revenue was positively impacted as the Company was able to work on projects which were not subjected to environmental windows, which are limitations as to the timing of when dredging activity can occur, unlike the prior year when such projects were not available.

Revenues from maintenance dredging projects in 2011 were $116.0 million, a decrease of $3.0 million, or 2.5%, from $119.0 million in 2010. Maintenance revenue in 2011 decreased slightly as $4.7 million of projects traditionally included in maintenance revenue was shifted to the rivers & lakes revenue category.

Revenues from rivers & lakes projects were $35.5 million for 2011. The Company purchased its rivers & lakes operations on December 31, 2010 and therefore had no revenues from rivers & lakes projects in 2010.

Revenues from foreign dredging operations in 2011 totaled $77.2 million, a decrease of $5.7 million, or 6.8%, from 2010 revenues of $82.9 million. In 2011, revenues were from projects comprised of smaller values and scopes than those in the prior year. Foreign revenues in 2011 also benefited from the resolution of outstanding project claims of approximately $3.8 million in the 2011 first quarter, offset by fewer projects in the Middle East.

The demolition segment recorded revenues in 2011 of $107.2 million, an increase of $29.2 million, or 37.5%, over 2010 revenues of $78.0 million. This increase was primarily related to improved market conditions in Massachusetts based on the continued economic recovery in this market and the I-10 bridge demolition project in Louisiana.

Dredging segment gross profit in 2011 decreased 30.0% to $82.7 million from $117.7 million in 2010, and dredging segment gross profit margin (dredging gross profit divided by dredging revenue) was 15.8% in 2011, down from 19.3% in 2010. Gross profit margin benefited in the prior year from a favorable project mix and better vessel employment on a number of domestic capital dredging projects allowing better fixed cost coverage. In addition the prior year experienced favorable project execution and weather conditions on beach nourishment projects.

Demolition segment gross profit increased $5.3 million to $10.3 million from $5.0 million in 2010 and demolition segment gross profit margin was 9.6%, up from 6.5% in 2010, primarily due to the increase in profit margin on new projects, led by the I-10 bridge demolition project in Louisiana as well as improved market conditions from the continued economic recovery in the demolition segment s primary market.

Dredging segment operating income for 2011 decreased 24.3% to $53.8 million, from $70.5 million in 2010 due to the lower revenues and gross profit described above, offset by $11.7 million of gains from sales of underutilized assets. In 2010, the dredging segment operating income included $6.4 million of severance, legal and consulting charges that were recorded in conjunction with the senior management reorganization.

Demolition segment operating income improved to $0.5 million for 2011 from an operating loss in 2010 of $2.1 million due to the higher revenues and gross profit described above, which were offset by the recognition of $1.8 million of additional legal and consulting expenses in 2011 relating to the subpoenas received in April 2011.

The Company s net interest expense for 2011 totaled $21.7 million compared with $13.5 million in 2010. This increase is primarily due to the Company s issuance of $250 million of 7.375% senior notes and the related redemption of the Company s $175 million of 7.75% senior subordinated notes in the 2011 first quarter. Due to

timing requirements, both of these note issuances were outstanding and accruing interest for approximately 30 days in 2011, resulting in duplicative interest expense of approximately $1.1 million. Although the senior notes accrue interest at a lower interest rate than the previously outstanding senior subordinated notes, the increase in principal outstanding resulted in an additional $4.5 million of interest expense in 2011 as compared to 2010. In addition, in 2011 the Company realized a $0.4 million gain on interest rate swaps, while favorable interest rates in 2010 led to a $2.1 million gain.

The Company incurred income tax expense of $9.5 million in 2011 compared with $20.6 million in 2010. This $11.1 million decrease is primarily the result of the decrease in the Company s operating income. The effective tax rate for the year ended December 31, 2011 was 35.4% compared to 37.9% for the year ended December 31, 2010.

For the year ended December 31, 2011, net income attributable to Great Lakes Dredge & Dock Corporation was $16.5 million compared to $34.6 million for the year ended December 31, 2010. This $18.1 million decrease was primarily driven by the lower operating income, net of taxes in 2011 described above.

Adjusted EBITDA (as defined above) was $93.7 million and $103.0 million for the year ended December 31, 2011 and 2010, respectively. The decrease of $9.3 million, or 9.0%, is related to the decrease in dredging segment operating income net of the increase in demolition segment operating income described above. In 2011, the Company recorded $40.8 million of depreciation and amortization expense that is included as a component of operating income, but is excluded for the purposes of calculating Adjusted EBITDA. The increase in depreciation from 2011 is partially related to the Company s decision to accelerate certain capital expenditures into 2011 to take advantage of the federal tax benefit allowing for full tax depreciation in the year of service for new assets. In addition, the purchase of Matteson assets in December 2010 added $1.7 million of depreciation in 2011 that had no associated impact in the prior year. The depreciation and amortization expense recorded in 2010 was $34.3 million.

Year Ended December 31, 2010 Compared to Year Ended December 31, 2009

Dredging revenues were $609 million in 2010, an increase of $34.7 million, or 6%, over 2009 dredging revenues of $574.3 million. This increase was primarily due to higher revenues in the domestic capital and beach markets more than offsetting lower revenues in the foreign and maintenance markets. Highlights from the Company s primary dredging sectors are as follows:

Revenues from domestic capital dredging projects of $300.9 million in 2010 increased $97.7 million, or 48.1%, from 2009 revenues of $203.1 million. During the second half of 2010, several of the Company s dredges and ancillary equipment worked on sand berm construction off the coast of Louisiana in response to the Deepwater Horizon oil spill in the Gulf of Mexico. In addition, domestic capital dredging revenues included continued deepening work in the ports of New York, New Jersey, and Jacksonville.

Revenues from beach nourishment projects of $106.2 million in 2010 increased $44.1 million, or 71.0%, from $62.1 million in 2009. The amount of beach work won by the Company in the second half of 2009 significantly exceeded the amount of beach work won by the Company in the second half of 2008. As the Company performs much of its beach work during the first half of each year, when environmental windows are open, the increased backlog at the end of 2009 resulted in increased 2010 beach revenues.

Revenues from maintenance dredging projects in 2010 were $119.0 million, a decrease of $55.9 million, or 31.9%, from $174.9 million in 2009. Maintenance revenue in 2009 was uncharacteristically high because the Corps put many delayed projects out to bid. The Company believes that funding of many maintenance projects bid in 2009 was augmented by the federal economic stimulus. The Company believes that substantially all of the stimulus funded projects were completed by June 30, 2010. In addition, the number of maintenance projects worked on during the second half of 2010 declined due to the dredging industry s response to the Deepwater Horizon oil spill in the Gulf of Mexico.

Revenues from foreign dredging operations in 2010 totaled $82.9 million, a decrease of $51.2 million, or 38.2%, from 2009 revenues of $134.1 million. Foreign revenues started to decline in the second half of 2009 as the global recession significantly slowed the rate of infrastructure development in the Middle East. In 2010, the Company worked on international projects outside of Bahrain, including in the United Arab Emirates and Brazil.

Demolition segment revenues in 2010 were $78.0 million, an increase of $30.1 million, or 62.6%, over 2009 revenues of $47.9 million. This increase was primarily related to improved market conditions in Massachusetts and increased activity in New York as well as new bridge demolition markets for the demolition segment. In 2009, demolition revenues were negatively impacted by the slowdown in the U.S. construction industry.

Dredging segment gross profit increased 32.4% to $117.7 million in 2010 from $88.9 million in 2009, and dredging segment gross profit margin (dredging gross profit divided by dredging revenue) was 19.3% in 2010, up from 15.6% in 2009. The increases in gross profit and gross profit margin were primarily due to increased dredging revenues and dredging project execution that in the aggregate was better than the Company s estimates.

Demolition segment gross profit increased $5.7 million from a gross loss of $0.7 million in 2009 to a gross profit of $5.0 million in 2010 and demolition segment gross profit margin was 6.5% in 2010, up from a negative gross profit margin of 1.8% in 2009, primarily due to improved market conditions which resulted in increased revenues. While demolition segment gross profit margins improved in 2010 compared to 2009, they remained lower than pre-recession gross profit margins, reflecting continued competitive pricing pressures.

Dredging segment operating income for 2010 increased 41.4% to $70.5 million versus $49.8 million in 2009, as increased gross profit offset a 20.9% increase in general and administrative expenses. These expenses increased primarily due to $7.2 million in costs that were incurred for severance, legal and consulting expenses that were incurred in conjunction with the senior management reorganization. See Note 14 to the Company s consolidated financial statements.

Demolition segment operating loss for 2010 decreased $5.5 million from $7.6 million in 2009 to $2.1 million in 2010. Despite improved gross profit, the demolition segment incurred losses with respect to certain projects including a large bridge demolition project, one of the demolition segment s first projects of this type. In 2010, the demolition segment recorded a loss of $3.0 million related to this bridge demolition project. In addition, demolition segment operating results in 2009 were negatively impacted by certain projects that had been worked on in 2008 and canceled in 2009, resulting in write-offs of $3.8 million. Demolition segment general and administrative expenses for 2010 of $6.8 million increased 7.9% compared with $6.3 million in 2009 primarily as a result of an increase in bad debt expense and incentive pay.

Consolidated general and administrative expenses as a percentage of revenue were generally consistent, ranging between 7.4% and 7.9% of revenues during 2008 through 2010. In 2010, general and administrative expenses increased due to additional expenses related to the Company s senior management reorganization.

The Company s net interest expense for 2010 totaled $13.5 million compared with $16.2 million in 2009. This decrease is due to the lower average outstanding borrowings on the Company s revolving credit facility during 2010. In addition, in 2010 the Company realized a $2.1 million gain on its outstanding interest rate swaps compared to a $0.4 million gain during 2009.

The Company incurred income tax expense of $20.6 million in 2010 compared with $10.9 million in 2009. This $9.7 million increase is primarily the result of the increase in the Company s operating income. The effective tax rate for the year ended December 31, 2010 was 37.9% compared to 42.7% for the year ended December 31, 2009. The decrease in the effective tax rate was due to the resolution of certain state tax matters.

For the year ended December 31, 2010, net income attributable to Great Lakes Dredge & Dock Corporation was $34.6 million compared to $17.5 million for the year ended December 31, 2009. This $17.1 million increase was primarily driven by higher operating income in 2010.

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Adjusted EBITDA (as defined above) for the year ended December 31, 2010 was $103.0 million as compared to $77.6 million for year ended December 31, 2009. The higher segment operating income for both the dredging and the demolition segments were the primary drivers for the higher Adjusted EBITDA in 2010. The Company recorded $34.3 million and $32.9 million of depreciation and amortization expense in the year ended December 31, 2010 and 2009, respectively. Depreciation and amortization are each components of operating income, but these expenses are excluded for the purposes of calculated Adjusted EBITDA.

Bidding Activity and Backlog

The following table sets forth, by segment and type of dredging work, the Company s backlog as of the dates indicated (in thousands):

	December 31, 2011	December 31, 2010	December 31, 2009
Backlog			
Dredging:			
Capital U.S.	$ 109,897	$ 117,866	$ 203,294
Capital foreign	78,379	65,334	35,715
Beach nourishment	84,607	18,080	63,390
Maintenance	31,293	56,140	63,335
Rivers & lakes	15,256	25,116*	
Total dredging backlog	319,432	282,536	365,734
Demolition	50,672	80,984	16,448
Total backlog	$ 370,104	$ 363,520	$ 382,182

* Represents backlog acquired by the Company on December 31, 2010 in connection with the Matteson acquisition.

The Company s contract backlog represents its estimate of the revenues that will be realized under the portion of the contracts remaining to be performed. For dredging contracts these estimates are based primarily upon the time and costs required to mobilize the necessary assets to and from the project site, the amount and type of material to be dredged and the expected production capabilities of the equipment performing the work. For demolition contracts, these estimates are based on the time and remaining costs required to complete the project relative to total estimated project costs and project revenues agreed to with the customer. However, these estimates are necessarily subject to variances based upon actual circumstances. Because of these factors, as well as factors affecting the time required to complete each job, backlog is not necessarily indicative of future revenues or profitability. In addition, 74% of the Company s 2011 dredging backlog relates to federal government contracts, which can be canceled at any time without penalty to the government, subject to the Company s contractual right to recover the Company s actual committed costs and profit on work performed up to the date of cancellation. In addition, the Company s backlog may fluctuate significantly from quarter to quarter based upon the type and size of the projects the Company is awarded from the bid market. A quarterly increase or decrease of the Company s backlog does not necessarily result in an improvement or a deterioration of the Company s business. The Company s backlog includes only those projects for which the Company has obtained a signed contract with the customer.

Approximately 97% of the Company s backlog at December 31, 2011 is expected to be completed and converted into revenue in 2012.

Dredging

The 2011 domestic dredging bid market totaled $1.041 billion, a 19% increase from the 2010 domestic dredging bid market of $875 million. The 2011 bid market grew primarily from federal and state funded projects for infrastructure and coastal restoration and protection. The beach nourishment bid market was the primary

reason for the increase as $317 million was awarded in 2011. This is an increase of $242 million from the 2010 bid market, which is over three times the size of the 2010 bid market. The Company won 43% of the overall 2011 domestic bid market, above its 30% win rate of the overall 2010 domestic bid market. The Company s three-year average win rate is 39%. The 2011 domestic bid market benefited from many projects deferred from prior years by governmental entities that were let to bid in 2011. In addition, the 2010 bid market excluded dredging work related to the construction of sand berms off the coast of Louisiana in response to the Deepwater Horizon oil spill in the Gulf of Mexico. Over $100 million of sand berm construction work was awarded to the Company directly by the prime contractor rather than through the customary bidding process. Variability in contract wins from period to period is not unusual. The Company believes trends in its win rate over the prior three year periods provide a historical background against which current year results can be compared.

The Company s December 31, 2011 contracted dredging backlog was $319.4 million. This represents an increase of $36.9 million, or 13%, over the Company s December 31, 2010 dredging backlog of $282.5 million. These amounts do not reflect approximately $36.1 million of domestic low bids pending formal award and additional phases (options) pending on projects currently in backlog. At December 31, 2010 the amount of domestic low bids pending award was $39.9 million. The increase in the Company s annual dredging backlog is primarily the result of the significantly higher beach nourishment awards remaining in backlog at year end that were primarily awarded late in the third quarter of 2011, partially offset by lower maintenance backlog as compared to the prior year.

The Company won 33%, or $117.8 million, of the domestic capital dredging projects awarded in 2011. Significant new awards during the year included $61 million for channel deepening in New York s Ambrose Channel and $43 million for Louisiana coastal restoration. Approximately $109.9 million, or 34%, of the Company s December 31, 2011 contracted dredging backlog consists of domestic capital dredging work, a substantial portion of which is expected to be performed in 2012. Domestic capital dredging backlog at December 31, 2011 was $8.0 million less than the prior year. In 2011, the Company earned 94% of its backlog carried forward from December 31, 2010 and replenished its revenue in backlog with new awards including those mentioned above. Federal capital projects are being prioritized by the Corps as it appropriates its annual funding for projects. The Company believes that many states and Washington D.C. will continue to focus on marine infrastructure as significant port and harbor authorities recognize that the ongoing expansion of the Panama Canal and initiatives to increase exports heightens the need for the U.S. to deepen its East and Gulf Coast ports to facilitate larger draft vessels from international trade. Due to certain regulatory and environmental hurdles, it does not appear that the first of these deepening projects will be released for proposal until the fourth quarter of 2012. In addition, the Company won a $46.5 million coastal restoration project in February 2012 that will add to its 2012 workload. This project continues to demonstrate that resources are being devoted to help restore the barrier islands and wetlands that provide natural protection from storms in the Gulf Coast area.

The Company won 62%, or $198.1 million, of the beach nourishment projects awarded in 2011. The Company was awarded eight significant coastal protection or beach nourishment projects along the East Coast totaling $144.4 million and several Florida projects in the year. The Company has contracted dredging backlog related to beach nourishment of $84.6 million at December 31, 2011 compared to $18.1 million at the end of 2010. The Company expects to perform its entire backlog throughout 2012. The beach nourishment market in 2011 was double the average bid market over the last three years. In 2010, many state and local governments experienced delays in getting the necessary funding to put their projects out to bid. Significant severe storms underscored the critical nature of these projects to the regions and the nation forcing beach nourishment projects that had been delayed to be brought to bid in 2011. The projects were funded with different combinations of federal, state and local resources allowing these communities to protect their coastlines from natural erosion and to provide a buffer to future severe storms.

The Company won 36%, or $109.2 million, of the maintenance dredging projects awarded in 2011. Harbor channel and river maintenance projects including $19 million of work on the Mississippi River and $18 million of work in Baltimore were awarded to the Company in 2011. The Company has contracted dredging backlog at December 31, 2011 for maintenance dredging of $31.3 million which is $24.8 million lower than the backlog at

December 31, 2010. The 2011 maintenance dredging bid market was 64% of the three-year average maintenance dredging bid market of $478 million. The Company continues to be optimistic about the passage of a Harbor Maintenance Trust Fund (HMTF) bill that allocates existing funding to maintenance dredging as intended. The industry has seen strong support from both Democrats and Republicans for this bill which politicians argue both creates domestic jobs and does not require new taxation.

Foreign capital dredging backlog increased to $78.4 million at December 31, 2011 from $65.3 million at the end of 2010. Although several Middle Eastern countries have experienced civil unrest and resulting governmental instability throughout 2011, the Company has maintained normal operations for its international projects and has a positive outlook for many of its foreign markets. The Company continues to observe an increase in international dredging and has pursued new opportunities in strategic foreign markets. In late 2011, the Company was awarded $34 million for its portion of a large land reclamation project in Bahrain. In addition, the Company recently announced a large opportunity in Australia for our backhoe dredge *New York*. The Company currently expects to realize approximately $180 million in revenue on this project with the potential for greater income once we finalize our participation. We will mobilize the vessel and ancillary equipment to Australia at the end of 2012 upon completion of the projects on which it is currently working. The Company s portion of the project is expected to take about 27 months to complete. The Company also sees additional opportunities in the Middle East, Southeast Asia and South America that it continues to pursue. We have recently made strategic moves to bolster our international sales and marketing effort, as we see an abundance of opportunities ahead, which we believe can yield better results from a more aggressive approach.

Rivers & lakes won 36%, or $20.0 million, of the projects in the markets where the group provides operations. Rivers & lakes has contracted backlog of $15.3 million at December 31, 2011 which is $9.8 million less than the backlog acquired in the Matteson transaction. The acquired backlog included $9.8 million for a large project, which was completed in 2011, requiring sediment removal from an inland lake. Rivers & lakes backlog does not include $14.6 million of low bids pending award that are expected to be formally awarded and under contract in the first quarter of 2012. During the year, the Company began to pursue municipal lake projects which expand the Company s service capabilities using existing equipment. The Company also launched a financing initiative to assist municipalities with finding financial partners to fund these capital improvements over time to balance project payments with project lives. This initiative will allow municipalities to move forward with their existing dredging projects that are being deferred due to funding concerns.

Demolition

Demolition services backlog was $50.7 million and $81.0 million at December 31, 2011 and 2010, respectively, a decrease of $30.2 million. The Company continued to work through backlog related to the larger New York and Boston area projects as well as the $28 million bridge demolition project in Louisiana. The demolition segment backlog does not include $22.1 million of low bids pending award that are expected to be formally awarded and under contract in the first half of 2012. There were no projects pending award in the prior year. A new management team in the demolition business has worked to cooperate with the dredging businesses as evidenced by bridge demolition projects which utilize the dredging segment s expertise on maritime projects. In addition, the demolition segment, our rivers & lakes division and our sediment remediation joint venture can combine resources to pursue large environmental remediation projects previously unavailable to the Company.

Liquidity and Capital Resources

The Company s principal sources of liquidity are net cash flows provided by operating activities and proceeds from the issuance of its 7.375% senior notes. See Note 7 in the Company s consolidated financial statements. The Company s principal uses of cash are to meet debt service requirements, finance capital expenditures, provide working capital and other general corporate purposes.

The Company s net cash provided by operating activities for the years ended December 31, 2011, 2010 and 2009 totaled $24.6 million, $123.5 million and $54.0 million, respectively. Normal increases or decreases in the level of working capital relative to the level of operational activity impact cash flow from operating activities. In

2011, lower net income and changes in working capital, resulted in lower net cash flows provided by operating activities. Working capital changes in 2011 were related to an increase in accounts receivable primarily from foreign operations (which usually experience longer accounts receivable collection periods) and demolition operations that increased in the latter half of the year, an increase in pipe inventories used to transport dredged material, and an income tax refund receivable that is included in other current assets related to estimated payments made for our 2011 federal tax return. In 2010, lower activity in foreign operations coupled with payments received on foreign accounts receivable that had been outstanding at the end of 2009 drove the increase in cash generated. Additionally, the increase in cash was generated by strong domestic dredging operations in 2010, which have by comparison shorter accounts receivable collections periods. In 2009, an increase in domestic accounts receivable resulting from increased domestic activity, offset by a decrease in pipe and spare parts inventory as well as other working capital items, decreased net cash provided by operating activities.

The Company s net cash flows used in investing activities for the years ended December 31, 2011, 2010 and 2009 totaled $16.7 million, $62.7 million and $24.9 million, respectively. Investing activities in all periods primarily relate to normal course upgrades and capital maintenance of the Company s dredging fleet. In 2011, the Company experienced several planned dry dock inspections required by regulatory obligation, as well as vessel upgrade and maintenance expenditures adding $4.3 million in costs above those required in 2010. In 2011, the Company sold the dredges Northerly Island and Victoria Island along with a parcel of land in Channelview, TX adding $15.6 million in proceeds from dispositions of property and equipment. The increase in 2010 is primarily due to the Company s acquisition of Matteson on December 31, 2010. See Note 14 to the Company s consolidated financial statements. The 2010 expenditures also included $14.6 million on the upgrade of the dredge Ohio.

The Company s net cash flows provided by (used in) financing activities for the years ended December 31, 2011, 2010 and 2009 totaled $57.4 million, ($15.6) million and ($36.4) million and, respectively. As further discussed below, in 2011 the Company issued $250 million of 7.375% senior notes, resulting in $244.2 million of net proceeds. The Company used a portion of these net proceeds to redeem its $175 million of 7.75% senior subordinated notes in 2011 for $180.0 million, which included a redemption premium and unpaid interest. The Company also paid $6.0 million in financing fees on the issuance of the senior notes in 2011. The Company paid dividends of $4.7 million in 2011, an increase of $0.7 million from dividends of $4.0 million in both 2010 and 2009.

On June 12, 2007, the Company entered into a credit agreement (as amended, the Credit Agreement) with Bank of America N.A. and various other financial institutions as lenders. The Credit Agreement provides for a revolving credit facility of up to $145.0 million in borrowings and includes sublimits for the issuance of letters of credit and swingline loans. The revolving credit facility matures on June 12, 2012. The revolving credit facility bears interest at rates selected at the option of Great Lakes, currently equal to either LIBOR plus an applicable margin or the Base Rate plus an applicable margin. The applicable margins for LIBOR loans and Base Rate loans, as well as any non-use fee, are subject to adjustment based upon the Company s ratio of Total Funded Debt to Adjusted Consolidated EBITDA (each as defined in the Credit Agreement). The obligations of Great Lakes under the Credit Agreement are unconditionally guaranteed by its direct and indirect domestic subsidiaries. Additionally, the obligations are secured by a perfected first priority lien on certain equipment of Great Lakes subsidiary, Great Lakes Dredge & Dock Company, LLC (GLDD Company); a perfected second priority lien on certain other equipment of GLDD Company, subject to a perfected first priority lien in favor of Great Lakes bonding company; a perfected first priority lien on the inter-company receivables of Great Lakes and its direct and indirect domestic subsidiaries and having an equal priority to the liens of Great Lakes bonding company; and a perfected second priority lien on the accounts receivable of Great Lakes and its direct and indirect subsidiaries that relate to bonded projects. The Credit Agreement contains various covenants and restrictions including (i) limitations on dividends to $5 million per year, (ii) limitations on redemptions and repurchases of capital stock, (iii) limitations on the incurrence of indebtedness, liens, leases and investments, and (iv) maintenance of certain financial covenants.

As of December 31, 2011, the Company had no borrowings and $26.9 million of letters of credit outstanding, resulting in $118.1 million of availability under the Credit Agreement. At December 31, 2011, the Company was in compliance with its various covenants under its Credit Agreement.

The Company s Credit Agreement matures on June 12, 2012 and the Company is in discussions with lenders to finalize a successor credit facility with substantially similar capabilities and terms as the current Credit Agreement. The Company believes that it will finalize a successor credit facility in the first quarter of 2012.

Performance and bid bonds are customarily required for dredging and marine construction projects, as well as some demolition projects. In September 2011, the Company entered into a new bonding agreement with Zurich American Insurance Company (Zurich) under which the Company can obtain performance, bid and payment bonds. The new bonding agreement contains no restrictive covenants and lesser collateral requirements than the previous bonding agreement. The Company is using Zurich for all bonding requirements beginning in September 2011. The existing bonding agreement with Travelers Casualty and Surety Company of America (Travelers) will remain in place until outstanding bonds expire as the projects underlying the bonds issued thereunder are completed. Pursuant to the existing bonding agreement, Travelers has been granted a security interest in a substantial portion of the Company s operating equipment with a net book value of $63 million at December 31, 2011.

The Travelers bonding agreement contains provisions requiring the Company to maintain certain financial ratios and restricting the Company s ability to pay dividends, incur indebtedness, create liens and take certain other actions. At December 31, 2011, the Company was in compliance with its various covenants under the bonding agreement with Travelers. Bid bonds are generally obtained for a percentage of bid value and amounts outstanding typically range from $1 million to $10 million. At December 31, 2011, the Company had outstanding performance bonds valued at approximately $336.1 million; however, the revenue value remaining in backlog related to these projects totaled approximately $247.0 million.

In addition to its credit facility, the Company has a $24 million International Letter of Credit Facility with Wells Fargo HSBC Trade Bank. This facility is used for performance and advance payment guarantees on foreign contracts, including our long-term land reclamation project in Bahrain. The Company s obligations under the agreement are guaranteed by the Company s foreign accounts receivable. In addition, the Export-Import Bank of the United States (Ex-Im Bank) has issued a guarantee under the Ex-Im Bank s Working Capital Guarantee Program, which covers 90% of the obligations owing under the facility. The Company had $11.7 million of letters of credit issued under this facility at December 31, 2011.

In January 2011, the Company issued $250 million in aggregate principal amount of its 7.375% senior notes due February 1, 2019. Approximately $180 million of the net proceeds from the issuance of the senior notes was used to prepay all of the Company s 7.75% senior subordinated notes due December 2013, including prepayment premiums and accrued and unpaid interest. The remaining net proceeds from the issuance of the senior notes will be used for general corporate purposes, which may include acquisitions. The Indenture governing the senior notes, among other things, limits the ability of the Company and its restricted subsidiaries to (i) pay dividends, or make certain other restricted payments or investments; (ii) incur additional indebtedness and issue disqualified stock; (iii) create liens on its assets; (iv) transfer and sell assets; (v) merge, consolidate or sell all or substantially all of its assets; (vi) enter into certain transactions with affiliates; (vii) create restrictions on dividends or other payments by its restricted subsidiaries and (viii) create guarantees of indebtedness by restricted subsidiaries. These covenants are subject to a number of important limitations and exceptions that are described in the Indenture governing the senior notes.

The Company increased its aggregate quarterly dividend to $1.2 million beginning in the second quarter of 2011, and will continue to pay such amount in the first quarter of 2012. Prior to that, the Company paid dividends of approximately $1 million each quarter, including during the first of quarter of 2011 and each quarter of 2010. The declaration and payment of dividends will be at the discretion of the Company s board of directors and will depend on many factors, including general economic and business conditions, the Company s strategic plans, its financial results and condition and legal requirements, including restrictions and limitations contained in the Credit Agreement, bonding agreements and the indenture relating to its senior notes. Accordingly, the Company cannot make any assurances as to the size of any such dividend or that it will pay any such dividend in future quarters.

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The Company believes its cash on hand, its anticipated cash flows from operations and availability under its revolving credit facility will be sufficient to fund the Company s operations, capital expenditures and scheduled debt service requirements for the next twelve months.

Beyond the next twelve months, the Company s ability to fund its working capital needs, planned capital expenditures, scheduled debt payments and dividends if any, and to comply with all of the financial covenants under the Credit Agreement and bonding agreement, depends on its future operating performance and cash flows, which in turn, are subject to prevailing economic conditions and to financial, business and other factors, some of which are beyond the Company s control.

Contractual Obligations

The following table summarizes the Company s contractual cash obligations at December 31, 2011. Additional information related to these obligations can be found in Note 7 and Note 12 to the Company s consolidated financial statements.

		Obligations coming due in year(s) ending: (in millions)			
	Total (1)	2012	2013-2015	2016-2018	2019 and beyond
Long term bank debt (2)	$	$	$	$	$
Senior notes (3)	388.2	18.4	55.3	55.3	259.2
Operating lease commitments	93.6	16.4	43.1	31.2	2.9
Promissory note (4)	5.6	2.8	2.8		
Equipment notes	0.6	0.5	0.1		
Total	$ 488.0	$ 38.1	$ 101.3	$ 86.5	$ 262.1

(1) Excluded from the above table are $0.8 million in liabilities for uncertain tax positions for which the period of settlement is not determinable.
(2) Represents the Company s senior credit facility. No amounts were outstanding at December 31, 2011.
(3) Includes cash interest payments calculated at stated fixed rate of 7.375%.
(4) Includes cash interest payments calculated at stated fixed rate of 6.00%. This note was issued in connection with the Matteson acquisition.

Other Off-Balance Sheet and Contingent Obligations

The Company had outstanding letters of credit relating to foreign contract guarantees and insurance payment liabilities totaling $38.6 million at December 31, 2011. All issued letters of credit were undrawn at year-end.

The Company has granted liens on a substantial portion of its owned operating equipment as security for borrowings under its Credit Agreement and its Travelers bonding agreement. The Company s Credit Agreement and Travelers bonding agreement also contain provisions that require the Company to maintain certain financial ratios and restrict its ability to pay dividends, incur indebtedness, create liens, and take certain other actions.

The Company finances certain key vessels used in its operations with off-balance sheet operating lease arrangements with unrelated lessors, requiring annual rentals of $16.4 million which decline to $0.4 million over the next ten years. These off-balance sheet leases contain default provisions, which are triggered by an acceleration of debt maturity under the terms of the Company s Credit Agreement. Additionally, the leases typically contain provisions whereby the Company indemnifies the lessors for the tax treatment attributable to such leases based on the tax rules in place at lease inception. The tax indemnifications do not have a contractual dollar limit. To date, no lessors have asserted any claims against the Company under these tax indemnification provisions.

At December 31, 2011, the Company had outstanding performance bonds valued at approximately $336.1 million; however, the revenue value remaining in backlog related to these projects totaled approximately $247.0 million.

Certain foreign projects performed by the Company have warranty periods, typically spanning no more than three to five years beyond project completion, whereby the Company retains responsibility to maintain the project site to certain specifications during the warranty period. Generally, any potential liability of the Company is mitigated by insurance, shared responsibilities with consortium partners, and/or recourse to owner-provided specifications.

The Company considers it unlikely that it would have to perform under any of the aforementioned contingent obligations, other than operating leases, and performance has never been required in any of these circumstances in the past.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

A significant portion of the Company s current dredging operations are conducted outside of the U.S., primarily in the Middle East. It is the Company s policy to hedge foreign currency exchange risk on contracts denominated in currencies other than the U.S. dollar, if available. Currently, the majority of the Company s foreign dredging work is in Bahrain. The currency in Bahrain, the Bahraini Dinar, is linked to the U.S. dollar; therefore, there is no foreign currency exposure on these transactions. At December 31, 2011, the Company had one foreign exchange forward contract outstanding to offset the change in fair value on outstanding accounts receivable in Brazilian Real with a fair value of $0.2 million. We expect any gains or losses on the forward contract to be substantially offset by a corresponding gain or loss on the underlying exposure. A 10% adverse movement in the foreign currency exchange rate would decrease the derivative value by $0.6 million.

At December 31, 2011, the Company had long-term senior notes outstanding with a recorded book value of $250.0 million. The fair value of these notes, which bear interest at a fixed rate of 7.375%, was $247.5 million at December 31, 2011 based on market prices. Assuming a 10% decrease in interest rates from the rates at December 31, 2011 the fair value of this fixed rate debt would have increased to $257.8 million.

In May 2009, the Company entered into two interest rate swap arrangements, which are effective until December 15, 2012, to swap a notional amount of $50.0 million from a fixed rate of 7.75% to a floating LIBOR-based rate in order to manage the interest rate paid with respect to the Company s 7.75% senior subordinated notes. The fair value asset of the swaps at December 31, 2011 was $0.8 million and is recorded in current assets. The swap is not accounted for as a hedge; therefore, the changes in fair value are recorded as adjustments to interest expense in each reporting period. Assuming a 10% increase in interest rates at December 31, 2010, the fair value of the asset would decline by $0.2 million.

A significant operating cost for the Company is diesel fuel, which represents approximately 10% of the Company s costs of contract revenues. The Company uses fuel commodity forward contracts, typically with durations of less than one year, to reduce the impacts of changing fuel prices on operations. The Company does not purchase fuel hedges for trading purposes. Based on the Company s 2011 projected domestic fuel consumption, a 10% increase in the average price per gallon of fuel would have an immaterial effect on fuel expense, after the effect of fuel commodity contracts in place at December 31, 2011. At December 31, 2011 the Company had outstanding arrangements to hedge the price of a portion of its fuel purchases related to domestic dredging work in backlog, representing approximately 59% of its anticipated domestic fuel requirements for 2012. As of December 31, 2011, there were 5.2 million gallons remaining on these contracts. Under these agreements, the Company will pay fixed prices ranging from $2.65 to $2.98 per gallon. At December 31, 2011, the fair value asset on these contracts was estimated to be $0.4 million, based on quoted market prices and is recorded in other current assets. A 10% change in forward fuel prices would result in an immaterial change in the fair value of fuel hedges outstanding at December 31, 2011.

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Item 8. Financial Statements and Supplementary Data

The consolidated financial statements (including financial statement schedules listed under Item 15 of this Report) of the Company called for by this Item, together with the Report of Independent Registered Public Accounting Firm dated March 9, 2012, are set forth on pages 60 to 96 inclusive, of this Report, and are hereby incorporated by reference into this Item. Financial statement schedules not included in this Report have been omitted because they are not applicable or because the information called for is shown in the consolidated financial statements or notes thereto.

Quarterly Results of Operations (Unaudited)

The following tables set forth our unaudited quarterly results of operations for 2011 and 2010. We have prepared this unaudited information on a basis consistent with the audited consolidated financial statements contained in this report and this unaudited information includes all adjustments, consisting only of normal recurring adjustments that we consider necessary for a fair presentation of our results of operations for the quarters presented. You should read this quarterly financial data along with the Condensed Consolidated Financial Statements and the related notes to those statements included in our Quarterly Reports on Form 10-Q filed with the Commission. The operating results for any quarter are not necessarily indicative of the results for the annual period or any future period.

	Quarter Ended			
	March 31,	June 30,	September 30,	December 31,
	Unaudited (in millions except share and per share data)			
2011				
Contract revenues	$ 155.3	$ 155.0	$ 158.5	$ 158.6
Costs of contract revenues	(127.9)	(135.2)	(131.1)	(140.2)
Gross profit	27.4	19.8	27.4	18.4
General and administrative expenses	(12.1)	(13.6)	(12.7)	(12.0)
Gain on sale of assets net	(0.3)	(2.5)	(0.1)	(8.8)
Operating income	15.6	8.7	14.8	15.2
Interest expense net	(6.0)	(4.9)	(5.6)	(5.2)
Equity in earnings (loss) of joint ventures	(0.6)	(0.1)	0.6	(0.3)
Loss on foreign currency transactions net			(0.5)	0.3
Loss on extinguishment of debt	(5.1)			
Income before income taxes	3.9	3.7	9.3	10.0
Income tax expense	(1.5)	(1.5)	(3.6)	(3.0)
Net income	2.4	2.2	5.7	7.0
Net income attributable to noncontrolling interests		(0.5)	(0.1)	(0.2)
Net income attributable to Great Lakes Dredge & Dock Corporation	$ 2.4	$ 1.7	$ 5.6	$ 6.8
Basic earnings per share	$ 0.04	$ 0.03	$ 0.10	$ 0.12
Basic weighted average shares	58,784,774	58,874,601	58,930,314	58,973,431
Diluted earnings per share	$ 0.04	$ 0.03	$ 0.09	$ 0.12
Diluted weighted average shares	59,237,749	59,182,999	59,160,808	59,235,709

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	Quarter Ended			
	March 31,	June 30,	September 30,	December 31,
	Unaudited (in millions except share and per share data)			
2010				
Contract revenues	$ 161.4	$ 180.1	$ 173.3	$ 172.1
Costs of contract revenues	(130.9)	(145.5)	(140.6)	(147.0)
Gross profit	30.5	34.6	32.7	25.1
General and administrative expenses	(11.1)	(14.4)	(16.5)	(12.3)
Operating income	19.4	20.2	16.2	12.8
Interest expense net	(3.2)	(3.0)	(3.3)	(4.0)
Equity in earnings (loss) of joint ventures	(0.7)	(0.1)	0.1	0.1
Income before income taxes	15.5	17.1	12.8	8.9
Income tax expense	(6.2)	(6.8)	(5.1)	(2.5)
Net income	9.3	10.3	7.7	6.4
Net loss attributable to noncontrolling interests	0.1	0.5		0.4
Net income attributable to Great Lakes Dredge & Dock Corporation	$ 9.4	$ 10.8	$ 7.7	$ 6.8
Basic earnings per share	$ 0.16	$ 0.18	$ 0.13	$ 0.12
Basic weighted average shares	58,547,990	58,601,649	58,698,299	58,750,621
Diluted earnings per share	$ 0.16	$ 0.18	$ 0.13	$ 0.11
Diluted weighted average shares	58,705,175	58,780,611	58,900,824	59,067,964

Note: Items may not sum due to rounding.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Disclosure Controls and Procedures.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company s disclosure controls and procedures, as required by Rule 13a-15(b) and 15d-15(b) under the Securities Exchange Act of 1934 (the Exchange Act) as of December 31, 2011. Our disclosure controls and procedures are designed to reasonably assure that information required to be disclosed by us in reports we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure and is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms.

Our management, with the participation of the Chief Executive Officer and Chief Financial Officer, believes that our disclosure controls and procedures are effective to provide such reasonable assurance. Our management, including the Chief Executive Officer and Chief Financial Officer, believes that any disclosure controls and procedures or internal controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must consider the benefits of controls relative to their costs.

Inherent limitations within a control system include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or

more people, or by unauthorized

override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Accordingly, because of the inherent limitations in a cost effective control system, misstatements due to error or fraud may occur and may not be prevented or detected.

Our management has also conducted an assessment of the Company s internal control over financial reporting as of December 31, 2011 as required by Section 404 of the Sarbanes-Oxley Act. Management s report on our internal control over financial reporting is included on page 49. Management has concluded that internal control over financial reporting is effective as of December 31, 2011. The Independent Registered Public Accounting Firm s report with respect to the effectiveness of our internal control over financial reporting is included on page 50.

Changes in Internal Controls.

There have been no changes in our internal controls over financial reporting during the fiscal quarter ended December 31, 2011 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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Management s Annual Report on Internal Control over Financial Reporting

The management of Great Lakes Dredge & Dock Corporation is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f), and 15d-15(f) under the Securities Exchange Act of 1934). Management has used the framework set forth in the report entitled *Internal Control Integrated Framework* published by the Committee of Sponsoring Organizations of the Treadway Commission to evaluate the effectiveness of the Company s internal control over financial reporting.

The internal control over financial reporting refers to the process designed by, or under the supervision of, our Chief Executive Officer and Chief Financial Officer, and overseen by our Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles, and includes those policies and procedures that:

- Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;

- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with general accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company s assets that could have a material effect on the financial statements.

Neither internal control over financial reporting nor disclosure controls and procedures can provide absolute assurance of achieving financial reporting objectives because of their inherent limitations. Internal control over financial reporting and disclosure controls are processes that involve human diligence and compliance, and are subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting and disclosure controls also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented, detected or reported on a timely basis by internal control over financial reporting or disclosure controls. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design safeguards for these processes that will reduce, although may not eliminate, these risks.

Our independent registered public accounting firm, Deloitte & Touche LLP, who audited Great Lakes consolidated financial statements included in this Form 10-K, has issued a report on Great Lakes internal control over financial reporting, which is included herein.

Management has concluded that our internal controls over financial reporting and our disclosure controls and procedures were effective, at a reasonable assurance level, as of December 31, 2011.

/s/ Jonathan W. Berger
Jonathan W. Berger
Chief Executive

Officer and Director

/s/ Bruce J. Biemeck
Bruce J. Biemeck
President,

Chief Financial Officer and Director

March 9, 2012

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

Great Lakes Dredge & Dock Corporation

Oak Brook, Illinois

We have audited the internal control over financial reporting of Great Lakes Dredge & Dock Corporation and subsidiaries (the Company) as of December 31, 2011, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed by, or under the supervision of, the company s principal executive and principal financial officers, or persons performing similar functions, and effected by the Company s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule as of and for the year ended December 31, 2011 of the Company and our report dated March 9, 2012 expressed an unqualified opinion on those financial statements and financial statement schedule.

/s/ Deloitte & Touche LLP

Chicago, Illinois

March 9, 2012

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Item 9B. Other Information

None.

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Part III

Item 10. Directors, Executive Officers and Corporate Governance

Information regarding our executive officers is incorporated by reference herein from the discussion under *Item 1. Business Executive Officers* in this Annual Report on Form 10-K.

Code of Ethics

The Company has adopted a written code of business conduct and ethics that applies to all of its employees, including its principal executive officer, principal financial officer, controller, and persons performing similar functions. The Company s code of ethics can be found on its website at www.gldd.com. The Company will post on our website any amendments to or waivers of the code of business conduct and ethics for executive officers or directors, in accordance with applicable laws and regulations.

The remaining information called for by this Item 10 is incorporated by reference herein from the discussions under the headings Election of Directors, Board of Directors and Corporate Governance and Security Ownership of Certain Beneficial Owners and Management and Section 16(a) Beneficial Ownership Reporting Compliance in the definitive Proxy Statement for the 2012 Annual Meeting of Stockholders.

Item 11. Executive Compensation

The information required by Item 11 of Form 10-K is incorporated by reference herein from the discussions under the headings Executive Compensation and Compensation Discussion and Analysis and Board of Directors and Corporate Governance in the definitive Proxy Statement for the 2012 Annual Meeting of Stockholders.

Item 12. Security Ownership of Certain Beneficial Owners and Management Related Stockholder Matters

The information required by Item 12 of Form 10-K is incorporated by reference herein from the discussion under the heading Security Ownership of Certain Beneficial Owners and Management and Equity Compensation Plan Information in our definitive Proxy Statement for the 2012 Annual Meeting of Stockholders.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by Item 13 of Form 10-K is incorporated by reference herein from the discussions under the headings Board of Directors and Corporate Governance and Change of Control of the Company and Certain Relationships and Related Transactions in the definitive Proxy Statement for the 2012 Annual Meeting of Stockholders.

Item 14. Principal Accounting Fees and Services

The information required by Item 14 of Form 10-K is incorporated by reference herein from the discussion under the heading Matters Related to Independent Registered Public Accounting Firm in the definitive Proxy Statement for the 2012 Annual Meeting of Stockholders.

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Part IV

Item 15. Exhibits, Financial Statement Schedules

(a) Documents filed as part of this report

1. Financial Statements

The financial statements are set forth on pages 60 to 96 of this Report and are incorporated by reference in Item 8 of this Report.

2. Financial Statement Schedules

All other schedules, except Schedule II Valuation and Qualifying Accounts on page 97, are omitted because they are not required or the required information is shown in the financial statements or notes thereto.

3. Exhibits

The exhibits required to be filed by Item 601 of Regulation S-K are listed in the Exhibit Index which is attached hereto and incorporated by reference herein.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

GREAT LAKES DREDGE & DOCK CORPORATION

By: /s/ BRUCE J. BIEMECK
Bruce J. Biemeck
President and Chief Financial Officer

Date: March 9, 2012

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capabilities and on the dates indicated.

Signature	Date	Title
/s/ JONATHAN W. BERGER Jonathan W. Berger	March 9, 2012	Chief Executive Officer and Director (Principal Executive Officer)
/s/ BRUCE J. BIEMECK Bruce J. Biemeck	March 9, 2012	President, Chief Financial Officer and Director (Principal Financial Officer and Principal Accounting Officer)
/s/ CARL A. ALBERT Carl A. Albert	March 9, 2012	Director
/s/ STEPHEN H. BITTEL Stephen H. Bittel	March 9, 2012	Director
/s/ PETER R. DEUTSCH Peter R. Deutsch	March 9, 2012	Director
/s/ NATHAN D. LEIGHT Nathan D. Leight	March 9, 2012	Director
/s/ DOUGLAS B. MACKIE Douglas B. Mackie	March 9, 2012	Director
/s/ JASON G. WEISS Jason G. Weiss	March 9, 2012	Director

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I. EXHIBIT INDEX

Number	Document Description
2.1	Amended and Restated Agreement and Plan of Merger dated as of December 22, 2003, among Great Lakes Dredge & Dock Corporation, GLDD Acquisitions Corp., GLDD Merger Sub, Inc. and Vectura Holding Company LLC. (1)
2.2	Agreement and Plan of Merger by and among GLDD Acquisitions Corp., Aldabra Acquisition Corporation, and certain shareholders of Aldabra Acquisition Corporation and GLDD Acquisitions Corp., dated as of June 20, 2006. (2)
2.3	Agreement and Plan of Merger, dated as of August 21, 2006, among Great Lakes Dredge & Dock Holdings Corp., Aldabra Acquisition Corporation, and GLH Merger Sub, L.L.C. (3)
3.1	Amended and Restated Certificate of Incorporation of Great Lakes Dredge & Dock Holdings Corp., effective December 26, 2006 (now renamed Great Lakes Dredge & Dock Corporation). (4)
3.2	Third Amended and Restated Bylaws of Great Lakes Dredge & Dock Corporation, effective as of March 8, 2011. (5)
3.3	Certificate of Ownership and Merger of Great Lakes Dredge & Dock Corporation with and into Great Lakes Dredge & Dock Holdings Corp. (6)
4.1	Indenture, dated January 28, 2011, by and among the Company, certain subsidiary guarantors named therein and Wells Fargo Bank, National Association, as trustee. (7)
4.2	Form of 7.375% Senior Note due 2019 (filed as Exhibit A to the Indenture, dated January 28, 2011, by and among the Company, certain subsidiary guarantors named therein and Wells Fargo Bank, National Association, as trustee). (7)
4.3	Specimen Common Stock Certificate for Great Lakes Dredge & Dock Corporation. (12)
10.1	Credit Agreement, dated as of June 12, 2007, among Great Lakes Dredge & Dock Corporation, the other loan parties from time to time party thereto, the financial institutions from time to time party thereto and LaSalle Bank National Association, as Swing Line Lender, Sole Lead Arranger and Administrative Agent. (13)
10.2	Amendment No. 1 to Credit Agreement, dated as of January 30, 2009, among Great Lakes Dredge & Dock Corporation, the other loan parties from time to time party thereto, the financial institutions from time to time party thereto and Bank of America, N.A., as successor by merger to LaSalle Bank National Association, as Swing Line Lender, Sole Lead Arranger, Issuing Lender and Administrative Agent. (10)
10.3	Amendment No. 2 to Credit Agreement, dated as of May 10, 2010, among Great Lakes Dredge & Dock Corporation, the other loan parties from time to time party thereto, the financial institutions from time to time party thereto and Bank of America, N.A., as successor by merger to LaSalle Bank National Association, as Swing Line Lender, Sole Lead Arranger, Issuing Lender and Administrative Agent. (28)
10.4	Consent and Amendment No. 3 to Credit Agreement, dated as of December 31, 2010, among Great Lakes Dredge & Dock Corporation, the other loan parties from time to time party thereto, the financial institutions from time to time party thereto and Bank of America, N.A., as successor by merger to LaSalle Bank National Association, as Swing Line Lender, Sole Lead Arranger, Issuing Lender and Administrative Agent. (8)
10.5	Amendment No. 4 to Credit Agreement dated as of September 7, 2011 among Great Lakes Dredge & Dock Corporation, the other Loan Parties from time to time party to the Credit Agreement, the Lenders signatory thereto and Bank of America, N.A. (successor by merger to LaSalle Bank National Association) as Swing Line Lender, Issuing Lender and Administrative Agent. (30)

Number	Document Description
10.6	Amendment No. 5 to Credit Agreement dated as of November 14, 2011 among Great Lakes Dredge & Dock Corporation, the other Loan Parties from time to time party to the Credit Agreement, the Lenders signatory thereto and Bank of America, N.A. (successor by merger to LaSalle Bank National Association) as Swing Line Lender, Issuing Lender and Administrative Agent. (31)
10.7	Third Amended and Restated Underwriting and Continuing Indemnity Agreement, dated as of December 22, 2003, among Great Lakes Dredge & Dock Corporation, certain of its subsidiaries, Travelers Casualty and Surety Company and Travelers Casualty and Surety Company of America. (9)
10.8	First Amendment to Third Amended and Restated Underwriting and Continuing Indemnity Agreement, dated as of September 30, 2004, by and among Great Lakes Dredge & Dock Corporation, certain of its subsidiaries, Travelers Casualty and Surety Company and Travelers Casualty and Surety Company of America. (11)
10.9	Second Amendment to Third Amended and Restated Underwriting and Continuing Indemnity Agreement, dated as of November 14, 2005, by and among the Great Lakes Dredge & Dock Corporation, the subsidiaries of Great Lakes Dredge & Dock Company, Travelers Casualty and Surety Company, United Pacific Insurance Company, Reliance National Insurance Company, Reliance Surety Company and Travelers Casualty and Surety Company of America. (15)
10.10	Third Amendment to Third Amended and Restated Underwriting and Continuing Indemnity Agreement dated as of September 28, 2006, by and among Great Lakes Dredge & Dock Corporation, certain of its subsidiaries, Travelers Casualty and Surety Company and Travelers Casualty and Surety Company of America. (16)
10.11	Fourth Amendment to Third Amended and Restated Underwriting and Continuing Indemnity Agreement dated as of June 12, 2007, by and among Great Lakes Dredge & Dock Corporation, certain of its subsidiaries, Travelers Casualty and Surety Company of America. (20)
10.12	Fifth Amendment to Third Amended and Restated Underwriting and Continuing Indemnity Agreement dated as of April 27, 2009, by and among Great Lakes Dredge & Dock Corporation, certain of its subsidiaries, Travelers Casualty and Surety Company of America. (17)
10.13	Sixth Amendment to Third Amended and Restated Underwriting and Continuing Indemnity Agreement, dated January 24, 2011, by and among the Company, the subsidiaries of the Company party thereto, Travelers Casualty and Surety Company and Travelers Casualty and Surety Company of America. (7)
10.14	Seventh Amendment to Third Amended and Restated Underwriting and Continuing Indemnity Agreement, dated as of November 11, 2011, by and among Great Lakes Dredge & Dock Corporation, certain of its subsidiaries, Travelers Casualty and Surety Company and Travelers Casualty and Surety Company of America. (31)
10.15	International Letter of Credit Agreement, dated September 29, 2006, by and among Great Lakes Dredge & Dock Corporation and Wells Fargo HSBC Trade Bank. (27)
10.16	First Amendment to International Letter of Credit Agreement, dated July 16, 2007, by and among Great Lakes Dredge & Dock Corporation and Wells Fargo HSBC Trade Bank. (18)
10.17	Second Amendment to International Letter of Credit Agreement dated September 29, 2009, by and among Great Lakes Dredge & Dock Corporation, Great Lakes Dredge & Dock Company, LLC and Wells Fargo HSBC Trade Bank, NA. (19)
10.18	Reaffirmation, Ratification and Assumption Agreement dated December 26, 2006, by and between Great Lakes Dredge & Dock Corporation (formerly named Great Lakes Dredge & Dock Holdings Corp.) and Wells Fargo HSBC Trade Bank, N.A. (6)

Number	Document Description
10.19	Amended and Restated Management Equity Agreement dated December 26, 2006 by and among Aldabra Acquisition Corporation, Great Lakes Dredge & Dock Holdings Corp. and each of the other persons identified on the signature pages thereto. (6)
10.20	Employment Agreement between the Company and Jonathan W. Berger. (14)
10.21	Employment Agreement between the Company and Bruce J. Biemeck. (14)
10.22	Summary of Oral Employment Agreements with Named Executive Officers. (12)
10.23	Second Amended and Restated Great Lakes Dredge & Dock Company, LLC Annual Bonus Plan effective as of January 1, 2012 (29)
10.24	401(k) Savings Plan. (21)
10.25	401(k) Lost Benefit Plan. (12)
10.26	Lease Agreement between North American Site Developers, Inc. and MJC Berry Enterprises, LLC, dated as of December 31, 2006. (22)
10.27	Form of Investor Rights Agreement among Aldabra Acquisition Corporation, Great Lakes Dredge & Dock Holdings Corp., Madison Dearborn Capital Partners IV, L.P., certain stockholders of Aldabra Acquisition Corporation and certain stockholders of GLDD Acquisitions Corp. (3)
10.28	Limited Liability Company Agreement, dated April 30, 2008, by and among NASDI Holdings Corporation, Christopher A. Berardi and NASDI, LLC. (23)
10.29	Employment Agreement, dated as of April 30, 2008, by and between NASDI Holdings Corporation and Christopher A. Berardi. (23)
10.30	Great Lakes Dredge & Dock Corporation 2007 Long-Term Incentive Plan. (24)
10.31	Form of Great Lakes Dredge & Dock Corporation Non-Qualified Stock Option Agreement pursuant to the Great Lakes Dredge & Dock Corporation 2007 Long-Term Incentive Plan. (25)
10.32	Form of Great Lakes Dredge & Dock Corporation Restricted Stock Unit Award Agreement pursuant to the Great Lakes Dredge & Dock Corporation 2007 Long-Term Incentive Plan. (25)
10.33	Form of Great Lakes Dredge & Dock Performance Vesting RSU Award Agreement pursuant to the Great Lakes Dredge & Dock Corporation 2007 Long-Term Incentive Plan. (25)
10.34	Employment Agreement between the Company and Richard Lowry. (32)
10.35	Separation Agreement with Douglas B. Mackie effective as of September 7, 2010. (14)
10.36	Asset Purchase Agreement dated as of December 31, 2010 among Great Lakes Dredge & Dock Corporation, L.W. Matteson, Inc., Lawrence W. Matteson and Larry W. Matteson. (8)
10.37	Lease Agreement dated as of December 31, 2010 between, L.W. Matteson, Inc. and Great Lakes Dredge & Dock Corporation. (8)
10.38	Secured Subordinated Promissory Note dated December 31, 2010, made and delivered by Great Lakes Dredge & Dock, LLC in favor of L.W. Matteson, Inc. (8)
12.1	Ratio of Earnings to Fixed Charges. *
14.1	Code of Business Conduct and Ethics. (26)
21.1	Subsidiaries of Great Lakes Dredge & Dock Corporation. *
23.1	Consent of Deloitte & Touche LLP. *

Number	Document Description
31.1	Certification Pursuant to Rules 13a-14 and 15d-14 under the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. *
31.2	Certification Pursuant to Rules 13a-14 and 15d-14 under the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. *
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. *
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. *
101.INS	XBRL Instance Document. *
101.SCH	XBRL Taxonomy Extension Schema. *
101.CAL	XBRL Taxonomy Extension Calculation Linkbase. *
101.DEF	XBRL Taxonomy Extension Definition Linkbase. *
101.LAB	XBRL Taxonomy Extension Label Linkbase. *
101.PRE	XBRL Taxonomy Extension Presentation Linkbase. *

(1) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K filed with the Commission on January 6, 2004 (Commission file no. 333-64687).

(2) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K filed with the Commission on June 22, 2006 (Commission file no. 333-64687).

(3) Incorporated by reference to Great Lakes Dredge & Dock Holding Corp. s Registration Statement on Form S-4 filed with the Commission on August 24, 2006 (Commission file no. 333-136861-01).

(4) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Registration Statement on Form 8-A filed with the Commission on December 26, 2006 (Commission file no. 001-33225).

(5) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K filed with the Commission on March 14, 2011 (Commission file no. 001-33225).

(6) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K filed with the Commission on December 29, 2006 (Commission file no. 001-33225).

(7) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K filed with the Commission on January 28, 2011 (Commission file no. 001-33225).

(8) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K filed with the Commission on January 3, 2011 (Commission file no. 001-33225).

(9) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K/A filed with the Commission on August 17, 2010 (Commission file no. 001-33225).

(10) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K filed with the Commission on February 5, 2009 (Commission file no. 001-33225).

(11) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K/A filed with the Commission on August 17, 2010 (Commission file no. 001-33225).

(12) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Annual Report on Form 10-K filed with the Commission on March 22, 2007 (Commission file no. 001-33225).

(13) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K filed with the Commission on June 15, 2007 (Commission file no. 001-33225).

(14) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K filed with the Commission on September 8, 2010 (Commission file no. 001-33225).

(15) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K filed with the Commission on November 17, 2005 (Commission file no. 333-64687).

(16) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K filed with the Commission on October 4, 2006 (Commission file no. 333-64687).

(17) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K filed with the Commission on April 29, 2009 (Commission file no. 001-33225).
(18) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K/A filed with the Commission on August 17, 2010 (Commission file no. 001-33225).
(19) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K filed with the Commission on October 5, 2009 (Commission file no. 001-33225).
(20) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K/A filed with the Commission on August 17, 2010 (Commission file no. 001-33225).
(21) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Annual Report on Form 10-K filed with the Commission on March 30, 2005 (Commission file no. 333-64687).
(22) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K filed with the Commission on February 20, 2007 (Commission file no. 001-33225).
(23) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K filed with the Commission on May 6, 2008 (Commission file no. 001-33225).
(24) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Registration Statement on Form S-8 filed with the Commission on April 3, 2008 (Commission file no. 333-150067).
(25) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K filed with the Commission on July 1, 2011 (Commission file no. 001-33225).
(26) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K filed with the Commission on October 24, 2005 (Commission file no. 333-64687).
(27) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K/A filed with the Commission on August 17, 2010 (Commission file no. 001-33225).
(28) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K filed with the Commission on May 11, 2010 (Commission file no. 001-33225).
(29) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K filed with the Commission on January 17, 2012 (Commission file no. 001-33225).
(30) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K filed with the Commission on September 13, 2011 (Commission file no. 001-33225).
(31) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K filed with the Commission on November 16, 2011 (Commission file no. 001-33225).
(32) Incorporated by reference to Great Lakes Dredge & Dock Corporation s Current Report on Form 8-K filed with the Commission on July 9, 2007 (Commission file no. 001-33225).
* Filed herewith
Compensatory plan or arrangement.

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GREAT LAKES DREDGE & DOCK CORPORATION AND SUBSIDIARIES

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

Great Lakes Dredge & Dock Corporation

Oak Brook, Illinois

We have audited the accompanying consolidated balance sheets of Great Lakes Dredge & Dock Corporation and subsidiaries (the Company) as of December 31, 2011 and 2010, and the related consolidated statements of operations, equity, and cash flows for each of the three years in the period ended December 31, 2011. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Great Lakes Dredge & Dock Corporation and subsidiaries as of December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company s internal control over financial reporting as of December 31, 2011, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 9, 2012 expressed an unqualified opinion on the Company s internal control over financial reporting.

/s/ Deloitte & Touche LLP

Chicago, Illinois
March 9, 2012

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GREAT LAKES DREDGE & DOCK CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

AS OF DECEMBER 31, 2011 AND 2010

(In thousands, except share and per share amounts)

	2011	2010
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 113,288	$ 48,478
Accounts receivable net	120,268	95,548
Contract revenues in excess of billings	26,412	24,842
Inventories	33,426	31,734
Prepaid expenses	3,979	3,448
Other current assets	28,405	18,919
Total current assets	325,778	222,969
PROPERTY AND EQUIPMENT Net	310,520	323,231
GOODWILL	98,049	98,049
OTHER INTANGIBLE ASSETS Net	814	3,280
INVENTORIES Noncurrent	30,103	27,128
INVESTMENTS IN JOINT VENTURES	6,923	7,329
OTHER	16,273	11,839
TOTAL	$ 788,460	$ 693,825
LIABILITIES AND EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 82,745	$ 82,721
Accrued expenses	31,121	32,809
Billings in excess of contract revenues	13,627	14,484
Current portion of note payable	2,500	2,500
Current portion of equipment debt	533	303
Total current liabilities	130,526	132,817
LONG TERM NOTE PAYABLE	2,500	5,000
7 3/8% SENIOR NOTES	250,000	
7 3/4% SENIOR SUBORDINATED NOTES		175,000
DEFERRED INCOME TAXES	104,352	92,466
OTHER	8,545	11,717
Total liabilities	495,923	417,000
COMMITMENTS AND CONTINGENCIES (Note 12)		
EQUITY:		
Common stock $.0001 par value; 90,000,000 authorized, 58,999,404 and 58,770,369 shares issued and outstanding at December 31, 2011 and December 31, 2010, respectively.	6	6

Additional paid-in capital	267,918	266,329
Retained earnings	24,042	12,261
Accumulated other comprehensive income	3	357
Total Great Lakes Dredge & Dock Corporation equity	291,969	278,953
NONCONTROLLING INTERESTS	568	(2,128)
Total equity	292,537	276,825
TOTAL	$ 788,460	$ 693,825

See notes to the consolidated financial statements.

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GREAT LAKES DREDGE & DOCK CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 2011, 2010 AND 2009

(In thousands, except per share amounts)

	2011	2010	2009
CONTRACT REVENUES	$ 627,333	$ 686,922	$ 622,244
COSTS OF CONTRACT REVENUES	534,316	564,140	534,000
GROSS PROFIT	93,017	122,782	88,244
OPERATING EXPENSES:			
GENERAL AND ADMINISTRATIVE EXPENSES	50,434	54,352	45,993
GAIN ON SALE OF ASSETS Net	(11,711)		
Total operating income	54,294	68,430	42,251
OTHER EXPENSE:			
Interest expense net	(21,665)	(13,542)	(16,150)
Equity in loss of joint ventures	(406)	(614)	(384)
Loss on foreign currency transactions net	(282)		
Loss on extinguishment of debt	(5,145)		
Total other expense	(27,498)	(14,156)	(16,534)
INCOME BEFORE INCOME TAXES	26,796	54,274	25,717
INCOME TAX EXPENSE	(9,545)	(20,554)	(10,983)
NET INCOME	17,251	33,720	14,734
Net (income) loss attributable to noncontrolling interests	(723)	889	2,734
NET INCOME ATTRIBUTABLE TO COMMON STOCKHOLDERS OF GREAT LAKES DREDGE & DOCK CORPORATION	$ 16,528	$ 34,609	$ 17,468
Basic earnings per share attributable to Great Lakes Dredge & Dock Corporation	$ 0.28	$ 0.59	$ 0.30
Basic weighted-average shares	58,891	58,647	58,507
Diluted earnings per share attributable to Great Lakes Dredge & Dock Corporation	$ 0.28	$ 0.59	$ 0.30
Diluted weighted-average shares	59,230	58,871	58,612

See notes to the consolidated financial statements.

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GREAT LAKES DREDGE & DOCK CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2011, 2010 AND 2009

(In thousands, except share and per share amounts)

	Shares of Common Stock	Common Stock	Additional Paid-In Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests	Total
BALANCE January 1, 2009	58,484,242	$ 6	$ 262,501	$ (31,812)	$ (3,415)	$ 833	$ 228,113
Acquisition of Yankee Environmental Services						662	662
Share-based compensation	57,796		1,078				1,078
Dividends declared and paid ($0.07 per share)				(3,974)			(3,974)
Dividend equivalents paid on restricted stock units				(18)			(18)
Comprehensive income (loss):							
Net income (loss)				17,468		(2,734)	14,734
Reclassification of derivative losses to earnings (net of tax of $2,101)					3,164		3,164
Change in fair value of derivatives (net of tax of $524)					790		790
Total comprehensive income (loss):						(2,734)	18,688
BALANCE December 31, 2009	58,542,038	6	263,579	(18,336)	539	(1,239)	244,549
Share-based compensation	79,067		2,094				2,094
Vesting of restricted stock units, including impact of shares withheld for taxes	13,302						
Exercise of stock options	135,962		656				656
Dividends declared and paid ($0.07 per share)				(3,988)			(3,988)
Dividend equivalents paid on restricted stock units				(24)			(24)
Comprehensive income (loss):							
Net income (loss)				34,609		(889)	33,720
Reclassification of derivative gains to earnings (net of tax of $213)					(321)		(321)
Change in fair value of derivatives (net of tax of $92)					139		139
Total comprehensive income (loss):						(889)	33,538
BALANCE December 31, 2010	58,770,369	6	266,329	12,261	357	(2,128)	276,825
Share-based compensation	116,329		1,838				1,838
Vesting of restricted stock units, including impact of shares withheld for taxes	106,428		(291)				(291)
Exercise of stock options	6,278		27				27
Excess income tax benefit from share based compensation			55				55
Acquisition of noncontrolling interest in NASDI, LLC			(40)			1,973	1,933

Dividends declared and paid ($0.08 per share)				(4,711)			(4,711)
Dividend equivalents paid on restricted stock units				(36)			(36)
Comprehensive income (loss):							
Net income				16,528		723	17,251
Currency translation adjustment (net of tax of $177)					(267)		(267)
Reclassification of derivative gains to earnings (net of tax of $882)					(1,437)		(1,437)
Change in fair value of derivatives (net of tax of $824)					1,350		1,350
Total comprehensive income:						723	16,897
BALANCE December 31, 2011	58,999,404	$ 6	$ 267,918	$ 24,042	$ 3	$ 568	$ 292,537

See notes to the consolidated financial statements.

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GREAT LAKES DREDGE & DOCK CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2011, 2010 AND 2009

(In thousands)

	2011	2010	20 0 9
OPERATING ACTIVITIES:			
Net income	$ 17,251	$ 33,720	$ 14,734
Adjustments to reconcile net income to net cash flows provided by operating activities:			
Depreciation and amortization	40,838	34,301	33,023
Equity in loss of joint ventures	406	614	384
Distribution from equity joint ventures			621
Loss on extinguishment of 7 3/4% senior subordinated notes	5,145		
Deferred income taxes	14,332	7,405	1,401
Gain on dispositions of property and equipment	(11,711)	(505)	(651)
Gain on adjustment of contingent earnout	(1,400)		
Amortization of deferred financing fees	1,515	1,607	1,677
Unrealized foreign currency loss	513		
Share-based compensation expense	1,838	2,094	1,078
Excess income tax benefit from share based compensation	(55)		
Changes in assets and liabilities:			
Accounts receivable	(25,659)	56,603	(33,281)
Contract revenues in excess of billings	(3,759)	3,510	2,925
Inventories	(4,667)	2,630	9,836
Prepaid expenses and other current assets	(12,340)	(847)	3,529
Accounts payable and accrued expenses	3,888	(5,053)	12,591
Billings in excess of contract revenues	(857)	(11,078)	5,119
Other noncurrent assets and liabilities	(715)	(1,470)	1,012
Net cash flows provided by operating activities	24,563	123,531	53,998
INVESTING ACTIVITIES:			
Purchases of property and equipment	(33,433)	(25,258)	(24,666)
Proceeds from dispositions of property and equipment	16,717	431	1,028
Acquisition of Matteson assets		(37,869)	
Acquisition of controlling interest in Yankee Environmental Services			(1,229)
Net cash flows used in investing activities	(16,716)	(62,696)	(24,867)
FINANCING ACTIVITIES:			
Proceeds from issuance of 7 3/8% senior notes	250,000		
Redemption of 7 3/4% senior subordinated notes	(175,000)		
Senior subordinated notes redemption premium	(2,264)		
Deferred financing fees	(5,962)		
Repayment of long term note payable	(2,500)		
Dividends paid	(4,711)	(3,988)	(3,974)
Dividend equivalents paid on restricted stock units	(36)	(24)	(18)
Taxes paid on settlement of vested share awards	(291)		
Repayments of equipment debt	(1,911)	(1,251)	(1,867)
Exercise of stock options	27	656	
Excess income tax benefit from share-based compensation	55		
Borrowings under revolving loans		14,968	158,877
Repayments of revolving loans		(25,968)	(189,377)
Net cash flows provided by (used in) financing activities	57,407	(15,607)	(36,359)
Effect of foreign currency exchange rates on cash and cash equivalents	(444)		

Net increase (decrease) in cash and cash equivalents	64,810	45,228	(7,228)
Cash and cash equivalents at beginning of year	48,478	3,250	10,478
Cash and cash equivalents at end of year	$ 113,288	$ 48,478	$ 3,250
Supplemental Cash Flow Information			
Cash paid for interest	$ 12,485	$ 13,269	$ 14,764
Cash paid for income taxes	$ 5,270	$ 16,332	$ 8,677
Non-cash Investing Activity			
Property and equipment purchased but not yet paid	$ 5,222	$ 8,559	$ 4,187
Property and equipment purchased on capital leases and equipment notes	$ 2,127	$ 109	$ 615
Acquisition of noncontrolling interest in NASDI, LLC	$ 40	$	$
Purchase price of Matteson assets comprised of promissory notes and other liabilities	$	$ 9,140	$

See notes to the consolidated financial statements.

GREAT LAKES DREDGE & DOCK CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2011 AND 2010 AND FOR THE

YEARS ENDED DECEMBER 31, 2011, 2010 AND 2009

(In thousands, except share and per share amounts)

1. NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization Great Lakes Dredge & Dock Corporation and its subsidiaries (the Company or Great Lakes) are in the business of marine construction, primarily dredging, and commercial and industrial demolition. The Company s primary dredging customers are domestic and foreign government agencies, as well as private entities, and its primary demolition customers are general contractors, corporations that commission projects, nonprofit institutions such as universities and hospitals, and local government and municipal agencies.

Principles of Consolidation and Basis of Presentation The consolidated financial statements include the accounts of Great Lakes Dredge & Dock Corporation and its majority-owned subsidiaries. All intercompany accounts and transactions are eliminated in consolidation. The equity method of accounting is used for investments in unconsolidated investees in which the Company has significant influence, but not control. Other investments, if any, are carried at cost.

Use of Estimates The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Revenue and Cost Recognition on Contracts Substantially all of the Company s contracts for dredging services are fixed-price contracts, which provide for remeasurement based on actual quantities dredged. The majority of the Company s demolition contracts are also fixed-price contracts, with others managed as time-and-materials. Contract revenues are recognized under the percentage-of-completion method, based on the Company s engineering estimates of the physical percentage completed for dredging projects and using a cost-to-cost approach for demolition projects. For dredging projects, costs of contract revenues are adjusted to reflect the gross profit percentage expected to be achieved upon ultimate completion. For demolition contracts, contract revenues are adjusted to reflect the estimated gross profit percentage. Revisions in estimated gross profit percentages are recorded in the period during which the change in circumstances is experienced or becomes known. As the duration of most of the Company s contracts is one year or less, the cumulative net impact of these revisions in estimates, individually and in the aggregate across our projects, does not significantly affect our results across reporting periods. Provisions for estimated losses on contracts in progress are made in the period in which such losses are determined. Claims for additional compensation due to the Company are not recognized in contract revenues until such claims are settled. Billings on contracts are generally submitted after verification with the customers of physical progress and may not match the timing of revenue recognition. The difference between amounts billed and recognized as revenue is reflected in the balance sheet as either contract revenues in excess of billings or billings in excess of contract revenues. Modifications may be negotiated when a change from the original contract specification is encountered, and a change in project scope, performance methodology and/or material disposal is necessary. Thus, the resulting modification is considered a change in the scope of the original project to which it relates. Significant expenditures incurred incidental to major contracts are deferred and recognized as contract costs based on contract performance over the duration of the related project. These expenditures are reported as prepaid expenses.

The components of costs of contract revenues include labor, equipment (including depreciation, maintenance, insurance and long-term rentals), subcontracts, fuel and project overhead. Hourly labor is generally hired on a project-by-project basis. Costs of contract revenues vary significantly depending on the type and

location of work performed and assets utilized. Generally, capital projects have the highest margins due to the complexity of the projects, while beach nourishment projects have the most volatile margins because they are most often exposed to variability in weather conditions. In the current year consolidated statements of operations, the Company has presented gains, net of losses, on the sale of assets as a separate line item in operating income. In the prior years, gains, net of losses, on the sale of assets were included in costs of contract revenues and were $467 and $614 for the years ended December 31, 2010 and 2009, respectively.

The Company s cost structure includes significant annual equipment-related costs, including depreciation, maintenance, insurance and long-term rentals. These costs have averaged approximately 21% to 22% of total costs of contract revenues over the prior three years. During the year, both equipment utilization and the timing of fixed cost expenditures fluctuate significantly. Accordingly, the Company allocates these fixed equipment costs to interim periods in proportion to revenues recognized over the year, to better match revenues and expenses. Specifically, at each interim reporting date the Company compares actual revenues earned to date on its dredging contracts to expected annual revenues and recognizes equipment costs on the same proportionate basis. In the fourth quarter, any over or under allocated equipment costs are recognized such that the expense for the year equals actual equipment costs incurred during the year.

Classification of Current Assets and Liabilities The Company includes in current assets and liabilities amounts realizable and payable in the normal course of contract completion, unless completion of such contracts extends significantly beyond one year.

Cash Equivalents The Company considers all highly liquid investments with a maturity at purchase of three months or less to be cash equivalents.

Accounts Receivable, net Accounts receivable represent amounts due or billable under the terms of contracts with customers, including amounts related to retainage. The Company anticipates collection of retainage generally within one year, and accordingly presents retainage as a current asset. A portion of retainage will not be collected until after one year and is classified as other non-current assets. The Company provides an allowance for estimated uncollectible accounts receivable when events or conditions indicate that amounts outstanding are not recoverable.

Inventories Inventories consist of pipe and spare parts used in the Company s dredging operations. Pipe and spare parts are purchased in large quantities; therefore, a certain amount of pipe and spare part inventories is not anticipated to be used within the current year and is classified as long-term. Inventories are stated at the lower of net realizable value or weighted average historical cost.

Property and Equipment Capital additions, improvements, and major renewals are classified as property and equipment and are carried at depreciated cost. Maintenance and repairs that do not significantly extend the useful lives of the assets or enhance the capabilities of such assets are charged to expenses as incurred. Depreciation is recorded over the estimated useful lives of property and equipment using the straight-line method and the mid-year depreciation convention. The estimated useful lives by class of assets are:

Class	Useful Life (years)
Buildings and improvements	10
Furniture and fixtures	5-10
Vehicles, dozers, and other light operating equipment and systems	3-5
Heavy operating equipment (dredges and barges)	10-30

Leasehold improvements are amortized over the shorter of their remaining useful lives or the remaining terms of the leases.

Goodwill and Other Intangible Assets Goodwill represents the excess of cost over fair value. Other identifiable intangible assets mainly represent developed technology and databases, customer relationships, and customer contracts acquired in business combinations and are being amortized over a one to ten-year period.

Goodwill is tested annually for impairment in the third quarter of each year, or more frequently should circumstances dictate. GAAP requires that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount.

The Company assesses the fair values of its reporting units using both a market-based approach and an income-based approach. Under the income approach, the fair value of the reporting unit is based on the present value of estimated future cash flows. The income approach is dependent on a number of factors, including estimates of future market growth trends, forecasted revenues and expenses, appropriate discount rates and other variables. The estimates are based on assumptions that the Company believes to be reasonable, but such assumptions are subject to unpredictability and uncertainty. Changes in these estimates and assumptions could materially affect the determination of fair value, and may result in the impairment of goodwill in the event that actual results differ from those estimates.

The market approach measures the value of a reporting unit through comparison to comparable companies. Under the market approach, the Company uses the guideline public company method by applying estimated market-based enterprise value multiples to the reporting unit s estimated revenue and Adjusted EBITDA. The Company analyzed companies that performed similar services or are considered peers. Due to the fact that there are no public companies that are direct competitors, the Company weighed the results of this approach less than the income approach.

The Company operates in two reportable segments: dredging and demolition. These reportable segments are the Company s operating segments and the reporting units at which the Company tests goodwill for impairment. In 2011, the Company early adopted new accounting guidance that allows for the option to perform a qualitative assessment prior to calculating the fair value of a reporting unit in the first step of the annual goodwill impairment testing. The adoption of this new accounting principle had no impact as the Company chose to perform a quantitative assessment of impairment in the current year. The Company performed its most recent annual test of impairment as of July 1, 2011 for the goodwill in both the dredging and demolition segments with no indication of goodwill impairment as of the test date. As of the test date, the fair value of both the dredging segment and the demolition segment were in excess of their carrying values by approximately 35% and 8%, respectively. Given the small margin with which the demolition segment s fair value is in excess of its carrying value, a more than insignificant decline in the demolition segment s future operating results or cash flow forecasts versus the segment s current forecasts could potentially cause a goodwill impairment charge to be recognized in a future period. The Company will perform its next scheduled annual test of goodwill in the third quarter of 2012 should no triggering events occur which would require a test prior to the next annual test.

Long-Lived Assets Long-lived assets are comprised of property and equipment and intangible assets subject to amortization. Long-lived assets to be held and used are reviewed for possible impairment whenever events indicate that the carrying amount of such assets may not be recoverable by comparing the undiscounted cash flows associated with the assets to their carrying amounts. If such a review indicates an impairment, the carrying amount would be reduced to fair value. If long-lived assets are to be disposed, depreciation is discontinued, if applicable, and the assets are reclassified as held for sale at the lower of their carrying amounts or fair values less estimated costs to sell. No triggering events were identified in 2011 or 2010.

Self-insurance Reserves The Company self-insures costs associated with its seagoing employees covered by the provisions of Jones Act, workers compensation claims, hull and equipment liability, and general business liabilities up to certain limits. Insurance reserves are established for estimates of the loss that the Company may ultimately incur on reported claims, as well as estimates of claims that have been incurred but not yet reported. In determining its estimates, the Company considers historical loss experience and judgments about the present and expected levels of cost per claim. Trends in actual experience are a significant factor in the determination of such reserves.

The Company was previously a member of an insurance association that provided personal injury coverage for its maritime workforce in excess of self-insurance retention limits. Under the prior plan the Company was subject to retroactive premium adjustments based on the association s claims experience and investment

performance. The Company accrued for retroactive premium adjustments when assessed by the insurance association. As the Company is no longer a member of the insurance association, there were no assessments accrued for the year ended December 31, 2011. During the years ended December 31, 2010 and 2009, there were $2,207 and $1,983 recorded for retroactive assessments, respectively.

Income Taxes The provision for income taxes includes federal, foreign, and state income taxes currently payable and those deferred because of temporary differences between the financial statement and tax basis of assets and liabilities. Recorded deferred income tax assets and liabilities are based on the estimated future tax effects of differences between the financial and tax basis of assets and liabilities, given the effect of currently enacted tax laws. The Company s current policy is to repatriate all earnings from foreign subsidiaries operations as generated and at this time no amounts are considered to be permanently reinvested in those operations.

Hedging Instruments The Company designates certain derivative contracts as a cash flow hedge as defined by GAAP. Accordingly, the Company formally documents, at the inception of each hedge, all relationships between hedging instruments and hedged items, as well as our risk-management objective and strategy for undertaking hedge transactions. This process includes linking all derivatives to highly-probable forecasted transactions.

The Company formally assesses, at inception and on an ongoing basis, the effectiveness of hedges in offsetting changes in the cash flows of hedged items. Hedge accounting treatment is discontinued when (1) it is determined that the derivative is no longer highly effective in offsetting changes in the cash flows of a hedged item (including hedged items for forecasted future transactions), (2) the derivative expires or is sold, terminated or exercised, (3) it is no longer probable that the forecasted transaction will occur or (4) management determines that designating the derivative as a hedging instrument is no longer appropriate. If management elects to stop hedge accounting, it would be on a prospective basis and any hedges in place would be recognized in accumulated other comprehensive income (loss) until all the related forecasted transactions are completed or are probable of not occuring.

Foreign Currency Translation The financial statements of the Company s foreign subsidiaries where the operations are primarily denominated in the foreign currency are translated into U.S. dollars for reporting. Balance sheet accounts are translated at the current foreign exchange rate at the end of each period and income statement accounts are translated at the average foreign exchange rate for each period. Gains and losses on foreign currency translations are reflected as a currency translation adjustment, net of tax, in accumulated other comprehensive income (loss). Foreign currency transaction gains and losses are included in loss on foreign currency transactions, net.

Noncontrolling Interest The Company previously owned 65% of the profits interests of NASDI, LLC (NASDI), a demolition service provider located in the Boston, Massachusetts area. Effective January 1, 2011 the Company reacquired Mr. Christopher Berardi s 35% membership interest in NASDI for no cost per the terms of NASDI s limited liability company agreement. This resulted in the elimination of noncontrolling interest of $1,973. The Company now owns 100% of NASDI.

In March 2011, Mr. Berardi resigned his employment with the Company s demolition segment effective April 29, 2011. Mr. Berardi s resignation and the repurchase of his NASDI membership interest also resulted in the reversal of a $1,933 accrual established in conjunction with a prior restructuring of ownership interest in NASDI. This reversal was recorded directly to equity as part of the reacquisition of the noncontrolling interest.

On January 1, 2009 the Company acquired a 65% interest in Yankee Environmental Services, LLC (Yankee). Noncontrolling interest at December 31, 2011 is related to the membership interest the Company does not own in Yankee.

Earnings Per Share Basic earnings per share is computed by dividing net income attributable to common stockholders by the weighted-average number of common shares outstanding during the reporting period. Diluted earnings per share is computed similar to basic earnings per share except that it reflects the potential dilution that

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could occur if dilutive securities or other obligations to issue common stock were exercised or converted into common stock. For the years ended December 31, 2011, 2010 and 2009, 299,132, zero and zero options to purchase shares of common stock (NQSO), respectively, were excluded from the calculation of diluted earnings per share. The options were excluded based on the application of the treasury stock method, as such options were determined to be anti-dilutive.

The computations for basic and diluted earnings per share for the years ended December 31, 2011, 2010 and 2009 are as follows:

	2011	2010	2009
Net income attributable to common shareholders of Great Lakes Dredge & Dock Corporation	$ 16,528	$ 34,609	$ 17,468
Weighted-average common shares outstanding basic	58,890,780	58,646,511	58,506,608
Effect of stock options and restricted stock units	339,039	224,426	105,674
Weighted-average common shares outstanding diluted	59,229,819	58,870,937	58,612,282
Earnings per share basic	$ 0.28	$ 0.59	$ 0.30
Earnings per share diluted	$ 0.28	$ 0.59	$ 0.30

Future Adoption of Accounting Standards In May 2011, the Financial Accounting Standards Board (FASB) issued an amendment to their accounting guidance to clarify existing standards and to improve comparability of fair value measurements disclosed in financial statements prepared in accordance with GAAP and International Financial Reporting Standards (IFRS). The amendment clarifies the FASB s intent as it relates to existing measurement guidance and revises some requirements for measuring or disclosing information about fair value measurements. The amendment will be effective for Great Lakes on January 1, 2012 and is not expected to have a significant impact on our consolidated financial statements.

In June and December 2011, the FASB issued amendments to their accounting guidance that requires presentation of net income and total comprehensive income, together with their components, either in a single continuous statement or in two separate but consecutive statements. The amendment does not alter any current recognition or measurement requirements in respect of items of other comprehensive income. When adopted, Great Lakes will cease to present the components of other comprehensive income within the statements of equity. The amendment will be effective for Great Lakes on January 1, 2012.

2. RESTRICTED AND ESCROWED CASH

At December 31, 2011 and 2010, other noncurrent assets include $1,500 of cash held in escrow as security for the Company s lease rental obligation under a long-term equipment operating lease.

At December 31, 2011 the Company held cash and cash equivalents of $6,489 in an escrow account related to its sale of real estate in Channelview, TX. The escrow is intended to transfer the proceeds from the sale to the purchase of a like-kind property, and due to the availability of the funds to the Company is not deemed to be restricted.

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3. ACCOUNTS RECEIVABLE AND CONTRACTS IN PROGRESS

Accounts receivable at December 31, 2011 and 2010, are as follows:

	2011	2010
Completed contracts	$ 38,317	$ 20,093
Contracts in progress	69,469	64,399
Retainage	20,692	18,634
	128,478	103,126
Allowance for doubtful accounts	(1,839)	(1,655)
Total accounts receivable	$ 126,639	$ 101,471
Current portion of accounts receivable, net	$ 120,268	$ 95,548
Long-term retainage	6,371	5,923
Total accounts receivable	$ 126,639	$ 101,471

The components of contracts in progress at December 31, 2011 and 2010, are as follows:

	2011	2010
Costs and earnings in excess of billings:		
Costs and earnings for contracts in progress	$ 173,187	$ 287,291
Amounts billed	(152,045)	(263,665)
Costs and earnings in excess of billings for contracts in progress	21,142	23,626
Costs and earnings in excess of billings for completed contracts	7,459	1,216
Total contract revenues in excess of billings	$ 28,601	$ 24,842
Current portion of contract revenues in excess of billings	$ 26,412	$ 24,842
Portion included in other noncurrent assets	2,189	
Total contract revenues in excess of billings	$ 28,601	$ 24,842
Billings in excess of costs and earnings:		
Amounts billed	$ (427,797)	$ (429,688)
Costs and earnings for contracts in progress	414,170	415,204
Total billings in excess of contract revenues	$ (13,627)	$ (14,484)

4. PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2011 and 2010 are as follows:

	2011	2010
Land	$ 2,764	$ 2,870
Buildings and improvements	5,184	5,190
Furniture and fixtures	3,636	3,074
Operating equipment	519,008	499,976
Total property and equipment	530,592	511,110
Accumulated depreciation	(220,072)	(187,879)
Property and equipment net	$ 310,520	$ 323,231

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Depreciation expense was $38,372, $33,874 and $32,251, for the years ended December 31, 2011, 2010 and 2009, respectively.

5. GOODWILL AND OTHER INTANGIBLE ASSETS

The change in the carrying amount of goodwill during the years ended December 31, 2011 and 2010 is as follows:

	Dredging Segment	Demolition Segment	Total
Goodwill	$ 76,575	$ 26,290	$ 102,865
Accumulated impairment losses		(4,816)	(4,816)
Balance January 1, 2010	76,575	21,474	98,049
Balance December 31, 2010	76,575	21,474	98,049
Balance December 31, 2011	$ 76,575	$ 21,474	$ 98,049

At December 31, 2011 and 2010, the net book value of identifiable intangible assets was as follows:

As of December 31, 2011	Cost	Accumulated Amortization	Net
Customer relationships	$ 1,481	$ 1,279	$ 202
Software and databases	1,209	1,063	146
Non-compete agreement	744	313	431
Trade names	88	53	35
	$ 3,522	$ 2,708	$ 814

As of December 31, 2010			
Customer relationships	$ 1,481	$ 1,223	$ 258
Backlog	2,611	480	2,131
Software and databases	1,209	991	218
Non-compete agreement	744	137	607
Trade names	88	35	53
Other	83	70	13
	$ 6,216	$ 2,936	$ 3,280

On December 31, 2010 the Company acquired the assets of L.W. Matteson, Inc. (Matteson) resulting in the recognition of additional intangible assets (See Note 14). The weighted average amortization period for intangible assets acquired in 2010 is 1.8 years. Intangible assets that were fully amortized at December 31, 2011 , including backlog and other intangible assets, have been removed from the balance sheet.

Amortization expense was $2,466, $427 and $773, for the years ended December 31, 2011, 2010 and 2009, respectively, and is included as a component of general and administrative expenses. Amortization expense related to intangible assets is estimated to be $254 in 2012, $254 in 2013, $163 in 2014 and $143 in 2015.

6. ACCRUED EXPENSES

Accrued expenses at December 31, 2011 and 2010 are as follows:

	2011	2010
Payroll and employee benefits	$ 10,763	$ 13,573
Insurance	8,285	11,039
Interest	7,759	604
Percentage of completion adjustment	1,855	3,232
Income and other taxes	1,261	2,977
Other	1,198	1,384
Total accrued expenses	$ 31,121	$ 32,809

7. LONG-TERM DEBT

Long-term debt at December 31, 2011 and 2010 is as follows:

	2011	2010
Equipment notes payable	$ 591	$ 366
Note payable	5,000	7,500
7.375% senior notes	250,000	
7.75% senior subordinated notes		175,000
Subtotal	255,591	182,866
Current portion of note payable	(2,500)	(2,500)
Current portion of equipment debt	(533)	(303)
Total	$ 252,558	$ 180,063

Credit agreement

On June 12, 2007, the Company entered into a credit agreement (as amended, the Credit Agreement) with Bank of America N.A. (successor by merger to LaSalle Bank National Association) as Administrative Agent and Issuing Lender, various other financial institutions as lenders and certain subsidiaries of the Company as Loan Parties. The Credit Agreement, provides for a revolving credit facility of up to $145,000 in borrowings and includes sublimits for the issuance of letters of credit and swingline loans. The revolving credit facility matures on June 12, 2012. The revolving credit facility bears interest at rates selected at the option of Great Lakes, currently equal to either LIBOR plus an applicable margin or the Base Rate plus an applicable margin. The applicable margins for LIBOR loans and Base Rate loans, as well as any non-use fee, are subject to adjustment based upon the Company s ratio of Total Funded Debt to Adjusted Consolidated Earnings before interest, taxes, depreciation and amortization (EBITDA) (each as defined in the Credit Agreement).

The obligations of Great Lakes under the Credit Agreement are unconditionally guaranteed by its direct and indirect domestic subsidiaries. Additionally, the obligations are secured by a perfected first priority lien on certain equipment of Great Lakes subsidiary, Great Lakes Dredge & Dock Company, LLC (GLDD Company); a perfected second priority lien on certain other equipment of GLDD Company, subject to a perfected first priority lien in favor of Great Lakes bonding company; a perfected first priority lien on the intercompany receivables of Great Lakes and its direct and indirect domestic subsidiaries and having an equal priority to the liens of Great Lakes bonding company; and a perfected second priority lien on the accounts receivable of Great Lakes and its direct and indirect subsidiaries that relate to bonded projects. The Credit Agreement contains various covenants and restrictions, including (i) limitations on dividends to $5 million per year, (ii) limitations on

redemptions and repurchases of capital stock, (iii) limitations on the incurrence of indebtedness, liens, leases, and investments, and (iv) maintenance of certain financial covenants.

As of December 31, 2011, the Company had no borrowings and $26,900 of letters of credit outstanding, resulting in $118,100 of availability under the Credit Agreement. There were no borrowings from the revolving credit facility during 2011.

At December 31, 2011, the Company was in compliance with its various covenants under its Credit Agreement.

Senior notes

In January 2011, the Company issued $250,000 of 7.375% senior notes due February 1, 2019. The senior notes were issued at 100% of face value resulting in net proceeds of $244,171. Also in January 2011, the Company redeemed all of its $175,000 of 7.75% senior subordinated notes due December 2013 for $180,014, which included a redemption premium and accrued and unpaid interest. The net proceeds of the issuance of the senior notes were used to redeem the senior subordinated notes. The remaining net proceeds from the issuance of the senior notes were used to augment working capital and could be used in the future for acquisitions.

Other

Great Lakes has a $24,000 International Letter of Credit Facility with Wells Fargo HSBC Trade Bank. This facility is used for performance and advance payment guarantees on foreign contracts, including our long-term land reclamation project in Bahrain. The Company s obligations under the agreement are guaranteed by the Company s foreign accounts receivable. In addition, the Export-Import Bank of the United States (Ex-Im Bank) has issued a guarantee under the Ex-Im Bank s Working Capital Guarantee Program, which covers 90% of the obligations owing under the facility. At December 31, 2011, there were $11,724 of letters of credit outstanding under this facility.

In accordance with the purchase of Matteson (See Note 14), the Company issued a secured promissory note in the amount of $7,500 to the former owners of Matteson. Remaining principal payments of $2,500 each are due on December 31, 2012 and 2013. Interest payments at the annual rate of 6% are due quarterly.

The scheduled principal payments through the maturity date of the Company s long-term debt, excluding equipment notes, at December 31, 2011, are as follows:

Years Ending December 31	
2012	$ 2,500
2013	2,500
2014	
2015	
Thereafter	250,000
Total	$ 255,000

The Company incurred amortization of deferred financing fees for its long term debt of $1,515, $1,607 and $1,677 for each of the years ended December 31, 2011, 2010 and 2009.

The Company sometimes enters into equipment note arrangements or capital leases to finance the acquisition of dozers, excavators and other operating equipment. In 2011 and 2010, the Company entered into equipment notes totaling $2,127 and $109, respectively. The current portion of equipment notes payable is $533 and $303, at December 31, 2011 and 2010, respectively. The long-term portion of these equipment notes is included in other long-term liabilities and totaled $58 and $63 at December 31, 2011 and 2010, respectively. The terms of these equipment notes extend through 2013. The net book value of the related assets was $2,450 and $1,335 at December 31, 2011 and 2010, respectively. Payments on these equipment notes will be $533 and $58 in 2012 and 2013.

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8. FAIR VALUE MEASUREMENTS

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. A fair value hierarchy has been established by GAAP that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The accounting guidance describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The Company utilizes the market approach to measure fair value for its financial assets and liabilities. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. The Company recognizes transfers between levels of the fair value hierarchy at the end of the reporting period in which the event giving rise to the transfer occurred. At December 31, 2011 and 2010, the Company held certain derivative contracts that it uses to manage foreign currency risk, commodity price risk and interest rate risk. The Company does not hold or issue derivatives for speculative or trading purposes. The fair value of these financial instruments are summarized as follows:

		Fair Value Measurements at Reporting Date Using		
Description	**At December 31, 2011**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Fuel hedge contracts	$ 449	$	$ 449	$
Interest rate swap contracts	755		755	
Foreign exchange contracts	155		155	
Total assets measured at fair value	$ 1,359	$	$ 1,359	$

		Fair Value Measurements at Reporting Date Using		
Description	**At December 31, 2010**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Fuel hedge contracts	$ 595	$	$ 595	$
Interest rate swap contracts	1,264			1,264
Total assets measured at fair value	$ 1,859	$	$ 595	$ 1,264

Interest rate swap contracts

In May 2009, the Company entered into two interest rate swap arrangements, which are effective through December 15, 2012, to swap a notional amount of $50 million from a fixed rate of 7.75% to a floating LIBOR-based rate in order to manage the interest rate paid with respect to the Company s 7.75% senior subordinated notes. Although the senior subordinated notes were redeemed in January 2011, the swaps remain in place. The swaps are not accounted for as a hedge; therefore, the changes in fair value are recorded as adjustments to interest expense in each reporting period.

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The Company previously verified the fair value of the interest rate swaps using a quantitative model that contained both observable and unobservable inputs. The unobservable inputs related primarily to the implied LIBOR forward rate and the long-term nature of the contracts. At the end of the fourth quarter of 2011, the unobservable inputs began to be corroborated by observable market data and accordingly the Company has transferred the swaps into Level 2 of the fair value hierarchy.

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)	
	2011	2010
Interest rate swap contracts		
Balance at January 1,	$ 1,264	$ (20)
Total unrealized gains (losses) included in earnings	(1,396)	419
Settlements	887	865
Transfers out of Level 3	(755)	
Balance at December 31,	$	$ 1,264

Foreign exchange contracts

The Company has exposure to foreign currencies that fluctuate in relation to the U.S. dollar. The Company periodically enters into foreign exchange forward contracts to hedge this risk. At December 31, 2011, the Company had one outstanding contract related to the Brazilian Real. This foreign exchange contract is not accounted for as a hedge.

Fuel hedge contracts

The Company is exposed to certain market risks, primarily commodity price risk as it relates to the diesel fuel purchase requirements, which occur in the normal course of business. The Company enters into heating oil commodity swap contracts to hedge the risk that fluctuations in diesel fuel prices will have an adverse impact on cash flows associated with its domestic dredging contracts. The Company s goal is to hedge approximately 80% of the fuel requirements for work in backlog.

As of December 31, 2011, the Company was party to various swap arrangements to hedge the price of a portion of its diesel fuel purchase requirements for work in its backlog to be performed through September 2012. As of December 31, 2011, there were 5.2 million gallons remaining on these contracts which represent approximately 59% of the Company s forecasted fuel purchases through September 2012. Under these swap agreements, the Company will pay fixed prices ranging from $2.65 to $2.98 per gallon.

At each balance sheet date, unrealized gains and losses on fuel hedge contracts are recorded as a component of accumulated other comprehensive income (loss) in the consolidated balance sheets. Gains and losses realized upon settlement of fuel hedge contracts are reclassified from accumulated other comprehensive income (loss) as the fuel is utilized, as an increase or a reduction of fuel expense, which is a component of costs of contract revenues in the consolidated statements of operations.

At December 31, 2011 and 2010, the fair value asset of the fuel hedge contracts was estimated to be $449 and $595, respectively, and is recorded in other current assets. The gain reclassified to earnings from changes in fair value of derivatives, net of cash settlements and taxes, for the period ended December 31, 2011 was $1,437. The remaining gains included in accumulated other comprehensive income at December 31, 2011 will be reclassified into earnings over the next nine months, corresponding to the period during which the hedged fuel is expected to be utilized. The fair values of fuel hedges are corroborated using inputs that are readily observable in public markets; therefore, the Company determines fair value of these fuel hedges using Level 2 inputs.

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The Company is exposed to counterparty credit risk associated with non-performance of its various derivative instruments. The Company s risk would be limited to any unrealized gains on current positions. To help mitigate this risk, the Company transacts only with counterparties that are rated as investment grade or higher. In addition, all counterparties are monitored on a continuous basis.

The fair value of derivative instruments outstanding as of December 31, 2011 and 2010, respectively, is as follows:

	Balance Sheet Location	**Fair Value at December 31,**	
Asset derivatives:		**2011**	**2010**
Derivatives designated as hedges			
Fuel hedge contracts	Other current assets	$ 449	$ 595
Derivatives not designated as hedges			
Interest rate swaps	Other current assets	755	816
Interest rate swaps	Other assets		448
Foreign exchange contracts	Other current assets	155	
Total asset derivatives		$ 1,359	$ 1,859

The carrying value of other financial instruments included in current assets and current liabilities approximates fair value due to the short-term maturities of these instruments. In January 2011, the Company issued $250,000 of 7.375% senior notes due February 1, 2019, which were outstanding at December 31, 2011 (See Note 7). The senior notes are senior unsecured obligations of the Company and its subsidiaries that guarantee the senior notes. The fair value of the Company s senior notes is $247,500 at December 31, 2011, which is a Level 1 fair value measurement as the senior notes value was obtained using quoted prices in active markets.

9. INCOME TAXES

The Company s pre- tax income from domestic and foreign operations for the years ended December 31, 2011, 2010 and 2009 is as follows:

	2011	**2010**	**2009**
Domestic operations	$ 21,590	$ 56,333	$ 28,745
Foreign operations	5,206	(2,059)	(3,028)
Total pre-tax income	$ 26,796	$ 54,274	$ 25,717

The provision for income taxes as of December 31, 2011, 2010 and 2009 is as follows:

	2011	**2010**	**2009**
Federal:			
Current	$ (5,657)	$ 11,602	$ 7,632
Deferred	13,762	6,772	1,737
State:			
Current	403	2,431	1,967
Deferred	700	(602)	(521)
Foreign current	337	351	168
Total	$ 9,545	$ 20,554	$ 10,983

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The Company s income tax provision reconciles to the provision at the statutory U.S. federal income tax rate of 35% as of December 31, 2011, 2010 and 2009 as follows:

	2011	2010	2009
Tax provision at statutory U.S. federal income tax rate	$ 9,378	$ 18,996	$ 9,001
State income tax net of federal income tax benefit	730	1,497	729
Foreign income tax benefit	(1,367)	440	
Secondary offering expenses			207
Tax on (income) loss attributable to noncontrolling interests	(253)	268	957
Changes in unrecognized tax benefits	15	(1,215)	
Changes in valuation allowance	1,588	59	
Other	(546)	509	89
Income tax provision	$ 9,545	$ 20,554	$ 10,983

At December 31, 2011 and 2010, the Company had net operating loss carryforwards for state income tax purposes totaling $26,159 and $17,481, respectively. The outstanding carryforwards will expire between 2017 and 2026. At December 31, 2011 and 2010, a valuation allowance has been established for a portion of the deferred tax asset related to these state net operating loss carryforwards in the amount of $492 and $271, respectively.

The Company also has foreign net operating loss carryforwards of approximately $10,164 and $7,463 as of December 31, 2011 and 2010, respectively. The net operating losses expire between 2012 and 2031. At December 31, 2011 and 2010, a full valuation allowance has been established for the deferred tax asset of $2,632 and $1,265, respectively, related to foreign net operating loss carryforwards, as the Company believes it is more likely than not that the net operating loss carryforwards will not be realized.

As of December 31, 2011 and 2010, the Company had $633 and $630, respectively, in unrecognized tax benefits, the recognition of which would have an impact of $347 and $345 on the effective tax rate.

The Company does not expect that total unrecognized tax benefits will significantly increase or decrease within the next 12 months. Below is a tabular reconciliation of the total amounts of unrecognized tax benefits at the beginning and end of each period.

	2011	2010	2009
Unrecognized tax benefits January 1	$ 630	$ 2,038	$ 2,220
Gross increases tax positions in prior period	3		142
Gross increases current period tax positions			69
Gross decreases expirations in prior period		(113)	(231)
Gross decreases tax positions in prior period		(1,015)	(42)
Settlements		(280)	(120)
Unrecognized tax benefits December 31,	$ 633	$ 630	$ 2,038

The Company s policy is to recognize interest and penalties related to income tax matters in income tax expense. As of December 31, 2011 and 2010, the Company had approximately $196 and $175, respectively, of interest and penalties recorded.

The Company files income tax returns at the U.S. federal level and in various state and foreign jurisdictions. U.S. federal income tax years prior to 2008 are closed and no longer subject to examination. With few exceptions, the statute of limitations in state taxing jurisdictions in which the Company operates has expired for all years prior to 2007. In foreign jurisdictions in which the Company operates, years prior to 2009 are closed and are no longer subject to examination.

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The Company s deferred tax assets (liabilities) at December 31, 2011 and 2010 are as follows:

	2011	2010
Deferred tax assets:		
Accrued liabilities	$ 8,177	$ 10,387
Tax credit carryforwards	391	
Foreign NOLs	2,632	1,265
State NOLs	1,285	777
Valuation allowance	(3,124)	(1,536)
Total deferred tax assets	9,361	10,893
Deferred tax liabilities:		
Depreciation and amortization	(106,671)	(94,713)
Investment in NASDI, LLC and Yankee Environmental Services	(942)	(155)
Fuel hedges	(179)	(237)
Total deferred tax liabilities	(107,792)	(95,105)
Net deferred tax liabilities	$ (98,431)	$ (84,212)
As reported in the balance sheet:		
Net current deferred tax assets (included in other current assets)	$ 5,921	$ 8,254
Net noncurrent deferred tax liabilities	(104,352)	(92,466)
Net deferred tax liabilities	$ (98,431)	$ (84,212)

Deferred tax assets relate primarily to reserves and other liabilities for costs and expenses not currently deductible for tax purposes. Deferred tax liabilities relate primarily to the cumulative difference between book depreciation and amounts deducted for tax purposes. With the exception of certain state and foreign net operating loss carryforwards, a valuation allowance has not been recorded to reduce the balance of deferred tax assets at either December 31, 2011, or December 31, 2010, because the Company believes that it is more likely than not that the deferred income tax assets will ultimately be realized.

10. SHARE-BASED COMPENSATION

The Company s 2007 Long-Term Incentive Plan (the Incentive Plan), as approved by the Board of Directors on September 18, 2007, permits the grant of stock options, stock appreciation rights, restricted stock and restricted stock units (RSUs) to its employees and directors for up to 5.8 million shares of common stock.

Compensation cost charged to expense related to these stock-based compensation arrangements was $1,838, $2,094 and $1,078 for the years ended December 31, 2011, 2010 and 2009, respectively.

Non-qualified stock options

The NQSO awards were granted with an exercise price equal to the market price of the Company s common stock at the date of grant. The option awards generally vest in three equal annual installments commencing on the first anniversary of the grant date, and have ten year exercise periods.

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The fair value of the NQSOs was determined at the grant date using a Black-Scholes option pricing model, which requires the Company to make several assumptions. The risk-free interest rate is based on the U.S. Treasury yield curve in effect for the expected term of the option at the time of grant. The annual dividend yield on the Company s common stock is based on estimates of future dividends during the expected term of the NQSOs. The expected life of the NQSOs was determined based upon a simplified assumption that the NQSOs will be exercised evenly from vesting to expiration, as the Company does not have sufficient historical exercise data to provide a reasonable basis upon which to estimate the expected life.

For grants issued in 2011 and 2010, the volatility assumptions were based on historical volatility of Great Lakes and comparable publicly-traded companies, primarily more mature and well-established companies in the engineering and construction sector.

For grants issued in 2009, the volatility assumptions were based upon historical volatilities of comparable companies whose shares are traded using daily stock price returns equivalent to the expected term of the option. Due to a lack of sufficient historical information at the time these NQSOs were issued (since the Company s shares were not publicly traded until December 2006) the historical volatility data for the Company was not considered in determining expected volatility. The Company also considered implied volatility data for comparable companies, using current exchange traded options.

There is not an active market for options on the Company s common stock and, as such, implied volatility for the Company s stock was not considered. Additionally, the Company s general policy is to issue new shares of registered common stock to satisfy stock option exercises or grants of restricted stock.

The weighted-average grant-date fair value of options granted during the years ended December 31, 2011, 2010 and 2009 was $2.23, $2.52 and $1.86 respectively. The fair value of each option was estimated using the following assumptions:

	2011	2010	2009
Expected volatility	50.0%	50.0%	60.0%
Expected dividends	1.6%	1.2%	1.8%
Expected term (in years)	5.5 - 6.5	5.5 - 6.5	5.0 - 6.0
Risk free rate	1.5% - 2.2%	2.2% - 2.8%	2.2%

A summary of stock option activity under the Incentive Plan as of December 31, 2011, and changes during the year ended December 31, 2011, is presented below:

Options	Shares	Weighted Average Exercise Price	Weighted-Average Remaining Contract Term (yrs)	Aggregate Intrinsic Value ($000 s)
Outstanding as of January 1, 2011	840,444	$ 4.99		
Granted	444,178	5.33		
Exercised	(6,278)	4.35		
Forfeited or Expired	(18,929)	5.06		
Outstanding as of December 31, 2011	1,259,415	$ 5.11	8.2	$ 607
Vested at December 31, 2011	602,395	$ 4.96	7.3	$ 502
Vested or expected to vest at December 31, 2011	1,248,140	$ 5.11	8.2	$ 603

Restricted stock units

RSUs generally vest in one installment on the third anniversary of the grant date. The fair value of RSUs was based upon the Company s stock price on the date of grant. A summary of the status of the Company s non-vested RSUs as of December 31, 2011, and changes during the year ended December 31, 2011, is presented below:

Nonvested Restricted Stock Units	Shares	Weighted-Average Grant-Date Fair Value
Outstanding as of January 1, 2011	355,298	$ 4.97
Granted	305,428	5.36
Vested	(154,511)	5.32
Forfeited	(41,332)	5.24
Outstanding as of December 31, 2011	464,883	$ 5.08
Expected to vest at December 31, 2011	446,695	$ 5.08

As of December 31, 2011, there was $2,881 of total unrecognized compensation cost related to non-vested NQSOs and RSUs granted under the Plan. That cost is expected to be recognized over a weighted-average period of 1.3 years.

The Incentive Plan permits the employee to use vested shares from RSUs to satisfy the grantee s U.S. federal income tax liability resulting from the issuance of the shares through the Company s retention of that number of common shares having a market value as of the vesting date equal to such tax obligation up to the minimum statutory withholding requirements. The amount related to shares used for such tax withholding obligations was approximately $291 for the year ended December 31, 2011.

In September 2010, Jonathan W. Berger and Bruce J. Biemeck each received 9,208 shares of the Company s common stock per the terms of their respective employment agreements. In March 2011, Messrs. Berger and Biemeck each received 16,490 shares of the Company s common stock per the terms of their respective employment agreements.

Director compensation

The Company uses a combination of cash and stock-based compensation to attract and retain qualified candidates to serve on our Board of Directors. Compensation is paid to non-employee directors. Directors who are employees receive no additional compensation for services as members of the Board or any of its committees. All of our directors are non-employee directors with the exception of Messrs. Berger and Biemeck. Douglas B. Mackie, the Company s former President and CEO, remains a director but is no longer an employee of the Company. Through December 31, 2011, Mr. Mackie has received $39 in compensation for the prorated portion of his term as a director subsequent to the end of his consulting agreement. Stock-based compensation is paid pursuant to the Incentive Plan. Each non-employee director of the Company received an annual retainer of $125, payable quarterly in arrears, and was paid 50% in cash and 50% in common stock of the Company. The Chairman of the Board receives an additional $150 of compensation, paid in stock. This was prorated to $123 from the date of appointment through the end of 2011.

In the years ended December 31, 2011 and 2010, 83,349 and 60,651 shares, respectively, of the Company s common stock were issued to non-employee directors under the Incentive Plan.

11. RETIREMENT PLANS

The Company sponsors four 401(k) savings plans, one covering substantially all non-union salaried employees (Salaried Plan), a second covering its non-union hourly employees (Hourly Plan), a third plan specifically for its employees that are members of a tugboat union and a fourth for the salary and non-union

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employees of the Company s rivers & lakes division. Under the Salaried Plan and Hourly Plan, individual employees may contribute a percentage of compensation and the Company will match a portion of the employees contributions. Additionally, the Salaried Plan includes a profit-sharing component, permitting the Company to make discretionary employer contributions to all eligible employees of the Salaried Plan. The Company s expense for matching and discretionary contributions for 2011, 2010 and 2009, was $3,942, $4,726 and $4,086, respectively.

The Company also contributes to various multiemployer pension plans pursuant to collective bargaining agreements. The information available to the Company about the multiemployer plans in which it participates, whether via request to the plan or publicly available, is generally dated due to the nature of the reporting cycle of multiemployer plans and legal requirements under the Employee Retirement Income Security Act (ERISA) as amended by the Multiemployer Pension Plan Amendments Act (MPPAA). Based upon these plans most recently available annual reports, the Company s contribution to these plans were less than 5% of each such plan s total contributions. Information on significant multiemployer pension plans in which the Company participates is included in the table below:

Pension Plan Legal Name	Federal Identification Number	Pension Protetion Act of 2006 Certified Zone Status at December 31, 2011	2010	Expiration of Collective Bargaining Arrangement with the Company	Company s Contributions 2011	2010	2009
Massachusetts Laborers Pension Fund	04-6128298 001	Yellow	Yellow	Various dates in 2012	$ 3,423	$ 3,084	$ 2,614
Central Pension Fund of the IUOE & Participating Employers	36-6052390 001	Green	Green	September 30, 2012	1,759	2,141	1,974
Excavators Union Local 731 Pension Fund	13-1809825 002	Green	Green	February 29, 2012	716	317	4
Seafarers Pension Trust	13-6100329 001	Green	Green	June 30, 2012	699	943	974
International Union of Operating Engineers Local 4 Pension Fund	04-6013863 001	Green	Green	May 31, 2014	583	624	602
Employers & Operating Engineers Local 520 Pension Fund	37-6053929 001	Green	Green	December 31, 2014	340	55	74
Iron Workers Locals 40, 361 & 417 Pension Fund	51-6102576 001	Yellow	Yellow	June 30, 2014	303	183	
Other pension plans					686	711	420
					$ 8,509	$ 8,058	$ 6,662

At December 31, 2011 a funding improvement plan was in place for the Massachusetts Laborers Pension Fund and the Iron Workers Locals 40, 361 & 417 Pension Fund. Neither plan required the Company to pay a surcharge on contributions for years presented. The Company does not expect any future increased contributions to have a material negative impact on its financial position, results of operations or cash flows for future years. The risks of participating in multiemployer plans are different from single employer plans as assets contributed are available to provide benefits to employees of other employers and unfunded obligations from an employer that discontinues contributions are the responsibility of all remaining employers. In addition, in the event of a plan s termination or the Company s withdrawal from a plan, the Company may be liable for a portion of the plan s unfunded vested benefits. However, information from the plans administrators is not available to permit the Company to determine its share, if any, of unfunded vested benefits.

12. COMMITMENTS AND CONTINGENCIES

Performance and bid bonds are customarily required for dredging and marine construction projects, as well as some demolition projects. In September 2011, the Company entered into a new bonding agreement with Zurich American Insurance Company (Zurich) under which the Company can obtain performance, bid and payment bonds. The new bonding agreement contains no restrictive covenants and lesser collateral requirements than the previous bonding agreement. The Company is using Zurich for all bonding requirements beginning in September 2011. The existing bonding agreement with Travelers Casualty and Surety Company of America (Travelers) will remain in place until outstanding bonds expire as the projects underlying the bonds issued thereunder are completed. Pursuant to the existing bonding agreement, Travelers has been granted a security interest in a substantial portion of the Company s operating equipment with a net book value of $62,682 at December 31, 2011.

The Travelers bonding agreement contains provisions requiring the Company to maintain certain financial ratios and restricting the Company s ability to pay dividends, incur indebtedness, create liens and take certain other actions. At December 31, 2011, the Company was in compliance with its various covenants under the bonding agreement with Travelers. Bid bonds are generally obtained for a percentage of bid value and amounts outstanding typically range from $1,000 to $10,000. At December 31, 2011, the Company had outstanding performance bonds valued at approximately $336,086; however, the revenue value remaining in backlog related to these projects totaled approximately $247,037.

Legal proceedings

As is customary with negotiated contracts and modifications or claims to competitively bid contracts with the federal government, the government has the right to audit the books and records of the Company to ensure compliance with such contracts, modifications, or claims, and the applicable federal laws. The government has the ability to seek a price adjustment based on the results of such audit. Any such audits have not had, and are not expected to have, a material impact on the financial position, operations, or cash flows of the Company.

Various legal actions, claims, assessments and other contingencies arising in the ordinary course of business are pending against the Company and certain of its subsidiaries. These matters are subject to many uncertainties, and it is possible that some of these matters could ultimately be decided, resolved, or settled adversely to the Company. Although the Company is subject to various claims and legal actions that arise in the ordinary course of business, except as described below, the Company is not currently a party to any material legal proceedings or environmental claims. The Company accrues reserves when it is probable a liability has been incurred and the amount of loss can be reasonably estimated. The Company does not believe any of these proceedings, individually or in the aggregate, would be expected to have a material effect on results of operations, cash flows or financial condition.

The Company or its former subsidiary, NATCO Limited Partnership, was named as a defendant in approximately 251 asbestos-related personal injury lawsuits, the majority of which were filed between 1989 and 2000. The claims were filed on behalf of seamen or their personal representatives alleging injury or illness from exposure to asbestos while employed as seamen on Company-owned vessels. In these cases, the Company is typically one of many defendants, including manufacturers and suppliers of products containing asbestos, as well as other vessel owners. Following certain administrative proceedings, counsel for plaintiffs agreed to name a group of cases that they intended to pursue and to dismiss the remaining cases without prejudice. Plaintiffs have currently named 39 cases against the Company that they intend to pursue, each of which involves one plaintiff. The remaining cases against the Company were dismissed. Plaintiffs in the dismissed cases could file a new lawsuit if they develop a new disease allegedly caused by exposure to asbestos on board our vessels. The Company is presently unable to quantify the amounts of damages being sought in these lawsuits because none of the complaints specify a damage amount. The Company does not believe that it is probable that losses from these claims could be material, and an estimate of a range of losses relating to these claims cannot reasonably be made. Based on the foregoing, management does not believe that any of the 39 lawsuits, individually or in the aggregate, will have a material impact on our business, financial position, results of operations or cash flows.

On August 26, 2009, the Company s subsidiary, NASDI, received a letter stating that the Attorney General for the Commonwealth of Massachusetts is investigating alleged violations of the Massachusetts Solid Waste Act. The Company believes that the Massachusetts Attorney General is investigating illegal dumping activities at a dump site NASDI contracted with to have waste materials disposed of between September 2007 and July 2008. Per the Massachusetts Attorney General s request, NASDI executed a tolling agreement regarding the matter in 2009 and engaged in further discussions with the Massachusetts Attorney General s office in the second quarter of 2011 but has had no further contact with the Massachusetts Attorney General s office since then. The matter remains open, and, to the Company s knowledge, no proceedings have currently been initiated against NASDI. Should a claim be brought, NASDI intends to defend itself vigorously. Based on consideration of all of the facts and circumstances now known, the Company does not believe this claim will have a material impact on its business, financial position, results of operations or cash flows.

On March 27, 2011, NASDI received a subpoena from a federal grand jury in the District of Massachusetts directing NASDI to furnish certain documents relating to certain projects performed by NASDI since January 2005. The Company conducted an internal investigation into this matter and continues to fully cooperate with the federal grand jury subpoena. Based on the early stage of the U.S. Department of Justice s investigation and the limited information known to the Company, the Company cannot predict the outcome of the investigation, the U.S. Attorney s views of the issues being investigated, any action the U.S. Attorney may take, or the impact, if any, that this matter may have on the Company s business, financial position, results of operations or cash flows.

On April 6, 2011, NASDI received a subpoena from the District Attorney for Richmond County, New York in connection with a grand jury investigation. The subpoena directs NASDI to furnish certain documents relating to one project performed by NASDI and one of its subcontractors. The subpoena appears to be related to the activities of NASDI s subcontractor for this project. The Company fully complied with the production of requested documents and has engaged in routine communications with the District Attorney s office. Based on the Company s internal investigation to date, the Company does not believe that it will have any liability with respect to this matter. In addition, the Company intends to continue to fully cooperate with the New York grand jury subpoena.

The Company has not accrued any amounts with respect to these three NASDI matters as the Company does not believe, based on information currently known to it, that a loss relating to these matters is probable, and an estimate of a range of potential losses relating to these matters cannot reasonably be made.

Lease obligations

The Company leases certain operating equipment and office facilities under long-term operating leases expiring at various dates through 2020. The equipment leases contain renewal or purchase options that specify prices at the then fair value upon the expiration of the lease terms. The leases also contain default provisions that are triggered by an acceleration of debt maturity under the terms of the Company s Credit Agreement, or, in certain instances, cross default to other equipment leases and certain lease arrangements require that the Company maintain certain financial ratios comparable to those required by its Credit Agreement. Additionally, the leases typically contain provisions whereby the Company indemnifies the lessors for the tax treatment attributable to such leases based on the tax rules in place at lease inception. The tax indemnifications do not have a contractual dollar limit. To date, no lessors have asserted any claims against the Company under these tax indemnification provisions.

Future minimum operating lease payments at December 31, 2011, are as follows:

2012	$ 16,432
2013	14,816
2014	14,286
2015	13,963
2016	13,952
Thereafter	20,166
Total minimum operating lease payments	$ 93,615

Total rent expense under long-term operating lease arrangements for the years ended December 31, 2011, 2010 and 2009 was $16,968, $17,397 and $17,718, respectively. This excludes expenses for equipment and facilities rented on a short-term, as-needed basis.

13. RELATED-PARTY TRANSACTIONS

The demolition business is operated out of a building owned by a minority interest owner in Yankee and prior to 2011, a profits interest owner in NASDI. In 2011, 2010 and 2009, NASDI and Yankee paid the minority interest owner $483, $312 and $312, respectively, for rent and property taxes.

Our rivers & lakes group operates out of a facility owned by the former owner of Matteson. The Company paid $103 in rent to the building owner during 2011. As the purchase of Matteson occurred on December 31, 2010, the Company paid no rents in 2010.

14. BUSINESS COMBINATIONS AND REORGANIZATIONS

Matteson acquisition

On December 31, 2010, the Company acquired the assets of L.W. Matteson, Inc., a maintenance dredging, environmental dredging and levee construction company located in Burlington, IA, for a base purchase price of $45 million. The Matteson acquisition expands the Company s service offering into inland river, lakes and environmental dredging and levee construction using dredge material. The purchase price was subject to an adjustment based upon the closing working capital balance, which resulted in the recognition of additional purchase price of $369. Furthermore, the seller may receive cash payments for any of the calendar years ended 2011, 2012 and 2013 if certain earnings based criteria are met. Per the purchase agreement, if Business EBITDA for any of these calendar years exceeds $9.0 million but is equal to or less than $12.0 million, the earnout payment shall be an amount equal to the product of (i) the amount by which Business EBITDA for such earnout period exceeds $9.0 million multiplied by (ii) 15%, and if Business EBITDA for such earnout period is greater than $12.0 million, the earnout payment shall be in an amount equal to the sum of (i) $450 plus (ii) the product of (x) the amount by which Business EBITDA for such earnout period exceeds $12.0 million multiplied by (y) 25%. There is no limit to the amount of earnout the seller may receive. In 2011 and 2010, the fair value of the recorded earnout liability was $240 and $1,640 of which $0 and $547 is recorded in accrued liabilities and $240 and $1,093 is recorded in other liabilities, respectively. The liability was reduced as projected future earnings lowered the estimated calculation of the contingent earnout.

The acquisition was funded with $37.5 million in cash and a seller note of $7.5 million. The following table summarizes the allocation of purchase price:

Property, plant and equipment	$ 36,173
Inventories	4,637
Accounts receivable	4,173
Intangible assets	2,670
Other assets and liabilities net	(644)

Total	$ 47,009

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The purchase price has been allocated to the assets acquired and liabilities assumed using estimated fair values as of the acquisition date.

As the acquisition took place on December 31, 2010, no income or earnings of Matteson were included in the consolidated statement of operations of the Company for the period ended December 31, 2010.

The following unaudited pro forma consolidated financial information present the consolidated results of operations of the Company as they may have appeared had the acquisition described above occurred as of January 1, 2009 for purposes of the unaudited pro forma consolidated statements of operations.

The unaudited pro forma consolidated financial information are provided for illustrative purposes only and do not purport to present what the actual results of operations would have been had the transaction actually occurred on the date indicated, nor does it purport to represent results of operations for any future period. The information does not reflect any cost savings or other benefits that may be obtained through synergies among the operations of the Company.

GREAT LAKES DREDGE & DOCK CORPORATION AND SUBSIDIARIES

PRO FORMA CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

	2010	2009
	(Unaudited)	
Revenue as reported	$ 686,922	$ 622,244
Revenue of purchased businesses for the period prior to acquisition	37,183	41,003
Pro forma revenue	$ 724,105	$ 663,247
Net income attributable to common stockholders of Great Lakes Dredge & Dock Corporation	$ 34,609	$ 17,468
Net income of Matteson including pro forma acquisition accounting adjustments	3,257	4,134
Pro forma net income attributable to common stockholders of Great Lakes Dredge & Dock Corporation	$ 37,866	$ 21,602

Senior management reorganization

In April 2010, the Board of Directors of the Company eliminated the position of Chief Operating Officer and created a new position, President of Dredging Operations. In connection with this operational restructuring, Richard M. Lowry, Chief Operating Officer, left the Company and is receiving severance in accordance with his Employment Agreement.

On September 7, 2010, the Company announced the resignation of Douglas B. Mackie as President and Chief Executive Officer and the appointment of Jonathan W. Berger as Chief Executive Officer. Mr. Mackie continues to serve as a director. Also, on September 7, 2010, the Company announced the resignation of Deborah A. Wensel as Senior Vice President, Chief Financial Officer, Treasurer and Secretary and the appointment of Bruce J. Biemeck as President and Chief Financial Officer.

The Company recorded expense of $6,428 in connection with the severance arrangements with its former executives in 2010. These payments are being made over a one to three year period per the terms of each former executive s arrangement and, as of December 31, 2011 and 2010, $2,335 and $4,474, respectively, remained unpaid and was included in accrued expenses and other liabilities.

Effective September 7, 2010, Messrs Berger and Biemeck continued as directors but are no longer appointed to Board Committees, and Mr. Biemeck no longer serves as Lead Director.

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15. SEGMENT INFORMATION

The Company and its subsidiaries currently operate in two reportable segments: dredging and demolition. The Company s financial reporting systems present various data for management to run the business, including profit and loss statements prepared according to the segments presented. Management uses operating income to evaluate performance between the two segments. Segment information for 2011, 2010 and 2009, is provided as follows:

	2011	2010	2009
Dredging:			
Contract revenues	$ 520,134	$ 608,969	$ 574,311
Operating income	53,793	70,504	49,844
Depreciation and amortization	37,176	31,532	29,853
Total assets	742,292	646,158	626,746
Property and equipment net	298,140	315,140	281,520
Goodwill	76,575	76,575	76,575
Investment in joint ventures	6,923	7,329	7,943
Capital expenditures	22,860	28,838	23,924
Demolition:			
Contract revenues	107,199	77,953	47,933
Operating income (loss)	501	(2,074)	(7,593)
Depreciation and amortization	3,662	2,769	3,170
Total assets	46,168	47,667	38,680
Property and equipment net	12,380	8,091	9,637
Goodwill	21,474	21,474	21,474
Capital expenditures	7,852	1,025	3,375
Total:			
Contract revenues	627,333	686,922	622,244
Operating income	54,294	68,430	42,251
Depreciation and amortization	40,838	34,301	33,023
Total assets	788,460	693,825	665,426
Property and equipment net	310,520	323,231	291,157
Goodwill	98,049	98,049	98,049
Investment in joint ventures	6,923	7,329	7,943
Capital expenditures	30,712	29,863	27,299

The Company classifies the revenue related to its dredging projects into the following types of work:

	2011	2010	2009
Capital dredging U.S.	$ 156,251	$ 300,873	$ 203,147
Capital dredging foreign	77,232	82,898	134,123
Beach nourishment dredging	135,164	106,163	62,133
Maintenance dredging	116,016	119,035	174,908
Rivers & lakes	35,471		
Total dredging	$ 520,134	$ 608,969	$ 574,311

The Company derived revenues and gross profit from foreign project operations for the years ended December 31, 2011, 2010, and 2009, as follows:

2011	2010	2009

Contract revenues	$ 77,232	$ 82,898	$ 134,123
Costs of contract revenues	(63,256)	(76,708)	(124,355)
Gross profit	$ 13,976	$ 6,190	$ 9,768

In 2011, 2010 and 2009, the majority of the Company s foreign revenue came from projects in the Middle East, primarily Bahrain. The majority of the Company s long-lived assets are marine vessels and related equipment. At any point in time, the Company may employ certain assets outside of the U.S., as needed, to perform work on the Company s foreign projects. As of December 31, 2011 and 2010, long-lived assets with a net book value of $96,376 and $110,586, respectively, were located outside of the U.S.

The Company s primary dredging customer is the U.S. Army Corps of Engineers (the Corps), which has responsibility for federally funded projects related to waterway navigation and flood control. In 2011, 2010 and 2009, 43.1%, 53.5% and 56.0%, respectively, of contract revenues were earned from dredging contracts with federal government agencies, including the Corps, as well as other federal entities such as the U.S. Coast Guard and U.S. Navy. At December 31, 2011 and 2010, approximately 36.9% and 32.9%, respectively, of accounts receivable, including contract revenues in excess of billings and retainage, were due on dredging contracts with federal government agencies. The Company depends on its ability to continue to obtain federal government dredging contracts, and indirectly, on the amount of federal funding for new and current government dredging projects. Therefore, the Company s dredging operations can be influenced by the level and timing of federal funding.

In addition, the Company s work overseas is primarily with the government of Bahrain which accounted for 7.6%, 8.1% and 20.3% of total revenue in 2011, 2010 and 2009, respectively. At December 31, 2011 and 2010, approximately 21.4% and 20.7%, respectively, of accounts receivable, including retainage and contract revenues in excess of billings, were due on dredging contracts with the government of Bahrain. There is a dependence on future projects in the Bahrain region, as vessels are currently located there. However, certain of the vessels located in Bahrain can be moved back to the U.S. or all can be moved to other international markets as opportunities arise.

16. SUBSIDIARY GUARANTORS

The Company s long-term debt at December 31, 2011 includes $250,000 of 7.375% senior notes due February 1, 2019. The Company s obligations under these senior unsecured notes are guaranteed by the Company s wholly-owned domestic subsidiaries. Such guarantees are full, unconditional and joint and several.

The following supplemental financial information sets forth for the Company s subsidiary guarantors (on a combined basis), the Company s non-guarantor subsidiaries (on a combined basis) and Great Lakes Dredge & Dock Corporation, exclusive of its subsidiaries (GLDD Corporation):

(i) balance sheets as of December 31, 2011 and 2010;

(ii) statements of operations for the years ended December 31, 2011, 2010 and 2009; and

(iii) statements of cash flows for the years ended December 31, 2011, 2010 and 2009.

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GREAT LAKES DREDGE & DOCK CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATING BALANCE SHEET

AS OF DECEMBER 31, 2011

(In thousands)

	Subsidiary Guarantors	Non-Guarantor Subsidiaries	GLDD Corporation	Eliminations	Consolidated Totals
ASSETS					
CURRENT ASSETS:					
Cash and cash equivalents	$ 108,985	$ 4,303	$	$	$ 113,288
Accounts receivable net	118,530	1,738			120,268
Receivables from affiliates	79,683	7,729	49,724	(137,136)	
Contract revenues in excess of billings	26,323	153		(64)	26,412
Inventories	33,426				33,426
Prepaid expenses	3,847		132		3,979
Other current assets	12,082	125	16,198		28,405
Total current assets	382,876	14,048	66,054	(137,200)	325,778
PROPERTY AND EQUIPMENT Net	310,459	61			310,520
GOODWILL	97,799	250			98,049
OTHER INTANGIBLE ASSETS Net	675	139			814
INVENTORIES Noncurrent	30,103				30,103
INVESTMENTS IN JOINT VENTURES	6,923				6,923
INVESTMENTS IN SUBSIDIARIES	4,385		627,754	(632,139)	
OTHER ASSETS	10,729	3	5,547	(6)	16,273
TOTAL	$ 843,949	$ 14,501	$ 699,355	$ (769,345)	$ 788,460
LIABILITIES AND EQUITY					
CURRENT LIABILITIES:					
Accounts payable	$ 81,971	$ 774	$	$	82,745
Payables to affiliates	85,865	7,234	44,053	(137,152)	
Accrued expenses	22,445	629	8,047		31,121
Billings in excess of contract revenues	13,607	68		(48)	13,627
Current portion of note payable	2,500				2,500
Current portion of equipment debt	533				533
Total current liabilities	206,921	8,705	52,100	(137,200)	130,526
LONG TERM NOTE PAYABLE	2,500				2,500
7 3/8% SENIOR NOTES			250,000		250,000
DEFERRED INCOME TAXES	399		103,959	(6)	104,352
OTHER	7,786		759		8,545
Total liabilities	217,606	8,705	406,818	(137,206)	495,923
Total Great Lakes Dredge & Dock Corporation equity	626,343	5,796	291,969	(632,139)	291,969
NONCONTROLLING INTERESTS			568		568
TOTAL EQUITY	626,343	5,796	292,537	(632,139)	292,537

TOTAL	$ 843,949	$ 14,501	$ 699,355	$ (769,345)	$ 788,460

GREAT LAKES DREDGE & DOCK CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATING BALANCE SHEET

AS OF DECEMBER 31, 2010

(In thousands)

	Subsidiary Guarantors	Non-Guarantor Subsidiaries	GLDD Corporation	Eliminations	Consolidated Totals
ASSETS					
CURRENT ASSETS:					
Cash and cash equivalents	$ 48,416	$ 62	$	$	$ 48,478
Accounts receivable net	93,983	1,565			95,548
Receivables from affiliates	5,338	5,798	6,745	(17,881)	
Contract revenues in excess of billings	24,777	94		(29)	24,842
Inventories	31,734				31,734
Prepaid expenses	3,246		202		3,448
Other current assets	9,853	8	9,058		18,919
Total current assets	217,347	7,527	16,005	(17,910)	222,969
PROPERTY AND EQUIPMENT Net	322,958	273			323,231
GOODWILL	97,799	250			98,049
OTHER INTANGIBLE ASSETS Net	3,017	263			3,280
INVENTORIES Noncurrent	27,128				27,128
INVESTMENTS IN JOINT VENTURES	7,329				7,329
INVESTMENTS IN SUBSIDIARIES	2,311		528,425	(530,736)	
OTHER ASSETS	7,704		4,350	(215)	11,839
TOTAL	$ 685,593	$ 8,313	$ 548,780	$ (548,861)	$ 693,825
LIABILITIES AND EQUITY					
CURRENT LIABILITIES:					
Accounts payable	$ 81,534	$ 1,187	$	$	$ 82,721
Payables to affiliates	14,151	3,655		(17,806)	
Accrued expenses	30,511	693	1,605		32,809
Billings in excess of contract revenues	14,121	467		(104)	14,484
Current portion of note payable	2,500				2,500
Current portion of equipment debt	303				303
Total current liabilities	143,120	6,002	1,605	(17,910)	132,817
LONG TERM NOTE PAYABLE	5,000				5,000
7 3/4% SENIOR SUBORDINATED NOTES			175,000		175,000
DEFERRED INCOME TAXES			92,681	(215)	92,466
OTHER	9,048		2,669		11,717
Total liabilities	157,168	6,002	271,955	(18,125)	417,000
Total Great Lakes Dredge & Dock Corporation Equity	528,425	2,311	278,953	(530,736)	278,953
NONCONTROLLING INTERESTS			(2,128)		(2,128)

TOTAL EQUITY	528,425	2,311	276,825	(530,736)	276,825
TOTAL	$ 685,593	$ 8,313	$ 548,780	$ (548,861)	$ 693,825

GREAT LAKES DREDGE & DOCK CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

FOR THE YEAR ENDED DECEMBER 31, 2011

(In thousands)

	Subsidiary Guarantors	Non-Guarantor Subsidiaries	GLDD Corporation	Eliminations	Consolidated Totals
Contract revenues	$ 619,643	$ 19,941	$	$ (12,251)	$ 627,333
Costs of contract revenues	(527,769)	(18,798)		12,251	(534,316)
Gross profit (loss)	91,874	1,143			93,017
OPERATING EXPENSES:					
General and administrative expenses	46,285	797	3,352		50,434
Gain on sale of assets net	(11,722)		11		(11,711)
Operating income (loss)	57,311	346	(3,363)		54,294
Interest expense net	(780)	(156)	(20,729)		(21,665)
Equity in earnings (loss) of subsidiaries	2,075		56,442	(58,517)	
Equity in loss of joint ventures	(406)				(406)
Loss on foreign currency transactions net	(264)	(18)			(282)
Loss on extinguishment of debt			(5,145)		(5,145)
Income (loss) before income taxes	57,936	172	27,205	(58,517)	26,796
Income tax (provision) benefit	404	5	(9,954)		(9,545)
Net income (loss)	58,340	177	17,251	(58,517)	17,251
Net income attributable to noncontrolling interests			(723)		(723)
Net income (loss) attributable to Great Lakes Dredge & Dock Corporation	$ 58,340	$ 177	$ 16,528	$ (58,517)	$ 16,528

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GREAT LAKES DREDGE & DOCK CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

FOR THE YEAR ENDED DECEMBER 31, 2010

(In thousands)

	Subsidiary Guarantors	Non-Guarantor Subsidiaries	GLDD Corporation	Eliminations	Consolidated Totals
Contract revenues	$ 683,460	$ 8,538	$	$ (5,076)	$ 686,922
Costs of contract revenues	(559,754)	(9,462)		5,076	(564,140)
Gross profit (loss)	123,706	(924)			122,782
OPERATING EXPENSES:					
General and administrative expenses	50,084	702	3,566		54,352
Operating income (loss)	73,622	(1,626)	(3,566)		68,430
Interest expense net	26	(95)	(13,473)		(13,542)
Equity in earnings (loss) of subsidiaries	(1,721)		72,886	(71,165)	
Equity in loss of joint ventures	(614)				(614)
Income (loss) before income taxes	71,313	(1,721)	55,847	(71,165)	54,274
Income tax (provision) benefit	1,573		(22,127)		(20,554)
Net income (loss)	72,886	(1,721)	33,720	(71,165)	33,720
Net income attributable to noncontrolling interests			889		889
Net income (loss) attributable to Great Lakes Dredge & Dock Corporation	$ 72,886	$ (1,721)	$ 34,609	$ (71,165)	$ 34,609

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GREAT LAKES DREDGE & DOCK CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

FOR THE YEAR ENDED DECEMBER 31, 2009

(In thousands)

	Subsidiary Guarantors	Non-Guarantor Subsidiaries	GLDD Corporation	Eliminations	Consolidated Totals
Contract revenues	$ 618,556	$ 7,776	$	$ (4,088)	$ 622,244
Costs of contract revenues	(530,803)	(7,240)	(45)	4,088	(534,000)
Gross profit (loss)	87,753	536	(45)		88,244
OPERATING EXPENSES:					
General and administrative expenses	41,809	1,034	3,150		45,993
Operating income (loss)	45,944	(498)	(3,195)		42,251
Interest expense net	(41)	(115)	(15,994)		(16,150)
Equity in earnings (loss) of subsidiaries	(613)		47,308	(46,695)	
Equity in loss of joint ventures	(384)				(384)
Income (loss) before income taxes	44,906	(613)	28,119	(46,695)	25,717
Income tax (provision) benefit	2,402		(13,385)		(10,983)
Net income (loss)	47,308	(613)	14,734	(46,695)	14,734
Net income attributable to noncontrolling interests			2,734		2,734
Net income (loss) attributable to Great Lakes Dredge & Dock Corporation	$ 47,308	$ (613)	$ 17,468	$ (46,695)	$ 17,468

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GREAT LAKES DREDGE & DOCK CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED DECEMBER 31, 2011

(In thousands)

	Subsidiary Guarantors	Non-Guarantor Subsidiaries	GLDD Corporation	Eliminations	Consolidated Totals
OPERATING ACTIVITIES:					
Net cash flows provided by (used in) operating activities	$ 51,145	$ (764)	$ (25,818)	$	$ 24,563
INVESTING ACTIVITIES:					
Purchases of property and equipment	(33,426)	(7)			(33,433)
Dispositions of property and equipment	16,717				16,717
Net cash flows used in investing activities	(16,709)	(7)			(16,716)
FINANCING ACTIVITIES:					
Proceeds from issuance of 7 3/8% senior notes			250,000		250,000
Redemption of 7 3/4% senior subordinated notes			(175,000)		(175,000)
Senior subordinated notes redemption premium			(2,264)		(2,264)
Deferred financing fees			(5,962)		(5,962)
Repayment of long term note payable	(2,500)				(2,500)
Dividends paid			(4,711)		(4,711)
Dividend equivalents paid on restricted stock units			(36)		(36)
Taxes paid on settlement of vested share awards			(291)		(291)
Net change in accounts with affiliates	33,962	2,038	(36,000)		
Capital contributions	(3,418)	3,418			
Repayments of equipment debt	(1,911)				(1,911)
Exercise of stock options			27		27
Excess income tax benefit from share-based compensation			55		55
Net cash flows provided by financing activities	26,133	5,456	25,818		57,407
Effect of exchange rate changes on cash and cash equivalents		(444)			(444)
Net change in cash and equivalents	60,569	4,241			64,810
Cash and cash equivalents at beginning of period	48,416	62			48,478
Cash and cash equivalents at end of period	$ 108,985	$ 4,303	$	$	$ 113,288

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GREAT LAKES DREDGE & DOCK CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED DECEMBER 31, 2010

(In thousands)

	Subsidiary Guarantors	Non-Guarantor Subsidiaries	GLDD Corporation	Eliminations	Consolidated Totals
OPERATING ACTIVITIES:					
Net cash flows provided by (used in) operating activities	$ 157,248	$ (1,026)	$ (32,691)	$	$ 123,531
INVESTING ACTIVITIES:					
Purchases of property and equipment	(25,204)	(54)			(25,258)
Dispositions of property and equipment	414	17			431
Purchase of Matteson	(37,869)				(37,869)
Net cash flows used in investing activities	(62,659)	(37)			(62,696)
FINANCING ACTIVITIES:					
Dividends paid			(3,988)		(3,988)
Dividend equivalents paid on restricted stock units			(24)		(24)
Net change in accounts with affiliates	(48,606)	903	47,703		
Repayments of equipment debt	(1,251)				(1,251)
Exercise of stock options	656				656
Borrowings under revolving loans			14,968		14,968
Repayments of revolving loans			(25,968)		(25,968)
Net cash flows provided by (used in) financing activities	(49,201)	903	32,691		(15,607)
Net change in cash and equivalents	45,388	(160)			45,228
Cash and cash equivalents at beginning of period	3,028	222			3,250
Cash and cash equivalents at end of period	$ 48,416	$ 62	$	$	$ 48,478

GREAT LAKES DREDGE & DOCK CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED DECEMBER 31, 2009

(In thousands)

	Subsidiary Guarantors	Non-Guarantor Subsidiaries	GLDD Corporation	Eliminations	Consolidated Totals
OPERATING ACTIVITIES:					
Net cash flows provided by (used in) operating activities	$ 82,946	$ (2,545)	$ (26,403)	$	$ 53,998
INVESTING ACTIVITIES:					
Purchases of property and equipment	(24,666)				(24,666)
Dispositions of property and equipment	1,028				1,028
Acquisition of controlling interest in Yankee Environmental Services	(1,229)	(1,891)		1,891	(1,229)
Net cash flows provided by (used in) investing activities	(24,867)	(1,891)		1,891	(24,867)
FINANCING ACTIVITIES:					
Dividends paid			(3,974)		(3,974)
Dividend equivalents paid on restricted stock units			(18)		(18)
Members capital contribution to acquire assets of Yankee		1,891		(1,891)	
Net change in accounts with affiliates	(63,657)	2,762	60,895		
Capital contributions					
Repayments of equipment debt	(1,867)				(1,867)
Borrowings under revolving loans			158,877		158,877
Repayments of revolving loans			(189,377)		(189,377)
Net cash flows provided by (used in) financing activities	(65,524)	4,653	26,403	(1,891)	(36,359)
Net change in cash and equivalents	(7,445)	217			(7,228)
Cash and cash equivalents at beginning of period	10,473	5			10,478
Cash and cash equivalents at end of period	$ 3,028	$ 222	$	$	$ 3,250

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Great Lakes Dredge & Dock Corporation

Schedule II Valuation and Qualifying Accounts

For the Years Ended December 31, 2011, 2010 and 2009

(In thousands)

		Additions			
	Beginning Balance	Charged to costs and expenses	Charged to other accounts	Deductions	Ending balance
Description					
Year ended December 31, 2009					
Allowances deducted from assets to which they apply:					
Allowances for doubtful accounts	$ 1,250	$ 69	$	$ (69)	$ 1,250
Year ended December 31, 2010					
Allowances deducted from assets to which they apply:					
Allowances for doubtful accounts	$ 1,250	$ 447	$	$ (42)	$ 1,655
Year ended December 31, 2011					
Allowances deducted from assets to which they apply:					
Allowances for doubtful accounts	$ 1,655	$ 260	$	$ (76)	$ 1,839

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ill not offer or sell any shares to persons in the United Kingdom except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995; (ii) it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000) received by it in connection with the issue or sale of any shares in circumstances in which section 21(1) of the FSMA does not apply to the issuer; and (iii) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the shares in, from or otherwise involving the United Kingdom.

The shares may not be offered or sold, transferred or delivered, as part of their initial distribution or at any time thereafter, directly or indirectly, to any individual or legal entity in the Netherlands other than to individuals or legal entities who or which trade or invest in securities in the conduct of their profession or trade, which includes banks, securities intermediaries, insurance companies, pension funds, other institutional investors and commercial enterprises which, as an ancillary activity, regularly trade or invest in securities.

The shares may not be offered or sold by means of any document other than to persons whose ordinary business is to buy or sell shares or debentures, whether as principal or agent, or in circumstances which do

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not constitute an offer to the public within the meaning of the Companies Ordinance (Cap. 32) of Hong Kong, and no advertisement, invitation or document relating to the shares may be issued, whether in Hong Kong or elsewhere, which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to shares which are or are intended to be disposed of only to persons outside Hong Kong or only to professional investors within the meaning of the Securities and Futures Ordinance (Cap. 571) of Hong Kong and any rules made thereunder.

The prospectus has not been and will not be registered as a prospectus with the Monetary Authority of Singapore. Accordingly, each underwriter acknowledges that the shares may not be offered or sold, or be made the subject of an invitation for subscription or purchase, nor may the prospectus and any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of the shares be circulated or distributed, whether directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor or other person specified in Section 274 of the Securities and Futures Act, Chapter 289 of Singapore (ii) to a sophisticated investor, and in accordance with the conditions, specified in Section 275 of the Securities and Futures Act, or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the Securities and Futures Act.

Each underwriter has acknowledged and agreed that the shares have not been registered under the Securities and Exchange Law of Japan and are not being offered or sold and may not be offered or sold, directly or indirectly, in Japan or to or for the account of any resident of Japan, except (i) pursuant to an exemption from the registration requirements of the Securities and Exchange Law of Japan and (ii) in compliance with any other applicable requirements of Japanese law.

We estimate that our total out-of-pocket expenses of the offering, excluding underwriting discounts and commissions, will be approximately $1,600,000.

A prospectus in electronic format will be made available on the websites maintained by one or more of the lead managers of this offering and may also be made available on websites maintained by other underwriters. The underwriters may agree to allocate a number of shares to underwriters for sale to their online brokerage account holders. Internet distributions will be allocated by the lead managers to underwriters that may make Internet distributions on the same basis as other allocations.

We have agreed to indemnify the several underwriters against certain liabilities, including liabilities under the Securities Act of 1933, as amended.

Certain of the underwriters and their respective affiliates have, from time to time, performed, and may in the future perform, various financial advisory and investment banking services for us, for which they received or will receive customary fees and expenses. Goldman, Sachs & Co., Morgan Stanley & Co. Incorporated, Banc of America Securities LLC, Credit Suisse First Boston LLC, J.P. Morgan Securities Inc. and Lazard Frères & Co. LLC are acting as underwriters in the concurrent public offering of our class B preferred stock. Furthermore, Banc of America Securities LLC and J.P. Morgan Securities Inc. are joint lead arrangers and joint bookrunners under our existing senior credit facility. Goldman, Sachs & Co. owns approximately 3.6 percent of our outstanding common stock, approximately 4.9 percent of our outstanding class A preferred stock and approximately 1.4 percent of our outstanding series A warrants. Lazard, Frères & Co. LLC has provided and continues to provide us with financial advisory services in connection with our restructuring and other matters.

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[P] UNDERWRITING

We and Goldman, Sachs & Co., Morgan Stanley & Co. Incorporated and the underwriters named below have entered into an underwriting agreement with respect to the shares of class B preferred stock being offered. The closing of the offering of the class B preferred stock is conditioned upon the closing of the concurrent offering of common stock. Subject to certain conditions, each underwriter has severally agreed to purchase the number of shares indicated in the following table. Goldman, Sachs & Co. and Morgan Stanley & Co. Incorporated are the representatives of the underwriters.

Underwriters	Number of Shares
Goldman, Sachs & Co.	
Morgan Stanley & Co. Incorporated	
J.P. Morgan Securities Inc.	
Banc of America Securities LLC	
Credit Suisse First Boston LLC	
Lazard Frères & Co. LLC	
Total	20,000,000

The underwriters are committed to take and pay for all of the shares being offered, if any are taken, other than the shares covered by the option described below unless and until this option is exercised.

If the underwriters sell more shares than the total number set forth in the table above, the underwriters have an option to buy up to an additional 3,000,000 shares from us to cover such sales. They may exercise that option for 30 days. If any shares are purchased pursuant to this option, the underwriters will severally purchase shares in approximately the same proportion as set forth in the table above.

The following table shows the per share and total underwriting discounts and commissions to be paid by us to the underwriters. Such amounts are shown assuming both no exercise and full exercise of the underwriters option to purchase 3,000,000 additional shares.

	Paid by Conseco	
	No Exercise	Full Exercise
Per Share	$	$
Total	$	$

Shares sold by the underwriters to the public will initially be offered at the initial price to public set forth on the cover of this prospectus. Any shares sold by the underwriters to securities dealers may be sold at a discount of up to $ per share from the initial price to public. Any such securities dealers may resell any shares purchased from the underwriters to other brokers or dealers at a discount of up to $ per share from the initial price to public. If all the shares are not sold at the initial price to public, the underwriters may change the offering price and the other selling terms.

We and our executive officers and directors have agreed with the underwriters not to dispose of or hedge any of our common stock or securities convertible into or exchangeable for shares of common stock during the period from the date of this prospectus continuing through the date 180 days after the date of this prospectus, except with the prior written consent of Goldman, Sachs & Co. and Morgan Stanley & Co. Incorporated. This agreement does not apply to any transfers (i) under our existing employee benefit plans, (ii) by gift, so long as the transferee agrees to be bound in writing by the restrictions for the remaining period, (iii) to an immediate family member, so long as such immediate family member agrees to be bound in writing by the restrictions for the remaining period, (iv) to any trust for the direct or indirect benefit of the undersigned or the immediate family of the undersigned, so long as such trust agrees to be bound in writing by the restrictions for the remaining period, (v) to an affiliate (as defined by Rule 405 under the Securities Act of 1933), so long as such affiliate agrees to be bound in writing by the restrictions for the remaining period and any such transfer does not involve a disposition for value or (vi) by us in the concurrent offering

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of our common stock. In addition, our president and chief executive officer and the non-executive chairman of our board of directors will be permitted to sell up to 50,000 and 66,667 shares of our common stock, respectively, during this period solely to satisfy tax obligations incurred as a result of the vesting of restricted stock acquired pursuant to our long-term equity incentive plan.

In connection with this offering, the underwriters may purchase and sell shares of our class B preferred stock in the open market. These transactions may include short sales, stabilizing transactions and purchases to cover positions created by short sales. Short sales involve the sale by the underwriters of a greater number of shares than they are required to purchase in this offering. Covered short sales are sales made in an amount not greater than the underwriters option to purchase additional shares from us in the offering. The underwriters may close out any covered short position by either exercising their option to purchase additional shares or purchasing shares in the open market. In determining the source of shares to close out the covered short position, the underwriters will consider, among other things, the price of shares available for purchase in the open market as compared to the price at which they may purchase additional shares pursuant to the option granted to them. Naked short sales are any sales in excess of such option. The underwriters must close out any naked short position by purchasing shares in the open market. A naked short position is more likely to be created if the underwriters are concerned that there may be downward pressure on the price of our class B preferred stock in the open market after pricing that could adversely affect investors who purchase in the offering. Stabilizing transactions consist of various bids for or purchases of class B preferred stock made by the underwriters in the open market prior to the completion of the offering.

The underwriters may also impose a penalty bid. This occurs when a particular underwriter repays to the underwriters a portion of the underwriting discount received by it because the underwriter effecting a stabilizing transaction has repurchased shares sold by or for the account of such underwriter in stabilizing or short covering transactions.

Purchases to cover a short position and stabilizing transactions may have the effect of preventing or retarding a decline in the market price of our class B preferred stock, and together with the imposition of the penalty bid, may stabilize, maintain or otherwise affect the market price of our class B preferred stock. As a result, the price of our class B preferred stock may be higher than the price that otherwise might exist in the open market. If these activities are commenced, they may be discontinued at any time. These transactions may be effected on the New York Stock Exchange, in the over-the-counter market or otherwise.

Each underwriter has represented, warranted and agreed that: (i) it will have not offered or sold and, prior to the expiry of a period of six months from the closing date, will not offer or sell any shares to persons in the United Kingdom except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995; (ii) it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000) received by it in connection with the issue or sale of any shares in circumstances in which section 21(1) of the FSMA does not apply to the issuer; and (iii) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the shares in, from or otherwise involving the United Kingdom.

The shares may not be offered or sold, transferred or delivered, as part of their initial distribution or at any time thereafter, directly or indirectly, to any individual or legal entity in the Netherlands other than to individuals or legal entities who or which trade or invest in securities in the conduct of their profession or trade, which includes banks, securities intermediaries, insurance companies, pension funds, other institutional investors and commercial enterprises which, as an ancillary activity, regularly trade or invest in securities.

The shares may not be offered or sold by means of any document other than to persons whose ordinary business is to buy or sell shares or debentures, whether as principal or agent, or in circumstances which do not constitute an offer to the public within the meaning of the Companies Ordinance (Cap. 32) of Hong Kong, and no advertisement, invitation or document relating to the shares may be issued, whether in Hong

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Kong or elsewhere, which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to shares which are or are intended to be disposed of only to persons outside Hong Kong or only to professional investors within the meaning of the Securities and Futures Ordinance (Cap. 571) of Hong Kong and any rules made thereunder.

The prospectus has not been and will not be registered as a prospectus with the Monetary Authority of Singapore. Accordingly, each underwriter acknowledges that the shares may not be offered or sold, or be made the subject of an invitation for subscription or purchase, nor may the prospectus and any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of the shares be circulated or distributed, whether directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor or other person specified in Section 274 of the Securities and Futures Act, Chapter 289 of Singapore (ii) to a sophisticated investor, and in accordance with the conditions, specified in Section 275 of the Securities and Futures Act, or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the Securities and Futures Act.

Each underwriter has acknowledged and agreed that the shares have not been registered under the Securities and Exchange Law of Japan and are not being offered or sold and may not be offered or sold, directly or indirectly, in Japan or to or for the account of any resident of Japan, except (i) pursuant to an exemption from the registration requirements of the Securities and Exchange Law of Japan and (ii) in compliance with any other applicable requirements of Japanese law.

We estimate that our total out-of-pocket expenses of the offering, excluding underwriting discounts and commissions, will be approximately $800,000.

A prospectus in electronic format will be made available on the websites maintained by one or more of the lead managers of this offering and may also be made available on websites maintained by other underwriters. The underwriters may agree to allocate a number of shares to underwriters for sale to their online brokerage account holders. Internet distributions will be allocated by the lead managers to underwriters that may make Internet distributions on the same basis as other allocations.

We have agreed to indemnify the several underwriters against certain liabilities, including liabilities under the Securities Act of 1933, as amended.

Certain of the underwriters and their respective affiliates have, from time to time, performed, and may in the future perform, various financial advisory and investment banking services for us, for which they received or will receive customary fees and expenses. Goldman, Sachs & Co., Morgan Stanley & Co. Incorporated, J.P. Morgan Securities Inc., Banc of America Securities LLC, Credit Suisse First Boston LLC and Lazard Frères & Co. LLC are acting as underwriters in the concurrent public offering of our common stock. Furthermore, J.P. Morgan Securities Inc. and Banc of America Securities LLC are joint lead arrangers and joint bookrunners under our existing senior credit facility. Goldman, Sachs & Co. owns approximately 3.6 percent of our outstanding common stock, approximately 4.9 percent of our outstanding class A preferred stock and approximately 1.4 percent of our outstanding series A warrants. Lazard, Freres & Co. LLC has provided and continues to provide us with financial advisory services in connection with our restructuring and other matters.

LEGAL MATTERS

[C] The validity of the shares of common stock offered hereby will be passed upon by Kirkland & Ellis LLP, Chicago, Illinois. William S. Kirsch has served as Executive Vice President, General Counsel and Corporate Secretary of Conseco, Inc. since September 2003. Mr. Kirsch s professional corporation, William S. Kirsch, P.C., is a partner of Kirkland & Ellis LLP. The underwriters have been represented by Cravath, Swaine & Moore LLP, New York, New York.

[P] The validity of the shares of class B preferred stock offered hereby will be passed upon by Kirkland & Ellis LLP, Chicago, Illinois. William S. Kirsch has served as Executive Vice President, General Counsel and Corporate Secretary of Conseco, Inc. since September 2003. Mr. Kirsch s professional corporation, William S. Kirsch, P.C., is a partner of Kirkland & Ellis LLP. The underwriters have been represented by Cravath, Swaine & Moore LLP, New York, New York.

EXPERTS

The financial statements included in this prospectus as of December 31, 2003 and for the period from September 1, 2003 through December 31, 2003 (successor company) and as of December 31, 2002 and for the period January 1, 2003 through August 31, 2003 and for the two years in the period ended December 31, 2002 (predecessor company) have been so included in reliance on the reports, which contain explanatory paragraphs related to the predecessor filing voluntary petitions for reorganization under chapter 11 of the United States Bankruptcy Code, of PricewaterhouseCoopers LLP, independent accountants, given on the authority of said firm as experts in auditing and accounting.

WHERE YOU CAN FIND MORE INFORMATION

We have filed with the Securities and Exchange Commission a registration statement on Form S-1 with respect to the securities offered in this prospectus. This prospectus is a part of the registration statement and, as permitted by the Securities and Exchange Commission s rules, does not contain all of the information presented in the registration statement. Whenever one of our contracts or other documents is described, summarized or referred to in this prospectus, please be aware that this description, summary or reference is not necessarily complete and that you should refer to the exhibits that are a part of the registration statement for a copy of the contract or other document. You may review a copy of the registration statement, including exhibits to the registration statement, at the Securities and Exchange Commission s public reference room at 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the Securities and Exchange Commission at 1-800-SEC-0330 for further information on the operation of the public reference room. Our filings with the Securities and Exchange Commission are also available to the public through the Securities and Exchange Commission s website at http://www.sec.gov.

We are subject to the informational requirements of the Exchange Act, and in accordance with the Exchange Act, we and our predecessor have filed annual, quarterly and current reports and other information with the Securities and Exchange Commission. You may read and copy any documents at the address set forth above.

You may request copies of the filings, at no cost, by writing to the following address or calling the following telephone number:

Investor Relations

Conseco, Inc.
11825 N. Pennsylvania Street
Carmel, Indiana 46032
(317) 817-2893

You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with different information. We are not offering these securities in any state where the offer is not permitted. You should not assume that information contained in this prospectus is accurate as of any date other than the date on the front cover of this prospectus.

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CONSECO, INC.

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REPORT OF INDEPENDENT AUDITORS

To the Shareholders and Board of Directors

Conseco, Inc.

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of operations, shareholders equity (deficit) and cash flows present fairly, in all material respects, the financial position of Conseco, Inc. and subsidiaries (Successor Company) at December 31, 2003 and the results of their operations and their cash flows for the period from September 1, 2003 through December 31, 2003 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company s management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the consolidated financial statements, the United States Bankruptcy Court for the Northern District of Illinois, Eastern Division confirmed the Company s Sixth Amended Joint Plan of Reorganization (the Plan) on September 9, 2003. The provisions of the plan are described in detail in Note 1. The Plan was substantially consummated on September 10, 2003 and the Company emerged from bankruptcy. In connection with its emergence from bankruptcy, the Company adopted fresh start accounting as of August 31, 2003.

PRICEWATERHOUSECOOPERS LLP

Indianapolis, Indiana
March 10, 2004

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REPORT OF INDEPENDENT AUDITORS

To the Shareholders and Board of Directors

Conseco, Inc.

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of operations, shareholders equity (deficit) and cash flows present fairly, in all material respects, the financial position of Conseco, Inc. and subsidiaries (Predecessor Company) at December 31, 2002 and the results of their operations and their cash flows for the period from January 1, 2003 through August 31, 2003, and for each of the two years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company s management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the consolidated financial statements, the Company filed a petition on December 17, 2002 with the United States Bankruptcy Court for the Northern District of Illinois, Eastern Division for reorganization under the provisions of Chapter 11 of the Bankruptcy Code. The Company s Sixth Amended Joint Plan of Reorganization (the Plan) was substantially consummated on September 10, 2003 and the Company emerged from bankruptcy. In connection with its emergence from bankruptcy, the Company adopted fresh start accounting.

As discussed in Note 4 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets in 2002.

PRICEWATERHOUSECOOPERS LLP

Indianapolis, Indiana
March 10, 2004

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CONSECO, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

(Dollars in millions)

	Successor December 31, 2003	Predecessor December 31, 2002
ASSETS		
Investments:		
Actively managed fixed maturities at fair value (amortized cost: 2003 $19,470.7; 2002 $18,989.8)	$19,840.1	$19,417.4
Equity securities at fair value (cost: 2003 $71.8; 2002 $161.4)	74.5	156.0
Mortgage loans	1,139.5	1,308.3
Policy loans	503.4	536.2
Trading securities	915.1	
Venture capital investment in AT&T Wireless Services, Inc. at fair value (cost: 2003 $; 2002 $14.2)		25.0
Other invested assets	324.1	340.8
Total investments	22,796.7	21,783.7
Cash and cash equivalents:		
Unrestricted	1,228.7	1,217.6
Restricted	31.9	51.3
Accrued investment income	315.5	389.8
Value of policies in force at the Effective Date	2,949.5	
Cost of policies purchased		1,170.0
Cost of policies produced	101.8	2,014.4
Reinsurance receivables	930.5	934.2
Income tax assets	24.6	101.5
Goodwill	952.2	100.0
Other intangible assets	155.2	
Assets held in separate accounts and investment trust	37.7	447.0
Assets of discontinued operations		17,624.3
Other assets	395.8	675.2
Total assets	$29,920.1	$46,509.0
LIABILITIES AND SHAREHOLDERS EQUITY (DEFICIT)		
Liabilities:		
Liabilities for insurance and asset accumulation products:		
Interest-sensitive products	$12,480.4	$13,122.7
Traditional products	11,431.8	8,318.2
Claims payable and other policyholder funds	892.3	909.2
Liabilities related to separate accounts and investment trust	37.7	447.0
Other liabilities	573.0	673.5
Liabilities of discontinued operations		17,624.3
Investment borrowings	387.3	669.7
Notes payable direct corporate obligations	1,300.0	
Total liabilities not subject to compromise	27,102.5	41,764.6
Liabilities subject to compromise		4,873.3

Total liabilities	27,102.5	46,637.9
Commitments and Contingencies		
Minority interest:		
Company-obligated mandatorily redeemable preferred securities of subsidiary trusts		1,921.5
Shareholders equity (deficit):		
Preferred stock	887.5	501.7
Common stock ($0.01 par value, 8,000,000,000 shares authorized, shares issued and outstanding at December 31, 2003 100,115,772; no par value, 1,000,000,000 shares authorized; shares issued and outstanding at December 31, 2002 346,007,133)	1.0	3,497.0
Additional paid-in-capital	1,641.9	
Accumulated other comprehensive income	218.7	580.6
Retained earnings (deficit)	68.5	(6,629.7)
Total shareholders equity (deficit)	2,817.6	(2,050.4)
Total liabilities and shareholders equity (deficit)	$29,920.1	$46,509.0

The accompanying notes are an integral part of the consolidated financial statements.

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CONSECO, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS

(Dollars in millions, except per share data)

	Successor	Predecessor		
	Four Months Ended December 31, 2003	Eight Months Ended August 31, 2003	Years Ended December 31, 2002	Years Ended December 31, 2001
Revenues:				
Insurance policy income	$ 1,005.8	$ 2,204.3	$ 3,602.3	$ 3,992.7
Net investment income:				
General account assets	427.0	933.3	1,534.1	1,712.5
Policyholder and reinsurer accounts	53.1	25.2	(100.5)	(119.6)
Venture capital income (loss) related to investment in AT&T Wireless Services, Inc.	(5.5)	10.5	(99.3)	(42.9)
Net realized investment gains (losses)	11.8	(5.4)	(556.3)	(340.0)
Gain on sale of interest in riverboat				192.4
Fee revenue and other income	13.3	34.3	70.1	96.9
Total revenues	1,505.5	3,202.2	4,450.4	5,492.0
Benefits and expenses:				
Insurance policy benefits	967.9	2,138.7	3,332.5	3,588.5
Provision for losses		55.6	240.0	169.6
Interest expense (contractual interest: $268.5 for the eight months ended August 31, 2003; and $345.3 for 2002)	36.8	202.5	341.9	400.0
Amortization	132.9	341.4	822.9	766.8
Other operating costs and expenses	218.4	422.3	736.2	747.1
Goodwill impairment			500.0	
Special charges			96.5	80.4
Gain on extinguishment of debt			(1.8)	(17.0)
Reorganization items		(2,130.5)	14.4	
Total benefits and expenses	1,356.0	1,030.0	6,082.6	5,735.4
Income (loss) before income taxes, minority interest, discontinued operations and cumulative effect of accounting change	149.5	2,172.2	(1,632.2)	(243.4)
Income tax expense (benefit):				
Tax expense (benefit) on period income (loss)	53.2	(13.5)	53.1	(57.6)
Valuation allowance for deferred tax assets			811.2	
Income (loss) before minority interest, discontinued operations and cumulative effect of accounting change	96.3	2,185.7	(2,496.5)	(185.8)
Minority interest:				
Distributions on Company-obligated mandatorily redeemable preferred securities of subsidiary trusts, net of income taxes			173.2	119.5

Income (loss) before discontinued operations and cumulative effect of accounting change	96.3	2,185.7	(2,669.7)	(305.3)
Discontinued operations, net of income taxes		16.0	(2,216.8)	(100.6)
Cumulative effect of accounting change, net of income taxes			(2,949.2)	
Net income (loss)	96.3	2,201.7	(7,835.7)	(405.9)
Preferred stock dividends (contractual distributions for 2002 of $2.1)	27.8		2.1	12.8
Net income (loss) applicable to common stock	$ 68.5	$ 2,201.7	$ (7,837.8)	$ (418.7)
Earnings per common share:				
Basic:				
Weighted average shares outstanding	100,110,000			
Net income	$ .68			
Diluted:				
Weighted average shares outstanding	143,486,000			
Net income	$ .67			

The accompanying notes are an integral part of the consolidated financial statements.

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CONSECO, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY (DEFICIT)

(Dollars in millions)

	Total	Preferred Stock	Common Stock and Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings
Predecessor balance, December 31, 2000	$ 4,374.4	$ 486.8	$ 2,911.8	$ (651.0)	$ 1,626.8
Comprehensive loss, net of tax:					
Net loss	(405.9)				(405.9)
Change in unrealized depreciation of investments (net of applicable income tax expense of $121.8)	212.0			212.0	
Total comprehensive loss	(193.9)				
Issuance of shares pursuant to stock purchase contracts related to FELINE PRIDES	496.6		496.6		
Issuance of shares pursuant to acquisition of ExlService.com, Inc.	52.1		52.1		
Issuance of shares for stock options and for employee benefit plans	23.8		23.8		
Payment-in-kind dividends on convertible preferred stock	12.8	12.8			
Dividends on preferred stock	(12.8)				(12.8)
Predecessor balance, December 31, 2001	4,753.0	499.6	3,484.3	(439.0)	1,208.1
Comprehensive loss, net of tax:					
Net loss	(7,835.7)				(7,835.7)
Change in unrealized depreciation of investments and other (net of applicable income tax expense of nil)	1,019.6			1,019.6	
Total comprehensive loss	(6,816.1)				
Issuance of shares for stock options and for employee benefit plans	12.7		12.7		
Payment-in-kind dividends on convertible preferred stock	2.1	2.1			
Dividends on preferred stock	(2.1)				(2.1)
Predecessor balance, December 31, 2002	(2,050.4)	501.7	3,497.0	580.6	(6,629.7)
Comprehensive income, net of tax:					
Net income	2,201.7				2,201.7
Change in unrealized appreciation of investments (net of applicable income tax benefit of nil)	(151.6)			(151.6)	
Total comprehensive income	2,050.1				
Change in shares for employee benefit plans	.3		.3		
Predecessor balance, August 31, 2003		501.7	3,497.3	429.0	(4,428.0)
Elimination of Predecessor s equity securities	(3,999.0)	(501.7)	(3,497.3)		
Issuance of Successor s equity securities	2,500.0	859.7	1,640.3		
Fresh start adjustments	3,999.0			(429.0)	4,428.0

Successor balance, August 31, 2003	2,500.0	859.7	1,640.3		
Comprehensive income, net of tax:					
Net income	96.3				96.3
Change in unrealized appreciation of investments (net of applicable income tax expense of $123.0)	218.7			218.7	
Total comprehensive income	315.0				
Issuance of shares for stock options and for employee benefit plans	2.6		2.6		
Payment-in-kind dividends on convertible exchangeable preferred stock	27.8	27.8			
Dividends on preferred stock	(27.8)				(27.8)
Successor balance, December 31, 2003	$ 2,817.6	$ 887.5	$ 1,642.9	$ 218.7	$ 68.5

The accompanying notes are an integral part of the consolidated financial statements.

CONSECO, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

(Dollars in millions)

	Successor	Predecessor		
	Four Months Ended December 31, 2003	Eight Months Ended August 31, 2003	Years Ended December 31, 2002	Years Ended December 31, 2001
Cash flows from operating activities:				
Insurance policy income	$ 876.3	$ 1,876.2	$ 3,041.3	$ 3,518.8
Net investment income	431.4	933.5	3,323.9	3,913.6
Fee revenue and other income	13.3	34.3	307.1	389.1
Insurance policy benefits	(567.9)	(1,466.1)	(1,996.9)	(2,792.8)
Interest expense	(25.5)		(1,279.6)	(1,570.5)
Policy acquisition costs	(111.6)	(287.5)	(509.2)	(667.0)
Special charges			(47.2)	(29.5)
Reorganization items		(26.5)	(31.7)	
Other operating costs	(254.7)	(360.8)	(1,406.1)	(1,466.8)
Taxes	77.8	44.2	(105.9)	29.8
Net cash provided by operating activities	439.1	747.3	1,295.7	1,324.7
Cash flows from investing activities:				
Sales of investments	5,163.7	5,378.9	19,465.4	24,179.7
Maturities and redemptions of investments	1,003.2	1,854.7	1,623.9	1,381.4
Purchases of investments	(5,593.3)	(7,385.9)	(19,879.4)	(25,509.5)
Cash received from the sale of finance receivables, net of expenses			2,372.9	867.2
Finance receivables originated			(7,877.9)	(12,320.3)
Principal payments received on finance receivables			8,294.0	8,611.3
Cash held by Conseco Finance Corp. and classified as assets held by discontinued operations			(562.3)	
Change in restricted cash	(6.8)	26.2	3.4	27.3
Other	1.4	(19.6)	(27.6)	(136.7)
Net cash provided (used) by investing activities	568.2	(145.7)	3,412.4	(2,899.6)
Cash flows from financing activities:				
Amounts received for deposit products	479.6	1,272.7	4,584.8	4,204.8
Withdrawals from deposit products	(583.5)	(1,784.2)	(5,682.8)	(4,489.4)
Issuance of notes payable			6,671.9	12,160.5
Payments on notes payable			(10,481.3)	(10,480.5)
Ceding commission received on reinsurance transaction			83.0	
Change in cash held in restricted accounts for settlement of borrowings			(13.0)	(241.8)
Investment borrowings	(837.1)	(145.3)	(1,573.0)	2,022.9
Issuance of common and convertible preferred shares				4.1
Dividends on common and preferred shares and distributions on Company-obligated mandatorily redeemable preferred securities of subsidiary trusts			(86.2)	(181.2)

Net cash provided (used) by financing activities	(941.0)	(656.8)	(6,496.6)	2,999.4
Net increase (decrease) in cash and cash equivalents	66.3	(55.2)	(1,788.5)	1,424.5
Cash and cash equivalents, beginning of the period	1,162.4	1,217.6	3,006.1	1,581.6
Cash and cash equivalents, end of the period	$ 1,228.7	$ 1,162.4	$ 1,217.6	$ 3,006.1

The accompanying notes are an integral part of the consolidated financial statements.

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Our Recent Emergence from Bankruptcy

Conseco, Inc., a Delaware corporation (CNO), is a holding company for a group of insurance companies operating throughout the United States that develop, market and administer supplemental health insurance, annuity, individual life insurance and other insurance products. CNO became the successor to Conseco, Inc., an Indiana corporation (Old Conseco), in connection with our bankruptcy reorganization. The terms Conseco , the Company , we , us , and our as used in this report refer to CNO and its subsidiaries and, unless the context requires otherwise, Ol Conseco and its subsidiaries. We focus on serving the senior and middle-income markets, which we believe are attractive, high growth markets. We sell our products through three distribution channels: career agents, professional independent producers (some of whom sell one or more of our product lines exclusively) and direct marketing.

We conduct our business operations through two primary operating segments, based on method of product distribution, and a third segment comprised of businesses in run-off:

Bankers Life, which consists of the businesses of Bankers Life and Casualty Company (Bankers Life and Casualty) and Colonial Penn Life Insurance Company (Colonial Penn). Bankers Life and Casualty markets and distributes Medicare supplement insurance, life insurance, long-term care insurance and fixed annuities to the senior market through approximately 4,000 exclusive career agents and sales managers. Colonial Penn markets graded benefit and simplified issue life insurance directly to consumers through television advertising, direct mail, the internet and telemarketing. Both Bankers Life and Casualty and Colonial Penn market their products under their own brand names.

Conseco Insurance Group, which markets and distributes specified disease insurance, Medicare supplement insurance, and certain life and annuity products to the senior and middle-income markets through over 500 independent marketing organizations (IMOs) that represent over 9,100 producing independent agents. This segment markets its products under the Conseco brand.

Other Business in Run-off, which includes blocks of business that we no longer market or underwrite and are managed separately from our other businesses. This segment consists of long-term care insurance sold through independent agents and major medical insurance.

We also have a corporate segment, which consists of holding company activities and certain noninsurance company businesses that are not related to our operating segments.

On December 17, 2002 (the Petition Date), Old Conseco and certain of its non-insurance company subsidiaries filed voluntary petitions for relief under Chapter 11 of Title 11 of the United States Bankruptcy Code (the Bankruptcy Code) in the United States Bankruptcy Court for the Northern District of Illinois, Eastern Division (the Bankruptcy Court). We emerged from bankruptcy protection under the Sixth Amended Joint Plan of Reorganization (the Plan), which was confirmed pursuant to an order of the Bankruptcy Court on September 9, 2003 (the Confirmation Date), and became effective on September 10, 2003 (the Effective Date). Upon the confirmation of the Plan, we implemented fresh start accounting in accordance with Statement of Position 90-7 Financial Reporting by Entities in Reorganization under the Bankruptcy Code (SOP 90-7). References in these consolidated financial statements to Predecessor refer to Old Conseco prior to August 31, 2003. References to Successor refer to the Company on and after August 31, 2003, after giving effect to the implementation of fresh start reporting. Our accounting and actuarial systems and procedures are designed to produce financial information as of the end of a month. Accordingly, for accounting convenience purposes, we applied the effects of fresh start accounting on August 31, 2003. The activity of the Company for the period from September 1, 2003 through September 10, 2003 is therefore included in the Successor s statement of operations and excluded from the Predecessor s statement of operations. We believe the net income impact of the use of a convenience date is immaterial.

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Plan generally provided for the full payment or reinstatement of allowed administrative claims, priority claims, fully secured claims and certain intercompany claims, and the distribution of new equity securities (including warrants) to partially secured and unsecured creditors of our Predecessor. Holders of claims arising under our Predecessor s $1.5 billion senior bank credit facility also received a pro rata interest in our Senior Credit Facility. Holders of our Predecessor s common stock and preferred stock did not receive any distribution under the Plan, and these securities, together with all other prepetition securities and the $1.5 billion senior bank credit facility of our Predecessor, were cancelled on the Effective Date.

On the Effective Date, under the terms of the Plan, we emerged from the bankruptcy proceedings with a capital structure consisting of:

- our $1.3 billion Senior Credit Facility;
- approximately 34.4 million shares of Class A Preferred Stock with an initial aggregate liquidation preference of approximately $859.7 million;
- 100.0 million shares of common stock, excluding shares issued to our new non-executive chairman upon his appointment and shares issued or to be issued to directors, officers or employees under a new equity incentive plan; and
- warrants to purchase 6.0 million shares of our common stock (the Series A Warrants).

Under the terms of the Plan, we distributed the equity securities to the creditors of our Predecessor in the amounts outlined below:

- lenders under our Predecessor s senior bank credit facility and director and officer loan program received approximately 34.4 million shares of our Class A Preferred Stock, with an initial aggregate liquidation preference of $859.7 million;
- holders of our Predecessor s senior notes received approximately 32.3 million shares of our common stock;
- holders of our Predecessor s guaranteed senior notes received approximately 60.6 million shares of our common stock;
- holders of our Predecessor s general unsecured claims received approximately 3.8 million shares of our common stock; and
- holders of trust preferred securities issued by our Predecessor s subsidiary trusts received approximately 1.5 million shares of our common stock and Series A Warrants to purchase 6.0 million shares of our common stock at an exercise price of $27.60 per share.

The distribution of our common stock summarized above represents approximately 98 percent of all of the shares of common stock to be distributed under the Plan. As of December 31, 2003, approximately 1.8 million of our outstanding shares of common stock have been reserved for distribution under the Plan in respect of disputed claims, the resolution of which is still pending. If reserved shares remain after resolution of these disputed claims, then the reserved shares will be reallocated to other general unsecured creditors of our Predecessor as provided for under the Plan.

As part of our Chapter 11 reorganization, we sold substantially all of the assets of our Predecessor s finance business and exited this line of business. Our finance business was conducted through our Predecessor s indirect wholly-owned subsidiary, Conseco Finance Corp. (CFC). We accounted for our finance business as a discontinued operation in 2002 once we formalized our plans to sell it. On April 1, 2003, CFC and 22 of its direct and indirect subsidiaries, which collectively comprised substantially all of the finance business, filed liquidating plans of reorganization with the Bankruptcy Court in order to facilitate the sale of this business. The sale of the finance business was completed in the second quarter of 2003. We did

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CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

not receive any proceeds from this sale in respect of our interest in CFC, nor did any creditors of our Predecessor. As of March 31, 2003, we ceased to include the assets and liabilities of CFC on our Predecessor s consolidated balance sheet. See the note to the consolidated financial statements entitled Financial Information Regarding CFC for information regarding this discontinued operation.

2. Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with SOP 90-7. Accordingly, all prepetition liabilities subject to compromise as of December 31, 2002, have been segregated in the Predecessor s consolidated balance sheet and classified as liabilities subject to compromise at the estimated amount of allowable claims.

Pursuant to SOP 90-7, professional fees associated with the Chapter 11 cases are expensed as incurred and reported as reorganization items. Interest expense was reported only to the extent that it was paid during the Chapter 11 cases. The Company recognized expenses associated with the Chapter 11 cases for fees payable to professionals to assist with the Chapter 11 cases totaling $70.9 million in the eight months ended August 31, 2003, and $14.4 million in 2002.

Upon our emergence from bankruptcy, we implemented fresh start reporting in accordance with SOP 90-7. These rules required the Company to revalue its assets and liabilities to current estimated fair value, re-establish shareholders equity at the reorganization value determined in connection with the Plan, and record any portion of the reorganization value which cannot be attributed to specific tangible or identified intangible assets as goodwill. As a result, the Company s financial statements for periods following August 31, 2003, will not be comparable with those of Old Conseco prepared before that date.

During the third quarter of 2002, Old Conseco entered into an agreement to sell Conseco Variable Insurance Company (CVIC), its wholly owned subsidiary and the primary writer of its variable annuity products. The sale was completed in October 2002. The operating results of CVIC have been reported as discontinued operations in all periods presented in the accompanying consolidated statement of operations. See the note to the consolidated financial statements entitled Financial Information Regarding CVIC.

During 2001, we stopped renewing a large portion of our major medical lines of business. These lines of business are referred to herein as the major medical business in run-off . These actions had a significant effect on the Predecessor s operating results during 2001. These lines had pre-tax losses of $130.3 million in 2001 including a write off of $77.4 million of the cost of policies produced and the cost of policies purchased related to this business that is not recoverable.

On July 31, 2001, we completed the acquisition of ExlService.com, Inc. (Exl), a firm that specializes in customer service and backroom outsourcing with operations in India. Old Conseco issued 3.4 million shares of our common stock in exchange for Exl s common stock. The total value of the transaction was $52.1 million. The Old Conseco Board of Directors (without Gary C. Wendt, the Company s former Chief Executive Officer, voting) approved the transaction, after receiving the recommendation of a special committee of outside directors. Mr. Wendt was one of the founders of Exl. Mr. Wendt and his wife owned 20.3 percent of Exl and his other relatives owned an additional 9.4 percent. Mr. Wendt and his wife received 692,567 shares of Old Conseco common stock in the transaction (worth approximately $9.7 million at the time the agreement was negotiated). However, these shares were restricted until Old Conseco recovered its $52.1 million acquisition price through cost savings achieved by transferring work to Exl and/or pre-tax profits from services provided to third parties by Exl. The shares also become unrestricted upon a change of control of 51 percent of the outstanding shares of Old Conseco common stock. In November 2002, Old Conseco completed the sale of Exl and recognized a loss of $20.0 million on the transaction. Old Conseco had previously written off a significant portion of the value of this investment in conjunction with the impairment charge related to goodwill pursuant to the Company s adoption of Statement of Financial

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Accounting Standards No. 142, Goodwill and Other Intangible Assets (SFAS 142) described below under Recently Issued Accounting Standards . Since Old Conseco did not recover the acquisition price prior to its sale of Exl, the shares held by Mr. Wendt and his wife remained restricted and were cancelled pursuant to the Plan.

For certain other special purpose entities related to our investment portfolio, we consider the requirements of Emerging Issues Task Force Issue Topic D-14, Transactions Involving Special-Purpose Entities (EITF D-14) in determining whether to consolidate such entities. We consolidate such entities if: (i) an independent third party has not made a substantial capital investment in the entity; (ii) such independent third party does not control the activities of the entity; and (iii) the independent party does not retain substantial risks and rewards of the special purpose entity s assets. See the note to the consolidated financial statements entitled Investments in Variable Interest Entities for additional information.

The accompanying financial statements include the accounts of the Company and all of its wholly owned insurance subsidiaries. Our consolidated financial statements exclude the results of material transactions between us and our consolidated affiliates, or among our consolidated affiliates. We reclassified certain amounts in our 2002 and 2001 consolidated financial statements and notes to conform with the 2003 presentation. These reclassifications have no effect on net income (loss) or shareholders equity (deficit).

3. Fresh Start Reporting

Upon the confirmation of the Plan on September 9, 2003, we implemented fresh start reporting in accordance with SOP 90-7. However, in light of the proximity of this date to the August month end, for accounting convenience purposes, we have reported the effects of fresh start accounting as if they occurred on August 31, 2003. We engaged an independent financial advisor to assist in the determination of our reorganization value as defined in SOP 90-7. We determined a reorganization value, together with our financial advisor, using various valuation methods, including: (i) selected comparable companies analysis; and (ii) actuarial valuation analysis. These analyses are necessarily based on a variety of estimates and assumptions which, though considered reasonable by management, may not be realized, and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. Changes in these estimates and assumptions may have had a significant effect on the determination of our reorganization value. The estimated reorganization value of the Company was calculated to be approximately $3.7 billion to $3.9 billion. We selected the midpoint of the range, $3.8 billion, as the reorganization value. Such value was confirmed by the Bankruptcy Court on the Confirmation Date.

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CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Under fresh start reporting, a new reporting entity is considered to be created and the Company is required to revalue its assets and liabilities to current estimated fair value, re-establish shareholders equity at the reorganization value determined in connection with the Plan, and record any portion of the reorganization value which can not be attributed to specific tangible or identified intangible assets as goodwill. In addition, all accounting standards that are required to be adopted in the financial statements within twelve months following the adoption of fresh start accounting were adopted as of August 31, 2003. Adjustments to the Predecessor s consolidated balance sheet as of August 31, 2003, to reflect the discharge of debt, change in capital structure and the fair value of our assets and liabilities are presented in the following table (dollars in millions):

	Predecessor Balance Sheet(a)	Debt Discharge and Reorganization(b)	Fresh Start Adjustments	Successor Balance Sheet
Assets:				
Investments	$22,018.3	$	$ 1,043.5 (c)	$23,101.3
			39.5 (d)	
Cash and cash equivalents	1,187.5		28.4 (c)	1,215.9
Accrued investment income	304.6			304.6
Value of policies in force at the Effective Date			3,102.6 (e)	3,102.6
Cost of policies purchased	1,099.2		(1,099.2)(e)	
Cost of policies produced	2,019.5		(2,019.5)(e)	
Reinsurance receivables	878.3		44.3 (f)	922.6
Goodwill	99.4		1,042.2 (f)	1,141.6
Other intangible assets			157.8 (f)	157.8
Income tax assets	88.0			88.0
Assets held in separate accounts and investment trust	87.7			87.7
Other assets	535.6		10.1 (f)	545.7
Total assets	$28,318.1	$	$ 2,349.7	$30,667.8
Liabilities:				
Liabilities for insurance and asset accumulation products	$22,175.6	$	$ 2,592.1 (g)	$24,767.7
Other liabilities	868.1		(23.2)(f)	875.7
			30.8 (c)	
Investment borrowings	524.4		700.0 (c)	1,224.4
Notes payable direct corporate obligations		1,300.0		1,300.0
Total liabilities not subject to compromise	23,568.1	1,300.0	3,299.7	28,167.8
Liabilities subject to compromise	6,951.4	(6,951.4)		
Total liabilities	30,519.5	(5,651.4)	3,299.7	28,167.8
Shareholders equity (deficit):				
Convertible preferred stock	501.7		(501.7)	
Convertible exchangeable preferred stock		859.7		859.7
Common stock and additional paid-in capital	3,497.3	1,640.3	(3,497.3)	1,640.3
Retained earnings (accumulated deficit)	(6,629.4)	3,151.4	3,478.0	
Accumulated other comprehensive income	429.0		(429.0)	

Total shareholders equity (deficit)	(2,201.4)	5,651.4	(950.0)	2,500.0
Total liabilities and shareholders equity (deficit)	$28,318.1	$	$ 2,349.7	$30,667.8

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(a) Predecessor balance sheet as of August 31, 2003, prior to the recording of the discharge of prepetition liabilities and the effects of the fresh start adjustments.

(b) The fresh start balance sheet reflects the reorganization value for Conseco of $3,800.0 million. After deducting from Conseco s reorganization value the long-term indebtedness of Conseco at the Effective Date, consisting of $1,300.0 million of indebtedness under the new senior secured bank credit facility, the total equity of Conseco is $2,500.0 million. After deducting from Conseco s total equity the value of the new Preferred Stock of $859.7 million, the value of the new common stock is $1,640.3 million. These adjustments also reflect the gain on the discharge of prepetition liabilities.

(c) In accordance with a new accounting pronouncement, the Company was required to consolidate the assets and liabilities of the partnership which owned the General Motors building into its balance sheet. As a result of the consolidation and the adoption of fresh start accounting we increased our investment in the General Motors building by $1,043.5 million and recognized the following other assets and liabilities held by the partnership which owns the General Motors building: (i) cash of $28.4 million; (ii) other liabilities of $30.8 million; and (iii) a note payable of $700 million. We sold the General Motors building in September 2003 at a value that was approximately equal to the fresh start value. The note payable of the partnership was paid in full and the net proceeds from the sale were distributed to the partners.

(d) The values of our mortgage loans, policy loans and other invested assets were adjusted to market value at the Effective Date. In addition, the cost basis of our actively managed fixed maturities was increased to recognize all of the unrealized appreciation based on the Predecessor cost basis at the Effective Date.

(e) The Company s historical cost of policies purchased and cost of policies produced are eliminated and replaced with the value of policies in force at the Effective Date. The value of policies in force reflects the estimated fair value of the Company s business in force and represents the portion of the estimated reorganization value allocated to the value of the right to receive future cash flows from the policies in force on the Effective Date.

A discount rate of 12 percent was used to determine the value of policies in force and is the rate of return which management of the Company (with assistance from an independent actuarial firm) believes would be required by a purchaser of the business based on conditions existing as of the Effective Date. In determining such rate of return, the following factors, among others, are considered.

The magnitude of the risks associated with each of the actuarial assumptions used in determining the expected cash flows.

Market rates of interest that would be applicable to an acquisition of the business.

The perceived likelihood of changes in insurance regulations and tax laws.

The complexity of the business.

Prices paid for similar blocks of business.

(f) Assets and liabilities are adjusted to reflect their estimated fair market value. The portion of the reorganization value that could not be attributed to specific tangible or identified intangible assets has been recorded as goodwill.

(g) The Company establishes reserves for insurance policy benefits based on assumptions as to investment yields, mortality, morbidity, withdrawals and lapses. These reserves include amounts for estimated future payment of claims based on actuarial assumptions. Many factors can affect these reserves, such as economic conditions, inflation, hospital and pharmaceutical costs, changes in doctrines of legal liability and extra contractual damage awards. The balance is based on the Company s best estimate (with assistance from an independent actuarial firm) of the future performance of this business, given recent and expected future changes in experience. Adjustments to the Predecessor s liabilities for insurance and asset accumulation products are further discussed in the note to the consolidated financial statements entitled Liabilities for Insurance and Asset Accumulation Products .

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Summary of Significant Accounting Policies

The following summary explains the significant accounting policies we use to prepare our financial statements. We prepare our financial statements in accordance with generally accepted accounting principles (GAAP). We follow the accounting standards established by the Financial Accounting Standards Board (FASB), the American Institute of Certified Public Accountants (AICPA) and the Securities and Exchange Commission (the SEC).

Investments

We classify our fixed maturity securities into three categories: (i) actively managed (which we carry at estimated fair value with any unrealized gain or loss, net of tax and related adjustments, recorded as a component of shareholders equity (deficit)); (ii) trading (which we carry at estimated fair value with changes in such value recognized as trading income); and (iii) held to maturity (which we carry at amortized cost). We had no fixed maturity securities classified as held to maturity during the periods presented in these financial statements.

At August 31, 2003, we established trading security accounts which are designed to act as a hedge for embedded derivatives related to: (i) our equity-indexed annuity products; and (ii) certain modified coinsurance agreements. See the note entitled Accounting for Derivatives for further discussion regarding the embedded derivatives and the trading accounts. In addition, the trading account includes the investments backing the market strategies of our multibucket annuity products. The change in market value of these securities is substantially offset by the change in insurance policy benefits for these products. Our trading securities totaled $915.1 million at December 31, 2003. The change in the market value of these securities is recognized currently in investment income (classified as income from policyholder and reinsurer accounts).

Equity securities include investments in common stock and non-redeemable preferred stock. We carry these investments at estimated fair value. We record any unrealized gain or loss, net of tax and related adjustments, as a component of shareholders equity. When declines in value considered to be other than temporary occur, we reduce the amortized cost to estimated fair value and recognize a loss in the statement of operations.

Mortgage loans held in our investment portfolio are carried at amortized unpaid balances, net of provisions for estimated losses.

Policy loans are stated at their current unpaid principal balances.

Venture capital investment in AT&T Wireless Services, Inc. (AWE) is carried at fair value, with changes in such value recognized as investment income (loss). In December 2003, we sold the remaining 4.1 million shares of AWE common stock. In 2002, we sold 10.3 million shares of AWE common stock which generated proceeds of $75.7 million. At December 31, 2002, we held 4.1 million shares of AWE common stock with a value of $25.0 million. We recognized venture capital investment income (losses) of $(5.5) million in the four months ended December 31, 2003; $10.5 million in the eight months ended August 31, 2003; and $(99.3) million and $(42.9) million in 2002 and 2001, respectively, related to this investment.

Other invested assets include: (i) Standard & Poor s 500 Index Call Options (S&P 500 Call Options); and (ii) certain non-traditional investments. We carry the S&P 500 Call Options at estimated fair value as further described below under Accounting for Derivatives . Non-traditional investments include investments in certain limited partnerships and promissory notes; we account for them using either the cost method, or for investments in partnerships, the equity method.

We defer any fees received or costs incurred when we originate investments. We amortize fees, costs, discounts and premiums as yield adjustments over the contractual lives of the investments. We consider

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

anticipated prepayments on mortgage-backed securities in determining estimated future yields on such securities.

When we sell a security (other than trading securities or venture capital investments), we report the difference between the sale proceeds and amortized cost (determined based on specific identification) as a realized investment gain or loss.

We regularly evaluate all of our investments based on current economic conditions, credit loss experience and other investee-specific developments. If there is a decline in a security s fair value that is other than temporary, we treat it as a realized investment loss and reduce the cost basis of the security to its estimated fair value.

Cash and Cash Equivalents

Cash and cash equivalents include commercial paper, invested cash and other investments purchased with original maturities of less than three months. We carry them at amortized cost, which approximates estimated fair value.

Provision for Losses

During 2003, 2002 and 2001, we established additional provisions for losses related to our guarantees of bank loans and the related interest loans to approximately 155 current and former directors, officers and key employees for the purchase of the common stock of Old Conseco (see the note to the consolidated financial statements entitled Commitments and Contingencies for additional information on this provision).

Cost of Policies Produced

In conjunction with the implementation of fresh start accounting, we eliminated the historical balance of Old Conseco s cost of policies produced as of August 31, 2003 and replaced it with the value of policies in force at the Effective Date.

The costs that vary with, and are primarily related to, producing new insurance business in the period after August 31, 2003 are referred to as cost of policies produced. We amortize these costs (using the interest rate credited to the underlying policy for universal life or investment-type products and the projected investment earnings rate for other products): (i) in relation to the estimated gross profits for universal life-type and investment-type products; or (ii) in relation to future anticipated premium revenue for other products.

When we realize a gain or loss on investments backing our universal life or investment-type products, we adjust the amortization to reflect the change in estimated gross profits from the products due to the gain or loss realized and the effect of the event on future investment yields. We also adjust the cost of policies produced for the change in amortization that would have been recorded if actively managed fixed maturity securities had been sold at their stated aggregate fair value and the proceeds reinvested at current yields. We include the impact of this adjustment in accumulated other comprehensive income (loss) within shareholders equity (deficit).

When we replace an existing insurance contract with another insurance contract with substantially different terms, all unamortized cost of policies produced related to the replaced contract is immediately written off. When we replace an existing insurance contract with another insurance contract with substantially similar terms, we continue to defer the cost of policies produced associated with the replaced contract. Such costs related to the replaced contracts which continue to be deferred were nil in the four months ended December 31, 2003; $2.9 million in the eight months ended August 31, 2003; and $7.6 million and $10.0 million in 2002 and 2001, respectively.

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

We regularly evaluate the recoverability of the unamortized balance of the cost of policies produced. We consider estimated future gross profits or future premiums, expected mortality or morbidity, interest earned and credited rates, persistency and expenses in determining whether the balance is recoverable. If we determine a portion of the unamortized balance is not recoverable, it is charged to amortization expense.

Value of Policies Inforce at the Effective Date

In conjunction with the implementation of fresh start accounting, we eliminated the historical balances of Old Conseco s cost of policies purchased and cost of policies produced as of the Effective Date and replaced them with the value of policies inforce as of the Effective Date.

The cost assigned to the right to receive future cash flows from contracts existing at August 31, 2003 is referred to as the cost of policies inforce as of the Effective Date. We also defer renewal commissions paid in excess of ultimate commission levels related to the existing policies in this account. The balance of this account is amortized, evaluated for recovery, and adjusted for the impact of unrealized gains (losses) in the same manner as the cost of policies produced described above.

The discount rate we used to determine the value of the cost of policies inforce as of the Effective Date is the rate of return which management of the Company (with assistance from an independent actuarial firm) believes would be required by a purchaser of the business based on conditions existing as of the Effective Date. In determining this required rate of return, we considered many factors including: (i) the magnitude of the risks associated with each of the actuarial assumptions used in determining expected future cash flows; (ii) market rates of interest that would be applicable to an acquisition of the business; (iii) the likelihood of changes in projected future cash flows that might occur if there are changes in insurance regulations and tax laws; (iv) the compatibility of the business with our future business plans that may favorably affect future cash flows; (v) the complexity of the business; and (vi) recent prices (i.e., discount rates used in determining valuations) paid by others to acquire similar blocks of business. The weighted average discount rate we used to determine the value of business inforce as of the Effective Date was 12 percent.

The Company expects to amortize approximately 10 percent of the December 31, 2003 balance of the value of policies inforce at the Effective Date in 2004, 10 percent in 2005, 9 percent in 2006, 8 percent in 2007 and 8 percent in 2008.

Goodwill

Upon our emergence from bankruptcy, we revalued our assets and liabilities to current estimated fair value and established our capital accounts at the reorganization value determined in connection with the Plan. We recorded the $1,141.6 million of the reorganization value which could not be attributed to specific tangible or identified intangible assets as goodwill. Under current accounting rules (which became effective January 1, 2002) goodwill is not amortized but is subject to an annual impairment test (or more frequent under certain circumstances). We obtained an independent appraisal of our business in connection with the preparation of the Plan and our implementation of fresh start accounting.

Although the goodwill balance will not be subject to amortization, it will be reduced by future use of the Company s net deferred income tax assets (including the tax operating loss carryforwards) existing at August 31, 2003 (such balance was reduced by $189.4 million in the four months ended December 31, 2003). A valuation allowance has been provided for the remaining balance of such net deferred income tax assets due to the uncertainties regarding their realization. See the note entitled Income Taxes for further discussion.

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CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Changes in the carrying amount of goodwill are as follows (dollars in millions):

	Successor
	Four Months Ended December 31, 2003
Goodwill balance, beginning of period	$1,141.6
Recognition of tax valuation reserve established at the Effective Date	(189.4)
Goodwill balance, end of period	$ 952.2

Reorganization Items

Reorganization items represent amounts the Predecessor incurred as a result of its Chapter 11 reorganization, and are presented separately in the consolidated statement of operations. These items consist of the following (dollars in millions):

	Eight Months Ended August 31, 2003	Year Ended December 31, 2002
Gain on discharge of prepetition liabilities	$3,151.4	$
Fresh start adjustments	(950.0)	
Professional fees	(70.9)	(14.4)
Total reorganization items	$2,130.5	$(14.4)

Liabilities Subject to Compromise

Under the Bankruptcy Code, actions by creditors to collect indebtedness owed prior to the Petition Date were stayed and certain other prepetition contractual obligations could not be enforced against the Filing Entities. The Filing Entities received approval from the Court to pay certain prepetition liabilities including employee salaries and wages, benefits and other employee obligations. All other prepetition liabilities were classified as liabilities subject to compromise in the December 31, 2002 consolidated balance sheet.

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CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes the components of the liabilities included in the line liabilities subject to compromise in our consolidated balance sheet at December 31, 2002 (dollars in millions):

	Predecessor
Other liabilities:	
Liability for guarantee of bank loans to former directors and current and former officers and key employees of Old Conseco to purchase common stock of Old Conseco	$ 480.8
Interest payable	171.6
Accrual for distributions on Company-obligated mandatorily redeemable preferred securities of subsidiary trusts of Old Conseco	90.1
Liability for retirement benefits pursuant to executive employment agreements	22.6
Liability for deferred compensation	2.3
Other liabilities	48.8
Total other liabilities subject to compromise	816.2
Notes payable direct corporate obligations	4,057.1
Total liabilities subject to compromise	$4,873.3

Other Intangible Assets

In conjunction with our adoption of fresh start accounting, we identified certain intangible assets other than goodwill. We determined the value of these assets with assistance from an independent valuation firm. In accordance with SFAS 142, other intangible assets with indefinite lives are not amortized, but are subject to impairment tests on an annual basis (or more frequent under certain circumstances). SFAS 142 requires intangible assets with finite useful lives to be amortized over their estimated useful lives and to be reviewed for impairment in accordance with Statement of Financial Accounting Standards No. 144, Accounting for Impairment or Disposal of Long-Lived Assets (SFAS 144). We amortize the value of our career agency force and our independent agency force over their estimated useful lives of 15 years using the straight line method. We continually evaluate the reasonableness of the useful lives of these assets.

The following summarizes other identifiable intangible assets as of December 31, 2003 (dollars in millions):

	Successor
Indefinite lived other intangible assets:	
Trademarks and tradenames	$ 25.1
State licenses and charters	17.0
Total indefinite lived other intangible assets	42.1
Finite lived other intangible assets:	
Career agency force	64.7
Independent agency force	49.8
Other	1.2
Less accumulated amortization	(2.6)

Total finite lived other intangible assets	113.1
Total other intangible assets	$ 155.2

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Assets Held in Separate Accounts and Investment Trust

Separate accounts are funds on which investment income and gains or losses accrue directly to certain policyholders. The assets of these accounts are legally segregated. They are not subject to the claims that may arise out of any other business of Conseco. We report separate account assets at market value; the underlying investment risks are assumed by the contractholders. We record the related liabilities at amounts equal to the market value of the underlying assets. We record the fees earned for administrative and contractholder services performed for the separate accounts in insurance policy income.

In addition, prior to its liquidation in the third quarter of 2003, we held investments in a trust for the benefit of the purchasers of certain products of our asset management subsidiary. Because we held the residual interests in the cash flows from the trust and actively managed its investments, we were required to include the accounts of the trust in our consolidated financial statements. We recorded the fees earned for investment management and other services provided to the trust as fee revenue. See the caption Brickyard Trust in the note to the consolidated financial statements entitled Investments in Variable Interest Entities for further information on these investments.

Recognition of Insurance Policy Income and Related Benefits and Expenses on Insurance Contracts

Generally, we recognize insurance premiums for traditional life and accident and health contracts as earned over the premium-paying periods. We establish reserves for future benefits on a net-level premium method based upon assumptions as to investment yields, mortality, morbidity, withdrawals and dividends. We record premiums for universal life-type and investment-type contracts that do not involve significant mortality or morbidity risk as deposits to insurance liabilities. Revenues for these contracts consist of mortality, morbidity, expense and surrender charges. We establish reserves for the estimated present value of the remaining net costs of all reported and unreported claims.

Reinsurance

In the first quarter of 2002, we completed a reinsurance agreement pursuant to which we ceded 80 percent of the inforce traditional life business of our subsidiary, Bankers Life and Casualty Company, to Reassure America Life Insurance Company (rated A+ by A.M. Best Company, or A.M. Best). The total insurance liabilities ceded pursuant to the contract were approximately $400 million. The reinsurance agreement and the related dividends of $110.5 million were approved by the appropriate state insurance departments and the dividends were paid to Old Conseco. The ceding commission approximated the amount of the cost of policies purchased and cost of policies produced related to the ceded business.

On June 28, 2002, we completed a reinsurance transaction pursuant to which we ceded 100 percent of the traditional life and interest-sensitive life insurance business of our subsidiary, Conseco Variable Insurance Company, to Protective Life Insurance Company (rated A+ by A.M. Best). The total insurance liabilities ceded pursuant to the contract were approximately $470 million. Our insurance subsidiary received a ceding commission of $49.5 million.

During the second quarter of 2002, one of our subsidiaries, Colonial Penn Life Insurance Company (formerly known as Conseco Direct Life Insurance Company), ceded a block of graded benefit life insurance policies to an unaffiliated company pursuant to a modified coinsurance agreement. Our subsidiary received a ceding commission of $83.0 million. The cost of policies purchased and the cost of policies produced were reduced by $123.0 million and we recognized a loss of $39.0 million related to the transaction.

In the normal course of business, we seek to limit our exposure to loss on any single insured or to certain groups of policies by ceding reinsurance to other insurance enterprises. We currently retain no more than $.8 million of mortality risk on any one policy. We diversify the risk of reinsurance loss by using a number of reinsurers that have strong claims-paying ratings. If any reinsurer could not meet its obligations,

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the Company would assume the liability. The likelihood of a material loss being incurred as a result of the failure of one of our reinsurers is considered remote. The cost of reinsurance is recognized over the life of the reinsured policies using assumptions consistent with those used to account for the underlying policy. The cost of reinsurance ceded totaled $92.1 million in the four months ended December 31, 2003; $196.4 million in the eight months ended August 31, 2003; and $327.8 million and $249.4 million in 2002 and 2001, respectively. We deduct this cost from insurance policy income. In each case, the ceding Conseco subsidiary is contingently liable for claims reinsured if the assuming company is unable to pay. Reinsurance recoveries netted against insurance policy benefits totaled $94.3 million in the four months ended December 31, 2003; $199.2 million in the eight months ended August 31, 2003; and $323.6 million and $201.3 million in 2002 and 2001, respectively.

From time-to-time, we assume insurance from other companies. Any costs associated with the assumption of insurance are amortized consistent with the method used to amortize the cost of policies produced described above. Reinsurance premiums assumed totaled $31.9 million in the four months ended December 31, 2003; $57.3 million in the eight months ended August 31, 2003; and $78.7 million and $146.0 million in 2002 and 2001, respectively.

See Accounting for Derivatives for a discussion of the derivative embedded in the payable related to certain modified coinsurance agreements.

Income Taxes

Our income tax expense includes deferred income taxes arising from temporary differences between the financial reporting and tax bases of assets and liabilities, capital loss carryforwards and net operating loss carryforwards. In assessing the realization of deferred income tax assets, we consider whether it is more likely than not that the deferred income tax assets will be realized. The ultimate realization of our deferred income tax assets depends upon generating future taxable income during the periods in which our temporary differences become deductible and before our net operating loss carryforwards expire. In addition, the use of the Company s net ordinary loss carryforwards is dependent, in part, on whether the IRS ultimately agrees with the tax position we plan to take in our current and future tax returns. We evaluate the realizability of our deferred income tax assets by assessing the need for a valuation allowance on a quarterly basis. As of December 31, 2003, a valuation allowance has been provided for the entire balance of the net deferred tax asset as the realization of the net deferred tax asset is uncertain.

Investment Borrowings

As part of our investment strategy, we may enter into reverse repurchase agreements and dollar-roll transactions to increase our investment return or to improve our liquidity. We account for these transactions as collateral borrowings, where the amount borrowed is equal to the sales price of the underlying securities. Reverse repurchase agreements involve a sale of securities and an agreement to repurchase the same securities at a later date at an agreed-upon price. Dollar rolls are similar to reverse repurchase agreements except that, with dollar rolls, the repurchase involves securities that are substantially the same as the securities sold (rather than being the same security). Such borrowings (excluding borrowings related to the GM building) averaged $488.9 million during the four months ended December 31, 2003; $689.1 million during the eight months ended August 31, 2003; and $1,155.8 million during 2002. These borrowings were collateralized by investment securities with fair values approximately equal to the loan value. The weighted average interest rates on such borrowings were 1.5 percent during the four months ended December 31, 2003; 1.8 percent during the eight months ended August 31, 2003; and 1.3 percent during 2002. The primary risk associated with short-term collateralized borrowings is that a counterparty will be unable to perform under the terms of the contract. Our exposure is limited to the excess of the net replacement cost of the securities over the value of the short-term investments (such excess was not material at December 31, 2003). We believe the

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

counterparties to our reverse repurchase and dollar-roll agreements are financially responsible and that the counterparty risk is minimal.

Use of Estimates

When we prepare financial statements in conformity with GAAP, we are required to make estimates and assumptions that significantly affect various reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting periods. For example, we use significant estimates and assumptions in calculating values for the cost of policies produced, the cost of policies purchased, the value of policies inforce at the Effective Date, certain investments, assets and liabilities related to income taxes, goodwill, liabilities for insurance and asset accumulation products, liabilities related to litigation, guaranty fund assessment accruals and liabilities related to guarantees of bank loans and the related interest loans to certain former directors and certain current and former officers and key employees. If our future experience differs from these estimates and assumptions, our financial statements would be materially affected.

Accounting for Derivatives

Our equity-indexed annuity products provide a guaranteed base rate of return and a higher potential return linked to the performance of the Standard & Poor s 500 Index (S&P 500 Index) based on a percentage (the participation rate) over an annual period. At the beginning of each policy year, a new index period begins. We are able to change the participation rate at the beginning of each index period, subject to contractual minimums. We buy S&P 500 Call Options in an effort to hedge potential increases to policyholder benefits resulting from increases in the S&P 500 Index to which the product s return is linked. We include the cost of the S&P 500 Call Options in the pricing of these products. Policyholder account balances for these annuities fluctuate in relation to changes in the values of these options. We reflect changes in the estimated market value of these options in net investment income. Option costs that are attributable to benefits provided were $19.1 million during the four months ended December 31, 2003; $53.5 million during the eight months ended August 31, 2003; and $97.5 million and $119.0 million during 2002 and 2001, respectively. These costs are reflected in the change in market value of the S&P 500 Call Options included in investment income. Net investment income (loss) related to equity-indexed products before this expense was $61.3 million in the four months ended December 31, 2003; $78.7 million in the eight months ended August 31, 2003; and $(3.0) million and $4.8 million in 2002 and 2001, respectively. These amounts were substantially offset by the corresponding charge to insurance policy benefits. The estimated fair value of the S&P 500 Call Options was $97.2 million and $32.8 million at December 31, 2003 and 2002, respectively. We classify these instruments as other invested assets. The Company accounts for the options attributed to the policyholder for the estimated life of the annuity contract as embedded derivatives as defined by Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities , as amended by Statement of Financial Accounting Standards No. 137, Deferral of the Effective Date of FASB Statement No. 133 and Statement of Financial Accounting Standards No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities (collectively referred to as SFAS 138). We record the changes in the fair values of the embedded derivatives in current earnings as a component of policyholder benefits. The fair value of these derivatives, which are classified as liabilities for interest-sensitive products was $214.7 million and $301.9 million at December 31, 2003 and 2002, respectively. We have transferred a specified block of investments which are equal to the balance of these liabilities to our trading securities account, which we carry at estimated fair value with changes in such value recognized as investment income (classified as investment income from policyholder accounts). The change in value of these trading securities should largely offset the portion of the change in the value of the embedded derivative which is caused by interest rate fluctuations.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

On June 29, 2001, we entered into interest rate swap agreements to convert the fixed rate on our senior notes (10.75 percent) to a variable rate based on LIBOR plus 4.75 percent. In accordance with the requirements of SFAS 138, the change in the fair value of the interest rate swap and the gain or loss on the hedged senior notes attributable to the hedged interest rate risk were recorded in current-period earnings. Because the terms of the interest rate swap agreements substantially matched the terms of the senior notes, the gain or loss on the swap and the senior notes was generally equal and offsetting (although the effective interest rate on our debt was affected).

In early October 2001, we terminated these interest rate swap agreements for cash proceeds of $19.0 million (the value of the terminated swap agreements). No gain was recognized upon the termination of the interest rate swap agreements. Instead, the change in the fair value of the senior notes recorded while the interest rate swaps were outstanding was amortized as a reduction to interest expense over the remaining life of our senior notes until such notes were discharged in accordance with the Plan.

In October 2001, we also entered into new interest rate swap agreements to replace the terminated agreements which converted the fixed rate on our 10.75% senior notes to a variable rate based on LIBOR plus 5.7525 percent. Such interest rate swap agreements were terminated in April 2002 generating cash proceeds of $3.5 million. Such amount represented $11.9 million of cash due to the Company pursuant to the terms of the swaps, net of $8.4 million which represented the fair value of the interest rate swaps on the date of termination. The $8.4 million was amortized as additional interest expense over the remaining life of our senior notes until such notes were discharged in accordance with the Plan.

The Company entered into a forward sale contract related to a portion of its venture capital investment in AWE. Such contract was carried at market value, with the change in such value being recognized as venture capital income (loss). The value of the derivative fluctuated in relation to the AWE common stock it related to. In the third quarter of 2002, we agreed with the counterparties to unwind the forward sale contract. The net effect of unwinding the forward purchase contract resulted in a small gain.

If the counterparties for the derivatives we hold fail to meet their obligations, we may have to recognize a loss. We limit our exposure to such a loss by diversifying among several counterparties believed to be strong and creditworthy. At December 31, 2003, all of the counterparties were rated A or higher by Standard & Poor s Corporation (S&P).

The FASB s Derivative Implementation Group issued SFAS No. 133 Implementation Issue No. B36, Embedded Derivatives: Modified Coinsurance Arrangements and Debt Instruments that Incorporate Credit Risk Exposures that are Unrelated or Only Partially Related to the Creditworthiness of the Obligor of Those Instruments (DIG B36) in April 2003. DIG B36 addresses specific circumstances under which bifurcation of an instrument into a host contract and an embedded derivative is required. DIG B36 requires the bifurcation of a derivative from the receivable or payable related to a modified coinsurance agreement, where the yield on the receivable and payable is based on a return of a specified block of assets rather than the creditworthiness of the ceding company. We implemented this guidance on August 31, 2003, in conjunction with our adoption of fresh start accounting. We have determined that certain of our reinsurance payable balances contain embedded derivatives. Such derivatives had an estimated fair value of $20.9 million and $27.2 million at August 31, 2003 and December 31, 2003, respectively. We record the change in the fair value of these derivatives as a component of investment income (classified as investment income from policyholder and reinsurer accounts). We have transferred the specific block of investments related to these agreements to our trading securities account, which we carry at estimated fair value with changes in such value recognized as investment income (also classified as investment income from reinsurer accounts). The change in value of these trading securities should largely offset the change in value of the embedded derivatives.

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Multibucket Annuity Product

The Company s multibucket annuity is a fixed annuity product that credits interest based on the experience of a particular market strategy. Policyholders allocate their annuity premium payments to several different market strategies based on different asset classes within the Company s investment portfolio. Interest is credited to this product based on the market return of the given strategy, less management fees, and funds may be moved between different strategies. The Company guarantees a minimum return of premium plus approximately 3 percent per annum over the life of the contract. The investments backing the market strategies of these products are designated by the Company as trading securities. The change in the fair value of these securities is recognized currently in investment income (classified as income from policyholder and reinsurer accounts) which is substantially offset by the change in insurance policy benefits for these products.

Accounting for Stock Options

In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation Transition and Disclosure , an Amendment of FASB Statement No. 123 (SFAS 148), which provides three alternative methods of transition to the fair value method of accounting for stock options. SFAS 148 also amends the disclosure requirements of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS 123).

We apply Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees and related interpretations in accounting for our stock option plans. Had compensation cost been determined based on the fair value at the grant dates for awards granted after January 1, 1995, consistent with the method of SFAS 123, the Company s pro forma net income (loss) and pro forma earnings (loss) per share would have been as follows (dollars in millions, except per share amounts):

	Successor	Predecessor		
	Four Months Ended December 31, 2003	Eight Months Ended August 31, 2003	Years Ended December 31, 2002	2001
Net income (loss), as reported	$96.3	$2,201.7	$(7,835.7)	$(405.9)
Less stock-based employee compensation expense determined under the fair value based method for all awards, net of income taxes	.4	7.2	12.4	28.2
Pro forma net income (loss)	$95.9	$2,194.5	$(7,848.1)	$(434.1)
Earnings per share:				
Basic, as reported	$ .68			
Basic, pro forma	$ .68			
Diluted, as reported	$ .67			
Diluted, pro forma	$ .67			

Pro forma compensation expense in the eight months ended August 31, 2003, has been reduced by $5.0 million due to the reversal of expense for options that were not vested upon cancellation of the outstanding stock options of the Predecessor.

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Fair Values of Financial Instruments

We use the following methods and assumptions to determine the estimated fair values of financial instruments:

Investment securities. For fixed maturity securities (including redeemable preferred stocks) and for equity and trading securities, we use quotes from independent pricing services, where available. For investment securities for which such quotes are not available, we use values obtained from broker-dealer market makers or by discounting expected future cash flows using a current market rate appropriate for the yield, credit quality, and (for fixed maturity securities) the maturity of the investment being priced.

Venture capital investment in AWE. We carry this investment at estimated fair value based on quoted market prices.

Cash and cash equivalents. The carrying amount for these instruments approximates their estimated fair value.

Mortgage loans and policy loans. We discount future expected cash flows for loans included in our investment portfolio based on interest rates currently being offered for similar loans to borrowers with similar credit ratings. We aggregate loans with similar characteristics in our calculations. The market value of policy loans approximates their carrying value.

Other invested assets. We use quoted market prices, where available. When quotes are not available, we estimate the fair value based on: (i) discounted future expected cash flows; or (ii) independent transactions which establish a value for our investment. When we are unable to estimate a fair value, we assume a market value equal to carrying value.

Insurance liabilities for interest-sensitive products. We discount future expected cash flows based on interest rates currently being offered for similar contracts with similar maturities.

Investment borrowings and notes payable. For publicly traded debt, we use current market values. For other notes, we use discounted cash flow analyses based on our current incremental borrowing rates for similar types of borrowing arrangements.

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Here are the estimated fair values of our financial instruments (dollars in millions):

	Successor		Predecessor	
	December 31, 2003		December 31, 2002	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Actively managed fixed maturities	$19,840.1	$19,840.1	$19,417.4	$19,417.4
Equity securities	74.5	74.5	156.0	156.0
Mortgage loans	1,139.5	1,174.1	1,308.3	1,335.7
Policy loans	503.4	503.4	536.2	536.2
Trading securities	915.1	915.1		
Venture capital investment in AT&T Wireless Services, Inc.			25.0	25.0
Other invested assets	324.1	324.1	340.8	340.8
Cash and cash equivalents	1,260.6	1,260.6	1,268.9	1,268.9
Financial liabilities:				
Insurance liabilities for interest-sensitive products(a)	12,480.4	12,480.4	13,122.7	13,122.7
Investment borrowings	387.3	387.3	669.7	669.7
Notes payable:				
Corporate(b)	1,300.0	1,300.0		
Company-obligated mandatorily redeemable preferred securities of subsidiary trusts			1,921.5	9.7

(a) The estimated fair value of the liabilities for interest-sensitive products was approximately equal to its carrying value at December 31, 2003 and 2002. This was because interest rates credited on the vast majority of account balances approximate current rates paid on similar products and because these rates are not generally guaranteed beyond one year. We are not required to disclose fair values for insurance liabilities, other than those for interest-sensitive products. However, we take into consideration the estimated fair values of all insurance liabilities in our overall management of interest rate risk. We attempt to minimize exposure to changing interest rates by matching investment maturities with amounts due under insurance contracts.

(b) At December 31, 2002, corporate notes payable were classified as liabilities subject to compromise.

Cumulative Effect of Accounting Change and Goodwill Impairment Related to Predecessor

The FASB issued SFAS 142, in June 2001. Under the new rule, intangible assets with an indefinite life are no longer amortized in periods subsequent to December 31, 2001, but are subject to annual impairment tests (or more frequent under certain circumstances), effective January 1, 2002. The Company determined that all of its goodwill had an indefinite life and was therefore subject to the new rules. The Company adopted SFAS 142 on January 1, 2002.

Pursuant to the transitional rules of SFAS 142, we completed the two-step impairment test during 2002 and, as a result of that test, we recorded the cumulative effect of the accounting change for the goodwill impairment charge of $2,949.2 million. The impairment charge is reflected in the cumulative effect of an accounting change in the accompanying consolidated statement of operations for the year ended December 31, 2002. Subsequent impairment charges are classified as an operating expense. As described below, the Company performed an impairment test in 2002, as a result of circumstances which indicated a possible impairment.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The significant factors used to determine the amount of the initial impairment included analyses of industry market valuations, historical and projected performance of our insurance segment, discounted cash flow analyses and the market value of our capital. The valuation utilized the best available information, including assumptions and projections we considered reasonable and supportable. The assumptions we used to determine the discounted cash flows involve significant judgments regarding the best estimate of future premiums, expected mortality and morbidity, interest earned and credited rates, persistency and expenses. The discount rate used was based on an analysis of the weighted average cost of capital for several insurance companies and considered the specific risk factors related to Conseco. Pursuant to the guidance in SFAS 142, quoted market prices in active markets are the best evidence of fair value and shall be used as the basis for measurement, if available.

On August 14, 2002, our insurance subsidiaries financial strength ratings were downgraded by A.M. Best to B (fair) and on September 8, 2002, the Company defaulted on its public debt. These developments caused sales of our insurance products to fall and policyholder redemptions and lapses to increase. The adverse impact on our insurance subsidiaries resulting from the ratings downgrade and parent company default required that an additional impairment test be performed as of September 30, 2002, in accordance with SFAS 142.

In connection with the preparation of the Plan, we retained an outside actuarial consulting firm to assist in valuing our insurance subsidiaries. That valuation work and our internal evaluation were used in performing the additional impairment tests that resulted in an impairment charge to goodwill of $500.0 million. The charge is reflected in the line item entitled Goodwill impairment in our consolidated statement of operations for the year ended December 31, 2002. The most significant changes made to the January 1, 2002 valuation that resulted in the additional impairment charge were: (i) reduced estimates of projected future sales of insurance products; (ii) increased estimates of future policyholder redemptions and lapses; and (iii) a higher discount rate to reflect the current rates used by the market to value life insurance companies. Management believes that the assumptions and estimates used were reasonable given all available facts and circumstances at the time made.

Prior to the adoption of SFAS 142, we determined whether goodwill was recoverable from projected undiscounted net cash flows for the earnings of our subsidiaries over the remaining amortization period. If we determined that undiscounted projected cash flows were not sufficient to recover the goodwill balance, we would reduce its carrying value with a corresponding charge to expense or shorten the amortization period. Cash flows considered in such an analysis were those of the business acquired, if separately identifiable, or the product line that acquired the business, if such earnings were not separately identifiable.

Changes in the carrying amount of Predecessor s goodwill for the eight months ended August 31, 2003, and the year ended December 31, 2002, are as follows (dollars in millions):

	Predecessor	
	Eight Months Ended August 31, 2003	Year Ended December 31, 2002
Goodwill balance, beginning of period	$100.0	$ 3,695.4
Cumulative effect of accounting change		(2,949.2)
Impairment charge		(500.0)
Reduction of tax valuation contingencies established at acquisition date for acquired companies	(.6)	(146.2)
Goodwill balance, end of period	$ 99.4	$ 100.0

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In accordance with SFAS 142, we discontinued the amortization of goodwill expense effective January 1, 2002. The following information summarizes the impact of goodwill amortization on income before discontinued operations and cumulative effect of accounting change; and net income for the periods presented in our consolidated statement of operations for periods prior to January 1, 2002 (dollars in millions, except per share data):

	Predecessor
	Year Ended December 31, 2001
Reported loss before discontinued operations and cumulative effect of accounting change	$(305.3)
Add back: goodwill amortization	108.2
Adjusted loss before discontinued operations and cumulative effect of accounting change	$(197.1)
Reported net loss applicable to common stock	$(418.7)
Add back: goodwill amortization	109.6
Adjusted net loss applicable to common stock	$(309.1)

Recently Issued Accounting Standards

Pursuant to SOP 90-7, we have implemented the provisions of accounting principles required to be adopted within twelve months of the adoption of fresh start accounting. The following summarizes the new accounting pronouncements we have recently adopted:

The FASB s Derivative Implementation Group issued DIG B36 in April 2003. DIG B36 addresses specific circumstances under which bifurcation of an instrument into a host contract and an embedded derivative is required. DIG B36 requires the bifurcation of a derivative from the receivable or payable related to a modified coinsurance agreement, where the yield on the receivable and payable is based on a return of a specified block of assets rather than the creditworthiness of the ceding company. We implemented this guidance on August 31, 2003, in conjunction with our adoption of fresh start accounting. See the note entitled Accounting for Derivatives for a discussion of the impact of implementing this guidance.

The FASB issued Financial Accounting Standards No. 149 Amendment of SFAS No. 133 on Derivative Instruments and Hedging Activities (SFAS 149) in April 2003. SFAS 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities. Except for certain implementation guidance included in SFAS 149 which is already effective, the new guidance is effective for: (i) contracts entered into or modified after June 30, 2003; and (ii) hedging relationships designated after June 30, 2003. The adoption of SFAS 149 did not have a material impact on the Company s consolidated financial statements.

The FASB issued Financial Accounting Standards No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity (SFAS 150) in May 2003. SFAS 150 establishes standards for classifying and measuring certain financial instruments that embody obligations of the issuer and have characteristics of both liabilities and equity. For example, mandatorily redeemable preferred stock is required to be classified as a liability pursuant to SFAS 150. SFAS 150 is effective immediately for financial instruments entered into or modified after May 31, 2003, and for all other financial instruments beginning with the third quarter of 2003. Effective July 1, 2003, Old Conseco s Company-

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

obligated mandatorily redeemable preferred securities of subsidiary trusts, or TOPrS, with an aggregate carrying value of $1,921.5 million, were reclassified to liabilities pursuant to the provisions of SFAS 150. The adoption of SFAS 150 does not impact the financial statements of Conseco subsequent to the Effective Date since the Company-obligated mandatorily redeemable preferred securities of subsidiary trusts are no longer outstanding.

The Accounting Standards Executive Committee of the American Institute of Certified Public Accountants issued Statement of Position 03-01 Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts (SOP 03-01) in July 2003. SOP 03-01 provides guidance on several insurance company disclosure and accounting matters including the appropriate accounting for: (i) separate accounts; (ii) additional interest (for example, persistency bonus) accruing to the investment contract holder; (iii) the liability for contracts where the amounts assessed against the contract holder each period are assessed in a manner that is expected to result in profits in earlier years and losses in subsequent years; (iv) potential benefits to annuity holders in addition to their account balance; (v) sales inducements to contract holders; and (vi) other provisions. The Company recently sold most of its separate account business. Accordingly, the new guidance related to separate accounts will have no impact on the Company s consolidated financial position, results of operations or cash flows. As a result of our adoption of fresh start accounting, we were required to revalue our insurance product liabilities and record them at their estimated fair market value. In calculating the value of the liabilities for insurance and asset accumulation products, we followed the guidance of SOP 03-01. We have changed the way we classify the costs related to sales inducements in accordance with the new guidance. However, such change was not material. Our reserve for sales inducement persistency bonus benefits was $282.8 million at December 31, 2003, and $278.6 million at August 31, 2003.

In January 2003, the FASB issued FIN 46, which requires expanded disclosures for and, in some cases, consolidation of significant investments in variable interest entities (VIE). A VIE is an entity in which the equity investors do not have the characteristics of a controlling financial interest, or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. Under FIN 46, a company is required to consolidate a VIE if it is the primary beneficiary of the VIE. FIN 46 defines primary beneficiary as the party which will absorb a majority of the VIE s expected losses or receive a majority of the VIE s expected residual returns, or both.

The Company has investments in various types of VIEs, some of which require additional disclosure under FIN 46, and several of which require consolidation under FIN 46. As further discussed in the note to the consolidated financial statements entitled Investments in Variable Interest Entities , we have consolidated all of our investments in VIEs. The adoption of the consolidation requirements of FIN 46 did not have a material impact on our financial condition or results of operations. The note entitled Investments in Variable Interest Entities includes the expanded disclosures required by FIN 46.

The FASB issued FASB Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN 45) in November 2002. FIN 45 requires certain guarantees to be recognized as liabilities at fair value. In addition, it requires a guarantor to make new disclosures regarding its obligations. We implemented the new disclosure requirements as of December 31, 2002. FIN 45 s liability recognition requirement is effective on a prospective basis for guarantees issued or modified after December 31, 2002. The adoption of FIN 45 did not impact the Company s results of operations or financial condition.

The FASB issued Statement of Financial Accounting Standards No. 146, Accounting for Exit or Disposal Activities (SFAS 146) in June 2002. SFAS 146 addresses financial accounting and reporting for costs that are associated with exit and disposal activities and supersedes Emerging Issues Task Force Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring) (EITF 94-3). SFAS 146 is required to be

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

used to account for exit or disposal activities that are initiated after December 31, 2002. The provisions of EITF 94-3 shall continue to apply for an exit activity initiated prior to the adoption of SFAS 146. SFAS 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of commitment to an exit or disposal plan. The Company adopted the provisions of SFAS 146 on January 1, 2003. The initial adoption of SFAS 146 did not have an impact on the Company s consolidated financial statements.

The FASB issued Statement of Financial Accounting Standards No. 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections (SFAS 145) in April 2002. Under previous guidance all gains and losses resulting from the extinguishment of debt were required to be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. SFAS 145 rescinds that guidance and requires that gains and losses from extinguishments of debt be classified as extraordinary items only if they are both unusual and infrequent in occurrence. SFAS 145 also amends previous guidance to require certain lease modifications that have economic effects similar to sale-leaseback transactions to be accounted for in the same manner as sale-leaseback transactions. The Company adopted SFAS 145 on January 1, 2003. Prior period amounts related to extraordinary gains on the extinguishment of debt have been reclassified in accordance with the new guidance.

The FASB issued SFAS 144 in August 2001. This standard addresses the measurement and reporting for impairment of all long-lived assets. It also broadens the definition of what may be presented as a discontinued operation in the consolidated statement of operations to include components of a company s business segments. SFAS 144 requires that long-lived assets currently in use be written down to fair value when considered impaired. Long-lived assets to be disposed of are written down to the lower of cost or fair value less the estimated cost to sell. The Company adopted this standard on January 1, 2002. We followed this standard in determining when it was appropriate to recognize impairments on assets we decided to sell as part of our efforts to raise cash. We also followed this standard in determining that our variable annuity business line and CFC should be presented as discontinued operations in our consolidated financial statements (see the note to the consolidated financial statements entitled Discontinued Operations).

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Investments

At December 31, 2003, the amortized cost and estimated fair value of actively managed fixed maturities and equity securities were as follows (dollars in millions):

	Successor			
	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
Investment grade:				
Corporate securities	$11,169.7	$279.8	$13.7	$11,435.8
United States Treasury securities and obligations of United States government corporations and agencies	1,068.9	14.1	1.7	1,081.3
States and political subdivisions	608.4	5.9	2.4	611.9
Debt securities issued by foreign governments	84.6	1.6		86.2
Structured securities	5,804.6	59.2	14.9	5,848.9
Below-investment grade (primarily corporate securities)	734.5	43.2	1.7	776.0
Total actively managed fixed maturities	$19,470.7	$403.8	$34.4	$19,840.1
Equity securities	$ 71.8	$ 2.8	$ .1	$ 74.5

At December 31, 2002, the amortized cost and estimated fair value of actively managed fixed maturities and equity securities were as follows (dollars in millions):

	Predecessor			
	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
Investment grade:				
Corporate securities	$10,529.0	$517.5	$293.9	$10,752.6
United States Treasury securities and obligations of United States government corporations and agencies	442.4	25.2	9.0	458.6
States and political subdivisions	418.0	23.2	.9	440.3
Debt securities issued by foreign governments	83.3	7.3		90.6
Structured securities	6,082.0	336.3	4.2	6,414.1
Below-investment grade (primarily corporate securities)	1,435.1	17.1	191.0	1,261.2
Total actively managed fixed maturities	$18,989.8	$926.6	$499.0	$19,417.4
Equity securities	$ 161.4	$ 4.5	$ 9.9	$ 156.0

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Accumulated other comprehensive income is primarily comprised of unrealized gains on actively managed fixed maturity investments. These amounts, included in shareholders equity (deficit) as of December 31, 2003 and 2002, were as follows (dollars in millions):

	Successor	Predecessor
	December 31, 2003	December 31, 2002
Net unrealized gains on investments	$ 375.2	$448.1
Adjustment to value of policies inforce at the Effective Date	(33.5)	
Adjustments to cost of policies purchased and cost of policies produced		(95.3)
Deferred income tax asset (liability)	(123.0)	249.6
Other		(21.8)
Accumulated other comprehensive income	$ 218.7	$580.6

Concentration of Actively Managed Fixed Maturity Securities

The following table summarizes the carrying values of our fixed maturity securities by industry category as of December 31, 2003 (dollars in millions):

	Carrying Value	Percent of Fixed Maturities
Mortgage-backed securities	$ 5,851.0	29.5%
Bank & Finance	2,713.5	13.7
Manufacturing	2,169.6	10.9
Utilities	1,322.1	6.7
Services	1,142.6	5.8
Communications	1,058.6	5.3
Asset-backed securities	761.6	3.8
Agri/ Forestry/ Mining	761.1	3.8
Government (US)	733.6	3.7
Transportation	498.3	2.5
Retail/ Wholesale	486.2	2.5
Other	2,341.9	11.8
Total fixed maturity securities	$19,840.1	100.0%

Below-Investment Grade Securities

At December 31, 2003, the amortized cost of the Company s fixed maturity securities in below-investment grade securities was $734.5 million, or 3.8 percent of the Company s fixed maturity portfolio. The estimated fair value of the below-investment grade portfolio was

$776.0 million, or 106 percent of the amortized cost. The value of these securities varies based on the economic terms of the securities, structural considerations and the creditworthiness of the issuer of the securities. Recently a number of large, highly leveraged issuers have experienced significant financial difficulties, which resulted in our recognition of other-than-temporary impairments.

Below-investment grade securities have different characteristics than investment grade corporate debt securities. Risk of loss upon default by the borrower is significantly greater with respect to below-investment

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

grade securities than with other corporate debt securities. Below-investment grade securities are generally unsecured and are often subordinated to other creditors of the issuer. Also, issuers of below-investment grade securities usually have higher levels of debt and are more sensitive to adverse economic conditions, such as recession or increasing interest rates, than are investment grade issuers. The Company attempts to reduce the overall risk in the below-investment grade portfolio, as in all investments, through careful credit analysis, strict investment policy guidelines, and diversification by issuer and/or guarantor and by industry.

Contractual Maturity

The following table sets forth the amortized cost and estimated fair value of actively managed fixed maturities at December 31, 2003, by contractual maturity. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Most of the mortgage-backed securities shown below provide for periodic payments throughout their lives (dollars in millions).

	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 103.9	$ 105.1
Due after one year through five years	1,256.0	1,271.2
Due after five years through ten years	5,229.6	5,318.3
Due after ten years	7,074.4	7,294.5
Subtotal	13,663.9	13,989.1
Structured securities(a)	5,806.8	5,851.0
Total actively managed fixed maturities	$ 19,470.7	$ 19,840.1

(a) Includes below-investment grade mortgage-backed securities with both an amortized cost and estimated fair value of $2.1 million.

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CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Net Investment Income

Net investment income consisted of the following (dollars in millions):

	Successor	Predecessor		
	Four Months Ended December 31, 2003	Eight Months Ended August 31, 2003	Years Ended December 31,	
			2002	2001
Fixed maturities	$381.7	$812.8	$1,375.2	$1,510.7
Venture capital investment income (loss)	(5.5)	10.5	(99.3)	(42.9)
Trading income related to policyholder and reinsurer accounts	10.9			
Equity securities	1.8	8.9	13.2	17.8
Mortgage loans	31.5	66.9	99.0	90.2
Policy loans	10.7	23.0	32.6	35.9
Change in value of S&P 500 Call Options related to equity-indexed products	42.2	25.2	(100.5)	(114.2)
Other invested assets	7.9	28.4	15.7	24.6
Cash and cash equivalents	4.2	11.5	27.6	60.5
Separate accounts				(5.4)
Gross investment income	485.4	987.2	1,363.5	1,577.2
Less investment expenses	10.8	18.2	29.2	27.2
Net investment income	$474.6	$969.0	$1,334.3	$1,550.0

The carrying value of fixed maturity investments and mortgage loans not accruing investment income totaled $50.7 million, $169.6 million and $140.2 million at December 31, 2003, 2002 and 2001, respectively.

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Net Realized Investment Gains (Losses)

Net realized investment gains (losses) were included in revenue as follows (dollars in millions):

	Successor	Predecessor		
	Four Months Ended December 31, 2003	Eight Months Ended August 31, 2003	Years Ended December 31, 2002	Years Ended December 31, 2001
Fixed maturities:				
Gross gains	$27.6	$129.0	$ 260.8	$ 295.8
Gross losses	(7.3)	(62.4)	(251.8)	(260.3)
Other-than-temporary decline in fair value	(3.7)	(44.7)	(500.6)	(293.2)
Net realized investment gains (losses) from fixed maturities	16.6	21.9	(491.6)	(257.7)
Equity securities		(3.4)	(7.5)	(1.8)
Mortgages		(15.6)	(1.4)	(1.9)
Other-than-temporary decline in fair value of equity securities and other invested assets	(5.9)	(6.6)	(56.2)	(68.5)
Other	1.1	(1.7)	.4	(10.1)
Net realized investment gains (losses)	$11.8	$ (5.4)	$(556.3)	$(340.0)

During the four months ended December 31, 2003, we recognized net realized investment gains of $11.8 million. Such net realized investment gains during the four months ended December 31, 2003 included: (i) $21.4 million of net gains from the sales of investments (primarily fixed maturities) which generated proceeds of $5.2 billion; net of (ii) $9.6 million of writedowns of fixed maturity investments, equity securities and other invested assets as a result of conditions which caused us to conclude a decline in fair value of the investment was other-than-temporary. During the first eight months of 2003, we recognized net realized investment losses of $5.4 million. The net realized investment losses during the first eight months of 2003 included: (i) $45.9 million of net gains from the sales of investments (primarily fixed maturities) which generated proceeds of $5.4 billion; net of (ii) $51.3 million of writedowns of fixed maturity investments, equity securities and other invested assets as a result of conditions which caused us to conclude a decline in fair value of the investment was other than temporary. At December 31, 2003, fixed maturity securities in default as to the payment of principal or interest had an aggregate amortized cost of $15.1 million and a carrying value of $16.6 million. Net realized investment losses during 2002 included: (i) $556.8 million of writedowns of fixed maturity investments, equity securities and other invested assets as a result of conditions which caused us to conclude a decline in fair value of the investment was other than temporary; net of (ii) $.5 million of net gains from the sales of investments (primarily fixed maturities). Net realized investment losses during 2001 included: (i) $361.7 million of writedowns of fixed maturity investments, equity securities and other invested assets as a result of conditions which caused us to conclude a decline in fair value of the investment was other than temporary; and (ii) $21.7 million of net gains from the sales of investments (primarily fixed maturities).

During the four months ended December 31, 2003, we sold $604.9 million of fixed maturity investments which resulted in gross investment losses (before income taxes) of $7.3 million. During the first eight months of 2003, we sold $2.7 billion of fixed maturity investments which resulted in gross investment

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

losses (before income taxes) of $62.4 million. Securities sold at a loss are sold for a number of reasons including: (i) changes in the investment environment; (ii) expectation that the market value could deteriorate further; (iii) desire to reduce our exposure to an issuer or an industry; (iv) changes in credit quality; and (v) our analysis indicating there is a high probability that the security is other-than-temporarily impaired.

The following summarizes the investments sold at a loss during the first eight months of 2003 which had been continuously in an unrealized loss position exceeding 20 percent of the amortized cost basis prior to the sale for the period indicated (there were no such investments sold at a loss during the four months ended December 31, 2003)(dollars in millions):

		At Date of Sale	
Period	Number of Issuers	Amortized Cost	Estimated Fair Value
Less than 6 months prior to sale	16	$32.0	$24.0
Greater than or equal to 6 and less than or equal to 12 months prior to sale	8	40.6	25.7
Greater than 12 months prior to sale	20	39.8	23.7

Investments with Other-Than-Temporary Losses

During the four months ended December 31, 2003, we recorded writedowns of fixed maturity investments and equity securities totaling $9.6 million as further described in the following paragraphs:

During the four months ended December 31, 2003, we recognized a loss of $5.7 million related to our holdings in a holding company for small investment management related firms. Alleged irregularities at one subsidiary of the holding company regarding late trading and market timing activities on behalf of clients have made it probable that the value of the subsidiary has been substantially diminished, negatively affecting the value of investments in the holding company. Accordingly, we concluded the decline in fair value was other than temporary.

During the four months ended December 31, 2003, we recognized a loss of $3.3 million related to our holdings in a utility plant in Brazil. This utility has experienced reduced earnings and cash flow, local corporate law and regulatory issues and has been impacted by economic difficulties in Brazil. Accordingly, we concluded the decline in fair value was other than temporary.

In addition to the specific investments discussed above, we recorded $.6 million of writedowns related to various other fixed maturities.

During the eight months ended August 31, 2003, we recorded writedowns of fixed maturity investments, equity securities and other invested assets totaling $51.3 million as further described in the following paragraphs:

During the eight months ended August 31, 2003, we recognized a loss of $11.1 million to record certain commercial loans at their estimated fair value as we intended to liquidate them and use the proceeds to repay the senior financing used to acquire the loans. No additional gain or loss was recognized upon the ultimate disposition of the loans.

During the eight months ended August 31, 2003, we recorded writedowns of $9.6 million related to holdings of a fixed income security in a trust which leases airplanes and related equipment. We believe that the collateral supporting these investments has eroded and, therefore, we concluded the decline in fair value was other than temporary.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

During the eight months ended August 31, 2003, we recorded writedowns of $8.4 million related to our holdings of fixed maturity investments in a major airline that has filed bankruptcy. Although our investments are backed by collateral, our analysis of the value of the underlying collateral indicated that the decline in fair value of the investment is other than temporary.

During the eight months ended August 31, 2003, we recorded writedowns of $4.2 million related to our investment in a limited partnership organized for the purpose of making, owning, managing and disposing of investments. Our analysis of the financial condition of the partnership indicated that the decline in fair value was other than temporary.

During the eight months ended August 31, 2003, we recorded writedowns of $3.7 million related to our holdings of fixed maturity investments in a fertilizer company that has filed for bankruptcy. A significant portion of its production capacity was rendered unprofitable due to high raw material costs and was temporarily idled. Accordingly, we concluded that the decline in fair value was other than temporary.

During the eight months ended August 31, 2003, we recorded writedowns of $1.8 million related to holdings in a health care company that has had financial problems due to financial misstatements, substantial regulatory and litigation exposure and its failure to meet debt service requirements. The adverse effect on liquidity and access to capital may force this issuer to file for bankruptcy. Accordingly, we concluded the decline in fair value was other than temporary.

During the eight months ended August 31, 2003, we recorded writedowns of $1.5 million related to holdings of a fixed income security of a finance company that has had significant financial and liquidity problems. Accordingly, we concluded the decline in fair value was other than temporary.

In addition to the specific investments discussed above, we recorded $11.0 million of writedowns related to various other fixed maturity investments. No other writedown of a single issuer exceeded $1.5 million.

Recognition of Losses

We regularly evaluate all of our investments for possible impairment based on current economic conditions, credit loss experience and other investee-specific developments. If there is a decline in a security s net realizable value that is other than temporary, the decline is recognized as a realized loss and the cost basis of the security is reduced to its estimated fair value.

Our evaluation of investments for impairment requires significant judgments to be made including: (i) the identification of potentially impaired securities; (ii) the determination of their estimated fair value; and (iii) assessment of whether any decline in estimated fair value is other than temporary. If new information becomes available or the financial condition of the investee changes, our judgments may change resulting in the recognition of an investment loss at that time.

Our periodic assessment of whether unrealized losses are other than temporary requires significant judgment. Factors considered include: (i) the extent to which market value is less than the cost basis; (ii) the length of time that the market value has been less than cost; (iii) whether the unrealized loss is event driven, credit-driven or a result of changes in market interest rates; (iv) the near-term prospects for improvement in the issuer and/or its industry; (v) whether the investment is investment-grade and our view of the investment s rating and whether the investment has been downgraded since its purchase; (vi) whether the issuer is current on all payments in accordance with the contractual terms of the investment and is expected to meet all of its obligations under the terms of the investment; (vii) our ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery; and (viii) the underlying current and prospective asset and enterprise values of the issuer and the extent to which our investment may be affected by changes in such values.

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

If a decline in value is determined to be other than temporary and the cost basis of the security is written down to fair value, we review the circumstances which caused us to believe that the decline was other than temporary with respect to other investments in our portfolio. If such circumstances exist with respect to other investments, those investments are also written down to fair value. Future events may occur, or additional or updated information may become available, which may necessitate future realized losses of securities in our portfolio. Significant losses in the carrying value of our investments could have a material adverse effect on our earnings in future periods.

The following table sets forth the amortized cost and estimated fair value of those actively managed fixed maturities with unrealized losses at December 31, 2003, by contractual maturity. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Most of the structured securities shown below provide for periodic payments throughout their lives (dollars in millions).

	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 37.8	$ 37.7
Due after one year through five years	86.8	84.7
Due after five years through ten years	556.9	550.9
Due after ten years	457.0	445.8
Subtotal	1,138.5	1,119.1
Structured securities	1,691.0	1,676.0
Total	$2,829.5	$2,795.1

The following summarizes the investments in our portfolio rated below-investment grade or classified as equity-type securities which have been continuously in an unrealized loss position exceeding 20 percent of the cost basis for the period indicated as of December 31, 2003 (dollars in millions):

Period	Number of Issuers	Cost Basis	Unrealized Loss	Estimated Fair Value
Less than 6 months(1)	2	$ .4	$ .1	$ .3

(1) No single issuer in this category had an unrealized loss exceeding $.5 million.

Our investment strategy is to maximize over a sustained period and within acceptable parameters of risk, investment income and total investment return through active investment management. Accordingly, we may sell securities at a gain or a loss to enhance the total return of the portfolio as market opportunities change. While we have both the ability and intent to hold securities with unrealized losses until they mature or recover in value, we may sell securities at a loss in the future because of actual or expected changes in our view of the particular investment, its industry, its type or the general investment environment.

Based on management s current assessment of these securities and other investments with unrealized losses at December 31, 2003, the Company believes the issuers of the securities will continue to meet their obligations (or with respect to equity-type securities, the investment value will recover to its cost basis). The Company has no current plans to sell these securities and has the ability to hold them to maturity. The recognition of an other-than-temporary impairment through a charge to earnings may be recognized in future periods if management later concludes that the decline in market value below the cost basis is other than temporary.

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Investment in General Motors Building

During the summer of 2003, we successfully enforced our contractual right to buy out our 50 percent equity partner in the GM building, a landmark 50-story office tower in New York City. After obtaining an award in arbitration, and confirming that award in the New York court system, we finally settled our differences with our equity partner, thus permitting us to put the building up for sale. On September 26, 2003, we sold our investment in the GM building. We received cash of $636.8 million, which was approximately equal to the value established upon the adoption of fresh start accounting.

Our investment in the GM building was made through a partnership which acquired the building in 1998 for $878 million. The initial capital structure of the partnership consisted of: (i) a $700 million senior mortgage; (ii) $200 million of subordinated debt with a stated fixed return of 12.7 percent payable-in-kind, and the opportunity to earn an additional residual return; and (iii) $30 million of partnership equity, owned 50 percent by Conseco and 50 percent by an affiliate of Donald Trump. A Trump affiliate also served as general manager of the acquired building. We owned 100 percent of the subordinated debt.

The $30 million of partnership equity represented less than 10 percent of the total capital of the partnership. In addition, the subordinated debt was intended to absorb virtually all expected losses and receive a significant portion of expected residual returns. Based on our 100 percent ownership of the subordinated debt, we were the primary beneficiary of the GM building. The partnership was consolidated in our financial statements effective August 31, 2003 in accordance with the requirements of FIN 46, which was implemented in conjunction with fresh start accounting. The August 31, 2003 fresh start balance sheet reflected the following balances of the partnership: the GM building at $1,336.3 million; cash of $28.4 million; and a non-recourse loan of $700 million (classified as an investment borrowing). Net investment income for the four months ended December 31, 2003, reflects $2.9 million related to this investment (representing our equity interest in the income from the building for the 26 days prior to the sale).

Structured Securities

At December 31, 2003, fixed maturity investments included $5.9 billion of structured securities (or 29 percent of all fixed maturity securities). Structured securities include mortgage-backed securities, collateralized mortgage obligations, asset-backed securities and commercial mortgage-backed securities. The yield characteristics of structured securities differ from those of traditional fixed-income securities. Interest and principal payments for mortgage-backed securities occur more frequently, often monthly. Mortgage-backed securities are subject to risks associated with variable prepayments. Prepayment rates are influenced by a number of factors that cannot be predicted with certainty, including: the relative sensitivity of the underlying mortgages backing the assets to changes in interest rates; a variety of economic, geographic and other factors; and the repayment priority of the securities in the overall securitization structures.

In general, prepayments on the underlying mortgage loans and the securities backed by these loans increase when prevailing interest rates decline significantly relative to the interest rates on such loans. The yields on mortgage-backed securities purchased at a discount to par will increase when the underlying mortgages prepay faster than expected. The yields on mortgage-backed securities purchased at a premium will decrease when the underlying mortgages prepay faster than expected. When interest rates decline, the proceeds from the prepayment of mortgage-backed securities may be reinvested at lower rates than we were earning on the prepaid securities. When interest rates increase, prepayments on mortgage-backed securities decrease as fewer underlying mortgages are refinanced. When this occurs, the average maturity and duration of the mortgage-backed securities increase, which decreases the yield on mortgage-backed securities purchased at a discount, because the discount is realized as income at a slower rate, and increases the yield on those purchased at a premium as a result of a decrease in the annual amortization of the premium.

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Pursuant to fresh start reporting, we were required to mark all of our investments to market value. The current interest rate environment is much lower than when most of our investments were purchased. Accordingly, the fresh start values of our investments generally exceed the par values of such investments. The amount of value exceeding par is referred to as a purchase premium which is amortized against future income. If prepayments in any period are higher than expected, purchase premium amortization is increased. In periods of unexpectedly high prepayment activity, the increased amortization will reduce net investment income.

The following table sets forth the par value, amortized cost and estimated fair value of structured securities, summarized by interest rates on the underlying collateral at December 31, 2003 (dollars in millions):

	Par Value	Amortized Cost	Estimated Fair Value
Below 4 percent	$ 60.4	$ 63.4	$ 63.8
4 percent - 5 percent	1,193.1	1,138.2	1,145.8
5 percent - 6 percent	998.6	990.5	1,005.8
6 percent - 7 percent	2,816.2	2,916.6	2,932.2
7 percent - 8 percent	579.5	613.4	618.6
8 percent and above	79.8	84.7	84.8
Total structured securities(a)	$5,727.6	$5,806.8	$5,851.0

(a) Includes below-investment grade structured securities with both an amortized cost and estimated fair value of $2.1 million.

The amortized cost and estimated fair value of structured securities at December 31, 2003, summarized by type of security, were as follows (dollars in millions):

		Estimated Fair Value	
Type	Amortized Cost	Amount	Percent of Fixed Maturities
Pass-throughs and sequential and targeted amortization classes	$3,690.6	$3,718.1	19%
Planned amortization classes and accretion-directed bonds	714.0	713.6	3
Commercial mortgage-backed securities	1,215.8	1,234.7	6
Subordinated classes and mezzanine tranches	183.8	181.9	1
Other	2.6	2.7	
Total structured securities(a)	$5,806.8	$5,851.0	29%

(a) Includes below-investment grade structured securities with both an amortized cost and estimated fair value of $2.1 million.

Pass-throughs and sequential and targeted amortization classes have similar prepayment variability. Pass-throughs historically provide the best liquidity in the mortgage-backed securities market. Pass-throughs are also used frequently in the dollar roll market and can be used as the collateral when creating collateralized mortgage obligations. Sequential classes are a series of tranches that return principal to the holders in sequence. Targeted amortization classes offer slightly better structure in return of principal than sequentials when prepayment speeds are close to

the speed at the time of creation.

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Planned amortization classes and accretion-directed bonds are some of the most stable and liquid instruments in the mortgage-backed securities market. Planned amortization class bonds adhere to a fixed schedule of principal payments as long as the underlying mortgage collateral experiences prepayments within a certain range. Changes in prepayment rates are first absorbed by support or companion classes. This insulates the planned amortization class from the consequences of both faster prepayments (average life shortening) and slower prepayments (average life extension).

Commercial mortgage-backed securities (CMBS) are bonds secured by commercial real estate mortgages. Commercial real estate encompasses income producing properties that are managed for economic profit. Property types include multi-family dwellings including apartments, retail centers, hotels, restaurants, hospitals, nursing homes, warehouses, and office buildings. The CMBS market currently offers high yields, strong credits, and call protection compared to similar-rated corporate bonds. Most CMBS have strong call protection features where borrowers are locked out from prepaying their mortgages for a stated period of time. If the borrower does prepay any or all of the loan, they will be required to pay prepayment penalties.

Subordinated and mezzanine tranches are classes that provide credit enhancement to the senior tranches. The rating agencies require that this credit enhancement not deteriorate due to prepayments for a period of time, usually five years of complete lockout, followed by another period of time where prepayments are shared pro rata with senior tranches. Subordinated and mezzanine tranches bear a majority of the risk of loss due to property owner defaults. Subordinated bonds are generally rated AA or lower; we typically do not hold securities rated lower than BB .

Mortgage Loans

At December 31, 2003, the mortgage loan balance was primarily comprised of commercial loans. Approximately 8 percent, 7 percent, 7 percent and 6 percent of the mortgage loan balance were on properties located in New York, Massachusetts, Florida and Pennsylvania, respectively. No other state comprised greater than 5 percent of the mortgage loan balance. Less than one percent of the mortgage loan balance was noncurrent at December 31, 2003. At December 31, 2003, we had no allowance for losses on mortgage loans (mortgage loans were recorded at market values at August 31, 2003, in conjunction with our adoption of fresh start accounting). Our allowance for loss on mortgage loans was $3.5 million at December 31, 2002.

Investment Borrowings

Our investment borrowings (excluding borrowings related to the GM building) averaged approximately $488.9 million during the four months ended December 31, 2003; $689.1 million during the eight months ended August 31, 2003; and $1,155.8 million during the year ended December 31, 2002 and were collateralized by investment securities with fair values approximately equal to the loan value. The weighted average interest rates on such borrowings (excluding borrowings related to the GM building) were 1.5 percent during the four months ended December 31, 2003; 1.8 percent during the eight months ended August 31, 2003; and 1.3 percent during the year ended December 31, 2002.

Other Investment Disclosures

Life insurance companies are required to maintain certain investments on deposit with state regulatory authorities. Such assets had an aggregate carrying value of $127.3 million and $144.5 million at December 31, 2003 and 2002, respectively.

Conseco had three investments in excess of 10 percent of shareholders equity at December 31, 2003 and two investments in excess of 10 percent of shareholders equity at December 31, 2002, (other than

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

investments issued or guaranteed by the United States government or a United States government agency) which are summarized below (dollars in millions):

	2003		2002	
Issuer	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Federal Home Loan Mortgage Corporation	$355.6	$364.5		
Federal Home Loan Bank	312.3	314.9		
Investors Guaranty Assurance	283.7	283.7	$305.0	$283.7
Carmel Fifth, LLC			212.7	212.5

6. Liabilities for Insurance and Asset Accumulation Products

These liabilities consisted of the following (dollars in millions):

			Successor	Successor	Predecessor
	Withdrawal Assumption	Mortality Assumption	Interest Rate Assumption	December 31, 2003	December 31, 2002
Future policy benefits:					
Interest-sensitive products:					
Investment contracts	N/A	N/A	(c)	$ 8,552.0	$ 8,856.8
Universal life-type contracts	N/A	N/A	N/A	3,928.4	4,265.9
Total interest-sensitive products				12,480.4	13,122.7
Traditional products:					
Traditional life insurance contracts	Company experience	(a)	5%	2,312.4	1,891.3
Limited-payment annuities	Company experience, if applicable	(b)	6%	1,003.7	846.5
Individual and group accident and health	Company experience	Company experience	6%	8,115.7	5,580.4
Total traditional products				11,431.8	8,318.2
Claims payable and other policyholder funds	N/A	N/A	N/A	892.3	909.2
Liabilities related to separate accounts and investment trust	N/A	N/A	N/A	37.7	447.0
Total				$24,842.2	$22,797.1

(a) Principally, modifications of the 1965 70 and 1975 80 Basic, Select and Ultimate Tables.

(b) Principally, the 1984 United States Population Table and the NAIC 1983 Individual Annuitant Mortality Table.

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CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(c) In 2003, all of this liability represented account balances where future benefits are not guaranteed. In 2002: (i) approximately 96 percent of this liability represented account balances where future benefits are not guaranteed; and (ii) approximately 4 percent represented the present value of guaranteed future benefits determined using an average interest rate of approximately 6 percent.

The Company establishes reserves for insurance policy benefits based on assumptions as to investment yields, mortality, morbidity, withdrawals, lapses and maintenance expenses. These reserves include amounts for estimated future payment of claims based on actuarial assumptions. The balance is based on the Company s best estimate (with assistance from an independent actuarial firm) of the future policyholder benefits to be incurred on this business, given recent and expected future changes in experience.

In accordance with SOP 90-7, the Successor established insurance liabilities and an asset for the value of policies inforce at the effective date using current assumptions. Adjustments to the Predecessor s liabilities for insurance and asset accumulation products as of August 31, 2003 are summarized below (dollars in millions):

	Predecessor Balance Sheet	Fresh Start Adjustments	Successor Balance Sheet
Liabilities for insurance and asset accumulation products:			
Traditional and limited payment products:			
Traditional life insurance products	$ 1,885.3	$ 320.3	$ 2,205.6
Limited pay annuities	880.0	140.0	1,020.0
Individual accident and health	5,245.8	1,887.9	7,133.7
Group life and health	692.0	136.7	828.7
Unearned premiums	3.3		3.3
Total liabilities for traditional and limited payment products	8,706.4	2,484.9	11,191.3
Interest-sensitive products:			
Investment contracts	8,489.8	132.9	8,622.7
Universal life-type products	3,994.6	(15.4)	3,979.2
Total liabilities for interest-sensitive products	12,484.4	117.5	12,601.9
Other liabilities for insurance and asset accumulation products:			
Separate accounts and investment trusts	87.7		87.7
Claims payable and other policyholder funds	897.1	(10.3)	886.8
Total other liabilities for insurance and asset accumulation products	984.8	(10.3)	974.5
Total liabilities for insurance and asset accumulation products	$22,175.6	$2,592.1	$24,767.7

The following provides explanations for the fresh-start adjustment to insurance liabilities related to our insurance inforce at the effective date.

CONSECO, INC. AND SUBSIDIARIES

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Traditional Insurance and Limited Pay Products

In accordance with Statement of Financial Accounting Standards No. 60, Accounting and Reporting by Insurance Enterprises and Statement of Financial Accounting Standards No. 97, Accounting and Reporting by Insurance Enterprises for certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments (SFAS 97), the Predecessor used the original actuarial assumptions determined when traditional long-duration and limited payment insurance contracts were issued in determining liability calculations through the fresh start date, provided the resulting liabilities were adequate to provide for future benefits and expenses under the related contracts. This accounting principle is referred to as the lock in principle and is only applicable to traditional insurance and limited pay products. The use of assumptions that are locked in at the time of issue means that absent loss recognition, the same assumptions are used in accounting for a particular block of business unless the block is subject to purchase or fresh start accounting.

At the Effective Date, the Successor established insurance liabilities at the present value of future benefits and expenses associated with the policies, by using current best-estimate assumptions with provisions for adverse deviation. Such assumptions include estimates as to investment yields, mortality, morbidity, withdrawals, lapses and maintenance expenses. The current best-estimate assumptions for these blocks of business differ from the original actuarial assumptions determined when the business was acquired or issued as further described in the following paragraphs.

Due to the current interest rate environment and the requirement to mark the value of the investment portfolio to market, we changed our assumptions related to future investment earnings. The weighted average expected yield on our investment portfolio decreased to approximately 5.6 percent at the Effective Date from 6.7 percent at December 31, 2002. Approximately $.9 billion of the fresh-start increase to insurance liabilities is the result of changes in future expected investment earnings.

The performance of our long-term care business (especially the acquired block originally sold through independent agents) has generally been unfavorable relative to the Predecessor s assumptions established when these blocks of business were acquired. For example, variance in actual versus estimated morbidity, lapses and expenses have been unfavorable to original assumptions. Approximately $1.4 billion of the increase to insurance liabilities is the result of changes in non-interest assumptions for our long-term care policies. Our assumption changes for long-term care business included: (i) changes in morbidity assumptions from estimates made when the business was acquired to recent Company experience; (ii) changes in mortality assumptions related to certain blocks of this business from the 1958 and 1980 Commissioners Standard Ordinary Mortality table to the 1983 Group Annuity Mortality table; and (iii) changes in ultimate lapse ratios from a range of approximately 3 percent to 5.5 percent prior to the adoption of fresh start accounting to a range of 2 percent to 3.5 percent.

Interest-Sensitive Products Subject to Requirements of SFAS 97

The insurance liability for asset accumulation products (such as deferred annuities and universal life products) is generally equal to current policyholder account balances. These balances generally do not change as a result of the adoption of fresh start accounting. The fresh-start adjustment to insurance liabilities for interest-sensitive products primarily results from: (i) the adoption of SOP 03-01 as of the Effective Date; and (ii) certain Predecessor insurance liabilities that were different from the present value of estimated future benefits as of August 31, 2003.

The adoption of SOP 03-01 as of the effective date required a change in methodology regarding persistency bonuses provided to policyholders who continue to keep their policies inforce for a stated period of time. The Predecessor recognized the cost of this benefit over the period prior to the time the benefit is credited in proportion to estimated gross profits and assumed a certain number of policies would terminate before the benefit was credited. Under SOP 03-01, the cost for such benefits is recognized ratably over the

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

period prior to the time the benefit is credited without assuming policy terminations. Insurance liabilities increased by approximately $.1 billion as a result of the adoption of SOP 03-01.

In addition, the insurance liabilities for certain Predecessor insurance liabilities were different than the present value of estimated future benefits as of the Effective Date.

The Predecessor had previously established an insurance liability related to certain business, to recognize the future loss expected to be recognized for the former practice of reducing the cost of insurance charges to amounts below the level permitted under the provisions of the policy. The Predecessor amortized this liability into income in proportion to estimated gross profits on the business, consistent with SFAS 97 requirements for unearned revenues. The Predecessor had previously decided to discontinue the practice of providing this nonguaranteed benefit. Accordingly, the remaining insurance liability established for this benefit was no longer required at August 31, 2003, resulting in a $.1 billion reduction to reserves in conjunction with our adoption of fresh-start accounting.

The liabilities established for our equity-indexed annuity products (including the value of options attributable to policyholders for the estimated life of the annuity contract and accounted for as embedded derivatives) are established pursuant to different accounting rules than other interest-sensitive products. At the Effective Date, the present value of estimated future benefits for our equity-indexed products exceeded the value of the Predecessor s liabilities by $.2 billion, resulting in a fresh-start adjustment.

Changes in the unpaid claims reserve and liabilities related to accident and health insurance were as follows (dollars in millions):

	December 31,		
	2003	2002	2001
Balance, beginning of the period	$ 1,461.3	$ 1,360.4	$ 1,368.4
Less reinsurance ceded	(52.8)	(104.1)	(29.8)
	1,408.5	1,256.3	1,338.6
Incurred claims related to:			
Current year	1,718.5	1,945.1	1,957.2
Prior year(a)	22.4	13.7	(80.0)
Total incurred	1,740.9	1,958.8	1,877.2
Interest on claim reserves	68.7	71.5	72.4
Paid claims related to:			
Current year	978.2	1,171.2	1,239.8
Prior year	743.2	706.9	792.1
Total paid	1,721.4	1,878.1	2,031.9
Balance, end of the period	1,496.7	1,408.5	1,256.3
Reinsurance ceded	31.8	52.8	104.1
	$ 1,528.5	$ 1,461.3	$ 1,360.4

(a) Such amounts will fluctuate based upon the estimation procedures used to determine the amount of unpaid losses. Such estimates are the result of ongoing analysis related to recent loss development trends.

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7. Income Taxes

The components of income tax expense (benefit) were as follows (dollars in millions):

	Successor	Predecessor		
	Four Months Ended December 31, 2003	Eight Months Ended August 31, 2003	Years Ended December 31,	
			2002	2001
Current tax provision (benefit)	$(14.4)	$(13.5)	$ 53.1	$ 132.2
Deferred tax provision (benefit)	67.6			(189.8)
Income tax expense (benefit) on period income	53.2	(13.5)	53.1	(57.6)
Valuation allowance			811.2	
Total income tax expense (benefit)	$ 53.2	$(13.5)	$864.3	$ (57.6)

The income tax expense (benefit) recorded in 2002 has been allocated entirely to continuing operations before the following items: minority interest, discontinued operations, cumulative effect of accounting change and other comprehensive income. This accounting treatment is required because the calculation of income tax expense is the same, both with and without the items other than continuing operations discussed above.

A reconciliation of the U.S. statutory corporate tax rate to the effective rate reflected in the consolidated statement of operations is as follows:

	Successor	Predecessor		
	Four Months Ended December 31, 2003	Eight Months Ended August 31, 2003	Years Ended December 31,	
			2002	2001
U.S. statutory corporate rate	35.0%	35.0%	(35.0)%	(35.0)%
Valuation allowance		25.8	49.6	
Gain on debt restructuring		(39.7)		
Subsidiary stock basis adjustment		(21.8)		
Net deferred benefits not recognized in the current period			27.7	
Nondeductible goodwill amortization and impairment			10.9	15.9
Other nondeductible expenses	.8	(.1)	(.1)	(.9)
State taxes	.7	.2	(.2)	3.0
Provision for tax issues and other	(.9)			(6.7)

Effective tax rate	35.6%	(.6)%	52.9%	(23.7)%

Conseco and its affiliates are currently under examination by the Internal Revenue Service for tax years ending December 31, 1999 through December 31, 2001. The outcome of these examinations is not expected to result in material adverse deficiencies, but may result in utilization or adjustment to the income tax loss carryforwards reported below.

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The components of the Company s income tax assets and liabilities were as follows (dollars in millions):

	Successor	Predecessor
	December 31, 2003	December 31, 2002
Deferred tax assets:		
Net operating loss carryforwards:		
Portion attributable to CFC worthless investment	$ 1,183.0	$
Other	84.2	615.0
Deductible temporary differences:		
Actively managed fixed maturities		196.0
Capital loss carryforwards	411.2	112.8
Interest-only securities		536.3
Insurance liabilities	1,591.3	750.4
Allowance for loan losses		252.2
Reserve for loss on loan guarantees	217.2	229.2
Debt obligations		39.4
Other		14.0
Gross deferred tax assets	3,486.9	2,745.3
Deferred tax liabilities:		
Actively managed fixed maturities	(33.4)	
Cost of policies purchased and cost of policies produced	(716.3)	(773.8)
Unrealized appreciation	(123.0)	(126.2)
Other	(252.1)	(125.7)
Gross deferred tax liabilities	(1,124.8)	(1,025.7)
Valuation allowance	(2,362.1)	(1,719.6)
Net deferred tax assets		
Current income taxes prepaid	24.6	66.9
Income tax liabilities classified as liabilities of discontinued operations		34.6
Net income tax assets	$ 24.6	$ 101.5

Our income tax expense includes deferred income taxes arising from temporary differences between the financial reporting and tax bases of assets and liabilities, capital loss carryforwards and net operating loss carryforwards. The net deferred tax assets totaled $2,362.1 million at December 31, 2003. In assessing the realization of our deferred income tax assets, we consider whether it is more likely than not that the deferred income tax assets will be realized. The ultimate realization of our deferred income tax assets depends upon generating future taxable income during the periods in which our temporary differences become deductible and before our net operating loss carryforwards expire. We evaluate the realizability of our deferred income tax assets by assessing the need for a valuation allowance on a quarterly basis. Based upon information existing at the time of our emergence from bankruptcy, we established a valuation allowance against our entire balance of net deferred income tax assets as we believed that the realization of such net deferred income tax assets in future periods was uncertain. As of December 31, 2003, we continue to believe that the realization of our net deferred income tax asset is uncertain and that a valuation allowance is

required for our entire balance of net deferred income tax assets. We reached this conclusion after considering the losses realized by the Company in recent years, the uncertainties related to the tax treatment for the worthlessness of

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

our investment in CFC, (which is more fully discussed below), and the likelihood of future taxable income exclusive of reversing temporary differences and carryforwards.

As of December 31, 2003, we had about $3.6 billion of net operating loss carryforwards (after taking into account the reduction in tax attributes described in the paragraph which follows and the loss resulting from the worthlessness of CFC discussed below), which expire as follows: $11.2 million in 2004; $4.6 million in 2005; $.2 million in 2006; $5.8 million in 2007; $6.6 million in 2008; $10.5 million in 2009; $4.2 million in 2010; $2.5 million in 2011; $16.0 million in 2012; $43.4 million in 2013; $6.9 million in 2014; $60.4 million in 2016; $41.5 million in 2017; $3,399.5 million in 2018; $.7 million in 2019; $5.5 million in 2020; and $1.0 million in 2022. The timing and manner in which we will utilize the net operating loss carryforwards in any year or in total may be limited by various provisions of the Internal Revenue Code (the Code) (and interpretation thereof) and our ability to generate sufficient future taxable income in the relevant carryforward period.

The Code provides that any income realized as a result of the cancellation of indebtedness (cancellation of debt income or CODI) in bankruptcy, will reduce certain tax attributes including net operating loss carryforwards. We realized an estimated $2.5 billion of CODI when we emerged from bankruptcy. Accordingly, our net operating loss carryforwards were reduced by $2.5 billion.

The following paragraphs summarize some of the various limitations and contingencies which exist with respect to the future utilization of the net operating loss carryforwards.

The Company realized an estimated $5.4 billion tax loss in 2003 as a result of its investment in CFC. In consultation with our tax advisors and based on relevant provisions of the Code, the Company intends to treat this loss as an ordinary loss, thereby increasing the Company s net operating loss carryforward. The Company has requested a pre-filing examination by the IRS to confirm that this loss should be treated as an ordinary loss. If the IRS were to disagree with our conclusion and such determination ultimately prevailed, the loss would be treated as a capital loss, which would only be available to reduce future capital gains for the next 5 years. The procedures related to the pre-filing examination are in process, but are not expected to be completed before August 2004.

The Code limits the extent to which losses realized by a non-life entity (or entities) may offset income from a life insurance company (or companies) to the lesser of: (i) 35 percent of the income of the life insurance company; or (ii) 35 percent of the total loss. There is no limitation with respect to the ability to utilize net operating losses generated by a life insurance company. Subsequent to our emergence from bankruptcy, we reorganized certain of our subsidiaries to improve their capital position. As a result of the reorganization, the loss related to CFC was realized by a life insurance company. Accordingly, we believe the loss should be treated as a life insurance loss and would not be subject to the limitations described above. However, if the IRS were to disagree with our conclusion and such determination ultimately prevailed, the loss related to CFC would be subject to the limitation described in the first sentence of this paragraph.

The timing and manner in which the Company will be able to utilize some or all of its net operating loss carryforward may be limited by Section 382 of the Code. Section 382 imposes limitations on a corporation s ability to use its net operating losses if the company undergoes an ownership change. Because the Company underwent an ownership change pursuant to its reorganization, we have determined that this limitation applies to the Company. In order to determine the amount of this limitation we must determine how much of our net operating loss carryforward relates to the period prior to our emergence from bankruptcy (such amount will be subject to the 382 limitation) and how much relates to the period after emergence (such amount will not be subject to the 382 limitation). Pursuant to the Code, we may: (i) allocate the current year tax loss on a pro rata basis to determine earnings (loss) post- and pre-emergence; or (ii) specifically identify transactions in each period and record it in the period it actually occurred. We intend to elect the latter, which we believe will result in a substantial portion of the loss related to CFC being

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

treated as post emergence and therefore not subject to the Section 382 limitation. Any losses that are subject to the Section 382 limitation will only be utilized by the Company up to approximately $140 million per year with any unused amounts carried forward to the following year.

The reduction of any portion of our deferred income tax valuation allowance (including the net operating loss carryforwards) existing as of August 31, 2003, will be accounted for as a reduction of goodwill when utilized pursuant to SOP 90-7. If all goodwill is eliminated, any additional reduction of the valuation allowance existing at August 31, 2003 will be accounted for as a reduction of other intangible assets until exhausted and thereafter as an addition to paid-in-capital. Goodwill was reduced by $189.4 million during the four months ended December 31, 2003, due to a reduction in the valuation allowance for net deferred income tax assets established at the Effective Date.

At December 31, 2003, Conseco had $1.2 billion of capital loss carryforwards. These carryforwards will expire as follows: $2.7 million in 2005; and $5.5 million in 2006; $484.4 million in 2007; and $682.2 million in 2008.

8. Notes Payable Direct Corporate Obligations

This note contains information regarding the following notes payable that were direct corporate obligations of the Company as of December 31, 2003 and 2002 (dollars in millions).

	Successor	Predecessor
	December 31, 2003	December 31, 2002
$1.3 billion credit agreement	$1,300.0	$
$1.5 billion senior credit facility		1,531.4
8.5% senior notes due 2002		224.9
8.5% guaranteed senior notes due 2003		1.0
8.125% senior notes due 2003		63.5
6.4% senior notes due 2003		234.1
6.4% guaranteed senior notes due 2004		14.9
10.5% senior notes due 2004		24.5
8.75% senior notes due 2004		423.7
8.75% guaranteed senior notes due 2006		364.3
6.8% senior notes due 2005		99.2
6.8% guaranteed senior notes due 2007		150.8
9.0% senior notes due 2006		150.8
9.0% guaranteed senior notes due 2008		399.2
10.75% senior notes due 2008		37.6
10.75% guaranteed senior notes due 2009		362.4
Total principal amount	1,300.0	4,082.3
Unamortized net discount related to issuance of notes payable		(34.0)
Unamortized fair market value of terminated interest rate swap agreements (as described in the note entitled Summary of Significant Accounting Policies)		8.8
Less amounts subject to compromise		(4,057.1)
Direct corporate obligations	$1,300.0	$

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Pursuant to the Plan, we entered into a senior secured bank credit facility with a principal balance of $1.3 billion (the New Credit Facility). The New Credit Facility consists of two tranches: Tranche A $1.0 billion; and Tranche B $.3 billion. Principal repayments are due as follows (dollars in millions):

	Tranche A	Tranche B
June 30, 2004	$ 50.0	$ 3.0
June 30, 2005	50.0	3.0
June 30, 2006	50.0	1.5
December 31, 2006	50.0	1.5
June 30, 2007	75.0	1.5
December 31, 2007	75.0	1.5
June 30, 2008	75.0	1.5
December 31, 2008	75.0	1.5
June 30, 2009		1.5
September 10, 2009	500.0	
December 31, 2009		1.5
September 10, 2010		282.0
	$1,000.0	$300.0

Tranche A and Tranche B borrowings bear interest, payable monthly, based on either an offshore rate or a base rate. Offshore rates are equal to LIBOR plus an applicable margin based on the rating of the Company s senior secured long-term debt securities by Moody s Investors Service, Inc. (Moody s) or S&P. Base rates are equal to: (i) the greater of: (a) the Federal funds rate plus .50 percent; or (b) Bank of America s prime rate; plus (ii) an applicable margin based on the rating of the Company s senior secured long-term debt securities by Moody s or S&P. With respect to Tranche A, the LIBOR rate may not be less than 2.00 percent through September 30, 2004, or less than 2.50 percent thereafter. With respect to Tranche B, the LIBOR rate may not be less than 2.25 percent through September 30, 2004, or less than 2.75 percent thereafter. The range of applicable margins are summarized in the following table:

	Offshore Rate Margin	Base Rate Margin
Tranche A	3.75% - 5.25%	1.75% - 3.25%
Tranche B	5.75% - 7.25%	3.75% - 5.25%

On December 31, 2003, the interest rates on our Tranche A and Tranche B borrowings were 7.25 percent and 9.50 percent, respectively.

Pursuant to the New Credit Facility, the Company is required to make mandatory prepayments with all or a portion of the proceeds from the following transactions or events including: (i) the issuance of certain indebtedness; (ii) equity issuances; (iii) certain asset sales or casualty events; (iv) a certain percentage of amounts received or recovered with respect to the D&O loans; and (v) excess cash flow as defined in the credit agreement. Proceeds not used to prepay indebtedness must generally be: (i) used to redeem a portion of our Preferred Stock; or (ii) contributed to the capital of our insurance subsidiaries.

The New Credit Facility requires the Company to maintain various financial ratios and balances, as defined in the agreement including: (i) a debt-to-total capitalization ratio of less than .356:1.0 or less at December 31, 2003, and decreasing over time to .200:1.0 at June 30, 2008 (such ratio was .334:1.0 at December 31, 2003); (ii) an interest coverage ratio greater than or equal to 1.00:1.0 for the quarter ending December 31, 2003, and increasing over time to 4.50:1.0 for the year ending December 31, 2009 (such ratio was greater than 1.25:1.0 for the quarter ending December 31, 2003); (iii) EBITDA, as defined in the credit

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

agreement, greater than or equal to $490.0 million for the two quarters ended March 31, 2004, and increasing over time to $1,296.0 million for the four quarters ending March 31, 2010; (iv) an aggregate risk-based capital ratio, as defined in the credit agreement, greater than or equal to 158 percent at December 31, 2003, and increasing over time to 225 percent at March 31, 2006 (such ratio was 287 percent at December 31, 2003); (v) minimum individual risk-based capital ratios for certain insurance companies as of the end of each fiscal year (such minimum ratios were exceeded at December 31, 2003); (vi) minimum levels of statutory capital and surplus, as defined in the credit agreement (statutory capital and surplus at December 31, 2003 exceeded such requirements); and (vii) minimum investment portfolio requirements (such minimum investment portfolio requirements were met at December 31, 2003).

The New Credit Facility prohibits or restricts, among other things: (i) the payment of cash dividends on the Company s common or preferred stock; (ii) the repurchase of our common stock; (iii) the issuance of additional debt or capital stock; (iv) liens; (v) asset dispositions; (vi) affiliate transactions; (vii) certain investment activities; (viii) change in business; and (ix) prepayment of indebtedness (other than the New Credit Facility). The obligations under our New Credit Facility are guaranteed by Conseco s current and future domestic subsidiaries, other than: (i) its insurance companies; (ii) subsidiaries of the insurance companies; or (iii) certain immaterial subsidiaries as defined in the credit agreement. This guarantee was secured by granting liens on substantially all the assets of the guarantors including the capital stock of our top tier insurance company, Conseco Life Insurance Company of Texas.

Pursuant to the New Credit Facility, the Company is required to pay a fee of $6.5 million on June 30, 2004, unless all borrowings under the credit agreement have been repaid.

The outstanding notes payable that were direct corporate obligations of Old Conseco prior to our emergence from bankruptcy and the $1.5 billion senior credit facility were discharged in accordance with the Plan.

In April 2002, Old Conseco completed an exchange of approximately $1.3 billion aggregate principal amount of newly issued guaranteed notes for its senior unsecured notes held by qualified institutional buyers, institutional accredited investors , or non-U.S. persons in transactions outside the United States. The bonds which were exchanged had identical principal and interest components, but the new bonds had extended maturities in exchange for an enhanced ranking in Old Conseco s capital structure. The purpose of the exchange offer was to extend the maturity profile of the existing notes in an effort to improve Old Conseco s financial flexibility and to enhance its future ability to refinance public debt. The new notes were guaranteed on a senior subordinated basis by CIHC. As a result, the new notes were structurally senior to the existing notes. The new notes were not registered under the Securities Act of 1933, as amended, and could not be offered or sold in the United States absent registration or an exemption from registration. Old Conseco entered into a registration rights agreement for the benefit of each exchange participant in which we agreed to file, and did file, an exchange offer registration statement with the SEC with respect to the new notes. However, as a result of the decision to restructure Old Conseco s capital, Old Conseco did not make the registered exchange offer. Accordingly, the affected notes accrued additional interest as liquidated damages under the registration rights agreement.

In connection with the exchange offer Old Conseco issued: (i) $991,000 of 8.5% senior notes due October 15, 2003, in exchange for an equal amount of 8.5% Original Notes due October 15, 2002 (the 8.5% Exchange Notes); (ii) $14,936,000 of 6.4% senior notes due February 10, 2004 in exchange for an equal amount of 6.4% Original Notes due February 10, 2003 (the 6.4% Exchange Notes); (iii) $364,294,000 of 8.75% senior notes due August 9, 2006 in exchange for an equal amount of 8.75% Original Notes due February 9, 2004 (the 8.75% Exchange Notes); (iv) $150,783,000 of 6.8% senior notes due June 15, 2007 in exchange for an equal amount of 6.8% Original Notes due June 15, 2005 (the 6.8% Exchange Notes); (v) $399,200,000 of 9.0% senior notes due April 15, 2008 in exchange for an equal amount of 9.0% Original Notes due October 15, 2006 (the 9.0% Exchange Notes); and (vi) $362,433,000 of 10.75% senior notes due

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 15, 2009 in exchange for an equal amount of 10.75% Original Notes due June 15, 2008 (the 10.75% Exchange Notes).

During 2002, we repurchased $77.4 million par value of our Predecessor s notes payable resulting in a gain on the extinguishment of debt of $1.8 million.

During 2001, we repurchased $893.8 million par value of our Predecessor s notes payable resulting in a gain on the extinguishment of debt of $17.0 million.

9. Commitments and Contingencies

Litigation

We are involved on an ongoing basis in lawsuits (including purported class actions) relating to our operations, including with respect to sales practices, and we and current and former officers and former directors are defendants in a pending class action lawsuit asserting claims under the securities laws. The ultimate outcome of these lawsuits cannot be predicted with certainty and we have estimated the potential exposure for each of the matters and have recorded a liability if a loss is deemed probable.

Securities Litigation

Since we announced our intention to restructure our capital on August 9, 2002, a total of eight purported securities fraud class action lawsuits have been filed in the United States District Court for the Southern District of Indiana. The complaints name us as a defendant, along with certain of our current and former officers. These lawsuits were filed on behalf of persons or entities who purchased our Predecessor s common stock on various dates between October 24, 2001 and August 9, 2002. In each case the plaintiffs allege claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended (the Exchange Act) and allege material omissions and dissemination of materially misleading statements regarding, among other things, the liquidity of Conseco and alleged problems in CFC s manufactured housing division, allegedly resulting in the artificial inflation of our Predecessor s stock price. On March 13, 2003, all of these cases were consolidated into one case in the United States District Court for the Southern District of Indiana, captioned *Franz Schleicher, et al. v. Conseco, Inc., Gary Wendt, William Shea, Charles Chokel and James Adams, et al., Case No. 02-CV-1332 DFH-TAB.* The lawsuits were stayed as to all defendants by order of the United States Bankruptcy Court for the Northern District of Illinois. The stay was lifted on October 15, 2003. The plaintiffs have filed a consolidated class action complaint with respect to the individual defendants. We expect to be filing a motion to dismiss in March 2004. Our liability with respect to these lawsuits was discharged in the Plan and our obligation to indemnify individual defendants who were not serving as one of our officers or directors on the Effective Date is limited to $3 million in the aggregate under the Plan. Our liability to indemnify individual defendants who were serving as an officer or director on the Effective Date, of which there is one such defendant, is not limited by the Plan. We believe these lawsuits are without merit and intend to defend them vigorously. The ultimate outcome of these lawsuits cannot be predicted with certainty.

Other Litigation

Collection efforts by the Company and its wholly owned subsidiary, Conseco Services, LLC, related to the 1996-1999 director and officer loan programs have been commenced against various past board members and executives with outstanding loan balances. In addition, certain former officers and directors have sued the companies for declaratory relief concerning their liability for the loans. Currently, we are involved in litigation with Stephen C. Hilbert, James D. Massey, Dennis E. Murray, Sr., Rollin M. Dick, James S. Adams, Maxwell E. Bublitz, Ngaire E. Cuneo, David R. Decatur, Donald F. Gongaware and Bruce A. Crittenden. The specific lawsuits include: *Hilbert v. Conseco, Case No. 03A 04283 (Bankr. Northern District,*

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Illinois); Conseco Services v. Hilbert, Case No. 29C01-0310 MF 1296 (Circuit Court, Hamilton County, Indiana); Murray and Massey v. Conseco, Case No. 1:03-CV-1482 LJM-WTL (Southern District, Indiana); Conseco Services v. Adams, et al, Case No. 29DO2-0312-CC-1035(Circuit Court, Hamilton County, Indiana); Conseco v. Adams, et al, Case No. 03A 04545, (Bankr. Northern District, Illinois) Dick v. Conseco Services, Case No. 29 D01-0207-PL-549 (Superior Court, Hamilton County, Indiana); Conseco Services v. Dick, et al., Case No. 06C01-0311-CC-356 (Circuit Court, Boone County, Indiana); Stephen C. Hilbert v. Conseco, Inc. and Kroll Inc., Case No. 29D02-0312-PL-1026 (Superior Court, Hamilton County, Indiana) and Crittenden v. Conseco, Case No. IP02-1823-C B/S (Southern District, Indiana). The Company and Conseco Services, LLC believe that all amounts due under the director and officer loan programs, including all applicable interest, are valid obligations owed to the companies. As part of the Plan, we have agreed to pay 45 percent of any net proceeds recovered in connection with these lawsuits, in an aggregate amount not to exceed $30 million, to former holders of our Predecessor s trust preferred securities that did not opt out of a settlement reached with the committee representing holders of these securities. We are required to use the balance of any net proceeds recovered in connection with these lawsuits to pay down our Senior Credit Facility. Any remaining proceeds will be used to contribute capital to our insurance subsidiaries. We intend to prosecute these claims to obtain the maximum recovery possible. Further, with regard to the various claims brought against the Company and Conseco Services, LLC by certain former directors and officers, we believe that these claims are without merit and intend to defend them vigorously. The ultimate outcome of the lawsuits cannot be predicted with certainty.

In October 2002, Roderick Russell, on behalf of himself and a class of persons similarly situated, and on behalf of the ConsecoSave Plan, filed an action in the United States District Court for the Southern District of Indiana against our Predecessor, Conseco Services, LLC and certain of our current and former officers *(Roderick Russell, et al. v Conseco, Inc., et al., Case No. 1:02-CV-1639 LJM).* The purported class action consists of all individuals whose 401(k) accounts held common stock of our Predecessor at any time since April 28, 1999. The complaint alleges, among other things, breaches of fiduciary duties under ERISA by continuing to permit employees to invest in our Predecessor s common stock without full disclosure of the Company s true financial condition. We filed a motion to dismiss the complaint in December 2002. This lawsuit was stayed as to all defendants by order of the Bankruptcy Court. The stay was lifted on October 15, 2003. It is expected that the plaintiffs will be amending their complaint in March or April of 2004. On February 13, 2004, the Company s fiduciary insurance carrier, RLI Insurance Company filed a declaratory judgment action asking the court to find no liability under its policy for the claims made in the Russell matter *(RLI Insurance Company v. Conseco, Inc., Stephen Hilbert, et al., Case No. 1:04-CV-0310DFH-TAB* (Southern District, Indiana.)) We believe the lawsuits are without merit and intend to defend them vigorously. The ultimate outcome of the lawsuit cannot be predicted with certainty.

On June 24, 2002, the heirs of a former officer, Lawrence Inlow, commenced an action against our Predecessor, Conseco Services, LLC and two former officers in the Circuit Court of Boone County, Indiana *(Inlow et al. v. Conseco, Inc., et al., Cause No. 06C01-0206-CT-244).* The heirs assert that unvested options to purchase 756,248 shares of our Predecessor s common stock should have been vested at Mr. Inlow s death. The heirs further claim that if such options had been vested, they would have been exercised, and that the resulting shares of common stock would have been sold for a gain of approximately $30 million based upon a stock price of $58.125 per share, the highest stock price during the alleged exercise period of the options. We believe the heirs claims are without merit and will defend the action vigorously. The maximum exposure to the Company for this lawsuit is estimated to be $33 million. The heirs did not file a proof of claim with the Bankruptcy Court. Subject to dispositive motions which are yet to be filed, the matter will continue to trial against Conseco Services, LLC and the other co-defendants on September 13, 2004. The ultimate outcome cannot be predicted with certainty.

On June 27, 2001, two suits against the Company s subsidiary, Philadelphia Life Insurance Company (now known as Conseco Life Insurance Company), both purported nationwide class actions seeking

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unspecified damages, were consolidated in the U.S. District Court, Middle District of Florida *(In Re PLI Sales Litigation, Cause No. 01-MDL-1404)*, alleging among other things, fraudulent sales and a vanishing premium scheme. Philadelphia Life filed a motion for summary judgment against both named plaintiffs, which motion was granted in June 2002. Plaintiffs appealed to the 11th Circuit. The 11th Circuit, in July 2003, affirmed in part and reversed in part, allowing two fraud counts with respect to one plaintiff to survive. The plaintiffs request for a rehearing with respect to this decision has been denied. Philadelphia Life has filed a summary judgment motion with respect to the remaining claims. This summary judgment was denied in February 2004. Philadelphia Life believes this lawsuit is without merit and intends to defend it vigorously. The ultimate outcome of the lawsuit cannot be predicted with certainty.

On December 1, 2000, the Company s former subsidiary, Manhattan National Life Insurance Company, was named in a purported nationwide class action seeking unspecified damages in the First Judicial District Court of Santa Fe, New Mexico *(Robert Atencio and Theresa Atencio, for themselves and all other similarly situated v. Manhattan National Life Insurance Company, an Ohio corporation, Cause No. D-0101-CV-2000-2817)*, alleging among other things fraud by non-disclosure of additional charges for those policyholders paying via premium modes other than annual. We retained liability for this litigation in connection with the sale of Manhattan National Life in June 2002. We believe this lawsuit is without merit and intend to defend it vigorously. The ultimate outcome of the lawsuit cannot be predicted with certainty.

On December 19, 2001, four of the Company s subsidiaries were named in a purported nationwide class action seeking unspecified damages in the District Court of Adams County, Colorado *(Jose Medina and others similarly situated v. Conseco Annuity Assurance Company, Conseco Life Insurance Company, Bankers National Life Insurance Company and Bankers Life and Casualty Company, Cause No. 01-CV-2465)*, alleging among other things breach of contract regarding alleged non-disclosure of additional charges for those policy holders paying via premium modes other than annual. On July 14 and 15, 2003 the plaintiff s motion for class certification was heard and the Court took the matter under advisement. On November 10, 2003, the Court denied the motion for class certification. On January 26, 2004, the plaintiff appealed the trial court s ruling denying class certification. All further proceedings have been stayed pending the outcome of the appeal. The defendants believe this lawsuit is without merit and intend to defend it vigorously. The ultimate outcome of the lawsuit cannot be predicted with certainty.

The Company s subsidiaries, Conseco Life Insurance Company and Bankers Life and Casualty Company, have recently been named in multiple purported class actions and individual lawsuits alleging, among other things, breach of contract with regard to a change made in the way monthly deductions are calculated for insurance coverage. This change was the adjustment of a non-guaranteed element, which was not in the applicable policy form. The specific lawsuits include: *David Barton v. Conseco Life Insurance Company, Case No. 04-20048-CIV-MORENO (Southern District, Florida); Stephen Hook, an individual, on behalf of himself and all others similarly situated v. Conseco Life Insurance Company and Bankers Life and Casualty Company and Does 1 through 10, Case No. CGC-04-428872 (Superior Court, San Francisco County, California); Donald King, as Trustee of the Irrevocable Trust of Arnold L. King v. Conseco Life Insurance Company, Case No. 1: 04CV0163 (Northern District, Ohio); Michael S. Kuhn, on behalf of himself and all others similarly situated v. Conseco Life Insurance Company and Does 1 through 100, Case No. 03-416786 (Superior Court, San Francisco County, California); Sidney H. Levine and Judith A. Levine v. Conseco Life Insurance Company, Mark F. Peters Insurance Services, Inc. Hon. John Garamendi (in his capacity as Insurance Commissioner for the State of California) and Does 1 through 10, Case No. 04 CV 125 LAB (BLM) (Southern District, California); Alene P. Mangelson, as Trustee for the Ned L. Mangelson Life Insurance Trust, Marie M. Berg and Michelle M. Wilcox on behalf of themselves and all others similarly situated v. Conseco Life Insurance Company, Case No. 29D02-0312-PL-1034 (Superior Court, Hamilton County, Indiana); Edward M. Medvene, an Individual, and Sherwin Samuels and Miles Rubin, as Trustees of the Edward Medvene 2984 Insurance Trust v. Conseco Life Insurance Company, Case No. CV04-846-AHM*

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(MCX) (Central District, California). We believe these lawsuits are without merit and intend to defend them vigorously. The ultimate outcome of the lawsuits cannot be predicted with certainty.

On February 7, 2003, the Company s subsidiary, Conseco Life Insurance Company, was named in a purported Texas statewide class action seeking unspecified damages in the County Court of Cameron County, Texas. On February 12, 2004, the complaint was amended to allege a purported nationwide class and to name Conseco Services, LLC as an additional defendant (*Lawrence Onderdonk and Yolanda Carrizales v. Conseco Life Insurance Company, Conseco Services, LLC, and Pete Ramirez, III, Cause No. 2003-CCL-102-C)*. The purported class consists of all former Massachusetts General Flexible Premium Adjustable Life Insurance Policy policyholders who were converted to Conseco Life Flexible Premium Adjustable Life Insurance Policies and whose accumulated values in the Massachusetts General policies were applied to first year premiums on the Conseco Life policies. The complaint alleges, among other things, civil conspiracy to convert the accumulated cash values of the plaintiffs and the class, and the violation of insurance laws nationwide. We believe this lawsuit is without merit and intend to defend it vigorously. The ultimate outcome of the lawsuit cannot be predicted with certainty.

On December 30, 2002 and December 31, 2002, five suits were filed in various Mississippi counties against Conseco Life Insurance Company *(Kathie Allen, et al. v. Conseco Life Insurance Company, et al., Circuit Court of Jones County, Mississippi, Cause No. 2002-448-CV12; Malcolm Bailey, et al. v. Conseco Life Insurance Company, et al., Circuit Court of Claiborne County, Mississippi, Cause No. CV-2002-371; Anthony Cascio, et al. v. Conseco Life Insurance Company, et al, Circuit Court of LeFlore County, Mississippi, Cause No. CV-2002-0242-CICI; William Garrard, et al. v. Conseco Life insurance Company, et al., Circuit Court of Sunflower County, Mississippi, Cause No. CV-2002-0753-CRL; and William Weaver, et al. v. Conseco Life Insurance Company, et al., Circuit Court of LeFlore County, Mississippi, Cause No. CV-2002-0238-CICI)* alleging, among other things, a vanishing premium scheme. Conseco Life removed all of the cases to the U.S. District Courts in Mississippi. In September 2003, plaintiffs motion to remand was denied in the Garrard and Weaver matters, but granted in the Cascio matter. In November 2003, Conseco Life again removed the Cascio matter to U.S. District Court. Conseco Life awaits the court s ruling on Plaintiff s motion to remand in the Allen matter. In Bailey the parties have agreed to stay in Federal court and the plaintiffs amended their complaint on January 15, 2004 to allege purported nationwide class action allegations regarding alleged wrongful collection of charges under the policy. On January 30, 2004 we filed a motion to dismiss or in alternative, motion for summary judgment. Conseco Life believes the lawsuits are without merit and intends to defend them vigorously. The ultimate outcome of the lawsuits cannot be predicted with certainty.

In addition, the Company and its subsidiaries are involved on an ongoing basis in other lawsuits and arbitrations (including purported class actions) related to their operations. The ultimate outcome of all of these other legal matters pending against the Company or its subsidiaries cannot be predicted, and, although such lawsuits are not expected individually to have a material adverse effect on the Company, such lawsuits could have, in the aggregate, a material adverse effect on the Company s consolidated financial condition, cash flows or results of operations.

Other Proceedings

On September 18, 2003, the Company received a grand jury subpoena from the U.S. District Court for the Southern District of Indiana in connection with a Department of Justice investigation requiring production of documents relating to the valuation of interest-only securities held by CFC, our Predecessor s former finance subsidiary, contemporaneous earnings estimates for the Predecessor, certain personnel records and other accounting and financial disclosure records for the period June 1, 1998 to June 30, 2000. The Company has subsequently received follow-up grand jury document subpoenas concerning other matters. All of these follow-up requests have been limited to the time period prior to the December 17, 2002 bankruptcy filing.

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The Company has been advised by the Department of Justice that neither it nor any of its current directors or employees are subjects or targets of this investigation. The Company is cooperating fully with the Department of Justice investigation.

On March 10, 2004, we entered into a settlement with the SEC in connection with the SEC s investigation of events in and before the spring of 2000, including CFC s accounting for its interest-only securities and servicing rights. These issues were among those addressed in our Predecessor s writedown and restatement in the spring of 2000, and were the subject of shareholder class action litigation, which we settled in the second quarter of 2003. Without admitting or denying the SEC s findings, we consented to the entry of a cease-and-desist order requiring future compliance with periodic reporting, record keeping, internal control and other provisions of the securities laws. The settlement did not impose any fine or monetary penalty, or require us to restate any of our historical financial statements.

On October 29, 2003, the New York Attorney General served Conseco Life Insurance Company of Texas (Conseco Life) with a document subpoena concerning customer transfers between mutual fund subaccounts offered by CVIC, a former wholly-owned subsidiary of Conseco Life, that occurred prior to the sale of CVIC to an unrelated third party in October 2002. The SEC served the Company with a similar subpoena shortly after we received the Attorney General s subpoena. Certain of our employees have also received subpoenas regarding duties they previously performed in respect of annuity sales by CVIC. The purchase agreement pursuant to which CVIC was sold contains indemnification provisions with respect to certain liabilities relating to Conseco Life s period of ownership, including provisions concerning certain business activities (including marketing activities) of CVIC. Conseco Life and the Company have cooperated with the Attorney General and the SEC in producing documents responsive to their subpoenas. In January 2004, the Company received telephonic notification of a potential enforcement action by the Attorney General and a Wells notification from the SEC regarding alleged market timing on the part of holders of variable annuity policies issued by CVIC. The Company and its affiliates have not issued any variable annuity policies since the sale of CVIC. The Company and Conseco Life believe, based on the information obtained and supplied to the investigators to date, that CVIC violated no federal or state law prior to the October 2002 sale. The investigations are in a preliminary stage and their outcome cannot be predicted with certainty. The Company and Conseco Life are cooperating fully with the Attorney General and the SEC in these investigations.

The deadline to file administrative claims in the bankruptcy proceeding was October 9, 2003. The Plan provides that all such claims must be paid in full, in cash. We are reviewing all timely filed administrative claims and may resolve disputes regarding allowance of such claims in the Bankruptcy Court. The amount of known disputed administrative claims as of March 1, 2004 was approximately $2.0 million.

Guaranty Fund Assessments

The balance sheet at December 31, 2003, includes: (i) accruals of $11.5 million, representing our estimate of all known assessments that will be levied against the Company s insurance subsidiaries by various state guaranty associations based on premiums written through December 31, 2003; and (ii) receivables of $5.8 million that we estimate will be recovered through a reduction in future premium taxes as a result of such assessments. At December 31, 2002, such guaranty fund assessment related accruals were $11.5 million and such receivables were $7.5 million. These estimates are subject to change when the associations determine more precisely the losses that have occurred and how such losses will be allocated among the insurance companies. We recognized expense (benefit) for such assessments of $1.2 million in the four months ended December 31, 2003; $4.1 million in the eight months ended August 31, 2003; and $(1.7) million and $6.5 million in 2002 and 2001, respectively.

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Guarantees

In conjunction with the Plan, $481.3 million principal amount of bank loans made to certain former directors and certain current and former officers and key employees to enable them to purchase common stock of Old Conseco were transferred to the Company. These loans had been guaranteed by Old Conseco. We received all rights to collect the balances due pursuant to the original terms of these loans. In addition, we hold loans to participants for interest on the bank loans which total approximately $220 million. The former bank loans and the interest loans are collectively referred to as the D&O loans. We regularly evaluate the collectibility of these loans in light of the collateral we hold and the credit worthiness of the participants. At December 31, 2003, we have estimated that approximately $51.0 million of the D&O balance (which is included in other assets) is collectible (net of the cost of collection). An allowance has been established to reduce the recorded balance of the D&O loans to this balance.

Pursuant to the settlement that was reached with the Official Committee of the Trust Originated Preferred Securities (TOPrS) Holders and the Official Committee of Unsecured Creditors in the Plan, the former holders of TOPrS (issued by Old Conseco s subsidiary trusts and eliminated in our reorganization) who did not opt out of the bankruptcy settlement, will be entitled to receive 45 percent of any proceeds from the collection of certain D&O loans in an aggregate amount not to exceed $30 million. We have established a liability of $23.1 million (which is included in other liabilities), representing our estimate of the amount which will be paid to the former holders of TOPrS pursuant to the settlement.

In accordance with the terms of the Company s former Chief Executive Officer s employment agreement, Bankers Life and Casualty Company, a wholly-owned subsidiary of the Company, is the guarantor of the former executive s nonqualified supplemental retirement benefit. The liability for such benefit at December 31, 2003 and 2002 was $15.6 million and $14.8 million, respectively, and is included in the caption Other liabilities in the liability section of the consolidated balance sheet.

Leases

The Company rents office space, equipment and computer software under noncancellable operating leases. Rental expense was $19.1 million in the four months ended December 31, 2003; $26.7 million in the eight months ended August 31, 2003; and $41.5 million and $45.3 million in 2002 and 2001, respectively. Future required minimum rental payments as of December 31, 2003, were as follows (dollars in millions):

2004	$ 23.0
2005	21.5
2006	18.7
2007	15.6
2008	14.1
Thereafter	24.1
Total	$117.0

10. Other Disclosures

Postretirement Plans

One of our insurance subsidiaries has a noncontributory, unfunded deferred compensation plan for qualifying members of its career agency force. Benefits are based on years of service and career earnings. The liability recognized in the consolidated balance sheet for the agents deferred compensation plan was $64.7 million and $54.2 million at December 31, 2003 and 2002, respectively. Included as an adjustment to

accumulated other comprehensive income (loss) as of December 31, 2002, was a $9.1 million adjustment representing the additional minimum liability associated with this plan. Substantially all of this liability

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

represents vested benefits. Costs incurred on this plan, primarily representing interest on unfunded benefit costs were $1.5 million in the four months ended December 31, 2003; $4.0 million in the eight months ended August 31, 2003; and $5.1 million and $4.9 million during 2002 and 2001, respectively.

The Company provides certain health care and life insurance benefits for certain eligible retired employees under partially funded and unfunded plans in existence at the date on which certain subsidiaries were acquired. Certain postretirement benefit plans are contributory, with participants contributions adjusted annually. Actuarial measurement dates of September 30 and December 31 are used for our postretirement benefit plans. Amounts related to the postretirement benefit plans were as follows (dollars in millions):

	Postretirement Benefits	
	Successor	Predecessor
	December 31, 2003	December 31, 2002
Benefit obligation, beginning of year	$ 24.6	$ 24.5
Interest cost	1.4	1.6
Plan participants contributions	.4	1.1
Actuarial loss (gain)	(1.1)	.4
Benefits paid	(2.7)	(3.0)
Benefit obligation, end of year	$ 22.6	$ 24.6
Fair value of plan assets, beginning of year	$ 1.1	$ 2.0
Actual return on plan assets		
Employer contributions	1.6	2.1
Benefits paid	(2.7)	(3.0)
Fair value of plan assets, end of year	$	$ 1.1
Funded status	$ (22.6)	$ (23.5)
Unrecognized net actuarial loss (gain)		(7.1)
Unrecognized prior service cost		(1.4)
Prepaid (accrued) benefit cost	$ (22.6)	$ (32.0)

Plan assets as of December 31, 2002, consisted of an investment in the Conseco Fixed Income Fund offered by Conseco Fund Group. The Conseco Fixed Income Fund invested primarily in investment-grade debt securities.

We used the following weighted average assumptions to calculate:

	2003	2002
Benefit obligations:		
Discount rate	6.2%	6.5%
Net periodic cost:		

Discount rate	6.5%	7.0%
Expected return on plan assets	4.6%	4.6%

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following assumed health care cost trend rates were used to determine our postretirement benefit obligation:

	2003	2002
Initial healthcare cost trend rate	10.0%	11.5%
Ultimate health care cost trend rate	6.0%	5.0%
Year the rate reaches the ultimate trend rate	2014	2015

A one percentage point change in the assumed health care cost trend rate would have the following effects (dollars in millions):

	One Percentage Point	
	Increase	Decrease
Effect on the postretirement benefit obligation	$1.5	$(1.4)
Effect on the net periodic post retirement benefit cost	.1	(.1)

Components of the cost we recognized related to postretirement plans were as follows (dollars in millions):

	Postretirement Benefits			
	Successor	Predecessor		
	Four Months Ended December 31, 2003	Eight Months Ended August 31, 2003	Years Ended December 31, 2002	Years Ended December 31, 2001
Interest cost	$ .5	$ .9	$1.6	$ 1.5
Expected return of plan assets			(.1)	(.1)
Amortization of prior service cost		(.1)	(.2)	(1.0)
Recognized net actuarial loss	(.3)	(.5)	(.5)	(.1)
Net periodic cost (benefit)	$ .2	$ .3	$ .8	$ .3

The Company has qualified defined contribution plans for which substantially all employees are eligible. Company contributions, which match certain voluntary employee contributions to the plan, totaled $6.6 million in 2002 and $4.7 million in 2001. No employer contributions were made during the 2003 periods. Prior to 2002, employer matching contributions were made in Old Conseco common stock. For the first nine months of 2002, employer matching contributions were made in cash. In September 2002, the plans were amended to make future employer matching contributions discretionary. Effective January 1, 2004, the Company resumed making matching contributions in cash.

Trust Preferred Securities

Prior to 2003, certain wholly-owned subsidiary trusts had issued preferred securities in public offerings. The trusts used the proceeds from these offerings to purchase subordinated debentures from Conseco. The terms of the preferred securities were parallel to the terms of the debentures, which accounted for substantially all trust assets. The preferred securities were to be redeemed on a pro rata basis, to the same extent as the debentures were repaid. Under certain circumstances involving a change in law or legal interpretation, the debentures could be distributed to the holders of the preferred securities. Our obligations under the debentures and related agreements, taken together, provided a full and unconditional guarantee of payments due on the preferred securities. The debentures issued to the subsidiary trusts and the common securities purchased by Conseco from the subsidiary trusts were eliminated in the consolidated financial

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

statements. The Trust Preferred Securities guaranteed by Old Conseco prior to our emergence from bankruptcy were discharged in accordance with the Plan.

On February 16, 2001, the trust preferred securities component of the FELINE PRIDES were retained by the Company (and subsequently retired) as payment under the stock purchase contract in accordance with their terms and, as a result, we issued 11.4 million shares of Old Conseco common stock to the holders of the FELINE PRIDES. The $496.6 million carrying value of the FELINE PRIDES that were retired (and used for payment pursuant to the stock purchase contracts) was transferred from minority interest to common stock and additional paid-in capital.

Trust Preferred Securities at December 31, 2002, were as follows:

	Year Issued	Par Value	Carrying Value	Distribution Rate	Earliest/Mandatory Redemption Dates
		(Dollars in millions)			
Trust Originated Preferred Securities	1999	$ 300.0	$ 296.5	9.44%	2004/2029
Trust Originated Preferred Securities	1998	500.0	496.9	8.70	2003/2028
Trust Originated Preferred Securities	1998	230.0	228.1	9.00	2003/2028
Capital Securities	1997	300.0	300.0	8.80	2027
Trust Originated Preferred Securities	1996	275.0	275.0	9.16	2001/2026
Capital Trust Pass-through Securities	1996	325.0	325.0	8.70	2026
		$1,930.0	$1,921.5		

Reclassification Adjustments Included in Comprehensive Income

The changes in unrealized appreciation (depreciation) included in comprehensive income are net of reclassification adjustments for after-tax net gains (losses) from the sale of investments included in net income (loss) of approximately $545 million and $240 million for the years ended December 31, 2002 and 2001, respectively. Such changes for the 2003 periods were not significant.

Sale of Interest in Riverboat

In the first quarter of 2001, the Company sold its 29 percent ownership interest in the riverboat casino in Lawrenceberg, Indiana, for $260 million. We recognized a net gain on the sale of $192.4 million.

11. Special Charges

2002

The following table summarizes the special charges incurred by the Company during 2002, which are further described in the paragraphs which follow (dollars in millions):

Loss related to reinsurance transactions and businesses sold to raise cash	$47.5
Costs related to debt modification and refinancing transactions	17.7
Expenses related to the termination of the former chief financial officer	6.5
Other items	24.8

Special charges before income tax benefit	$96.5

Loss Related to Debt Modification and Reinsurance Transactions and Businesses Sold to Raise Cash

We completed various asset sales and reinsurance transactions to raise cash which resulted in net losses of $47.5 million in 2002. These amounts included: (i) a loss of $39.0 million related to the reinsurance of a

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

portion of our life insurance business; (ii) a loss of $20.0 million associated with the sale of our subsidiary in India; partially offset by (iii) asset sales resulting in a net gain of $11.5 million.

Costs Related to Debt Modification and Refinancing Transactions

In conjunction with the various modifications to borrowing arrangements (including the debt exchange offer completed in April 2002), entered into in 2002 we incurred costs of $17.7 million which are not permitted to be deferred pursuant to GAAP.

Expenses Related to Termination of the Former Chief Financial Officer

The employment of Old Conseco s chief financial officer was terminated in the first quarter of 2002. As a result, the vesting provisions associated with the restricted stock issued to the chief financial officer pursuant to his employment agreement were accelerated. We recognized a charge of $5.1 million related to the immediate vesting of such restricted stock in the first quarter of 2002. In addition, we recognized severance benefits of $1.4 million associated with the termination.

Other Items

Other items include expenses incurred: (i) in conjunction with the transfer of certain customer service and backroom operations to our India subsidiary; (ii) for severance benefits related to the transfer of such operations; and (iii) for other items which are not individually significant. The Company sold its India subsidiary in the fourth quarter of 2002 and has significantly reduced the customer service and backroom operations conducted there.

2001

The following table summarizes the special charges incurred by the Company during 2001, which are further described in the paragraphs which follow (dollars in millions):

Organizational restructuring:	
Severance benefits	$12.4
Office closings and sale of artwork	7.9
Transfer of certain customer service and backroom operations to our India subsidiary	10.6
Amounts related to disputed reinsurance balances	8.5
Litigation expenses	23.8
Other items	17.2
Special charges before income tax benefit	$80.4

Severance Benefits

During 2001, Conseco undertook several restructuring actions in an effort to improve the Company s operations and profitability. The planned changes included moving a significant number of jobs to India. Pursuant to GAAP, the Company is required to recognize the costs associated with most restructuring activities as the costs are incurred. However, costs associated with severance benefits are required to be recognized when the costs are: (i) attributable to employees services that have already been rendered; (ii) relate to obligations that accumulate; and (iii) are probable and can be reasonably estimated. Since the severance costs associated with our planned activities met these requirements, we recognized a charge of $12.4 million in 2001.

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CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Office Closings and Sale of Artwork

In conjunction with our restructuring activities, we closed certain offices, which resulted in the abandonment of certain leasehold improvements. Further, certain antiques and artwork, formerly displayed in the Company s executive offices were sold. We recognized losses of $7.9 million related to these actions in 2001.

Amounts Related to Disputed Reinsurance Balances

During 2001, we discontinued marketing certain medical insurance products. Several reinsurers who assumed most of the risks associated with these products disputed the reinsurance receivables due to us. We established an allowance of $8.5 million for disputed balances that were ultimately written off due to their uncollectibility.

Litigation Expenses

Litigation expenses primarily include the cost and proposed settlement related to our securities litigation class action lawsuit which was subsequently settled in the second quarter of 2003.

Other Items

Other items include expenses incurred: (i) for consulting fees with respect to services provided related to various debt and organizational restructuring transactions; (ii) pursuant to the terms of the employment agreement for our chief executive officer; and (iii) for other items which are not individually significant.

12. Shareholders Equity

Pursuant to the Plan, CNO issued 34.4 million shares of Preferred Stock with an aggregate liquidation preference of approximately $859.7 million. The Preferred Stock has a par value of $.01 per share and a liquidation preference of $25 per share. Dividends are payable at a rate equal to 10.5 percent of the liquidation preference per share, payable semi-annually on March 1 and September 1. This rate will increase to 11 percent beginning September 11, 2005. These dividends are payable in additional shares of Preferred Stock until the later of: (i) September 10, 2005; or (ii) the beginning of the first fiscal quarter after which our primary insurance companies have received a financial strength rating of at least A- by A.M. Best. Thereafter, dividends are payable, at our option, in cash or additional shares of Preferred Stock. The Preferred Stock may be redeemed by CNO, in whole or in part, at any time in cash equal to the liquidation preference plus cumulative unpaid dividends thereon.

The Preferred Stock is convertible, at the option of the holder, into common stock of CNO at any time on or after September 30, 2005. The conversion rate is equal to the total liquidation preference plus cumulative unpaid dividends thereon divided by $20.35 which was the average price of CNO s common stock, as defined, for each of the trading days in the 60 calendar day period immediately preceding January 8, 2004.

The Preferred Stock is exchangeable, at the option of the holder, into common stock of CNO at any time on or after September 10, 2013. The exchange rate is equal to the total liquidation preference plus cumulative unpaid dividends thereon divided by the average market price of CNO s common stock, as defined, for the ten trading days ending on the date of exchange. The maximum number of common shares that can be issued shall not exceed the greater of: (i) 7.84 billion shares of common stock; or (ii) the number of authorized but unissued shares of CNO s common stock. In addition, CNO, at its option, may pay cash in an amount equal to the liquidation preference in lieu of delivering the exchanged common stock.

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The holders of the Preferred Stock will be entitled to voting rights beginning September 30, 2005 or earlier if there is: (i) a reduction in the financial strength rating assigned to any of our active material insurance subsidiaries (as defined) by A.M. Best; (ii) an event of default under our credit agreement; (iii) the occurrence of a material adverse regulatory event, as defined, with respect to any of our material insurance subsidiaries (as defined); or (iv) a failure to maintain various financial ratios and balances.

Pursuant to the Plan, we issued 6.0 million Series A Warrants (the Warrants) entitling the holders to purchase shares of CNO common stock at a price of $27.60 per share. The Warrants expire on September 10, 2008. The exercise price and number of common shares issuable are subject to adjustment based on the occurrence of certain events, including: (i) stock dividends; (ii) stock splits; and (iii) the issuance of instruments or securities which are exercisable for or convertible into shares of common stock entitling the holders to purchase shares of common stock at a price per share that is less than the market price on the date of issuance.

On the Effective Date, the Successor adopted a new long-term incentive plan, which permits the grant of CNO incentive or non-qualified stock options and restricted stock awards to certain directors, officers and employees of CNO and certain other individuals who perform services for the Company. A maximum of 10 million shares may be issued under the plan. Restricted share grants are limited to 3.3 million shares. During September 2003, the Company granted options to purchase 500,000 shares of CNO common stock at $16.40 per share and 500,000 restricted shares of CNO common stock to the Chief Executive Officer in accordance with his employment agreement. These options and restricted stock vest over the next four years. In addition, the Company granted options to purchase 500,000 shares of CNO common stock at $19.61 per share and 500,000 restricted shares of CNO common stock to the non-executive Chairman of the Board of Directors in accordance with his agreement. These options and restricted shares vest over the next three years.

Changes in the number of shares of common stock outstanding during the four months ended December 31, 2003, the eight months ended August 31, 2003 and the years ended December 31, 2002 and 2001 were as follows (shares in thousands):

	Successor	Predecessor		
	Four Months Ended December 31, 2003	Eight Months Ended August 31, 2003	Years Ended December 31, 2002	Years Ended December 31, 2001
Balance, beginning of period		346,007	344,743	325,318
Issuance of shares pursuant to Plan	100,000			
Stock options exercised			6	432
Stock warrants exercised				3,327
Shares issued in conjunction with the acquisition of Exl				3,411
Shares issued pursuant to stock purchase contracts related to the FELINE PRIDES				11,351
Shares issued under employee benefit compensation plans	116		1,258	904
Cancelled pursuant to the Plan		(346,007)		
Balance, end of period	100,116		346,007	344,743

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CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In February 2001, the Company issued 11.4 million shares of Old Conseco common stock pursuant to stock purchase contracts related to the FELINE PRIDES. This transaction is discussed in further detail in the note to the consolidated financial statements entitled Other Disclosures .

The Predecessor s 1994 Stock and Incentive Plan authorized the granting of options to employees and directors of the Company to purchase up to 24 million shares of Old Conseco common stock at a price not less than its market value on the date the option was granted. In 1997, the Company adopted the 1997 Non-qualified Stock Option Plan, which authorized the granting of non-qualified options to employees of the Company to purchase shares of Old Conseco common stock.

A summary of the Company s stock option activity and related information for the four months ended December 31, 2003, the eight months ended August 31, 2003 and the years ended December 31, 2002 and 2001, is presented below (shares in thousands):

	Successor		Predecessor					
	Four Months Ended December 31, 2003		Eight Months Ended August 31, 2003		Years Ended December 31, 2002		2001	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at the beginning of the period		$	23,520	$ 15.95	40,292	$ 15.01	36,107	$ 18.38
Options granted	1,000	18.01			2,572	3.57	8,609	6.32
Exercised					(6)	1.51	(432)	9.88
Cancelled pursuant to the Plan			(17,438)	18.29				
Forfeited or terminated			(6,082)	9.26	(19,338)	12.35	(3,992)	27.27
Outstanding at the end of the year	1,000	18.01			23,520	15.95	40,292	15.01
Options exercisable at the end of the period					13,593		13,591	
Available for future grant	7,982				52,668		34,903	

All outstanding stock options of the Predecessor were cancelled pursuant to the Plan.

The following table summarizes information about stock options outstanding at December 31, 2003 (shares in thousands):

	Options Outstanding			Options Exercisable	
Exercise Prices	Number Outstanding	Remaining Life (in Years)	Exercise Price	Number Exercisable	Exercise Price

$16.40	500	9.75	$16.40	
19.61	500	9.75	19.61	
	1,000			—

We estimated the fair value of each option grant used to determine the pro forma amounts summarized above using the Black-Scholes option valuation model with the following weighted average assumptions for

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CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the four months ended December 31, 2003, the eight months ended August 31, 2003 and the years ended December 31, 2002 and 2001:

	Successor	Predecessor		
	Four Months Ended December 31, 2003 Grants	Eight Months Ended August 31, 2003 Grants	Years Ended December 31, 2002 Grants	2001 Grants
Weighted average risk-free interest rates	3.7%		4.7%	4.8%
Weighted average dividend yields	0.0%		0.0%	0.0%
Volatility factors	35%		40%	40%
Weighted average expected life	6.1 years		6.4 years	6.4 years
Weighted average fair value per share	$ 7.71		$ 1.73	$ 3.04

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

A reconciliation of net income (loss) and shares used to calculate basic and diluted earnings per share is as follows (dollars in millions and shares in thousands):

	Successor	Predecessor		
	Four Months Ended December 31, 2003	Eight Months Ended August 31, 2003	Years Ended December 31,	
			2002	2001
Net income (loss):				
Net income (loss)	$ 96.3	$2,201.7	$(7,835.7)	$(405.9)
Preferred stock dividends	(27.8)		(2.1)	(12.8)
Income (loss) applicable to common ownership for basic earnings per share	68.5	2,201.7	(7,837.8)	(418.7)
Effect of dilutive securities	27.8			
Income (loss) applicable to common ownership and assumed conversions for diluted earnings per share	$ 96.3	$2,201.7	$(7,837.8)	$(418.7)
Shares:				
Weighted average shares outstanding for basic earnings per share	100,110			
Effect of dilutive securities on weighted average shares:				
Preferred stock	43,257			
Stock options, warrants and employee benefit plans(a)	119			
Dilutive potential common shares	43,376			
Weighted average shares outstanding for diluted earnings per share	143,486			

(a) The dilutive effect is determined under the treasury stock method using the average market price during the period.

Basic earnings per common share (EPS) is computed by dividing income applicable to common stock by the weighted average number of common shares outstanding for the period. Restricted shares are not included in basic EPS until vested. Diluted EPS reflects the potential dilution that could occur if the Preferred Stock were converted into common stock, the options were exercised and the restricted stock was vested. The dilution from options and restricted shares are calculated using the treasury stock method.

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

13. Other Operating Statement Data

Insurance policy income consisted of the following (dollars in millions):

	Successor	Predecessor		
	Four Months Ended December 31, 2003	Eight Months Ended August 31, 2003	Years Ended December 31, 2002	Years Ended December 31, 2001
Traditional products:				
Direct premiums collected	$1,477.9	$ 3,264.3	$ 5,100.2	$ 5,426.3
Reinsurance assumed	31.9	57.3	78.7	146.0
Reinsurance ceded	(92.1)	(196.4)	(327.8)	(249.4)
Premiums collected, net of reinsurance	1,417.7	3,125.2	4,851.1	5,322.9
Change in unearned premiums	(15.4)	13.5	(19.7)	1.9
Less premiums on universal life and products without mortality and morbidity risk which are recorded as additions to insurance liabilities	(528.2)	(1,266.4)	(1,792.7)	(1,828.2)
Premiums on traditional products with mortality or morbidity risk, recorded as insurance policy income	874.1	1,872.3	3,038.7	3,496.6
Fees and surrender charges on interest-sensitive products	131.7	332.0	563.6	496.1
Insurance policy income	$1,005.8	$ 2,204.3	$ 3,602.3	$ 3,992.7

The four states with the largest shares of 2003 collected premiums were Florida (8.1 percent), Illinois (6.8 percent), Texas (6.6 percent), and California (6.5 percent). No other state accounted for more than 5 percent of total collected premiums.

Other operating costs and expenses were as follows (dollars in millions):

	Successor	Predecessor		
	Four Months Ended December 31, 2003	Eight Months Ended August 31, 2003	Years Ended December 31, 2002	Years Ended December 31, 2001
Commission expense	$ 66.4	$117.9	$195.1	$218.6

Salaries and wages	70.5	136.3	215.1	206.0
Other	81.5	168.1	326.0	322.5
Total other operating costs and expenses	$218.4	$422.3	$736.2	$747.1

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CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Changes in the value of policies inforce at the Effective Date were as follows (dollars in millions):

	Successor
	Four Months Ended December 31, 2003
Successor balance, beginning of the period	$3,102.6
Additional acquisition expense	2.4
Amortization	(122.0)
Amounts related to fair value adjustment of actively managed fixed maturities	(33.5)
Successor balance, end of the period	$2,949.5

Based on current conditions and assumptions as to future events on all policies inforce, the Company expects to amortize approximately 10 percent of the December 31, 2003 balance of the value of policies inforce at the Effective Date in 2004, 10 percent in 2005, 9 percent in 2006, 8 percent in 2007 and 8 percent in 2008. The discount rate used to determine the amortization of the value of policies inforce at the Effective Date averaged 5 percent in the four months ended December 31, 2003.

Changes in the cost of policies purchased were as follows (dollars in millions):

	Predecessor		
	Eight Months Ended August 31, 2003	Twelve Months Ended December 31, 2002	Twelve Months Ended December 31, 2001
Balance, beginning of the period	$ 1,170.0	$1,657.8	$1,954.8
Additional acquisition expense on acquired policies	7.4	11.3	12.5
Amortization	(74.1)	(215.5)	(242.0)
Amounts related to fair value adjustment of actively managed fixed maturities	4.7	(81.9)	(49.0)
Reinsurance transactions		(73.4)	
Net amounts related to discontinued operations		(66.6)	(13.9)
Amounts related to sales of subsidiaries		(60.0)	
Other	(8.8)	(1.7)	(4.6)
Elimination of Predecessor balance	(1,099.2)		
Balance, end of the period	$	$1,170.0	$1,657.8

The discount rates used to determine the amortization of the cost of policies purchased averaged 7 percent in the eight months ended August 31, 2003, 7 percent in 2002 and 6 percent in 2001.

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CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Changes in the cost of policies produced were as follows (dollars in millions):

	Successor	Predecessor		
	Four Months Ended December 31, 2003	Eight Months Ended August 31, 2003	Years Ended December 31, 2002	2001
Balance, beginning of the period	$	$ 2,014.4	$2,570.2	$2,480.5
Additions	110.1	280.1	486.0	612.8
Amortization	(8.3)	(252.8)	(544.3)	(396.3)
Amounts related to fair value adjustment of actively managed fixed maturities		(20.5)	(121.0)	(28.2)
Reinsurance transactions			(134.6)	
Net amounts related to discontinued operations			(103.3)	15.0
Amounts related to sales of subsidiaries			(140.8)	
Other		(1.7)	2.2	(113.6)
Elimination of Predecessor balance		(2,019.5)		
Balance, end of the period	$101.8	$	$2,014.4	$2,570.2

In 2001, the Company stopped renewing portions of our major medical lines of business in several unprofitable states in accordance with the contractual terms of the policies. As a result, we determined that approximately $77.4 million of the cost of policies produced and the cost of policies purchased would not be recoverable. Such amount is recorded as amortization in the accompanying statement of operations.

Policyholder redemptions of annuity and, to a lesser extent, life products have increased in recent periods. We experienced additional redemptions following the downgrade of our A.M. Best financial strength rating to B (fair) in August of 2002. When redemptions are greater than our previous assumptions, we are required to accelerate the amortization of our cost of policies produced and cost of policies purchased to write off the balance associated with the redeemed policies. Accordingly, amortization expense has increased. In 2002, we changed the lapse assumptions used to determine the amortization of the cost of policies produced and the cost of policies purchased related to certain universal life products and our annuities to reflect our then current estimates of future lapses. For certain universal life products, we changed the ultimate lapse assumption from: (i) a range of 6 percent to 7 percent; to (ii) a tiered assumption based on the level of funding of the policy of a range of 2 percent to 10 percent. We recorded additional amortization of the cost of policies produced and the cost of policies purchased related to higher redemptions and changes to our lapse assumptions of $203.2 million in 2002.

The cost of policies produced and the cost of policies purchased are amortized in relation to the estimated gross profits to be earned over the life of our annuity products. As a result of economic developments, actual experience of our products and changes in our expectations, we changed our investment yield assumptions used in calculating the estimated gross profits to be earned on our annuity products. Such changes resulted in additional amortization of the cost of policies produced and the cost of policies purchased of $35.0 million (of which $7.2 million related to discontinued operations) in 2001.

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CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

14. Consolidated Statement of Cash Flows

The following disclosures supplement our consolidated statement of cash flows (dollars in millions):

	Successor	Predecessor		
	Four Months Ended December 31, 2003	Eight Months Ended August 31, 2003	Years Ended December 31, 2002	2001
Non-cash items not reflected in the investing and financing activities section of the consolidated statement of cash flows:				
Issuance of common stock under stock option and employee benefit plans	$ 2.6	$	$12.7	$ 19.7
Issuance of convertible preferred shares	27.8	5.3	2.1	12.8
Value of FELINE PRIDES retired and transferred from minority interest to common stock and additional paid-in capital				496.6
Issuance of common stock in connection with the acquisition of Exl				52.1
Decrease in notes payable-direct corporate obligations and increase in other liabilities reflecting the estimated fair value of interest rate swap agreements				13.5

The effect on our consolidated balance sheet of implementing fresh start accounting is discussed in the note to the consolidated financial statements entitled Fresh Start Reporting . Such non-cash adjustments are not reflected in our consolidated statement of cash flows.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following reconciles net income (loss) to net cash provided by operating activities (dollars in millions):

	Successor	Predecessor		
	Four Months Ended December 31, 2003	Eight Months Ended August 31, 2003	Years Ended December 31, 2002	Years Ended December 31, 2001
Cash flows from operating activities:				
Net income (loss)	$ 96.3	$ 2,201.7	$(7,835.7)	$ (405.9)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:				
Interest-only securities investment income			(10.6)	(51.5)
Cash received from interest-only securities, net			(73.3)	14.3
Servicing income			(83.9)	(115.3)
Cash received from servicing activities			46.9	71.7
Provision for losses		55.6	1,160.8	707.2
(Gain) loss on sale of finance receivables			49.5	(26.9)
Amortization and depreciation	144.7	369.8	1,017.8	848.0
Income taxes	131.0	31.4	758.3	(140.7)
Insurance liabilities	207.2	265.8	509.5	334.4
Accrual and amortization of investment income	20.1	43.2	227.9	97.2
Deferral of cost of policies produced and purchased	(111.6)	(287.5)	(509.2)	(667.0)
Gain on sale of interest in riverboat				(192.4)
Impairment charges			1,514.4	386.9
Goodwill impairment			500.0	
Special charges			171.2	72.4
Reorganization items		(2,157.0)		
Cumulative effect of accounting change			2,949.2	
Minority interest			173.2	183.9
Net realized investment (gains) losses	(11.8)	5.4	673.7	413.7
Discontinued operations		(16.7)	93.1	
Gain on extinguishment of debt			(8.1)	(26.9)
Other	(36.8)	235.6	(29.0)	(178.4)
Net cash provided by operating activities	$ 439.1	$ 747.3	$ 1,295.7	$1,324.7

At December 31, 2003, restricted cash consisted of: (i) $17.3 million held in trust for the payment of bankruptcy-related professional fees; and (ii) $14.6 million of cash held by three investment trusts (which are

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CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

further described in the note to the consolidated financial statements entitled Investments in Variable Interest Entities).

15. Statutory Information (Based on Non-GAAP Measures)

Statutory accounting practices prescribed or permitted by regulatory authorities for the Company s insurance subsidiaries differ from GAAP. The Company s insurance subsidiaries reported the following amounts to regulatory agencies, after appropriate elimination of intercompany accounts among such subsidiaries (dollars in millions):

	2003	2002
Statutory capital and surplus	$ 1,514.1	$ 1,064.4
Asset valuation reserve	40.9	11.6
Interest maintenance reserve	217.4	311.3
Total	$ 1,772.4	$ 1,387.3

The statutory capital and surplus shown above included investments in upstream affiliates, all of which were eliminated in the consolidated financial statements prepared in accordance with GAAP, as follows (dollars in millions):

	2003	2002
Securitization debt issued by special purpose entities and guaranteed by our finance subsidiary, all of which was purchased by our insurance subsidiaries prior to the acquisition of CFC	$	$ 2.0
Preferred and common stock of intermediate holding company	159.0	146.4
Other		2.5
Total	$ 159.0	$ 150.9

Statutory earnings build the capital adequacy required by rating agencies and regulators. Statutory earnings and fees and interest paid by the insurance companies to the parent company create the cash flow capacity the parent company needs to meet its obligations, including debt service. The combined statutory net income (loss) (a non-GAAP measure) of our life insurance subsidiaries was $286.1 million, $(465.0) million and $(137.8) million in 2003, 2002 and 2001, respectively. Included in such net income (loss) are net realized capital gains (losses), net of income taxes, of $32.8 million, $(516.1) million and $(188.0) million in 2003, 2002 and 2001, respectively. In addition, the insurance subsidiaries incur fees and interest to Conseco or its non-life subsidiaries; such amounts totaled $85.8 million, $194.8 million and $279.2 million in 2003, 2002 and 2001, respectively.

The ability of our insurance subsidiaries to pay dividends is subject to state insurance department regulations. These regulations generally permit dividends to be paid from statutory earned surplus of the insurance company for any 12-month period in amounts equal to the greater of (or in a few states, the lesser of): (i) statutory net gain from operations or statutory net income for the prior year; or (ii) 10 percent of statutory capital and surplus as of the end of the preceding year. Any dividends in excess of these levels require the approval of the director or commissioner of the applicable state insurance department. During 2002, our insurance subsidiaries paid dividends to Conseco totaling $240.0 million. In 2003, a non-cash dividend of $4.5 million representing affiliated common stock was paid to CDOC.

On October 30, 2002, Bankers National Life Insurance Company and Conseco Life Insurance Company of Texas (on behalf of itself and all other Conseco insurance subsidiaries), our insurance subsidiaries domiciled in Texas, each entered into consent orders with the Commissioner of Insurance for the State of

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Texas whereby they agreed: (i) not to request any dividends or other distributions before January 1, 2003 and, thereafter, not to pay any dividends or other distributions to parent companies outside of the insurance system without the prior approval of the Texas Insurance Commissioner; (ii) to continue to maintain sufficient capitalization and reserves as required by the Texas Insurance Code; (iii) to request approval from the Texas Insurance Commissioner before making any disbursements not in the ordinary course of business; (iv) to complete any pending transactions previously reported to the proper insurance regulatory officials prior to and during Conseco s restructuring, unless not approved by the Texas Insurance Commissioner; (v) to obtain a commitment from Conseco to maintain their infrastructure, employees, systems and physical facilities prior to and during Conseco s restructuring; and (vi) to continue to permit the Texas Insurance Commissioner to examine its books, papers, accounts, records and affairs. The consent orders were formally released on November 19, 2003. We have agreed with the Texas Insurance Department to provide prior notice of certain transactions, including up to 30 days prior notice of the payment of dividends by an insurance subsidiary to any non-insurance company parent, and periodic reporting of information concerning our financial performance and condition.

The National Association of Insurance Commissioners Risk-Based Capital for Life and/or Health Insurers Model Act (the Model Act) provides a tool for insurance regulators to determine the levels of statutory capital and surplus an insurer must maintain in relation to its insurance and investment risks and whether there is a need for possible regulatory attention. The Model Act provides four levels of regulatory attention, varying with the ratio of the insurance company s total adjusted capital (defined as the total of its statutory capital and surplus, AVR and certain other adjustments) to its company action level risk based capital (RBC): (i) if a company s total adjusted capital is less than 100 percent but greater than or equal to 75 percent of its RBC (the Company Action Level), the company must submit a comprehensive plan to the regulatory authority proposing corrective actions aimed at improving its capital position; (ii) if a company s total adjusted capital is less than 75 percent but greater than or equal to 50 percent of its RBC (the Regulatory Action Level), the regulatory authority will perform a special examination of the company and issue an order specifying the corrective actions that must be taken; (iii) if a company s total adjusted capital is less than 50 percent but greater than or equal to 35 percent of its RBC (the Authorized Control Level), the regulatory authority may take any action it deems necessary, including placing the company under regulatory control; and (iv) if a company s total adjusted capital is less than 35 percent of its RBC (the Mandatory Control Level), the regulatory authority must place the company under its control. In addition, the Model Act provides for an annual trend test if a company s total adjusted capital is between 100 percent and 125 percent of its RBC at the end of the year. The trend test calculates the greater of the decrease in the margin of total adjusted capital over RBC: (i) between the current year and the prior year; and (ii) for the average of the last 3 years. It assumes that such decrease could occur again in the coming year. Any company whose trended total adjusted capital is less than 95 percent of its RBC would trigger a requirement to submit a comprehensive plan as described above for the Company Action Level.

The 2003 statutory annual statements filed with the state insurance regulators of each of our insurance subsidiaries reflected total adjusted capital in excess of the levels subjecting the subsidiaries to any regulatory action. However, as a result of losses on the long-term care business within the Other Business in Run-off segment, the RBC ratio of one of our subsidiaries is near the level which would require it to submit a comprehensive plan aimed at improving its capital position.

The consolidated RBC ratio for our insurance subsidiaries was approximately 287 percent at December 31, 2003. We calculate the consolidated RBC ratio by assuming all of the assets, liabilities, capital and surplus and other aspects of the business of our insurance subsidiaries are combined together in one insurance subsidiary, with appropriate intercompany eliminations.

Our insurance subsidiaries hold principal protected senior notes of three trusts which invest in fixed maturities, mortgages, preferred stock, common stock and limited partnerships. We consolidate the trusts in

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

our financial statements prepared in accordance with GAAP and at December 31, 2003, the estimated fair value of the trust investments slightly exceeded their GAAP book value. During the fourth quarter of 2003, the trusts began liquidating their portfolios, a process which is expected to be completed in the first quarter of 2004. Under statutory accounting practices, which differ from GAAP, realized capital losses of $45.9 million were recorded on the fourth quarter 2003 partial redemption of the senior notes issued by the trusts that are owned by the insurance subsidiaries. Additional statutory realized capital losses of $94.9 million were recorded at December 31, 2003 since a decision had been made to redeem the remaining senior notes at amounts less than their amortized cost. The total statutory realized losses of $140.8 million on the senior notes were included in the interest maintenance reserve.

16. Business Segments

After our emergence from bankruptcy, we began to manage our business operations through two primary operating segments, based on method of product distribution, and a third segment comprised of business in run-off. We refer to these segments as: (i) Bankers Life; (ii) Conseco Insurance Group; and (iii) Other Business in Run-Off. Prior to its disposition effective March 31, 2003, we also had a finance segment (which is reflected in our discontinued operations in the consolidated statement of operations). We also have a corporate segment, which consists of holding company activities and certain noninsurance company businesses that are not related to our other operating segments. Prior period segment data has been reclassified to conform to the current period presentation.

Operating information regarding our segments was as follows (dollars in millions):

	Successor	Predecessor		
	Four Months Ended December 31, 2003	Eight Months Ended August 31, 2003	Years Ended December 31,	
			2002	2001
Revenues:				
Bankers Life:				
Insurance policy income:				
Annuities	$ 17.3	$ 32.9	$ 39.6	$ 31.4
Supplemental health	384.2	760.4	1,122.8	1,082.5
Life	51.5	91.5	125.1	271.2
Other	3.8	7.9	12.6	15.0
Net investment income(a)	135.5	258.2	367.4	376.4
Fee revenue and other income(a)	.5	.2	1.3	1.2
Net realized investment gains (losses)(a)	3.4	5.5	(128.7)	(43.5)
Total Bankers Life segment revenues	596.2	1,156.6	1,540.1	1,734.2

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Successor	Predecessor		
	Four Months Ended December 31, 2003	Eight Months Ended August 31, 2003	Years Ended December 31, 2002	Years Ended December 31, 2001
Conseco Insurance Group:				
Insurance policy income:				
Annuities	8.8	51.6	121.3	56.8
Supplemental health	250.9	499.0	727.9	684.4
Life	125.7	303.9	503.8	524.5
Other	13.1	38.3	101.9	111.7
Net investment income(a)	288.6	582.6	896.3	1,010.1
Fee revenue and other income(a)	.5	17.0	25.4	31.4
Net realized investment gains (losses)(a)	9.5	(17.1)	(368.1)	(209.1)
Total Conseco Insurance Group segment revenues	697.1	1,475.3	2,008.5	2,209.8
Other Business in Run-Off:				
Insurance policy income supplemental health	150.5	418.8	847.3	1,215.2
Net investment income(a)	55.3	101.5	155.8	166.7
Fee revenue and other income(a)	.9		.8	1.2
Net realized investment gains (losses)(a)	(.7)	6.3	(58.2)	(24.6)
Total Other Business in Run-Off segment revenues	206.0	526.6	945.7	1,358.5
Corporate:				
Net investment income(a)	.7	16.2	14.0	39.7
Venture capital gain (loss) related to investment in AWE	(5.5)	10.5	(99.3)	(23.4)
Gain on sale of interest in riverboat				192.4
Net realized investment gains (losses)(a)	(.4)	(.1)	(1.3)	(62.8)
Fee and other income	11.4	17.1	59.2	68.5
Total corporate segment revenues	6.2	43.7	(27.4)	214.4
Eliminations			(16.5)	(24.9)
Total revenues	1,505.5	3,202.2	4,450.4	5,492.0
Expenses:				
Bankers Life:				
Insurance policy benefits	395.8	795.1	1,090.9	1,108.8
Amortization	62.3	113.9	168.7	193.4
Interest expense on investment borrowings	.8	3.4	4.6	6.1
Other operating costs and expenses	51.8	84.6	94.4	130.6
Special charges			45.0	6.0

Total Bankers Life segment expenses	510.7	997.0	1,403.6	1,444.9

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Successor	Predecessor		
	Four Months Ended December 31, 2003	Eight Months Ended August 31, 2003	Years Ended December 31,	
			2002	2001
Conseco Insurance Group:				
Insurance policy benefits	421.2	746.3	1,377.0	1,390.1
Amortization	64.4	201.8	541.4	324.6
Interest expense on investment borrowings	1.6	4.7	10.2	19.7
Other operating costs and expenses	115.6	222.6	292.1	273.9
Special charges			(.7)	15.5
Total Conseco Insurance Group segment expenses	602.8	1,175.4	2,220.0	2,023.8
Other Business in Run-Off:				
Insurance policy benefits	150.7	597.3	864.6	1,089.6
Amortization	6.3	25.7	112.2	160.1
Interest expense on investment borrowings		.2	.6	2.0
Other operating costs and expenses	36.2	74.7	185.1	212.8
Total Other Business in Run-Off segment expenses	193.2	697.9	1,162.5	1,464.5
Corporate:				
Interest expense on corporate debt	34.4	194.2	325.5	369.6
Provision for losses and interest expense related to stock purchase plan		55.6	240.0	169.6
Amortization related to operations			.6	108.2
Interest expense on investment borrowings			1.0	2.6
Other operating costs and expenses	14.9	40.4	181.1	135.2
Goodwill impairment			500.0	
Gain on extinguishment of debt			(1.8)	(17.0)
Reorganization items		(2,130.5)	14.4	
Special charges			52.2	58.9
Total corporate segment expenses	49.3	(1,840.3)	1,313.0	827.1
Eliminations			(16.5)	(24.9)
Total expenses	1,356.0	1,030.0	6,082.6	5,735.4

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Successor	Predecessor		
	Four Months Ended December 31, 2003	Eight Months Ended August 31, 2003	Years Ended December 31, 2002	Years Ended December 31, 2001
Income (loss) before income taxes, minority interest, discontinued operations and cumulative effect of accounting change:				
Bankers Life	85.5	159.6	136.5	289.3
Conseco Insurance Group	94.3	299.9	(211.5)	186.0
Other Business in Run-Off	12.8	(171.3)	(216.8)	(106.0)
Corporate operations	(43.1)	1,884.0	(1,340.4)	(612.7)
Income (loss) before income taxes, minority interest, discontinued operations and cumulative effect of accounting change	$149.5	$2,172.2	$(1,632.2)	$(243.4)

(a) It is not practicable to provide additional components of revenue by product or services.

Segment balance sheet information was as follows (dollars in millions):

	Successor	Predecessor
	December 31, 2003	December 31, 2002
Assets:		
Bankers Life	$ 9,826.2	$ 8,306.8
Conseco Insurance Group	16,343.0	17,121.6
Other Business in Run-Off	3,511.2	2,831.7
Corporate	239.7	624.6
Assets of discontinued operations		17,624.3
Total assets	$29,920.1	$46,509.0
Liabilities:		
Bankers Life	$ 8,338.1	$ 6,774.3
Conseco Insurance Group	13,774.9	14,924.7
Other Business in Run-Off	3,511.2	2,138.8
Corporate	1,478.3	5,175.8
Liabilities of discontinued operations		17,624.3
Total liabilities	$27,102.5	$46,637.9

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CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following tables present selected financial information of our segments (dollars in millions):

Segment	Value of Policies Inforce at the Effective Date	Cost of Policies Produced and Cost of Policies Purchased	Insurance Liabilities	Goodwill
2003				
Bankers Life	$1,328.5	$ 83.3	$ 8,092.5	$172.5
Conseco Insurance Group	1,394.0	18.5	13,251.1	779.7
Other Business in Run-off	227.0		3,498.6	
Total	$2,949.5	$ 101.8	$24,842.2	$952.2
2002				
Bankers Life	$	$1,165.5	$ 6,323.6	$100.0
Conseco Insurance Group		1,760.8	14,350.4	
Other Business in Run-off		258.1	2,123.1	
Total	$	$3,184.4	$22,797.1	$100.0

17. Quarterly Financial Data (Unaudited)

We compute earnings per common share for each quarter independently of earnings per share for the year. The sum of the quarterly earnings per share may not equal the earnings per share for the year because of: (i) transactions affecting the weighted average number of shares outstanding in each quarter; and (ii) the uneven distribution of earnings during the year. Quarterly financial data (unaudited) was as follows (dollars in millions, except per share data).

	Predecessor			Successor	
	1st Qtr.	2nd Qtr.	Two Months Ended August 31	One Month Ended September 30	4th Qtr.
2003					
Revenues	$1,237.2	$1,230.1	$ 734.9	$366.3	$1,139.2
Income (loss) before income taxes, minority interest and discontinued operations	(47.5)	(39.3)	2,259.0	37.8	111.7
Net income (loss)	(19.0)	(20.6)	2,241.3	24.2	72.1
Income (loss) per common share:					
Basic:					
Net income				$ .19	$ .50
Diluted:					

Net income	$ .17	$ .49

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CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Predecessor			
	1st Qtr.	**2nd Qtr.**	**3rd Qtr.**	**4th Qtr.**
2002				
Revenues	$ 1,258.5	$ 990.4	$ 990.8	$ 1,210.7
Loss before income taxes, minority interest, discontinued operations, and cumulative effect of accounting change	(85.7)	(386.9)	(952.9)	(206.7)
Net loss	(3,045.1)	(1,333.1)	(1,769.0)	(1,688.5)

18. Investments in Variable Interest Entities

The Company has investments in various types of special purpose entities and other entities, some of which are VIEs under FIN 46, as described in the note to the consolidated financial statements entitled Summary of Significant Accounting Policies . The following are descriptions of our significant investments in VIEs:

Brickyard Trust

Brickyard Loan Trust (Brickyard) was a collateralized debt obligation trust which participated in an underlying pool of commercial loans. The trust was formed by the Predecessor and was fully liquidated in the third quarter of 2003. The initial capital structure of Brickyard consisted of $575 million of senior financing provided by unrelated third party investors and $127 million of notes and subordinated certificates owned by the Company and others. As a result of our 85 percent ownership interest in the subordinated certificates, we were the primary beneficiary of Brickyard. In accordance with ARB 51 Consolidated Financial Statements , Brickyard was consolidated in our financial statements because: (i) our investment management subsidiary, 40/86 Advisors, Inc. was the investment manager; and (ii) we owned a significant interest in the subordinated certificates.

In the fourth quarter of 2002, the trust decided to begin the process of liquidating its portfolio of commercial loans. The trust planned to use the proceeds to: (i) repay the senior debt; and (ii) distribute residual proceeds to the subordinated certificate holders. As a result of the trust s intent to sell the commercial loans in the near future, we determined the decline in value of certain commercial loans was other than temporary. Accordingly, we recognized the decline in value of $45.5 million in 2002 as a realized loss and the cost basis of the commercial loans was reduced to estimated fair value. We included the $410.2 million carrying value of the commercial loans which served as collateral for Brickyard s obligations in assets held in separate accounts and investment trust at December 31, 2002. Such carrying value approximated the estimated fair value of the trust s assets. The liabilities and minority interest of the trust totaled $392 million at December 31, 2002 and included: (i) $384 million of amounts due to the holders of the senior note obligations (including principal amount due plus accrued interest less $92 million in a cash reserve account held for the benefit of the senior note holders); and (ii) $8 million representing the interests of the minority holders of the subordinated certificates. These amounts were included in liabilities related to separate accounts and investment trust . The senior note obligations of the trust had no recourse to the general credit of the Company.

The trust sold all of the commercial loans, repaid the senior notes and distributed its remaining assets to the subordinated certificate holders during the third quarter of 2003. We recognized an impairment loss of $11.1 million during the second quarter of 2003 to record an other than temporary decline in the value of certain of the trust s commercial loans. No additional gain or loss was recognized upon the ultimate disposition of Brickyard.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Other Investment Trusts

In December 1998, Old Conseco formed three investment trusts which invest in various fixed maturity, limited partnership and other types of investments. The initial capital structure of each of the trusts consisted of: (i) principal-protected senior notes; (ii) subordinated junior notes; and (iii) equity. The senior principal-protected notes are collateralized by zero coupon treasury notes with par values and maturities matching the par values and maturities of the principal-protected senior notes. Conseco s life insurance subsidiaries own 100 percent of the senior principal-protected notes. Certain of Conseco s non-life insurance subsidiaries own all of the subordinated junior notes, which have a preferred return equal to the total return on the trusts assets in excess of principal and interest on the senior notes. The equity of the trusts is owned by unrelated third parties.

The three investment trusts are VIEs under FIN 46 because the trusts equity represents significantly less than 10 percent of total capital and the subordinated junior notes were intended to absorb expected losses and receive virtually all expected residual returns. Based on our 100 percent ownership of the subordinated junior notes, we are the primary beneficiary of the investment trusts. All three trusts are consolidated in our financial statements. The carrying value of the total invested assets in the three trusts was approximately $228 million and $382 million at December 31, 2003 and 2002, respectively, which also represents Conseco s maximum exposure to loss as a result of our ownership interests in the trusts. The trusts have no obligations or debt to outside parties. During the fourth quarter of 2003, the trusts began liquidating their portfolios, a process which is expected to be completed in the first quarter of 2004. The investments held by the trusts are reflected in our investments in the consolidated balance sheet.

Investment in General Motors Building

See the note to the consolidated financial statements entitled Investments for a discussion of this investment.

19. Financial Information Regarding CFC

As part of our Chapter 11 reorganization, we sold substantially all of the assets of our Predecessor s finance business and exited from this line of business. Our finance business was conducted through our Predecessor s indirect wholly-owned subsidiary, CFC. We accounted for our finance business as a discontinued operation in 2002 once we formalized our plans to sell it. On April 1, 2003, CFC and 22 of its direct and indirect subsidiaries, which collectively comprised substantially all of the finance business, filed liquidating plans of reorganization with the Bankruptcy Court in order to facilitate the sale of this business. The sale of the finance business was completed in the second quarter of 2003. We did not receive any proceeds from this sale in respect of our interest in CFC, nor did any creditors of our Predecessor. As of March 31, 2003, we ceased to include the assets and liabilities of CFC on our Predecessor s consolidated balance sheet. The consolidated statement of operations reflects the operations of the discontinued finance business in the caption Discontinued operations for all periods. Our December 31, 2002 consolidated balance sheet includes the total assets of the finance segment in the caption Assets of discontinued operations and the total liabilities of the finance segment in the caption Liabilities of discontinued operations .

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following summarizes selected balance sheet information of CFC as of December 31, 2002:

CFC

CONSOLIDATED BALANCE SHEET INFORMATION
December 31, 2002
(Dollars in millions)

	2002
ASSETS	
Retained interests in securitization trusts at fair value (amortized cost:	
2002 $189.1)	$ 252.6
Cash and cash equivalents	562.3
Cash held in segregated accounts for investors in securitizations	394.7
Cash held in segregated accounts related to servicing agreements and securitization transactions	998.4
Finance receivables	2,023.1
Finance receivables securitized	12,460.0
Receivables due from Conseco, Inc.(a)	276.1
Other assets	997.7
Total assets	$ 17,964.9
LIABILITIES AND SHAREHOLDER S DEFICIT	
Liabilities:	
Investor payables	$ 394.7
Guarantee liability related to interests in securitization trusts held by others	326.7
Liabilities related to certificates of deposit	2,326.0
Servicing liability	333.4
Income tax liability	34.6
Other liabilities	279.1
Notes payable:	
Related to securitized finance receivables structured as collateralized borrowings	13,069.7
Debtor in possession facilities	82.0
Total liabilities not subject to compromise	16,846.2
Liabilities subject to compromise	1,204.9
Total liabilities	18,051.1
Shareholder s deficit:	
Preferred stock(a)	750.0
Common stock and additional paid-in capital(a)	1,209.4
Accumulated other comprehensive income (net of applicable deferred income tax benefit: 2002 $(63.8))(a)	110.6
Retained deficit(a)	(2,156.2)

Total shareholder s deficit	(86.2)
Total liabilities and shareholder s deficit	$17,964.9

(a) Intercompany accounts were eliminated when consolidated with Conseco and its other wholly-owned subsidiaries.

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following summarizes selected statement of operations information of CFC for the years ended December 31, 2002 and 2001:

CFC

CONSOLIDATED STATEMENT OF OPERATIONS INFORMATION (a)
For the Years Ended December 31, 2002 and 2001
(Dollars in millions)

	2002	2001
Revenues:		
Net investment income:		
Finance receivables and other	$ 2,062.4	$2,150.1
Retained interests	75.0	125.3
Affiliated(b)	11.8	19.6
Gain (loss) on sale of finance receivables	(49.5)	26.9
Servicing income	83.9	115.3
Impairment charges	(1,449.9)	(386.9)
Fee revenue and other income	189.9	220.5
Total revenues	923.6	2,270.8
Expenses:		
Provision for losses	950.0	537.7
Interest expense affiliated(b)	10.3	28.5
Interest expense	1,119.7	1,205.9
Other operating costs and expenses	608.0	639.4
Other operating costs and expenses affiliated(b)	8.0	3.0
Gain on extinguishment of debt	(6.3)	(9.9)
Special charges	121.9	21.5
Reorganization items	17.3	
Total expenses	2,828.9	2,426.1
Loss before income taxes	(1,905.3)	(155.3)
Income tax expense (benefit):		
Tax (benefit) expense on period income	36.8	(52.6)
Valuation allowance for deferred tax assets	245.3	
Net loss	(2,187.4)	(102.7)
Preferred stock dividends payable to Conseco(b)	67.5	67.5
Net loss applicable to common stock	$(2,254.9)	$ (170.2)

(a) CFC s statement of operations information has been presented as a discontinued operation in Conseco s consolidated financial statements for the periods summarized.

(b) Intercompany accounts were eliminated when consolidated with Conseco and its other wholly-owned subsidiaries.

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CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table reconciles CFC s loss before cumulative effect of accounting change as presented on the previous page to the amount included in discontinued operations in the accompanying consolidated statement of operations (dollars in millions):

	2002	2001
Net loss	$(2,187.4)	$(102.7)
Income taxes(a)	282.1	
Net expenses eliminated in consolidation, net of income tax	6.5	7.7
Impairment charge related to investment in CFC	(64.5)	
Loss recognized as discontinued operations	$(1,963.3)	$ (95.0)

(a) Amount is considered in determining the income tax expense in the consolidated statement of operations.

Summary of Significant Accounting Policies

Significant accounting policies, not described in the note to the consolidated financial statements entitled Summary of Significant Accounting Policies, which are more relevant to CFC are discussed below:

Retained Interest in Securitization Trusts

Retained interests in securitization trusts represent the right to receive certain future cash flows from securitization transactions structured prior to CFC s September 8, 1999 announcement (see Revenue Recognition for Sales of Finance Receivables and Amortization of Servicing Rights below). Such cash flows generally are equal to the value of the principal and interest to be collected on the underlying financial contracts of each securitization in excess of the sum of the principal and interest to be paid on the securities sold and contractual servicing fees. CFC carried retained interests at estimated fair value. We determined fair value by discounting the projected cash flows over the expected life of the receivables sold using current prepayment, default, loss and interest rate assumptions. CFC determined the appropriate discount rate to value these securities based on it s estimates of current market rates of interest for securities with similar yield, credit quality and maturity characteristics. The discount rate was 16 percent at December 31, 2002. CFC recorded any unrealized gain or loss determined to be temporary, net of tax, as a component of shareholder s equity. Declines in value are considered to be other than temporary when: (i) the fair value of the security is less than its carrying value; and (ii) the timing and/or amount of cash expected to be received from the security has changed adversely from the previous valuation which determined the carrying value of the security. When declines in value considered to be other than temporary occurred, CFC reduced the amortized cost to estimated fair value and recognize a loss in the statement of operations. The assumptions used to determine new values were based on CFC s internal evaluations.

Finance Receivables

Finance receivables included manufactured housing, home equity, home improvement, retail credit and floor plan loans. CFC carried finance receivables at amortized cost, net of an allowance for credit losses.

CFC deferred fees received and costs incurred when it originated finance receivables. CFC amortized deferred fees, costs, discounts and premiums over the estimated lives of the receivables. CFC included such deferred fees or costs in the amortized cost of finance receivables.

CFC generally stopped accruing investment income on finance receivables after three consecutive months of contractual delinquency.

Finance receivables transferred to securitization trusts in transactions structured as securitized borrowings are classified as *finance receivables securitized.* These receivables were held as collateral for the notes issued to investors in the securitization trusts. Finance receivables held by CFC that had not been securitized are classified as *finance receivables.*

Provision for Losses

The provision for credit losses was based upon an assessment of current and historical loss experience, loan portfolio trends, prevailing economic and business conditions, and other relevant factors. In management s opinion, the provision was sufficient to maintain the allowance for credit losses at a level that adequately provided for losses inherent in the portfolio.

CFC reduced the carrying value of finance receivables to net realizable value at the earlier of: (i) six months of contractual delinquency; or (ii) when it took possession of the property securing the finance receivable.

Liabilities Related to Certificates of Deposit

These liabilities related to the certificates of deposits issued by CFC s bank subsidiaries. The liability and interest expense account were also increased for the interest which accrued on the deposits. At December 31, 2002, the weighted average interest crediting rate on these deposits was 3.5 percent.

Revenue Recognition for Sales of Finance Receivables and Amortization of Servicing Rights

Subsequent to September 8, 1999, CFC generally structured its securitizations in a manner that required them to be accounted for under the portfolio method, whereby the loans and securitization debt remain on CFC s balance sheet pursuant to Financial Accounting Standards Board Statement No. 140, Accounting for the Transfer and Servicing of Financial Assets and Extinguishments of Liabilities (SFAS 140). The ratings downgrades and other events that followed the Company s August 9, 2002, announcement, eliminated CFC s access to the securitization markets.

For securitizations structured prior to September 8, 1999, CFC accounted for the transfer of finance receivables as sales. In accordance with GAAP, CFC recognized a gain, representing the difference between the proceeds from the sale (net of related sale costs) and the carrying value of the component of the finance receivable sold. CFC determined such carrying value by allocating the carrying value of the finance receivables between the portion sold and the interests retained (generally interest-only securities, servicing rights and, in some instances, other subordinated securities), based on each portion s relative fair values on the date of the sale.

CFC amortized the servicing rights it retained after the sale of finance receivables in proportion to, and over the estimated period of, net servicing income.

CFC evaluated servicing rights for impairment on an ongoing basis, stratified by product type and securitization period. To the extent that the recorded amount exceeded the fair value for any strata, CFC established a valuation allowance through a charge to earnings. If CFC determined, upon subsequent measurement of the fair value of these servicing rights, that the fair value equaled or exceeded the amortized cost, any previously recorded valuation allowance would be deemed unnecessary and restored to earnings.

Liabilities Subject to Compromise

Under the Bankruptcy Code, actions by creditors to collect indebtedness CFC owed prior to the Petition Date were stayed and certain other prepetition contractual obligations were not enforced against the Finance Company Debtors. CFC received approval from the Bankruptcy Court to pay certain prepetition liabilities

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

including employee salaries and wages, benefits, and other employee obligations. All other prepetition liabilities were classified as liabilities subject to compromise in CFC s December 31, 2002 consolidated balance sheet.

The following table summarizes the components of the liabilities included in the line liabilities subject to compromise in CFC s consolidated balance sheet as of December, 2002 (dollars in millions):

Other liabilities:	
Liability for litigation	$ 38.8
Accounts payable and accrued expenses	65.8
Total other liabilities subject to compromise	104.6
Preferred stock dividends payable to Conseco, Inc.	153.6
Notes payable:	
Master repurchase agreements(a)	174.4
Credit facility collateralized by retained interests in securitizations(a)	497.7
Due to Conseco, Inc.	273.2
Other borrowings	1.4
Total notes payable subject to compromise	946.7
Total liabilities subject to compromise	$ 1,204.9

(a) The Finance Company Debtors have guaranteed these facilities.

Finance Receivables and Retained Interests in Securitization Trusts

During 2002, CFC completed six securitization transactions, securitizing $2.7 billion of finance receivables. These securitizations were structured in a manner that required them to be accounted for as secured borrowings, whereby the loans and securitization debt remained on CFC s balance sheet, rather than as sales, pursuant to SFAS 140. Such accounting method is referred to as the portfolio method .

CFC classified the finance receivables transferred to the securitization trusts and held as collateral for the notes issued to investors as finance receivables-securitized . The average interest rate on these receivables was approximately 12.4 percent at December 31, 2002. CFC classified the notes issued to investors in the securitization trusts as notes payable related to securitized finance receivables structured as collateralized borrowings .

Conseco s leveraged condition and liquidity difficulties eliminated CFC s ability to access the securitization markets. This required CFC to pursue whole loan sales to maintain availability under its warehouse facilities for new originations. Accordingly, CFC classified its unsecuritized finance receivables as held for sale which required the assets to be carried at the lower of cost or market. At December 31, 2002, CFC had an allowance of $47.1 million for certain finance receivables with current estimated market values below cost.

During 2002, CFC completed various loan sale transactions. CFC sold $2.1 billion of finance receivables which generated net losses of $49.5 million. CFC also recognized a loss of $96.0 million related to the sale of $.5 billion of certain finance receivables sold as part of its cash raising initiatives in order to meet its debt obligations. See Special Charges elsewhere in the notes to the consolidated financial statements.

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes CFC s finance receivables securitized by business line (dollars in millions):

	December 31, 2002
Primary lines:	
Manufactured housing	$ 6,965.3
Mortgage services	5,005.9
Retail credit	641.5
Consumer finance closed-end	407.7
	13,020.4
Less allowance for credit losses	560.4
Total finance receivables securitized	$ 12,460.0

The following table summarizes CFC s other finance receivables by business line and categorized as either a part of CFC s primary lines or a part of other lines (discontinued in previous periods) (dollars in millions):

	December 31, 2002
Primary lines:	
Manufactured housing	$ 159.5
Mortgage services	260.7
Retail credit	1,599.1
Consumer finance closed-end	35.8
	2,055.1
Less allowance for credit losses	86.5
Net other finance receivables for primary lines	1,968.6
Other lines (discontinued in previous periods)	71.4
Less allowance for credit losses	16.9
Net other finance receivables for other lines	54.5
Total other finance receivables	$ 2,023.1

The changes in CFC s allowance for credit losses included in finance receivables (both securitized and other portfolios) were as follows (dollars in millions):

	2002	2001

Allowance for credit losses, beginning of year	$ 421.3	$ 306.8
Additions to the allowance:		
Provision for losses	950.0	537.7
Change in allowance due to purchases and sales of certain finance receivables	(21.3)	(.1)
Credit losses	(686.2)	(423.1)
Allowance for credit losses, end of year	$ 663.8	$ 421.3

The securitizations structured prior to September 8, 1999, met the applicable criteria to be accounted for as sales. At the time the loans were securitized and sold, CFC recognized a gain and recorded its retained

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

interest represented by the interest-only security and servicing rights. The interest-only security represented the right to receive, over the life of the pool of receivables: (i) the excess of the principal and interest received on the receivables transferred to the special purpose entity over the principal and interest paid to the holders of other interests in the securitization; and (ii) contractual servicing fees. In some of those securitizations, CFC also retained B-2 securities. CFC s net retained interests in securitization trusts at December 31, 2002 are summarized below (dollars in millions):

	December 31, 2002	
	Amortized Cost	Estimated Fair Value
Retained interests in securitization trusts:		
Interests securitized in the form of B-2 securities	$ 548.0	$ 611.5
Interest-only securities	(358.9)	(358.9)
Total retained interests, excluding guarantee liabilities	189.1	252.6
Guarantee liability related to interests in securitization trusts held by others	(326.7)	(326.7)
Total retained interests, net of guarantee liabilities	$(137.6)	$ (74.1)

During 2002, CFC recognized no gain on sale related to securitized transactions.

The retained interests in securitization trusts on CFC s balance sheet represented an allocated portion of the cost basis of the finance receivables in the securitization transactions accounted for as sales. CFC s retained interests in those securitization transactions were subordinate to the interests of other investors. Their values were subject to credit, prepayment, and interest rate risk on the securitized finance receivables. Management of CFC determined the discount rate to value these securities based on CFC s estimates of current market rates of interest for securities with similar yield, credit quality and maturity characteristics. CFC included the difference between estimated fair value and the amortized cost of the retained interests (after adjustments for impairments required to be recognized in earnings) in accumulated other comprehensive income (loss), net of taxes.

The determination of the value of CFC s retained interests in securitization trusts required significant judgment. CFC recognized significant charges when the interest-only securities did not perform as well as anticipated based on its assumptions and expectations. In securitizations to which these retained interests related, CFC retained certain contingent risks in the form of guarantees of certain lower-rated securities issued by the securitization trusts. As of December 31, 2002, the total nominal amount of these guarantees was approximately $1.4 billion. CFC considered any potential payments related to these guarantees in the projected cash flows used to determine the value of its retained interests. The discounted present value of the expected future payments related to the guarantees were classified as the Guarantee liability related to interests in securitization trusts held by others in CFC s balance sheet. The $1.4 billion nominal amount of these guarantees represented the par value of the guaranteed lower-rated securities. During 2002 and 2001, interest and principal payments related to such guarantees totaled $45.5 million and $32.7 million, respectively. CFC suspended guarantee payments in the fourth quarter of 2002.

Together, the interest-only securities and the B-2 securities, represented CFC s retained interests in these securitization trusts.

During 2002, CFC s ability to access the securitization markets was eliminated. The securitization markets were CFC s main source of funding for loans made to purchasers of repossessed manufactured homes. CFC believed that its loss severity rates were positively impacted when it used retail channels to

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

dispose of repossessed inventory (where the repossessed units are sold through company-owned sales lots or its dealer network). Since CFC was no longer able to fund the loans made on repossessed homes sold through these channels, sales through these channels decreased and CFC had to use the wholesale channel to dispose of repossessed manufactured housing units, through which recovery rates are significantly lower. Accordingly, CFC changed the loss severity assumptions used to value its retained interests to reflect the higher loss severity expected to be experienced in the future. In addition, CFC s previous assumptions reflected its belief that the adverse manufactured housing default experience in recent periods would continue through the first half of 2002 and then improve over time. Accordingly, CFC increased the default assumptions it used to value its retained interests to reflect its future expectations. CFC s home equity/home improvement assumptions were adjusted to reflect recent default experience as well as CFC s future expectations.

The Company adopted the requirements of EITF 99-20 effective July 1, 2000. Under EITF 99-20, declines in the value of CFC s retained interests in securitization trusts are recognized when: (i) the fair value of the retained beneficial interests are less than their carrying value; and (ii) the timing and/or amount of cash expected to be received from the retained beneficial interests have changed adversely from the previous valuation which determined the carrying value of the retained beneficial interests. When both occur, the retained beneficial interests are written down to fair value as an other-than-temporary impairment.

As a result of the requirements of EITF 99-20 and the assumption changes described above, CFC recognized an impairment charge of $1,077.2 million in 2002 for the retained beneficial interests. CFC also recognized a $336.5 million increase in the valuation allowance as a result of changes to the expected future cost of servicing the finance receivables. The levels of delinquent and defaulting loans caused servicing costs to increase.

CFC recognized an impairment charge of $386.9 million in 2001, for the interest-only securities that were not performing as well as expected based on its previous valuation estimates.

The following table summarizes certain cash flows received from and paid to the securitization trusts during 2002 (dollars in millions):

Servicing fees received	$ 46.9
Cash flows from retained interests, net of guarantee payments	22.3
Servicing advances paid	(275.9)
Repayment of servicing advances	257.1

During the third quarter and again in the fourth quarter of 2002, CFC changed the assumptions used to estimate the value of its retained interests to: (i) project higher severity losses related to the defaults, reflecting CFC s inability to finance the sale of repossessed manufactured homes resulting in reliance on the wholesale disposition channel for repossessed manufactured homes; and (ii) project higher rates of default in the future, based on its then current expectations.

Effective September 30, 2001, CFC transferred substantially all of its interest-only securities into a securitization trust. The transaction provided a means to finance a portion of the value of its interest-only securities by selling some of the cash flows to Lehman. The transfer was accounted for as a sale in accordance with SFAS 140. However, no gain or loss was recognized because the aggregate fair value of the interest retained by CFC and the cash received from the sale were equal to the carrying value of the interest-only securities prior to their transfer to the trust. The trust is a qualifying special purpose entity and is not consolidated pursuant to SFAS 140. CFC received a trust security representing an interest in the trust equal to 85 percent of the estimated future cash flows of the interest-only securities held in the trust. Lehman purchased the remaining 15 percent interest. The value of the interest purchased by Lehman was $20.4 million at December 31, 2002. CFC continued to be the servicer of the finance receivables underlying the interest-only securities transferred to the trust. Lehman had the ability to accelerate the principal payments related to their interest after a stated period. Until such time, Lehman was required to maintain a 15 percent

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CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

interest in the estimated future cash flows of the trust. By aggregating the interest-only securities into one structure, the impairment tests for these securities are conducted on a single set of cash flows representing CFC s 85 percent interest in the trust. Accordingly, adverse changes in cash flows from one interest-only security are offset by positive changes in another. The new structure did not avoid an impairment charge if sufficient positive cash flows in the aggregate were not available (such as was the case at December 31, 2002).

On December 2, 2002, CFC elected not to make approximately $4.7 million in guarantee payments of which $.6 million was owed to outside third parties.

At December 31, 2002, key economic assumptions used to determine the estimated fair value of CFC s retained interests in securitizations and the sensitivity of the current fair value of residual cash flows to immediate 10 percent and 20 percent changes in those assumptions were as follows (dollars in millions):

	Manufactured Housing	Home Equity/ Home Improvement	Consumer/ Equipment	Total	Interests Held by Others	Interests Held by Conseco
Carrying amount/fair value of retained interests:						
Retained interests	$ 24.6	$ 234.4	$ 14.0	$ 273.0	$(20.4)	$ 252.6
Guarantee liability	(299.7)	(5.8)	(21.2)	(326.7)		(326.7)
Servicing liabilities	(320.1)	(5.9)	(7.4)	(333.4)		(333.4)
Total retained interests	$ (595.2)	$ 222.7	$ (14.6)	$ (387.1)	$(20.4)	$(407.5)
Cumulative principal balance of sold finance receivables at December 31, 2002	$15,429.6	$3,723.2	$787.2	$19,940.0		
Weighted average life in years	6.9	3.6	2.5	6.1		
Weighted average stated customer interest rate on sold finance receivables	9.7%	11.9%	10.5%	10.2%		
Assumptions to determine estimated fair value of retained interests at December 31, 2002:						
Expected prepayment speed as a percentage of principal balance of sold finance receivables(a)	7.1%	18.9%	18.0%	9.8%		
Impact on fair value of 10 percent decrease	$ (6.7)	$ 2.0	$ (.6)	$ (5.3)		
Impact on fair value of 20 percent decrease	(18.1)	5.9	(1.1)	(13.3)		
Impact on fair value of 10 percent increase	8.0	(1.3)	.4	7.1		
Impact on fair value of 20 percent increase	15.8	(1.9)	.9	14.8		

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CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Manufactured Housing	Home Equity/ Home Improvement	Consumer/ Equipment	Total	Interests Held by Others	Interests Held by Conseco
Expected nondiscounted credit losses as a percentage of principal balance of related finance receivables(a)	20.3%	9.0%	11.7%	17.9%		
Impact on fair value of 10 percent decrease	$ 26.8	$ 17.4	$ 2.2	$ 46.4		
Impact on fair value of 20 percent decrease	115.3	37.6	5.2	158.1		
Impact on fair value of 10 percent increase	(6.3)	(15.8)	(2.0)	(24.1)		
Impact on fair value of 20 percent increase	(30.3)	(30.3)	(3.5)	(64.1)		
Weighted average discount rate	16.0%	16.0%	16.0%	16.0%		
Impact on fair value of 10 percent decrease	$ (11.8)	$ 20.3	$ .9	$ 9.4		
Impact on fair value of 20 percent decrease	(24.4)	43.6	2.0	21.2		
Impact on fair value of 10 percent increase	11.2	(17.8)	(1.0)	(7.6)		
Impact on fair value of 20 percent increase	21.6	(33.5)	(1.8)	(13.7)		

(a) The valuation of retained interests in securitization trusts is affected not only by the projected level of prepayments of principal and net credit losses, but also by the projected timing of such prepayments and net credit losses. Should such timing differ materially from CFC s projections, it could have a material effect on the valuation of its retained interests. Additionally, such valuation is determined by discounting cash flows over the entire expected life of the receivables sold.

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in fair value based on a 10 percent variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, in this table, the effect of a variation in a particular assumption on the fair value of the retained interest is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another (for example, increases in market interest rates may result in lower prepayments and increased credit losses), which might magnify or counteract the sensitivities.

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CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes quantitative information about delinquencies, net credit losses, and components of managed finance receivables (dollars in millions):

	Principal Balance	Principal Balance 60 days or More Past Due	Net Credit Losses
	At December 31,		For the Year Ended December 31,
	2002	2002	2002
Type of finance receivables			
Manufactured housing	$23,022.4	$ 803.3	$ 756.3
Home equity/home improvement	8,842.8	122.6	282.7
Consumer	3,334.6	83.8	219.3
Commercial	82.7	6.5	17.7
Total managed receivables	35,282.5	1,016.2	1,276.0
Less finance receivables securitized and repossessed assets	19,908.8	528.5	589.8
Finance receivables held on balance sheet before allowance for credit losses and deferred points and other, net	15,373.7	$ 487.7	$ 686.2
Less allowance for credit losses	663.8		
Less deferred points and other, net	226.8		
Finance receivables held on balance sheet	$14,483.1		

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following schedule reconciles CFC s retained interests, net of guarantee liabilities, from the beginning to the end of the years presented (dollars in millions):

	2002	2001
Balance, beginning of year	$ 670.2	$ 927.5
Investment income	75.0	125.3
Cash paid (received):		
Gross cash received	(67.8)	(132.6)
Guarantee payments related to clean-up calls(a)		45.3
Guarantee payments related to interests held by others	45.5	32.7
Impairment charge to reduce carrying value	(1,077.2)	(264.8)
Sale of securities related to a discontinued line and other	15.9	(12.4)
Change in interest purchased by Lehman in conjunction with securitization transaction	34.8	(55.2)
Transfer to servicing rights in conjunction with securitization transaction		(50.0)
Change in unrealized appreciation (depreciation) recorded in shareholders equity (deficit)	229.5	54.4
Balance, end of year	$ (74.1)	$ 670.2

(a) During 2001, clean-up calls were exercised for certain securitizations that were previously recognized as sales. The interest-only securities related to these securitizations had previously been separately securitized with other interest-only securities in transactions recognized as sales. CFC holds the residual interests issued by the securitization trusts. The terms of the residual interests require the holder to make payments to the securitization trust when a clean-up call related to an underlying trust (a trust which issued interest-only securities held by the securitization trust) occurs. These payments are used to accelerate principal payments to the holders of the other securities issued by the securitization trusts. During 2001, CFC was required to make payments to the securitization trusts. These payments increased CFC s basis in the retained interests, as the related liability assumed by CFC (and reflected in the value of the retained interest) was extinguished.

Income Taxes

CFC s income tax expense included deferred income taxes arising from temporary differences between the financial reporting and tax bases of assets and liabilities. These amounts were reflected in the balance of deferred income tax assets which totaled $925.7 million at December 31, 2002. In assessing the realization of deferred income tax assets, CFC considered whether it was more likely than not that the deferred income tax assets would be realized. The ultimate realization of deferred income tax assets depended upon generating future taxable income during the periods in which temporary differences became deductible. CFC evaluated the realizability of its deferred income tax assets by assessing the need for a valuation allowance on a quarterly basis. A valuation allowance of $925.7 million had been provided for the entire net deferred tax asset balance as of December 31, 2002, as CFC believed that the realization of such assets in future periods

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CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

was uncertain. The components of CFC s income tax assets and liabilities were as follows (dollars in millions):

	2002
Deferred tax assets (liabilities):	
Net operating loss carryforwards	$ 193.3
Deductible timing differences:	
Interest-only securities	536.3
Unrealized appreciation	(22.4)
Allowance for loan losses	252.2
Other	(33.7)
Total deferred tax assets	925.7
Valuation allowance	(925.7)
Net deferred tax liability	
Current income taxes payable	(34.6)
Net income tax liabilities	$ (34.6)

Income tax expense (benefit) was as follows (dollars in millions):

	2002	2001
Current tax provision	$ 36.8	$ 59.5
Deferred tax benefit		(112.1)
Income tax expense (benefit)	36.8	(52.6)
Valuation allowance	245.3	
Net income tax expense (benefit)	$ 282.1	$ (52.6)

The income tax benefit differed from that computed at the applicable federal statutory rate (35 percent) for the following reasons (dollars in millions):

	2002	2001
Tax benefit on loss before income taxes at statutory rate	$ (666.8)	$ (54.0)
Valuation allowance	245.3	.2
Net deferred benefits not recognized in the current period	761.0	
State taxes, net	(57.4)	1.2
Income tax expense (benefit)	$ 282.1	$ (52.6)

At December 31, 2002, CFC had $552.4 million of net operating loss carryforwards. The carryforwards were to expire as follows: $54.7 in 2018; $273.6 in 2020; and $224.1 in 2022.

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CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Pension Plan of CFC

CFC provided certain pension benefits for certain eligible retired employees under a partially funded plan. Amounts related to the pension plan were as follows (dollars in millions):

	Pension Benefits
	2002
Benefit obligation, beginning of year	$14.8
Interest cost	.9
Actuarial loss	7.1
Benefits paid	(4.6)
Benefit obligation, end of year	$18.2
Fair value of plan assets, beginning of year	$14.2
Actual return on plan assets	(1.1)
Employer contributions	.4
Benefits paid	(4.6)
Fair value of plan assets, end of year	$ 8.9
Funded status	$ (9.3)
Unrecognized net actuarial loss	12.9
Prepaid benefit cost	$ 3.6

CFC used the following weighted average assumptions to calculate benefit obligations for its 2002 valuations: postretirement discount rate of approximately 5.0 percent; preretirement discount rate of approximately 6.0 percent; and an expected return on plan assets of approximately 9.0 percent. Beginning in 2000, as a result of plan amendments, no assumption for compensation increases was required. Included as an adjustment to accumulated other comprehensive income (loss) is a $12.7 million adjustment representing the additional minimum liability associated with this plan.

Components of the cost CFC recognized related to its pension plan were as follows (dollars in millions):

	Pension Benefits	
	2002	**2001**
Interest cost	$ .9	$ 1.1
Expected return of plan assets	(1.1)	(1.5)
Settlement loss	2.2	1.3
Recognized net actuarial loss	.6	.3

Net periodic cost	$ 2.6	$ 1.2

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Notes Payable, Representing Direct Finance Obligations (Excluding Notes Payable Related to Securitized Finance Receivables Structured as Collateralized Borrowings)

Notes payable (excluding notes payable related to securitized finance receivables structured as collateralized borrowings) of CFC at December 31, 2002, were as follows (interest rates as of December 31, 2002) (dollars in millions):

	2002
Master repurchase agreements (Warehouse Facilities) due on various dates in 2003 (3.10%)	$ 176.3
Residual facility collateralized by retained interests in securitizations due 2004 (Residual Facility) (3.88%)	497.7
Debtor in possession facility due May 2003 (10.0%)	82.0
Note payable to Conseco (2.91%)	273.2
Other	1.4
Total principal amount	1,030.6
Unamortized net discount and deferred fees	(1.9)
Direct finance obligations	$ 1,028.7

As of the Petition Date, CFC s remaining liquidity sources were a warehouse facility (the Warehouse Facility) and a residual facility (Residual Facility) with Lehman and a bank credit facility with U.S. Bank and together with the Warehouse Facility and Residual Facility, the CFC Facilities . The direct borrower under (i) the Warehouse Facility was CFC s non-debtor subsidiary Green Tree Finance Corp. Five (GTFC), and (ii) the Residual Facility was CFC s non-debtor subsidiary Green Tree Residual Finance Corp. I (GTRFC). The Warehouse Facility and the Residual Facility were fully guaranteed by CFC and, up to an aggregate of $125 million, by CIHC. CFC was the direct borrower under the U.S. Bank Facility, which was also guaranteed by CIHC up to an aggregate of $125 million.

Prior to the Petition Date, CFC was in default under the CFC Facilities as a result of (i) cross-defaults triggered by Old Conseco s defaulting on its debt obligations, (ii) cross-defaults among the U.S. Bank Facility, the Warehouse Facility and the Residual Facility, (iii) failure to make payments required by CFC s guarantees of payments on B-2 securities, which were issued to investors in certain finance receivable securitization transactions; and (iv) breaches of several financial covenants under the CFC Facilities. CFC entered into forbearance agreements with Lehman with respect to the Warehouse Facility and Residual Facility and with U.S. Bank with respect to U.S. Bank Facility, pursuant to which Lehman and U.S. Bank agreed to temporarily refrain from exercising any rights arising from events of default that occurred under each CFC Facility prior to the Petition Date.

The Warehouse Facility was a repurchase facility under which primarily newly originated manufactured housing, home equity, home improvement and recreational vehicle loans originated by CFC or affiliates of CFC and transferred to GTFC were sold by GTFC to Lehman with an agreement to repurchase those loans at a later date and at a higher price. The price differential reflected the cost of financing. The Warehouse Facility provided funding to CFC for new loan originations. The Warehouse Facility and the Residual Facility were cross-collateralized.

The Residual Facility was collateralized by retained interests in securitizations. CFC was required to maintain collateral based on current estimated fair values in accordance with the terms of such facility. Due to the decrease in the estimated fair value of its retained interests, CFC s collateral was deficient at December 31, 2002 (as calculated in accordance with the relevant transaction documents, which provide that Lehman calculates the value of CFC s collateral within its sole discretion). Pursuant to the forbearance agreement entered into with Lehman on December 20, 2002, Lehman agreed not to accelerate the repayment

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CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

of the Residual Facility based on the collateral deficiency. Under the terms of this forbearance agreement, Lehman retained the cash flows from CFC s retained interests pledged under this facility and applied those cash flows to the margin deficit. The filing by Old Conseco, CIHC and CFC of a Chapter 11 petition triggered additional defaults under the CFC Facilities.

On December 19, 2002, shortly after the filing of the Chapter 11 Cases, CFC obtained the FPS DIP provided by U.S. Bank and FPS DIP LLC, an affiliate of Fortress Investment Group LLC (Fortress), J.C. Flowers & Co. LLC. (Flowers) and Cerberus Capital Management, L.P. (Cerberus). The DIP financing is for up to $125,000,000. The DIP financing motion was granted by the Bankruptcy Court on January 14, 2003.

From time to time, CFC failed to comply with certain covenants regarding the maximum permissible variance of the budgets provided to the FPS DIP lenders in connection with the FPS DIP. In each instance, CFC obtained appropriate waivers.

On December 20, 2002, CFC, GTFC, and GTRFC, entered into several agreements with Lehman: (the Lehman December 20 Agreements) (i) providing that Lehman temporarily refrain from exercising any rights arising from events of default that occurred under each relevant CFC Facility (including, but not limited to, those arising out of Old Conseco, CIHC and CFC filing for Chapter 11 relief); (ii) indirectly providing CFC with up to $25,000,000 in postpetition financing by allowing GTFC to provide intercompany loans to CFC with cash flows obtained from the Warehouse Facility; (iii) decreasing the capacity of the Warehouse Facility to a maximum of $250,000,000; and (iv) otherwise amending the Warehouse Facility and the Residual Facility. These agreements were subject to a number of conditions.

As a result of CFC s defaults and the Lehman December 20 Agreements, CFC could not draw funds from the Residual Facility.

During 2002, CFC repurchased $46.9 million par value of its senior subordinated notes and medium term notes resulting in a gain on the extinguishment of debt of $6.3 million. In March 2002, CFC completed a tender offer pursuant to which it purchased $75.8 million par value of its senior subordinated notes due June 2002. The purchase price was equal to 100 percent of the principal amount of the notes plus accrued interest. The remaining principal amount outstanding of $58.5 million (including $23.7 million held by Conseco) of the senior subordinated notes was retired at maturity on June 3, 2002.

In April 2002, CFC completed a tender offer pursuant to which it purchased $158.5 million par value of its medium term notes due September 2002 and $3.7 million par value of its medium term notes due April 2003. The purchase price was equal to 100 percent of the principal amount of the notes plus accrued interest. In June 2002, CFC tendered for the remaining $8.2 million par value of its medium term notes due September 2002. Pursuant to the tender offer $5.5 million par value of the notes was tendered in July. The purchase price was equal to 101 percent of the principal amount of the notes plus accrued interest. The remaining principal amount outstanding of the medium term notes after giving effect to both tender offers and other debt repurchases completed prior to the tender offers of $2.7 million was retired at maturity on September 26, 2002.

During 2001, CFC repurchased: $55.4 million par value of its 10.25% senior subordinated notes due June 2002 for $51.9 million, resulting in a gain on the extinguishment of debt of $3.4 million; and $34.0 million par value of its 6.5% medium term notes due September 2002 for $27.5 million, resulting in a gain on the extinguishment of debt of $6.5 million.

Notes Payable Related to Securitized Finance Receivables Structured as Collateralized Borrowings

Notes payable related to securitized finance receivables structured as collateralized borrowings were $13,069.7 million at December 31, 2002. The principal and interest on these notes were paid using the cash

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CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

flows from the underlying finance receivables which served as collateral for the notes. Accordingly, the timing of the principal payments on these notes was dependent on the payments received on the underlying finance receivables which back the notes. In some instances, CFC was required to advance principal and interest payments even though the payments on the underlying finance receivables which back the notes had not yet been received. The average interest rate on these notes was 6.7 percent at December 31, 2002. The notes payable balance also included amounts related to financing transactions securitized by: (i) capitalized expenses related to the refurbishment of repossessed assets; and (ii) principal and interest advances. The outstanding liability on these facilities at December 31, 2002 was $85 million.

Special Charges

2002

The following table summarizes the special charges incurred by CFC during 2002, which are further described in the paragraphs which follow (dollars in millions):

Loss related to assets sold to raise cash	$ 97.6
Costs related to debt modification and refinancing transactions	39.4
Reduction in value of Lehman warrant	(38.1)
Abandonment of computer processing system	16.3
Other items	6.7
Special charges before income tax benefit	$121.9

Loss Related to Assets Sold to Raise Cash

CFC completed various asset sales which resulted in net losses of $97.6 million in 2002. Such amounts included the loss of $96.0 million related to the sales of $463 million of certain finance receivables and $1.6 million of additional loss related to receivables required to be repurchased from the purchaser of the vendor services receivables pursuant to the repurchase clauses in the agreements.

Costs Related to Debt Modification and Refinancing Transactions

In conjunction with the various modifications to borrowing arrangements and refinancing transactions and the recognition of deferred expenses for terminated financing arrangements, CFC incurred costs of $39.4 million in 2002 which were not permitted to be deferred pursuant to GAAP.

Reduction in Value of Lehman Warrant

As partial consideration for a financing transaction, Conseco Finance issued a warrant to Lehman which permitted the holder to purchase 5 percent of Conseco Finance at a nominal price. The holder of the warrant or Conseco Finance may cause the warrant and any stock issued upon its exercise to be purchased for cash at an appraised value in May 2003. Since the warrant permitted cash settlement at fair value at the option of the holder of the warrant, it was included in other liabilities and was measured at fair value, with changes in its value reported in earnings. The estimated fair value of the warrant at December 31, 2002 was nil based on current valuations of Conseco Finance. Accordingly, CFC recorded a $38.1 million reduction in the value of the warrant during 2002.

Abandonment of Computer Processing Systems

In 2002, CFC incurred a $16.3 million charge for the abandonment of certain computer processing systems. CFC is abandoning such systems given the recent changes to its business and its decision to no longer originate certain types of loans.

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2001

The following table summarizes the special charges incurred by CFC during 2001, which are further described in the paragraphs which follow (dollars in millions):

Severance benefits, litigation reserves and other restructuring charges	$ 20.3
Loss related to sale of certain finance receivables	11.2
Change in value of warrant	(10.0)
Special charges before income tax benefit	$ 21.5

Severance Benefits, Litigation Reserves and Other Restructuring Charges

During 2001, Conseco developed plans to change the way it operates. Such changes were undertaken in an effort to improve CFC s operations and profitability. The planned changes included moving a significant number of jobs to India, where a highly-educated, low-cost, English-speaking labor force was available. Pursuant to GAAP, CFC was required to recognize the costs associated with most restructuring activities as the costs were incurred. However, costs associated with severance benefits are required to be recognized when the costs are: (i) attributable to employees services that have already been rendered; (ii) relate to obligations that accumulate; and (iii) are probable and can be reasonably estimated. Since the severance costs associated with their planned activities met these requirements, CFC recognized a charge of $6.2 million in 2001 related to severance benefits and other restructuring charges. CFC also recognized charges of: (i) $7.5 million related to its decision to discontinue the sale of certain types of life insurance in conjunction with lending transactions; and (ii) $6.6 million related to certain litigation matters.

Loss Related to the Sale of Certain Finance Receivables

During 2001, CFC recognized a loss of $2.2 million on the sale of $11.2 million of finance receivables. Also, during 2001, the purchaser of certain credit card receivables returned certain receivables pursuant to a return of accounts provision included in the sales agreement. Such returns and the associated losses exceeded the amounts CFC initially anticipated when the receivables were sold. CFC recognized a loss of $9.0 million related to the returned receivables.

Change in Value of Warrant

As partial consideration for a financing transaction, CFC issued a warrant which permits the holder to purchase 5 percent of Conseco Finance at a nominal price. The holder of the warrant or CFC may cause the warrant and any stock issued upon its exercise to be purchased for cash at an appraised value in May 2003. Since the warrant permitted cash settlement at fair value at the option of the holder of the warrant, it was included in other liabilities and was measured at fair value, with changes in its value reported in earnings. The estimated fair value of the warrant at December 31, 2001 was $38.1 million. The estimated value was determined based on discounted cash flow and market multiple valuation techniques. During 2001, CFC recognized a $10.0 million benefit as a result of the decreased value of the warrant (which was classified as a reduction to special charges).

20. Financial Information Regarding CVIC

In October 2002, Conseco Life Insurance Company of Texas (a wholly-owned subsidiary of the Company) completed the sale of CVIC to Inviva, Inc. (Inviva). CVIC marketed tax qualified annuities and certain employee benefit-related insurance products through professional independent agents. Pursuant to SFAS 144, CVIC is accounted for as a discontinued operation. Our consolidated statement of operations reflects the operations of CVIC in the caption Discontinued operations for all periods. The consideration

CONSECO, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

received from Inviva at closing (subject to adjustment based upon the adjusted statutory balance sheet of CVIC at September 30, 2002) totaled $83.7 million, of which $35.0 million was in the form of Series D Preferred Shares (the Preferred Shares) issued by Inviva and the remainder was in cash. The purchase price was finalized in July 2003, which reduced the amount of Preferred Shares received by $10.5 million. In addition, Conseco Life Insurance Company of Texas received a dividend of approximately $75 million from CVIC immediately prior to the closing. We recognized a loss on the sale of $93.1 million. There was no income tax benefit recognized on the transaction. As part of the CVIC sale, Conseco agreed that it would not engage in the variable annuity or variable insurance business for a period of three years after the closing.

The Preferred Shares accrued dividends (in-kind) at an annual rate of 19 percent through October 15, 2003, but no dividends accrued after that date. In October 2003, $10.0 million of the Preferred Shares were redeemed by Inviva. Our insurance subsidiary that holds these shares may elect to exchange the Preferred Shares for non-voting common stock of JNF Holding Company, Inc., a wholly-owned subsidiary of Inviva, (JNF) that now owns all of the stock of CVIC. After the exchange has occurred, such JNF common stock may be repurchased by JNF at any time at 115 percent of the stated value of the Preferred Shares plus accrued and unpaid dividends thereon immediately prior to the exchange.

The following summarizes selected financial information of CVIC (dollars in millions):

	Years Ended December 31,	
	2002	2001
Insurance policy income	$ 30.5	$ 73.0
Net investment income	(217.3)	(61.7)
Net realized investment losses	(76.7)	(34.3)
Total revenues	(263.3)	(23.0)
Insurance policy benefits	(234.7)	(81.7)
Amortization	117.4	33.7
Total expenses	(102.9)	(17.4)
Pre-tax loss	(160.4)	(5.6)
Net loss	$(101.6)	$ (5.6)
Income taxes	(58.8)(a)	
Loss on sale of CVIC	(93.1)	
Amount classified as discontinued operations	$(253.5)	$ (5.6)

(a) Amount is considered in determining the income tax expense in the consolidated statement of operations.

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[C]

44,000,000 Shares

Common Stock

Goldman, Sachs & Co.

Morgan Stanley

Banc of America Securities LLC

Credit Suisse First Boston

Deutsche Bank Securities
JPMorgan
Lazard
Advest, Inc.
Keefe, Bruyette & Woods

[P]

20,000,000 Shares

% Mandatorily Convertible Preferred Stock, Class B

Goldman, Sachs & Co. **Morgan Stanley**

JPMorgan

Banc of America Securities LLC

Credit Suisse First Boston

Lazard

PART II

INFORMATION NOT REQUIRED IN PROSPECTUS

Item 13. ***Other Expenses of Issuance and Distribution.***

Set forth below is an estimate (except in the case of the registration fee) of the amount of fees and expenses to be paid by Conseco in connection in connection with the issuance and distribution of the offered securities, excluding underwriting discounts and commissions.

Securities and Exchange Commission registration fee	$ 218,558
NASD filing fee	30,500
New York Stock Exchange listing fee	250,800
Blue Sky fees and expenses (including attorneys fees and expenses)	10,000
Printing expenses	375,000
Accounting fees and expenses	500,000
Transfer agent s fees and expenses	30,000
Legal fees and expenses	800,000
Miscellaneous fees and expenses	185,142
Total	$ 2,400,000

Item 14. ***Indemnification of Directors and Officers.***

We are incorporated under the laws of the State of Delaware. Our Amended and Restated Certificate of Incorporation provides, as authorized by Section 102(b)(7) of the Delaware General Corporation Law, that our directors will not be personally liable to us or our stockholders for monetary damages for breach of fiduciary duty as a director, except for liability: (i) for any transaction from which the director derives an improper personal benefit; (ii) for any act or omission not in good faith or that involves intentional misconduct or a knowing violation of law; (iii) for any improper payment of dividends or redemption of shares; or (iv) for any breach of the director s duty of loyalty to us or our stockholders.

Our Amended and Restated Certificate of Incorporation and Second Amended and Restated Bylaws further provide, as permitted by Section 145 of the Delaware General Corporation Law, that each person who was, is or is threatened to be made a party to or is otherwise involved with any action, suit or proceeding, whether civil, criminal, administrative or investigative, by reason of the fact that he or she is or was a director or officer or, while a director or officer, is or was serving at the request of Conseco as a director, officer, employee or agent of another company or enterprise (an indemnitee), will be indemnified and held harmless by us to the fullest extent authorized by the Delaware General Corporation Law, against all expense, liability and loss (including attorneys fees), reasonably incurred or suffered by such indemnitee in connection therewith. This right of indemnification includes our obligation to provide an advance of expenses, although the indemnitee may be required to repay such an advance if there is a judicial determination that the indemnitee was not entitled to the indemnification.

As permitted by our Second Amended and Restated Bylaws, we have entered into indemnification agreements with our directors, and our subsidiary, Conseco Life Insurance Company of Texas, has entered into limited undertaking agreements with our directors whereby it has agreed, subject to limitations set forth therein, to guarantee our obligations under the indemnification agreements. Forms of these agreements are attached as exhibits hereto and are incorporated by reference herein.

The foregoing statements are subject to the detailed provisions of the Delaware General Corporation Law, our Amended and Restated Certificate of Incorporation, our Second Amended and Restated Bylaws, the indemnification agreements and the limited undertaking agreements.

Our directors and officers are covered under directors and officers liability insurance policies maintained by us.

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Item 15. ***Recent Sales of Unregistered Securities.***

(1) On September 10, 2003, the effective date of our plan of reorganization, we issued 100,000,000 shares of our common stock, 34,386,740 shares of our class A preferred stock and 6,000,000 series A warrants to our predecessor s pre-bankruptcy creditors pursuant to the plan of reorganization. Based upon the exemption from the registration requirements under the Securities Act provided by section 1145 of the Bankruptcy Code, which we relied on pursuant to an order from the bankruptcy court, we believe that none of these securities were required to be registered under the Securities Act or under any state or local law requiring registration for offer or sale of a security or registration or licensing of an issuer of, underwriter of, or broker or dealer in, such securities, in connection with their issuance and distribution pursuant to the plan of reorganization.

(2) On September 29, 2003, we issued R. Glenn Hilliard, our non-executive chairman, 98,119 shares of our common stock in reliance on the exemption from registration provided by Section 4(2) of the Securities Act. Mr. Hilliard received these shares in connection with a bankruptcy court-approved agreement whereby Mr. Hilliard agreed to serve as our non-executive chairman upon our emergence from bankruptcy.

Item 16. ***Exhibits and Financial Statement Schedules.***

(a) *Exhibits.*

Reference is made to the attached Exhibit Index.

(b) *Financial Statement Schedules.*

The following financial statement schedules are listed as part of this Registration Statement immediately following the signature pages.

Schedule II Condensed Financial Information of Registrant (Parent Company)

Schedule IV Reinsurance

Item 17. ***Undertakings.***

The undersigned registrant hereby undertakes:

1. For purposes of determining any liability under the Securities Act, the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by the registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act shall be deemed to be part of this registration statement as of the time it was declared effective.

2. For the purpose of determining any liability under the Securities Act, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of their counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

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SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, Conseco, Inc. has duly caused this Amendment No. 4 to Form S-1 Registration Statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Carmel and State of Indiana on May 6, 2004.

CONSECO, INC.

By: /s/ EUGENE M. BULLIS

Eugene M. Bullis
Executive Vice President and
Chief Financial Officer

Pursuant to the requirements of the Securities Act of 1933, this Amendment No. 4 to Form S-1 has been signed by the following persons in the capacities and on the dates indicated:

Signatures	Capacity	Date
* William J. Shea	President, Chief Executive Officer and Director (Principal Executive Officer)	May 6, 2004
/s/ EUGENE M. BULLIS Eugene M. Bullis	Executive Vice President and Chief Financial Officer (Principal Financial Officer)	May 6, 2004
* John R. Kline	Senior Vice President and Chief Accounting Officer (Principal Accounting Officer)	May 6, 2004
* R. Glenn Hilliard	Chairman of the Board	May 6, 2004
* Neal Schneider	Director	May 6, 2004
* Philip R. Roberts	Director	May 6, 2004
* John G. Turner	Director	May 6, 2004
* Michael T. Tokarz	Director	May 6, 2004

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Signatures	Capacity	Date
* Michael S. Shannon	Director	May 6, 2004

*By: /s/ EUGENE M. BULLIS

Eugene M. Bullis
Attorney-in-Fact

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Report of Independent Auditors on Financial Statement Schedules

To the Shareholders and Board of Directors

Conseco, Inc.

Our report on the consolidated financial statements of Conseco, Inc. and subsidiaries (Successor Company) is included on page F-2 of this Amendment No. 4 to Form S-1. In connection with our audit of such financial statements, we have also audited the related financial statement schedules at December 31, 2003 and for the period from September 1, 2003 through December 31, 2003 listed in the index on page II-2 of this Amendment No. 4 to Form S-1. In our opinion, the financial statement schedules referred to above, present fairly, in all material respects, the information set forth therein when read in conjunction with the related financial statements.

As discussed in Note 1 to the consolidated financial statements, the United States Bankruptcy Court for the Northern District of Illinois, Eastern Division confirmed the Company s Sixth Amended Joint Plan of Reorganization (the Plan) on September 9, 2003. The provisions of the plan are described in detail in Note 1. The Plan was substantially consummated on September 10, 2003 and the Company emerged from bankruptcy. In connection with its emergence from bankruptcy, the Company adopted fresh start accounting as of August 31, 2003.

/s/ PricewaterhouseCoopers, LLP

PricewaterhouseCoopers, LLP

Indianapolis, Indiana

March 10, 2004

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Report of Independent Auditors on Financial Statement Schedules

To the Shareholders and Board of Directors

Conseco, Inc.

Our report on the consolidated financial statements of Conseco, Inc. and subsidiaries (Predecessor Company) is included on page F-3 of this Amendment No. 4 to Form S-1. In connection with our audits of such financial statements, we have also audited the related financial statement schedules at December 31, 2002 and for the period from January 1, 2003 through August 31, 2003, and for each of the two years in the period ended December 31, 2002 listed in the index on page II-2 of this Amendment No. 4 to Form S-1. In our opinion, the financial statement schedules referred to above, present fairly, in all material respects, the information set forth therein when read in conjunction with the related financial statements.

As discussed in Note 1 to the consolidated financial statements, the Company filed a petition on December 17, 2002 with the United States Bankruptcy Court for the Northern District of Illinois, Eastern Division for reorganization under the provisions of Chapter 11 of the Bankruptcy Code. The Company s Sixth Amended Joint Plan of Reorganization (the Plan) was substantially consummated on September 10, 2003 and the Company emerged from bankruptcy. In connection with its emergence from bankruptcy, the Company adopted fresh start accounting.

/s/ PricewaterhouseCoopers, LLP

PricewaterhouseCoopers, LLP

Indianapolis, Indiana

March 10, 2004

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CONSECO, INC. AND SUBSIDIARIES

SCHEDULE II

CONDENSED FINANCIAL INFORMATION OF REGISTRANT (PARENT COMPANY)

BALANCE SHEET

(Dollars in millions)

	Successor	Predecessor
	December 31, 2003	December 31, 2002
ASSETS		
Cash and cash equivalents:		
Unrestricted	$ 11.1	$ 15.6
Restricted	17.3	
Other invested assets	.1	.1
Investment in wholly-owned subsidiaries (eliminated in consolidation)	4,150.2	4,661.2
Receivable from subsidiaries (eliminated in consolidation)	.6	414.4
Income tax assets	1.7	137.0
Other assets	67.0	66.7
Total assets	$4,248.0	$ 5,295.0
LIABILITIES AND SHAREHOLDERS EQUITY (DEFICIT)		
Liabilities:		
Notes payable	$1,300.0	$
Payable to subsidiaries (eliminated in consolidation)	45.4	
Liabilities subject to compromise		4,865.8
Affiliated liabilities subject to compromise		558.1
Other liabilities	85.0	
Total liabilities	1,430.4	5,423.9
Commitments and Contingencies		
Company-obligated mandatorily redeemable preferred securities of subsidiary trusts		1,921.5
Shareholders equity (deficit):		
Preferred stock	887.5	501.7
Common stock and additional paid-in capital ($.01 par value, 8,000,000,000 shares authorized, shares issued and outstanding at December 31, 2003 100,115,772; no par value, 1,000,000,000 shares authorized, shares issued and outstanding: 2002 346,007,133)	1,642.9	3,497.0
Accumulated other comprehensive income (loss)	218.7	580.6
Retained earnings (deficit)	68.5	(6,629.7)
Total shareholders equity (deficit)	2,817.6	(2,050.4)
Total liabilities and shareholders equity (deficit)	$4,248.0	$ 5,295.0

The accompanying notes are an integral part of the condensed financial information.

CONSECO, INC. AND SUBSIDIARIES

SCHEDULE II

CONDENSED FINANCIAL INFORMATION OF REGISTRANT (PARENT COMPANY)

STATEMENT OF OPERATIONS

(Dollars in millions)

	Successor	Predecessor		
	Four months ended December 31, 2003	Eight months ended August 31, 2003	Years ended December 31,	
			2002	2001
Revenues:				
Net investment income	$ .1	$ 3.7	$ 2.4	$ 15.0
Dividends from subsidiaries (eliminated in consolidation)				24.0
Fee and interest income from subsidiaries (eliminated in consolidation)		.2	27.2	96.0
Net investment losses		(1.9)		(12.1)
Other income	5.6	.2	1.5	.8
Total revenues	5.7	2.2	31.1	123.7
Expenses:				
Interest expense on notes payable (contractual interest: $268.5 for the eight months ended August 31, 2003; and $345.3 for 2002)	34.3	194.0	325.3	369.2
Provision for loss		15.9	147.2	169.6
Intercompany expenses (eliminated in consolidation)	.1	6.7	1.2	3.0
Operating costs and expenses	14.6	(5.6)	94.1	69.7
Special charges			25.7	36.7
Gain on extinguishment of debt			(1.8)	(17.0)
Reorganization items, net		(2,133.8)	14.4	
Total expenses	49.0	(1,922.8)	606.1	631.2
Income (loss) before income taxes, equity in undistributed earnings of subsidiaries, distributions on Company-obligated mandatorily redeemable preferred securities of subsidiary trusts, discontinued operations and cumulative effect of accounting change	(43.3)	1,925.0	(575.0)	(507.5)
Income tax expense (benefit):				
Tax benefit on period income	(6.1)	8.5	(108.2)	(181.4)
Valuation allowance for deferred tax assets			753.9	
Income (loss) before equity in undistributed earnings of subsidiaries, distributions on Company-obligated mandatorily redeemable preferred securities of subsidiary trusts, discontinued operations and cumulative effect of accounting change	(37.2)	1,916.5	(1,220.7)	(326.1)
Equity in undistributed earnings of subsidiaries before discontinued operations, and cumulative effect of accounting change (eliminated in consolidation)	133.5	269.2	(1,275.8)	140.3

Income (loss) before distributions on Company-obligated mandatorily redeemable preferred securities of subsidiary trusts, discontinued operations and cumulative effect of accounting change	96.3	2,185.7	(2,496.5)	(185.8)
Distributions on Company-obligated mandatorily redeemable preferred securities of subsidiary trusts (contractual distributions for 2002 of $179.8)			173.2	119.5
Income (loss) before discontinued operations, and cumulative effect of accounting change	96.3	2,185.7	(2,669.7)	(305.3)
Discontinued operations of subsidiaries, net of income taxes		16.0	(2,216.8)	(100.6)
Cumulative effect of accounting change of subsidiaries, net of income taxes			(2,949.2)	
Net loss	96.3	2,201.7	(7,835.7)	(405.9)
Preferred stock dividends (contractual distributions for 2002 of $2.1)	27.8		2.1	12.8
Income (loss) applicable to common stock	$ 68.5	$ 2,201.7	$ (7,837.8)	$ (418.7)

The accompanying notes are an integral part of the condensed financial information.

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CONSECO, INC. AND SUBSIDIARIES

SCHEDULE II

CONDENSED FINANCIAL INFORMATION OF REGISTRANT (PARENT COMPANY)

STATEMENT OF CASH FLOWS

(Dollars in millions)

	Successor	Predecessor		
	Four months ended December 31, 2003	Eight months ended August 31, 2003	Years ended December 31, 2002	Years ended December 31, 2001
Cash flows from operating activities:				
Net income (loss)	$ 96.3	$ 2,201.7	$ (7,835.7)	$ (405.9)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:				
Equity in undistributed earnings of consolidated subsidiaries*	(133.5)	(269.2)	1,275.8	(140.3)
Discontinued operations of subsidiaries		(16.0)	2,216.8	100.6
Cumulative effect of accounting change of subsidiaries			2,949.2	
Provision for loss on loan guarantees		15.9	147.2	169.6
Net investment losses		1.9		12.1
Income taxes	19.6	8.8	(243.1)	(162.7)
(Gain) loss on extinguishment of debt			(1.8)	(17.0)
Distributions on Company-obligated mandatorily redeemable preferred securities of subsidiary trusts			173.2	183.9
Reorganization items and special charges		(2,157.0)	10.2	32.1
Other-affiliated*	16.8	42.0	927.4	256.1
Other	(8.1)	163.8	191.9	32.9
Net cash provided (used) by operating activities	(8.9)	(8.1)	(188.9)	61.4
Cash flows from investing activities:				
Sales and maturities of investments			16.0	33.1
Investments and advances to consolidated subsidiaries*		(3.5)	(121.3)	(12.9)
Purchases of investments			(56.7)	(49.5)
Change in restricted cash	(17.3)			
Payments from subsidiaries*	.8	5.5	414.0	950.1
Net cash provided (used) by investing activities	(16.5)	2.0	252.0	920.8
Cash flows from financing activities:				
Issuance of common and convertible preferred shares				4.1
Issuance of notes payable and commercial paper				404.9
Payments on notes payable			(75.5)	(1,349.4)
Issuance of notes payable to affiliates*	27.0			
Dividends to subsidiaries*			(36.0)	(36.0)
Dividends and distributions on Company-obligated mandatorily redeemable preferred securities of subsidiary trusts			(86.2)	(181.2)

Net cash provided (used) by financing activities	27.0		(197.7)	(1,157.6)
Net increase (decrease) in cash and cash equivalents	1.6	(6.1)	(134.6)	(175.4)
Cash and cash equivalents, beginning of the period	9.5	15.6	150.2	325.6
Cash and cash equivalents, end of the period	$ 11.1	$ 9.5	$ 15.6	$ 150.2

* Eliminated in consolidation

The accompanying notes are an integral part of the condensed financial information.

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CONSECO, INC. AND SUBSIDIARIES

SCHEDULE II

NOTES TO CONDENSED FINANCIAL INFORMATION

1. Basis of Presentation

The condensed financial information should be read in conjunction with the consolidated financial statements of Conseco, Inc. The condensed financial information includes the accounts and activity of the parent company.

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CONSECO, INC. AND SUBSIDIARIES

SCHEDULE IV

REINSURANCE

(Dollars in millions)

	Successor	Predecessor	
	2003	2002	2001
Life insurance inforce:			
Direct	$ 85,830.2	$ 94,098.3	$116,075.0
Assumed	1,753.8	3,380.7	1,996.5
Ceded	(23,431.2)	(26,368.9)	(26,088.6)
Net insurance inforce	$ 64,152.8	$ 71,110.1	$ 91,982.9
Percentage of assumed to net	2.7%	4.8%	2.2%

	Successor	Predecessor		
	Four months ended December 31, 2003	Eight months ended August 31, 2003	Years ended December 31, 2002	Years ended December 31, 2001
Premiums recorded as revenue for generally accepted accounting principles:				
Direct	$934.3	$2,011.4	$3,287.8	$3,600.0
Assumed	31.9	57.3	78.7	146.0
Ceded	(92.1)	(196.4)	(327.8)	(249.4)
Net premiums	$874.1	$1,872.3	$3,038.7	$3,496.6
Percentage of assumed to net	3.6%	3.1%	2.6%	4.2%

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EXHIBIT INDEX

Exhibit No.	Description
1.1**	Form of Underwriting Agreement relating to Common Stock.
1.2**	Form of Underwriting Agreement relating to Class B Mandatorily Convertible Preferred Stock.
2.1	Sixth Amended Joint Plan of Reorganization of Conseco, Inc. and affiliated Debtors, incorporated by reference to Exhibit 2.2 of our Current Report on Form 8-K filed September 15, 2003.
2.2	Order Confirming Reorganizing Debtors Sixth Amended Joint Plan of Reorganization, incorporated by reference to Exhibit 2.3 of our Current Report on Form 8-K filed September 15, 2003.
3.1	Amended and Restated Certificate of Incorporation of Conseco, Inc., incorporated by reference to Exhibit 3.1 of our Current Report on Form 8-K filed September 15, 2003.
3.2**	Second Amended and Restated Bylaws of Conseco, Inc.
4.1	Certificate of Designations relating to Class A Senior Cumulative Convertible Exchangeable Preferred Stock of Conseco, Inc., incorporated by reference to Exhibit 4.1 of our Current Report on Form 8-K filed September 15, 2003.
4.2	Series A Warrant Agreement between Conseco, Inc. and Wachovia Bank, N.A., as Warrant Agent, incorporated by reference to Exhibit 4.2 of our Current Report on Form 8-K filed September 15, 2003.
4.3**	Form of Certificate of Designations relating to Class B Mandatorily Convertible Preferred Stock.
5.1**	Opinion of Kirkland & Ellis LLP.
10.1	Credit Agreement dated as of September 10, 2003 among Conseco, Inc., Bank of America, N.A., as Agent, and other financial institutions, incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K filed September 15, 2003.
10.2**	Amendment No. 1 to Credit Agreement dated as of January 15, 2004 among Conseco, Inc., Bank of America, N.A., as Agent, and other financial institutions.
10.3	Amendment No. 2 to Credit Agreement dated as of March 5, 2004 among Conseco, Inc., Bank of America, N.A., as Agent, and other financial institutions, incorporated by reference to Exhibit 10.3 of our Annual Report on Form 10-K for the year ended December 31, 2003.
10.4	Guarantee and Security Agreement dated as of September 10, 2003 among Conseco, Inc., the Subsidiary Guarantors Party Thereto and Bank of America, N.A., as Agent, incorporated by reference to Exhibit 10.4 of our Quarterly Report on Form 10-Q for the quarter ended September 30, 2003.
10.5	Common Stock Registration Rights Agreement dated as of September 10, 2003, incorporated by reference to Exhibit 10.2 of our Current Report on Form 8-K filed September 15, 2003.
10.6	Preferred Stock Registration Rights Agreement dated as of September 10, 2003, incorporated by reference to Exhibit 10.3 of our Current Report on Form 8-K filed September 15, 2003.
10.7	Employment Agreement dated as of May 27, 2003 between Conseco, Inc. and William J. Shea, incorporated by reference to Exhibit 10.5 of our Quarterly Report on Form 10-Q for the quarter ended September 30, 2003.
10.8	Agreement dated as of June 18, 2003 between Conseco, Inc. and R. Glenn Hilliard, incorporated by reference to Exhibit 10.6 of our Quarterly Report on Form 10-Q for the quarter ended September 30, 2003.
10.9**	Amendment dated as of December 30, 2003 to Agreement dated as of June 18, 2003 between Conseco, Inc. and R. Glenn Hilliard.
10.10**	Employment Agreement dated as of September 10, 2003 between Conseco, Inc. and Eugene M. Bullis.
10.11**	Employment Agreement dated as of July 15, 2002 between Conseco, Inc. and John R. Kline.

Exhibit No.	Description
10.12**	Employment Agreement dated as of September 10, 2003 between 40y86 Advisors, Inc. and Eric R. Johnson.
10.13	Conseco, Inc. 2003 Long-Term Equity Incentive Plan, incorporated by reference to Exhibit 4 of our Registration Statement on Form S-8 (No. 333-108835).
10.14**	Form of Indemnification Agreement among Conseco, Inc., CDOC, Inc., Conseco Services, LLC and each director of Conseco, Inc.
10.15**	Form of Limited Undertaking among Conseco Life Insurance Company of Texas, Conseco, Inc. and each director of Conseco, Inc.
12.1	Computation of Ratio of Earnings to Fixed Charges, Preferred Stock Dividends and Distributions on Company-obligated Mandatorily Redeemable Preferred Securities of Subsidiary Trusts.
21.1**	Subsidiaries of Conseco, Inc.
23.1	Consent of PricewaterhouseCoopers LLP.
23.2**	Consent of Kirkland & Ellis LLP (included in Exhibit 5.1).
24.1**	Powers of Attorney.

** Previously filed.