1998

Financial Highlights

	1998	1997	1996
Revenues	$ 530,506,000	$ 630,737,000	$ 670,443,000
Net securities gains (losses)	$ (60,871,000)	$ 3,249,000	$ 24,117,000
Income (loss) from continuing operations before income taxes, minority expense of trust preferred securities and extraordinary loss	$ 29,377,000	$ (24,238,000)	$ (48,187,000)
Income tax benefit	$ (25,073,000)	$ (9,891,000)	$ (19,326,000)
Minority expense of trust preferred securities, net of taxes	$ (8,248,000)	$ (7,942,000)	$ –
Income (loss) from continuing operations before extraordinary loss	$ 46,202,000	$ (22,289,000)	$ (28,861,000)
Income from discontinued operations, net of taxes	$ 8,141,000	$ 58,516,000	$ 84,376,000
Gain on disposal of discontinued operations, net of taxes	$ –	$ 627,645,000	$ –
Income before extraordinary loss	$ 54,343,000	$ 663,872,000	$ 55,515,000
Extraordinary loss from early extinguishment of debt, net of taxes	$ –	$ (2,057,000)	$ (6,838,000)
Net income	$ 54,343,000	$ 661,815,000	$ 48,677,000
Earnings (loss) per common share:			
Basic: Income (loss) from continuing operations before extraordinary loss	$ .73	$ (.36)	$ (.48)
Income from discontinued operations	$ .13	$ .94	$ 1.40
Gain on disposal of discontinued operations	$ –	$ 10.09	$ –
Extraordinary loss	$ –	$ (.03)	$ (.11)
Net income	$ .86	$ 10.64	$ .81
Diluted: Income (loss) from continuing operations before extraordinary loss	$ .73	$ (.36)	$ (.48)
Income from discontinued operations	$ .13	$ .94	$ 1.40
Gain on disposal of discontinued operations	$ –	$ 10.09	$ –
Extraordinary loss	$ –	$ (.03)	$ (.11)
Net income	$ .86	$ 10.64	$ .81
Total assets	$ 3,958,951,000	$ 3,745,336,000	$ 2,776,591,000
Cash and investments	$ 2,229,895,000	$ 2,453,555,000	$ 1,246,220,000
Common shareholders' equity	$ 1,853,159,000	$ 1,863,531,000	$ 1,118,107,000
Book value per common share	$ 29.90	$ 29.17	$ 18.51

Letter from the Chairman and President

To Our Shareholders

In 1998, the Company earned $54.3 million after tax, or $.86 per share, a 2.9% return on ending equity. Net worth ended the year at $1.85 billion or $29.90 per share. This represents a 27% return per annum of book value per share since December 31, 1979, shortly after this management took over. Market price of the stock was $31.50 at December 31, 1998 versus $34.50 at year-end 1997. During the waning months of 1998, and up until March 17, 1999, the Company purchased 3,734,970 Leucadia common shares in the open market at an average price of $29.50. Since 1978, and as of December 31, 1998, we have repurchased 37,316,491 shares (adjusted for splits), at an average price of $4.65. In addition to the repurchase of these shares, we have decided to dividend to the shareholders 44% of the 1998 year ending net worth as a capital gain. More about that, and plans for the future, after reviewing recent developments and current operations.

Empire Insurance Company

Empire Insurance has become our bête noir. Beginning in 1995, we have strengthened reserves by $131.5 million. It reminds us of the street in front of Empire's former office on Fifth Avenue in New York. A huge pothole appeared due to a large water main break. It took days and days to stop the flow of water and many tons of fill and asphalt to repair the street. We have periodically filled our pothole with money called reserves, but we are not sure the repair is going to hold. Empire, if nothing else, is a testimony to our persistence, if not our competence.

For the last four years, when the actuaries looked at current results and compared them with our previous predictions, they found more claims than expected, with the cost of settling the claims higher as well. These adverse developments have a nasty result. Reserves must be adjusted upward for past business and the loss predictions being used for current business are put in doubt.

Actuaries are naturally conservative folks. They are not interested in optimistic forecasts. This means that Empire will not be reporting earnings until we and they are sure the reserving problems are behind us. We hope that the understandable conservatism of our current reserving practices will have happier results in the future.

We continue to work on improving all the moving parts at Empire. To that end, we have hired Robert Toppi as the CEO. He has 30 years of insurance experience, a considerable amount of it in the New York City market. He is working hard to stabilize, reengineer and lower costs to fit a smaller sized operation, which will be the inevitable result of proper reserving and profitable pricing of our insurance products. Empire has in the past covered some of its overhead by acting as a servicing carrier for others and by purchasing assigned risk business. These opportunities have been dramatically reduced and are slowly disappearing. Empire's restructuring is made more difficult by the excess of capital in the property and casualty industry. As a result, many competitors are reaching for the incremental premium dollar hoping it will be marginally profitable. All of us involved in the Empire restructuring hope we are nearing the end of these difficult times. Let us pray!

Banking and Lending

The Company's banking and lending operations are conducted by its national bank subsidiary, American Investment Bank, N.A. (AIB), and a Utah state chartered Industrial Loan Corporation, American Investment Financial (AIF). This segment at December 31, 1998, had total assets of $269.3 million and total capital of $49.5 million.

AIB and AIF have been hibernating for the past several years. AIB's largest market segment, sub-prime auto lending, became inundated with competitors making substandard loans at standard interest rates, with, as you might expect, disastrous consequences. When this phenomenon began four years ago, AIB retreated and waited. During 1998, two things happened. The most irrational participants either withdrew from the market or were carried off by their creditors; those who remain have been pricing more sensibly. During this interregnum, AIB has improved its collection methods and has added a three-tiered risk-based pricing structure, installed new technology, paid great attention to static pool analysis (business is tracked every quarter throughout its life), and improved operating procedures. By the end of 1998, AIB and AIF were able to double their monthly loan volume. Preliminary review indicates the results are adequate and improving – the good economy has helped. Also during 1998, AIB acquired at a discount a $37 million portfolio of subprime auto loans, which will increase yield on assets and help amortize fixed costs. AIF's boat and recreational vehicle programs reached profitability. The Small Business Administration lending program is advancing slowly.

We have spoken before about the state of consumer banking. It has become overly competitive and over-loaned to already financially burdened consumers. In response to this problem, AIB and AIF made a timely exit from their executive and professional loan programs by selling in 1998 substantially all of their portfolios for a pre-tax gain of $6.5 million. In preparation for the meeting to consider the sale of executive and professional loan portfolios, AIB's chairman, H.E. "Bud" Scruggs, was overheard mumbling something about "credit Armageddon." Leucadia's general caution, conservatism, and fear for the future of financial assets is alive and well.

The banking entities posted pre-tax earnings of $13.9 million for 1998. Management, ably led by Bud Scruggs, maintained credit quality and managed risks, while taking advantage of windows of opportunity.

Manufacturing

Having sold all of our other manufacturing companies, Conwed Plastics is our only remaining manufacturing company. Its sales were up 11% year-over-year and profitability was up 10%. Lower raw material prices have provided an offset for higher depreciation costs resulting from needed plant expansions. Several new products have been introduced and we hope to increase efficiencies as Conwed continues to grow moderately. Congratulations to John Rosenberger and his team.

Winery

Our wineries, Pine Ridge in Napa Valley, California, and Archery Summit in the Willamette Valley of Oregon, performed according to plan. We continue to reinvest all of their cashflow in the improvements and expansion necessary to get to our target of about 115,000 cases of estate-bottled wine per year. At these levels, we believe there is an effective utilization of fixed assets. Last year we sold 62,000 cases of primarily estate-bottled wine. Estate–bottled wine, for you non-wine "geeks," is defined as wine made by the winery from grapes grown on vineyards farmed by the winery.

We are proud that the Pine Ridge 1996 Carneros Merlot was featured on the March 1999 cover of *Wine Enthusiast*, along with several other world-class wines, including Petrus. Call 1-800-486-0503 to arrange a visit to either winery or to locate suppliers in your area. Our wines are exceptional and you will bring glory to your name by encouraging your local restaurant and liquor store to carry both brands!

Gary and Nancy Andrus and their extraordinary staff continue to make, sell and improve the wine. The cellars are almost bare.

Argentina

Until March 18, 1999, the Company owned a 30% interest in Caja de Ahorro y Seguro, S.A. (La Caja), a Buenos Aires based holding company for life insurance, property and casualty insurance, workers' compensation insurance and a small bank. We acquired this interest for $46 million in 1994 along with our Argentine partner, the Werthein family, who also purchased a similar interest.

We have sold our interest to the Italian insurance company, Assicurazioni Generali Group, for $166 million, which includes cash and a $40 million secured note from our Argentine partner, due April 2001. In 1999, we will report a pre-tax gain of $120 million on this sale. Our experiences in Argentina were altogether pleasant, except for the commute, which leaves something to be desired. Tom Mara, our executive vice president and 20-year colleague, has been to Argentina more times than either he or his family cares to remember. He did an outstanding job supervising this investment.

Real Estate

At December 31, 1998, the carrying value of the Company's real estate investments totaled $397 million versus $93 million at year-end 1997. We have previously reported that we are sellers of real estate. As fast as we sell, other good opportunities have appeared. What follows is a description of the largest of these investments.

Of the $397 million, $246 million is represented by our new consolidated 95.4% French subsidiary, Compagnie Fonciere FIDEI (Fidei). The assets of Fidei consist of 150 buildings, and condominium interests in buildings, located primarily in Paris, France, and its environs, which aggregate more than 3,500,000 square feet. We paid $62.3 million for this equity stake and we have put all of Fidei's real estate holdings up for sale in an orderly manner. So far, most sale prices have been at or greater than were projected. So far so good!

In 1994, we purchased out of bankruptcy two 41-story condominium towers across from the convention center in San Diego, California. All but two of the 201 residential units have been sold or are under contract, and a portion of the commercial space is rented to the splendid restaurant Morton's of Chicago, at which we are two regular patrons. We paid too much for this property, but thanks to the efforts of Paul Borden and many others, the investment has a high single-digit return. All of our bad deals should be so good!

We have distributed to our shareholders of record as of August 25, 1998, a pro rata dividend of beneficial interests in a trust that holds 41.2% of the common stock of HomeFed Corporation and contracts which will increase that ownership to 89.6%. This dividend resulted in 1998 income of $.1426 for each common share of Leucadia held by you on August 25, 1998, even though there has been no physical distribution of shares. The effective date of a Securities and Exchange Commission registration statement with respect to HomeFed shares is expected to occur later this year. Once that occurs, Leucadia shareholders as of the record date of August 25, 1998 will receive 1.0 share of HomeFed common stock for each 1.26 common shares of Leucadia. By the time you read this, shareholders of record as of August 25, 1998 should have received a Form 1099-DIV for the amount of this dividend. However, as of this writing, it has come to our attention that several financial institutions have not yet sent out these forms. You may want to contact your broker.

HomeFed is a real estate development company based in San Diego County, California. Its main project is San Elijo Hills, a fully entitled 3,400 single-family home development located in San Marcos, California. Grading and infrastructure construction are underway, and hopefully the first 750 homesites will be sold to builders during 1999.

In October of 1998, HomeFed purchased 4,800 acres in the Otay Ranch south and east of San Diego, in Chula Vista, California, for $19.5 million. Now begins the long, arduous, difficult and frustrating process of getting the land zoned and permitted. In the future, you will hear about HomeFed from the HomeFed management.

Last year, in another bankruptcy transaction, Leucadia purchased 630,000 square feet of empty office space in Washington, D.C., for $23 million. Renovations are all but complete and the City of Washington, D.C. has leased this space and is currently moving in. The opportunity and land exists to build another 250,000 square foot building on this site. Several offers to purchase the property for a handsome return are being considered. Our vice president, Mark Hornstein, and our old friend and partner in this venture, Chip Akridge, have done a great job.

Renaissance Plaza, which was completed in 1998, is located in downtown Brooklyn, New York. It is a mixed-use project consisting of 809,000 square feet of office space, a very successful 384 room Marriott Hotel, and 1,100 indoor parking spaces. We own 57.5% of the office building and garage and 16% of the hotel. Empire Insurance has moved into its beautiful new quarters along with the other tenant, the City of New York. Leucadia is obligated to invest up to $25 million in the project and to date has invested $5 million.

Our community development project in Rosemary Beach, Florida, continues to do well. Sales to date have returned substantially all of our investment and sales in the future will, after costs and expenses, contribute profits. The Home and Garden cable channel recently purchased one of the lots on which they built a house to give away in its March lottery. Kudos to Patrick Bienvenue and his crew.

With our partner and old friend, Denis Sullivan, we have developed and are beginning to sell a 372-lot subdivision surrounding a golf course near San Luis Obispo, California. For the time being, we are keeping and operating the golf course. Again, this project is expected to have a very satisfactory return. This will be the second successful partnership we have done with Denis. We hope there will be more, if we can pry him away from the golf course.

Russia

We first went to Russia in 1994. We purchased $25 million in common shares of a wide-range of companies by participating in the voucher auctions. We still hold most of these shares. We have sold some, bought others, and our current book value of this portfolio is $8.5 million. During 1998, the Company recorded a $75 million pre-tax write down of its Russian and Polish debt and equity securities. Ouch!

We just recently completed our sale of Pepsi International Bottlers back to PepsiCo. In 1999, we will report a $29.5 million pre-tax gain on the sale. On a cash basis, however, we lost $40 million in our attempt to become the Pepsi bottler for two-thirds of Russia. When at bat, sometimes you strike out!

Larry Hershfield has moved back to the United States and will continue to monitor Russia from home. Our remaining $8.5 million portfolio of securities is mainly concentrated in larger Russian companies such as the telephone company, the national electrical utility, and several oil and gas companies. Our theory is that if Russia succeeds, this is a bet with a very large upside. As we write this, there are no immediate signs that cause us to be optimistic. It is, however, a large country with abundant resources and an educated workforce.

Money and Other Things

In a remarkable windfall, the Company was able to repurchase for $42.2 million, $51.8 million liquidation amount of 8.65% trust issued preferred securities of Leucadia Capital Trust I (TRUPS) as a result of the demise of an unfortunately over-leveraged hedge fund. The difference between the book value and the amount paid was added directly to shareholders' equity.

Under its $100 million bank credit facility, the Company borrowed $62.3 million to finance the acquisition of Fidei. The Company entered into a currency swap to hedge most of this currency exposure.

During 1998, the Company bought 1,996,400 of its common shares for $58.1 million, and in 1999 bought an additional 1,738,570 shares for $52.1 million as of March 17, 1999. These share purchases were funded from cash on the balance sheet.

In December of 1998, the Company entered into an agreement to sell its remaining life insurance subsidiaries to Allstate for statutory capital, plus $3.6 million. The expected pre-tax gain from this transaction is approximately $20 million, which is expected to close in 1999, after receiving regulatory approval.

In February of 1999, the Company sold the S & H Green Stamps Company back to its founder's family, the Beineckes, who have their own plans for its rebirth. The Company will recognize a $19 million pre-tax gain on the sale.

We believe the year 2000 problem is under control.

The Future

Last year in these ruminations we described to you some of the frustrations we felt in trying to keep the large amount of shareholders' money to work at above average rates of return in these crazed economic times. We have concluded that for us this is impossible.

Our mail room manager, on the other hand, is a day trader in high tech stocks and has done very well—he thinks we are crazy for working so hard. E-Bay and amazon.com are not our forte (see below). In the process of deciding what to do, not surprisingly, we rediscovered our history. As we have told you many times, what we do is:

> We tend to be buyers of companies that are troubled or out of favor and as a result are selling substantially below the values which we believe are there. From time to time, we sell parts of these operations when prices available in the market reach what we believe to be advantageous levels. While we are not perfect in executing this strategy, we are proud of our long-term track record. We are not income statement driven and do not run your company with an undue emphasis on either quarterly or annual earnings. We believe we are conservative in our accounting practices and policies and that our balance sheet is conservatively stated.[1]

We have stuck with this strategy single-mindedly, and we hope you would agree, successfully. Most importantly, we have enjoyed it, prospered doing it, and don't want to quit. We have, however, too much money to effectively invest for you and for us!

Therefore, as we write this letter, we expect to return to the shareholders a dividend of $812 million, or $13.48 per share, and, for the foreseeable future, we will continue to manage Leucadia. The Company has received a ruling from the I.R.S. providing that any gain realized on such a dividend will be treated as a capital gain. After the dividend and certain 1999 first quarter asset sales, the Company will have a $1.13 billion net worth and $900 million in cash, marketable securities and collateralized notes. Under some of our bond covenants, this distribution will require the Company to tender at 101% for its 8¼% and 7⅞% Senior Subordinated Debt with an aggregate principal amount of $235 million. This may leave the Company with less cash, depending on the number of bonds tendered. With all of the activity that has occurred so far in 1999, which we have reported herein, this year has the potential to be a good one. Whether it will continue, we knoweth not! If opportunities do not present themselves, we intend to consider other alternatives to benefit shareholders.

[1] Originally reported in the 1988, and repeated in 1990, 1991, 1995 and 1996 annual reports.

As we head off for our second 20 years together, one of us is excited and energized by the opportunities at hand, the other is hunkered down for fear a tsunami resulting from the next Kondratief Long Cycle[2] will wash us all into poverty. Hopefully, somewhere in between lies the truth. We have enjoyed this journey and each other and plan to continue until one of us doesn't enjoy one or the other!

This year, Andrea Bernstein deserves special thanks. She has labored long and hard as an associate at Weil, Gotshal & Millionaire working on our legal affairs. She is a newly minted partner and it is richly deserved. Almost twenty years ago on April 29, 1979, we purchased our interest in Leucadia (then Talcott National Corporation), with Andrea's mentor, Steve Jacobs, at our side then, as he is now. They are an extraordinary team!

For the first time, in the last year we hired a number of new people who didn't come with acquired businesses. We welcome them and commend to them our long-serving colleagues for advice and comfort. Many at Leucadia work long hours and sacrifice much. To our senior colleagues, we thank you. Without you and our advisors, none of this is possible.

Ian M. Cumming
Chairman

Joseph S. Steinberg
President

[2] Russian economist Nikolai Kondratief pioneered the concept of long wave cycles in 1926.