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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

JOINT QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 1997

BROOKE GROUP LTD.
(Exact name of registrant as specified in its charter)

DELAWARE	1-5759	51-0255124
(State or other jurisdiction of incorporation or organization)	Commission File Number	(I.R.S. Employer Identification No.)

BGLS INC.
(Exact name of registrant as specified in its charter)

DELAWARE	33-93576	13-3593483
(State or other jurisdiction of incorporation or organization)	Commission File Number	(I.R.S. Employer Identification No.)

100 S.E. SECOND STREET
MIAMI, FLORIDA 33131
305/579-8000
(Address, including zip code and telephone number, including area code, of the principal executive offices)

Indicate by check mark whether the Registrants (1) have filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), during the preceding 12 months (or for such shorter period that the Registrants were required to file such reports), and (2) have been subject to such filing requirements for the past 90 days. [X] Yes [ ] No

Explanatory Note: BGLS Inc. is required to file all reports required by Section 13 or 15(d) of the Exchange Act in connection with its 15.75% Series B Senior Secured Notes due 2001.

At August 11, 1997, Brooke Group Ltd. had 18,097,096 shares of common stock outstanding, and BGLS Inc. had 100 shares of common stock outstanding, all of which are held by Brooke Group Ltd.

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BROOKE GROUP LTD.
BGLS INC.

FORM 10-Q

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Item 1. CONSOLIDATED FINANCIAL STATEMENTS

BROOKE GROUP LTD. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	June 30, 1997	December 31, 1996
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 19,549	$ 1,941
Accounts receivable - trade	12,106	19,475
Other receivables	731	1,217
Receivables from affiliates	11,965	47
Inventories	47,447	53,691
Other current assets	3,749	4,181
Total current assets	95,547	80,552
Property, plant and equipment, at cost, less accumulated depreciation of $32,204 and $31,047	31,605	80,282
Intangible assets, at cost, less accumulated amortization of $18,375 and $17,457	3,524	4,421
Investment in affiliate		3,051
Other assets	4,641	9,371
Total assets	$ 135,317	$ 177,677
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT):		
Current liabilities:		
Notes payable and current portion of long-term debt	$ 70,695	$ 55,242
Accounts payable	16,224	32,461
Due to affiliates		990
Dividends payable		1,387
Cash overdraft		6
Accrued promotional expenses	30,390	30,257
Accrued taxes payable	21,350	26,379
Accrued interest	23,383	24,354
Other accrued liabilities	24,350	33,387
Total current liabilities	186,392	204,463
Notes payable, long-term debt and other obligations, less current portion	342,253	378,243
Noncurrent employee benefits	29,662	31,256
Other liabilities	30,329	18,704
Commitments and contingencies		
Stockholders' equity (deficit):		
Preferred Stock, par value $1.00 per share, authorized 10,000,000 shares		
Series G Preferred Stock, 2,184,834 shares, convertible, participating, cumulative, each share convertible to 1,000 shares of common stock and cash or stock distribution, liquidation preference of $1.00 per share		
Common stock, par value $0.10 per share, authorized 40,000,000 shares, issued 24,998,043 shares, outstanding 18,097,096 and 18,497,096 shares	1,850	1,850
Additional paid-in capital	91,454	94,169
Deficit	(496,642)	(490,706)
Other	(15,842)	(27,963)
Less: 6,900,947 and 6,500,947 shares of common stock in treasury, at cost	(34,139)	(32,339)
Total stockholders' equity (deficit)	(453,319)	(454,989)
Total liabilities and stockholders' equity (deficit)	$ 135,317	$ 177,677

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

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

BGLS INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	June 30, 1997	December 31, 1996
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 19,273	$ 1,940
Accounts receivable - trade	12,106	19,475
Other receivables	700	1,166
Receivables from affiliates	11,965	47
Inventories	47,447	53,691
Other current assets	3,293	3,878
Total current assets	94,784	80,197
Property, plant and equipment, at cost, less accumulated depreciation of $31,848 and $30,762	31,366	79,972
Intangible assets, at cost, less accumulated amortization of $18,375 and $17,457	3,524	4,421
Investment in affiliate		3,051
Other assets	7,884	10,467
Total assets	$ 137,558	$ 178,108
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT):		
Current liabilities:		
Notes payable and current portion of long-term debt	$ 70,220	$ 53,945
Accounts payable	16,099	32,336
Cash overdraft		6
Due to parent	22,217	29,598
Accrued promotional expenses	30,390	30,257
Accrued taxes payable	21,350	26,379
Accrued interest	23,383	24,354
Other accrued liabilities	24,187	32,861
Total current liabilities	207,846	229,736
Notes payable, long-term debt and other obligations, less current portion	342,253	378,243
Noncurrent employee benefits	29,662	31,256
Other liabilities	36,529	21,958
Commitments and contingencies		
Stockholder's equity (deficit):		
Common stock, par value $0.01 per share; 100 shares authorized, issued and outstanding		
Additional paid-in capital	39,081	39,081
Deficit	(506,211)	(499,264)
Other	(11,602)	(22,902)
Total stockholder's deficit	(478,732)	(483,085)
Total liabilities and stockholder's equity (deficit)	$ 137,558	$ 178,108

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

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

BROOKE GROUP LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	Three Months Ended		Six Months Ended	
	June 30, 1997	June 30, 1996	June 30, 1997	June 30, 1996
Revenues*	$ 96,593	$ 125,213	$ 176,598	$ 215,729
Cost of goods sold*	50,951	63,522	92,796	110,570
Gross profit	45,642	61,691	83,802	105,159
Operating, selling, administrative and general expenses	39,715	58,264	77,037	103,156
Operating income	5,927	3,427	6,765	2,003
Other income (expenses):				
Interest income	692	110	1,251	128
Interest expense	(15,499)	(15,457)	(30,966)	(30,234)
Equity in loss of affiliate	(5,841)	(1,306)	(14,398)	(2,883)
Sale of assets	1,065		23,086	
Retirement of debt			2,963	
Proceeds from legal settlement			4,125	
Other, net	61	2,219	180	2,334
Loss from continuing operations before income taxes	(13,595)	(11,007)	(6,994)	(28,652)
Provision (benefit) for income taxes	45	(289)	789	146
Loss from continuing operations	(13,640)	(10,718)	(7,783)	(28,798)
Discontinued operations:				
(Loss) income from discontinued operations	(321)	46	42	349
Gain on disposal	5		5	
(Loss) income from discontinued operations	(316)	46	47	349
Net loss	(13,956)	(10,672)	(7,736)	(28,449)
Proportionate share of New Valley capital transaction, retirement of Class A Preferred Shares				1,782
Net loss applicable to common shares	$ (13,956)	$ (10,672)	$ (7,736)	$ (26,667)
Per common share:				
Loss from continuing operations	$ (0.75)	$ (0.58)	$ (0.42)	$ (1.46)
(Loss) income from discontinued operations	$ (0.02)	$	$	0.02
Net loss applicable to common shares	$ (0.77)	$ (0.58)	$ (0.42)	$ (1.44)
Weighted average common shares outstanding	18,097,096	18,497,096	18,240,743	18,497,096

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* Revenues and Cost of goods sold include federal excise taxes of $19,153, $29,487, $36,013 and $50,684, respectively.

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

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

BGLS INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	Three Months Ended		Six Months Ended	
	June 30, 1997	June 30, 1996	June 30, 1997	June 30, 1996
Revenues*	$ 96,593	$ 125,213	$ 176,598	$ 215,729
Cost of goods sold*	50,951	63,522	92,796	110,570
Gross profit	45,642	61,691	83,802	105,159
Operating, selling, administrative and general expenses	39,581	58,073	76,657	102,660
Operating income	6,061	3,618	7,145	2,499
Other income (expenses):				
Interest income	680	60	1,239	78
Interest expense	(16,411)	(16,395)	(32,792)	(32,063)
Equity in loss of affiliate	(5,841)	(1,306)	(14,398)	(2,883)
Sale of assets	1,279		27,663	
Retirement of debt			2,963	
Other, net	61	1,703	173	1,668
Loss from continuing operations before income taxes	(14,171)	(12,320)	(8,007)	(30,701)
Provision (benefit) for income taxes	45	(253)	787	198
Loss from continuing operations	(14,216)	(12,067)	(8,794)	(30,899)
Discontinued operations:				
(Loss) income from discontinued operations	(321)	46	42	349
Gain on disposal	5		5	
(Loss) income from discontinued operations	(316)	46	47	349
Net loss	$ (14,532)	$ (12,021)	$ (8,747)	$ (30,550)

* Revenues and Cost of goods sold include federal excise taxes of $19,153, $29,487, $36,013 and $50,684, respectively.

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

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

BROOKE GROUP LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	Common Stock		Additional Paid-In			Treasury	
	Shares	Amount	Capital	Deficit	Other	Stock	Total
Balance, December 31, 1996	18,497,096	$ 1,850	$ 94,169	$(490,706)	$(27,963)	$(32,339)	$(454,989)
Net loss				(7,736)			(7,736)
Distributions on common stock ($0.15 per share)			(2,715)				(2,715)
Amortization of deferred compensation					821		821
Unrealized holding gain on investment in New Valley					11,965		11,965
Effect of New Valley capital transactions					(665)		(665)
Settlement of loan	(400,000)			1,800		(1,800)	
Balance, June 30, 1997	18,097,096	$ 1,850	$ 91,454	$(496,642)	$(15,842)	$(34,139)	$(453,319)

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

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

BGLS INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY (DEFICIT)
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	Common Stock		Additional Paid-In			
	Shares	Amount	Capital	Deficit	Other	Total
Balance, December 31, 1996	100	$	$39,081	$(499,264)	$(22,902)	$(483,085)
Net loss				(8,747)		(8,747)
Unrealized holding gain on investment in New Valley					11,965	11,965
Effect of New Valley capital transactions					(665)	(665)
Settlement of loan				1,800		1,800
Balance, June 30, 1997	100	$	$39,081	$(506,211)	$(11,602)	$(478,732)

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

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

BROOKE GROUP LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	Six Months Ended	
	June 30, 1997	June 30, 1996
Net cash used in operating activities	$ (20,003)	$ (735)
Cash flows from investing activities:		
Proceeds from sale of businesses and assets, net	43,245	4,415
Capital expenditures	(3,653)	(14,680)
Dividends from New Valley		6,183
Other, net		(491)
Net cash provided by (used in) investing activities	39,592	(4,573)
Cash flows from financing activities:		
Proceeds from debt	4,225	15,161
Repayments of debt	(6,852)	(7,769)
Borrowings under revolver	137,062	172,043
Repayments on revolver	(132,308)	(166,050)
Decrease in cash overdraft	(6)	(4,266)
Distributions on common stock	(4,102)	(2,775)
Net cash (used in) provided by financing activities	(1,981)	6,344
Net increase in cash and cash equivalents	17,608	1,036
Cash and cash equivalents, beginning of period	1,941	3,370
Cash and cash equivalents, end of period	$ 19,549	$ 4,406
Supplemental non-cash financing activities:		
Exchange of Series 2 Senior Secured Notes for Series A Notes		$ 99,154
Exchange of 14.50% Subordinated Debentures for Series B Notes		125,495
Issuance of Series A Notes for options		822
Exchange of Series A Notes for Series B Notes		99,976
Issuance of promissory notes for shares of Liggett-Ducat		1,643
Promissory note from New Valley	$ 33,500	

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

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

BGLS INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	Six Months Ended	
	June 30, 1997	June 30, 1996
Net cash used in operating activities	$ (25,202)	$ (73)
Cash flows from investing activities:		
Proceeds from sale of businesses and assets, net	43,245	4,415
Capital expenditures	(3,653)	(14,680)
Dividends from New Valley		6,183
Other, net		(491)
Net cash provided by (used in) investing activities	39,592	(4,573)
Cash flows from financing activities:		
Proceeds from debt	3,750	14,519
Repayments of debt	(5,555)	(7,514)
Borrowings under revolver	137,062	172,043
Repayments on revolver	(132,308)	(166,050)
Decrease in cash overdraft	(6)	(3,761)
Distributions paid to parent		(3,621)
Net cash provided by financing activities	2,943	5,616
Net increase in cash and cash equivalents	17,333	970
Cash and cash equivalents, beginning of period	1,940	3,370
Cash and cash equivalents, end of period	$ 19,273	$ 4,340
Supplemental non-cash financing activities:		
Exchange of Series 2 Senior Secured Notes for Series A Notes		$ 99,154
Exchange of 14.50% Subordinated Debentures for Series B Notes		125,495
Issuance of Series A Notes for options		822
Exchange of Series A Notes for Series B Notes		99,976
Forgiveness of debt by parent		13,705
Issuance of promissory notes for shares of Liggett-Ducat		1,643
Promissory note from New Valley	$ 33,500	

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

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

BROOKE GROUP LTD.
BGLS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

1. PRINCIPLES OF REPORTING

The consolidated financial statements of Brooke Group Ltd. (the "Company") include the consolidated statements of its wholly owned subsidiary, BGLS Inc. ("BGLS"). The consolidated statements of BGLS include the accounts of Liggett Group Inc. ("Liggett"), Brooke (Overseas) Ltd. ("BOL"), New Valley Holdings, Inc. ("NV Holdings"), Liggett-Ducat Ltd. ("Liggett-Ducat") and other less significant subsidiaries. Liggett is engaged primarily in the manufacture and sale of cigarettes, principally in the United States. Liggett-Ducat is engaged in the manufacture and sale of cigarettes in Russia. All significant intercompany balances and transactions have been eliminated.

The interim consolidated financial statements of the Company and BGLS are unaudited and, in the opinion of management, reflect all adjustments necessary (which are normal and recurring) to present fairly the Company's and BGLS' consolidated financial position, results of operations and cash flows. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's and BGLS' Annual Report on Form 10-K, as amended, for the year ended December 31, 1996, as filed with the Securities and Exchange Commission. The consolidated results of operations for interim periods should not be regarded as necessarily indicative of the results that may be expected for the entire year.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses. Actual results could differ from those estimates.

Certain amounts in the 1996 consolidated financial statements have been reclassified to conform to the 1997 presentation.

LIQUIDITY:

The Company's principal sources of liquidity for 1997 include, among other things, proceeds from the sale of BrookeMil Ltd. ("BML"), a subsidiary of BOL, to an affiliate, New Valley Corporation ("New Valley"), on January 31, 1997, and certain funds available from New Valley subject to limitations imposed by BGLS' indenture agreements. New Valley may acquire or seek to acquire additional operating businesses through merger, purchase of assets, stock acquisition or other means, or to make other investments, which may limit its ability to make such distributions.

Liggett had net capital and working capital deficiencies of $178,660 and $78,481, respectively, at June 30, 1997, is highly leveraged and has substantial near-term debt service requirements. Further, Liggett's Senior Secured Notes (the "Liggett Notes") require a mandatory principal redemption of $37,500 on February 1, 1998 and a payment at maturity on February 1, 1999 of $107,400, and Liggett's revolving credit facility (the "Facility") expires on March 8, 1998 unless extended by its lenders. Based on Liggett's net loss for 1996 and anticipated 1997 operating results, Liggett does not anticipate it will be able to generate sufficient cash from operations to make such payments. While Liggett is currently in negotiations with its note holders to restructure the terms of the Liggett Notes and, with its lenders, to extend the Facility, there are no commitments to restructure the Liggett Notes or to extend the Facility at this time, and no assurances can be given in this regard. In conjunction with these discussions, the Company is also engaged in negotiations with the principal holders of the BGLS 15.75% Series B Senior Secured Notes (the "BGLS Notes") with respect to certain related modifications to the terms of such debt.

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Pending completion of the negotiations, BGLS and Liggett have postponed making the interest payments of approximately $18,338 for the BGLS Notes due on July 31, 1997 and approximately $9,700 for the Liggett Notes due on August 1, 1997. The indentures governing the BGLS Notes and the Liggett Notes provide for a 30-day grace period before the failure to pay interest will be an event of default.

The failure to pay interest on the Liggett Notes would permit Liggett's lenders under the Facility to cease making further advances. While the lenders have continued to make such advances, and Liggett's management currently anticipates that they will continue to do so, no assurances can be given in this regard. If Liggett is unable to restructure the terms of the Liggett Notes, extend the Facility, or otherwise make all payments thereon within the applicable grace periods, substantially all of Liggett's long-term debt and the Facility would be in default and holders of such debt could accelerate the maturity of such debt. In such event, Liggett may be forced to seek protection from creditors under applicable laws. These matters raise substantial doubt about Liggett meeting its liquidity needs and its ability to continue as a going concern.

BOL is in the process of constructing a new tobacco factory and is actively pursuing various potential financial alternatives related thereto. (Refer to Note 5.)

NEW ACCOUNTING PRONOUNCEMENTS

In June 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income". SFAS 130 establishes standards for reporting and display of comprehensive income. The purpose of reporting comprehensive income is to present a measure of all changes in equity that result from recognized transactions and other economic events of the period other than transactions with owners in their capacity as owners. SFAS 130 requires that an enterprise classify items of other comprehensive income by their nature in a financial statement and display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of the balance sheet. SFAS 130 is effective for fiscal years beginning after December 15, 1997, with earlier application permitted. The Company has not yet determined the impact of the implementation of SFAS 130.

In June 1997, the FASB issued SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information". SFAS 131 specifies revised guidelines for determining an entity's operating segments and the type and level of financial information to be disclosed. Once operating segments have been determined, SFAS 131 provides for a two-tier test for determining those operating segments that would need to be disclosed for external reporting purposes. In addition to providing the required disclosures for reportable segments, SFAS 131 also requires disclosure of certain "second level" information by geographic area and for products/services. SFAS 131 also makes a number of changes to existing disclosure requirements. SFAS 131 is effective for fiscal years beginning after December 15, 1997, with earlier application encouraged. The Company has not yet determined the impact of the implementation of SFAS 131.

BROOKE GROUP LTD.
BGLS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
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2. INVESTMENT IN NEW VALLEY CORPORATION

The Company's and BGLS' investment in New Valley at June 30, 1997 is summarized below:

	NUMBER OF SHARES	FAIR VALUE	CARRYING AMOUNT	UNREALIZED HOLDING LOSS
Class A Preferred Shares	618,326	$ 57,504	$ 57,504	$(12,412)
Class B Preferred Shares	250,885	1,254	1,254	(600)
Common Shares	3,989,710(A)	3,990	(58,758)	
		$ 62,748	$	$(13,012)

(A) Gives effect to July 1996 one-for-twenty stock split.

The $15.00 Class A Increasing Rate Cumulative Senior Preferred Shares ($100 Liquidation Value), $.01 par value (the "Class A Preferred Shares"), and the $3.00 Class B Cumulative Convertible Preferred Shares ($25 Liquidation Value), $.10 par value (the "Class B Preferred Shares"), are accounted for as debt and equity securities, respectively, pursuant to the requirements of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities", and are classified as available-for-sale. Through September 1996, earnings on the Class A Preferred Shares were comprised of dividends accrued during the period and the accretion of the difference between the Company's basis and their mandatory redemption price. New Valley's Common Shares, $.01 par value (the "Common Shares"), were accounted for pursuant to APB No. 18, "The Equity Method of Accounting for Investments in Common Stock".

During the quarter ended September 30, 1996, the decline in the market value of the Class A Preferred Shares, the dividend received on the Class A Preferred Shares and the Company's equity in losses incurred by New Valley caused the carrying value of the Company's investment in New Valley to be reduced to zero. Beginning in the fourth quarter of 1996, the Company suspended the recording of its earnings on the dividends accrued and the accretion of the difference between the Company's basis in the Class A Preferred Shares and their mandatory redemption price.

At June 30, 1997, the Company's investment in New Valley consisted of an approximate 42% voting interest. The Company's investment is represented by 618,326 Class A Preferred Shares (57.7%), 3,989,710 Common Shares (41.7%) (giving effect to a one-for-twenty reverse stock split by New Valley in July 1996) and 250,885 Class B Preferred Shares (9.0%).

During the first quarter of 1996, New Valley repurchased 72,104 Class A Preferred Shares for a total amount of $10,530. The Company has recorded its proportionate interest in the excess of the carrying value of the shares over the cost of the shares repurchased as a credit to additional paid-in capital in the amount of $1,782, along with other New Valley capital transactions of $1,563, for the six months ended June 30, 1996. No such repurchases have been made during the six months ended June 30, 1997. Other New Valley capital transactions charged to equity were $665 for the six months ended June 30, 1997.

The Class A Preferred Shares of New Valley are required to be redeemed on January 1, 2003 for $100.00 per share plus dividends accrued to the redemption date. The shares are redeemable, at

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BGLS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

any time prior to that date, at the option of New Valley, at $100.00 per share plus accrued dividends. The holders of Class A Preferred Shares are entitled to receive a quarterly dividend, as declared by the Board of Directors, payable at the rate of $19.00 per annum. On March 13, 1996, New Valley declared a cash dividend of $10.00 per share on its Class A Preferred Shares payable on March 27, 1996. NV Holdings received $6,183 in the distribution. At June 30, 1997, the accrued and unpaid dividends arrearage on the Class A Preferred Shares was $139,017 or $129.75 per share.

Holders of the Class B Preferred Shares are entitled to receive a quarterly dividend, as declared by the Board, at a rate of $3.00 per annum. At June 30, 1997, the accrued and unpaid dividends arrearage on Class B Preferred Shares was $127,266 or $45.60 per share. No dividends on the Class B Preferred Shares have been declared since the fourth quarter of 1988.

Summarized financial information for New Valley as of June 30, 1997 and December 31, 1996 and for the three and six months ended June 30, 1997 and 1996 follows:

	June 30, 1997	December 31, 1996
Current assets, primarily cash and marketable securities	$ 114,175	$ 183,720
Non-current assets	311,005	222,820
Current liabilities	127,130	98,110
Non-current liabilities	175,258	170,223
Redeemable preferred stock	233,531	210,571
Shareholders' equity (deficit)	(110,739)	(72,364)

	Three Months Ended		Six Months Ended	
	June 30, 1997	June 30, 1996	June 30, 1997	June 30, 1996
Revenues	$ 24,404	$ 30,449	$ 44,157	$ 62,434
Costs and expenses	29,594	35,138	61,519	73,316
Loss from continuing operations	(4,270)	(4,872)	(15,483)	(10,484)
(Loss) income from discontinued operations	(759)	110	113	838
Net loss applicable to common shares(A)	(21,779)	(20,408)	(48,100)	(36,475)

(A) Considers all preferred accrued dividends, whether or not declared, and the excess of carrying value of redeemable preferred shares over cost of shares purchased.

ACQUISITION OF COMMON SHARES OF BML:

On January 31, 1997, New Valley acquired substantially all the common shares of BML from BOL for $55,000. (Refer to Note 3.)

RJR NABISCO HOLDINGS CORP.:

At June 30, 1997, New Valley held 1,062,650 shares of RJR Nabisco Holdings Corp. ("RJR Nabisco") common stock with a market value of $34,270 (cost of $32,574). The unrealized gain on New Valley's investment in RJR Nabisco common stock was $1,696 at June 30, 1997. Based on the

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market price of RJR Nabisco common stock at August 8, 1997 ($30.625 per share), no amounts are payable by the Company or New Valley under any of its net profit-sharing arrangements with respect to the RJR Nabisco common stock.

3. INVESTMENT IN BROOKE (OVERSEAS) LTD.

On January 31, 1997, BOL sold all its shares of BML to New Valley for $21,500 in cash and a promissory note of $33,500 payable $21,500 on June 30, 1997 and $12,000 on December 31, 1997 with interest at 9%. The consideration received exceeded the carrying value of the Company's investment in BML by $43,700. The Company recognized a gain on the sale in the amount of $21,300. The remaining $22,400 was deferred in recognition of the fact that the Company retains an interest in BML through its 42% equity ownership in New Valley and that a portion of the property sold is subject to a put option held by New Valley. The option allows New Valley, under certain circumstances, to put a portion of the property sold back to the Company at the greater of the appraised fair value of the property at the date of exercise or $13,600. On April 18, 1997, BML sold one of its office buildings, Ducat Place I, to a third party. Accordingly, the Company recognized approximately $1,240 of its deferred gain on the BML sale in the second quarter, 1997.

On April 28, 1997 and June 30, 1997, New Valley paid BOL $3,500 and $18,000, respectively, representing a portion of the promissory note together with accrued interest thereon. As of June 30, 1997, the balance remaining on the note was $12,000 and is due on December 31, 1997.

In connection with the sale of its BML shares to New Valley, certain specified liabilities aggregating $40,800, including the Vneshtorgbank loan with a balance of $13,927 at June 30, 1997, remained with BML, and New Valley indemnified the Company and its subsidiaries with respect to any obligation arising from such liabilities.

4. INVENTORIES

Inventories consist of:

	June 30, 1997	December 31, 1996
Finished goods	$ 13,874	$ 15,304
Work-in-process	4,445	4,435
Raw materials	30,377	34,002
Replacement parts and supplies	5,208	4,406
Inventories at current cost	53,904	58,147
LIFO adjustments	(6,457)	(4,456)
	$ 47,447	$ 53,691

At June 30, 1997, Liggett and Liggett-Ducat had leaf tobacco purchase commitments of approximately $13,828 and $3,935, respectively.

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5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of:

	June 30, 1997	December 31, 1996
Land and improvements	$ 455	$ 455
Buildings	6,443	14,205
Machinery and equipment	50,663	49,401
Leasehold improvements	302	302
Construction-in-progress	5,946	46,966
	63,809	111,329
Less accumulated depreciation	32,204	31,047
	$ 31,605	$ 80,282

On May 6, 1997, Liggett-Ducat Tobacco Ltd., a subsidiary of Liggett-Ducat, entered into two contracts for construction of a new tobacco factory on the outskirts of Moscow which provide for payments of $1,700 over a three-month period ending July 1997 and of $18,760 payable over a twelve-month period ending July 1998. In addition, a pre-construction payment of $520 was paid in April 1997.

6. INCOME TAXES

The provision for taxes for the six months ended June 30, 1997 and 1996 does not bear the customary relationship to the pretax loss/income for the Company and BGLS due principally to the effects of taxes provided for foreign operations and an increase in the valuation allowance related to deferred tax assets.

7. NOTES PAYABLE, LONG-TERM DEBT AND OTHER OBLIGATIONS

Notes payable, long-term debt and other obligations consist of:

	June 30, 1997	December 31, 1996
15.75% Series B Senior Secured Notes due 2001, net of unamortized discount of $1,326 and $1,511	$231,538	$231,353
14.500% Subordinated Debentures due 1998	800	800
Notes payable - Foreign	5,755	22,668
Other	1,240	2,425
Liggett:		
11.500% Senior Secured Series B Notes due 1999, net of unamortized discount of $302 and $424	112,310	119,688
Variable Rate Series C Senior Secured Notes due 1999	32,279	32,279
Revolving credit facility	29,026	24,272
Total notes payable and long-term debt	412,948	433,485
Less current maturities	70,695	55,242
Amount due after one year	$342,253	$378,243

REVOLVING CREDIT FACILITY - LIGGETT:

On March 8, 1994, Liggett entered into the Facility for $40,000 with a syndicate of commercial lenders. The Facility is collateralized by all inventories and receivables of Liggett. At June 30, 1997,

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$209 was available under the Facility based on eligible collateral. Borrowings under the Facility, whose interest is calculated at a rate equal to 1.5% above the Philadelphia National Bank's prime rate (8.25%), bore a rate of 9.75% at March 31, 1997. On April 1, 1997, Philadelphia National Bank raised its prime rate to 8.5%, thereby increasing Liggett's interest rate to 10.0%. The Facility requires Liggett's compliance with certain financial and other covenants. The Facility also limits the amount of cash dividends and distributions by Liggett and imposes requirements with respect to Liggett's adjusted net and working capital. In January 1997, the Facility was extended for one year. The Facility is classified as short-term at June 30, 1997, since it is due on March 8, 1998, unless extended by the lender. No assurances can be given that the Facility will be further extended.

During the first quarter of 1997, Liggett violated the working capital covenant contained in the Facility. This violation occurred during February 1997 when $37,500 of the Liggett Notes were reclassified from long-term to current as a result of the February 1, 1998 mandatory redemption requirement of such Notes. On March 19, 1997, the lead lender agreed to waive this covenant default, and the Facility was amended as follows: (i) the working capital definition was changed to exclude the current portion of the Liggett Notes; (ii) the maximum permitted working capital deficit was reduced to $12,000 (as computed in accordance with the agreement); (iii) the maximum permitted adjusted net worth deficit was increased to $180,000 (as computed in accordance with the agreement); and (iv) the permitted advance rates under the Facility for eligible inventory were reduced by five percent.

LIGGETT 11.500% SENIOR SECURED SERIES B NOTES DUE 1999:

On February 14, 1992, Liggett issued $150,000 in Senior Secured Notes (the "Liggett Series B Notes"). Interest on the Liggett Series B Notes is payable semiannually on February 1 and August 1 at an annual rate of 11.5%. The Liggett Notes referred to below require mandatory principal redemptions of $7,500 on February 1 in each of the years 1993 through 1997 and $37,500 on February 1, 1998 with the balance of the Liggett Notes due on February 1, 1999. In February 1997, $7,500 of Liggett Series B Notes were purchased using the Facility and credited against the mandatory redemption requirements. The transaction resulted in a net gain of $2,963. The Liggett Notes are collateralized by substantially all of the assets of Liggett, excluding inventories and receivables. Eve Holdings Inc. is a guarantor for the Liggett Notes. The Liggett Notes may be redeemed, in whole or in part, at a price equal to 102% and 100% of the principal amount in the years 1997 and 1998, respectively, at the option of Liggett. The Liggett Notes contain restrictions on Liggett's ability to declare or pay cash dividends, incur additional debt, grant liens and enter into any new agreements with affiliates, among others.

ISSUANCE OF LIGGETT SERIES C VARIABLE RATE NOTES:

On January 31, 1994, Liggett issued $22,500 of Variable Rate Series C Senior Secured Notes Due 1999 (the "Liggett Series C Notes"). The Liggett Series C Notes bore a 16.5% interest rate, which was reset on February 1, 1995 to 19.75%, the maximum reset rate. The Series C Notes have the same terms (other than interest rate) and stated maturity as the Liggett Series B Notes.

FOREIGN LOANS:

On January 31, 1997, in connection with the sale of BML shares to New Valley, the Russian bank loan in the amount of $20,419 remained with BML (refer to Note 3). The Company is a guarantor on lines of credit opened by BOL during the first quarter 1997 with two Russian banks in total amount of $4,000. These lines of credit are collateralized by accounts receivable, inventory and equipment.

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At June 30, 1997, the balance outstanding was $3,250. Interest on such lines of credit is currently 23%. The lines of credit expire in August and September 1997.

SUBSEQUENT EVENT:

As discussed above, the Liggett Notes require a mandatory principal redemption of $37,500 on February 1, 1998 and a payment at maturity on February 1, 1999 of $107,400, and the Facility expires on March 8, 1998 unless extended by Liggett's lenders. Liggett is currently in negotiations with its note holders to restructure the Liggett Notes and, with its lenders, to extend the Facility. In conjunction with these discussions, the Company is also engaged in negotiations with the principal holders of the BGLS Notes with respect to certain related modifications to the terms of such debt.

Pending completion of the negotiations, BGLS and Liggett have postponed making the interest payments due on July 31, 1997 on the BGLS Notes and on August 1, 1997 on the Liggett Notes, respectively. The indentures governing the BGLS Notes and the Liggett Notes provide for a 30-day grace period before the failure to pay interest will be an event of default. The failure to pay interest on the Liggett Notes would permit the lenders under the Facility to cease making further advances. While the lenders have continued to make such advances, and Liggett's management currently anticipates that they will continue to do so, no assurances can be given in this regard. For information concerning Liggett's substantial near-term debt service requirements and other related matters, refer to Note 1.

8. STOCK COMPENSATION

As of January 1, 1997, the Company granted to employees of the Company non-qualified stock options to purchase 422,000 shares of the Company's common stock at an exercise price of $5.00 per share. The options, which will become exercisable over the ten-year term, vest in six equal annual installments. No compensation expense was recorded in this transaction, since the options had no intrinsic value.

9. RELATED PARTY TRANSACTIONS

Effective July 1, 1990, a former executive transferred all of his equity in the Company to the Chairman and resigned from substantially all of his positions with the Company and its affiliates. In consideration for this transfer, a partnership (the "Partnership") controlled by the Chairman agreed, among other things, to make certain payments to the Company on account of the former executive's outstanding indebtedness of $8,677 (deducted from equity). In connection with this transaction, the Partnership pledged 1,681,715 of the shares it held of the Company's common stock to secure this non-recourse obligation, except as to the pledged shares. In May 1994, the Partnership paid $3,200 in partial satisfaction of the obligation. In consideration thereof, the Company released 1,281,715 of the pledged shares. On March 7, 1997, the Partnership transferred to the Company the remaining 400,000 pledged shares in final satisfaction of the obligation. As a result, the Company credited retained earnings $1,800, the fair market value of the pledged shares which were returned to treasury.

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10. RESTRUCTURING CHARGES

During the first six months of 1997, Liggett reduced its headcount by 114 full-time positions and recorded a $1,831 restructuring charge to operations for severance programs, primarily salary continuation and related benefits for terminated employees. Approximately $285 in restructuring charges will be funded in subsequent years. Liggett expects to continue its cost reduction programs.

11. CONTINGENCIES

TOBACCO-RELATED LITIGATION:

OVERVIEW. Since 1954, Liggett and other United States cigarette manufacturers have been named as defendants in a number of direct and third-party actions predicated on the theory that they should be liable for damages from cancer and other adverse health effects alleged to have been caused by cigarette smoking or by exposure to secondary smoke (environmental tobacco smoke, "ETS") from cigarettes. These cases are reported hereinafter as though having been commenced against Liggett (without regard to whether such cases were actually commenced against the Company or Liggett). There has been a noteworthy increase in the number of cases pending against both Liggett and the other tobacco companies. The cases generally fall into three categories: Individual Actions, Class Actions and Attorneys General Actions, although recently several actions have been commenced on behalf of other interest groups. As new cases are commenced, the costs associated with defending such cases and the risks attendant to the inherent unpredictability of litigation continue to increase. Liggett had been receiving certain financial and other assistance from others in the industry in defraying the costs and other burdens incurred in the defense of smoking and health litigation and related proceedings, but these benefits have ended. Certain joint defense arrangements, and the financial benefits incident thereto, have also ended. The future financial impact on the Company of the termination of this assistance and the effects of the tobacco litigation settlements discussed below is not quantifiable at this time.

INDIVIDUAL ACTIONS. As of June 30, 1997, there were 145 cases pending against Liggett where individual plaintiffs allege injury resulting from cigarette smoking, addiction to cigarette smoking or exposure to ETS and seek compensatory and, in some cases, punitive damages. Of these, 57 are pending in the State of Florida, 43 are pending in the State of New York and 17 are pending in the State of Texas. The balance of individual cases are pending in 14 states.

The plaintiffs' allegations of liability in those cases in which individuals seek recovery for personal injuries allegedly caused by cigarette smoking are based on various theories of recovery, including negligence, gross negligence, special duty, voluntary undertaking, strict liability, fraud, misrepresentation, design defect, failure to warn, breach of express and implied warranties, conspiracy, aiding and abetting, concert of action, unjust enrichment, common law public nuisance, indemnity, market share liability, and violations of deceptive trade practices laws, the Federal Racketeer Influenced and Corrupt Organization Act ("RICO") and antitrust statutes. Plaintiffs also seek punitive damages in many of these cases. Defenses raised by defendants in these cases include lack of proximate cause, assumption of the risk, comparative fault and/or contributory negligence, lack of design defect, statute of limitations, equitable defenses such as "unclean hands" and lack of benefit, failure to state a claim and federal preemption. Several representative cases are described below.

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On June 24, 1992, in an action entitled CIPOLLONE V. LIGGETT GROUP INC., ET AL., the United States Supreme Court issued an opinion concluding that the Federal Cigarette Labeling and Advertising Act did not preempt state common law damage claims but that The Public Health Cigarette Smoking Act of 1969 (the "1969 Act") did preempt certain, but not all, state common law damage claims. The decision bars plaintiffs from asserting claims that, after the effective date of the 1969 Act, the tobacco companies either failed to warn adequately of the claimed health risks of cigarette smoking or sought to neutralize those claimed risks in their advertising or promotion of cigarettes. Bills have been introduced in Congress on occasion to eliminate the federal preemption defense. Enactment of any federal legislation with such an effect could result in a significant increase in claims, liabilities and litigation costs.

On March 27, 1987, an action entitled ROGERS V. LIGGETT GROUP INC. ET AL., Superior Court, Marion County, Indiana, was filed against Liggett and others. The plaintiff sought compensatory and punitive damages for cancer alleged to have been caused by cigarette smoking. Trial commenced on January 31, 1995. The trial ended on February 22, 1995 when the trial court declared a mistrial due to the jury's inability to reach a verdict. The court directed a verdict in favor of the defendants as to the issue of punitive damages during the trial of this action. A second trial commenced on August 5, 1996 and, on August 23, 1996, the jury returned a verdict in favor of the defendants. This verdict is currently on appeal.

On May 12, 1992, an action entitled CORDOVA V. LIGGETT GROUP INC., ET AL., Superior Court of the State of California, City of San Diego, was filed against Liggett and others. In her complaint, plaintiff, purportedly on behalf of the general public, alleges that defendants have been engaged in unlawful, unfair and fraudulent business practices by allegedly misrepresenting and concealing from the public scientific studies pertaining to smoking and health funded by, and misrepresenting the independence of, the Council on Tobacco Research ("CTR") and its predecessor. The complaint seeks equitable relief against the defendants, including the imposition of a corrective advertising campaign, restitution of funds, disgorgement of revenues and profits and the imposition of a constructive trust. On June 5, 1997, Liggett settled this matter.

On September 10, 1993, an action entitled SACKMAN V. LIGGETT GROUP INC., United States District Court, Eastern District of New York, was filed against Liggett alleging as injury lung cancer. On May 25, 1996, the District Court granted Liggett summary judgment on plaintiff's fraud and breach of warranty claims, but, on June 9, 1997 denied Liggett's Motion for Summary Judgment on plaintiffs' conspiracy claim. On June 27, 1997, the magistrate issued an order compelling Liggett to produce certain CTR documents with respect to which Liggett had asserted various privilege claims. The other cigarette manufacturers and the CTR are appealing the order.

In February 1995, an action entitled CARTER, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Superior Court for the State of Florida, Duval County, was filed against Liggett and others. Plaintiff sought compensatory damages, including, but not limited to, reimbursement for medical costs. Both American Tobacco and Liggett were subsequently dismissed from this action. On August 9, 1996, a jury returned a verdict against the remaining defendant, Brown & Williamson Tobacco Corporation ("B&W"), in the amount of $750. The court also awarded plaintiff's attorney's fees in the amount of $1,785. B&W has appealed this verdict.

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CLASS ACTIONS. As of June 30, 1997, there were 29 actions pending, which have either been certified as a class or are seeking class certification, where Liggett, among others, was a named defendant. Two of these cases, FLETCHER, ET AL. V. BROOKE GROUP LTD., ET AL. and WALKER, ET AL. V. LIGGETT GROUP INC., ET AL. have been settled, subject to court approval. These two settlements are more fully discussed below under the "Attorneys General Actions" section.

On October 31, 1991, an action entitled BROIN, ET AL. V. PHILIP MORRIS INCORPORATED, ET AL., Circuit Court of the Eleventh Judicial District in and for Dade County, Florida, was filed against Liggett and others. This case was the first class action commenced against the industry and has been brought by plaintiffs on behalf of all flight attendants that have worked or are presently working for airlines based in the United States and who have never regularly smoked cigarettes but allege that they have been damaged by involuntary exposure to ETS. The trial in this action commenced on June 2, 1997 and is currently in progress.

On March 25, 1994, an action entitled CASTANO, ET AL. V. THE AMERICAN TOBACCO COMPANY INC., ET AL., United States District Court, Eastern District of Louisiana, was filed against Liggett and others. The class action complaint sought relief for a nationwide class of smokers based on their alleged addiction to nicotine. The District Court granted plaintiffs' motion for class certification.

On March 12, 1996, the Company and Liggett entered into an agreement, subject to court approval, to settle the CASTANO class action tobacco litigation. Under the CASTANO settlement agreement, upon final court approval of the settlement, the CASTANO class would be entitled to receive up to five percent of Liggett's pretax income (income before income taxes) each year (up to a maximum of $50,000 per year) for the next 25 years, subject to certain reductions provided for in the agreement, and a $5,000 payment from Liggett if the Company or Liggett fail to consummate a merger or similar transaction with another non-settling tobacco company defendant within three years of the date of the settlement. The Company and Liggett have the right to terminate the CASTANO settlement under certain circumstances. On May 11, 1996, the CASTANO Plaintiffs Legal Committee filed a motion with the United States District Court for the Eastern District of Louisiana seeking preliminary approval of the CASTANO settlement. On May 23, 1996, the Court of Appeals for the Fifth Circuit reversed the February 17, 1995 order of the District Court certifying the CASTANO suit as a nationwide class action and instructed the District Court to dismiss the class complaint. On September 6, 1996, the CASTANO plaintiffs withdrew the motion for approval of the CASTANO settlement.

On March 14, 1996, the Company, the CASTANO Plaintiffs Legal Committee and the CASTANO plaintiffs entered into a letter agreement. According to the terms of the letter agreement, for the period ending nine months from the date of Final Approval (as defined in the letter), if granted, of the CASTANO settlement or, if earlier, the completion by the Company or Liggett of a combination with any defendant in CASTANO, except Philip Morris, the CASTANO plaintiffs and their counsel agree not to enter into any more favorable settlement agreement with any CASTANO defendant which would reduce the terms of the CASTANO settlement agreement. If the CASTANO plaintiffs or their counsel enter into any such settlement during this period, they shall pay the Company $250,000 within 30 days of the more favorable agreement and offer the Company and Liggett the option to enter into a settlement on terms at least as favorable as those included in such other settlement. The letter agreement further provides that during the same time period, and if the CASTANO settlement agreement has not been earlier terminated by the Company in accordance with its terms, the Company and its affiliates will not enter into any business transaction with any third party which would cause the termination of the

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CASTANO settlement agreement. If the Company or its affiliates enter into any such transaction, then the CASTANO plaintiffs will be entitled to receive $250,000 within 30 days from the transacting party.

ATTORNEYS GENERAL ACTIONS. As of June 30, 1997, 32 Attorneys General actions were filed and served on Liggett and the Company. As more fully discussed below, Liggett has reached settlements in 25 of these actions. In certain of the pending proceedings, state and local government entities and others seek reimbursement for Medicaid and other health care expenditures allegedly caused by tobacco products. The claims asserted in these Medicaid recovery actions vary. All plaintiffs assert the equitable claim that the tobacco industry was "unjustly enriched" by plaintiffs' payment of health care costs allegedly attributable to smoking and seek reimbursement of those costs. Other claims made by some but not all plaintiffs include the equitable claim of indemnity, common law claims of negligence, strict liability, breach of express and implied warranty, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under state and federal statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under RICO.

On May 23, 1994, an action entitled MOORE, ATTORNEY GENERAL, EX REL STATE OF MISSISSIPPI V. THE AMERICAN TOBACCO COMPANY, ET AL., Chancery Court of Jackson County, Mississippi, was commenced against Liggett and others seeking restitution and indemnity for medical payments and expenses allegedly made or incurred for tobacco related illnesses. In May 1994, the State of Florida enacted legislation, effective July 1, 1994, allowing certain state authorities or entities to commence litigation seeking recovery of certain Medicaid payments made on behalf of Medicaid recipients as a result of diseases (including, but not limited to, diseases allegedly caused by cigarette smoking) allegedly caused by liable third parties (including, but not limited to, the tobacco industry). On February 21, 1995, the State of Florida commenced an action pursuant to this statutory scheme. The Florida Medicaid trial has recently commenced. See "Settlements", below. Legislation similar to that enacted in Florida has been introduced in the Massachusetts and New Jersey legislatures.

SETTLEMENTS. On March 15, 1996, in addition to the CASTANO settlement discussed above, the Company and Liggett entered into a settlement of tobacco-related litigation with the Attorneys General of Florida, Louisiana, Mississippi, West Virginia and Massachusetts. The settlement with the Attorneys General releases the Company and Liggett from all tobacco-related claims by these states including claims for Medicaid reimbursement and concerning sales of cigarettes to minors. The settlement provides that additional states which commence similar Attorney General actions may agree to be bound by the settlement prior to six months from the date thereof (subject to extension of such period by the settling defendants). Certain of the terms of the settlement are summarized below.

Under the Attorneys General settlement, the five states would share an initial payment by Liggett of $5,000 ($1,000 of which was paid on March 22, 1996, with the balance payable over nine years and indexed and adjusted for inflation), provided that any unpaid amount will be due 60 days after either a default by Liggett in its payment obligations under the settlement or a merger or other similar transaction by the Company or Liggett with another defendant in the lawsuits. In addition, Liggett will be required to pay the states a percentage of Liggett's pretax income (income before income taxes) each year from the second through the twenty-fifth year. This annual percentage is 2-1/2% of Liggett's pretax income, subject to increase to 7-1/2% depending on the number of additional states joining the settlement. No additional states

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have joined this settlement to date. All of Liggett's payments are subject to certain reductions provided for in the agreement. Liggett has also agreed to pay to the states $5,000 if the Company or Liggett fails to consummate a merger or other similar transaction with another defendant in the lawsuits within three years of the date of the settlement.

Settlement funds received by the Attorneys General will be used to reimburse the states' smoking-related healthcare costs. The Company and Liggett also have agreed to phase in compliance with certain of the proposed interim FDA regulations on the same basis as provided in the CASTANO settlement.

The Company and Liggett have the right to terminate the settlement with respect to any state participating in the settlement if any of the remaining defendants in the litigation succeed on the merits in that state's Attorney General action. The Company and Liggett may also terminate the settlement if they conclude that too many states have filed Attorney General actions and have not resolved such cases as to the settling defendants by joining in the settlement.

At December 31, 1995, the Company had accrued approximately $4,000 for the present value of the fixed payments under the March 1996 Attorneys General settlement, and no additional amounts have been accrued with respect to the recent settlements discussed below. The Company cannot quantify the future costs of the settlements at this time as the amount Liggett must pay is based, in part, on future operating results. Possible future payments based on a percentage of pretax income, and other contingent payments based on the occurrence of a business combination, will be expensed when considered probable.

On March 20, 1997, Liggett, together with the Company, entered into a comprehensive settlement of tobacco litigation through parallel agreements with the Attorneys General of 17 additional states and with a nationwide class of individuals and entities that allege smoking-related claims. Thereafter, settlements were entered into with several other Attorneys General. The settlements cover all smoking-related claims, including both addiction-based and tobacco injury claims against the Company and Liggett, brought by the Attorneys General and, upon court approval, the nationwide class.

As of June 30, 1997, settlements with 25 Attorneys General were reached, including the Attorneys General of Alaska, Arizona, California, Connecticut, Hawaii, Illinois, Indiana, Iowa, Kansas, Maryland, Michigan, Minnesota, New Jersey, New York, Oklahoma, Oregon, Texas, Utah, Washington and Wisconsin. The Company's and Liggett's previous settlements on March 15, 1996 with the Attorneys General of Florida, Louisiana, Massachusetts, Mississippi and West Virginia remain in full force and effect. Other states have either recently filed Medicaid recovery actions or indicated intentions to do so. Both Liggett and the Company will endeavor to resolve those matters on substantially the same terms and conditions as the prior settlements; however, there can be no assurance that any such settlements will be completed.

The settlement with the nationwide class covers all smoking-related claims. On March 20, 1997, Liggett, the Company and plaintiffs filed the mandatory class settlement agreement in an action entitled FLETCHER, ET AL. V. BROOKE GROUP LTD., ET AL., Circuit Court of Mobile County, Alabama, where the court granted preliminary approval and preliminary certification of the class, and on May 15, 1997, a similar mandatory class settlement agreement was filed in an action entitled WALKER, ET AL. V. LIGGETT GROUP INC., ET AL., United States District Court, Southern District of West Virginia. The WALKER court

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also granted preliminary approval and preliminary certification of the nationwide class; however, on August 5, 1997, the court vacated its preliminary certification of the settlement class.

In the FLETCHER action, it is anticipated that class members will be notified of the settlement and will have an opportunity to appear at a later court hearing. Effectiveness of the mandatory settlement is conditioned on final court approval of the settlement after a fairness hearing. There can be no assurance as to whether, or when, such court approval will be obtained. There are no opt out provisions in this settlement, except for Medicaid claims by states that are not party to the Attorneys General settlements.

Pursuant to the settlements, the Company and Liggett agreed to cooperate fully with the Attorneys General and the nationwide class in their respective lawsuits against the tobacco industry. The Company and Liggett agreed to provide to these parties all relevant tobacco documents in their possession, other than those subject to claims of joint defense privilege, and to waive, subject to court order, certain attorney-client privileges and work product protections regarding Liggett's smoking-related documents to the extent Liggett and the Company can so waive these privileges and protections. The Attorneys General and the nationwide class agreed to keep Liggett's documents under protective order and, subject to final court approval, to limit their use to those actions brought by parties to the settlement agreements. Those documents that may be subject to a joint defense privilege with other tobacco companies will not be produced to the Attorneys General or the nationwide class, but will be, pursuant to court order, submitted to the appropriate court and placed under seal for possible IN CAMERA review. Additionally, under similar protective conditions, the Company and Liggett agreed to offer their employees for witness interviews and testimony at deposition and trial. Pursuant to both settlement agreements, Liggett also agreed to place an additional warning on its cigarette packaging stating that "smoking is addictive" and to issue a public statement, as requested by the Attorneys General. Liggett has commenced distribution of cigarette packaging which displays the new warning label.

Under the terms of the new settlement agreements, Liggett will pay, on an annual basis, 25% of its pretax income for the next 25 years into a settlement fund, commencing with the first full fiscal year starting after the date of the agreements. Monies collected in the settlement fund will be overseen by a court-appointed committee and utilized to compensate state health care programs and settlement class members and to provide counter-market advertising. Liggett agreed to phase-in compliance with certain proposed FDA regulations regarding smoking by children and adolescents, including a prohibition on the use of cartoon characters in tobacco advertising and limitations on the use of promotional materials and distribution of sample packages where minors are present.

Under both settlement agreements, any other tobacco company defendant, except Philip Morris, merging or combining with Liggett or the Company, prior to the fourth anniversary of the settlement agreements, would receive certain settlement benefits, including limitations on potential liability and not having to post a bond to appeal any future adverse judgment. In addition, within 120 days following such a combination, Liggett would be required to pay the settlement fund $25,000. Both the Attorneys General and the nationwide class have agreed not to seek an injunction preventing a defendant tobacco company combining with Liggett or the Company from spinning off any of its affiliates which are not engaged in the domestic tobacco business.

The Company and Liggett are also entitled to certain "most favored nation" benefits not available to the other defendant tobacco companies. In addition, in the event of a "global" tobacco settlement

enacted through Federal legislation or otherwise, the Attorneys General and tobacco plaintiffs agreed to use their "best efforts" to ensure that the Company and Liggett's liability under such a plan should be no more onerous than under these new settlements. See "Other Matters", below.

IMMINENT TRIALS. Although trial schedules are subject to change, the next individual cases scheduled for trial, where Liggett is a defendant, are WESTMORELAND V. LIGGETT GROUP INC., ET AL., United States District Court, Middle District of Florida, Tampa Division, and SACKMAN, both of which are scheduled for trial in October, 1997. There are two other individual cases scheduled for trial in 1997. In addition to the BROIN trial currently in progress, there is one other class action scheduled for trial in 1997, ENGLE, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL.

OTHER MATTERS. On June 20, 1997, Philip Morris Incorporated ("Philip Morris"), R. J. Reynolds Tobacco Company ("RJR"), B&W, Lorillard Tobacco Company ("Lorillard") and the United States Tobacco Company, along with the Attorneys General for the States of Arizona, Connecticut, Florida, Mississippi, New York and Washington and the CASTANO Plaintiffs' Litigation Committee executed a Memorandum of Understanding to support the adoption of federal legislation and necessary ancillary undertakings, incorporating the features described in a proposed resolution. The proposed resolution mandates a total reformation and restructuring of how tobacco products are manufactured, marketed and distributed in the United States. The proposals are currently being reviewed by the White House, Congress and various public interest groups. Management is unable to predict the ultimate effect, if any, of the enactment of legislation adopting the proposed resolution. Management is also unable to predict the ultimate content of any such legislation; however, adoption of any such legislation could have a material adverse effect on the business of the Company and Liggett.

On March 20, 1997, RJR, Philip Morris, B&W and Lorillard obtained a temporary restraining order from a North Carolina state court preventing the Company and Liggett and their agents, employees, directors, officers and lawyers from turning over documents allegedly subject to the joint defense privilege in connection with the settlements, which restraining order was converted to a preliminary injunction by the court on April 9, 1997. This ruling is currently on appeal by the Company and Liggett. On June 5, 1997, the North Carolina Supreme Court denied Liggett's Motion to Stay the case pending appeal. On March 24, 1997, the United States District Court for the Eastern District of Texas and state courts in Mississippi and Illinois each issued orders enjoining the other tobacco companies from interfering with Liggett's filing with the courts, under seal, those documents.

The Company understands that a grand jury investigation is being conducted by the office of the United States Attorney for the Eastern District of New York regarding possible violations of criminal law relating to the activities of The Council for Tobacco Research - USA, Inc. Liggett was a sponsor of The Council for Tobacco Research - USA, Inc. at one time. The Company is unable, at this time, to predict the outcome of this investigation.

In March 1996, Liggett received a subpoena from a Federal grand jury sitting in the Southern District of New York. Documents have been produced in response to the subpoena. The Company understands that this investigation has been transferred to the main office of the United States Department of Justice. In addition, in May 1996, Liggett was served with a subpoena by a grand jury sitting in the District of Columbia, to which Liggett has responded by producing documents. Liggett was also served with a subpoena from the District of Columbia grand jury in July, 1997. Liggett is in the process of responding to that subpoena. The Company and Liggett are unable, at this time, to predict the outcome of these investigations.

BROOKE GROUP LTD.
BGLS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

The Antitrust Division of the United States Department of Justice investigation into the United States tobacco industry activities in connection with product development efforts regarding "fire-safe" or self-extinguishing cigarettes has been concluded. No action by the Department of Justice was taken.

Litigation is subject to many uncertainties, and it is possible that some of the aforementioned actions could be decided unfavorably against the Company or Liggett. An unfavorable outcome of a pending smoking and health case could encourage the commencement of additional similar litigation. The Company is unable to evaluate the effect of these developing matters on pending litigation or the possible commencement of additional litigation.

There are several other proceedings, lawsuits and claims pending against the Company unrelated to product liability. Management is of the opinion that the liabilities, if any, ultimately resulting from such other proceedings, lawsuits and claims should not materially affect the Company's financial position, results of operations or cash flows.

The Company is unable to make a meaningful estimate of the amount or range of loss that could result from an unfavorable outcome of the cases pending against the Company and Liggett. It is possible that the Company's consolidated financial position, results of operations and cash flows could be materially adversely affected by an ultimate unfavorable outcome in any of such pending litigation.

LEGISLATION AND REGULATION:

On August 28, 1996, the FDA filed in the Federal Register a Final Rule (the "FDA Rule") classifying tobacco as a drug, asserting jurisdiction by the FDA over the manufacture and marketing of tobacco products and imposing restrictions on the sale, advertising and promotion of tobacco products. The FDA's stated objective and focus for its initiative is to limit access to cigarettes by minors by measures beyond the restrictions either mandated by existing federal, state and local laws or voluntarily implemented by major manufacturers in the industry. Litigation was commenced in the United States District Court for the Middle District of North Carolina challenging the legal authority of the FDA to assert such jurisdiction, as well as challenging the constitutionality of the rules. The court, after argument, granted plaintiffs' motion for summary judgment prohibiting the FDA from regulating or restricting the promotion and advertising of tobacco products and denied plaintiffs' motion for summary judgment on the issue of whether the FDA has the authority to regulate access to, and labeling of, tobacco products. The four major cigarette manufacturers and the FDA have filed notices of appeal. The Company and Liggett support the FDA Rule and have begun to phase in compliance with certain of the proposed interim FDA regulations. See discussions of the CASTANO and Attorneys General settlements above.

In August 1996, the Commonwealth of Massachusetts enacted legislation requiring tobacco companies to publish information regarding the ingredients in cigarettes and other tobacco products sold in that state. On February 7, 1997, the United States District Court for the District of Massachusetts denied an attempt to block the new legislation on the ground that it is preempted by federal law. The Company and Liggett support this proposed legislation.

BROOKE GROUP LTD.
BGLS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

On September 13, 1995, the President of the United States issued Presidential Proclamation 6821, which established a tariff rate quota ("TRQ") on certain imported tobacco, imposing extremely high tariffs on imports of flue-cured and burley tobacco in excess of certain levels which vary from country to country. Oriental tobacco is exempt from the quota as well as all tobacco originating from Canada, Mexico or Israel. Management believes that the TRQ levels are sufficiently high to allow Liggett to operate without material disruption to its business.

On February 20, 1996, the United States Trade representative issued an "advance notice of rule making" concerning how tobaccos imported under the TRQ should be allocated. Currently, tobacco imported under the TRQ is allocated on a "first-come, first-served" basis, meaning that entry is allowed on an open basis to those first requesting entry in the quota year. Others in the cigarette industry have suggested an "end-user licensing" system under which the right to import tobacco under the quota would be initially assigned on the basis of domestic market share. Such an approach, if adopted, could have a material adverse effect on the Company and Liggett.

In April 1994, the United States Occupational Safety and Health Administration ("OSHA") issued a proposed rule that could ultimately ban smoking in the workplace. Hearings were completed during 1995. OSHA has not yet issued a final rule or a proposed revised rule. While the Company cannot predict the outcome, some form of federal regulation of smoking in workplaces may result.

In January 1993, the United States Environmental Protection Agency ("EPA") released a report on the respiratory effect of ETS which concludes that ETS is a known human lung carcinogen in adults, and in children causes increased respiratory tract disease and middle ear disorders and increases the severity and frequency of asthma. In June 1993, the two largest of the major domestic cigarette manufacturers, together with other segments of the tobacco and distribution industries, commenced a lawsuit against the EPA seeking a determination that the EPA did not have the statutory authority to regulate ETS, and that given the current body of scientific evidence and the EPA's failure to follow its own guidelines in making the determination, the EPA's classification of ETS was arbitrary and capricious. Whatever the outcome of this litigation, issuance of the report may encourage efforts to limit smoking in public areas.

As part of the budget agreement recently approved by Congress, federal excise taxes on a pack of cigarettes, which are currently 24 cents, would rise 10 cents in the year 2000 and 5 cents more in the year 2002.

Liggett has been involved in certain environmental proceedings, none of which, either individually or in the aggregate, rise to the level of materiality. Liggett's current operations are conducted in accordance with all environmental laws and regulations. Management is unaware of any material environmental conditions affecting its existing facilities. Compliance with federal, state and local provisions regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, have not had a material effect on the capital expenditures, earnings or competitive position of Liggett.

In addition to the foregoing, there have been a number of other restrictive regulatory actions, adverse political decisions and other unfavorable developments concerning cigarette smoking and the tobacco industry, the effects of which, at this time, the Company is not able to evaluate.

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

BROOKE GROUP LTD.
BGLS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

12. SALES OF ASSETS

On January 31, 1997, BOL sold BML to New Valley for $21,500 in cash and a promissory note of $33,500 payable $21,500 on June 30, 1997 and $12,000 on December 31, 1997. (Refer to Note 3.)

On March 11, 1997, Liggett sold to Blue Devil Ventures, a North Carolina limited liability partnership, certain surplus realty for $2,200 and recognized a gain of $1,531.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

INTRODUCTION

The following discussion provides an assessment of the consolidated results of operations, capital resources and liquidity of Brooke Group Ltd. (the "Company") and its subsidiaries and should be read in conjunction with the Consolidated Financial Statements and notes thereto of the Company and BGLS Inc. ("BGLS") included elsewhere in this report. BGLS is a wholly owned subsidiary of the Company. The consolidated financial statements include the accounts of BGLS, Liggett Group Inc. ("Liggett"), Brooke (Overseas) Ltd. ("BOL"), New Valley Holdings, Inc. ("NV Holdings"), Liggett-Ducat Ltd. ("Liggett-Ducat") and other less significant subsidiaries. The Company holds an equity interest in New Valley Corporation ("New Valley") through NV Holdings.

On January 31, 1997, BOL sold its interest in BrookeMil Ltd. ("BML"), a real estate investment company doing business in Russia, to New Valley. See Note 3 to the Company's Consolidated Financial Statements.

For purposes of this discussion and other consolidated financial reporting, the Company's significant business segments are tobacco for the six months ended June 30, 1997 and tobacco and real estate for the six months ended June 30, 1996.

RECENT DEVELOPMENTS

NEW VALLEY. As of June 30, 1997, New Valley held 1,062,650 shares of RJR Nabisco Holdings Corp. ("RJR Nabisco") common stock with a market value of $34,270 (cost of $32,574). New Valley's unrealized gain on its investment in RJR Nabisco common stock was $1,696 at June 30, 1997. For information concerning the acquisition of BML by New Valley, see "BOL" below.

BOL. On January 31, 1997, New Valley acquired from BOL 10,483 shares (99.1%) of common stock of BML for a purchase price of $55,000, consisting of $21,500 in cash and a $33,500 9% promissory note of New Valley (the "Note"). The Note is collateralized by the BML Shares. During the second quarter 1997, New Valley paid $21,500 to BOL. The remaining balance on the note is $12,000 and is due on December 31, 1997. The Company recognized a gain of $21,300 on the sale in the first quarter, 1997. On April 18, 1997, BML sold one of its office buildings to a third party. Accordingly, the Company recognized approximately $1,240 of the deferred gain. See Note 3 to the Company's Consolidated Financial Statements.

LIGGETT. In January 1997, Liggett underwent a major restructuring from a centralized organization to a decentralized enterprise with four Strategic Business Units, each a profit center, and a corporate headquarters. This restructuring is intended to more closely align sales and marketing strategies with the unique requirements of regional markets as well as reduce working capital by improved production planning and inventory control. As a result of this reorganization, Liggett is further reducing its salaried, hourly and part-time headcount by a total of 273 positions (35%) over an eight-month transition period.

On March 11, 1997, Liggett sold to Blue Devil Ventures, a North Carolina limited liability partnership, certain surplus realty for $2,200. The Company recognized a gain of $1,531.

NEGOTIATIONS WITH NOTE HOLDERS. Liggett is engaged in negotiations with a committee composed of a majority of its note holders with respect to a restructuring of the terms of Liggett's Senior Secured Notes (the "Liggett Notes") and, with its lenders, to extend its revolving credit facility (the "Facility"). In conjunction with these discussions, the Company is also engaged in negotiations with the principal holders of the BGLS 15.75% Series B Senior Secured Notes (the "BGLS Notes") with respect to certain related modifications to the terms

of such debt. Pending completion of the negotiations, BGLS and Liggett have postponed making the interest payments due on July 31, 1997 on the BGLS Notes and on August 1, 1997 on the Liggett Notes.

With respect to Liggett's near-term debt service requirements and related matters, refer to "Capital Resources and Liquidity" below.

NEW ACCOUNTING PRONOUNCEMENTS. In June 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income". SFAS 130 establishes standards for reporting and display of comprehensive income. The purpose of reporting comprehensive income is to present a measure of all changes in equity that result from recognized transactions and other economic events of the period other than transactions with owners in their capacity as owners. SFAS 130 requires that an enterprise classify items of other comprehensive income by their nature in a financial statement and display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of the balance sheet. SFAS 130 is effective for fiscal years beginning after December 15, 1997, with earlier application permitted. The Company has not yet determined the impact of the implementation of SFAS 130.

In June 1997, the FASB issued SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information". SFAS 131 specifies revised guidelines for determining an entity's operating segments and the type and level of financial information to be disclosed. Once operating segments have been determined, SFAS 131 provides for a two-tier test for determining those operating segments that would need to be disclosed for external reporting purposes. In addition to providing the required disclosures for reportable segments, SFAS 131 also requires disclosure of certain "second level" information by geographic area and for products/services. SFAS 131 also makes a number of changes to existing disclosure requirements. SFAS 131 is effective for fiscal years beginning after December 15, 1997, with earlier application encouraged. The Company has not yet determined the impact of the implementation of SFAS 131.

RECENT DEVELOPMENTS IN THE CIGARETTE INDUSTRY

PRICING ACTIVITY. On March 7, 1997, R. J. Reynolds Tobacco Company ("RJR") initiated another list price increase on all brands of $.40 per carton (approximately 4%). Brown & Williamson Tobacco Corporation ("B&W"), Lorillard Tobacco Company ("Lorillard") and Liggett have matched this increase, and, on March 21, 1997, Philip Morris Incorporated ("Philip Morris") announced a price increase of $.50 per carton. Subsequently, Liggett and the other manufacturers matched Philip Morris' price increase.

LEGISLATION, REGULATION AND LITIGATION. The cigarette industry continues to be challenged on numerous fronts. New cases continue to be commenced against Liggett and the Company and other cigarette manufacturers. As of June 30, 1997, there were 145 individual suits, 29 class actions or actions where class certification has been sought and 32 state (and several municipality) Medicaid reimbursement actions pending in the United States in which Liggett is a named defendant and has been served. As new cases are commenced, the costs associated with defending such cases and the risks attendant to the inherent unpredictability of litigation continue to increase. Recently, there have been a number of restrictive regulatory actions from various Federal administrative bodies, including the United States Environmental Protection Agency ("EPA") and the Food and Drug Administration ("FDA"), adverse political and legal decisions and other unfavorable developments concerning cigarette smoking and the tobacco industry, including the commencement and certification of class actions and the commencement of Medicaid reimbursement suits by various states' Attorneys General. These developments generally receive widespread media attention. The Company is not able to evaluate the effect of these developing matters on pending litigation or the possible commencement of additional litigation, but it is possible that the Company's financial position, results of operations and cash flows could be materially adversely affected by an ultimate unfavorable outcome in any of such pending litigation. See Note 11 to the Company's Consolidated Financial Statements for a description of legislation, regulation and litigation.

The plaintiffs' allegations of liability in those cases in which individuals seek recovery for personal injuries allegedly caused by cigarette smoking are based on various theories of recovery, including negligence, gross negligence, special duty, voluntary undertaking, strict liability, fraud, misrepresentation, design defect, failure to warn, breach of express and implied warranties, conspiracy, aiding and abetting, concert of action, unjust enrichment, common law public nuisance, indemnity, market share liability, and violations of deceptive trade practices laws, the Federal Racketeer Influenced and Corrupt Organization Act ("RICO") and antitrust statutes. Plaintiffs also seek punitive damages in many of these cases. Defenses raised by defendants in these cases include lack of proximate cause, assumption of the risk, comparative fault and/or contributory negligence, lack of design defect, statutes of limitations, equitable defenses such as "unclean hands" and lack of benefit, failure to state a claim and federal preemption.

The claims asserted in the Medicaid recovery actions vary. All plaintiffs assert the equitable claim that the tobacco industry was "unjustly enriched" by plaintiffs' payment of health care costs allegedly attributable to smoking and seek reimbursement of those costs. Other claims made by some but not all plaintiffs include the equitable claim of indemnity, common law claims of negligence, strict liability, breach of express and implied warranty, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under state and federal statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under RICO.

SETTLEMENTS. On March 12, 1996, Liggett, together with the Company, entered into an agreement to settle the CASTANO class action tobacco litigation, and on March 15, 1996, Liggett, together with the Company, entered into an agreement with the Attorneys General of West Virginia, Florida, Mississippi, Massachusetts and Louisiana to settle certain actions brought against Liggett and the Company by such states. Liggett and the Company, while neither consenting to FDA jurisdiction nor waiving their objections thereto, agreed to withdraw their objections and opposition to the proposed FDA regulations and to phase in compliance with certain of the proposed interim FDA regulations.

Under the CASTANO settlement agreement, upon final court approval of the settlement, the CASTANO class would be entitled to receive up to five percent of Liggett's pretax income (income before income taxes) each year (up to a maximum of $50,000 per year) for the next 25 years, subject to certain reductions provided for in the agreement, and a $5,000 payment from Liggett if the Company or Liggett fail to consummate a merger or similar transaction with another non-settling tobacco company defendant within three years of the date of the settlement. The Company and Liggett have the right to terminate the CASTANO settlement under certain circumstances. On May 11, 1996, the CASTANO Plaintiffs Legal Committee filed a motion with the United States District Court for the Eastern District of Louisiana seeking preliminary approval of the CASTANO settlement. On May 23, 1996, the Court of Appeals for the Fifth Circuit reversed the February 17, 1995 order of the District Court certifying the CASTANO suit as a nationwide class action and instructed the District Court to dismiss the class complaint. On September 6, 1996, the CASTANO plaintiffs withdrew the motion for approval of the CASTANO settlement.

On March 14, 1996, the Company, the CASTANO Plaintiffs Legal Committee and the CASTANO plaintiffs entered into a letter agreement. According to the terms of the letter agreement, for the period ending nine months from the date of Final Approval (if granted) of the CASTANO settlement or, if earlier, the completion by the Company or Liggett of a combination with any defendant in CASTANO, except Philip Morris, the CASTANO plaintiffs and their counsel agree not to enter into any more favorable settlement agreement with any CASTANO defendant which would reduce the terms of the CASTANO settlement agreement. If the CASTANO plaintiffs or their counsel enter into any such settlement during this period, they shall pay the Company $250,000 within 30 days of the more favorable agreement and offer the Company and Liggett the option to enter into a settlement on terms at least as favorable as those included in such other settlement. The letter agreement further provides that during the same time period, and if the CASTANO settlement agreement has not been earlier terminated by the Company in accordance with its terms, the Company and its affiliates will not enter into any business transaction with any third party which would cause the termination of the CASTANO settlement agreement. If the Company or its affiliates enter into any such transaction, then the CASTANO plaintiffs will be entitled to receive $250,000 within 30 days from the transacting party.

Under the Attorneys General settlement, the five states would share an initial payment by Liggett of $5,000 ($1,000 of which was paid on March 22, 1996, with the balance payable over nine years and indexed and adjusted for inflation), provided that any unpaid amount will be due 60 days after either a default by Liggett in its payment obligations under the settlement or a merger or other similar transaction by the Company or Liggett with another defendant in the lawsuits. In addition, Liggett will be required to pay the states a percentage of Liggett's pretax income (income before income taxes) each year from the second through the twenty-fifth year. This annual percentage is 2-1/2% of Liggett's pretax income, subject to increase to 7-1/2% depending on the number of additional states joining the settlement. No additional states have joined this settlement to date. All of Liggett's payments are subject to certain reductions provided for in the agreement. Liggett has also agreed to pay to the states $5,000 if the Company or Liggett fails to consummate a merger or other similar transaction with another defendant in the lawsuits within three years of the date of the settlement.

On March 20, 1997, Liggett, together with the Company, entered into a comprehensive settlement of tobacco litigation through parallel agreements with the Attorneys General of 17 states and with a nationwide class of individuals and entities that allege smoking-related claims. Thereafter, settlements were entered into with several other Attorneys General. The settlements cover all smoking-related claims, including both addiction-based and tobacco injury claims against Liggett and the Company, and upon court approval, the nationwide class.

As of June 30, 1997, settlements with 25 Attorneys General were reached, including the Attorneys General of Alaska, Arizona, California, Connecticut, Hawaii, Illinois, Indiana, Iowa, Kansas, Maryland, Michigan, Minnesota, New Jersey, New York, Oklahoma, Oregon, Texas, Utah, Washington and Wisconsin. The Company's and Liggett's previous settlements on March 15, 1996 with the Attorneys General of Florida, Louisiana, Massachusetts, Mississippi and West Virginia remain in full force and effect. Other states have either recently filed Medicaid recovery actions or indicated intentions to do so. Both Liggett and the Company will endeavor to resolve those matters on substantially the same terms and conditions as the prior settlements; however, there can be no assurance that any such settlements will be completed.

The settlement with the nationwide class covers all smoking-related claims. On March 20, 1997, Liggett, the Company and plaintiffs filed the mandatory class settlement agreement in an action entitled FLETCHER, ET AL. V BROOKE GROUP LTD., ET AL., Circuit Court of Mobile County, Alabama, where the court granted preliminary approval and preliminary certification of the class, and on May 15, 1997, a similar mandatory class settlement agreement was filed in an action entitled WALKER, ET AL. V. LIGGETT GROUP INC., ET AL., United States District Court, Southern District of West Virginia. The WALKER court also granted preliminary approval and preliminary certification of the nationwide class; however, on August 5, 1997, the court vacated its preliminary certification of the settlement class.

In the FLETCHER action, it is anticipated that class members will be notified of the settlement and will have an opportunity to appear at a later court hearing. Effectiveness of the mandatory settlement is conditioned on final court approval of the settlement after a fairness hearing. There can be no assurance as to whether, or when, court approval will be obtained. There are no opt out provisions in this settlement, except for Medicaid claims by states that are not party to the Attorneys General settlements.

Pursuant to the settlements, the Company and Liggett agreed to cooperate fully with the Attorneys General and the nationwide class in their respective lawsuits against the tobacco industry. The Company and Liggett agreed to provide to these parties all relevant tobacco documents in their possession, other than those subject to claims of joint defense privilege, and to waive, subject to court order, certain attorney-client privileges and work product protections regarding Liggett's smoking-related documents to the extent Liggett and the Company can so waive these privileges and protections. The Attorneys General and the nationwide class agreed to keep Liggett's documents under protective order and, subject to final court approval, to limit their use to those actions brought by parties to the settlement agreements. Those documents that may be subject to a joint defense privilege with other tobacco companies will not be produced to the Attorneys General or the nationwide class, but will be, pursuant to court order, submitted to the appropriate court and placed under seal for possible IN CAMERA review. Additionally, under similar protective conditions, the Company and Liggett agreed to offer their employees for witness interviews and

testimony at deposition and trial. Pursuant to both settlement agreements, Liggett also agreed to place an additional warning on its cigarette packaging stating that "smoking is addictive" and to issue a public statement, as requested by the Attorneys General. Liggett has commenced distribution of cigarette packaging which displays the new warning label.

Under the terms of the new settlement agreements, Liggett will pay on an annual basis 25% of its pretax income for the next 25 years into a settlement fund, commencing with the first full fiscal year starting after the date of the agreements. Monies collected in the settlement fund will be overseen by a court-appointed committee and utilized to compensate state health care programs and settlement class members and to provide counter-market advertising. Liggett agreed to phase in compliance with certain proposed FDA regulations regarding smoking by children and adolescents, including a prohibition on the use of cartoon characters in tobacco advertising and limitations on the use of promotional materials and distribution of sample packages where minors are present.

Under both settlement agreements, any other tobacco company defendant, except Philip Morris, merging or combining with Liggett or the Company, prior to the fourth anniversary of the settlement agreements, would receive certain settlement benefits, including limitations on potential liability and not having to post a bond to appeal any future adverse judgment. In addition, within 120 days following such a combination, Liggett would be required to pay the settlement fund $25,000. Both the Attorneys General and the nationwide class agreed not to seek an injunction preventing a defendant tobacco company combining with Liggett or the Company from spinning off any of its affiliates which are not engaged in the domestic tobacco business.

The Company and Liggett are also entitled to certain "most favored nation" benefits not available to the other defendant tobacco companies. In addition, in the event of a "global" tobacco settlement enacted through Federal legislation or otherwise, the Attorneys General and tobacco plaintiffs agreed to use their "best efforts" to ensure that the Company and Liggett's liability under such a plan should be no more onerous than under these new settlements. See "Other Matters" below.

At December 31, 1995, the Company had accrued approximately $4,000 for the present value of the fixed payments under the initial Attorneys General settlement and no additional amounts have been accrued with respect to the recent settlements discussed above. The Company cannot quantify the future costs of the settlements at this time as the amount Liggett must pay is based, in part, on future operating results. Possible future payments based on a percentage of pretax income, and other contingent payments based on the occurrence of a business combination, will be expensed when considered probable. See the discussions of the tobacco litigation settlements appearing in Note 11 to the Company's Consolidated Financial Statements.

OTHER MATTERS. On June 20, 1997, Philip Morris, RJR, B&W, Lorillard and the United States Tobacco Company, along with the Attorneys General for the States of Arizona, Connecticut, Florida, Mississippi, New York and Washington and the CASTANO Plaintiffs' Litigation Committee executed a Memorandum of Understanding to support the adoption of federal legislation and necessary ancillary undertakings, incorporating the features described in a proposed resolution. The proposed resolution mandates a total reformation and restructuring of how tobacco products are manufactured, marketed and distributed in the United States. The proposals are currently being reviewed by the White House, congress and various public interest groups. Management is unable to predict the ultimate effect, if any, of the enactment of legislation adopting the proposed resolution. Management is also unable to predict the ultimate content of any such legislation. However, adoption of any such legislation could have a material adverse effect on the business of the Company and Liggett.

RESULTS OF OPERATIONS

THREE MONTHS ENDED JUNE 30, 1997 COMPARED TO THREE MONTHS ENDED JUNE 30, 1996.

REVENUES. Total revenues were $96,593 for the three months ended June 30, 1997 compared to $125,213 for the three months ended June 30, 1996. This 22.9% decrease in revenues was primarily due to

a $35,144 or 31.0% decrease in revenues at Liggett reflecting a 38.3% decrease in Liggett's overall unit sales volume, partially offset by an increase of $8,463 or 84.7% over the same period in 1996 in tobacco revenues and an increase of 39.5% in overall unit sales volume at Liggett-Ducat. (See also "Recent Developments in the Cigarette Industry-Pricing Activity" for a discussion of the March 1997 price increase). The decline in overall units sales volume of 38.3% at Liggett was comprised of declines within the premium segment of 32.9% and discount segment (which includes generic, control label and branded discount products) of 36.2%. The decline in premium and discount unit sales volume was due to certain competitors continuing leveraging rebate programs tied to their products and increased promotional activity by certain other manufacturers. The increase in tobacco revenues at Liggett-Ducat is attributable to increased unit sales volume of 39.5% and significant net price increases. The increase in tobacco revenues at Liggett-Ducat is offset by a decline in real estate revenues of $668 due to the sale of the BML Shares.

GROSS PROFIT. Gross profit was $45,642 for the three months ended June 30, 1997 compared to $61,691 for the three months ended June 30, 1996, a decrease of $16,049 when compared to the same period last year, due primarily to the decline in unit sales volume at Liggett discussed above. Overall, the Company's gross profit as a percentage of revenues decreased 2.0% when compared to the same period in the prior year. Liggett's gross profit as a percentage of revenues (excluding federal excise taxes) for the period decreased to 71.1% compared to 72.5% in the same period in the prior year. This decrease is the result of increased tobacco costs due to a reduction in the average discount available to Liggett from leaf tobacco dealers on tobacco purchased under prior years' purchase commitments, partially offset by the March 1997 list price increase discussed above. See "Recent Developments in the Cigarette Industry".

EXPENSES. Selling, general and administrative expenses were $39,715 for the three months ended June 30, 1997 compared to $58,264 for the same period last year. The decrease of $18,549 is due primarily to lower promotion, marketing and administrative expenses at Liggett partially offset by restructuring charges of $70 and higher legal expenses at Liggett.

OTHER INCOME (EXPENSE). Interest expense was $15,499 for the three months ended June 30, 1997 compared to $15,457 for the same period last year.

Equity in earnings of affiliate was a loss of $5,841 for the three months ended June 30, 1997 compared to a loss of $1,306 for the three months ended June 30, 1996 and relates primarily to the decline in market value of the New Valley Class A Preferred Shares and to New Valley's net loss of $5,029 compared to its net loss of $4,762 in 1996.

Interest expense and loss in equity of affiliate were partially offset by the sale of assets of $1,065, primarily recognition of the deferred gain on Ducat Place I which was sold to a third party by BML on April 18, 1997.

SIX MONTHS ENDED JUNE 30, 1997 COMPARED TO SIX MONTHS ENDED JUNE 30, 1996.

REVENUES. Total revenues were $176,598 for the six months ended June 30, 1997 compared to $215,729 for the six months ended June 30, 1996. This 18.1% decrease in revenues was primarily due to a $47,331 or 24.7% decrease in revenues at Liggett reflecting a 31.5% decrease in Liggett's unit sales volume, partially offset by an increase of $11,774 or 58.0% over the same period in 1996 in tobacco revenues and an increase of 24.8% in overall unit sales volume at Liggett-Ducat. The decline in overall units sales volume of 31.5% at Liggett was comprised of declines within the premium segment of 24.8% and discount segment (which includes generic, control label and branded discount products) of 30.6%. The decline in premium and discount unit sales volume was due to certain competitors continuing leveraging rebate programs tied to their products and increased promotional activity by certain other manufacturers. The increase in tobacco revenues at Liggett-Ducat is attributable to increased unit sales volume of 24.8% and significant net price increases. The increase in tobacco revenues at Liggett-Ducat is offset by a decline in real estate rental revenues of $1,116 due to the sale of the BML Shares.

GROSS PROFIT. Gross profit was $83,802 for the six months ended June 30, 1997 compared to $105,159 for the six months ended June 30, 1996, a decrease of $21,357 when compared to the same period last year, due primarily to the decline in unit sales volume at Liggett discussed above. Overall, the Company's gross profit as a percentage of revenues decreased 1.3% when compared to the same period in the prior year. Liggett's gross profit as a percentage of revenues (excluding federal excise taxes) for the period decreased to 71.9% compared to 73.0% in the same period in the prior year. This decrease is the

result of increased tobacco costs due to a reduction in the average discount available to Liggett from leaf tobacco dealers on tobacco purchased under prior years' purchase commitments, partially offset by the March 1997 list price increase. See "Recent Developments in the Cigarette Industry".

EXPENSES. Selling, general and administrative expenses were $77,037 for the six months ended June 30, 1997 compared to $103,156 for the same period last year. The decrease of $26,119 is due primarily to lower promotion, marketing and administrative expenses at Liggett due primarily to the decline in unit sales volume discussed above partially offset by restructuring charges of $1,831 and higher legal expenses at Liggett.

OTHER INCOME (EXPENSE). Interest expense was $30,966 for the six months ended June 30, 1997 compared to $30,234 for the same period last year.

Equity in earnings of affiliate was a loss of $14,398 for the six months ended June 30, 1997 compared to a loss of $2,883 for the six months ended June 30, 1996 and relates to the decline in market value of the Class A Preferred Shares and to New Valley's net loss of $15,370 in 1997 compared to its net loss of $9,646 in 1996.

Interest expense and loss in equity of affiliate were offset by the gain on sale of assets, which includes the sale of the BML shares and surplus realty at Liggett, and proceeds from a legal settlement. See Notes 3, 11 and 12 to the Company's Consolidated Financial Statements.

CAPITAL RESOURCES AND LIQUIDITY

Net cash and cash equivalents increased $17,608 and $1,036 for the six months ended June 30, 1997 and 1996, respectively. Net cash used in operations for the six months ended June 30, 1997 was $20,003 compared to net cash used in operations of $735 for the comparable period of 1996, due to a net loss of $7,736, an increase in receivables of $32,498 resulting from the sale of the BML shares to New Valley, a decrease in accounts payable and accrued expenses of $21,564. These items were offset by a decrease in trade receivables at Liggett due to declining sales volume, equity in loss of affiliate of $14,398 and the impact of the deferred gain on the sale of the BML shares of approximately $22,000.

Cash provided by investing activities of $39,592 for the period ended June 30, 1997 includes principally cash of $43,000 received in the sale of the BML shares to New Valley and net cash received in the sale of certain of Liggett's surplus realty to Blue Devil Ventures. Cash received was offset by capital expenditures of $3,653 at Liggett and BOL. Capital expenditures include $1,086 and $2,567 for real estate development at BOL and for equipment modernization at Liggett, respectively. Cash used in investing activities of $4,573 for the six months ended June 30, 1996 includes capital expenditures of approximately $12,200 for real estate development at BOL and $2,500 for equipment modernization at Liggett. Capital expenditures were offset by dividends received on the New Valley Class A Preferred Shares of $6,183 or $10.00 per share and proceeds from the sale of certain surplus realty at Liggett.

Cash used in financing activities was $1,981 for the six months ended June 30, 1997 compared to cash provided of $6,344 for the same period in 1996. Proceeds from financing activities primarily include proceeds at BOL from credit lines of $3,250 and net borrowings under Liggett's Facility of $4,754. These proceeds were offset by repayments on debt including principally the required repurchase of $7,500 face amount of the Liggett Notes on February 1, 1997 at a net gain of $2,963. Distributions on common stock include distributions declared in the fourth quarter 1996 which were paid in January 1997 and distributions declared and paid in March and June 1997. Proceeds from debt in the same period in 1996 include the private placement of BGLS' Series A Notes (later exchanged for Series B Notes) for net cash proceeds of $6,065, borrowings by BOL for real estate development of $8,454 and borrowings of $6,000 by Liggett and BOL under their revolving credit facilities. These transactions were primarily offset by the

redemption for approximately $6,237 of BGLS' 16.125% Senior Subordinated Reset Notes including premium and accrued interest thereon, and distributions to the Company's shareholders of $2,775.

LIGGETT. Liggett had a net capital deficiency of $178,660 as of June 30, 1997, is highly leveraged and has substantial near-term service requirements. Due to the many risks and uncertainties associated with the cigarette industry and the impact of recent tobacco litigation settlements, there can be no assurance that Liggett will be able to meet its future earnings or cash flow goals. Consequently, Liggett could be in violation of certain debt covenants, and if its lenders were to exercise acceleration rights under the Facility or the Liggett Notes indenture, or refuse to lend under the Facility, Liggett would not be able to satisfy such demands or its working capital requirements.

Further, the Liggett Notes require a mandatory principal redemption of $37,500 on February 1, 1998 and a payment at maturity on February 1, 1999 of $107,400, and the Facility expires on March 8, 1998 unless extended by its lenders. Based on Liggett's net loss for 1996 and anticipated 1997 operating results, Liggett does not anticipate it will be able to generate sufficient cash from operations to make such payments. While Liggett is currently in negotiations with its note holders to restructure the terms of the Liggett Notes and, with its lenders, to extend the Facility, there are no commitments to restructure the Liggett Notes or to extend the Facility at this time, and no assurances can be given in this regard. In conjunction with these discussions, the Company is also engaged in negotiations with the principal holders of the BGLS Notes with respect to certain related modifications to the terms of such debt. Pending completion of the negotiations, both BGLS and Liggett have postponed making the interest payments of approximately $18,338 for the BGLS Notes due on July 31, 1997 and approximately $9,700 for the Liggett Notes due on August 1, 1997. The indentures governing the BGLS Notes and the Liggett Notes provide for a 30-day grace period before the failure to pay interest will be an event of default.

The failure to pay interest on the Liggett Notes would permit Liggett's lenders under the Facility to cease making further advances. While the lenders have continued to make such advances, and Liggett's management currently anticipates that they will continue to do so, no assurances can be given in this regard. If Liggett is unable to restructure the terms of the Liggett Notes, extend the Facility, or otherwise make all payments thereon within the applicable grace periods, substantially all of Liggett's long-term debt and the Facility would be in default and holders of such debt could accelerate the maturity of such debt. In such event, Liggett may be forced to seek protection from creditors under applicable laws. These matters raise substantial doubt about Liggett meeting its liquidity needs and its ability to continue as a going concern.

On March 8, 1994, Liggett entered into the Facility under which it can borrow up to $40,000 (depending on the amount of eligible inventory and receivables as determined by the lenders) from a syndicate of commercial lenders. At June 30, 1997, $28,767 was outstanding and $209 was available under the Facility based on eligible collateral. The Facility is collateralized by all inventories and receivables of Liggett. Borrowings under the Facility, whose interest is calculated at a rate equal to 1.5% above Philadelphia National Bank's (the indirect parent of Congress Financial Corporation, the lead lender) prime rate, bore a rate of 9.75% at March 31, 1997. On April 1, 1997, Philadelphia National Bank raised its prime rate to 8.5%, thereby increasing Liggett's interest rate to 10.0% for the quarter ended June 30, 1997. The Facility contains certain financial covenants similar to those contained in the Liggett Notes Indenture, including restrictions on Liggett's ability to declare or pay cash dividends, incur additional debt, grant liens and enter into any new agreements with affiliates, among others. In addition, the Facility currently imposes requirements with respect to Liggett's adjusted net worth (not to fall below a deficit of $180,000 as computed in accordance with the agreement) and working capital (not to fall below a deficit of $12,000 as computed in accordance with the agreement). The Facility is classified as short-term at June 30, 1997, since it is due on March 8, 1998, unless extended by the lender. As discussed above, Liggett is currently in negotiations to extend the Facility.

During the first quarter of 1997, Liggett violated the working capital covenant contained in the Facility as a result of the 1998 mandatory redemption payment on the Liggett Notes becoming due within one year. On March 19, 1997, the lead lender agreed to waive this covenant default, and the Facility was amended as follows: (i) the working capital definition was changed to exclude the Liggett Notes; (ii) the maximum permitted working capital deficit, as defined, was reduced to $12,000 (as computed in

accordance with the agreement); (iii) the maximum permitted adjusted net worth deficit, as defined, was increased to $180,000 (as computed in accordance with the agreement); and (iv) the permitted advance rates under the Facility for eligible inventory were reduced by five percent.

In February 1997, Liggett purchased $7,500 of Series B Notes using revolver availability and credited such Notes against the 1997 mandatory redemption requirement. Liggett recorded a net gain of $2,963 for this transaction in the first quarter, 1997. Current maturities of both the Liggett Notes and the Facility of approximately $74,000 contribute substantially to the working capital deficit of $78,481 at June 30, 1997.

Liggett (and, in certain cases, the Company) and other United States cigarette manufacturers have been named as defendants in a number of direct and third-party actions (and purported class actions) predicated on the theory that they should be liable for damages from cancer and other adverse health effects alleged to have been caused by cigarette smoking or by exposure to so-called secondary smoke (environmental tobacco smoke) from cigarettes. As new cases are commenced, the costs associated with defending such cases and the risk attendant to the inherent unpredictability of litigation continue. Liggett had been receiving certain financial and other assistance from others in the industry in defraying the costs and other burdens incurred in the defense of smoking and health litigation and related proceedings, but these benefits have recently ended. Certain joint defense arrangements, and the financial benefits incident thereto, have also ended. The future financial impact on the Company of the termination of this assistance and the effects of the tobacco litigation settlements discussed above is not quantifiable at this time.

The Company believes, and has been so advised by counsel handling the respective cases, that the Company and Liggett have a number of valid defenses to the claim or claims asserted against them. Litigation is subject to many uncertainties, and it is possible that some of these actions could be decided unfavorably. An unfavorable outcome of a pending smoking and health case could encourage the commencement of additional similar litigation. Recently, there have been a number of adverse regulatory, political and other developments concerning cigarette smoking and the tobacco industry, including the commencement of the purported class actions referred to above. These developments generally receive widespread media attention. Neither the Company nor Liggett is able to evaluate the effect of these developing matters on pending litigation or the possible commencement of additional litigation.

The Company is unable to make a meaningful estimate of the amount or range of loss that could result from an unfavorable outcome of the cases pending against the Company and Liggett. It is possible that the Company's consolidated financial position, results of operations or cash flows could be materially affected by an ultimate unfavorable outcome in any such pending litigation.

BGLS. At June 30, 1997, BGLS' long-term debt was approximately $233,000. See "Liggett" above for a discussion of certain recent developments with respect to the BGLS Notes. BGLS or its affiliates may, from time to time, based on current market conditions, purchase Liggett Notes in the open market or in privately negotiated transactions.

BOL. As discussed in "Recent Developments," on January 31, 1997, BOL sold its 99.1% interest in BML to New Valley for $55,000. The purchase price paid was $21,500 in cash and a 9% promissory note of $33,500, of which $21,500 was paid during the second quarter 1997. The remaining balance of $12,000 is due on December 31, 1997.

In October 1995, Liggett-Ducat entered into a loan agreement with Vneshtorgbank, Moscow, Russia, to borrow up to $20,400 to fund real estate development. Interest on the note is based on the London Interbank Offered Rate plus 10%. The Company has guaranteed the payment of the note. In December 1996, the loan was assigned by Liggett-Ducat to BML. On January 31, 1997, New Valley purchased BOL's 99.1% interest in BML and indemnified the Company and its subsidiaries with respect to the loan.

Liggett-Ducat plans to build a new cigarette factory on the outskirts of Moscow. The new factory, which will utilize Western cigarette making technology and have a capacity of 24 billion units per year, will produce American and international blend cigarettes, as well as traditional Russian cigarettes. Preliminary construction has begun, and management is actively pursuing various potential financing alternatives that

would permit the new factory to be operational by the end of 1998, although no assurance can be given that such financing can be obtained on satisfactory terms.

THE COMPANY. As a result of the 1995 debt exchange offer, the redemption of the Reset Notes in 1996, the sale of the BML shares to New Valley in January 1997 and the redemption of $7,500 of the Liggett Notes on February 1, 1997, the Company decreased its scheduled near-term debt maturities to approximately $74,000 due in the year 1998; at June 30, 1997, substantially all of this debt relates to Liggett. In addition, Liggett has a payment due at maturity of the Liggett Notes on February 1, 1999 of $107,400. The BGLS Notes Indenture limits the amount of restricted payments BGLS is permitted to make to the Company during the calendar year. At June 30, 1997, the remaining amount available through December 31, 1997 in the Restricted Payment Basket related to BGLS' payment of dividends to the Company (as defined by the BGLS Notes Indenture) is $7,801. In March 1997, the Company provided for its quarterly dividend of $1,395 with proceeds from the legal settlement received in January 1997. Company expenditures (exclusive of Liggett and Liggett-Ducat) in 1997 for current operations include debt service estimated at $36,800, dividends on the Company's shares (currently at an annual rate of approximately $5,500) and corporate expense. The Company anticipates funding 1997 current operations with the proceeds from the sale of BML, management fees and other payments from subsidiaries of approximately $5,000 and the proceeds from the legal settlement of $4,100. The Company expects to finance its long-term growth, working capital requirements, capital expenditures and debt service requirements through a combination of cash provided from operations, proceeds from the sale of certain assets, additional public or private debt and/or equity financing and distributions from New Valley. New Valley may acquire or seek to acquire additional operating businesses through merger, purchase of assets, stock acquisition or other means, or to make other investments, which may limit its ability to make such distributions.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

The Company and its representatives may from time to time make oral or written "forward-looking statements" within the meaning of the Private Securities Reform Act of 1995 (the "Reform Act"), including any statements that may be contained in the foregoing discussion in "Management's Discussion and Analysis of Financial Condition and Results of Operations", in this report and in other filings with the Securities and Exchange Commission and in its reports to shareholders, which reflect management's current views with respect to future events and financial performance. These forward-looking statements are subject to certain risks and uncertainties and, in connection with the "safe-harbor" provisions of the Reform Act, the Company is hereby identifying important factors that could cause actual results to differ materially from those contained in any forward-looking statement made by or on behalf of the Company. Liggett continues to be subject to risk factors endemic to the domestic tobacco industry including, without limitation, health concerns relating to the use of tobacco products and exposure to ETS, legislation, including tax increases, governmental regulation, privately imposed smoking restrictions, governmental and grand jury investigations and litigation. Each of the Company's operating subsidiaries, namely Liggett and Liggett-Ducat, are subject to intense competition, changes in consumer preferences, the effects of changing prices for its raw materials and local economic conditions. Furthermore, the performance of Liggett-Ducat's cigarette operations in Russia are affected by uncertainties in Russia which include, among others, political or diplomatic developments, regional tensions, currency repatriation restrictions, foreign exchange fluctuations, inflation, and an undeveloped system of commercial laws and legislative reform relating to foreign ownership in Russia. In addition, the Company has a high degree of leverage and substantial near-term debt service requirements, as well as a net worth deficiency and recent losses from continuing operations. See "Capital Resources and Liquidity" for a discussion of certain matters which raise substantial doubt about Liggett meeting its liquidity needs and its ability to continue as a going concern. The Indenture for the BGLS Notes provides for, among other things, the restriction of certain affiliated transactions between the Company and its affiliates, as well as for certain restrictions on the use of future distributions received from New Valley. Due to such uncertainties and risks, readers are cautioned not to place undue reliance on such forward-looking statements, which speak only as of the date on which such statements are made. The Company does not undertake to update any forward-looking statement that may be made from time to time by or on behalf of the Company.

PART II
OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

Reference is made to information entitled "Contingencies" in Note 11 to the Consolidated Financial Statements of Brooke Group Ltd. and BGLS Inc. (collectively, the "Companies") included elsewhere in this report on Form 10-Q.

Item 3. DEFAULTS UPON SENIOR SECURITIES

As of June 30, 1997, New Valley Corporation, the Companies' affiliate, had the following respective accrued and unpaid dividend arrearages on its 1,072,462 outstanding shares of $15.00 Class A Increasing Rate Cumulative Senior Preferred Shares ($100 Liquidation Value), $.01 par value per share (the "Class A Shares"), and 2,790,776 outstanding shares of $3.00 Class B Cumulative Convertible Preferred Shares ($25 Liquidation Value), $.10 par value per share (the "Class B Shares"): (1) $139.0 million or $129.75 per Class A Share; and (2) $127.3 million or $45.60 per Class B Share.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY-HOLDERS

During the second quarter of 1997, the Company submitted the following matter to a vote of security-holders at its Annual Meeting of Stockholders held on June 2, 1997 (the "Annual Meeting"). Proxies for the Annual Meeting were solicited pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended.

The sole matter voted upon at the Annual Meeting was the election of three (3) directors and the following is a tabulation of the results:

Total shares of Common Stock outstanding as of April 28, 1997 (the record date) - 18,097,096

Total shares of Common Stock voted in person or by proxy - 17,415,378

Election of Directors:

	FOR	WITHHOLD
Bennett S. LeBow	17,727,829	86,884
Robert J. Eide	17,727,829	88,890
Jeffrey S. Podell	17,727,829	86,884

Item 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) EXHIBITS

10.1 Class Settlement Agreement, dated May 15, 1997, by and between the named and representative plaintiff in EARL WILLIAM WALKER, ET AL. V. LIGGETT GROUP INC. ET AL., for himself and on behalf of the plaintiff settlement class, and Brooke Group Ltd. and Liggett Group Inc.

27.1 Brooke Group Ltd.'s Financial Data Schedule (for SEC use only)

27.2 BGLS Inc.'s Financial Data Schedule (for SEC use only)

99.1 Liggett Group Inc.'s Interim Consolidated Financial Statements for the quarterly period ended June 30, 1997.

99.2 New Valley Corporation's Interim Consolidated Financial Statements for the quarterly period ended June 30, 1997.

99.3 Brooke (Overseas) Ltd.'s Interim Consolidated Financial Statements for the quarterly period ended June 30, 1997.

99.4 New Valley Holdings, Inc.'s Interim Consolidated Financial Statements for the quarterly period ended June 30, 1997.

(b) REPORTS ON FORM 8-K

During the second quarter of 1997, the following current reports on Form 8-K were filed:

	REGISTRANT(S)	DATE OF REPORT	ITEM(S)	FINANCIAL STATEMENTS
1.	Brooke Group Ltd. BGLS Inc.	June 11, 1997	5, 7	None
2.	Brooke Group Ltd.	April 14, 1997	7	None

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.

BROOKE GROUP LTD.
(REGISTRANT)

By: /s/ Joselynn D. Van Siclen

Joselynn D. Van Siclen
Vice President and Chief
Financial Officer

Date: August 19, 1997

BGLS INC.
(REGISTRANT)

By: /s/ Joselynn D. Van Siclen

Joselynn D. Van Siclen
Vice President and Chief
Financial Officer

Date: August 19, 1997

Exhibit 10.1

CLASS SETTLEMENT AGREEMENT

This CLASS SETTLEMENT AGREEMENT is entered into this 15th day of May 1997 by and between the named and representative plaintiff ("Plaintiff") in EARL WILLIAM WALKER, ET AL. V. LIGGETT GROUP INC., ET AL., Civil Action No. 2:97-0102, United States District Court, Southern District of West Virginia (the "WALKER Action"), for himself and on behalf of the plaintiff settlement class as hereinafter defined ("Settlement Class"), and Brooke Group Ltd., a Delaware corporation ("Brooke Group"), Liggett & Myers Inc., a Delaware corporation ("Myers"), and Liggett Group Inc., a Delaware corporation (which, with Myers, is hereinafter referred to as "Liggett").

RECITALS

WHEREAS,

1 On February 7, 1997, Plaintiff filed a complaint to commence the WALKER Action against Liggett, asserting claims on behalf of a putative nationwide class of all persons who have incurred or are alleged to have incurred costs or other damages arising from cigarette smoking and seeking, among other things, equitable/injunctive relief, a declaratory judgment, and compensatory and/or punitive damages, according to proof, as set forth in the complaint.

2 On March 19, 1997, a complaint was filed to commence the action CAROL FLETCHER, ET AL. V. BROOKE GROUP, LTD., ET AL., Civil No. 97-13, in the Circuit Court of Mobile, Alabama ("FLETCHER") against Liggett and Brooke Group asserting claims on behalf of a putative nationwide class of all persons and entities which have incurred or are alleged to have incurred costs or other damages arising from cigarette smoking and seeking, among other things,

equitable/injunctive relief, a declaratory judgment, and compensatory and/or punitive damages, according to proof, as set forth in the complaint.

3 On March 20, 1997, the plaintiffs in FLETCHER and Liggett and Brooke Group entered into a settlement (the "FLETCHER Settlement") of the nationwide class action brought by the plaintiffs in FLETCHER, pursuant to which Liggett agreed to, among other things, make certain payments into a settlement fund to be equitably distributed to the settlement class, comply with certain proposed regulations restricting the marketing and sale of cigarettes to minors, and offer cooperation in connection with the prosecution of lawsuits against other tobacco companies; all in accordance with the terms of the FLETCHER Settlement, a copy of which is annexed hereto as Appendix A.

4 Subsequent to the execution of the FLETCHER Settlement, the parties to the WALKER Action engaged in settlement discussions and succeeded in renegotiating that settlement for the purpose of resolving the WALKER Action.

5 The primary purpose of this Class Settlement Agreement (and the FLETCHER Settlement) is to provide certain compensatory, equitable and injunctive relief sought by Plaintiff and other settlement class members, including, among other things, payments by Liggett to a settlement fund, the cooperation of Liggett and Brooke Group with respect to class members' claims against other tobacco manufacturers, the preclusion of certain advertisement and marketing practices, and the addition of a further warning to Liggett cigarettes. The mechanism for accomplishing the compensatory relief set forth in this Agreement is the creation of a settlement fund board, to which the claims of all settlement class members against Liggett and

Brooke Group shall be directed. The compensatory, equitable and injunctive relief are components of an integrated settlement set forth in this Class Settlement Agreement.

6 Apart from this action and the FLETCHER action, scores of individual and putative class actions, as well as several actions brought on behalf of states and other governmental bodies and other entities, have been filed against Liggett and Brooke Group and other tobacco defendants seeking, among other things, equitable relief and damages allegedly arising from cigarette smoking. Moreover, actions are still being filed and many more are expected to be filed in the future. Smoking-related litigation has resulted in extensive discovery concerning the potential liability of Liggett and Brooke Group as well as extensive consideration of the legal and factual bases of smoking-related litigation.

7 The plaintiffs and the defendant tobacco companies have spent, and continue to spend, enormous resources litigating these smoking-related claims. Such litigation is depleting and will continue to deplete the defendant tobacco companies' resources otherwise available to compensate claimants. Absent an alternative method of resolution, Liggett, a financially troubled company, would not be able to satisfy the smoking-related claims pending against it, let alone the claims which may be asserted in the future.

8 Counsel for the Plaintiff have substantial experience in the litigation of smoking-related cases and class actions, including the litigation of individual smokers' cases.

9 Liggett and Brooke Group have denied, and continue to deny any wrongdoing or any legal liability of any kind in all smoking-related litigation.

10 In light of the uncertainties associated with the pending litigation and Liggett's financial condition, there are substantial risks that adjudications with respect to smoking-related claims by certain settlement class members will, as a practical matter, be dispositive of the claims and interests of certain other settlement class members not yet adjudicated or will substantially impair or impede the ability of such other settlement class members to protect their interests.

11 Liggett and Brooke Group recognize and acknowledge that defending the continued prosecution of the WALKER Action (and other similar putative class actions and individual suits) against them, through trial and appeals, would require considerable resources and expense, would entail uncertainty and risk, and constitutes circumstances under which the available assets of Liggett may be properly characterized as a "limited fund" in comparison to the aggregate potential claims of all settlement class members. Liggett and Brooke Group have determined that the settlement, in accordance with this Class Settlement Agreement, of the claims asserted in the WALKER Action against them will be beneficial by enabling Liggett to continue the legal business of selling cigarettes, under terms of candor and full disclosure to the public, while avoiding bankruptcy or other insolvency that could otherwise result from the transaction costs and potential exposure of ongoing litigation.

12 Plaintiffs allege that Liggett and Brooke Group have acted or refused to act on grounds generally applicable to the settlement class, thereby making final injunctive relief appropriate with respect to the class as a whole in accordance with Rule 23(b)(2) of the Federal Rules of Civil Procedure in the context of this settlement.

13 Liggett has made available relevant information, and Plaintiff, through counsel, have investigated such information and other relevant information, as to the nature, extent and availability of Liggett's financial resources, and have concluded preliminarily that the criteria of Federal Rule of Civil Procedure 23(b)(1)(B) apply to Liggett and its affiliates in the context of this settlement.

14 Plaintiff and Liggett and Brooke Group recognize and support the public interest in preventing smoking by, or the promotion of smoking to, children and adolescents and further recognize that it is of extreme importance to halt any marketing efforts directed to children and adolescents and to provide for full disclosure of material facts relating to tobacco products.

15 Plaintiff recognizes and acknowledges that the continued prosecution of the WALKER Action and other smoking-related litigation against Liggett and Brooke Group through trial and appeals would require considerable time and expense and would entail uncertainty, risk and delay, including the risk of bankruptcy or other insolvency of Liggett. Plaintiffs have determined that the settlement, in accordance with this Class Settlement Agreement, of the claims asserted in the WALKER Action will be beneficial to the settlement class by providing the class with compensatory relief, as well as substantial and critical non-monetary equitable and injunctive relief.

NOW, THEREFORE, in consideration of the foregoing and of the promises and covenants set forth in this Class Settlement Agreement, Plaintiff, on his own behalf and on behalf of the Settlement Class (as defined below), and Liggett and Brooke Group hereby stipulate and agree that, conditional upon the approval of the Court as required by Rule 23 of the Federal

Rules of Civil Procedure and as provided herein, the WALKER Action shall be settled as against Liggett and Brooke Group and that all claims asserted by or on behalf of the Walker putative class members against the Settling Defendants shall be dismissed with prejudice, all on the terms and conditions contained herein, as follows:

1 DEFINITIONS.

As used in and solely for the purposes of this Agreement, the following terms shall have the following respective meanings:

"Actively Assist" means to engage in all reasonable efforts to provide full and timely cooperation and assistance.

"Affiliate" means a Present Affiliate or a Future Affiliate.

"Agreement" means this Settlement Agreement.

"Arbitrator" means the person or persons agreed to by the Settling States and the Settlement Class (and/or the FLETCHER Settlement Class), and/or their counsel, or appointed by the Court, the FLETCHER Court or the Multidistrict Litigation Panel, as the case may be, to make decisions regarding allocations of the Settlement Fund between the Settling States and the Settlement Class (and/or the FLETCHER Settlement Class), and to resolve disputes of the Oversight Committee.

"Attorneys General" means those State Attorneys General or other parties who have brought Attorney General Actions.

"Attorney General Actions" means actions by or on behalf of States seeking injunctive relief and/or damages in connection with smoking and/or Medicaid or other expenses allegedly resulting therefrom.

"Attorneys General Settlement Agreement" means that agreement entered into on or about March 20, 1997 between Brooke Group and Liggett and the Attorneys General of certain states, a copy of which is annexed hereto as Exhibit B.

"Brooke Group" means Brooke Group Ltd. and its Present Affiliates other than Liggett.

"Cigarette" means any product including components, accessories, or parts which is intended to be burned under ordinary conditions of use and consists of: (1) any roll of tobacco wrapped in paper or in any substance not containing tobacco; or (2) any roll of tobacco wrapped in any substances containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in subparagraph (1).

"Cigarette Pack" means a unit of twenty Cigarettes or one ounce of Tobacco Snuff.

"Cost Per Cigarette Pack" means, with respect to a Tobacco Company, the aggregate costs incurred by such Tobacco Company under a Global Settlement during a specified year, divided by the number of Cigarette Packs manufactured by such Tobacco Company during such year, as determined by The Maxwell Consumer Report published by Wheat First Butcher Singer or a similar or successor report.

"Court" means the United States District Court for the Southern District of West Virginia.

"Domestic Tobacco Operations" means the manufacture and/or sale of Cigarettes and any other tobacco products in the United States, its territories, its possessions and the Commonwealth of Puerto Rico.

"FDA Rule" means the regulations promulgated by the FDA concerning the sale and distribution of cigarettes and other products on August 28, 1996 at 60 Fed. Reg. 44396, to be codified at 21 C.F.R. Parts 801, 803, 804, 807, 820 and 897.

"FLETCHER Class Counsel" means the settlement class counsel listed in Section 25.8 of the FLETCHER Settlement Agreement.

"FLETCHER Court" means the Circuit Court of Mobile County, Alabama.

"FLETCHER Settlement Agreement" means the mandatory class action settlement entered into by plaintiffs and Liggett and Brooke Group in CAROL FLETCHER, ET AL. V. BROOKE GROUP, LTD., ET AL., Civil No. 97-13, in the Circuit Court of Mobile, Alabama on March 20, 1997, a copy of which is annexed hereto as Appendix A.

"FLETCHER Settlement Class" means the settlement class as defined in the FLETCHER Settlement Agreement.

"Future Affiliate" means any one entity, other than an entity with a Market Share greater than 30% as of the date of this Agreement, which is a Non-settling Tobacco Company (including any successor to or assignee of its assets) if such entity or an Affiliate of such entity with the prior written approval of Brooke Group, subsequent to the date, and during the term, of

this Agreement but prior to the fourth anniversary of the date of execution of this Settlement Agreement: (i) directly or indirectly acquires or is acquired by Liggett or Brooke Group; (ii) directly or indirectly acquires all or substantially all of the stock or assets of Liggett or Brooke Group; (iii) all or substantially all of whose stock or assets are directly or indirectly acquired by Liggett or Brooke Group; or (iv) directly or indirectly merges with Liggett or Brooke Group or otherwise combines on any basis with Liggett or Brooke Group.

"Future Affiliate Transaction" means a transaction, or series of transactions, by which an entity becomes a Future Affiliate.

"Global Settlement" means any National disposition, settlement, agreement or other arrangement, such as "Tobacco Claims Legislation", by way of legislation, executive order, regulation, taxation, levy, fine, class action settlement, court order or otherwise, of smoking-related litigation, in direct or indirect connection with which one or more Tobacco Companies receives the benefit of a limitation of, or total or partial immunity from, liability to the members of the Settlement Class for the types of claims released under this Agreement.

"Initial Notice" means the written notice document to be provided by Liggett and its Present Affiliates to Settlement Class members as defined in Section 8.1 of this Agreement.

"Initial Notice Date" means the first date upon which Initial Notice is given by Liggett and its Present Affiliates to the Settlement Class pursuant to Section 8.1 of this Agreement.

"Injury" means any physical, mental or emotional injury, including, by way of example and not limitation, cancer, heart disease, emphysema, addiction and phobia.

"Liggett" means Liggett Group Inc. and Liggett & Myers, Inc.

"Mandatory Class Fairness Hearing" means the hearing to be conducted by the Court in connection with the determination of the fairness, adequacy and reasonableness of this Agreement under Rule 23 of the Federal Rules of Civil Procedure, insofar as the Agreement applies to Liggett and its Present Affiliates.

"Mandatory Class Final Order and Judgment" or "Mandatory Class Final Approval" means the order to be entered by the Court, with respect to Liggett and its Present Affiliates, approving this Agreement without material alterations, as fair, adequate and reasonable under Rule 23 of the Federal Rules of Civil Procedure, confirming the Settlement Class certification under Rule 23 thereof, and making such other findings and determinations as the Court deems necessary and appropriate to effectuate the terms of this Agreement and to exercise its continuing and exclusive jurisdiction over the enforcement and administration of all terms of this Settlement Agreement.

"Mandatory Class Settlement Date" or "Settlement Date" means the date on which all of the following shall have occurred: (a) the entry of the Mandatory Class Final Order and Judgment without material modification, and (b) the achievement of finality for the Mandatory Class Final Order and Judgment by virtue of that order having become final and non-appealable through (i) the expiration of all appropriate appeal periods without an appeal having been filed; (ii) final affirmance of the Mandatory Class Final Order and Judgment on appeal or final dismissal or denial of all such appeals, including petitions for review, rehearing or certiorari; or

(iii) final disposition of any proceedings, including any appeals, resulting from any appeal from the entry of the Mandatory Class Final Order and Judgment.

"Market Share" means, with respect to a specified Tobacco Company and a specified year, the Domestic Tobacco Operations market share in that year of all of such company's cigarettes and other tobacco products (as the case may be), as determined by The Maxwell Consumer Report published by Wheat First Butcher Singer or a similar or successor report.

"National" means actually covering or potentially covering (whether by block grants to states, localities or other governmental entities or otherwise) the United States or the United States and one or more of its territories, possessions and the Commonwealth of Puerto Rico.

"Non-Settling Tobacco Companies" means each of The American Tobacco Co., Lorillard Tobacco Co., Philip Morris Inc., R.J. Reynolds Tobacco Co., Brown & Williamson Tobacco Corp., and United States Tobacco Co., unless and until it becomes a Future Affiliate, as herein defined.

"Other Settlement" means a settlement of a Tobacco Action which is not a Global Settlement.

"Oversight Committee" means a committee, made up of no less than nine (9) individuals, to oversee the cooperation provided by Settling Defendants under Sections 5.3.1 and 5.3.2 hereof. The committee shall have not less than 75% of its composition from representation of the Attorneys General.

"Parent", with respect to Liggett means Brooke Group, and with respect to any other specified corporation or entity, means another corporation, partnership or other entity which directly or indirectly controls such specified corporation or entity.

"Parties" means the Plaintiffs and Brooke Group and Liggett.

"Population" means, with respect to a geographic area, the population of that area as reported in the most recent census conducted by the United States Bureau of the Census.

"Population Quotient" means, with respect to an Other Settlement or judgment, a quotient whose numerator is the Population of the United States and whose denominator is the total Population of the state(s), jurisdictions, or other grouping of persons covered by such Other Settlement or judgment.

"Preliminary Approval" means the Court's provisional certification of the Settlement Class, preliminary approval of this Agreement, approval of the form of Initial Notice to the Settlement Class pursuant to Rule 23 of the Federal Rules of Civil Procedure, or the setting of a date for the approval or submission for approval of the form of such notice.

"Present Affiliate" means with respect to a specified corporation, another corporation, partnership or other entity which as of the date of this Agreement, directly or indirectly, controls, is controlled by, or is under common control with, such specified corporation or entity including any and all Parents, subsidiaries, and/or sister corporations or entities of such specified corporation or entity.

"Present Value" means, with respect to a specified amount or amounts, the present value of such amount or amounts as calculated using a discount rate equal to the yield on 10-year

Treasury Notes as reported in the WALL STREET JOURNAL at the time of such calculation; provided that where such amount or amounts are not otherwise determinable, the amount or amounts to be present-valued shall be deemed to be the average for the most recent three years. "Pretax Income", with respect to Liggett, means for a specified year, the "Income before Income Taxes" as determined in accordance with generally accepted accounting principles ("GAAP") of Liggett for its most recent fiscal year, as report in filings to the United States Securities and Exchange Commission or, if there is no such filing, as reported by Liggett's independent outside auditors. If GAAP changes in any material respect during the term of this Agreement so that the benefits anticipated by the parties (in light of GAAP applicable on the date of this Agreement), an appropriate adjustment shall be made to the formulas and calculations hereunder to achieve the parties' expectations as of the date hereof.

"Protective Order" or "Stipulation Regarding Liggett Documents" means, with respect to privileged documents produced by a Settling Defendant pursuant to Paragraph 5.3.2 an order of the Court: (a) protecting the confidentiality of such documents; (b) providing that such documents may be used only in actions against Non-Settling Tobacco Companies and, to the extent permitted by law, only under seal; (c) providing that, to the extent such documents are or may be subject to the attorney/client privilege or attorney work product doctrine, such production or use of the documents does not constitute a waiver of such privilege, doctrine or protection with respect to any party other than the parties to whom the documents are produced subject to the order. The provisions of the Protective Order shall not apply to documents claimed to be privileged but which are determined by the Court or by any other court not to be privileged for reasons other than waiver due to production pursuant to this Agreement.

"Settlement Class" means a settlement class composed of:

(a) all Smokers who reside in the United States, its territories, possessions and the Commonwealth of Puerto Rico; and

(b) the estates, representatives, and administrators of these Smokers; and

(c) the spouses, children, relatives and "significant others" of these Smokers as their heirs or survivors; and

(d) all persons who reside in the United States, its territories, possessions and the Commonwealth of Puerto Rico who, prior to or during the term of this Agreement, have been exposed to or claim to have been exposed to (including, through market share theory) environmental or second-hand tobacco smoke from tobacco products manufactured by Liggett or its predecessors and have suffered or claim to have suffered Injury as a consequence thereof; and

(e) all persons or entities (including, without limitation, any territory, city, county, state, parish, possession or any other political subdivision thereof, or any agency or instrumentality of any of the foregoing, or any insurance company) in the United States, its territories, possessions, and the Commonwealth of Puerto Rico, which, prior to or during the term of this Agreement, have incurred or claim to have incurred losses as a result of, based on, or by reason of paying for or providing treatment for diseases, illnesses, or medical conditions allegedly caused by Cigarettes (or exposure thereto, including by way of environmental or second hand smoke) to the persons defined in subparagraphs (a) through (d) above; and

(f) all persons who reside in the United States, its territories, possessions and the Commonwealth of Puerto Rico, who, prior to or during the term of this Agreement, have either smoked Cigarettes or used tobacco products (or been exposed thereto, including by way of environmental or second hand smoke) and claim (i) to have suffered Injury as a consequence thereof, and (ii) in connection with such claim, allege that Liggett and/or Brooke Group or their predecessors engaged in a fraud, conspiracy or any concerted activity with one or more other tobacco product manufacturers in the manufacturing, sale or marketing of tobacco products;

provided that excluded from such settlement class are (i) officers and directors of any of the Settling Defendants, (ii) any person or entity which has entered into any prior or contemporaneous settlement with Liggett of a Tobacco Action, and (iii) any State that opts out of this Settlement pursuant to Section 9 of this Agreement.

"Settlement Class Counsel" means the firms listed in Section 24.8 of this Agreement.

"Settlement Class Representatives" means the Plaintiff or Plaintiffs approved by the Court to serve as Settlement Class representatives.

"Settlement Fund" means the fund established in accordance with the terms of Section 7 of this Agreement, which shall be established in a reputable bank or other financial institution subject to the jurisdiction of the Court, to provide a secure and interest-bearing fund, which shall be jointly controlled by the Settling States and the Settlement Class (and/or the FLETCHER Settlement Class).

"Settlement Fund Board" or "Board" means the board which shall be established pursuant to this Agreement (and/or the FLETCHER Settlement Agreement) to administer that portion of the Settlement Fund allocated to the Settlement Class and/or the FLETCHER Settlement Class pursuant to such Agreements. Board representatives shall be appointed by the Court pursuant to procedures for selection of the representatives established by the Court. At least one-third of the Board shall be comprised of representatives of the public health community who shall be designated by majority vote of the other members of the Board.

"Settling Defendants" means Brooke Group and/or Liggett.

"Settling Defendants' Counsel" means the law firm of Kasowitz, Benson, Torres & Friedman L.L.P.

"Settling States" means those States that entered into the Attorneys General Settlement Agreement.

"Smokers" means all persons who, prior to or during the term of this Agreement, have smoked Cigarettes or have used other tobacco products manufactured by Liggett or its predecessors and have suffered or claim to have suffered Injury as a consequence thereof.

"Subsequent Notice" means the written notice to be provided by Liggett and its Present Affiliates to Settlement Class members as defined and provided by Section 8.4 of this Agreement.

"Subsequent Notice Dates" means the dates defined in Section 8.4 hereof.

"Tobacco Action" means any individual lawsuit or putative or certified class action lawsuit brought against one or more Tobacco Companies in connection with smoking-related claims such as (without limitation) those asserted in the WALKER Action.

"Tobacco Companies" means The American Tobacco Co., Lorillard Tobacco Co., Philip Morris Inc., R.J. Reynolds Tobacco Co., Brown & Williamson Tobacco Corp., Liggett and United States Tobacco Co. and/or their respective Affiliates.

"Tobacco Snuff" means any cut, ground, powdered, or leaf tobacco that is intended to be placed in the oral cavity.

2. SETTLEMENT PURPOSES ONLY.

This Agreement is for settlement purposes only, and neither the fact of, nor any provision contained in, this Agreement nor any action taken hereunder shall constitute, be construed as, or be admissible in evidence against the Settling Defendants as, any admission of the validity of any claim, any argument or any fact alleged or which could have been alleged by Plaintiffs in the Action or alleged or which could have been alleged in any other action or proceeding of any kind or of any wrongdoing, fault, violation of law, or liability of any kind on the part of the Settling Defendants or any admission by them of any claim or allegation made or which could have been made in the Action or in any other action or proceeding of any kind, or as an admission by any of the Plaintiffs or members of the Settlement Class of the validity of any fact or defense asserted or which could have been asserted against them in the Action or in any other action or proceeding of any kind.

3. SUBMISSION FOR PRELIMINARY APPROVAL.

Promptly after execution of this Agreement, the Parties shall, through their respective attorneys, jointly submit this Agreement to the Court and move the Court for Preliminary Approval.

4. PARTIES.

4.1. This Agreement shall be binding, in accordance with the terms hereof, upon Plaintiffs, the Settlement Class, Brooke Group and Liggett; provided that, notwithstanding anything else contained in this Agreement, the payment obligations of this Agreement shall be binding only upon Liggett and its successors.

4.2. No Settling Defendant shall sell, dispose or transfer substantially all of its cigarette brands or businesses without first causing the acquiror, on behalf of itself and its successors, to be bound by all of the obligations of a Settling Defendant pursuant to Sections 5.2 and 5.4 through 5.8 hereunder as to such transferred brands or businesses; provided that this Section 4.2 shall not apply to the extent such sale, disposition or transfer is required by the Federal Trade Commission, Department of Justice, State Attorney General or court order.

4.3. The Parties acknowledge and agree that the willingness of Brooke Group and Liggett to enter into this Agreement, and in particular their willingness to agree to the equitable and other relief relating to cigarette marketing and to cooperation provided for in Section 5 hereof, are important to the interests of the Settlement Class.

5. CONSENT DECREES; WARNINGS; COOPERATION.

5.1. Upon execution of this Settlement Agreement, Liggett shall, by and through its Director, Bennett S. LeBow, issue a public statement substantially in the following form and substance:

The tobacco industry has for many years acted in concert to seek to deny, refute or dilute warnings concerning smoking issued by the United States Surgeon General, the Environmental Protection Agency and other respected health authorities. We at Liggett have determined, in entering into agreements settling smoking-related litigation, that we will not be a party to this industry activity. Our settlement agreements with a national settlement class, including our agreement submitted today in federal court in West Virginia for preliminary approval, have reaffirmed our commitment to aid the settlement class members and their counsel in revealing the true nature and extent of this industry conduct.

5.2. As promptly as reasonably practicable, but no later than six months after execution of the Attorneys General Settlement Agreement, Settling Defendants shall cause to be printed boldly, on all of their Cigarette packages and in all of their Cigarette advertising, in addition to the warnings mandated under the Federal Cigarette Labeling and Advertising Act, as amended, 15 U.S.C. Section 1331 ET SEQ., the statement that cigarette smoking is addictive. To the extent any Settling Defendant manufactures and sells other tobacco products, a similar warning shall be placed on such product.

5.3.1. Upon execution of this Agreement, each Settling Defendant shall:

(1) cooperate with the Settlement Class, its members and counsel, in that such Settling Defendant will take no steps to impede or frustrate their investigations into, or prosecutions of, any of the non-settling defendants in Tobacco Actions, so as to secure the just, speedy and inexpensive determination of all such smoking-related claims against said non-settling persons and entities;

(2) cooperate in and facilitate reasonable non-party discovery from Settling Defendants in connection with Tobacco Actions;

(3) actively assist the Settlement Class, its members and counsel in identifying and locating any and all persons known to such Settling Defendant to have documents or information that is discoverable in such proceedings, and to actively assist in interviewing and obtaining documents and information from all such persons, and to encourage such person to cooperate with the Settlement Class; and shall actively assist in interpreting documents relating to litigation against Non-settling Tobacco Companies; and

(4) actively assist the Settlement Class, its members and counsel, by requesting, and if necessary, moving the Court to compel, the Non-settling Tobacco Companies to produce to Liggett all documents (1) that are relevant to the subject matter of Tobacco Actions or which are likely to lead to admissible evidence in connection with the claims asserted in a Tobacco Action, and (2) that the Non-settling Tobacco Companies claim are subject to a joint defense or common interest privilege. Settling Defendants will review such documents, and

shall deposit those documents with respect to which Settling Defendants have concerns regarding whether such documents should be protected from discovery under seal for IN CAMERA inspection by the Court, together with a statement to the Court of Settling Defendants' concerns regarding whether they should be protected from discovery. The Parties agree to request that the Court shall retain jurisdiction to resolve that issue; and

(5) insofar as such Settling Defendant has or obtains any material information concerning any fraudulent or illegal conduct on the part of any parties, including Non-settling Tobacco Companies, their agents, attorneys, or their co-defendants designed to frustrate or defeat the claims of the plaintiffs against such parties, companies, agents, attorneys, or co-defendants, or which have the effect of unlawfully suppressing evidence relevant to smoking claims, disclose such information to the appropriate judicial and regulatory agencies, and to Settlement Class Counsel.

5.3.2. With respect to each Settlement Class member and her counsel, subject to, and promptly after (i) the entry of a Protective Order by the Court, and (ii) an agreement by such Settlement Class member and her counsel to abide by, and not object to this Settlement Agreement, each Settling Defendant shall:

(1) promptly provide all documents and information that are relevant to the subject matter of the Actions or which are likely to lead to admissible

evidence in connection with the claims asserted in a Tobacco Action, subject to the provisions of Section 5.3.2(2) hereof;

(2) waive any and all applicable attorney-client privileges and work product protections with respect to such documents and information. Such waiver shall not extend to (a) documents and information not relevant to the subject matter of Tobacco Actions or not reasonably likely to lead to admissible evidence in connection with claims asserted in any Tobacco Action (b) documents subject to a joint defense or other privilege or protection which Settling Defendants cannot legally waive unilaterally, except that the waiver by the Settling Defendant shall apply, to the extent permitted by law, to its own joint defenses or other privileges. To the extent that a Settling Defendant has a good faith belief, or one or more Non-settling Tobacco Companies claims, that documents to be provided pursuant to Section 5.3.2(1) hereof may be subject to a joint defense or other privilege (or a claim of such privilege) of one or more of the Non-settling Tobacco Companies, such documents shall be deposited under seal for in camera inspection by the Court, or a court in which a Tobacco Action is pending, together with a statement to the Court that such Settling Defendant has concerns as to whether some or all of such documents should be protected from discovery, and the Parties agree to request that the Court shall retain jurisdiction to resolve that issue. Liggett will participate in proceedings, including by way of court

appearances or declarations, concerning issues of whether such documents are discoverable;

(3) offer their employees, and any and all other individuals over whom they have control, to provide witness interviews of such employees and to testify, in depositions and at trial; it being understood and agreed that Liggett will waive and hereby does waive any and all applicable confidentiality agreements to the extent such confidentiality agreements would restrict testimony under this Agreement, if any, to which such witnesses may be subject;

(4) demand from its past or current national legal counsel all documents and information obtained in the course of representation of any Settling Defendant which in any way relates to the cooperation required in paragraphs 5.3.1(1) - 5.3.2(3) above, which shall be provided to the Settlement Class, its members and counsel as provided under this paragraph.

5.3.3. With respect to the cooperation set forth in paragraphs 5.3.1 and 5.3.2 above, the Attorneys General and Settlement Class Counsel (and/or FLETCHER Class Counsel) shall appoint, on a yearly basis, an Oversight Committee, to oversee such cooperation so that it fairly assists them and minimizes the burden on a Settling Defendant. All requests for cooperation will be first made to the Oversight Committee. The Oversight Committee shall coordinate such requests giving due regard to the legitimate needs of the litigants requesting cooperation and the burden on the Settling Defendant. Nothing in this Agreement shall waive or alter the rights of Settlement Class

members to obtain discovery of Liggett as required by a court order or case management order in any Tobacco Action, provided that no order is sought that is inconsistent with this Agreement.

5.3.4. In the event the Oversight Committee cannot agree on the sharing of cooperation by litigants, any member of the Committee may seek resolution by an Arbitrator. In the event that the Oversight Committee cannot agree on the selection of an Arbitrator, the Oversight Committee will petition the Multidistrict Litigation Panel for appointment of an Arbitrator. In the event any Settling Defendant, absent good cause, does not provide requested cooperation as promptly as reasonably practicable, after receiving written notice from the Committee of such request, (1) the Committee may seek relief from an Arbitrator, and (2) the Committee, upon notice to the Settling Defendant, may petition an Arbitrator for specific performance of such requested cooperation.

5.4. Each Settling Defendant, promptly after becoming bound by this Agreement, shall consent to jurisdiction by the FDA, for the sole purpose of promulgating the FDA Rule with respect to all Tobacco Companies. Further, each Settling Defendant, promptly after execution of this Agreement, shall endorse, support and assist in attempts by the FDA to have the FDA Rule become enforceable. Such efforts shall include, if and as reasonably requested by the Attorneys General, filing appropriate amicus briefs and other court papers in litigation relating to the FDA Rule.

5.5. Each Settling Defendant shall follow and abide by the provisions of the FDA Rule, insofar as they pertain solely to such Settling Defendant's Domestic Tobacco

Operations, as set forth in, and modified by, paragraphs 5.5.1 - 5.5.4 hereof until a final determination is reached respecting the FDA Rule at which time the Settling Defendants will be bound by the FDA Rule only insofar as, and to the extent that, the FDA Rule becomes an enforceable obligation binding upon all of the Tobacco Companies:

1 FDA Rule Section 897.16(b), as proposed.

2 FDA Rule Section 897.16(d), as proposed.

3 FDA Rule Section 897.30(a), as proposed.

4 FDA Rule Section 897.30(b), but only to the extent that such section applies to billboards within 1,000 feet of a clearly marked public or private elementary or secondary school or a clearly marked, outdoor, municipal or other government-operated public playground for children.

5.6. Notwithstanding anything to the contrary in the Proposed Rule or in this Agreement, Liggett will commence compliance with Section 5.5 of this Agreement as soon as reasonably practicable, according priority as to compliance to the States listed in Appendix A to the Attorneys General Settlement Agreement and then to Subsequent Settling States; provided that Liggett may limit its compliance to the extent, if any, necessary to ensure that the net annual out-of-pocket cost to Liggett of such compliance not exceed $1 million; and provided further that Liggett shall not be obligated pursuant hereto to breach pre-existing legal obligations, if any, it may have with respect to the matters covered by Section 5.5 (and shall use its reasonable best efforts to minimize the degree to which any such obligations would impede its full compliance therewith). For purposes of this paragraph, the phrase "net annual out-of-pocket costs" means

the excess of (a) the additional out-of-pocket expenditures incurred during a particular year by Liggett in complying with the matters specified in Section 5.5, over (b) savings, if any, in out-of-pocket expenditures realized during such year by Liggett directly from the implementation of the matters covered by Section 5.5.

5.7. If, when and to the extent that the FDA Rule, in whole or in part, becomes an enforceable legal obligation binding upon all of the Defendants, each Settling Defendant will comply therewith, without consideration of any limits or exceptions herein. If the FDA Rule does not so become such a legal obligation, Liggett shall, during the duration of this Agreement, continue to comply with Section 5.5.

5.8. Each Settling Defendant shall not use cartoon characters, such as "Joe Camel" in any of its advertising and promotional materials and activities with respect to tobacco products. No Settling Defendant shall enter into any new contract for advertising and promotion with respect to tobacco products using any such cartoon characters after the date the Settling Defendants become bound by this Agreement.

6. GLOBAL SETTLEMENT.
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2 Effective upon the execution hereof, Settlement Class Counsel each agree (a) to exercise best efforts to ensure that the financial terms, financial obligations or financial conditions of any Global Settlement are no more onerous on, or less favorable to, Brooke Group and Liggett than the financial terms, financial obligations or financial conditions of this Settlement Agreement, and (b) to issue a public statement substantially in the following form and substance:

The historic settlements entered into by Liggett, whereby Liggett has agreed, among other things, to provide full cooperation to twenty-two Attorneys General and a nationwide settlement class and to consent to FDA regulation of tobacco marketing, are a major advance in our efforts to prevent smoking by children and adolescents and to ensure that the tobacco industry markets its products lawfully. Accordingly, the undersigned counsel will use their best efforts in Congress and elsewhere to ensure that any such industry-wide resolution provide for financial terms for Liggett that reflect appropriate recognition of Liggett's cooperative efforts, and which are no more onerous on, or less favorable to Liggett than those provided for in our Settlement Agreement.

3 In the event there is a Global Settlement at any time which contains financial terms, financial obligations or financial conditions as to Brooke Group and Liggett which are more onerous on, or less favorable to, Brooke Group and Liggett than those of this Settlement Agreement, then, in addition to and not in derogation of any other rights or remedies Brooke Group and Liggett may have, Brooke Group and Liggett shall have the right, at their option, to withdraw from future performance of this Agreement.

7. SETTLEMENT FUND.

7.1. Except as may otherwise be provided herein, all amounts due and owing by each Settling Defendant under this Agreement shall be paid when due into the Settlement Fund to be allocated and distributed to Settlement Class members (and/or FLETCHER Settlement Class members) and Settling States in accordance with this Agreement (and/or the FLETCHER

Settlement Agreement) and the Attorneys General Settlement Agreement. In the event that the Settling States and Settlement Class Counsel (and/or FLETCHER Class Counsel) cannot agree to an equitable allocation of the Settlement Fund between the Settling States and the Settlement Class (and/or the FLETCHER Settlement Class), the Settling States and Settlement Class Counsel (and/or FLETCHER Class Counsel) shall seek to agree on the selection of an Arbitrator to determine such allocation. In the event that the Settling States and Settlement Class Counsel (and/or FLETCHER Class Counsel) cannot agree on the selection of an Arbitrator, the Settling States and Settlement Class Counsel (and/or FLETCHER Class Counsel) will petition the Court to determine such allocation; it being understood that some portion of the Settlement Fund will be allocated to counter-market advertising.

7.2. Settling Defendants shall have no interest in or responsibility for allocations or distributions from the Settlement Fund and do not guarantee any earnings or insure against any losses from any portion of the Settlement Fund assets that may be maintained or administered as provided in Section 7.1 above.

7.3. Subject to the terms of this Agreement, Liggett shall make the following payments:

7.3.1. An initial payment of $25 million due 120 days from the date of a Future Affiliate Transaction; and

7.3.2. Subject to the provisions of Sections 7.7 - 7.9, payments, each equivalent to 25% of Liggett's Pretax Income, due 120 days after the end of each fiscal year of

Liggett. The first payment shall be made with respect to the first full fiscal year commencing after the date of this Settlement Agreement.

7.4. Liggett shall pay the reasonable and necessary expenses of the administration, allocation, and distribution of the Settlement Fund; provided that Liggett shall not be obligated to pay more than $1 million in any year for such expenses or the costs of Initial and each Subsequent Notice.

7.5. The amounts payable hereunder to the Settlement Fund shall represent the maximum amounts payable to the Settlement Fund under this Agreement (and/or the FLETCHER Settlement Agreement) and the Attorneys General Settlement Agreements. Subject to the approval of the Court (and/or the FLETCHER Court) the Settlement Fund Board shall institute a process for the allocation of the Settlement Fund to the Settlement Class, as set forth in this Agreement.

7.6. The Court shall retain exclusive and continuing jurisdiction over the Settlement Fund, and any and all claims thereto. All allocations of, and distributions from, the Settlement Fund to the Settlement Class shall be subject to Court approval.

7.7. In the event of a Global Settlement, the Settling Defendants shall have the right to reduce the aggregate payments due from Liggett in each year pursuant to this Agreement so that such aggregate payments shall be no more than the lesser of (A) on a Cost Per Cigarette Pack basis, one-third of the lowest Cost Per Cigarette Pack due in such year from the Non-Settling Tobacco Companies under such Global Settlement and (B) on a percentage of Pretax Income basis, one-third of the lowest percentage of Pretax Income due in such year from the

Non-Settling Tobacco Companies under such Global Settlement (such percentage to be computed as if the payments due from such companies were included in revenues and earnings).

7.8. Liggett shall receive as a credit against any and all amounts due hereunder, any and all amounts it is required to pay under a Global Settlement.

7.9. In the event that one or more States elect to opt out of the Settlement Class (and/or the FLETCHER Settlement Class) and action(s) are brought against any Settling Defendant on behalf of such State(s), the annual payment amount due under Sections 7.3.2 of this Agreement from a Settling Defendant shall be reduced by an amount equal to the product of (i) the ratio that the Medicaid Population of the States that elect to opt out of the FLETCHER Settlement Class then bears to the total Medicaid Population and (ii) 20% of Liggett's Pretax Income.

7.10. The Settlement Fund shall constitute the sole source of recovery on any and all claims against Liggett and its Present Affiliates which have been, will be, or could be asserted, directly or indirectly, by, on behalf, or for the benefit of any and all Settlement Class members, such that, subject to the Court's final determination that this Settlement Agreement is fair pursuant to Mandatory Class Final Approval, Liggett and its Present Affiliates shall enjoy a universal release from all claims associated with or resulting from the smoking of their cigarettes in consideration of their agreeing to the entry of the Consent Decree and of Liggett's payments into the Settlement Fund and of the reasonable expenses of the administration, allocation, and distribution of the Settlement Fund, for the benefit of Settlement Class members, in accordance with this Agreement.

7.11. The Board shall institute a process for the equitable adjudication of smoking-related claims against Liggett for compensatory damages by Settlement Class members in view of, among other things, the history of the outcome of such claims; it being understood that all claims for punitive, exemplary or other such damages are hereby waived. The Board shall also consider any and all comments, recommendations, requests and suggestions from Settlement Class members and their counsel, as to the appropriate and equitable allocation and distribution of the Settlement Fund, for evaluation and recommendation by the Board to the Court for its approval. The Court shall not be requested by the Parties or the Board to make any specific orders regarding the ultimate allocation and distribution of the Settlement Fund at the time of Preliminary or Mandatory Class Final Approval. The notice forms to be submitted to the Court for its approval shall inform Settlement Class members that issues of allocation and distribution are reserved for future rulings, conditioned upon and subsequent to Mandatory Class Final Approval, and that any and all Settlement Class members who wish to do so may submit their comments, recommendations, requests and suggestions for the allocation and distribution of the Settlement Fund, under a procedure to be established by the Court. The Court will be requested to grant Preliminary and Mandatory Class Final Approval without regard to the ultimate equitable allocation and distribution of the Settlement Fund, in order to provide Settlement Class members with a full opportunity to participate in the allocation decision-making process after the Settlement Fund is in place; and to avoid distracting the parties and the Court, during the settlement approval process, with comments or objections more properly directed at the specifics of allocation and distribution with respect to particular claimants rather than the

common class interest in the overall fairness, adequacy, and reasonableness of the Settlement itself, in the context of the "limited fund" available from Liggett to pay claims, the provision of valuable equitable relief, and the compromise of disputed and risky claims.

7.12. Settling Defendants agree not to take any action the primary purpose of which is to reduce Liggett's payment obligations under this Agreement.

7.13. Settling Defendants represent that prior to entering into this Settlement Agreement, Settling Defendants took no action the primary purpose of which was to reduce Liggett's anticipated payment obligations under this Agreement.

8. NOTICE TO THE SETTLEMENT CLASS.

8.1. Upon Preliminary Approval, and as the Court may direct, each Settling Defendant shall cause notice of the settlement embodied herein (the "Initial Notice") to be given to the members of the Settlement Class.

8.2. The Initial Notice to Settlement Class members shall inform them as follows:

> The allocation of the Settlement Fund to specific uses or among particular claimants has not been determined. Future allocation and distribution of the Settlement Fund will be administered by the Settlement Fund Board. The Board shall be comprised of representatives appointed by the Attorneys General of certain settling states and by Settlement Class Counsel with the approval of the Court, and it shall include representatives of the public health community. The Board shall be responsible for recommending and implementing guidelines and procedures for the administration of

claims. The Settlement Agreement does not specify any particular allocation of Settlement proceeds. Settlement Class members will be given notice and an opportunity to be heard and make suggestions regarding allocation before any final allocation or distribution decisions are made.

8.3. The Initial Notice, in a form to be approved by the Court, shall be disseminated as provided in this Section 8 over the course of a period not to exceed ninety (90) days from the Initial Notice Date, subject to approval by the Court.

8.4. At the end of each successive three-year interval during the term of this Agreement ("Subsequent Notice Dates"), each Settling Defendant shall cause notice of the settlement embodied herein (the "Subsequent Notice") to be given to the members of the Settlement Class.

8.5. Each Subsequent Notice, in a form to be approved by the Court, shall be disseminated over the course of four periods each not to exceed sixty (60) days from each applicable Subsequent Notice Date.

9. MANDATORY CLASS CERTIFICATION AS TO LIGGETT.

The mandatory certification of the Settlement Class under Rule 23(b)(1)(B) and/or 23(b)(2) of the Federal Rules of Civil Procedure is essential to the ability of the Parties to perform the terms and conditions set forth in this Settlement Agreement. It is the intent and understanding of the Parties that the undertakings of Liggett and Brooke Group as described in Section 5 of this Settlement Agreement, with respect to Liggett's promotional, advertising, marketing and sales practices in order to inform the Settlement Class and the American public of

the dangers of smoking and the addictive nature of nicotine, to prevent sales of cigarettes to children and adolescents, and to provide active and meaningful cooperation in the prosecution of smokers' claims against Non-Settling Tobacco Companies constitute injunctive, equitable, and declaratory relief of real, immediate, and ongoing benefit to the Settlement Class and the public, sufficient to satisfy the criteria of mandatory class certification under Rule 23. The Parties shall cooperate in establishing, to the satisfaction of the Court, the evidentiary predicates for the Court's determination of a "limited fund" under Rule 23. In the event the Settlement Class is not certified under one or more of these mandatory provisions, or is later decertified by the Court or on appeal, Liggett and Brooke Group shall have the right and option to withdraw from this Settlement Agreement.

10. FUTURE AFFILIATE.

10.1. The terms of this Agreement shall not be binding upon or applicable to a Future Affiliate of the Settling Defendants, except as provided for in this Section 10.

10.2. (a) In the event of a Future Affiliate Transaction, the Settlement Class shall not seek to enjoin or otherwise challenge a spinoff or like disposition of the stock or assets of any Affiliate of the Future Affiliate which is not engaged in Domestic Tobacco Operations. The Settlement Class reserves the right to seek to enjoin such a spinoff in the event that such spinoff or like disposition is sought by someone other than Brooke Group or a Future Affiliate or an Affiliate of a Future Affiliate.

(b) In the event of and after a Future Affiliate Transaction: (i) the Settlement Class members each release (pursuant to, MUTATIS MUTANDIS, Section 11.1 hereof) and

covenant not to bring suit for any claim so released against any Affiliate of the Future Affiliate, other than the Affiliate engaged in Domestic Tobacco Operations; and (ii) if prior to the Future Affiliate Transaction, a Settlement Class member shall have obtained a verdict or judgment in an action, against an Affiliate (including the Parent) of the Future Affiliate, other than against the Affiliate engaged in Domestic Tobacco Operations, such Settlement Class member shall not seek to enforce such verdict or judgment against any such Affiliate other than the Affiliate engaged in Domestic Tobacco Operations.

10.3. In the event a Settlement Class member obtains a verdict or judgment against a Non-settling Tobacco Company in a Tobacco Action, and a Settling Defendant commences a proxy contest or similar action seeking control of such Non-settling Tobacco Company or an Affiliate thereof, then such Non-settling Tobacco Company or an Affiliate thereof will not be required to post a bond in order to stay enforcement of such verdict or judgment, and such Settlement Class member will not seek to enforce such verdict or judgment against such Non-settling Tobacco Company or such Affiliate, for a period of the earlier of (i) one year from the commencement of such proxy contest or action, and (ii) completion or resolution of the proxy or merger vote.

10.4. In the event that subsequent to a Future Affiliate Transaction, and in conformity with Section 10.2(b) hereof, a Settlement Class member obtains a verdict or judgment against a Future Affiliate in an action, such Future Affiliate will not be required to post a bond in order to stay enforcement of such verdict or judgment, and such Settlement Class member will

not seek to enforce such judgment against such Future Affiliate or an Affiliate of such Future Affiliate until the verdict or judgment becomes final and non-appealable.

10.5. Prior to a Future Affiliate Transaction, Settling Defendants shall not enter into any agreement with any prospective Future Affiliate which diminishes or impairs the prospective Future Affiliate's assets, other than in the established and/or ordinary course of business of such prospective Future Affiliate, and shall use best efforts to prevent such prospective Future Affiliate from diminishing or impairing such assets. In the event of a Future Affiliate Transaction, the Settlement Class reserves all of their rights to prevent the Future Affiliate from diminishing or impairing the Future Affiliate's assets, other than in the established and/or ordinary course of business of such Future Affiliate.

10.6. With respect to subsections 10.1 - 10.5 above, nothing in these provisions, or elsewhere in this Agreement, limits the authority of the Settlement Class to challenge any transaction which they reasonably believe is in violation of federal or state antitrust law.

10.7. In the event of a Future Affiliate Transaction, after which Liggett remains as a separate entity such that Liggett's Pretax Income is readily calculable, Section 7.3.2 hereof shall remain in effect with respect to Pretax Income solely attributable to such separate entity. In the event of a Future Affiliate Transaction, Settling Defendants and the Attorneys General and their respective counsel, each agree to exercise best efforts to negotiate in good faith a payment schedule to replace that set forth in Section 7.3.2. Nothing in this Section 10.7 affects in any way Liggett's payment obligations under Section 7.3.1 hereof.

10.8. Promptly after a Future Affiliate Transaction, a Future Affiliate shall abide by Sections 5.4 - 5.7 hereof.

10.9. Promptly after a Future Affiliate Transaction, Settling Defendants and the Settlement Class Counsel, each agree to exercise best efforts to negotiate in good faith a settlement of all claims against a Future Affiliate.

10.10. As promptly as reasonably practicable after a Future Affiliate Transaction, a Future Affiliate shall agree to eliminate cartoon characters such as "Joe Camel," from all of its advertising and promotional materials and activities with respect to tobacco products.

11. RELEASE.

11.1. Upon the Mandatory Class Settlement Date, with respect to each Settling Defendant, for good and sufficient consideration as described herein, all members of the Settlement Class, collectively and individually, on behalf of themselves, the persons they represent, their heirs, executors, administrators, trustees, beneficiaries, agents, attorneys, successors, assigns, affiliates, officers, directors, employees and shareholders shall be deemed to and do hereby release, dismiss and discharge each and every claim, right, and cause of action (including, without limitation, all claims for damages, medical expenses, restitution, medical monitoring, or any similar legal or equitable relief, under federal, state or common law), known or unknown, asserted or unasserted, direct or indirect, which they had, now have, or may hereafter have against each Settling Defendant (including its past, present and future parents, subsidiaries, affiliates and their past, present and future agents, servants, attorneys, employees, officers, directors, shareholders, and beneficial owners) (and downstream distribution entities of

Liggett, but only to the extent that such downstream distribution entities would have cross-claims against Liggett) which is based on any and all harm, injury or damages claimed by members of the Settlement Class to be caused by smoking, addiction to, or dependence upon, cigarettes or which is asserted in the Action in connection with, or arising out of the conduct, acts, facts, transactions, occurrences, representations or omissions set forth, alleged, referred to or otherwise embraced in the Action complaint or any and all other Tobacco Actions.

Provided, however, as follows:

1) If this Agreement expires upon completion of its full term, this release shall continue and apply in full force and effect with respect to all released claims which accrued or shall accrue prior to, through and including the date of such expiration, such that such claims shall be forever released, but only as to such claims through and including such date; if this Agreement terminates for any reason prior to its full term, this release shall be of no further force and effect and Settling Defendants shall be entitled to a credit to the extent otherwise provided in this Agreement against all claims covered by the release for the full amount paid by such Settling Defendants hereunder.

2) Except as specifically provided herein, this release does not pertain or apply to any other existing or potential defendant in any present or future action.

3) This release does not release Settling Defendants from claims which may be asserted by the Settlement Class against a Settling Defendant involving conduct unrelated to the manufacture and/or sale of tobacco products.

11.2. Except as specifically provided herein, nothing in this Agreement shall prejudice or in any way interfere with the rights of the Plaintiffs, Settlement Class members, and the Settling Defendants to pursue all of their rights and remedies against Non-settling Tobacco Companies or other defendants.

12. EXCLUSIVE REMEDY; DISMISSAL OF ACTION; JURISDICTION OF COURT.

12.1. Except as otherwise provided in this Agreement, this Agreement shall be the sole and exclusive remedy for any and all released claims of Settlement Class members against the Settling Defendants, and upon the entry of the Mandatory Class Final Order and Judgment by the Court, each Settlement Class member shall be barred from initiating, asserting, or prosecuting any released claims against Brooke Group or Liggett.

12.2. On the Mandatory Class Settlement Date, the Action shall be dismissed as against each Settling Defendant, subject to the continuing and exclusive jurisdiction of the Court over the enforcement and administration of the Settlement Agreement, and the allocation and distribution of the Settlement Fund. Settlement Class members may not commence or prosecute actions against Brooke Group or Liggett on claims released pursuant to this Agreement once the Mandatory Class Final Order and Judgment is entered. The Settlement Class Counsel agree to provide reasonable cooperation to stay or dismiss, as appropriate, any action of any Settlement Class member for such released claims pending in state or federal court against the Settling Defendants.

12.3. The Court shall retain exclusive and continuing jurisdiction over the Action, all Parties, all Settlement Class members and the Settlement Fund to interpret and enforce the terms, conditions, and obligations of this Agreement. Nothing in this Agreement shall be construed to divest or limit the jurisdiction of the Court with respect to claims which may be alleged by the Settlement Class against Non-settling Tobacco Companies or other defendants.

13. TERM.

13.1. Unless earlier terminated in accordance with the provisions of this Agreement, the duration of this Agreement shall be twenty-five (25) years from the Liggett Settlement Date; provided that in the event of a Global Settlement, the duration of this Agreement shall be equal to the duration of the Global Settlement.

13.2. The performance of this Agreement by Liggett and Brooke Group is expressly contingent upon the Court's issuance of the Mandatory Class Final Order and Judgment. If the Court fails to hold the Mandatory Class Fairness Hearing within six (6) months of the date hereof or to issue a Mandatory Class Final Order and Judgment within sixty (60) days following conclusion of the Mandatory Class Fairness Hearing, Liggett and Brooke Group may elect to terminate this Agreement by written notice to the Court and the Settlement Class Counsel within twenty (20) business days following the end of either such period.

13.3. Except as may be otherwise specifically provided in this Agreement, a termination by a Settling Defendant hereunder shall have the effect of rendering this Agreement as having no force or effect whatsoever, null and void AB INITIO, and not admissible as evidence for any purpose in any pending or future litigation in any jurisdiction. However, a termination

shall not affect any prior cooperation or require the return of any documents produced to a Settlement Class member pursuant to this Agreement.

14. CONTINUING ENFORCEABILITY.

14.1. The parties acknowledge and agree that the purpose of this Agreement and the mandatory certification of the Settlement Class with respect to Liggett and its Present Affiliates is to provide the Settlement Class with certain equitable and other relief, and a secure and ongoing source of recovery, subject to equitable allocation and distribution, while ensuring that Liggett may make its payments hereunder without risking bankruptcy or other insolvency; this Agreement is intended to be a mutually beneficial and equitable alternative to the prospect of bankruptcy.

14.2. Unless earlier terminated, as to the Settlement Class, this Agreement and each provision of or obligation arising from this Agreement shall continue and remain fully executory and enforceable if a Settling Defendant institutes or is subject to the institution against it of any proceeding or voluntary case under title 11 of the UnIted States Code, or other proceeding seeking to adjudicate it insolvent or seeking liquidation, winding up, reorganization, arrangement, adjustment, protection, relief or composition of it or its debts under any law relating to bankruptcy, insolvency or reorganization or relief or protection of debtors or other proceeding seeking the entry of an order for relief or the appointment of a receiver, trustee, custodian or other similar official for it or for any part of its property (each, a "Bankruptcy Proceeding"). Brooke Group has the right but not the obligation to cure and to perform any and all obligations of Liggett under this Agreement notwithstanding the occurrence and continuation

of any Bankruptcy Proceeding with respect to Liggett; provided, however, that until such time as Liggett decides whether to reject or assume this Agreement, Brooke Group shall have the obligation to pay the annual installments as provided by Section 7 hereof and any and all rights the Settlement Class may have not to accept such cure or performance in any Bankruptcy Proceeding are waived.

15. ENTRY OF GOOD FAITH BAR ORDER ON CONTRIBUTION AND INDEMNITY CLAIMS; INDEMNIFICATION.

15.1. The Parties shall request that the Court enter an order barring and prohibiting the commencement and prosecution of any claim or action by any Non-settling Tobacco Company in any smoking-related litigation against Settling Defendants, including but not limited to any contribution, indemnity and/or subrogation claim seeking reimbursement for payments made or to be made to any Settlement Class member for claims settled under this Agreement. Settling Defendants shall be entitled to dismissal with prejudice of any such Non-settling Tobacco Company's claims against them which violate or are inconsistent with this bar.

15.2. Any Settlement Class member making a claim against a non-settling person for what would be a claim settled under this Agreement if asserted against a Settling Defendant shall indemnify and hold harmless each Settling Defendant from any claim ever asserted against such Settling Defendant arising from such claim.

15.3. Claims by or on behalf of any Settlement Class members against any non-settling parties are not released and shall not be barred, precluded, limited, or reduced as a

consequence of this Agreement or the subsequent award and distribution of funds to such Settlement Class members from the Settlement Fund, except if and to the extent required under federal or state law applicable under choice-of-law doctrines in the forum in which any such claims may be instituted or pursued.

16. EXPENSES AND FEES.

16.1. Subject to Section 7.4 hereof, all reasonable and necessary expenses incurred by the Board in administering, allocating and distributing the Settlement Fund, and the costs of Initial and Subsequent Notices, shall be paid by the Settling Defendants in addition to, and without reducing, their payments into the Settlement Fund.

16.2. In addition to the above described expenses of administration and notice, the reasonable fees and expenses of the Settlement Class Counsel, if and as approved by the Court, shall be paid by the Settling Defendants after the Settlement Date separate and apart from, and in addition to, their initial payments into the Settlement Fund.

16.3. In the event of a failure by the Court to issue the Final Order and Judgment or a decision by any Settling Defendant to exercise its right to withdraw pursuant to Section 13 of this Agreement, the Settling Defendants will bear, in accordance with the terms of this Agreement, the costs of the Initial Notice incurred to such point (in the case of Brooke Group and Liggett not to exceed a total of $1 million; provided that Brooke Group, Liggett and Plaintiffs shall each have the right to terminate this Agreement in the event that the Court orders Initial Notice costing in excess of $1 million, unless Brooke Group and/or Liggett and/or Plaintiffs and/or Settlement Class Counsel agree to pay such excess.)

17. TAX STATUS OF SETTLEMENT FUND.

17.1. The Settlement Fund created under this Agreement will be established and maintained as a Qualified Settlement Fund ("QSF") in accordance with Section 468B of the Internal Revenue Code of 1986, as amended (the "IRC"), and the regulations promulgated thereunder. Any Settling Defendant shall be permitted, in its discretion, and at its own cost, to seek a private letter ruling from the Internal Revenue Service ("IRS") regarding the tax status of the Settlement Fund. The parties agree to negotiate in good faith, subject to Court approval, any changes to the Agreement which may be necessary to obtain IRS approval of the Settlement Fund as a QSF.

17.2. Representatives of the Settling States and the Settlement Class will be appointed to act as administrator of the Settlement Fund. As administrator, such representatives will undertake the following actions in accordance with the regulations under IRC section 468B: (a) apply for the tax identification number required for the Settlement Fund; (b) file, or cause to be filed, all tax returns the Settlement Fund is required to file under federal or state laws; (c) pay from the Settlement Fund all taxes that are imposed upon the Settlement Fund by federal or state laws; and (d) file, or cause to be filed, tax elections available to the Settlement Fund, including a request for a prompt assessment under IRC sec. 6501(d), if and when the administrator deems it appropriate to do so.

17.3. The Settling Defendants, as transferors of the Settlement Fund, shall prepare and file the information statements concerning their settlement payments to

the Settlement Fund as required to be provided to the IRS pursuant to the regulations under IRC Section 468B.

18. COURT'S SETTLEMENT APPROVAL ORDER.

Except as specifically provided herein, this Agreement is subject to and conditioned upon the issuance by the Court, following the fairness hearing, of a Mandatory Class Final Order and Judgment.

19. EFFECT OF DEFAULT OF ANY SETTLING DEFENDANT.

In the event any Settling Defendant fails to make a payment due and owing under the terms of this Agreement, or is in default of this Agreement in any other respect, the Settlement Class Counsel shall so notify the Court. The defaulting Settling Defendant shall then be given up to sixty (60) calendar days to "cure" the default. If the defaulting Settling Defendant does not "cure" the default in the time provided in this Section 19, the Settlement Class Counsel may apply to the Court for relief, including withdrawal from the agreement.

20. REPRESENTATIONS AND WARRANTIES; COVENANTS.

20.1. Each Settling Defendant represents and warrants that (i) it has all requisite corporate power and authority to execute, deliver and perform this Agreement and to consummate the transactions contemplated hereby; (ii) the execution, delivery and performance by such Settling Defendant of this Agreement and the consummation by it of the actions contemplated herein have been duly authorized by all necessary corporate action on the part of such Settling Defendant; and (iii) this Agreement has been duly and validly executed and delivered by such Settling Defendant and constitutes its legal, valid and binding obligation.

20.2. Each Settling Defendant covenants and agrees for the benefit of the Settlement Class that it will not enter into any transaction involving the borrowing of funds in excess of $100 million unless such transaction is fair from a financial perspective to the Settling Defendant and represents the reasonable exercise of such Settling Defendant's business judgment.

21. ARBITRATION.

21.1. In the event that the Parties are unable to agree, after good faith efforts, as to the determination or calculation of Pretax Income or Market Share for any year hereunder, such determination or calculation shall be submitted to binding arbitration under the supervision of the Court.

21.2. The Settlement Class Counsel shall during the term of this Agreement have the right, at its sole cost, to have an independent auditor review the Settling Defendants' compliance with their payment obligations under this Agreement; provided that any such review will not be binding upon such Settling Defendants.

22. MOST FAVORED NATION.

22.1. In the event of any Other Settlement with any Non-Settling Tobacco Company, the payments due from each Settling Defendant in each year under this Agreement shall be reduced to the extent, if any, necessary to ensure that such payments are the lesser of (a) on a percentage of Pretax Income basis, payments such that the percentage in each year of such Settling Defendant's Pretax Income represented by such payments is no more than one-third of the percentage in such year of such Non-Settling Tobacco Company's Pretax Income

represented by the product of (i) the average annual payments due from such Non-Settling Tobacco Company under such Other Settlement and (ii) the Population Quotient with respect to such Other Settlement and (b) on a Cost Per Cigarette Pack basis, no more than the product of (i) one-third of the lowest Cost Per Cigarette Pack due in such year from the Non-Settling Tobacco Companies under such Other Settlement and (ii) the Population Quotient with respect to such Other Settlement. The Benchmark Figure set forth in this Section 22.1 does not reflect in any fashion the Settlement Class's or Settlement Class Counsels' views as to an appropriate settlement or resolution with any Non-Settling Tobacco Company.

22.2. In the event of the entry of any final monetary judgment (other than by way of settlement) in a Tobacco Action, against any one or more of the Non-Settling Tobacco Companies, then each Settling Defendant shall have the right to reduce the payments it is obligated to make pursuant to this Agreement to the extent, if any, necessary to make the sum of all amounts theretofore paid and the then Present Value of all amounts thereafter payable pursuant to this Agreement (assuming for purposes of such Present Value calculation that the annual amounts due hereunder remain unchanged from the then most recent fiscal year) by any Settling Defendant per percentage point of the then Market Share of such Settling Defendant no more than the lesser of (a) fifty (50%) of (i) the dollar amount of the product of (A) such judgment and (B) the Population Quotient with respect to such judgment per (ii) percentage point of the then Market Share of each such Non-Settling Tobacco Company and (b) on a Cost Per Cigarette Pack basis, no more than the product of (i) one-third of the lowest Cost Per Cigarette Pack due in each year from such Non-Settling Tobacco Company under such judgment and

(ii) the Population Quotient with respect to such judgment; provided that such Settling Defendant shall give written notice of such reduction and the method of calculating such reduction to the Court and Settlement Class Counsel as soon as practicable after the entry of such judgment.

22.3. In each year beginning with the second year a Settling Defendant becomes bound by this Agreement, the annual payment amount due under Section 7.3 of this Agreement from such Settling Defendant shall be decreased in proportion to any decrease, and (only if there shall have been a prior such decrease) increased in proportion to any increase, in such Settling Defendant's Market Share from the prior year; provided, however, that (a) such annual payment amount shall not be so decreased to the extent, if any, that such annual payment amount in such year is decreased as a result of a decrease in such Settling Defendant's Pretax Income and (b) such annual payment amount shall never be increased such that the aggregate amount of any such increases exceeds the aggregate amount of any such decreases. Such Settling Defendant, as soon as practicable after the end of such year, shall give written notice of any such decrease or increase and the method of calculating it to the Court and Settlement Class Counsel.

22.4. The Plaintiffs, on behalf of themselves (upon the execution hereof) and the Settlement Class (upon Preliminary Approval), Settlement Class Counsel, and any attorneys or representatives of any of the foregoing, agree that for the next fifteen (15) years neither the Plaintiffs, the Settlement Class, nor any attorneys or representatives of the foregoing will, without the express written consent of Brooke Group (which may be withheld for any reason or for no reason) discuss, negotiate, support, approve or enter into any agreement or understanding

with any creditor, claimant, trustee, receiver or other party-in-interest, of Liggett, Brooke Group or any of their affiliates, other than Brooke Group itself (collectively, "Prohibited Parties"), with respect to any restructuring, liquidation or reorganization of Liggett, Brooke Group or any of their affiliates, including with respect to any plan under Chapter 11 or Chapter 7 of title 11, United States Code (the "Bankruptcy Code").

22.5. The rights and remedies of each Settling Defendant under this Section 22 are cumulative and not exclusive of each other and shall survive the termination of this Agreement.

23. FURTHER ACTIONS.

Each of the Parties and their respective counsel shall take such actions and execute such additional documents as may be reasonably necessary or appropriate to consummate or implement the settlement contemplated by this Agreement.

24. MISCELLANEOUS.

24.1. This Agreement, including all Exhibits attached hereto, shall constitute the entire agreement among the Parties with regard to the subject matter of this Agreement and shall supersede any previous agreements and understandings between the Parties with respect to the subject matter of this Agreement. This Agreement may not be changed, modified, or amended except in writing signed by all parties, subject to Court approval.

24.2. This Agreement shall be construed under and governed by the laws of the State of West Virginia.

24.3. This Agreement may be executed by the Parties in one or more counterparts each of which shall be deemed an original but all of which together shall constitute one and the same instrument.

24.4. This Agreement shall be binding upon and inure to the benefit of the Settlement Class, the Settling Defendants, and their representatives, heirs, successors, and assigns.

24.5. Nothing in this Agreement shall be construed to subject any Settling Defendant's parent or affiliated company to the obligations or liabilities of that Settling Defendant.

24.6. There shall be no third party beneficiaries of this Agreement other than non-party releases hereunder. No person other than the Parties hereto, the Settlement Class members and the releasees hereunder shall have any right or claim under or in respect of this Agreement.

24.7. The headings of the Sections of this Agreement are included for convenience only and shall not be deemed to constitute part of this Agreement or to affect its construction.

24.8. Any notice, request, instruction, application for Court approval or application for Court orders sought in connection with this Agreement or other document to be given by any Party to any other Party shall be in writing and delivered personally or sent by registered or certified mail, postage prepaid, if to the Settling Defendants to the attention of each Settling Defendant's respective representative and to the Settlement Class Counsel on behalf of Settlement Class members, or to other recipients as the Court may specify. As of the date of this Agreement, the respective representatives are as follows:

Settlement Class Counsel

Kenneth B. McClain
Gregory Leyh
HUMPHREY, FARRINGTON & McCLAIN, P.C.
221 West Lexington
Suite 400
Independence, Missouri 64051

James F. Humphreys
JAMES F. HUMPHREYS & ASSOCIATES, L.C.
Bank One Center
Suite 1113
707 Virginia Street, East
Charleston, West Virginia 25301

Brooke Group and Liggett

Mr. Bennett S. LeBow
BROOKE GROUP LTD.
100 S.E. Second Street
Miami, Florida 33131

Mr. Marc E. Kasowitz
Mr. Daniel R. Benson
KASOWITZ, BENSON, TORRES & FRIEDMAN LLP
1301 Avenue of the Americas
New York, New York 10019

Mr. Michael L. Hirschfeld
MILBANK, TWEED, HADLEY & MCCLOY
1 Chase Manhattan Plaza
New York, New York 10005-1413

The above designated representatives may be changed from time to time by any Party upon giving notice to all other Parties in conformance with this Section 24.8.

24.9. References to or use of a singular noun or pronoun in this Agreement shall include the plural, unless the context implies otherwise.

IN WITNESS WHEREOF the Parties have executed this Agreement as of the day and date first written above.

SETTLEMENT CLASS COUNSEL

By: /s/ Kenneth B. McClain

Date: May 15, 1997

BROOKE GROUP LTD.

By: /s/ Bennett S. Lebow

Date: May 15, 1997

LIGGETT GROUP INC.

By: /s/ Bennett S. LeBow

Date: May 15, 1997

5
0000059440
BROOKE GROUP LTD
1,000

6-MOS	
DEC-31-1997	
JAN-01-1997	
JUN-30-1997	
	19,549
	0
	13,208
	1,102
	47,447
	95,547
	63,809
	32,204
	135,317
	186,392
	342,253
	0
	0
	1,850
	(455,169)
	135,317
	176,598
	176,598
	92,796
	92,796
	14,398
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	30,966
	(6,994)
	789
	(7,783)
	47
	0
	0
	(7,736)
	(0.42)
	(0.42)

5

EXHIBIT 27.2

0000927388
BGLS INC
1,000

6-MOS	
DEC-31-1997	
JAN-01-1997	
JUN-30-1997	
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	31,848
	137,558
	207,846
	342,253
	0
	0
	0
	(478,732)
	137,558
	176,598
	176,598
	92,796
	92,796
	14,398
	0
	(32,792)
	(8,007)
	787
	(8,794)
	47
	0
	0
	(8,747)
	0
	0

Exhibit 99.1

LIGGETT GROUP INC.

CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 1997

LIGGETT GROUP, INC.

CONSOLIDATED FINANCIAL STATEMENTS

TABLE OF CONTENTS

LIGGETT GROUP INC.

CONSOLIDATED BALANCE SHEETS
(Unaudited)
(Dollars in thousands, except per share amounts)

	June 30, 1997	December 31, 1996
ASSETS		
Current assets:		
Cash	$ 506	$ -
Accounts receivable:		
Trade, less allowances of $1,102 and $1,280, respectively	11,838	19,316
Other	792	744
Inventories	42,925	50,122
Other current assets	912	1,205
Total current assets	56,973	71,387
Property, plant and equipment, at cost, less accumulated depreciation of $29,058 and $29,511, respectively	17,943	18,705
Intangible assets, at cost, less accumulated amortization of $18,247 and $17,388, respectively	2,468	3,327
Other assets and deferred charges, at cost, less accumulated amortization of $8,241 and $7,410, respectively	3,402	4,258
Total assets	$ 80,786	$ 97,677

(continued)

LIGGETT GROUP INC.

CONSOLIDATED BALANCE SHEETS (Continued)
(Unaudited)
(Dollars in thousands, except per share amounts)

	June 30, 1997	December 31, 1996
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Current liabilities:		
Current maturities of long-term debt	$ 66,474	$ 31,807
Cash overdraft	-	6
Accounts payable:		
Trade	11,537	14,979
Affiliates	1,323	216
Accrued expenses:		
Promotional	30,390	33,666
Compensation and related items	734	682
Taxes, principally excise taxes	3,319	7,565
Estimated allowance for sales returns	5,000	5,000
Interest	8,072	8,435
Other	8,605	9,380
Total current liabilities	135,454	111,736
Long-term debt, less current maturities	107,280	144,698
Non-current employee benefits and other liabilities	16,712	17,721
Commitments and contingencies (Notes 5 and 8)		
Stockholder's equity (deficit):		
Redeemable preferred stock (par value $1.00 per share; authorized 1,000 shares; no shares issued and outstanding)		
Common stock (par value $0.10 per share; authorized 2,000 shares; issued and outstanding 1,000 shares) and contributed capital	47,640	49,840
Accumulated deficit	(226,300)	(226,318)
Total stockholder's deficit	(178,660)	(176,478)
Total liabilities and stockholder's equity (deficit)	$ 80,786	$ 97,677

The accompanying notes are an integral part of these financial statements.

LIGGETT GROUP INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(Dollars in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	1997	1996	1997	1996
Net sales*	$78,142	$113,286	$144,443	$191,774
Cost of sales*	36,214	52,533	66,473	88,825
Gross profit	41,928	60,753	77,970	102,949
Selling, general and administrative expenses	37,430	54,552	71,353	96,249
Restructuring	70	733	1,831	1,154
Operating income	4,428	5,468	4,786	5,546
Other income (expense):				
Interest income	3	-	60	-
Interest expense	(5,930)	(5,993)	(11,970)	(11,849)
Equity in income of affiliate	218	-	185	-
Sale of assets	2,402	3,714	3,994	3,698
Retirement of debt	-	-	2,963	-
Miscellaneous, net	1	(4)	-	-
Net income (loss)	$ 1,122	$ 3,185	$ 18	$ (2,605)

*Net sales and cost of sales include federal excise taxes of $19,153, $29,487, $36,013, and $50,684, respectively.

The accompanying notes are an integral part of these financial statements.

LIGGETT GROUP INC.

CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY (DEFICIT)
(Unaudited)
(Dollars in thousands)

	Common Stock and Contributed Capital	Accumulated Deficit	Total Stockholder's Deficit
Balance at December 31, 1996	$49,840	$(226,318)	$(176,478)
Net income	-	18	18
Consideration for option to acquire affiliate stock in excess of its net assets (Note 9)	(2,200)	-	(2,200)
Balance at June 30, 1997	$47,640	$(226,300)	$(178,660)

The accompanying notes are an integral part of these financial statements.

LIGGETT GROUP INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(Dollars in thousands)

	Six Months Ended June 30,	
	1997	1996
Cash flows from operating activities:		
Net income (loss)	$ 18	$ (2,605)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	3,482	4,013
Deferred income taxes	-	-
Gain on sale of property, plant and equipment	(3,994)	(3,698)
Gain on retirement of notes	(2,963)	-
Deferred finance charges and debt discount written off	130	-
Equity in income of affiliate	(185)	-
Changes in assets and liabilities:		
Accounts receivable	7,430	2,250
Inventories	7,197	5,399
Accounts payable	(2,364)	(5,043)
Accrued expenses	(8,607)	177
Non-current employee benefits	(205)	(371)
Other, net	(974)	(882)
Net cash used in operating activities	(1,035)	(760)
Cash flows from investing activities:		
Proceeds from sale of property, plant and equipment	4,743	4,415
Capital expenditures	(1,086)	(2,484)
Purchase of an option in affiliate	(2,200)	-
Net cash provided by investing activities	1,457	1,931
Cash flows from financing activities:		
Repayments of long-term debt	(4,664)	(127)
Borrowings under revolving credit facility	137,062	170,217
Repayments under revolving credit facility	(132,308)	(165,848)
Decrease in cash overdraft	(6)	(3,761)
Net cash provided by financing activities	84	481
Net increase in cash and cash equivalents	506	1,652
Cash and cash equivalents:		
Beginning of period	-	-
End of period	$ 506	$ 1,652
Supplemental cash flow information:		
Cash payments during the period for:		
Interest	$ 11,984	$ 11,584
Income taxes	$ 108	$ 75

The accompanying notes are an integral part of these financial statements.

LIGGETT GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Dollars in thousands, except per share amounts)

1. The Company

Liggett Group Inc. ("Liggett" or the "Company") is a wholly-owned subsidiary of BGLS Inc. ("BGLS"), a wholly-owned subsidiary of Brooke Group Ltd. ("BGL"). Liggett is engaged primarily in the manufacture and sale of cigarettes, principally in the United States. Certain management and administrative functions are performed by affiliates (see Note 9).

The consolidated financial statements included herein are unaudited and, in the opinion of management, reflect all adjustments necessary (which are normal and recurring) to present fairly the Company's consolidated financial position, results of operations and cash flows. The December 31, 1996 balance sheet has been derived from audited financial statements. These consolidated financial statements should be read in conjunction with the consolidated financial statements included in the Company's Annual Report on Form 10-K, as amended, for the year ended December 31, 1996, as filed with the Securities and Exchange Commission. The results of operations for interim periods should not be regarded as necessarily indicative of the results that may be expected for the entire year.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. Liggett had a net capital deficiency of $178,660 as of June 30, 1997, is highly leveraged and has substantial near-term debt service requirements. Due to the many risks and uncertainties associated with the cigarette industry and the impact of tobacco litigation (see Note 8), there can be no assurance that the Company will be able to meet its future earnings or cash flow goals. Consequently, the Company could be in violation of certain debt covenants, and if its lenders were to exercise acceleration rights under its revolving credit facility (the "Facility") or the indenture for its Senior Secured Notes (the "Liggett Notes") or refuse to lend under the Facility, the Company would not be able to satisfy such demands or its working capital requirements.

Further, the Liggett Notes require a mandatory principal redemption of $37,500 on February 1, 1998 and a payment at maturity on February 1, 1999 of $107,400 and the Facility expires on March 8, 1998 unless extended by its lenders. Current maturities of both the Liggett Notes and the Facility of approximately $66,474 contribute substantially to the working capital deficit of approximately $78,481 as of June 30, 1997.

While the Company is currently in negotiations with its note holders to restructure the terms of the Liggett Notes and, with its lenders, to extend the Facility, there are no commitments to restructure the Liggett Notes or to extend the Facility at this time, and no assurances can be given in this regard. Based on the Company's net loss for 1996 and anticipated 1997 operating results, the Company does not anticipate it will be able to generate sufficient cash from operations to make such payments. Pending completion of the negotiations, the Company postponed making the interest payment of approximately $9,700 due on August 1, 1997 on the Liggett Notes. The indenture governing the Liggett Notes provides for a 30-day grace period before the failure to pay interest will be an event of default.

The failure to pay interest on the Liggett Notes would permit the lenders under the Facility to cease making further advances. While the lenders have continued to make such advances, and management currently anticipates that they will continue to do so, no assurances can be given in this regard. If the Company is unable to restructure the terms of the Liggett Notes, extend the Facility, or otherwise make all payments thereon within the applicable grace periods, substantially all of its long-term debt and the Facility would be in default and holders of such debt could accelerate the maturity of such debt. In such event, the Company may be forced to seek protection from creditors under applicable laws.

These matters raise substantial doubt about the Company meeting its liquidity needs and its ability to continue as a going concern.

The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

2. Estimates and Assumptions

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses. Significant estimates subject to material changes in the near term include deferred tax assets, allowance for doubtful accounts, sales returns and allowances, actuarial assumptions of pension plans and litigation and defense costs. Actual results could differ from those estimates.

3. Per Share Data

All of the Company's common shares (1,000 shares, issued and outstanding for all periods presented herein) are owned by BGLS. Accordingly, earnings and dividends per share data are not presented in these consolidated financial statements.

4. Sale of Assets

On April 29, 1996, Liggett executed a definitive agreement (as amended) with Blue Devil Ventures, a North Carolina limited liability partnership, for the sale by Liggett to Blue Devil Ventures of certain surplus realty in Durham, North Carolina, for a sale price of $2,200. The transaction closed on March 11, 1997. A gain of $1,531 was recognized, net of costs required to prepare the properties for sale and selling costs.

On April 28, 1997, Liggett sold excess production equipment to Brooke (Overseas) Ltd. ("BOL") for $3,000. See Note 9.

5. Inventories

Inventories consist of the following:

	June 30, 1997	Deecember 31, 1996
Finished goods	$13,873	$15,304
Work-in-process	4,208	4,382
Raw materials	27,677	31,338
Replacement parts and supplies	3,624	3,554
Inventories at current cost	49,382	54,578
LIFO adjustment	(6,457)	(4,456)
Inventories at LIFO cost	$42,925	$50,122

The Company has a leaf inventory management program whereby, among other things, it is committed to purchase certain quantities of leaf tobacco. The purchase commitments are for quantities

not in excess of anticipated requirements and are at prices, including carrying costs, established at the date of the commitment. Liggett had leaf tobacco purchase commitments of approximately $13,828 at June 30, 1997.

6. Property, Plant and Equipment

Property, plant and equipment consists of the following:

	June 30, 1997	December 31, 1996
Land and improvements	$ 455	$ 455
Buildings	6,150	5,848
Machinery and equipment	40,396	41,913
Property, plant and equipment	47,001	48,216
Less accumulated depreciation	(29,058)	(29,511)
Property, plant and equipment, net.	$ 17,943	$ 18,705

7. Long-Term Debt

Long-term debt consists of the following:

	June 30, 1997	December 31, 1996
11.5% Senior Secured Notes due February 1, 1999, net of unamortized discount of $302 and $424, respectively	$112,310	$119,688
Variable Rate Series C Senior Secured Notes due February 1, 1999	32,279	32,279
Borrowings outstanding under revolving credit facility	29,026	24,272
Other	139	266
	173,754	176,505
Current portion	(66,474)	(31,807)
Amount due after one year	$107,280	$144,698

Senior Secured Notes

On February 14, 1992, Liggett issued $150,000 in Senior Secured Notes (the "Series B Notes"). Interest on the Series B Notes is payable semiannually on February 1 and August 1 at an annual rate of 11.5%. The Series B Notes and Series C Notes referred to below (collectively, the "Liggett Notes") require mandatory principal redemptions of $7,500 on February 1 in each of the years 1993 through 1997 and $37,500 on February 1, 1998 with the balance of the Liggett Notes due on February 1, 1999. In February 1997, $7,500 of the Series B Notes were purchased using revolver availability and credited against the mandatory redemption requirements. The transaction resulted in a net gain of $2,963. The Liggett Notes are collateralized by substantially all of the assets of the Company, excluding inventories

and receivables. Eve is a guarantor for the Notes. The Liggett Notes may be redeemed, in whole or in part, at a price equal to 102% and 100% of the principal amount in the years 1997 and 1998, respectively, at the option of the Company. The Liggett Notes contain restrictions on Liggett's ability to declare or pay cash dividends, incur additional debt, grant liens and enter into any new agreements with affiliates, among others.

On January 31, 1994, the Company issued $22,500 of Variable Rate Series C Senior Secured Notes (the "Series C Notes"). The Series C Notes have the same terms (other than interest rate) and stated maturity as the Series B Notes. The Series C Notes bore a 16.5% interest rate, which was reset on February 1, 1995 to 19.75%. The Company had received the necessary consents from the required percentage of holders of its Series B Notes allowing for an aggregate principal amount up to but not exceeding $32,850 of Series C Notes to be issued under the Series C Notes indenture. In connection with the consents, holders of Series B Notes received Series C Notes totaling two percent of their current Series B Notes holdings. The total principal amount of such Series C Notes issued was $2,842. On November 20, 1994, the Company issued the remaining $7,508 of Series C Notes in exchange for an equal amount of Series B Notes and cash of $375. The Series B Notes so exchanged were credited against the mandatory redemption requirements for February 1, 1995.

Revolving Credit Facility

On March 8, 1994, Liggett entered into the Facility under which it can borrow up to $40,000 (depending on the amount of eligible inventory and receivables as determined by the lenders) from a syndicate of commercial lenders. Availability under the Facility was approximately $209 based upon eligible collateral at June 30, 1997. The Facility is collateralized by all inventories and receivables of the Company. Borrowings under the Facility, whose interest is calculated at a rate equal to 1.5% above Philadelphia National Bank's (the indirect parent of Congress Financial Corporation, the lead lender) prime rate of 8.25%, bore a rate of 9.75% on March 31, 1997. On April 1, 1997, Philadelphia National Bank raised its prime rate to 8.5%, thereby increasing Liggett's interest rate to 10.0%. The Facility contains certain financial covenants similar to those contained in the Liggett Notes indenture, including restrictions on Liggett's ability to declare or pay cash dividends, incur additional debt, grant liens and enter into any new agreements with affiliates, among others. In addition, the Facility currently imposes requirements with respect to the Company's adjusted net worth (not to fall below a deficit of $180,000 as computed in accordance with the agreement) and working capital (not to fall below a deficit of $12,000 as computed in accordance with the agreement). The Facility is classified as short-term debt as of March 31, 1997, as it becomes due on March 8, 1998, unless extended by the lenders.

During the first quarter of 1997, the Company violated the working capital covenant contained in the Facility as a result of the 1998 mandatory redemption payment on the Liggett Notes becoming due within one year. On March 19, 1997, the lead lender agreed to waive this covenant default, and the Facility was amended as follows: (i) the working capital definition was changed to exclude the current portion of the Liggett Notes; (ii) the maximum permitted working capital deficit, as defined, was reduced to $12,000; (iii) the maximum permitted adjusted net worth deficit was increased to $180,000; and (iv) the permitted advance rates under the Facility for eligible inventory were reduced by five percent.

The Company is currently in negotiations with a committee composed of a majority of its note holders to restructure the terms of the Liggett Notes and, with it lenders, to extend the Facility. Pending completion of the negotiations, the Company postponed making the interest payment of approximately $9,700 due on August 1, 1997 on the Liggett Notes. The indenture governing the Liggett Notes provides for a 30-day grace period before the failure to pay interest will be an event of default. The failure to pay interest on the Liggett Notes would permit the lenders under the Facility to cease making further advances. While the lenders have continued to make such advances, and management currently anticipates that they will continue to do so, no assurances can be given in this regard. For information concerning Liggett's substantial near-term debt service requirements and other related matters, see Note 1.

8. Contingencies

Tobacco-Related Litigation

OVERVIEW. Since 1954, Liggett and other United States cigarette manufacturers have been named as defendants in a number of direct and third-party actions predicated on the theory that they should be liable for damages from cancer and other adverse health effects alleged to have been caused by cigarette smoking or by exposure to secondary smoke (environmental tobacco smoke, "ETS") from cigarettes. These cases are reported hereinafter as though having been commenced against Liggett (without regard to whether such cases were actually commenced against Liggett or BGL). There has been a noteworthy increase in the number of cases pending against both Liggett and the other tobacco companies. The cases generally fall into three categories: Individual Actions, Class Actions and Attorneys General Actions, although recently several actions have been commenced on behalf of other interest groups. As new cases are commenced, the costs associated with defending such cases and the risks attendant to the inherent unpredictability of litigation continue to increase. Liggett had been receiving certain financial and other assistance from others in the industry in defraying the costs and other burdens incurred in the defense of smoking and health litigation and related proceedings, but these benefits have ended. Certain joint defense arrangements, and the financial benefits incident thereto, have also ended. The future financial impact on Liggett of the termination of this assistance and the effects of the tobacco litigation settlements discussed below is not quantifiable at this time.

INDIVIDUAL CASES. As of June 30, 1997, there were 145 cases pending against Liggett where individual plaintiffs allege injury resulting from cigarette smoking, addiction to cigarette smoking or exposure to ETS and seek compensatory and, in some cases, punitive damages. Of these, 57 are pending in the State of Florida, 43 are pending in the State of New York and 17 are pending in the State of Texas. The balance of individual cases are pending in 14 states.

The plaintiffs' allegations of liability in those cases in which individuals seek recovery for personal injuries allegedly caused by cigarette smoking are based on various theories of recovery, including negligence, gross negligence, special duty, voluntary undertaking, strict liability, fraud, misrepresentation, design defect, failure to warn, breach of express and implied warranties, conspiracy, aiding and abetting, concert of action, unjust enrichment, common law public nuisance, indemnity, market share liability, and violations of deceptive trade practices laws, the Federal Racketeer Influenced and Corrupt Organization Act ("RICO") and antitrust statutes. Plaintiffs also seek punitive damages in many of these cases. Defenses raised by defendants in these cases include lack of proximate cause, assumption of the risk, comparative fault and/or contributory negligence, lack of design defect, statute of limitations, equitable defenses such as "unclean hands" and lack of benefit, failure to state a claim and federal preemption. Several representative cases are described below.

On June 24, 1992, in an action entitled Cipollone v. Liggett Group Inc., et al., the United States Supreme Court issued an opinion concluding that The Federal Cigarette Labeling and Advertising Act did not preempt state common law damage claims but that The Public Health Cigarette Smoking Act of 1969 (the "1969 Act") did preempt certain, but not all, state common law damage claims. The decision bars plaintiffs from asserting claims that, after the effective date of the 1969 Act, the tobacco companies either failed to warn adequately of the claimed health risks of cigarette smoking or sought to neutralize those claimed risks in their advertising or promotion of cigarettes. Bills have been introduced in Congress on occasion to eliminate the federal preemption defense. Enactment of any federal legislation with such an effect could result in a significant increase in claims, liabilities and litigation costs.

On March 27, 1987, an action entitled Rogers v. Liggett Group Inc. et al., Superior Court, Marion County, Indiana, was filed against Liggett and others. The plaintiff sought compensatory and punitive damages for cancer alleged to have been caused by cigarette smoking. Trial commenced on January 31, 1995. The trial ended on February 22, 1995 when the trial court declared a mistrial due to the

jury's inability to reach a verdict. The court directed a verdict in favor of the defendants as to the issue of punitive damages during the trial of this action. A second trial commenced on August 5, 1996 and, on August 23, 1996, the jury returned a verdict in favor of the defendants. This verdict is currently on appeal.

On May 12, 1992, an action entitled Cordova v. Liggett Group Inc., et al., Superior Court of the State of California, City of San Diego, was filed against Liggett and others. In her complaint, plaintiff, purportedly on behalf of the general public, alleges that defendants have been engaged in unlawful, unfair and fraudulent business practices by allegedly misrepresenting and concealing from the public scientific studies pertaining to smoking and health funded by, and misrepresenting the independence of, the Council on Tobacco Research ("CTR") and its predecessor. The complaint seeks equitable relief against the defendants, including the imposition of a corrective advertising campaign, restitution of funds, disgorgement of revenues and profits and the imposition of a constructive trust. On June 5, 1997, Liggett settled this matter.

On September 10, 1993, an action entitled Sackman v. Liggett Group Inc., United States District Court, Eastern District of New York, was filed against Liggett alleging as injury lung cancer. On May 25, 1996, the District Court granted Liggett summary judgment on plaintiff's fraud and breach of warranty claims, but, on June 9, 1997 denied Liggett's Motion for Summary Judgment on plaintiffs' conspiracy claim. On June 27, 1997, the magistrate issued an order compelling Liggett to produce certain CTR documents with respect to which Liggett had asserted various privilege claims. The other cigarette manufacturers and the CTR are appealing the order.

In February 1995, an action entitled Carter, et al. v. The American Tobacco Company, et al., Superior Court for the State of Florida, Duval County, was filed against Liggett and others. Plaintiff sought compensatory damages, including, but not limited to, reimbursement for medical costs. Both American Tobacco and Liggett were subsequently dismissed from this action. On August 9, 1996, a jury returned a verdict against the remaining defendant, Brown & Williamson Tobacco Corporation ("B&W"), in the amount of $750. The court also awarded plaintiff's attorney's fees in the amount of $1,785. B&W has appealed this verdict.

CLASS ACTIONS. As of June 30, 1997, there were 29 actions pending, which have either been certified as a class or are seeking class certification, where Liggett, among others, was a named defendant. Two of these cases, Fletcher, et al. v. Brooke Group Ltd., et al. and Walker, et al. v. Liggett Group Inc., et al. have been settled, subject to court approval. These two settlements are more fully discussed below under the "Attorneys General Actions" section.

On October 31, 1991, an action entitled Broin, et al. v. Philip Morris Incorporated, et al., Circuit Court of the Eleventh Judicial District in and for Dade County, Florida, was filed against Liggett and others. This case was the first class action commenced against the industry and has been brought by plaintiffs on behalf of all flight attendants that have worked or are presently working for airlines based in the United States and who have never regularly smoked cigarettes but allege that they have been damaged by involuntary exposure to ETS. The trial in this action commenced on June 2, 1997 and is currently in progress.

On March 25, 1994, an action entitled Castano, et al. v. The American Tobacco Company Inc., et al., United States District Court, Eastern District of Louisiana, was filed against Liggett and others. The class action complaint sought relief for a nationwide class of smokers based on their alleged addiction to nicotine. The District Court granted plaintiffs' motion for class certification.

On March 12, 1996, Liggett and BGL entered into an agreement, subject to court approval, to settle the Castano class action tobacco litigation. Under the Castano settlement agreement, upon final court approval of the settlement, the Castano class would be entitled to receive up to five percent of Liggett's pretax income (income before income taxes) each year (up to a maximum of $50,000 per year)

for the next 25 years, subject to certain reductions provided for in the agreement, and a $5,000 payment from Liggett if Liggett or BGL fail to consummate a merger or similar transaction with another non-settling tobacco company defendant within three years of the date of the settlement. Liggett and BGL have the right to terminate the Castano settlement under certain circumstances. On May 11, 1996, the Castano Plaintiffs Legal Committee filed a motion with the United States District Court for the Eastern District of Louisiana seeking preliminary approval of the Castano settlement. On May 23, 1996, the Court of Appeals for the Fifth Circuit reversed the February 17, 1995 order of the District Court certifying the Castano suit as a nationwide class action and instructed the District Court to dismiss the class complaint. On September 6, 1996, the Castano plaintiffs withdrew the motion for approval of the Castano settlement.

On March 14, 1996, BGL, the Castano Plaintiffs Legal Committee and the Castano plaintiffs entered into a letter agreement. According to the terms of the letter agreement, for the period ending nine months from the date of Final Approval (as defined in the letter), if granted, of the Castano settlement or, if earlier, the completion by Liggett or BGL of a combination with any defendant in Castano, except Philip Morris, the Castano plaintiffs and their counsel agree not to enter into any more favorable settlement agreement with any Castano defendant which would reduce the terms of the Castano settlement agreement. If the Castano plaintiffs or their counsel enter into any such settlement during this period, they shall pay BGL $250,000 within 30 days of the more favorable agreement and offer Liggett and BGL the option to enter into a settlement on terms at least as favorable as those included in such other settlement. The letter agreement further provides that during the same time period, and if the Castano settlement agreement has not been earlier terminated by BGL in accordance with its terms, BGL and its affiliates will not enter into any business transaction with any third party which would cause the termination of the Castano settlement agreement. If BGL or its affiliates enter into any such transaction, then the Castano plaintiffs will be entitled to receive $250,000 within 30 days from the transacting party.

ATTORNEYS GENERAL ACTIONS. As of June 30, 1997, 32 Attorneys General actions were filed and served on Liggett and BGL. As more fully discussed below, Liggett has reached settlements in 25 of these actions. In certain of the pending proceedings, state and local government entities and others seek reimbursement for Medicaid and other health care expenditures allegedly caused by tobacco products. The claims asserted in these Medicaid recovery actions vary. All plaintiffs assert the equitable claim that the tobacco industry was "unjustly enriched" by plaintiffs' payment of health care costs allegedly attributable to smoking and seek reimbursement of those costs. Other claims made by some but not all plaintiffs include the equitable claim of indemnity, common law claims of negligence, strict liability, breach of express and implied warranty, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under state and federal statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under RICO.

On May 23, 1994, an action entitled Moore, Attorney General, ex rel State of Mississippi v. The American Tobacco Company, et al., Chancery Court of Jackson County, Mississippi, was commenced against Liggett and others seeking restitution and indemnity for medical payments and expenses allegedly made or incurred for tobacco related illnesses. In May 1994, the State of Florida enacted legislation, effective July 1, 1994, allowing certain state authorities or entities to commence litigation seeking recovery of certain Medicaid payments made on behalf of Medicaid recipients as a result of diseases (including, but not limited to, diseases allegedly caused by cigarette smoking) allegedly caused by liable third parties (including, but not limited to, the tobacco industry). On February 21, 1995, the State of Florida commenced an action pursuant to this statutory scheme. The Florida Medicaid trial has recently commenced. See "Settlements", below. Legislation similar to that enacted in Florida has been introduced in the Massachusetts and New Jersey legislatures.

SETTLEMENTS. On March 15, 1996, in addition to the Castano settlement discussed above, Liggett and BGL entered into a settlement of tobacco-related litigation with the Attorneys General of

Florida, Louisiana, Mississippi, West Virginia and Massachusetts. The settlement with the Attorneys General releases Liggett and BGL from all tobacco-related claims by these states including claims for Medicaid reimbursement and concerning sales of cigarettes to minors. The settlement provides that additional states which commence similar Attorney General actions may agree to be bound by the settlement prior to six months from the date thereof (subject to extension of such period by the settling defendants). Certain of the terms of the settlement are summarized below.

Under the Attorneys General settlement, the states would share an initial payment by Liggett of $5,000 ($1,000 of which was paid on March 22, 1996, with the balance payable over nine years and indexed and adjusted for inflation), provided that any unpaid amount will be due 60 days after either a default by Liggett in its payment obligations under the settlement or a merger or other similar transaction by Liggett or BGL with another defendant in the lawsuits. In addition, Liggett will be required to pay the states a percentage of Liggett's pretax income (income before income taxes) each year from the second through the twenty-fifth year. This annual percentage is 2-1/2% of Liggett's pretax income, subject to increase to 7-1/2% depending on the number of additional states joining the settlement. No additional states have joined this settlement to date. All of Liggett's payments are subject to certain reductions provided for in the agreement. Liggett has also agreed to pay to the states $5,000 if Liggett or BGL fails to consummate a merger or other similar transaction with another defendant in the lawsuits within three years of the date of the settlement.

Settlement funds received by the Attorneys General will be used to reimburse the states' smoking-related healthcare costs. Liggett and BGL also have agreed to phase in compliance with certain of the proposed interim FDA regulations on the same basis as provided in the Castano settlement.

Liggett and BGL have the right to terminate the settlement with respect to any state participating in the settlement if any of the remaining defendants in the litigation succeed on the merits in that state's Attorney General action. Liggett and BGL may also terminate the settlement if they conclude that too many states have filed Attorney General actions and have not resolved such cases as to the settling defendants by joining in the settlement.

At December 31, 1995, Liggett had accrued approximately $4,000 for the present value of the fixed payments under the March 1996 Attorneys General settlement, and no additional amounts have been accrued with respect to the recent settlements discussed below. BGL cannot quantify the future costs of the settlements at this time as the amount Liggett must pay is based, in part, on future operating results. Possible future payments based on a percentage of pretax income, and other contingent payments based on the occurrence of a business combination, will be expensed when considered probable.

On March 20, 1997, Liggett, together with BGL, entered into a comprehensive settlement of tobacco litigation through parallel agreements with the Attorneys General of 17 additional states and with a nationwide class of individuals and entities that allege smoking-related claims. Thereafter, settlements were entered into with several other Attorneys General. The settlements cover all smoking-related claims, including both addiction-based and tobacco injury claims against Liggett and BGL, brought by the Attorneys General and, upon court approval, the nationwide class.

As of June 30, 1997, a total of 25 Attorneys General settlements, were reached, including the Attorneys General of Alaska, Arizona, California, Connecticut, Hawaii, Illinois, Indiana, Iowa, Kansas, Maryland, Michigan, Minnesota, New Jersey, New York, Oklahoma, Oregon, Texas, Utah, Washington and Wisconsin. Liggett's and BGL's previous settlements on March 15, 1996 with the Attorneys General of Florida, Louisiana, Massachusetts, Mississippi and West Virginia remain in full force and effect. Other states have either recently filed Medicaid recovery actions or indicated intentions to do so. Both Liggett and BGL will endeavor to resolve those matters on substantially the same terms and conditions as the prior settlements; however, there can be no assurance that any such settlements will be completed.

The settlement with the nationwide class covers all smoking-related claims. On March 20, 1997, Liggett, BGL and plaintiffs filed the mandatory class settlement agreement in an action entitled Fletcher, et al. v. Brooke Group Ltd., et al., Circuit Court of Mobile County, Alabama, where the court granted preliminary approval and preliminary certification of the class, and on May 15, 1997 a similar mandatory class settlement agreement was filed in an action entitled Walker, et al. v. Liggett Group Inc., et al., United States District Court, Southern District of West Virginia. The West Virginia Court also granted preliminary approval and preliminary certification of the nationwide class; however, on August 5, 1997, the court vacated its preliminary certification of the settlement class.

In the Fletcher action, it is anticipated that class members will be notified of the settlement and will have an opportunity to appear at a later court hearing. Effectiveness of the mandatory settlement is conditioned on final court approval of the settlement after a fairness hearing. There can be no assurance as to whether, or when, such court approval will be obtained. There are no opt out provisions in this settlement, except for Medicaid claims by states that are not party to the Attorneys General settlements.

Pursuant to the settlements, Liggett and BGL agreed to cooperate fully with the Attorneys General and the nationwide class in their respective lawsuits against the tobacco industry. Liggett and BGL agreed to provide to these parties all relevant tobacco documents in their possession, other than those subject to claims of joint defense privilege, and to waive, subject to court order, certain attorney-client privileges and work product protections regarding Liggett's smoking-related documents to the extent Liggett and BGL can so waive these privileges and protections. The Attorneys General and the nationwide class agreed to keep Liggett's documents under protective order and, subject to final court approval, to limit their use to those actions brought by parties to the settlement agreements. Those documents that may be subject to a joint defense privilege with other tobacco companies will not be produced to the Attorneys General or the nationwide class, but will be, pursuant to court order, submitted to the appropriate court and placed under seal for possible in camera review. Additionally, under similar protective conditions, Liggett and BGL agreed to offer their employees for witness interviews and testimony at deposition and trial. Pursuant to both settlement agreements, Liggett also agreed to place an additional warning on its cigarette packaging stating that "smoking is addictive" and to issue a public statement, as requested by the Attorneys General. Liggett has commenced distribution of cigarette packaging which displays the new warning label.

Under the terms of the new settlement agreements, Liggett will pay on an annual basis 25% of its pretax income for the next 25 years into a settlement fund, commencing with the first full fiscal year starting after the date of the agreements. Monies collected in the settlement fund will be overseen by a court-appointed committee and utilized to compensate state health care programs and settlement class members and to provide counter-market advertising. Liggett also agreed to phase-in compliance with certain proposed FDA regulations regarding smoking by children and adolescents, including a prohibition on the use of cartoon characters in tobacco advertising and limitations on the use of promotional materials and distribution of sample packages where minors are present.

Under both settlement agreements, any other tobacco company defendant, except Philip Morris, merging or combining with Liggett or BGL, prior to the fourth anniversary of the settlement agreements, would receive certain settlement benefits, including limitations on potential liability and not having to post a bond to appeal any future adverse judgment. In addition, within 120 days following such a combination, Liggett would be required to pay the settlement fund $25,000. Both the Attorneys General and the nationwide class have agreed not to seek an injunction preventing a defendant tobacco company combining with Liggett or BGL from spinning off any of its affiliates which are not engaged in the domestic tobacco business.

Liggett and BGL are also entitled to certain "most favored nation" benefits not available to the other defendant tobacco companies. In addition, in the event of a "global" tobacco settlement enacted through Federal legislation or otherwise, the Attorneys General and tobacco plaintiffs agreed to use their

"best efforts" to ensure that Liggett's and BGL's liability under such a plan should be no more onerous than under these new settlements. See "Other Matters", below.

IMMINENT TRIALS. Although trial schedules are subject to change, the next individual cases scheduled for trial, where Liggett is a defendant, are Westmoreland v. Liggett Group Inc., et al., United States District Court, Middle District of Florida, Tampa Division, and Sackman, both of which are scheduled for trial in October, 1997. There are two other individual cases scheduled for trial in 1997. In addition to the Broin trial currently in progress, there is one other class action scheduled for trial in 1997, Engle, et al. v. R. J. Reynolds Tobacco Company, et al.

OTHER MATTERS. On June 20, 1997, Philip Morris Incorporated ("Philip Morris"), R. J. Reynolds Tobacco Company ("RJR"), B&W, Lorillard Tobacco Company ("Lorillard") and the United States Tobacco Company, along with the Attorneys General for the States of Arizona, Connecticut, Florida, Mississippi, New York and Washington and the Castano Plaintiffs' Litigation Committee executed a Memorandum of Understanding to support the adoption of federal legislation and necessary ancillary undertakings, incorporating the features described in a proposed resolution. The proposed resolution mandates a total reformation and restructuring of how tobacco products are manufactured, marketed and distributed in the United States. The proposals are currently being reviewed by the White House, Congress and various public interest groups. Management is unable to predict the ultimate effect, if any, of the enactment of legislation adopting the proposed resolution. Management is also unable to predict the ultimate content of any such legislation; however, adoption of any such legislation could have a material adverse effect on the business of Liggett.

On March 20, 1997, RJR, Philip Morris, B&W, and Lorillard obtained a temporary restraining order from a North Carolina state court preventing Liggett and BGL and their agents, employees, directors, officers and lawyers from turning over documents allegedly subject to the joint defense privilege in connection with the settlements, which restraining order was converted to a preliminary injunction by the court on April 9, 1997. This ruling is currently on appeal by Liggett and BGL. On June 5, 1997, the North Carolina Supreme Court denied Liggett's Motion to Stay the case pending appeal. On March 24, 1997, the United States District Court for the Eastern District of Texas and state courts in Mississippi and Illinois each issued orders enjoining the other tobacco companies from interfering with Liggett's filing with the courts, under seal, those documents.

Liggett understands that a grand jury investigation is being conducted by the office of the United States Attorney for the Eastern District of New York regarding possible violations of criminal law relating to the activities of The Council for Tobacco Research - USA, Inc. Liggett was a sponsor of The Council for Tobacco Research - USA, Inc. at one time. Liggett is unable, at this time, to predict the outcome of this investigation.

In March 1996, Liggett received a subpoena from a Federal grand jury sitting in the Southern District of New York. Documents have been produced in response to the subpoena. Liggett understands that this investigation has been transferred to the main office of the United States Department of Justice. In addition, in May 1996, Liggett was served with a subpoena by a grand jury sitting in the District of Columbia, to which Liggett has responded by producing documents. Liggett was also served with a subpoena from the District of Columbia grand jury in July, 1997. Liggett is in the process of responding to that subpoena. Liggett is unable, at this time, to predict the outcome of these investigations.

The Antitrust Division of the United States Department of Justice investigation into the United States tobacco industry activities in connection with product development efforts regarding "fire-safe" or self-extinguishing cigarettes has been concluded. No action by the Department of Justice was taken.

On March 15, 1996, an action entitled Spencer J. Volk v. Liggett Group Inc. was filed in the United States District Court for the Southern District of New York, Case No. 96-CIV-1921, wherein the

plaintiff, who was formerly employed as Liggett's President and Chief Executive Officer, seeks recovery of certain monies allegedly owing by Liggett to him for long-term incentive compensation. At a September 19, 1996 hearing, the court dismissed the plaintiff's alternate claim for recovery under a fraud theory and by order dated March 10, 1997, the court dismissed the balance of plaintiff's claims. Plaintiff has appealed the verdict.

Litigation is subject to many uncertainties, and it is possible that some of the aforementioned actions could be decided unfavorably against Liggett. An unfavorable outcome of a pending smoking and health case could encourage the commencement of additional similar litigation. Liggett is unable to evaluate the effect of these developing matters on pending litigation or the possible commencement of additional litigation.

There are several other proceedings, lawsuits and claims pending against Liggett unrelated to product liability. Management is of the opinion that the liabilities, if any, ultimately resulting from such other proceedings, lawsuits and claims should not materially affect Liggett's financial position, results of operations or cash flows.

Liggett is unable to make a meaningful estimate of the amount or range of loss that could result from an unfavorable outcome of the cases pending against Liggett. It is possible that Liggett's financial position, results of operations and cash flows could be materially adversely affected by an ultimate unfavorable outcome in any of such pending litigation.

Legislation and Regulation

On August 28, 1996, the FDA filed in the Federal Register a Final Rule (the "FDA Rule") classifying tobacco as a drug, asserting jurisdiction by the FDA over the manufacture and marketing of tobacco products and imposing restrictions on the sale, advertising and promotion of tobacco products. The FDA's stated objective and focus for its initiative is to limit access to cigarettes by minors by measures beyond the restrictions either mandated by existing federal, state and local laws or voluntarily implemented by major manufacturers in the industry. Litigation was commenced in the United States District Court for the Middle District of North Carolina challenging the legal authority of the FDA to assert such jurisdiction, as well as challenging the constitutionality of the rules. The court, after argument, granted plaintiffs' motion for summary judgment prohibiting the FDA from regulating or restricting the promotion and advertising of tobacco products and denied plaintiffs' motion for summary judgment on the issue of whether the FDA has the authority to regulate access to, and labeling of, tobacco products. The four major cigarette manufacturers and the FDA have filed notices of appeal. Liggett and BGL support the FDA Rule and have begun to phase in compliance with certain of the proposed interim FDA regulations. See discussions of the Castano and Attorneys General settlements above.

In August 1996, the Commonwealth of Massachusetts enacted legislation requiring tobacco companies to publish information regarding the ingredients in cigarettes and other tobacco products sold in that state. On February 7, 1997, the United States District Court for the District of Massachusetts denied an attempt to block the new legislation on the ground that it is preempted by federal law. Liggett and BGL support this proposed legislation.

On September 13, 1995, the President of the United States issued Presidential Proclamation 6821, which established a tariff rate quota ("TRQ") on certain imported tobacco, imposing extremely high tariffs on imports of flue-cured and burley tobacco in excess of certain levels which vary from country to country. Oriental tobacco is exempt from the quota as well as all tobacco originating from Canada, Mexico or Israel. Management believes that the TRQ levels are sufficiently high to allow Liggett to operate without material disruption to its business.

On February 20, 1996, the United States Trade representative issued an "advance notice of rule making" concerning how tobaccos imported under the TRQ should be allocated. Currently, tobacco

imported under the TRQ is allocated on a "first-come, first-served" basis, meaning that entry is allowed on an open basis to those first requesting entry in the quota year. Others in the cigarette industry have suggested an "end-user licensing" system under which the right to import tobacco under the quota would be initially assigned on the basis of domestic market share. Such an approach, if adopted, could have a material adverse effect on Liggett.

In April 1994, the United States Occupational Safety and Health Administration ("OSHA") issued a proposed rule that could ultimately ban smoking in the workplace. Hearings were completed during 1995. OSHA has not yet issued a final rule or a proposed revised rule. While Liggett cannot predict the outcome, some form of federal regulation of smoking in workplaces may result.

In January 1993, the United States Environmental Protection Agency ("EPA") released a report on the respiratory effect of ETS which concludes that ETS is a known human lung carcinogen in adults, and in children causes increased respiratory tract disease and middle ear disorders and increases the severity and frequency of asthma. In June 1993, the two largest of the major domestic cigarette manufacturers, together with other segments of the tobacco and distribution industries, commenced a lawsuit against the EPA seeking a determination that the EPA did not have the statutory authority to regulate ETS, and that given the current body of scientific evidence and the EPA's failure to follow its own guidelines in making the determination, the EPA's classification of ETS was arbitrary and capricious. Whatever the outcome of this litigation, issuance of the report may encourage efforts to limit smoking in public areas.

As part of the budget agreement recently approved by Congress, federal excise taxes on a pack of cigarettes, which are currently 24 cents, would rise 10 cents in the year 2000 and 5 cents more in the year 2002.

Liggett has been involved in certain environmental proceedings, none of which, either individually or in the aggregate, rise to the level of materiality. Liggett's current operations are conducted in accordance with all environmental laws and regulations. Management is unaware of any material environmental conditions affecting its existing facilities. Compliance with federal, state and local provisions regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, have not had a material effect on the capital expenditures, earnings or competitive position of Liggett.

In addition to the foregoing, there have been a number of other restrictive regulatory actions, adverse political decisions and other unfavorable developments concerning cigarette smoking and the tobacco industry, the effects of which, at this time, Liggett is not able to evaluate.

9. Related Party Transactions

On July 5, 1996, Liggett purchased 140,000 shares (19.97%) of Liggett-Ducat Ltd.'s ("Liggett-Ducat") tobacco operations from BOL, an indirect subsidiary of BGL, for $2,100. Liggett-Ducat, which produces cigarettes in Russia, manufactured and marketed 11.4 billion cigarettes in 1996. Liggett also acquired on that date for $3,400 a ten-year option, exercisable by Liggett in whole or in part, to purchase from BOL at the same per share price up to 292,407 additional shares of Liggett-Ducat, thereby entitling Liggett to increase its interest in Liggett-Ducat to approximately 62%. The option fee is to be credited against the purchase price. In addition, as part of the same transaction, Liggett had the right on or before June 30, 1997 to acquire from BOL for $2,200 another ten-year option on the same terms to purchase the remaining shares of Liggett-Ducat (an additional 33%). On March 13, 1997, Liggett acquired this option and paid BOL $2,000, and recorded a payable to BOL for the remaining $0.2 million. Liggett accounts for its investment in Liggett-Ducat under the equity method of accounting. Liggett's equity in the net income of Liggett-Ducat amounted to $185 for the six months ended June 30, 1997. The excess of the cost of the option over carrying amount of net assets to be acquired under the option has been charged to stockholder's deficit.

Liggett is party to a Tax-Sharing Agreement dated June 29, 1990 with BGL and certain other entities pursuant to which Liggett has paid taxes to BGL as if it were filing a separate company tax return, except that the agreement effectively limits the ability of Liggett to carry back losses for refunds. Liggett is entitled to recoup overpayments in a given year out of future payments due under the agreement.

Liggett is a party to an agreement dated February 26, 1991, as amended October 1, 1995, with BGL to provide various management and administrative services to the Company in consideration for an annual management fee of $900 paid in monthly installments and annual overhead reimbursements of $864 paid in quarterly installments.

Liggett has entered into an annually renewable Corporate Services Agreement with BGLS wherein BGLS agreed to provide corporate services to the Company at an annual fee paid in monthly installments. Corporate services provided by BGLS under this agreement include the provision of administrative services related to Liggett's participation in its parent company's multi-employer benefit plan, external publication of financial results, preparation of consolidated financial statements and tax returns and such other administrative and managerial services as may be reasonably requested by Liggett. The charges for services rendered under the agreement amounted to $830 in 1997 and $790 in 1996. This fee is in addition to the management fee and overhead reimbursements described above.

Since April 1994, the Company has leased equipment from BGLS for $50 per month. On April 28, 1997, BOL purchased excess production equipment from Liggett for $3,000, for a gain of $2,578.

10. Restructuring Charges

In the first half of 1997, the Company reduced its headcount by 114 full-time positions and recorded a $1,831 restructuring charge to operations for severance programs, primarily salary continuation and related benefits for terminated employees. Approximately $285 in restructuring charges will be funded in subsequent years. The Company expects to continue its cost reduction programs.

EVE HOLDINGS INC.

BALANCE SHEETS
(Unaudited)
(Dollars in thousands, except per share amounts)

	June 30, 1997	December 31, 1996
ASSETS		
Cash	$ 10	$ -
Office equipment	1	2
Trademarks, at cost, less accumulated amortization of $18,144 and $17,294, respectively	2,269	3,119
Total assets	$ 2,280	$ 3,121
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Federal income taxes currently payable to parent	$ 74	$ -
Dividends payable	1,127	4,623
Cash overdraft	-	92
Other current liabilities	3	19
Deferred income taxes	794	1,092
Total liabilities	1,998	5,826
Stockholder's equity (deficit):		
Common stock (par value $1.00 per share; authorized, issued and outstanding 100 shares) and contributed capital	49,148	46,548
Receivables from parent:		
Note receivable - interest at 14%, due no sooner than February 1, 1999	(44,520)	(44,520)
Other	(4,346)	(4,733)
Total stockholder's equity (deficit)	282	(2,705)
Total liabilities and stockholder's equity (deficit)	$ 2,280	$ 3,121

The accompanying notes are an integral part of these financial statements.

EVE HOLDINGS INC.

STATEMENTS OF OPERATIONS
(Unaudited)
(Dollars in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	1997	1996	1997	1996
Revenues:				
Royalties - parent	$1,761	$2,437	$3,306	$4,150
Interest - parent	1,576	1,577	3,153	3,153
	3,337	4,014	6,459	7,303
Expenses:				
Amortization of trademarks	425	425	851	851
Miscellaneous, net	27	35	64	58
Income before income taxes	2,885	3,554	5,544	6,394
Income tax provision	458	1,244	837	2,238
Net income	$2,427	$2,310	$4,707	$4,156

The accompanying notes are an integral part
of these financial statements.

EVE HOLDINGS INC.
STATEMENTS OF CASH FLOWS
(Unaudited)
(Dollars in thousands)

	Six Months Ended June 30,	
	1997	1996
Cash flows from operating activities:		
Net income	$4,707	$4,156
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	851	851
Deferred income taxes	(298)	(298)
Changes in assets and liabilities:		
Federal income taxes currently payable to parent	74	(29)
Other current liabilities	(16)	-
Net cash provided by operating activities	5,318	4,680
Cash flows from financing activities:		
Dividends/capital distributions	(5,603)	(4,658)
Decrease (increase) in due from parent	387	(22)
Decrease in cash overdraft	(92)	-
Net cash used in financing activities	(5,308)	(4,680)
Net increase in cash	10	-
Cash:		
Beginning of period	-	8
End of period	$ 10	$ 8
Supplemental cash flow information:		
Payments of income taxes through receivable from parent	$1,060	$2,314
Income taxes	32	-
Dividends/capital distributions declared but not paid	1,127	2,176

The accompanying notes are an integral part
of these financial statements.

EVE HOLDINGS INC.

NOTES TO FINANCIAL STATEMENTS
(Unaudited)
(Dollars in thousands, except per share amounts)

1. The Company

Eve Holdings Inc. ("Eve") is a wholly-owned subsidiary of Liggett Group Inc. ("Liggett"). Eve, formed in June 1990, is the proprietor of, and has all right, title and interest in, certain federal trademark registrations (the "Trademarks"). Eve has entered into an exclusive licensing agreement with Liggett (effective until 2010) whereby Eve grants the use of the Trademarks to Liggett in exchange for royalties, computed based upon Liggett's annual net sales, excluding excise taxes. The Trademarks are pledged as collateral for Liggett's borrowings under the notes indentures (see Note 3).

2. Summary of Significant Accounting Policies

a. Going Concern

The accompanying financial statements have been prepared assuming that Eve will continue as a going concern. Eve's revenues are comprised solely of royalties and interest income from Liggett. In addition, Eve holds a note receivable from Liggett for $44,520 due no sooner than February 1, 1999. Liggett had a working capital deficiency of $78,481 and a net capital deficiency of $178,660 as of June 30, 1997, is highly leveraged and has substantial near-term debt service requirements. These matters raise substantial doubt about Eve and Liggett meeting their liquidity needs and their ability to continue as going concerns.

The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

b. Per Share Data

All of Eve's common shares (100 shares authorized, issued and outstanding for all periods presented herein) are owned by Liggett. Accordingly, earnings and dividends per share data are not presented in these financial statements.

3. Guarantee of Liggett Notes

On February 14, 1992, Liggett issued $150,000 of Senior Secured Notes (the "Series B Notes"). In connection with the issuance of the Series B Notes, the Trademarks were pledged as collateral. In addition, Eve is a guarantor for the Series B Notes.

During 1994, Liggett issued $32,850 of Series C Senior Secured Notes (the "Series C Notes"). Eve is a guarantor for the Series C Notes.

4. Income Taxes

Eve qualifies as a company conducting operations exempt from income taxation under Delaware General Statute Section 1903(b). In recent years, some states have been aggressively pursuing companies exempt under this statute. Eve's management believes that certain state income tax rulings supporting these states' arguments will be ultimately reversed and that Eve's status as a company not conducting business in these states will be respected. Consequently, management has not provided a reserve for additional state income taxes. No assurance can be given with regard to future state income tax rulings and audit activity with respect to Eve.

Exhibit 99.2

NEW VALLEY CORPORATION

CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 1997

NEW VALLEY CORPORATION AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

TABLE OF CONTENTS

NEW VALLEY CORPORATION AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	June 30, 1997	December 31, 1996
ASSETS		
Current assets:		
Cash and cash equivalents	$ 21,519	$ 57,282
Investment securities available for sale	48,930	61,454
Trading securities owned	24,440	29,761
Restricted assets	708	2,080
Receivable from clearing brokers	14,163	23,870
Other current assets	4,415	9,273
Total current assets	114,175	183,720
Investment in real estate	256,570	179,571
Investment securities available for sale	2,592	2,716
Restricted assets	5,441	6,766
Long-term investments, net	16,874	13,270
Other assets	29,528	20,497
Total assets	$ 425,180	$406,540
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable and accrued liabilities	$ 44,624	$ 44,888
Prepetition claims and restructuring accruals	15,780	15,526
Income taxes	18,304	18,243
Securities sold, not yet purchased	20,185	17,143
Note payable to related party	12,000	--
Current portion of notes payable and long-term obligations	16,237	2,310
Total current liabilities	127,130	98,110
Notes payable	157,733	157,941
Other long-term obligations	17,525	12,282
Redeemable preferred shares	233,531	210,571
Shareholders' equity (deficit):		
Cumulative preferred shares; liquidation preference of $69,769; dividends in arrears, $127,266 and $115,944	279	279
Common Shares, $.01 par value; 850,000,000 shares authorized; 9,577,624 shares outstanding	96	96
Additional paid-in capital	625,858	644,789
Accumulated deficit	(737,224)	(721,854)
Unearned compensation on stock options	(444)	(731)
Unrealized gain on investment securities	696	5,057
Total shareholders' equity (deficit)	(110,739)	(72,364)
Total liabilities and shareholders' equity (deficit)	$ 425,180	$406,540

See accompanying Notes to Quarterly Consolidated Financial Statements

NEW VALLEY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	1997	1996	1997	1996
Revenues:				
Principal transactions, net	$ 3,227	$ 6,172	$ 5,726	$ 14,910
Commissions	3,431	4,820	6,824	8,683
Real estate leasing	6,303	5,958	12,585	11,664
Interest and dividends	2,582	4,642	4,123	9,826
Other income	8,861	8,857	14,899	17,351
Total revenues	24,404	30,449	44,157	62,434
Cost and expenses:				
Operating, general and administrative	25,551	30,399	49,818	64,053
Interest	4,043	4,739	7,905	9,263
Provision for loss on long-term investment	--	--	3,796	--
Total costs and expenses	29,594	35,138	61,519	73,316
Loss from continuing operations before income taxes and minority interest	(5,190)	(4,689)	(17,362)	(10,882)
Income tax provision	45	400	95	300
Minority interests in loss from continuing operations of consolidated subsidiary	965	217	1,974	698
Loss from continuing operations	(4,270)	(4,872)	(15,483)	(10,484)
Discontinued operations:				
Income (loss) from discontinued operations	(289)	110	583	838
Loss on sale of discontinued operations	(470)	--	(470)	--
Income (loss) of discontinued operations	(759)	110	113	838
Net loss	(5,029)	(4,762)	(15,370)	(9,646)
Dividend requirements on preferred shares	(16,750)	(15,646)	(32,730)	(31,108)
Excess of carrying value of redeemable preferred shares over cost of shares purchased	--	--	--	4,279
Net loss applicable to Common Shares	$ (21,779)	$ (20,408)	$ (48,100)	$ (36,475)
Loss per common share:				
Continuing operations	$ (2.19)	$ (2.14)	$ (5.03)	$ (3.90)
Discontinued operations	(.08)	.01	.01	.09
Net loss per Common Share	$ (2.27)	$ (2.13)	$ (5.02)	$ (3.81)
Number of shares used in computation	9,578,000	9,578,000	9,578,000	9,578,000

See accompanying Notes to Quarterly Consolidated Financial Statements

NEW VALLEY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIT)
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	Class B Preferred Shares	Common Shares	Paid-In Capital	Accumulated Deficit	Unearned Compensation on Stock Options	Unrealized Gain
Balance, December 31, 1996.....	$279	$96	$644,789	$(721,854)	$ (731)	$ 5,057
Net loss.....				(15,370)		
Undeclared dividends and accretion on redeemable preferred shares...			(21,409)			
Unrealized loss on investment securities.....						(4,361)
Public sale of subsidiary's common stock.....			2,715			
Adjustment to unearned compensation on stock options....			(237)		237	
Compensation expense on stock option grants.....					50	
Balance, June 30, 1997.....	$279	$96	$625,858	$(737,224)	$ (444)	$ 696

See accompanying Notes to Quarterly Consolidated Financial Statements

NEW VALLEY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	Six Months Ended June 30,	
	1997	1996
Cash flows from operating activities:		
Net loss	$ (15,370)	$ (9,646)
Adjustments to reconcile net loss to net cash provided from (used for) operating activities:		
Income from discontinued operations	(113)	(838)
Depreciation and amortization	3,945	2,332
Provision for loss on long-term investment	3,796	
Stock based compensation expense	1,601	
Changes in assets and liabilities, net of effects from acquisitions:		
Decrease (increase) in receivables and other assets	15,249	(11,873)
Decrease (increase) in income taxes	61	(3,329)
Increase (decrease) in accounts payable and accrued liabilities	(11,460)	10,234
Net cash used for continuing operations	(2,291)	(13,120)
Net cash provided from discontinued operations	1,523	838
Net cash used for operating activities	(768)	(12,282)
Cash flows from investing activities:		
Sale or maturity of investment securities	24,138	60,899
Purchase of investment securities	(15,851)	(15,843)
Sale or liquidation of long-term investments	2,807	14,500
Purchase of long-term investments	(8,357)	(1,269)
Purchase or improvements of real estate	(45)	(24,882)
Sale of other assets	5,561	
Payment of prepetition claims	(1,142)	(6,655)
Return of prepetition claims paid	1,396	
Decrease in restricted assets	2,697	20,191
Payment for acquisitions, net of cash acquired	(20,014)	1,915
Net cash provided from (used for) investing activities	(8,810)	48,856
Cash flows from financing activities:		
Payment of preferred dividends		(10,354)
Purchase of Class A preferred stock		(10,530)
Increase in margin loans payable		7,406
Sale of subsidiary's common stock	5,417	
Repayment of notes payable	(21,708)	
Repayment of other obligations	(9,894)	(9,217)
Net cash used for financing activities	(26,185)	(22,695)
Net decrease in cash and cash equivalents	(35,763)	13,879
Cash and cash equivalents, beginning of period	57,282	51,742
Cash and cash equivalents, end of period	$ 21,519	$ 65,621

See accompanying Notes to Quarterly Consolidated Financial Statements

NEW VALLEY CORPORATION AND SUBSIDIARIES
NOTES TO QUARTERLY CONSOLIDATED FINANCIAL STATEMENTS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

1. PRINCIPLES OF REPORTING

The consolidated financial statements include the accounts of New Valley Corporation and Subsidiaries (the "Company"). The consolidated financial statements as of June 30, 1997 presented herein have been prepared by the Company without an audit. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the financial position as of June 30, 1997 and the results of operations and cash flows for all periods presented have been made. Results for the interim periods are not necessarily indicative of the results for an entire year.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

These financial statements should be read in conjunction with the consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 1996, as filed with the Securities and Exchange Commission.

NEW ACCOUNTING PRONOUNCEMENTS

In June 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" (SFAS 130). SFAS 130 establishes standards for reporting and display of comprehensive income. The purpose of reporting comprehensive income is to present a measure of all changes in equity that result from recognized transactions and other economic events of the period other than transactions with owners in their capacity as owners. SFAS 130 requires that an enterprise classify items of other comprehensive income by their nature in the financial statement and display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of the balance sheet. SFAS 130 is effective for fiscal years beginning after December 15, 1997, with earlier application permitted. The Company has not yet determined the impact of the implementation of SFAS 130.

In June 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information" (SFAS 131). SFAS 131 specifies revised guidelines for determining an entity's operating segments and the type and level of financial information to be disclosed. Once operating segments have been determined, SFAS 131 provides for a two-tier test for determining those operating segments that would need to be disclosed for external reporting purposes. In addition to providing the required disclosures for reportable segments, SFAS 131 also requires disclosure of certain "second level" information by geographic area and for products/services. SFAS 131 also makes a number of changes to existing disclosure requirements. SFAS 131 is effective for fiscal years beginning after December 15, 1997, with earlier application encouraged. The Company has not yet determined the impact of the implementation of SFAS 131.

NEW VALLEY CORPORATION AND SUBSIDIARIES
NOTES TO QUARTERLY CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

2. ACQUISITION

On January 31, 1997, the Company entered into a stock purchase agreement (the "Purchase Agreement") with Brooke (Overseas) Ltd. ("Brooke (Overseas)"), a wholly-subsidiary of Brooke Group Ltd. ("Brooke"), a related party through the ownership of an approximate 42% voting interest in the Company. Pursuant to the Purchase Agreement, the Company acquired 10,483 shares (the "BML Shares") of the common stock of BrookeMil Ltd. ("BML") from Brooke (Overseas) for a purchase price of $55,000, consisting of $21,500 in cash and a $33,500 9% promissory note of the Company (the "Note"). The BML Shares comprise 99.1% of the outstanding shares of BML, a real estate development company in Russia. The Note is collateralized by the BML Shares and, as of June 30, 1997, had a balance of $12,000 which is payable on December 31, 1997.

BML is developing a three-phase complex on 2.2 acres of land in downtown Moscow, for which it has a 49-year lease. In 1993, the first phase of the project, Ducat Place I, a 46,500 sq. ft. Class-A office building, was constructed and leased. On April 18, 1997, BML sold Ducat Place I to one of its tenants for approximately $7,500, which purchase price has been reduced to reflect prepayments of rent. In 1995, BML began construction of Ducat Place II, a 150,000 sq. ft. office building. Ducat Place II has been substantially pre-leased to a number of leading international companies with occupancy for most tenants expected by September 1997. The third phase, Ducat Place III, is planned as a 400,000 sq. ft. mixed-use complex, with construction anticipated to commence in 1998. The Company is currently evaluating plans for financing the construction of Ducat Place III.

The acquisition was treated as a purchase for financial reporting purposes and, accordingly, these consolidated financial statements include the operations of BML from the date of acquisition.

The purchase price was allocated as follows: current assets of approximately $9,000, investment in real estate of $79,200, other assets of $8,800, assumption of current liabilities of $35,146 and long-term liabilities of $6,854. Current assets consisted primarily of an asset held for sale of $6,400 related to the estimated proceeds from the sale of Ducat Place I, net of $1,100 in accrued closing costs. Liabilities included a $20,400 loan to a Russian bank for the construction of Ducat Place II ("Construction Loan"). The Construction Loan, which matures $6,100 in April 1997 (paid with the proceeds from the sale of Ducat Place I), $4,100 in July 1997 and $10,200 in October 1997, is collateralized by a mortgage on Ducat Place II. In addition, the liabilities of BML included approximately $13,800 of rents and related payments prepaid by tenants of Ducat Place II for periods generally ranging from 15 to 18 months. Proforma operating results for the six months ended June 30, 1997 and 1996 are not presented herein as the historical operating results of BML are not material to the historical operating results of the Company.

On August 13, 1997, BML executed a new credit agreement with a Russian bank. Upon closing, all amounts due under the Construction Loan would be refinanced with borrowings under the new facility, which borrowings would bear interest at 16% per year, mature no later than August 2002, with principal payments commencing after the first year, and be collateralized by a mortgage on Ducat Place II and guaranteed by the Company.

(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

The components of the Company's investment in real estate at June 30, 1997 are as follows:

	U.S.	BML	TOTAL
Land	$ 36,162	$ 14,200	$ 50,362
Buildings	147,033	65,000	212,033
Construction-in-progress	14	51	65
Total	183,209	79,251	262,460
Less: accumulated depreciation	(5,870)	(20)	(5,890)
Net investment in real estate	$ 177,339	$ 79,231	$ 256,570

3. DISCONTINUED OPERATIONS

During the fourth quarter of 1996, Thinking Machines Corporation ("Thinking Machines") adopted a plan to terminate its parallel processing computer sales and service business. Consequently, the operating results of this segment have been classified as discontinued operations, and the quarterly results for 1996 have been reclassified. Accordingly, the financial statements reflect the financial position and the results of operations of the discontinued operations of Thinking Machines separately from continuing operations.

Summarized operating results of the discontinued operations of Thinking Machines are as follows:

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	1997	1996	1997	1996
Revenues	$ 286	$ 4,098	$ 3,386	$8,797
Operating income	$ (471)	$ 179	$ 950	$1,365
Income (loss) before income taxes and minority interests	$ (471)	$ 179	$ 950	$1,365
Minority interests	182	(69)	(367)	(527)
Net income (loss)	$ (289)	$ 110	$ 583	$ 838

In April 1997, Thinking Machines sold the remaining part of its discontinued operations for $2,405 in cash which resulted in the Company recording a loss on disposal of discontinued operations of $470, after the recognition of minority interests of $592 and the write-off of goodwill of $1,410.

4. INCOME TAXES

At June 30, 1997, the Company had approximately $100,000 of unrecognized net deferred tax assets, comprised primarily of net operating loss carryforwards, available to offset future taxable income for federal tax purposes. A valuation allowance has been provided against the amount as it is deemed more likely than not that the benefit of the deferred tax assets will not be utilized. The Company continues to evaluate the realizability of the deferred tax assets and its estimate is subject to change. The income tax provision (benefit), which principally represented the effects of state income taxes, for the six months ended June 30, 1997 and 1996, does not bear a customary relationship with pre-tax accounting income principally as a consequence of the change in the valuation allowance relating to deferred tax assets.

(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

5. INVESTMENT SECURITIES AVAILABLE FOR SALE

Investment securities classified as available for sale are carried at fair value, with net unrealized gains included as a separate component of shareholders' equity (deficit). The Company had realized gains on sales of investment securities available for sale of $3,358 and $7,052 for the three and six months ended June 30, 1997, respectively.

The components of investment securities available for sale at June 30, 1997 are as follows:

	COST	GROSS UNREALIZED GAIN	UNREALIZED LOSS	FAIR VALUE
Marketable equity securities:				
RJR Nabisco common stock	$ 32,574	$ 1,696		$ 34,270
Other marketable equity securities	9,720	766	$ 674	9,812
Total marketable equity securities	42,294	2,462	674	44,082
Marketable debt securities (short-term)	4,848			4,848
Marketable debt securities (long-term)	3,685		1,093	2,592
Total securities available for sale	50,827	2,462	1,767	51,522
Less long-term portion of investment securities	(3,685)		(1,093)	(2,592)
Investment securities - current portion	$ 47,142	$ 2,462	$ 674	$ 48,930

As of June 30, 1997, the long-term portion of investment securities available for sale consisted of marketable debt securities which mature in two years.

As of June 30, 1997, the Company, through a wholly-owned subsidiary, held approximately 1.06 million shares of RJR Nabisco Holdings Corp. ("RJR Nabisco") common stock with a market value of $34,270 (cost of $32,574). Based on the market price of the RJR Nabisco common stock at August 8, 1997 ($30.625 per share), no amounts are payable by the Company under any of its profit sharing arrangements with respect to the RJR Nabisco common stock.

6. LONG-TERM INVESTMENTS

At June 30, 1997, long-term investments consisted primarily of investments in limited partnerships of $15,675 and an equity investment in a company of $1,000. The Company determined that an other than temporary impairment in the value of its investment in a joint venture had occurred and wrote-down this investment to zero in March 1997 with a charge to operations of $3,796. The fair value of the Company's long-term investments approximates its carrying amount. The Company's estimates of the fair value of its long-term investments are subject to judgment and are not necessarily indicative of the amounts that could be realized in the current market.

In January 1997, the Company converted an investment in preferred stock made in 1995 into a majority equity interest in a small on-line directory assistance development stage company and, accordingly, began consolidating the results of this development stage company. This long-term investment of $1,001 was written off in 1996 due to continuing losses of this company. In May 1997, this development stage company completed an initial public offering and, as a result, the Company recorded $2,715 as additional paid-in capital which represented its 50.1% ownership in this company's shareholders' equity after this offering. As of June 30, 1997, this development stage company had revenues and losses of $160 and $2,023, respectively, since its inception.

The Company is required under certain limited partnership agreements to make additional investments up to an aggregate of $18,000 as of June 30, 1997. The Company's investments in limited partnerships are illiquid and the ultimate realization of these investments are subject to the performance of the underlying partnership and its management by the general partners.

7. REDEEMABLE PREFERRED SHARES

At June 30, 1997, the Company had authorized and outstanding 2,000,000 and 1,071,462, respectively, of its Class A Senior Preferred Shares. At June 30, 1997 and December 31, 1996, respectively, the carrying value of such shares amounted to $233,531 and $210,571, including undeclared dividends of $139,017 and $117,117, or $129.75 and $109.31 per share. As of June 30, 1997, the unamortized discount on the Class A Senior Preferred Shares was $5,188.

For the six months ended June 30, 1997, the Company recorded $1,551 in compensation expense related to certain Class A Senior Preferred Shares awarded to an officer of the Company in 1996. At June 30, 1997, the balance of the deferred compensation and the unamortized discount related to these award shares was $4,530 and $2,917, respectively.

8. PREFERRED SHARES NOT SUBJECT TO REDEMPTION REQUIREMENTS

The undeclared dividends, as adjusted for conversions of Class B Preferred Shares into Common Shares, cumulatively amounted to $127,266 and $115,944 at June 30, 1997 and December 31, 1996, respectively. These undeclared dividends represent $45.60 and $41.55 per share as of the end of each period. No accrual was recorded for such undeclared dividends as the Class B Preferred Shares are not mandatorily redeemable.

9. PREPETITION CLAIMS UNDER CHAPTER 11 AND RESTRUCTURING ACCRUALS

Those liabilities that are expected to be resolved as part of the Company's First Amended Joint Chapter 11 Plan of Reorganization, as amended (the "Joint Plan"), are classified in the Consolidated Balance Sheets as prepetition claims and restructuring accruals. On January 18, 1995, approximately $550 million of prepetition claims were paid pursuant to the Joint Plan. The prepetition claims remaining as of June 30, 1996 of $15,780 may be subject to future adjustments depending on pending discussions with the various parties and the decisions of the Bankruptcy Court.

10. CONTINGENCIES

LITIGATION

On or about March 13, 1997, a shareholder derivative suit was filed against the Company, as a nominal defendant, its directors and Brooke in the Delaware Chancery Court, by a shareholder of the Company. The suit alleges that the Company's purchase of the BML Shares constituted a self-dealing transaction which involved the payment of excessive consideration by the Company. The plaintiff seeks (i) a declaration that the Company's directors breached their fiduciary duties, Brooke aided and abetted such breaches and such parties are therefore liable to the Company, and (ii) unspecified damages to be awarded to the Company. The Company's time to respond to the complaint has not yet expired. The Company believes that the allegations are without merit, and it intends to defend the suit vigorously.

The Company is also a defendant in various other lawsuits and may be subject to unasserted claims primarily in connection with its activities as a securities broker-dealer and participation in public underwritings. These lawsuits involve claims for substantial or indeterminate amounts and are in varying stages of legal proceedings. In the opinion of management, after consultation with counsel, the ultimate resolution of these matters will not have a material adverse effect on the Company's consolidated financial position, results of operations, or cash flows.

Exhibit 99.3

BROOKE (OVERSEAS) LTD. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 1997

BROOKE (OVERSEAS) LTD. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

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BROOKE (OVERSEAS) LTD. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	June 30, 1997	December 31, 1996
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,272	$ 1,875
Accounts receivable - trade	268	166
Receivables from affiliates	12,107	
Inventories	4,522	3,569
Prepaid expenses and other	2,373	2,640
Total current assets	20,542	8,250
Property, plant and equipment, at cost, less accumulated depreciation of $595 and $676	14,433	59,607
Goodwill, net	1,056	1,094
Deferred finance costs		2,805
Other	5	540
Total assets	$ 36,036	$ 72,296
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Current liabilities:		
Notes payable and current portion of long-term debt	$ 3,250	$ 21,658
Accounts payable - trade	4,438	13,074
Due to affiliates	48,045	48,875
Unearned revenue	103	7,406
Accrued taxes	8,013	8,474
Taxes due to affiliate	11,741	
Accrued interest		597
Other accrued liabilities	1,895	2,692
Total current liabilities	77,485	102,776
Notes payable and long-term debt	2,505	
Unearned revenue		9,458
Other liabilities	25,498	1,494
Commitments and contingencies		
Stockholder's equity (deficit):		
Common stock, par value $1 per share, 701,000 shares authorized, issued and outstanding	701	701
Additional paid-in-capital	5,600	3,400
Deficit	(75,753)	(45,533)
Total stockholder's equity (deficit)	(69,452)	(41,432)
Total liabilities and stockholder's equity (deficit)	$ 36,036	$ 72,296

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

BROOKE (OVERSEAS) LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	Three Months Ended		Six Months Ended	
	June 30, 1997	June 30, 1996	June 30, 1997	June 30, 1996
Net sales	$ 18,451	$ 10,657	$ 32,155	$ 21,496
Cost of sales	15,294	10,178	26,623	20,173
Gross profit	3,157	479	5,532	1,323
Operating, selling, administrative and general expenses	1,940	2,940	3,918	5,001
Operating income (loss)	1,217	(2,461)	1,614	(3,678)
Other income (expense):				
Interest income	671		1,151	
Interest expense	(2,376)	(2,123)	(4,524)	(3,947)
Gain on sale of stock	1,492		27,055	
Gain on foreign currency exchange	110	347	310	560
Other, net	(71)	(1,846)	(100)	(2,062)
Income (loss) before income taxes	1,043	(6,083)	25,506	(9,127)
Provision (benefit) for income taxes	45	(253)	12,527	198
Net income (loss)	$ 998	$ (5,830)	$ 12,979	$ (9,325)

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

BROOKE (OVERSEAS) LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY (DEFICIT)
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	COMMON STOCK		ADDITIONAL PAID-IN		
	SHARES	AMOUNT	CAPITAL	DEFICIT	TOTAL
Balance, December 31, 1996.....	701,000	$701	$3,400	$(45,533)	$(41,432)
Net income.....				12,979	12,979
Distributions to parent.....				(43,199)	(43,199)
Capital contribution.....			2,200		2,200
Balance, June 30, 1997.....	701,000	$701	$5,600	$(75,753)	$(69,452)

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

BROOKE (OVERSEAS) LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	Six Months Ended	
	June 30, 1997	June 30, 1996
Net cash provided by operating activities	$ 1,366	$ 3,396
Cash flows from investing activities:		
Capital expenditures	(5,567)	(12,134)
Proceeds from sale of BML, net	41,502	
Proceeds from sale of option to purchase stock in Liggett-Ducat	2,200	
Investment		(500)
Net cash provided by (used in) investing activities	38,135	(12,634)
Cash flows from financing activities:		
Proceeds from debt	3,750	8,454
Repayments of debt	(655)	(930)
Borrowings under revolver		1,566
Repayments on revolver		(155)
Distributions paid to parent	(43,199)	
Net cash (used in) provided by financing activities	(40,104)	8,935
Net decrease in cash and cash equivalents	(603)	(303)
Cash and cash equivalents, beginning of period	1,875	1,660
Cash and cash equivalents, end of period	$ 1,272	$ 1,357

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

BROOKE (OVERSEAS) LTD. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

1. ORGANIZATION

Brooke (Overseas) Ltd. ("the Company"), a Delaware corporation, is a wholly-owned subsidiary of BGLS Inc. ("BGLS") and an indirect subsidiary of Brooke Group Ltd. ("Brooke"). The consolidated financial statements of the Company include Liggett-Ducat Ltd. ("Liggett-Ducat"), a Russian closed joint stock company engaged in the manufacture and sale of cigarettes in Russia, Liggett-Ducat Tobacco Ltd. ("LDT"), a wholly-owned subsidiary engaged in the construction of a new cigarette factory, and, prior to January 31, 1997, BrookeMil Ltd. ("BML"), a wholly-owned subsidiary engaged in construction of office buildings and property management in Moscow, Russia.

On July 5, 1996, Liggett Group Inc. ("Liggett"), a wholly-owned subsidiary of BGLS, purchased from the Company 140,000 shares (19.97%) of the tobacco operations of Liggett-Ducat for $2,100. Ten-year option agreements currently in place enable Liggett to increase its ownership in Liggett-Ducat to 95%. (Refer to Note 7.)

In December 1996, the Company cancelled BML intercompany debt in exchange for 10,483 shares of newly issued BML common stock. These shares represent 99.1% of the outstanding shares of BML. On January 31, 1997, such shares were sold to New Valley Corporation ("NVC"). (Refer to Note 3.)

The interim consolidated financial statements of the Company are unaudited and, in the opinion of management, reflect all adjustments necessary (which are normal and recurring) to present fairly the Company's consolidated financial position, results of operations and cash flows. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included as Exhibit 99.4 in Brooke's and BGLS' Annual Report on Form 10-K, as amended, for the year ended December 31, 1996, as filed with the Securities and Exchange Commission. The consolidated results of operations for interim periods should not be regarded as necessarily indicative of the results that may be expected for the entire year.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities and the reported amounts of revenues and expenses. Actual results could differ from those estimates.

Certain amounts in the 1996 consolidated financial statements have been reclassified to conform to the 1997 presentation.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

LIQUIDITY:

The Company has historically relied on Brooke and BGLS for sources of financing. At June 30, 1997, the Company had net capital and working capital deficiencies of $69,452

and $56,943, respectively. The Company has upgraded the cigarette operations' tobacco processing complex and is continuing to implement cost-saving measures. Liggett-Ducat plans to begin the manufacture and marketing of western style cigarettes within the next year. Management believes that such activities will result in improved operations and cash flow, but there can be no assurances in this regard. In addition, the Company is in the process of constructing a new tobacco factory as discussed in Note 5 and is actively pursuing various potential financing alternatives related thereto.

3. SALE OF BROOKEMIL

On January 31, 1997, the Company sold its 99.1% of the outstanding shares of BML to New Valley Corporation ("New Valley") for $21,500 in cash and a promissory note of $33,500, collateralized by the BML shares, payable during 1997 with an annual interest rate of 9%. The consideration received exceeded the carrying value of the Company's investment in BML by $52,500. The Company recognized an immediate gain on the sale in the amount of $25,500. The remaining $27,000 was deferred, reflecting recognition that the Company's parent, BGLS, retains an interest in BML through its 42% equity ownership in New Valley, and that further, a portion of the property sold is subject to a put option held by New Valley. This option allows New Valley, under certain circumstances, to put a portion of the property sold back to the Company at the greater of the appraised fair value of the property at the date of exercise or $13,600. The Company distributed the $21,500 cash proceeds received from the sale of BML to BGLS on January 31, 1997. On April 28, 1997 and June 30, 1997, New Valley paid BOL $3,500 and $18,000, respectively, representing a portion of the promissory note together with accrued interest thereon. During the second quarter 1997, BOL distributed to BGLS $18,500 in proceeds received from New Valley together which accrued interest thereon.

On April 18, 1997, BML sold one of its office buildings, Ducat Place I, to a third party. Accordingly, the Company recognized approximately $1,490 of the deferred gain. At June 30, 1997, the balance of the deferred gain was approximately $25,500.

In connection with the sale of the BML shares, certain specified liabilities aggregating $40,800, including the Vneshtorgbank loan with a balance of $20,418 ($13,927 at June 30, 1997), remained with BML. Further, the Company, Brooke and BGLS each contributed to the capital of BML, through cancellation of all indebtedness of BML to each such entity, the aggregate amount of which was $19,275 including accrued interest thereon. In addition, Liggett-Ducat entered into a Use Agreement with BML whereby Liggett-Ducat is permitted to continue to utilize the existing factory site on the same basis as in the past. The Use Agreement is terminable by BML on 270 days' prior notice.

BROOKE (OVERSEAS) LTD. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in Thousands, Except Per Share Amounts) - (Continued)
(Unaudited)

4. INVENTORIES

Inventories consist of:

	June 30, 1997	December 31, 1996
Finished goods	$	$
Work-in-process	238	53
Raw materials	2,700	2,664
Replacement parts and supplies	1,584	852
	$4,522	$3,569

The Company has a leaf inventory management program whereby, among other things, it is committed to purchase certain quantities of leaf tobacco. The purchase commitments are for quantities not in excess of anticipated requirements and are at prices established at the date of the commitment. At June 30, 1997, the Company had leaf tobacco purchase commitments of $3,935.

5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consists of:

	June 30, 1997	December 31, 1996
Buildings	$	$ 8,064
Factory machinery and equipment	8,163	4,419
Computers and software	296	289
Office furniture and equipment	205	129
Vehicles	418	416
Construction-in-progress	5,946	46,966
	15,028	60,283
Less accumulated depreciation	595	676
	$14,433	$59,607

Purchase commitments of approximately $2,000 have been made for factory machinery. Of this amount, $1,000 was paid in July 1997; the other $1,000 is payable over a period of 5 years with interest at 8% per annum.

On April 28, 1997, the Company purchased excess production equipment from Liggett for $3,000.

On May 6, 1997, LDT entered into two contracts for construction of a new tobacco factory on the outskirts of Moscow which provide for payments of $1,700 over a three-month period ending July 1997 and $18,760 over a twelve-month period ending July 1998. A pre-construction payment of $520 was paid in April 1997.

BROOKE (OVERSEAS) LTD. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in Thousands, Except Per Share Amounts) - (Continued)
(Unaudited)

6. NOTES PAYABLE, LONG-TERM DEBT AND OTHER OBLIGATIONS

Notes payable, long-term debt and other obligations consist of:

	June 30, 1997	December 31, 1996
Bank loan	$	$20,418
Deferred financing fees		1,240
Notes payable	5,755	
Total notes payable and long-term debt	5,755	21,658
Less current maturities	3,250	21,658
Amount due after one year	$ 2,505	$

In October 1995, Liggett-Ducat entered into a loan agreement with Vneshtorgbank to borrow up to $20,418 to fund real estate development. At December 31, 1996, BML had drawn down $20,418 of the loan. In connection with the sale of BML to New Valley, the Russian bank loan remained at BML and the Company and Brooke, as guarantor, were indemnified by New Valley with respect to this liability. (Refer to Note 3.)

REVOLVING CREDIT FACILITIES:

In February and March 1997, the Company obtained lines of credit in the amounts of $1,000 at 28% per annum and $2,000 at 26%, respectively, in order to secure tobacco commitment purchases. The lines of credit were extended in May 1997 and interest rates reduced to 23%. Also in April 1997, an additional $1,000 line of credit was obtained. At June 30, 1997, the balance outstanding was $3,250. Brooke is a guarantor on the lines of credit which are collateralized by accounts receivable, inventory and equipment. The lines of credit expire in August and September 1997.

7. RELATED PARTY TRANSACTIONS

The Company has obtained funding through a revolving credit facility with Brooke and BGLS at an annual interest rate of 20% to cover certain expenses including the cost of certain administrative services and personnel, tobacco and material purchases and upgrades of factory equipment. In addition, prior to January 31, 1997, Brooke and BGLS had advanced funds to BML for its real estate developments projects. The amount due to Brooke and BGLS under this facility at June 30, 1997 was $33,702 together with interest of $14,243, of which $13,997 together with interest of $6,922 is due from Liggett-Ducat and LDT.

On March 13, 1997, Liggett acquired a second option to purchase all remaining shares of Liggett-Ducat (an additional 33%) from the Company for $2,200. Of that amount, $2,050 was paid in cash and the Company recorded a receivable of $150.

BROOKE (OVERSEAS) LTD. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in Thousands, Except Per Share Amounts) - (Continued)
(Unaudited)

8. INCOME TAXES

The entire 1996 and a portion ($786) of the 1997 provision for income taxes is payable pursuant to Russian statutory requirements. Further, the Company has recorded a provision for income taxes of $11,741 related to its sale of BML in 1997 in accordance with its tax sharing agreement with Brooke.

The provision for taxes for the six months ended June 30, 1997 and 1996 does not bear the customary relationship to the pretax loss/income for the Company due principally to the effects of taxes provided for foreign operations and an increase in the valuation allowance related to deferred tax assets.

9. CONTINGENCIES

BGLS has pledged its ownership interest in the Company's Common Stock as collateral in connection with the issuance of BGLS' 15.75% Senior Secured Notes ("BGLS Notes") due 2001. Liggett is currently in negotiations with its note holders to restructure the terms of its Senior Secured Notes. Pending completion of the negotiations, BGLS has postponed making its interest payment due on July 31, 1997 of approximately $18,338 on the BGLS Notes. The indenture governing the BGLS Notes provides for a 30-day grace period before the failure to pay interest will be an event of default.

Exhibit 99.4

NEW VALLEY HOLDINGS, INC.

FINANCIAL STATEMENTS

JUNE 30, 1997

NEW VALLEY HOLDINGS, INC.

FINANCIAL STATEMENTS

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NEW VALLEY HOLDINGS, INC.
BALANCE SHEETS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	June 30, 1997	December 31, 1996
ASSETS		
Cash and cash equivalents	$ 8	$ 1
Investment in New Valley:		
Redeemable preferred stock	57,504	72,962
Common stock	(57,504)	(72,962)
Total investment in New Valley		
Total assets	$ 8	$ 1
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Payable to parent	$ 43	$ 4
Accrued expenses		7
Current income taxes payable to parent	6,304	6,312
Total liabilities	6,347	6,323
Commitments and contingencies		
Common stock, $0.01 par value, 100 shares authorized, issued and outstanding		
Additional paid-in capital	7,633	7,633
Deficit	(15,022)	(727)
Other	1,050	(13,228)
Total stockholder's equity (deficit)	(6,339)	(6,322)
Total liabilities and stockholder's equity (deficit)	$ 8	$ 1

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

NEW VALLEY HOLDINGS, INC.
STATEMENTS OF OPERATIONS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	Three Months Ended		Six Months Ended	
	June 30, 1997	June 30, 1996	June 30, 1997	June 30, 1996
Equity in loss of New Valley	$ (5,811)	$ (1,487)	$(14,325)	$ (2,983)
Interest income		41	6	48
General and administrative expenses	(7)	(2)	(30)	(4)
Loss from continuing operations before income taxes	(5,818)	(1,448)	(14,349)	(2,939)
(Benefit) provision for income taxes:				
Current	(1)	13	(8)	448
Deferred	(16)	(520)	(16)	(3,208)
Income tax benefit	(17)	(507)	(24)	(2,760)
Loss from continuing operations	(5,801)	(941)	(14,325)	(179)
(Loss) income from discontinued operations of New Valley, net of taxes	(331)		30	
Net loss	$ (6,132)	$ (941)	$(14,295)	$ (179)

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

NEW VALLEY HOLDINGS, INC.
STATEMENT OF STOCKHOLDER'S EQUITY (DEFICIT)
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	COMMON STOCK		ADDITIONAL PAID-IN			
	SHARES	AMOUNT	CAPITAL	DEFICIT	OTHER	TOTAL
Balance, December 31, 1996	100	$	$ 7,633	$ (727)	$(13,228)	$ (6,322)
Proportionate share of New Valley's capital transactions					(662)	(662)
Unrealized holding gain on investment in New Valley					14,940	14,940
Net loss				(14,295)		(14,295)
Balance, June 30, 1997	100	$	$ 7,633	$(15,022)	$ 1,050	$ (6,339)

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

NEW VALLEY HOLDINGS, INC.
STATEMENTS OF CASH FLOWS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	Six Months Ended	
	June 30, 1997	June 30, 1996
Net cash provided by operating activities	$ 7	$ (257)
Cash flows from investing activities:		
Dividends received from New Valley		6,183
Net cash provided by investing activities		6,183
Cash flows from financing activities:		
Distributions paid to parent		(5,801)
Net cash used in financing activities		(5,801)
Net increase in cash and cash equivalents	7	125
Cash and cash equivalents at beginning of period	1	738
Cash and cash equivalents at end of period	$ 8	$ 863

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

NEW VALLEY HOLDINGS, INC.
NOTES TO FINANCIAL STATEMENTS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

1. PRINCIPLES OF REPORTING

ORGANIZATION. New Valley Holdings, Inc. (the "Company") was formed on September 9, 1994 by BGLS Inc. ("BGLS") to act as a holding company for certain stock investments in New Valley Corporation ("New Valley"). BGLS owns 100% of the authorized, issued and outstanding common stock of the Company. BGLS is a wholly-owned subsidiary of Brooke Group Ltd. ("Brooke").

The interim financial statements of the Company are unaudited and, in the opinion of management, reflect all adjustments necessary (which are normal and recurring) to present fairly the Company's financial position, results of operations and cash flows. These financial statements should be read in conjunction with the financial statements and the notes thereto included as Exhibit 99.3 in Brooke's and BGLS' Annual Report on Form 10-K, as amended, for the year ended December 31, 1996, as filed with the Securities and Exchange Commission. The results of operations for interim periods should not be regarded as necessarily indicative of the results that may be expected for the entire year.

Certain amounts in the 1996 financial statements have been reclassified to conform to the 1997 presentation.

USE OF ESTIMATES AND ASSUMPTIONS:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses. Actual results could differ from those estimates.

2. INVESTMENT IN NEW VALLEY CORPORATION

The Company's investment in New Valley at June 30, 1997 is summarized below:

	NUMBER OF SHARES	FAIR VALUE	CARRYING AMOUNT	UNREALIZED HOLDING LOSS
Class A Preferred Shares	618,326	$ 57,504	$ 57,504	$ (9,941)
Common Shares	3,969,962	3,970	(57,504)	
		$ 61,474	$	$ (9,941)

(A) Gives effect to July 1996 one-for-twenty reverse stock split.

The $15.00 Class A Increasing Rate Cumulative Senior Preferred Shares ($100 Liquidation Value), $.01 par value (the "Class A Preferred Shares"), are accounted for as debt securities pursuant to the requirements of Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities", and are classified as available-for-sale. Through September 1996, earnings on the Class A Preferred Shares were comprised of dividends accrued during the period and the accretion of the difference between the Company's basis and their mandatory redemption price. New Valley's Common Shares, $.01 par value (the "Common Shares") were accounted for pursuant to APB No. 18, "The Equity Method of Accounting for Investments in Common Stock".

NEW VALLEY HOLDINGS, INC.
NOTES TO FINANCIAL STATEMENTS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) - (CONTINUED)
(UNAUDITED)

During the quarter ended September 30, 1996, the decline in the market value of the Class A Preferred Shares, the dividend received on the Class A Preferred Shares and the Company's equity in losses incurred by New Valley caused the carrying value of the Company's investment in New Valley to be reduced to zero. Beginning in the fourth quarter of 1996, the Company suspended the recording of its earnings on the dividends accrued and the accretion of the difference between the Company's basis in the Class A Preferred Shares and their mandatory redemption price.

At June 30, 1997, the Company's investment in New Valley consisted of an approximate 42% voting interest. The Company's investment is represented by 618,326 Class A Preferred Shares (57.7%) and 3,969,962 Common Shares (41.5%) after giving effect to a one-for-twenty reverse stock split by New Valley in July 1996.

During the first quarter of 1996, New Valley repurchased 72,104 Class A Preferred Shares for a total amount of $10,530. The Company has recorded its proportionate interest in the excess of the carrying value of the shares over the cost of the shares repurchased as a credit to additional paid-in capital in the amount of $1,782, along with other New Valley capital transactions of $1,563 for the six months ended June 30, 1996. No such repurchases have been made during the quarter ended June 30, 1997. Other New Valley capital transactions charged to equity were $662 for the six months ended June 30, 1997.

The Class A Preferred Shares of New Valley are required to be redeemed on January 1, 2003 for $100.00 per share plus dividends accrued to the redemption date. The shares are redeemable, at any time, at the option of New Valley, at $100.00 per share plus accrued dividends. The holders of Class A Preferred Shares are entitled to receive a quarterly dividend, as declared by the Board of Directors, payable at the rate of $19.00 per annum. On March 27, 1996, New Valley paid a cash dividend on the Class A Preferred Shares of $10.00 per share. The Company received $6,183 in the distribution. At June 30, 1997, the accrued and unpaid dividends arrearage was $139,017 ($129.75 per share).

3. NEW VALLEY CORPORATION

Summarized financial information for New Valley as of June 30, 1997 and December 31, 1996 and for the six months ended June 30, 1997 and 1996 follows:

	June 30, 1997	December 31, 1996
Current assets, primarily cash and marketable securities	$ 114,175	$ 183,720
Non-current assets	311,005	222,820
Current liabilities	127,130	98,110
Non-current liabilities	175,258	170,223
Redeemable preferred stock	233,531	210,571
Shareholders' equity (deficit)	(110,739)	(72,364)

NEW VALLEY HOLDINGS, INC.
NOTES TO FINANCIAL STATEMENTS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) - (CONTINUED)
(UNAUDITED)

	Three Months Ended		Six Months Ended	
	June 30, 1997	June 30, 1996	June 30, 1997	June 30, 1996
Revenues	$ 24,404	$ 30,449	$ 44,157	$ 62,434
Costs and expenses	29,594	35,138	61,519	73,316
Loss from continuing operations	(4,270)	(4,872)	(15,483)	(10,484)
(Loss) income from discontinued operations	(759)	110	113	838
Net loss applicable to common shares(A)	(21,779)	(20,408)	(48,100)	(36,475)

(A) Considers all preferred accrued dividends, whether or not declared, and the excess of carrying value of redeemable preferred shares over cost of shares purchased.

ACQUISITION OF COMMON SHARES OF BML:

On January 31, 1997, New Valley acquired substantially all the common shares of BrookeMil Ltd., a real estate investment company doing business in Russia, from Brooke Overseas Ltd. ("BOL"), for $55,000, $21,500 payable in cash and a promissory note of $33,500. On April 28, 1997 and June 30, 1997, New Valley paid BOL $3,500 and $18,000, respectively, representing a portion of the promissory note together with accrued interest thereon. As of June 30, 1997, the balance remaining on the note is $12,000 and is due on December 31, 1997.

RJR NABISCO HOLDINGS CORP.:

At June 30, 1997, New Valley held 1,062,650 shares of RJR Nabisco Holdings Corp. ("RJR Nabisco") common stock with a market value of $34,270 (cost of $32,574). The unrealized gain on New Valley's investment in RJR Nabisco common stock was $1,696 at June 30, 1997. Based on the market price of RJR Nabisco common stock at June 30, 1997, no amounts are payable by Brooke or New Valley under any of their net profit-sharing arrangements with respect to the RJR Nabisco common stock.

4. FEDERAL INCOME TAX

At June 30, 1997, the Company had $8,400 of unrecognized net deferred tax assets, comprised primarily of future deductible temporary differences. A valuation allowance has been provided against this deferred tax asset as it is presently deemed more likely than not that the benefit of the tax asset will not be utilized. The Company continues to evaluate the realizability of its deferred tax assets and its estimate is subject to change.

The provision for taxes for the six month period ended June 30, 1996 does not bear a customary relationship to the pretax income for the Company due principally to the effects of the 80% dividends received deduction for Federal taxes. The benefit for income taxes at June 30, 1997 is based on the current taxable loss.

NEW VALLEY HOLDINGS, INC.
NOTES TO FINANCIAL STATEMENTS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) - (CONTINUED)
(UNAUDITED)

5. CONTINGENCIES

BGLS has pledged its ownership interest in the Company's common stock and the Company's investments in the New Valley securities as collateral in connection with the issuance of BGLS' 15.75% Senior Secured Notes ("BGLS Notes") due 2001. Liggett Group Inc., a subsidiary of BGLS, is currently in negotiations with its note holders to restructure the terms of its Senior Secured Notes. Pending completion of the negotiations, BGLS has postponed its interest payment of approximately $18,338 due July 31, 1997, on the BGLS Notes The indenture governing the BGLS Notes provides for a 30-day grace period before the failure to pay interest will be an event of default.