SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

JOINT ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For The Fiscal Year Ended December 31, 1996

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)

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

Title of each class	Name of each exchange on which registered
Brooke Group Ltd. Common Stock, par value $.10 per share	New York

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

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. BGLS Inc. meets the conditions set forth in General Instruction I(l)(a) and (b) of Form 10-K and is therefore filing this form with the reduced disclosure format.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statement incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X] Yes [ ] No

The aggregate market value of the voting stock held by non-affiliates of Brooke Group Ltd. as of March 21, 1997 was approximately $33,640,000. Directors and officers and ten percent or greater stockholders of Brooke Group Ltd. are considered affiliates for purposes of this calculation but should not necessarily be deemed affiliates for any other purpose.

At March 21, 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.

Documents Incorporated by Reference:

Part III (items 10, 11, 12 and 13) from the definitive Proxy Statement of Brooke Group Ltd. for the 1997 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission no later than 120 days after the end of the Registrant's fiscal year covered by this report.

BROOKE GROUP LTD.
BGLS INC.

FORM 10-K

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PART I

ITEM 1. BUSINESS

GENERAL

Brooke Group Ltd. (the "Company"), a Delaware corporation founded in 1980, is a holding company for a number of businesses. The Company is principally engaged, through its subsidiary Liggett Group Inc. ("Liggett"), in the manufacture and sale of cigarettes in the United States; through its subsidiary Brooke (Overseas) Ltd. ("BOL"), in the manufacture and sale of cigarettes in Russia; and through its investment in New Valley Corporation ("New Valley"), in the investment banking and brokerage business, in real estate development in Russia and the Ukraine, in the ownership and management of commercial real estate in the United States and in the acquisition of operating companies. The Company holds such businesses through its wholly-owned subsidiary, BGLS Inc., a Delaware corporation organized in 1990 ("BGLS").

The Company is controlled by Bennett S. LeBow, the Chairman and Chief Executive Officer of the Company, BGLS and New Valley, who owns directly or indirectly approximately 53% of the Company's common stock. The principal executive offices of the Company and BGLS are located at 100 S.E. Second Street, Miami, Florida 33131 and the telephone number is (305) 579-8000.

LIGGETT GROUP INC.

GENERAL. The Company's tobacco business in the United States is conducted through its indirect wholly-owned subsidiary Liggett, which is the operating successor to the Liggett & Myers Tobacco Company. Substantially all of Liggett's manufacturing facilities are located in or near Durham, North Carolina. Liggett is registered under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and files periodic reports and other information with the Securities and Exchange Commission (the "SEC").

Liggett is engaged in the manufacture and sale of cigarettes, primarily in the United States. According to The Maxwell Consumer Report, a recognized industry publication (the "Maxwell Report"), Liggett's domestic shipments of approximately 8.95 billion cigarettes during 1996 accounted for 1.9% of the total cigarettes shipped in the United States during such year. This represents a market share decline of 0.3% from 1995 and 0.4% from 1994. Liggett produces both premium cigarettes as well as discount cigarettes (which include among others, control label, branded discount and generic cigarettes). Premium cigarettes are generally marketed under well-recognized brand names at full retail prices to adult smokers with strong preference for branded products, whereas discount cigarettes are marketed at lower retail prices to adult smokers who are more cost conscious. Liggett's cigarettes are produced in over 325 combinations of length, style and packaging.

Liggett produces four premium cigarette brands: L&M, Chesterfield, Lark and Eve. Liggett's premium cigarettes represented approximately 33%, 32% and 33% of net sales (excluding federal excise taxes) in 1996, 1995 and 1994, respectively, and contributed a substantial portion of Liggett's operating profits for the respective periods. Liggett's share of the premium market segment was approximately 0.7% for 1996, compared to 0.8% and 0.9% for 1995 and 1994, respectively, according to the Maxwell Report.

In 1980, Liggett was the first major domestic cigarette manufacturer to successfully introduce discount cigarettes as an alternative to premium cigarettes. In 1989, Liggett established a new price point within the discount market segment by introducing Pyramid, a branded discount product which, at that time, sold for less than most other discount cigarettes. Liggett continues to produce discount cigarettes with a share of approximately 4.9% of the discount market segment for 1996, according to the Maxwell Report, compared to 5.5% and 5.4% for 1995 and 1994, respectively.

At the present time, Liggett has no foreign operations other than through its investment in Liggett-Ducat Ltd. ("Liggett-Ducat"), which is engaged in the manufacture and sale of cigarettes in Russia (see "Brooke (Overseas) Ltd."). Liggett does not own the international rights to its premium cigarette brands. Liggett does, however, export cigarettes which are sold primarily in Eastern Europe and the Middle East. Export sales of approximately 473 million units accounted for approximately 5% of Liggett's 1996 total unit sales volume. Revenues from export sales were $3.3 million for 1996, compared to $5.4 million and $4.7 million for 1995 and 1994, respectively. Operating loss attributable to export sales for each of the years 1996, 1995 and 1994 was $1.8 million, $2.1 million and $1.1 million, respectively. Management's strategy is to increase volume in foreign markets only where Liggett can sell its brands at a profit.

BUSINESS STRATEGY. Liggett's near-term business strategy is to reduce further certain operating and selling costs in order to increase the profitability of both its premium and discount products at their current unit sales volume and to reduce further its investment in working capital. As part of this strategy, Liggett restructured its headquarters and manufacturing operations and reduced its workforce by 235 positions in 1993 and reorganized its sales force in early 1994, reducing its field sales force by 150 permanent positions and adding approximately 300 part-time positions. Liggett has also reduced costs in both administrative and manufacturing functions by making additional modifications to its manufacturing operations and significantly curtailing employee benefit programs. In 1995, Liggett continued its efforts towards reducing costs by, among other things, offering voluntary retirement programs to eligible employees and reducing headcount by an additional 120 positions.

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 will further reduce its salaried, hourly and part-time headcount by a total of 273 positions (35%) over an eight-month transition period.

Liggett's long-term business strategy in the premium segment of the market is to maintain or improve its profit margins in the face of declining unit sales and market share by improving operating efficiencies and implementing further cost reduction programs. Liggett's long-term business strategy in the discount segment of the market is to maintain its market share or improve its profit margins by consistently providing high-quality products and services at prices and on terms comparable to those available elsewhere in the market.

SALES, MARKETING AND DISTRIBUTION. Liggett's products are distributed from a central distribution center in Durham, North Carolina to 27 public warehouses located throughout the United States. These warehouses serve as local distribution centers for Liggett's customers. Liggett's products are transported from the central distribution center to the warehouses via third-party trucking companies to meet pre-existing contractual obligations to its customers.

Liggett's customers are primarily candy and tobacco distributors, the military and large grocery, drug and convenience store chains. Liggett offers its customers discount payment terms, traditional rebates and promotional incentives. Customers typically pay for purchased goods within two weeks following delivery from Liggett. Liggett's largest single customer accounted for approximately 13.7% of net sales in 1996, and approximately 11.6% of net sales in 1995, the majority of which were in the private label discount segment. No single customer accounted for more than 10% of Liggett's net sales in 1994.

Following the January 1997 restructuring, Liggett's marketing and sales functions will be performed by approximately 100 direct sales representatives calling on national and regional customer accounts, together with approximately 145 part-time retail sales consultants who service retail outlets. In addition, Liggett employs food broker groups in certain geographic locations to perform these marketing and sales functions.

TRADEMARKS. All of the major trademarks used by Liggett are federally registered or are in the process of being registered in the United States and other markets where Liggett's products are sold. Trademarks typically have a duration of ten years and can be renewed at Liggett's option prior to their expiration date. In view of the significance of cigarette brand awareness among consumers, management believes that the protection afforded by these trademarks is material to the conduct of its business. All of Liggett's trademarks are owned by its wholly-owned subsidiaries, Eve Holdings Inc. ("Eve") and Cigarette Exporting Company of America, Ltd. ("CECOA"). Liggett does not own the international rights to its premium cigarette brands.

MANUFACTURING. Liggett purchases and maintains leaf tobacco inventory to support its cigarette manufacturing requirements. Liggett believes that there is a sufficient supply of tobacco within the worldwide tobacco market to satisfy its current production requirements. Liggett stores its leaf tobacco inventory in warehouses in North Carolina and Virginia. There are several different types of tobacco, including flue-cured leaf, burley leaf, Maryland leaf, oriental leaf, cut stems and reconstituted sheet. Leaf components of cigarettes are generally the flue-cured and burley tobaccos. While premium and discount brands use many of the same tobacco products, input ratios of tobacco products account for the differences between premium and discount products. Domestically grown tobacco is an agricultural commodity subject to United States government production controls and price supports which can substantially affect its market price. Foreign flue-cured and burley tobaccos, some of which are used in the manufacture of Liggett's cigarettes, are generally 10% to 15% less expensive than comparable domestic tobaccos. Liggett normally purchases all of its tobacco requirements from domestic and foreign leaf tobacco dealers, much of it, under long-term purchase commitments. As of December 31, 1996, approximately 73% of Liggett's commitments were for the purchase of foreign tobacco. Increasing tobacco costs due to reduced worldwide supply of tobacco, a reduction in the average discount available to Liggett from leaf tobacco dealers on tobacco purchased under prior years' purchase commitments and capitalized interest on leaf inventory will have an unfavorable impact on Liggett's operations during 1997.

Liggett's cigarette manufacturing facilities are designed for the execution of short production runs in a cost-effective manner, which enables Liggett to manufacture and market a wide variety of cigarette brand styles. Liggett's cigarettes are produced in over 325 different brand styles under Eve's and CECOA's trademarks and brand names as well as private labels for other companies, typically retail or wholesale distributors who supply supermarkets and convenience stores. Liggett believes that its existing facilities are sufficient to accommodate a substantial increase in production.

While Liggett pursues product development, its total expenditures for research and development on new products have not been financially material over the past three years.

COMPETITION. Liggett is the smallest of the five major manufacturers of cigarettes in the United States. The four largest manufacturers of cigarettes are Philip Morris, Inc. ("Philip Morris"), R.J. Reynolds Tobacco Company ("RJR"), Brown & Williamson Tobacco Corporation, and Lorillard Tobacco Company, Inc.

There are substantial barriers to entry into the cigarette business, including extensive distribution organizations, large capital outlays for sophisticated production equipment, substantial inventory investment, costly promotional spending, regulated advertising and strong brand loyalty. In this industry, the major cigarette manufacturers compete among themselves for market share on the basis of brand loyalty, advertising and promotional activities and trade rebates and incentives. Liggett's four major competitors all have substantially greater financial resources than Liggett, and most of these competitors' brands have greater sales and consumer recognition than Liggett's brands.

According to the Maxwell Report, Philip Morris' and RJR's sales together accounted for approximately 72.4% of the domestic cigarette market in 1996. Liggett's domestic shipments of approximately 8.95 billion cigarettes during 1996 accounted for 1.9% of the approximately 483 billion cigarettes shipped in the United States during such year, compared to 10.52 billion cigarettes (2.2%) and 11.32 billion cigarettes (2.3%) during 1995 and 1994, respectively.

Industry-wide shipments of cigarettes in the United States have been declining for a number of years, although this trend reversed itself in 1996. While the Maxwell Report estimates that domestic industry-wide shipments increased by approximately 0.5% in 1996, Liggett's management believes that industry-wide shipments of cigarettes in the United States will continue to remain flat or decline as a result of numerous factors, including health considerations, diminishing social acceptance of smoking, legislative limitations on smoking in public places and federal and state excise tax increases which have augmented cigarette price increases.

Historically, because of their dominant market share, Philip Morris and RJR have been able to determine cigarette prices for the various pricing tiers within the industry, and the other cigarette manufacturers have brought their prices into line with the levels established by the two industry leaders. Off-list price discounting by manufacturers, however, has substantially affected the average price differential at retail, which can be significantly greater than the manufacturers' list price gap.

LEGISLATION, REGULATION AND LITIGATION. Reports with respect to the alleged harmful physical effects of cigarette smoking have been publicized for many years and, in the opinion of Liggett's management, have had and may continue to have an adverse effect on cigarette sales. Since 1964, the Surgeon General of the United States and the Secretary of Health and Human Services have released a number of reports which claim that cigarette smoking is a causative factor with respect to a variety of health hazards, including cancer, heart disease and lung disease, and have recommended various government actions to reduce the incidence of smoking.

Since 1966, federal law has required that cigarettes manufactured, packaged or imported for sale or distribution in the United States include specific health warnings on their packaging . Since 1972, Liggett and the other cigarette manufacturers have included the federally required warning statements in print advertising, on billboards and on certain categories of point-of-sale display materials relating to cigarettes.

The Comprehensive Smoking Education Act ("CSEA"), which became effective October 12, 1985, requires that packages of cigarettes distributed in the United States and cigarette advertisements (other than billboard advertisements) in the United States bear one of the following four warning statements, in lieu of the prior warning notice, on a quarterly rotating basis: "SURGEON GENERAL'S

WARNING: Smoking Causes Lung Cancer, Heart Disease, Emphysema, and May Complicate Pregnancy"; "SURGEON GENERAL'S WARNING: Quitting Smoking Now Greatly Reduces Serious Risks to Your Health"; "SURGEON GENERAL'S WARNING: Smoking by Pregnant Women May Result in Fetal Injury, Premature Birth, and Low Birth Weight"; and "SURGEON GENERAL'S WARNING: Cigarette Smoke Contains Carbon Monoxide". Shortened versions of these statements are also required, on a rotating basis, on billboard advertisements. By a limited eligibility amendment to the CSEA for which Liggett qualifies, Liggett is allowed to display all four required package warnings for the majority of its brand packages on a simultaneous basis (such that the packages at any time may carry any one of the four required warnings), although it rotates the required warnings for advertising on a quarterly basis in the same manner as do the other major cigarette manufacturers. The law also requires that each person who manufactures, packages or imports cigarettes annually provide to the Secretary of Health and Human Services a list of ingredients added to tobacco in the manufacture of cigarettes. Annual reports to the United States Congress are also required from the Secretary of Health and Human Services as to current information on the health consequences of smoking and from the Federal Trade Commission on the effectiveness of cigarette labeling and current practices and methods of cigarette advertising and promotion. Both federal agencies are also required annually to make such recommendations as they deem appropriate with regard to further legislation.

On August 28, 1996, the Food and Drug Administration ("FDA") filed in the Federal Register a Final 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 has been 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. A hearing on the tobacco industry's motion for summary judgment in that case was held on February 10, 1997 and a decision by the court is expected soon. The FDA's proposed restrictions, some of which became effective as early as February 28, 1997, purport to: (i) limit access to tobacco products and (ii) limit advertising and marketing. Management is unable to predict whether the Final Rule will be upheld as enforceable against the industry. Management is also unable to predict the effects of the proposed restrictions, if implemented, on Liggett's operations, but such actions could have an unfavorable impact thereon.

The Company and Liggett, while neither consenting to FDA jurisdiction nor waiving their objections thereto, agreed to withdraw their objections and opposition to the proposed rule making and to phase in compliance with certain of the proposed interim FDA regulations. See discussions of the tobacco litigation settlements in Note 16 to the Consolidated Financial Statements of the Company and BGLS (the "Company's Consolidated Financial Statements") included elsewhere in this report.

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. Regulations adopted pursuant to this legislation are scheduled to become effective on July 1, 1997. 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.

In 1993, the United States Congress amended the Agricultural Adjustment Act of 1938 to require each United States cigarette manufacturer to use at least 75% domestic tobacco in the aggregate of the cigarettes manufactured by it in the United States, effective January 1, 1994, on an annualized basis or pay a domestic marketing assessment ("DMA") based upon price differentials between foreign and domestic tobacco and, under certain circumstances, make purchases of domestic tobacco from the tobacco stabilization cooperatives organized by the United States government.

After an audit, the United States Department of Agriculture ("USDA") informed Liggett that it did not satisfy the 75% domestic tobacco usage requirement for 1994 and was subject to a DMA of approximately $5.5 million. Liggett has agreed to pay this assessment in quarterly installments, with interest, over a five-year period. Since the levels of domestic tobacco inventories on hand at the tobacco stabilization organizations are below reserve stock levels, Liggett was not obligated to make purchases of domestic tobacco from the tobacco stabilization cooperatives.

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. In addition, the Presidential Proclamation served to limit the application of the legislation establishing the DMA to only those activities occurring in calendar year 1994.

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 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 environmental tobacco smoke ("ETS") which concluded 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 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.

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). This statute purportedly abrogates certain defenses typically available to defendants. This legislation would impose on the tobacco industry, if ultimate liability of the industry is established in litigation, liability based upon market share for such payments made by the state as a result of such smoking-related diseases. On February 22, 1995, suit was commenced by the State of Florida, acting through the Agency for Health Care Administration, against Liggett and others, seeking restitution of monies expended in the past and which may be expended in the future, by the State of Florida, to provide health care to Medicaid recipients for injuries and ailments allegedly caused by the use of cigarettes and other tobacco products. Plaintiffs also seek a variety of other forms of relief including a disgorgement of all profits from the sale of cigarettes in Florida. The Florida action is scheduled for trial in August 1997. In addition to Florida, 21 states (and several municipalities) have brought actions against Liggett and other cigarette manufacturers seeking restitution and indemnity for medical payments and expenses allegedly made or incurred for tobacco related illnesses. Other states are contemplating initiating similar litigation. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations - Recent Developments in the Cigarette Industry - Legislation and Litigation" and Note 16 to the Company's Consolidated Financial Statements for a discussion of such legislation and related litigation, and of the Company's and Liggett's recent Attorneys General settlements.

All radio and television advertising of cigarettes has been prohibited by federal statute since 1971 and federal law now prohibits smoking aboard aircraft for domestic flights of six hours or less. The United States Interstate Commerce Commission has banned smoking on buses transporting passengers interstate. In addition, the United States Congress and a number of states and local government units have enacted or are considering legislation which is intended to discourage smoking through educational efforts or which imposes various restrictions or requirements relating to smoking including restrictions on public smoking. Certain employers have initiated programs restricting or eliminating smoking in the workplace. Other proposals previously presented to or currently before Congress and certain states and local government units include, but are not limited to, legislative efforts to further restrict or ban the advertising and promotion of cigarettes, to eliminate the income tax deductibility of expenses incurred for such advertising and promotion, to restrict or prohibit smoking in public buildings and other areas, to increase excise taxes, to require additional warnings on cigarette packaging and advertising, to ban vending machine sales, to eliminate the federal preemption defense in product liability actions, to place cigarettes under the regulatory jurisdiction of the FDA and to require that cigarettes meet certain fire safety standards. If adopted, at least certain of the foregoing legislative proposals could have a material adverse impact on Liggett's operations.

While attitudes toward cigarette smoking vary around the world, a number of foreign countries have also taken steps to discourage cigarette smoking, to restrict or prohibit cigarette advertising and promotion and to increase taxes on cigarettes. Such restrictions are, in some cases, more onerous than restrictions imposed in the United States. Due to Liggett's lack of foreign operations with the exception of its investment in Liggett-Ducat, and minimal export sales to foreign countries, the risks of foreign limitations or restrictions on the sale of cigarettes are limited to entry barriers into additional foreign markets and the inability to grow the existing markets.

The price of cigarettes includes federal excise taxes at the rate of $12.00 per 1,000 cigarettes. A substantial excise tax increase could accelerate the trend away from smoking.

The cigarette industry continues to be challenged on numerous fronts. New cases continue to be commenced against Liggett and other cigarette manufacturers. As of March 14, 1997, there were 108 individual suits, 12 purported class actions and 22 state (and several municipality) Medicaid reimbursement actions pending in the United States in which Liggett is a named defendant. 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, strict liability, fraud, misrepresentation, design defect, failure to warn, breach of express and implied warranties, conspiracy, concert of action, unjust enrichment, common law public nuisance, indemnity, market share liability, and violations of deceptive trade practice laws and antitrust statutes. Plaintiffs also seek punitive damages in many of these cases. 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 the Federal Racketeer Influenced and Corrupt Organization Act.

On March 12, 1996, Liggett, together with the Company, entered into an agreement to settle the CASTANO class action tobacco litigation (which is no longer in effect due to the recent settlements discussed below), 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. On March 20, 1997, Liggett, together with the Company, entered into comprehensive settlements with each of the remaining 17 states which have filed Medicaid actions and with a nationwide class of individuals and entities that allege smoking-related claims. See the discussion of the settlements in Note 16 to the Company's Consolidated Financial Statements.

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.

Management believes that Liggett is in compliance in all material respects with the laws regulating cigarette manufacturers.

See Note 16 to the Company's Consolidated Financial Statements for a description of legislation, regulation and litigation.

BROOKE (OVERSEAS) LTD.

LIGGETT-DUCAT LTD. Brooke (Overseas) Ltd. ("BOL"), a wholly-owned subsidiary of BGLS, is engaged in the manufacture and sale of cigarettes in Russia through Liggett-Ducat, a Russian joint stock company. BOL owns a 75.33% equity interest in Liggett-Ducat, and Liggett owns a 19.97% interest in Liggett-Ducat acquired on July 5, 1996. On that date, Liggett purchased from BOL 140,000 shares of Liggett-Ducat's tobacco operations for $2.1 million. Liggett also acquired from BOL a ten-year option to purchase up to 292,407 additional shares of Liggett-Ducat stock at the same per share price ($15.00) for $3.4 million, 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, on March 13, 1997, Liggett acquired another ten-year option from BOL for $2.2 million entitling Liggett to purchase the remaining shares of Liggett-Ducat owned by BOL on the same terms. See Note 4 to the Company's Consolidated Financial Statements.

Liggett-Ducat, one of Russia's leading cigarette producers since 1892, manufactured and marketed 11.4 billion cigarettes in 1996. Liggett-Ducat produces or has rights to produce 19 different brands of cigarettes, including Russian brands such as PEGAS, PRIMA, NOVOSTI AND BALOMORKANAL.

Liggett-Ducat manufactures three types of cigarettes: filter, non-filter and papirossi. Paparosi is a traditional type of Russian cigarette featuring a long paper filter comprising twothirds of the cigarette with tobacco filling up the balance. In 1996, Liggett-Ducat sold 3.1 billion filter cigarettes (27%), 6.7 billion non-filter cigarettes (59%) and 1.6 billion papirossi (14%).

The long-term strategy of Liggett-Ducat is to upgrade the quality of its traditional Russian cigarette brands to international standards and to expand the range of cigarettes it offers to include the higher-margin American blend and international blend cigarettes. The new types of cigarettes will appeal to the growing segment of the market that prefers American blend cigarettes over traditional Russian blended cigarettes. Russian blend cigarettes have a very strong flavored oriental tobacco blend with a heavy pungent odor, while the American blend is a lighter flavored Virginia tobacco blend. The international blend will be a mix between Russian and American blends. As markets have developed in Eastern Europe, consumer preferences have typically shifted toward international and American blend cigarettes.

Liggett-Ducat produces its cigarettes in a 150,000 square foot factory complex located on Gasheka Street in downtown Moscow and operates a 150,000 square foot warehouse outside of the city. Liggett-Ducat plans to build a new cigarette factory on the outskirts of Moscow on land it has leased for a term of 49 years. 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 commenced, 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.

Liggett-Ducat currently manufactures its cigarettes on four production lines, comprised of both Russian-made and imported machinery. Liggett-Ducat is currently upgrading the equipment at the existing factory to improve its operations, and all upgraded equipment will be utilized at the new factory. During 1996, Liggett-Ducat installed an upgraded primary processing complex manufactured by GBE Tobacco which will enable the factory to produce international standard cigarettes. In addition, Liggett-Ducat recently acquired a new filter-making complex from Hoechst Celanese which allows Liggett-Ducat to produce Western quality filters, previously purchased from outside vendors, and installed a new rejected cigarette tobacco reclamation machine to reduce waste.

The Russian cigarette market is one of the largest and fastest growing cigarette markets in the world. Annual consumption of cigarettes is estimated at 250 billion units in Russia (1996 estimate), making the market the third largest in the world after the United States and China. The potential size of the market is estimated by management at up to 450 billion units per year. Approximately 61% of Russian men and 17% of Russian women are estimated to smoke cigarettes. The market has been growing rapidly over the past several years (particularly the female market) as imported cigarettes have become available to satisfy increasing demand.

Growth in consumption has been restrained historically by static domestic cigarette making capacity. In 1996, approximately 150 billion cigarettes (68% of the market) were produced domestically. Excess demand and demand for Western style cigarettes were satisfied by approximately 100 billion units of imported cigarettes (40% of the market).

New Russian customs legislation has served to support local producers. During the past twelve months, the Russian Government raised the duties on imported cigarettes several times to a current effective rate of 115% of cost. In the past, many imported cigarettes were sold illegally without payment of required duties. Recent efforts to improve enforcement of import duties, if successful, will further increase the differential between the price of imported and domestic cigarettes. Imported cigarettes currently range in price at retail from approximately 2,000 to

18,000 rubles ($.35 to $3.16) per pack, as compared to domestically produced cigarettes which sell for approximately 650 to 8,000 rubles ($.11 to $1.40) per pack.

Liggett-Ducat's brands currently compete primarily against those of other Russian cigarette makers. Liggett-Ducat as well as other Russian producers sell their cigarettes at the lowest price points in the market. Competition in this sector of the market is generally based on price and name recognition of the producing factory. There is very limited advertising of these products, typically only in trade publications and wholesale catalogs. Liggett-Ducat's brands also compete to a lesser extent against lower priced imported cigarettes from Eastern Europe and Asia.

In order to increase their presence in the vast Russian market and avoid import duties, several of the major international cigarette manufacturers have begun to produce American and international blend cigarettes domestically. Such activities by companies with well established, international brands will provide significant additional competition to Liggett-Ducat as its seeks to increase its sales of such higher margin products upon completion of the new factory.

SALE OF BROOKEMIL LTD. Until January 31, 1997, BOL was also engaged in the real estate development business in Moscow through its subsidiary BrookeMil Ltd. ("BML"). On January 31, 1997, BOL entered into a stock purchase agreement (the "Purchase Agreement") with New Valley, pursuant to which BOL sold 10,483 shares of the common stock of BML to New Valley, comprising 99.1% of the outstanding shares of BML (the "BML Shares"). The following description of the BML sale is qualified in its entirety by reference to the Purchase Agreement and the annexes thereto, copies of which are incorporated by reference as an exhibit to this report and are incorporated herein by reference. See Note 4 to the Company's Consolidated Financial Statements for a discussion of the transaction and information regarding a pending lawsuit relating to New Valley's purchase of the BML Shares.

New Valley paid to BOL, for the BML Shares, a purchase price of $55 million, consisting of $21.5 million in cash and a $33.5 million 9% promissory note of New Valley (the "Note"). The Note is collateralized by the BML Shares and is payable $21.5 million on June 30, 1997 and $12 million on December 31, 1997. The transaction was approved by the independent members of the Board of Directors of the Company. The Company retained independent legal counsel in connection with the evaluation and negotiation of the transaction.

BML is developing the three-phase Ducat Place complex on 2.2 acres of land in downtown Moscow, for which it has a 98-year lease. In 1993, the first phase of the project, Ducat Place I, a 46,500 square foot Class-A office building, was successfully built and leased. Tenants include Citicorp, the G-7 Group of Nations and the European Bank for Reconstruction and Development. In 1995, BML began construction of Ducat Place II, a premier 150,000 square foot office building. Ducat Place II has been pre-leased to a number of leading international companies including Motorola, Conoco, Lukoil-Arco and Morgan Stanley. The third phase, Ducat Place III, is planned as a 400,000 square foot mixed-use complex, with construction anticipated to commence in 1998.

In connection with the purchase of the BML Shares by New Valley, certain specified liabilities of BML, aggregating approximately $ 40.8 million, remained as liabilities of BML after the closing. These liabilities include a $20.4 million loan due in 1997 to Vneshtorgbank, a Russian bank, for the construction of Ducat Place II, which is collateralized by a mortgage on the building. In addition, the liabilities of BML include approximately $13.8 million of rents and related payments prepaid by tenants in Ducat Place II for periods generally ranging from 15 to 18 months.

The site of the proposed third phase of the Ducat project is currently used by Liggett-Ducat as the site for its existing cigarette factory. In connection with the sale of the BML Shares, Liggett-Ducat entered into a Use Agreement with BML whereby Liggett-Ducat is permitted to continue to utilize the site on the same basis as in the past. The Use Agreement is terminable by BML on 270 days' prior notice. In addition, New Valley has the right under the Purchase Agreement to require BOL and BGLS to repurchase this site for the then appraised fair market value, but in no event less than $13.6 million, during the period Liggett-Ducat operates the factory on such site.

NEW VALLEY CORPORATION

New Valley is engaged, through its ownership of Ladenburg Thalmann & Co. Inc. ("Ladenburg"), in the investment banking and brokerage business, through its ownership of BML, in the real estate development business in Russia and the Ukraine, through its New Valley Realty division, in the ownership and management of commercial real estate in the United States, and in the acquisition of operating companies. New Valley is registered under the Exchange Act and files periodic reports and other information with the SEC.

The Company indirectly holds, through BGLS and BGLS' wholly-owned subsidiary, New Valley Holdings, Inc. ("NV Holdings"), approximately 42% of the voting interest in New Valley. This approximate 42% interest consists, as of March 25, 1997, of (i) 19,748 shares of common stock (the "New Valley Common Shares") (approximately 0.2% of the class) and 250,885 shares of $3.00 Class B Cumulative Convertible Shares (the "Class B Preferred Shares") (approximately 9.0% of the class) held directly by BGLS and (ii) 3,969,962 New Valley Common Shares (approximately 41.4% of the class) and 618,326 $15.00 Class A Increasing Rate Cumulative Senior Preferred Shares (the "Class A Preferred Shares") (approximately 57.7% of the class) held by NV Holdings. See Note 2 to the Company's Consolidated Financial Statements.

Bennett S. LeBow, Chairman of the Board, President and Chief Executive Officer of the Company and of BGLS and the controlling stockholder of the Company, serves as Chairman of the Board and Chief Executive Officer of New Valley. Howard M. Lorber, a consultant to the Company and its subsidiaries and a stockholder of the Company, serves as President and Chief Operating Officer, and is a director, of New Valley. Richard J. Lampen, Executive Vice President of the Company and of BGLS, serves as Executive Vice President, and is a director, of New Valley. Richard S. Ressler, a greater than 5% stockholder of the Company and a former consultant to the Company and its subsidiaries, serves as a director of New Valley.

On January 18, 1995, New Valley emerged from bankruptcy reorganization proceedings and completed substantially all distributions to creditors under its First Amended Joint Chapter 11 Plan of Reorganization, as amended (the "Joint Plan"). The Joint Plan was confirmed by the United States Bankruptcy Court for the District of New Jersey, Newark Division on November 1, 1994, and pursuant thereto, New Valley effected certain related asset dispositions. For further information with respect to the asset dispositions, see "Dispositions Pursuant to the Joint Plan", below.

Acquisitions by New Valley

LADENBURG THALMANN & CO. INC. On May 31, 1995, New Valley acquired all of the outstanding shares of common stock and other equity interests of Ladenburg for $25.8 million, net of cash acquired, subject to adjustment. Ladenburg is a full service broker-dealer which has been a member of the New York Stock Exchange since 1876. Its specialties include investment banking, trading, research, market making, client services, institutional sales and asset management.

Ladenburg's investment banking area maintains relationships with businesses and provides them with research, advisory and investor relations support. Services include merger and acquisition consulting, management of and participation in underwriting of equity and debt financing, private debt and equity financing, and rendering appraisals, financial evaluations and fairness opinions. Ladenburg's listed securities and over-the-counter trading areas include trading a variety of financial instruments in both national and international markets. Ladenburg's client services and institutional sales departments serve over 20,000 accounts worldwide and its asset management area provides investment management and financial planning services to individuals and institutions.

Ladenburg is a wholly-owned subsidiary of Ladenburg Thalmann Group Inc. ("Ladenburg Group"), which has other subsidiaries specializing in merchant banking, venture capital and investment banking activities on an international level. Ladenburg Thalmann International ("LTI"), a wholly-owned subsidiary of Ladenburg Group, is engaged in establishing a corporate finance and capital markets presence in Russia and the Ukraine, seeking, among other things, mandates to raise capital for local corporate issuers in the international capital markets. LTI, headquartered in New York City, has offices in Kiev, Ukraine and Moscow, Russia.

BROOKEMIL LTD. On January 31, 1997, New Valley acquired the BML Shares, representing 99.1% of the outstanding shares of BML from BOL. The Company paid to BOL a purchase price of $55 million, consisting of $21.5 million in cash and the $33.5 million 9% Note of New Valley. The Note is collateralized by the BML Shares and is payable $21.5 million on June 30, 1997 and $12 million on December 31, 1997. For further information with respect to this transaction, see "Brooke (Overseas) Ltd. - Sale of BrookeMil Ltd.".

NEW VALLEY REALTY DIVISION. On January 10 and January 11, 1996, New Valley acquired four commercial office buildings (the "Office Buildings") and eight shopping centers (the "Shopping Centers"), respectively, for an aggregate purchase price of $183.9 million, consisting of $23.9 million in cash and $160 million in non-recourse mortgage financing. The Office Buildings and Shopping Centers are being operated through New Valley's New Valley Realty division.

The Office Buildings consist of two adjacent commercial office buildings in Troy, Michigan and two adjacent commercial office buildings in Bernards Township, New Jersey. New Valley acquired the Office Buildings in Michigan from Bellemead of Michigan, Inc. ("Bellemead Michigan") and the Office Buildings in New Jersey from Jared Associates, L.P (each, a "Seller"), for an aggregate purchase price of $111.4 million. Each Seller is an affiliate of Bellemead Development Corporation, which is indirectly wholly-owned by The Chubb Corporation. The purchase price was paid for the Office Buildings as follows: (i) $23.5 million for the 700 Tower Drive property, located in Troy, Michigan; (ii) $28.1 million for the 800 Tower Drive property, located in Troy, Michigan; (iii) $48.3 million for the Westgate I property, located in Bernards Township, New Jersey; and (iv) $11.4 million for the Westgate II property, located in Bernards Township, New Jersey. The two Michigan buildings were constructed in 1987 and the two New Jersey buildings were constructed in 1991. The gross square footage of the Office Buildings ranges from approximately 50,300 square feet to approximately 244,000 square feet.

New Valley acquired a fee simple interest in each Office Building (subject to certain rights of existing tenants), together with a fee simple interest in the land underlying three of the Office Buildings and a 98-year ground lease (the "Ground Lease") underlying one of the Office Buildings. Under the Ground Lease, Bellemead Michigan, as lessor, is entitled to receive rental payments of a fixed monthly amount and a specified portion of the income received from the 700 Tower Drive property. Space in the Office Buildings is leased to commercial tenants and, as of March 25, 1997, the Office Buildings were fully occupied.

Concurrently with the acquisition of the Office Buildings, New Valley engaged a property-management affiliate of Sellers that had previously managed the Office Buildings to act as the managing agent and leasing agent for the Office Buildings. The agreement has a fifteen-year term, but may be terminated by either party on 60 days' notice without cause or economic penalty.

On January 11, 1996, New Valley acquired the Shopping Centers from various limited partnerships (AP Century I., L.P., AP Century II, L.P., AP Century III, L.P., AP Century IV, L.P., AP Century V, L.P., AP Century VI, L.P., AP Century VIII, L.P., and AP Century IX, L.P.) (each, a "Partnership") for an aggregate purchase price of $72.5 million. Each Partnership is an affiliate of Apollo Real Estate Investment Fund, L.P ("Apollo"). The Shopping Centers are located in Marathon and Royal Palm Beach, Florida; Lincoln, Nebraska; Santa Fe, New Mexico; Milwaukee, Oregon; Richland and Marysville, Washington; and Charleston, West Virginia. New Valley acquired a fee simple interest in each Shopping Center and the underlying land for each property. Space in the Shopping Center is leased to a variety of commercial tenants and, as of March 25, 1997, the aggregate occupancy of the Shopping Centers was approximately 92%. The Shopping Centers were constructed at various times during the period 1963-1988. The gross square footage of the Shopping Centers ranges from approximately 108,500 square feet to approximately 222,500 square feet.

The purchase price paid for the Shopping Centers was as follows: (i) $3.9 million for the Marathon Shopping Center property, located in Marathon, Florida; (ii) $9.8 million for the Village Royale Plaza Shopping Center property, located in Royal Palm Beach, Florida; (iii) $6.0 million for the University Place property, located in Lincoln, Nebraska; (iv) $9.6 million for the Coronado Shopping Center property, located in Santa Fe, New Mexico; (v) $7.3 million for the Holly Farm Shopping Center property, located in Milwaukee, Oregon; (vi) $10.6 million for the Washington Plaza property, located in Richland, Washington; (vii) $12.4 million for the Marysville Towne Center property, located in Marysville, Washington; and (viii) $12.9 million for the Kanawha Mall property, located in Charleston, West Virginia (the properties described in clauses (i), (ii), (v), (vii) and (viii) are subject to an underlying mortgage in favor of a single lender and are referred to collectively as the "Properties"). See Notes 3 and 7 to New Valley's Consolidated Financial Statements accompanying this report.

Concurrently with the acquisition of the Shopping Centers, New Valley engaged a property-management firm, whose principals were the former minority partners in the Partnerships, that had previously operated the Shopping Centers to act as the managing agent and leasing agent for the Shopping Centers. Effective December 31, 1996, such firm's engagement was terminated, and Kravco Company was engaged as managing agent and leasing agent for the Kanawha Mall and Insignia Commercial Group, Inc. as managing agent and leasing agent for the remaining Shopping Centers.

The acquisition of the Office Buildings was effected pursuant to a purchase agreement dated January 10, 1996. The acquisition of the Shopping Centers was effected pursuant to a purchase agreement dated January 11, 1996. As of March 25, 1997, an affiliate of Apollo and the Partnerships was the holder of debt securities of BGLS. The foregoing description of these acquisitions by New Valley is qualified in its entirety by reference to the purchase agreements, copies of which are incorporated by reference as exhibits to New Valley's Annual Report on Form 10-K for the year ended December 31, 1996, and are incorporated by reference herein.

RJR NABISCO HOLDINGS CORP. As of March 14, 1997, New Valley held approximately 1.06 million shares of common stock of RJR Nabisco Holdings Corp. ("RJR Nabisco") with a market value of approximately $36.0 million (cost of $32.6 million). For additional information concerning

New Valley's investment in RJR Nabisco and the Company's and BGLS' involvement with respect thereto and related matters, see "Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations - Recent Developments - Certain Matters Relating to RJR Nabisco" and Note 3 to the Company's Consolidated Financial Statements.

THINKING MACHINES CORPORATION. On January 11, 1996, Ladenburg Thalmann Capital Corp. ("Ladenburg Capital"), the merchant banking subsidiary of Ladenburg Group, in connection with the First Amended Joint Plan of Reorganization (the "TMC Plan") of Thinking Machines Corporation ("Thinking Machines") made a $10.6 million convertible bridge loan (the "Loan") to TMCA Acquisition Corp. ("TMCA"). TMCA is an entity formed to invest the Loan proceeds (net of certain expenses) in Thinking Machines, currently a developer and marketer of data mining and knowledge discovery software and, through 1996, of parallel software for high-end and networked computer systems (discontinued in 1996).

On February 8, 1996, the date of confirmation of the TMC Plan, Thinking Machines emerged from bankruptcy and merged with TMCA pursuant to the TMC Plan. As a result of the merger, the Loan was converted into a controlling interest in a partnership which holds approximately 61% of the outstanding common stock of Thinking Machines. Thinking Machines has used the Loan proceeds to help fund its advanced product development and marketing.

Thinking Machines produces, markets and sells data mining and knowledge discovery software and services. Darwin(TM), the company's open, scaleable data mining application, enables businesses to reveal patterns, trends and correlations that exist hidden in very large corporate databases. With this information, organizations can (i) improve the effectiveness and profitability of marketing programs, including telemarketing, direct mail and cross-selling; (ii) formulate strategies to strengthen vendor and customer relationships; (iii) identify fraudulent transactions or situations; and (iv) perform risk-assessment for credit programs. Thinking Machines has initially focused on marketing Darwin to the financial (e.g., banking, credit card, insurance, securities) and telecommunications industries. To date, no material revenues have been recognized by Thinking Machines with respect to the sale or licensing of such software and services.

During the fourth quarter of 1996, Thinking Machines adopted a plan to terminate its parallel processing computer sales and service business. As a result, Thinking Machines wrote-down certain assets, principally inventory, related to these operations to their net realizable value by $6.1 million. Thinking Machines sold its parallel processing software business on November 19, 1996 for $4.3 million and intends to sell the remaining parallel processing service business in 1997.

MISCELLANEOUS INVESTMENTS. In 1995, New Valley made an investment of $1 million in convertible preferred stock of PC411, Inc. ("PC411"), a development stage company which provides on-line electronic directory assistance to personal computer users. PC411 is currently offering a limited version of the PC411 service over the Internet. PC411's long-term strategy is to position itself as an Internet/intranet (private server based networks) information publishing and distribution company.

In June 1996, New Valley determined that, based on PC411's operating losses incurred, an other than temporary impairment in the value of its investment had occurred and, accordingly, $1.0 million was provided as an impairment charge. In June 1996, New Valley entered into a loan agreement with PC411 pursuant to which New Valley agreed from time to time to lend PC411 up to an aggregate of $750,000. Through March 14, 1997, New Valley has advanced PC411 approximately $538,000 thereunder. In connection with the loan agreement, the conversion ratio on the preferred stock was increased and, upon conversion of the preferred stock in January

1997, New Valley held 67% of the outstanding common shares of PC411. In February 1997, PC411 filed a registration statement with the SEC relating to a proposed initial public offering.

In addition, as of December 31, 1996, New Valley's long-term investments included investments in limited partnerships of $7.1 million, equity in a joint venture of $3.8 million, an equity investment in a foreign corporation of $2.0 million (which New Valley has subsequently sold for an amount approximating its cost), and other investments of $.42 million. See Note 8 to New Valley's Consolidated Financial Statements accompanying this report.

New Valley may acquire additional operating businesses through merger, purchase of assets, stock acquisition or other means, or seek to acquire control of operating companies through one of such means. There can be no assurance that New Valley will be successful in targeting or consummating any such acquisitions.

Dispositions Pursuant to the Joint Plan

Pursuant to the Joint Plan, on November 15, 1994, New Valley sold the assets and operations with which it provided domestic and international money transfer services, bill payment services, telephone cards, money orders and bank card services (collectively, the "Money Transfer Business") which included the capital stock of its subsidiary, Western Union Financial Services, Inc. ("FSI") and certain related assets, to First Financial Management Corporation ("FFMC"), and, on January 13, 1995, it sold to FFMC all of the trademarks and tradenames used in the Money Transfer Business and constituting the Western Union name and trademark. The aggregate purchase price was approximately $1.193 billion, including $893 million in cash and $300 million representing the assumption by FFMC of substantially all of New Valley's obligations under its pension plan. Pursuant to the Joint Plan, all of New Valley's debt and allowed claims were satisfied in full and all classes of equity and other equity interests were reinstated and retained all of their legal, equitable and contractual rights.

Through October 1, 1995, New Valley was engaged in the messaging services business through its wholly-owned subsidiary, Western Union Data Services Company, Inc. ("DSI"). On October 31, 1995, New Valley completed the sale of substantially all of the assets (exclusive of certain contracts) and conveyance of substantially all of the liabilities of DSI to FFMC for $20 million, subject to certain adjustments. This transaction was effective as of October 1, 1995.

CERTAIN DISPOSITIONS AND OTHER MATTERS

On July 15, 1996, BGLS sold substantially all of the non-cash assets and certain liabilities of COM Products Inc., a subsidiary engaged in the sale of micrographics equipment and supplies, for approximately $4.2 million. See Note 8 to the Company's Consolidated Financial Statements. On January 31, 1997, BOL sold the BML Shares to New Valley for $55 million. See "Brooke (Overseas) Ltd. - Sale of BrookeMil Ltd.".

The Company and BGLS are presently considering a reorganization in which, among other things, substantially all of the assets of BGLS other than Liggett, would be transferred to a newly formed holding company that would hold all of the capital stock of the Company ("Holdco"). Holdco would retain an indirect interest in Liggett through its ownership of the Company.

EMPLOYEES

At December 31, 1996, the Company and its consolidated subsidiaries had approximately 1,545 full-time employees, of whom approximately 584 were employed by Liggett and approximately 952 were employed by Liggett-Ducat. Additionally, Liggett employs approximately 145 people on a part-time basis. Approximately 21% of the Company's (including its consolidated subsidiaries) employees are hourly employees and are represented by unions. The Company and its consolidated subsidiaries have not experienced any significant work stoppages since 1977, and the Company believes that relations with its employees and their unions are satisfactory.

ITEM 2. PROPERTIES

The Company's and BGLS' principal executive offices are located in Miami, Florida. The Company subleases 12,356 square feet of office space from an unaffiliated company in an office building in Miami, which it shares with BGLS and New Valley and various of their subsidiaries. New Valley has entered into an expense-sharing arrangement for use of such office space. The sublease expires on February 28, 1999.

Substantially all of Liggett's tobacco manufacturing facilities, consisting principally of factories, distribution and storage facilities, are located in or near Durham, North Carolina. Such facilities are both owned and leased. As of December 31, 1996, the principal properties owned or leased by Liggett are as follows:

Type	Location	Owned or Leased	Approximate Total Footage
Office and Manufacturing Complex	Durham, NC	Owned	1,231,000
Warehouse	Durham, NC	Owned	203,000
Storage Facilities	Danville, VA	Owned	578,000
Distribution Center	Durham, NC	Leased	240,000

Liggett's Durham, North Carolina complex consists of 15 major structures over approximately 20 acres. Included are Liggett's manufacturing plant, research facility and corporate offices. Liggett's management believes its property, plant and equipment are well maintained and in good condition and that its existing facilities are sufficient to accommodate a substantial increase in production.

Liggett leases the Durham, North Carolina distribution center pursuant to a lease which expires in May 1999. Liggett has an option to purchase the leased property at any time during the term of the lease. Liggett utilizes approximately 40% of the distribution center and subleases the remaining 60% to a third party. Liggett also leases excess space in its research facility and corporate offices to third parties.

On May 14, 1996, Liggett sold certain surplus realty in Durham, North Carolina to the County of Durham for a sale price of $4.3 million. The Company recognized a gain of approximately $3.6 million on the sale.

On March 11, 1997, Liggett sold to Blue Devil Ventures, a North Carolina limited liability partnership, certain surplus realty in Durham, North Carolina, for a sale price of $2.2 million. The Company will recognize a gain of approximately $1.6 million on the sale.

Ligget-Ducat has a 49-year land lease on a site on the outskirts of Moscow, Russia where Liggett-Ducat plans to build a new cigarette factory. Liggett-Ducat utilizes the site for its existing cigarette factory in Moscow pursuant to a Use Agreement with BML. See Item 1. "Business - Brooke (Overseas) Ltd. - Sale of BrookeMil Ltd."

ITEM 3. LEGAL PROCEEDINGS

Reference is made to Notes 4 and 16 to the Company's Consolidated Financial Statements, which contain a description of certain legal proceedings to which the Company and/or BGLS or their subsidiaries are a party and certain related matters.

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

During the last quarter of 1996 no matter was submitted to the Company's stockholders for their vote or approval, through the solicitation of proxies or otherwise. Such information with respect to BGLS is omitted due to the fact that BGLS meets the conditions set forth in General Instruction (I)(1)(a) and (b) of Form 10-K and is therefore filing this report with the reduced disclosure format.

EXECUTIVE OFFICERS OF THE REGISTRANTS

The table below, together with the accompanying text, present certain information regarding all current executive officers of the Company and of BGLS as of March 25, 1997. Each of the executive officers of the Company and of BGLS serves until the election and qualification of such individual's successor or until such individual's death, resignation or removal by the Board of Directors of the respective company.

Name	Age	Position	Year individual became an executive officer
Bennett S. LeBow	59	Chairman of the Board, President and Chief Executive Officer of the Company and of BGLS	1990
Richard J. Lampen	43	Executive Vice President of the Company and of BGLS	1996
Joselynn D. Van Siclen	56	Vice President, Chief Financial Officer and Treasurer of the Company and of BGLS	1996
Ronald S. Fulford	62	Chairman of the Board, President and Chief Executive Officer of Liggett	1996

BENNETT S. LEBOW has been the Chairman of the Board, President and Chief Executive Officer of the Company, a New York Stock Exchange-listed holding company, since June 1990, and has been a director of the Company since October 1986. Since November 1990, he has been Chairman of the Board, President and Chief Executive Officer of BGLS, which directly or indirectly holds the Company's equity interests in several private and public companies. Each of the public companies have been, directly or indirectly, operating companies.

Mr. LeBow has been a director of Liggett since June 1990 and Chairman of the Board of Liggett from July 1990 to May 1993. He served as one of three interim Co-Chief Executive Officers from March 1993 to May 1993.

He has been Chairman of the Board of New Valley, in which the Company holds an indirect voting interest of approximately 42%, since January 1988, and Chief Executive Officer since November 1994. In November 1991, an involuntary petition seeking an order for relief under Chapter 11 of Title 11 of the United States Code was commenced against New Valley by certain of its bondholders. New Valley emerged from bankruptcy reorganization proceedings in January 1995. He has been Chairman of the Board, President and Chief Executive Officer of NV Holdings since September 1994.

He was a director of MAI Systems Corporation ("MAI"), the Company's former indirect majority-owned subsidiary from September 1984 to October 1995, Chairman of the Board from November 1990 to May 1995 and the Chief Executive Officer from November 1990 to April 1993. In April 1993, MAI filed for protection under Chapter 11 of Title 11 of the United States Code. In November 1993, MAI emerged from bankruptcy reorganization proceedings. MAI is engaged in the development, sale and service of a variety of computer and software products.

RICHARD J. LAMPEN has served as the Executive Vice President of the Company and of BGLS since July 1996. Since October 1995, Mr. Lampen has been the Executive Vice President of New Valley. From May 1992 to September 1995, Mr. Lampen was a partner at Steel Hector & Davis, a law firm located in Miami, Florida. From January 1991 to April 1992, Mr. Lampen was a Managing Director at Salomon Brothers Inc., an investment bank, and was an employee at Salomon Brothers Inc. from 1986 to April 1992. Mr. Lampen is a director of New Valley, Thinking Machines and PC411. Mr. Lampen has served as a director of a number of other companies, including U.S. Can Corporation and The International Bank of Miami, N.A., as well as a court-appointed independent director of Trump Plaza Funding, Inc.

JOSELYNN D. VAN SICLEN has been Vice President, Chief Financial Officer and Treasurer of the Company and of BGLS since May 1996, and currently holds various positions with certain of BGLS' subsidiaries, including Vice President and Treasurer of Eve Holdings, Inc., a wholly-owned subsidiary of Liggett, since April 1994 and May 1996, respectively. Prior to May 1996, Ms. Van Siclen served as Director of Finance of the Company and was employed in various accounting capacities for various subsidiaries of the Company since 1992. Since before 1990 to November 1992, Ms. Van Siclen was an audit manager for the accounting firm of Coopers & Lybrand L.L.P.

RONALD S. FULFORD has served as Chairman of the Board, President and Chief Executive Officer of Liggett since September 1996. Mr. Fulford has also served as a consultant to the Company since March 1996. From June, 1986 until February 1996, Mr. Fulford served as Executive Chairman of Imperial Tobacco ("Imperial"), the British tobacco unit of the British conglomerate Hanson PLC ("Hanson"). Before Imperial, Mr. Fulford was chief executive of three other Hanson companies: London Brick, British EverReady UK & South Africa and United Gas Industries UK & Europe.

PART II

ITEM 5. MARKET FOR REGISTRANTS' COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's common stock, $.10 par value per share, is listed and traded on the New York Stock Exchange ("NYSE") under the symbol "BGL". The high and low sale prices for a share of the Company's common stock on the NYSE, as reported by the NYSE, for each fiscal quarter of 1996 and 1995 were as follows (in dollars):

Year	High	Low
1996:		
Fourth Quarter	5 3/4	4 1/4
Third Quarter	6 1/4	4 5/8
Second Quarter	8 7/8	5 5/8
First Quarter	10 1/8	7 3/4
1995:		
Fourth Quarter	9 7/8	6 5/8
Third Quarter	11 3/8	4 3/8
Second Quarter	5 1/2	3 1/8
First Quarter	4 1/4	3 15/64

There is no public market for BGLS' common stock, $.01 par value per share, as all of such common stock is held by the Company.

HOLDERS

At March 14, 1997, there were 338 holders of record of the Company's common stock.

DIVIDENDS

During 1996 and 1995, the Company declared and paid regular quarterly cash dividends of $.075 per share on its common stock. The declaration of future cash dividends is within the discretion of the Board of Directors of the Company and is subject to a variety of contingencies such as market conditions, earnings and the financial condition of the Company as well as the availability of cash. The payment of dividends and other distributions to the Company by BGLS are subject to the Indenture. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations--Capital Resources and Liquidity".

RECENT SALES OF UNREGISTERED SECURITIES

Since 1994, the Company has issued an aggregate of 500,000 shares of its common stock and granted stock options to purchase 500,000 and 1,000,000 shares of common stock at $2.00 per share and $1.00 per share, respectively, to a consultant who serves as a director and President of New Valley. In addition, in 1997, the Company granted stock options to purchase 422,000 shares of common stock at $5.00 per share to certain employees. These transactions did not involve public offerings of the Company's securities and were exempt from the registration requirements of the Securities Act of 1933, as amended, pursuant to Section 4(2) thereunder. See Note 15 to the Company's Consolidated Financial Statements.

ITEM 6. SELECTED FINANCIAL DATA

	Year Ended December 31,				
	1996	1995	1994	1993	1992
	(dollars in thousands, except per share amounts)				
Statement of Operations Data:					
Revenues(1)	$452,656	$461,459	$479,343	$493,041	$632,791
Restructuring charges				(11,913)	
(Loss) income from continuing operations	(64,918)	(45,344)	(17,991)	(69,228)	(7,724)
Income (loss) from discontinued operations(2)	2,385	21,229	174,683	62,001	(232,397)
(Loss) income from extraordinary items		(9,810)	(46,597)	153,741	7,994
Net (loss) income	(62,533)	(33,925)	110,095	106,780	(232,127)
(Loss) income from continuing operations per share(3)	(3.41)	(1.56)	(1.02)	(4.19)	(1.10)
Income (loss) from discontinued operations per share	0.13	1.16	9.92	3.45	(11.01)
(Loss) income from extraordinary items per share		(0.54)	(2.65)	8.55	0.38
Net (loss) income per share(3)	(3.28)	(0.94)	6.25	5.60	(11.73)
Cash distributions declared per common share(4)	0.30	0.30			0.42
Balance Sheet Data:					
Current assets	$ 80,552	$ 96,615	$ 87,504	$114,411	$256,160
Total assets	177,677	225,620	229,425	164,819	366,206
CVR liability(5)					44,943
Current liabilities	204,463	119,177	144,351	220,207	493,631
Notes payable, long-term debt and other obligations, less current portion	378,243	406,744	405,798	389,671	452,188
Noncurrent employee benefits, deferred credits and other long-term liabilities	49,960	55,803	54,128	69,623	65,332
Stockholders' equity (deficit)	(454,989)	(356,104)	(374,852)	(514,682)	(644,945)

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(1) Revenues include federal excise taxes of $104,518, $123,420, $131,877, $127,341 and $147,701, respectively.
(2) See Note 5 to the Company's Consolidated Financial Statements.
(3) Per share computations include the impact of New Valley's repurchase of Class A Preferred Shares in 1996 and 1995 and the impact of the CVR liability in the years 1993 and 1992.
(4) Cash dividends declared per common share exclude other distributions. See Note 5 to the Company's Consolidated Financial Statements.
(5) See Note 16 to the Company's Consolidated Financial Statements.

ITEM 7. 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 results of operations, capital resources and liquidity of the Company and should be read in conjunction with the Company's Consolidated Financial Statements and notes thereto included elsewhere in this report. The operating results of the periods presented were not significantly affected by inflation. The consolidated financial statements include the accounts of BGLS, Liggett, BOL, NV Holdings, other less significant subsidiaries and, as of December 29, 1995, Liggett-Ducat.

The Company holds an equity interest in New Valley, which sold its money transfer business in November 1994 and its messaging service business in 1995. See Notes 2 and 5 to the Company's Consolidated Financial Statements. Accordingly, the Company's earnings from discontinued operations for the year ended December 31, 1994 and 1995 reflect its portion of the gains ($139,935 and $5,231, respectively) on disposal of those operations. The Company accounts for its share of earnings based on its ownership of New Valley Common Shares, Class B Preferred Shares and Class A Preferred Shares, which at December 31, 1996 was approximately 42%, 58% and 9%, respectively. The Common Shares are accounted for pursuant to the equity method; the Class A Preferred Shares and the Class B Preferred Shares (which Class B shares were acquired in 1995) are accounted for under Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities".

On February 13, 1995, the Board of Directors of the Company distributed a special dividend of one share of MAI common stock for every six shares of the Company's common stock (the "MAI Distribution"). In 1995, the Company sold its remaining shares in SkyBox International Inc. ("SkyBox"), its former subsidiary whose shares were distributed to the holders of the Company's common stock in 1993. Results of MAI and SkyBox have been reclassified as discontinued operations for all periods presented. See Note 5 to the Company's Consolidated Financial Statements.

On January 31, 1997, BOL sold its interest in BML, a real estate investment company doing business in Russia, to New Valley. See Item 1. "Business - Brooke (Overseas) Ltd. - Sale of BrookeMil Ltd." and Note 4 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 and real estate.

RECENT DEVELOPMENTS

Certain Matters Relating to RJR Nabisco

As of December 31, 1996, New Valley held 1,741,000 shares of RJR Nabisco common stock with a market value of $59,199 (cost of $53,372). From the period January 1, 1997 to March 14, 1997, New Valley sold approximately 678,000 shares of RJR Nabisco common stock and recognized a gain on sales of $2,243. At March 14, 1997, New Valley held 1,063,000 shares of RJR Nabisco common stock with a market value of $35,997 (cost of $32,574). New Valley's unrealized gain on its investment in RJR Nabisco common stock decreased from $5,827 at December 31, 1996 to $3,423 at March 14, 1997.

For the year ended December 31, 1996, New Valley had expensed $11,724 for costs relating to the investment in RJR Nabisco common stock. Pursuant to a December 27, 1995 agreement, New Valley agreed, among other things to pay directly or reimburse the Company and its subsidiaries for out-of-pocket expenses in connection with the Company's solicitation of consents and proxies from the shareholders of RJR Nabisco. Pursuant to this agreement, New Valley reimbursed the Company and its subsidiaries $2,453, of which $1,034 was expensed in 1996.

On February 29, 1996, New Valley entered into a total return equity swap transaction (the "Swap") with an unaffiliated company relating to an additional 1,000,000 shares of RJR Nabisco common stock. The Swap was terminated during the third quarter of 1996. New Valley realized a loss of $7,305 on the Swap.

New Valley

On July 29, 1996, New Valley completed its reincorporation from the State of New York to the State of Delaware and effected a one-for-twenty reverse stock split of New Valley's Common Shares. After giving effect to this reverse stock split, the Company now holds 3,989,710 (41.7%) Common Shares.

On January 11, 1996, a subsidiary of New Valley made a $10,600 convertible bridge loan to finance Thinking Machines, a developer and marketer of parallel software for high-end and networked computer systems. In February 1996, the loan was converted into a controlling interest in a partnership which holds approximately 61% of the outstanding common stock of Thinking Machines.

In October 1996, Thinking Machines adopted a plan to dispose of its parallel processing computer segment. A gain on disposal of $2,386 was offset by a net loss from discontinued operations of $3,818 for the year ended December 31, 1996, net of minority interests benefit.

On January 11, 1996, New Valley Realty, a division of New Valley, completed the acquisition of four office buildings and eight shopping centers for an aggregate purchase price of $183,900 which consisted of $23,900 in cash and $160,000 in non-recourse mortgage financing.

In the first quarter of 1996, New Valley repurchased 72,104 Class A Preferred Shares for a total amount of $10,530. New Valley declared and paid cash dividends on the Class A Preferred Shares of $40 per share in 1996. At December 31, 1996, the Company owned 618,326 (57.71%) of the New Valley Class A Preferred Shares.

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 and is payable $21,500 on June 30, 1997 and $12,000 on December 31, 1997. The Company anticipates it will recognize in 1997 a gain of approximately $21,300 on the sale. See Note 4 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 will further reduce its salaried, hourly and part-time headcount by a total of 273 positions (35%) over an eight-month transition period. During 1996, Liggett recorded a $3,428 restructuring charge to operations.

On March 11, 1997, Liggett sold to Blue Devil Ventures, a North Carolina limited liability partnership, certain surplus realty for $2,200. The Company will recognize a gain of approximately $1,600.

New Accounting Pronouncements

Effective January 1, 1996, the Company adopted SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of". SFAS No. 121 establishes accounting standards for the impairment of long-lived assets, certain identifiable intangibles, and goodwill related to those assets. There was no material effect on the financial position or results of operations from the adoption because the Company's prior impairment recognition practice was consistent with the major provisions of SFAS No. 121. Under provisions of SFAS No. 121, impairment losses are recognized when expected future cash flows are less than the assets' carrying value. Accordingly, when indicators of impairment are present, the Company evaluates the carrying value of property, plant and equipment and intangibles in relation to the operating performance and estimates of future discounted cash flows of the underlying business.

Effective January 1, 1996, SFAS No. 123, "Accounting for Stock-Based Compensation" was adopted by the Company as required for its fiscal 1996 financial statements and will not have a material effect on the Company's financial position or results of operations for the year ended 1996. Upon adoption of SFAS 123, the Company will continue to measure compensation expense for stock-based employee compensation plans using the intrinsic value method prescribed by APB Opinion No. 25, "Accounting for Stock Issued to Employees," and will provide pro forma disclosures of net income as if the fair value-based method prescribed by SFAS No. 123 had been applied in measuring compensation expense. For grants extended to nonemployees, compensation expense will be measured and disclosed in accordance with SFAS No. 123.

In February 1997, the Financial Accounting Standards Board issued SFAS No. 128, "Earnings Per Share". SFAS No. 128 specifies new standards designed to improve the earnings per share ("EPS") information provided in financial statements by simplifying the existing computational guidelines, revising the disclosure requirements and increasing the comparability of EPS data on an international basis. Some of the changes made to simplify the EPS computations include: (a) eliminating the presentation of primary EPS and replacing it with basic EPS, with the principal difference being that common stock equivalents are not considered in computing basic EPS, (b) eliminating the modified treasury stock method and the three percent materiality provision and (c) revising the contingent share provisions and the supplemental EPS data requirements. SFAS No. 128 also makes a number of changes to existing disclosure requirements. SFAS No. 128 is effective for financial statements issued for periods ending after December 15, 1997, including interim periods. The Company has not yet determined the impact of the implementation of SFAS No. 128.

RECENT DEVELOPMENTS IN THE CIGARETTE INDUSTRY

Pricing Activity

On May 5, 1995, R. J. Reynolds Tobacco Company ("RJR") initiated a list price increase on all brands of $.30 per carton. Philip Morris, Inc. and Brown & Williamson Tobacco Corporation ("B&W"), which together with RJR comprise 90% of the market, matched the price increase on the same day. Liggett followed on May 9, 1995.

On April 8, 1996, Philip Morris announced a list price increase on all brands of $.40 per carton. The other manufacturers, including Liggett, matched the price increase.

On March 7, 1997, RJR initiated another list price increase on all brands of $.40 per carton (approximately 4%). B&W, Lorillard and Liggett have matched this increase, and, on March 21, 1997, Philip Morris announced a price increase of $.50 per carton.

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 March 14, 1997, there were 108 individual suits, 12 purported class actions and 22 state (and several municipality) Medicaid reimbursement actions pending in the United States in which Liggett is a named defendant. 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 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 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 16 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, strict liability, fraud, misrepresentation, design defect, failure to warn, breach of express and implied warranties, conspiracy, concert of action, unjust enrichment, common law public nuisance, indemnity, market share liability, and violations of deceptive trade practices laws and antitrust statutes. Plaintiffs also seek punitive damages in many of these cases. Defenses raised by defendants in these cases include lack of design defect, statutes of limitations or response, equitable defenses such as "unclean hands" and lack of benefit, failure to state a claim and preemption by the Federal Cigarette Labeling and Advertising Act, as amended.

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 the Federal Racketeer Influenced and Corrupt Organization Act.

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 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). 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 settlements 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.

RECENT SETTLEMENTS. 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. The Company and Liggett have now obtained settlements with each of the 22 states that have commenced suit against them. The settlements cover all smoking-related claims, including both addiction-based and tobacco injury claims against the Company and Liggett, brought by the 22 states and, upon court approval, the nationwide class.

The settlement with the Attorneys General, which does not require court approval, includes the states of Arizona, Connecticut, Hawaii, Illinois, Indiana, Iowa, Kansas, Maryland, Michigan, Minnesota, New Jersey, New York, Oklahoma, 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.

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 LTD., ET AL., Circuit Court of Mobile County, Alabama where the court granted preliminary approval and preliminary certification of the class. 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. In light of this, the March 1996 CASTANO settlement is no longer in effect.

Pursuant to the settlements, the Company and Liggett have agreed to cooperate fully with the Attorneys General and the nationwide class in their lawsuits against the tobacco industry. The Company and Liggett have 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 have 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, the Company and Liggett have agreed to offer their employees for witness interviews and testimony at deposition and trial. Pursuant to both settlement agreements, Liggett has 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.

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 has 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 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 million. Both the Attorneys General and the nationwide class have also 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 have 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.

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. 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 these four companies from interfering with Liggett's filing with the courts, under seal, those documents.

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 16 to the Company's Consolidated Financial Statements.

RESULTS OF OPERATIONS

1996 compared to 1995

REVENUES. Consolidated revenues were $452,656 for the year ended December 31, 1996 compared to $461,459 for the year ended December 31, 1995, a decrease of $8,803 primarily due to a decline in sales of $54,604 at Liggett offset by an increase in tobacco revenues at Liggett-Ducat of $45,677. Results of operations for Liggett-Ducat were not included in 1995 since consolidation occurred as of December 29, 1995. Net sales at Liggett were $401,062 for the year ended December 31, 1996 versus $455,666 for the same period for the prior year. The 12% decrease in revenues was due primarily to a 15.3% decline in domestic unit sales volume, partially offset by the effects of the April 1996 list price increase (see "Recent Developments in the Cigarette Industry - Pricing Activity"). This change in unit sales volume was comprised of declines within the premium and discount market segments of 13.7% and 16.2%, respectively. 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. Liggett experienced a significant increase in volume at the end of the fourth quarter of 1996, in part due to ongoing trade programs based on quarterly volume targets for its customers and to consumer promotional programs consisting of coupons and variable price reductions. The effects of these trade programs may have a negative impact on sales in future periods.

Liggett-Ducat (not included in the prior year results) increased unit sales volume over the prior year by 8.7% to approximately 11.4 billion units and increased revenues by $9,832 driven by the expanding market in Russia.

GROSS PROFIT. Consolidated gross profit of $217,023 for the year ended December 31, 1996 decreased $28,249 from gross profit of $245,272 for the same period in 1995, reflecting a decrease in gross profit at Liggett of $30,089 for the year ended December 31, 1996 compared to the same period in the prior year. Gross profit margin was further reduced by restructuring charges of $1,595, the major portion of which was pension curtailment expense. This was somewhat offset by gross margin at Liggett-Ducat of $4,036 which margins were not included in the prior year's results. The decrease at Liggett was due primarily to the decline in unit sales volume discussed above. As a percent of revenues (excluding federal excise taxes), Liggett's gross profit decreased to 72.0% for 1996 compared to 73.2% for 1995. This decrease is the result of increased tobacco costs due to reduced worldwide supply of tobacco, and 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 April 1996 list price increase. Gross profit for 1995 was reduced by an accrual of approximately $4,900 for the United States Department of Agriculture ("USDA") domestic marketing assessment. See Note 16 to the Company's Consolidated Financial Statements.

EXPENSES. Consolidated operating, selling, general and administrative expenses were $220,950 for the year ended December 31, 1996 compared to $237,212 for the same period for the prior year, a decrease of $16,262. The decrease was due primarily to Liggett's decrease in sales volume with corresponding reductions in spending on promotional programs offset by charges for restructuring of $3,428 for severance programs ($132 of which is included in cost of sales). The anticipated savings of the restructuring relate primarily to reduced payroll and benefits expenses in future periods. Of the total restructuring expense recorded during 1996, $1,416 was funded during 1996 and $2,012 remains to be funded in subsequent years. In addition, corporate expenses, primarily legal fees, decreased by approximately $4,000. In 1995, expenses increased due to increased spending on trade and promotional programs and the accrual of approximately $4,000 for the settlement of certain tobacco litigations with the Attorneys General of certain states. See Note 16 to the Company's Consolidated Financial Statements.

OTHER INCOME (EXPENSE). Consolidated interest expense was $60,556 for the year ended December 31, 1996 compared to $57,505 for the same period for the prior year. The increase of $3,051 relates to interest expense at Liggett-Ducat not reflected in the prior year's consolidation, increased interest accrued for the USDA domestic marketing assessment expense at Liggett partially offset by redemption of $7,000 of the Liggett Senior Secured Notes (the "Liggett Series B Notes") and an increase in interest expense at corporate due to an increase in outstanding indebtedness of approximately $9,000. Equity in loss of affiliates of $7,211 represents the Company's proportionate share of losses from continuing operations at New Valley. This is partially offset in discontinued operations in which the Company reflected its portion of New Valley's loss from discontinued operations ($1,591) and the gain on disposal ($3,976). Other income includes the sale of assets of COM Products Inc. and the sale of surplus realty at Liggett as a result of which the Company realized gains of $3,047 and $3,669, respectively.

LOSS FROM CONTINUING OPERATIONS. The loss from continuing operations for the year ended December 31, 1996 was $64,918 compared with a loss of $45,344 for the same period in the prior year. A tax provision of $1,402 in 1996 and $342 in 1995 relates to foreign income taxes at the subsidiary level in 1996 and state income taxes at the subsidiary level in 1995.

OTHER. At December 31, 1996, the Company and its consolidated group had net operating loss carryforwards for tax purposes of approximately $114,000 which may be subject to certain restrictions and limitations and which will generally expire in the years 2006 to 2009.

DISCONTINUED OPERATIONS. Income from discontinued operations of $2,385 for the year ended December 31, 1996 and $21,229 for the prior year reflects the Company's proportionate interest in the discontinued operations of Thinking Machines, a subsidiary of New Valley, in 1996 and the redemption/sale of SkyBox preferred and common stock and the sale of New Valley's message servicing business in 1995.

1995 compared to 1994

REVENUES. Consolidated revenues were $461,459 for the year ended December 31, 1995 compared to $479,341 for the year ended December 31, 1994, a decrease of $17,882 primarily due to a decline in sales at Liggett and other less significant subsidiaries. Net sales at Liggett were $455,666 for the year ended December 31, 1995 versus $465,676 for the same period for the prior year. This 2.1% decrease in revenues was primarily due to a 5.6% decrease in unit sales volume, partially offset by the effects of the May 9, 1995 list price increase (see "Recent Developments in the Cigarette Industry - Pricing Activity"). The decrease in unit sales volume was comprised of decreases in the premium, discount and military categories, partially offset by an increase in the international category. Both premium and discount products suffered a temporary decline in volume as a result of the implementation of a new distribution and marketing program in one of Liggett's sales zones and national accounts during 1995. Also, heavy discounting of a competitor's product within the premium segment contributed to the premium volume decline. The decrease in discount volume was due to decreases in generic and branded discount brands as a result of leveraged rebate programs tied to the premium products of other cigarette manufacturers and trade and promotional programs for new brands offered by competitors on branded discount products. The decrease in discount volume was partially offset by the continued growth of Liggett's control label brands since their introduction in 1993. The decrease in the military volume is primarily due to heavy discounting of a competitor's product within this category. The overall decline in unit sales volume would have been much greater except for aggressive trade programs offered near the end of the fourth quarter of 1995.

GROSS PROFIT. Consolidated gross profit of $245,272 for the year ended December 31, 1995 decreased $4,264 from gross profit of $249,536 for the same period in 1994, reflecting a decrease in gross profit at smaller subsidiaries somewhat offset by Liggett which had a slight increase in gross profit ($450) for the year ended December 31, 1995 compared to the prior year. Gross profit at Liggett as a percent of revenue (excluding federal excise taxes) for the period increased to 73.2% compared to 72.8% for the prior year, due primarily to the May 9, 1995 list price increase and lower per unit cost of sales. The reduction in cost of sales is a result of the effects of Liggett's continuing cost reduction programs begun in 1993. The cost reductions were offset by the accrual of approximately $4,900 for the USDA marketing assessment.

EXPENSES. Consolidated operating, selling, general and administrative expenses were $237,212 for the year ended December 31, 1995 compared to $235,374 for the same period for the prior year, an increase of $1,838. The increase was primarily caused by increased spending on trade and promotional programs at Liggett to combat heavy competition by other cigarette manufacturers for unit sales volume along with the accrual of approximately $4,000 for the settlement of certain tobacco litigations with the Attorneys General of certain states. Such increases were partially offset by expense reductions at corporate which, in 1994, included charges of $7,500 for debt restructuring and $7,682 of stock compensation expense. Expenses in 1995 were only partially offset by the net effects of the restructuring program at Liggett discussed above.

OTHER INCOME (EXPENSE). Consolidated interest expense was $57,505 for the year ended December 31, 1995 compared to $55,952 for the prior year. The increase of $1,553 relates to the incurrence of additional indebtedness by the Company for the Series 1 Notes (which were redeemed on June 12, 1995), increases in the interest rate on the Series 1 Notes and the Series 2 Notes from February 1 through September 6, 1995 (or, in the case of the Series 1 Notes, through June 12, 1995) and an increase in the interest rate of the Liggett Series C Notes, which were reset from 16.50% to 19.75% on February 1, 1995 as well as the issuance of additional Series C Notes in November 1994, such notes being outstanding for all of 1995.

LOSS FROM CONTINUING OPERATIONS. The loss from continuing operations for the year ended December 31, 1995 was $45,344 compared with a loss of $17,991 for the same period in the prior year. A tax provision of $342 in 1995 relating to state income taxes at the subsidiary level increased the 1995 loss while the loss in 1994 was mitigated by a tax benefit of $24,487 related to the completion of an audit by the Internal Revenue Service through December 31, 1991.

DISCONTINUED OPERATIONS. Income of discontinued operations of $21,229 for the year ended December 31, 1995 and $174,683 for the prior year reflects the redemption/sale of SkyBox preferred and common stock and the sale of New Valley's message servicing business in 1995 and the redemption/sale of SkyBox preferred and common stock and the sale of New Valley's money transfer business in 1994.

CAPITAL RESOURCES AND LIQUIDITY

Net cash and cash equivalents decreased $1,429, $906 and $11,497 for the twelve months ended December 31, 1996, 1995 and 1994, respectively.

Net cash used in operations in 1996 of $3,705 was lower than cash used last year, primarily due to the declining sales volume at Liggett resulting in lower working capital requirements, decreasing trade receivables and increases in accrual of promotional expense. This is compared to net cash used in 1995 of $22,986, primarily the impact of non-cash adjustments relating to discontinued operations and an increase in inventory levels. Such effects on the uses of cash were offset by an increase in liabilities for various legal settlements, debt issuance costs and unearned revenue.

Net cash used in operations in 1994 was $44,060. Net income of $110,095 in 1995 was due principally to earnings from discontinued operations at SkyBox and New Valley. Cash received from sales and redemptions of SkyBox equities of $31,120 was offset by the non-cash impact of the gain on disposal of $117,275 at the Company's equity investee, New Valley.

Net cash used in investing activities in 1996 of $4,279 was principally due to continuing capital expenditures for real estate development in Russia of $29,800 and expenditures at Liggett of $4,300 for equipment modernization and to maintain production facilities partially offset by dividends received from New Valley on the Class A Preferred Shares held by the Company and the proceeds from the sale of assets at both Liggett and the Company.

Net cash provided by investing activities was $66,874 for the year ended December 31, 1995 compared to cash provided by investing activities of $23,861 for the same period in 1994. In the year ended December 31, 1995, cash was provided through dividends from New Valley on the Class A Preferred Shares of $61,832, the redemption of SkyBox preferred stock for $4,000 and the sale of the SkyBox common stock for $9,282. These amounts were offset by capital expenditures, particularly for building improvements related to real estate development in Russia. At Liggett, capital expenditures in 1995 and 1994 to maintain production facilities and for operational efficiencies at Liggett were minimal. Capital expenditures at Liggett declined in 1994 and 1995 because of significant equipment modernization occurring in the 1980s and early 1990s. In the year ended December 31, 1994, cash provided by investing activities was largely the result of the sale/redemption of SkyBox common and preferred stock (approximately $29,000) offset by the impact of the Company's discontinuation of its investment in MAI and capital expenditures of $3,023.

Net cash provided by financing activities in 1996 was $6,680, primarily due to bank loans for Russian real estate development, the sale by BGLS of additional 15.75% Series A Senior Secured Notes Due 2001 (the "Series A Notes") later exchanged for the 15.75% Series B Senior Secured Notes Due 2001 (the "Series B Notes") and an increase in borrowings under Liggett's revolving credit facility (the "Facility"). Cash provided was offset by redemption of BGLS' 16.125% Senior Subordinated Reset Notes Due 1997 (the "Reset Notes"), a decrease in the cash overdraft and distributions to the Company's stockholders of $4,162.

Cash used in financing activities for the year ended December 31, 1995 was $44,794 reflecting the redemption of BGLS' Series 1 Senior Secured Notes on June 12, 1995 in the amount of $23,594, repayments and redemptions of Liggett's long-term debt of $7,983, repayments under Liggett's revolver of $3,830, distributions by the Company of $5,475 to stockholders and a decrease in cash overdraft of $594 partially offset by proceeds from debt of $2,568.

Cash flows provided by financing activities in 1994 was $8,765. Proceeds from financing activities in 1994 included proceeds from issuance of the Liggett Series C Notes by Liggett, stockholder loan repayments with interest offset principally by decreases in cash overdrafts and payment of Series G Preferred dividends.

Liggett

Liggett had a net capital deficiency of $176,478 as of December 31, 1996, is highly leveraged and has substantial near-term service requirements. Due to the many risks and uncertainties associated with the cigarette industry, the impact of recent tobacco litigation settlements (see "Recent Developments in the Cigarette Industry - Legislation and Litigation") and increased tobacco costs, there can be no assurance that Liggett will be able to meet its future earnings goals. Consequently, Liggett could be in violation of certain debt covenants, and if its lenders were to exercise acceleration rights under the Facility or senior secured notes indentures or refuse to lend under the Facility, Liggett would not be able to satisfy such demands or its working capital requirements.

Further, Liggett's senior secured 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 its Facility expires on March 8, 1998 unless extended by its lenders. The Facility is classified as a short-term debt thereby creating a working capital deficit of approximately $40,694 at December 31, 1996.

While Liggett management currently intends to seek to refinance and/or restructure with Liggett's note holders the redemption and maturity requirements on the senior secured notes and to extend the Facility, there are no refinancing or restructuring arrangements for the notes or commitments to extend the Facility at this time, and no assurances can be given in this regard. Based on Liggett's net loss for 1996 and projected 1997 operating results, Liggett does not anticipate it will be able to generate sufficient cash from operations to make such payments. If Liggett is unable to refinance or restructure such obligations, renegotiate the payment terms of the senior secured notes, extend the Facility or otherwise make such payments, 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, Liggett may be forced to seek protection from creditors under applicable laws. These matters raise substantial doubt about Liggett meeting its liquidity needs and Liggett's ability to continue as a going concern.

On May 14, 1996, Liggett sold certain surplus realty in Durham, North Carolina to the County of Durham for a sale price of $4,300. A gain of approximately $3,600 was recognized on this sale.

On March 11, 1997, Liggett sold certain surplus realty in Durham, North Carolina to Blue Devil Ventures, a North Carolina limited liability partnership, for a sale price of $2,200. A gain of approximately $1,600 was recognized on this sale.

Liggett has acquired from BOL for $7,700 shares (19.97%) of Liggett-Ducat and options to acquire additional shares of Liggett-Ducat which entitle Liggett to increase its ownership to 95%. The transactions were funded principally with the proceeds of the May 1996 and March 1997 sales of surplus reality. See Item 1. "Business - Brooke (Overseas) Ltd. - Liggett-Ducat Ltd."

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 $13,098 based on eligible collateral at December 31, 1996. 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, bear a rate of 9.75% at December 31, 1996. The Facility contains certain financial covenants similar to those contained in Liggett's Note 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 imposes requirements with respect to Liggett's adjusted net worth (not to fall below a deficit of $175,000 as computed in accordance with the agreement) and working capital (not to fall below a deficit of $35,000 as computed in accordance with the agreement). At December 31, 1996, Liggett was in compliance with all covenants under 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 Senior Secured 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 Senior Secured Notes; (ii) the maximum permitted working capital deficit 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.

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 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. The Liggett Notes are collateralized by substantially all of the assets of Liggett, excluding accounts receivable and inventory. Eve is 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. At December 31, 1996, Liggett was in compliance with all debt covenants under the Liggett Notes indentures.

On January 31, 1994, Liggett issued a total of $22,500 of Variable Rate Series C Senior Secured Notes ("Liggett Series C Notes"). The Liggett Series C Notes have the same terms (other than interest rate) and stated maturity as the Liggett Series B Notes. The Liggett Series C Notes bore a 16.5% interest rate, which was reset on February 1, 1995 to 19.75%. On November 20, 1994, Liggett issued the remaining $7,508 of Liggett Series C Notes in exchange for an equal amount of Liggett Series B Notes and cash of $375. The Liggett Series B Notes were credited against the mandatory redemption requirements for February 1, 1995. In December 1995, $7,000 of Liggett Series B Notes were purchased using revolver availability and credited against the mandatory redemption requirements for February 1, 1996. The transaction resulted in a net gain of $1,114. The remaining $500 mandatory redemption requirement for February 1, 1996 was met by retiring the $500 Series C Notes held in treasury. In February 1997, Liggett purchased $7,500 of Series B Notes using revolver availability and credited such Notes against the mandatory redemption requirement. Liggett will record a net gain of $2,963 for this transaction in the first quarter, 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. For a discussion of the recent settlements, see "Recent Developments in the Cigarette Industry - Legislation and Litigation" and Note 16 to the Company's Consolidated Financial Statements.

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 December 31, 1996, BGLS' long-term debt was approximately $233,000.

On November 27, 1995, BGLS commenced an offer to exchange a total of $232,864 principal amount of 15.75% Senior Secured Notes due January 31, 2001, for all its outstanding 13.75% Series 2 Senior Secured Notes Due 1997 ("Series 2 Notes"), Reset Notes and 14.50% Subordinated Debentures Due 1998 ("Subordinated Debentures"). The exchange ratio was $1,087.47 principal amount of new Series A Notes for each $1,000 principal amount of Series 2 Notes exchanged, $1,132.28 principal amount of Series B Notes for each $1,000 principal amount of Reset Notes exchanged and $1,000 principal amount of new Series B Notes for each $1,000 principal amount of Subordinated Debentures exchanged. The new Series A Notes and the new Series B Notes were identical except that the Series B Notes were not subject to restrictions on transfer.

The exchange offer closed on January 30, 1996. All $91,179 of the Series 2 Notes and $125,495 of the Subordinated Debentures were exchanged. In addition, BGLS cancelled all of the Subordinated Debentures ($13,705) held by the Company. Subordinated Debentures in the amount of $800 remain outstanding. As part of the exchange offer, substantially all of the covenants and events of default were eliminated pertaining to the Subordinated Debentures.

Holders of Reset Notes did not exchange, and the Reset Notes were redeemed on March 29, 1996 for a total amount of $5,785, including premium, together with accrued interest of $452. On March 7, 1996, an additional $7,397 face amount of Series A Notes were sold for $6,300 including accrued interest with the proceeds being used for the redemption of the Reset Notes.

Pursuant to a registered exchange offer, holders of the Series A Notes exchanged all of the $107,373 outstanding principal amount for an equal principal amount of Series B Notes. The exchange closed March 21, 1996. The Company has cancelled all the Series A Notes.

The new Series B Notes are collateralized by substantially all of BGLS' assets, including a pledge of BGLS' equity interests in Liggett, BOL and NV Holdings as well as a pledge of all of the New Valley securities held by BGLS and NV Holdings. The BGLS Series B Notes Indenture contains certain covenants, which among other things, limit the ability of BGLS to make distributions to the Company to $6,000 per year ($12,000 if less than 50% of the Series B Notes remain outstanding), limit additional indebtedness of BGLS to $10,000, limit guaranties of subsidiary indebtedness by BGLS to $50,000, and restrict certain transactions with affiliates that exceed $2,000 in any year subject to certain exceptions which include payments to the Company not to exceed $6,500 per year for permitted operating expenses, payment of the Chairman's salary and bonus and certain other expenses, fees and payments. In addition, the Indenture contains certain restrictions on the ability of the Chairman and certain of his affiliates to enter into certain transactions with, and receive payments above specified levels from, New Valley. Interest is payable at the rate of 15.75% per annum on January 31 and July 31 of each year, except for the period ended July 31, 1996 when interest was payable at 13.75% from October 1, 1995 to January 30, 1996 and at 15.75% from January 31, 1996 through July 31, 1996.

The Company recorded an extraordinary charge of approximately $9,700 for the year ended December 31, 1995 relating to the exchanged debt securities discussed above.

BOL

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, payable $21,500 on June 30, 1997 and $12,000 on December 31, 1997. See Item 1. "Business - Brooke (Overseas) Ltd. - Sale of BrookeMil Ltd."

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%. Principal repayments are due over the period April through October of 1997. Deferred financing fees of $4,044 are being amortized over the term of the loan. The Company has guaranteed the payment of the note. In December 1996, the loan was assigned by Liggett-Ducat to BML which has pledged Ducat Place II, the second phase of BML's Ducat Place real estate development, as collateral for the loan. 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

Prior to the 1995 exchange offer, the Company had substantial near-term consolidated debt service requirements, with aggregate required principal payments of $318,106 due in the years 1995 through 1998. As a result of the 1995 exchange offer, the redemption of the Reset Notes in 1996 and the sale of the BML shares to New Valley in January 1997, the Company decreased its scheduled debt maturities to $94,758 due in the years 1997-1998; approximately $91,800 of this debt relates to Liggett and BOL. At March 25, 1997, such scheduled debt maturities have been reduced to $63,793 because of Liggett's sinking fund payment on February 1, 1997 and the assumption of the foreign bank loan by New Valley through the purchase of BML on January 31, 1997. In addition, Liggett has a payment at maturity on February 1, 1999 of $107,400. The Company believes that it will continue to meet its liquidity requirements through 1997, although the BGLS Series B Notes Indenture limits the amount of restricted payments BGLS is permitted to make to the Company during the calendar year. At December 31, 1996, 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 BGLS' Series B Notes Indenture) is $9,225. In September 1996, the Company provided for its quarterly dividend of $1,387 with proceeds from the CVR distribution received in July 1996. 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 proceeds from a 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 and real estate development operations in Russia are each 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. The Indenture for BGLS' Series B 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.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The Company's Consolidated Financial Statements and Notes thereto, together with the report thereon of Coopers & Lybrand L.L.P. ("Coopers & Lybrand") dated March 27, 1997, and quarterly financial results are set forth beginning on page F-1 of this report.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEMS 10, 11, 12 and 13.

The information called for by Items 10, 11, 12 and 13 with respect to the Company will be contained in the Company's definitive Proxy Statement for its 1997 annual meeting of stockholders, to be filed with the SEC not later than 120 days after the end of the Company's fiscal year covered by this report pursuant to Regulation 14A under the Exchange Act, and incorporated herein by reference.

Such information with respect to BGLS is omitted due to the fact that BGLS meets the conditions set forth in General Instruction (I)(1)(a) and (b) of Form 10-K and is therefore filing this report with the reduced disclosure format.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a)(1) INDEX TO 1996 CONSOLIDATED FINANCIAL STATEMENTS:

The Company's Consolidated Financial Statements and the Notes thereto, together with the report thereon of Coopers & Lybrand dated March 27, 1997, appears beginning on page F-1 of this report. Financial statement schedules not included in this report have been omitted because they are not applicable or the required information is shown in the Consolidated Financial Statements or the Notes thereto.

(a)(2) FINANCIAL STATEMENT SCHEDULES:

(a)(3) EXHIBITS

(a) The following is a list of exhibits filed herewith as part of the report on Form 10-K:

INDEX OF EXHIBITS

EXHIBIT NO.	DESCRIPTION
* 2.1	Stock Purchase Agreement dated as of January 31, 1997 among BrookeMil Ltd. ("BML"), Brooke (Overseas) Ltd. ("BOL"), BGLS Inc. ("BGLS") and New Valley Corporation ("New Valley") (incorporated by reference to exhibit 2.1 in New Valley's Current Report on Form 8-K dated January 31, 1997, Commission File No. 1-2493 (the "New Valley Form 8-K")).
* 3.1	Restated Certificate of Incorporation of Liggett Group Inc. (the predecessor to Brooke Group Ltd. (the "Company")) (incorporated by reference to the Company's Registration Statement on Form S-1, Commission File No. 33-16868).
* 3.2	Certificate of Amendment of the Restated Certificate ofIncorporation of the Company (incorporated by reference to the Company's Form 10-Q for the quarter ended June 30, 1990, Commission File No. 1-5759).
* 3.3	Amended and Restated By-Laws of the Company, effective December 5, 1995 (incorporated by reference to the Company's current Report on Form 8-K dated December 5, 1995, Commission File No. 1-5759).
* 3.4	Certificate of Designations of Series A Junior Convertible Participating PIK Preferred Stock, Series B Junior Convertible Participating Reset Preferred Stock, Series C Junior Convertible Participating Reset Preferred Stock and Series D Junior Convertible Participating Reset Preferred Stock (incorporated by reference to the Company's Form 10-Q for the quarter ended September 30, 1990, Commission File No. 1-5759).
* 3.5	Certificate of Designation of Series E Junior Convertible Participating Preferred Stock of the Company (incorporated by reference to the Company's Report on Form 8-K dated October 29, 1993).
* 3.6	Certificate of Designation of Series F Junior Convertible Participating Preferred Stock of the Company (incorporated by reference to the Company's Report on Form 8-K dated October 29, 1993, Commission File No. 1-5759).
* 3.7	Certificate of Designation of Series G Junior Convertible Participating Preferred Stock of the Company (incorporated by reference to the Company's Form 10-K for the fiscal year ended 1993, Commission File No. 1-5759).

EXHIBIT NO.	DESCRIPTION
* 3.8	Certificate of Incorporation of BGLS (incorporated by reference to exhibit 3.1 in BGLS' Registration Statement on Form S-4 dated December 19, 1995, Commission File Number 33-80593).
* 3.9	By-Laws of BGLS (incorporated by reference to exhibit 3.2 in BGLS' Registration Statement on Form S-4 dated December 19, l995, Commission File Number 33-80593).
* 4.1	Indenture, dated as of January 1, 1996, between BGLS Inc. ("BGLS") and Fleet National Bank of Massachusetts ("Fleet"), as Trustee, relating to the "Series A Notes" and the 15.75% Series B Senior Secured Notes due 2001 (the "Series B Notes"), including the form of Series A Note and the form of Series B Note (the "Series A and Series B Indenture") (incorporated by reference to exhibit 4.1 in BGLS' Registration Statement on Form S-4 dated December 19, 1995, Commission File No. 33-80593).
* 4.2	Pledge and Security Agreement, dated as of January 1, 1996, between BGLS and Fleet, as Trustee, under the Series A and Series B Indenture (incorporated by reference to exhibit 4.2 in BGLS' Registration Statement on Form S-4 dated December 19, 1995, Commission File No. 33-80593).
* 4.3	A/B Exchange and Registration Rights Agreement, dated as of November 21, 1995, among the Company, BGLS, AIF II L.P., Artemis America Partnership, Tortoise Corp., and Mainstay High Yield Corporate Bond Fund (incorporated by reference to exhibit 4.3 in BGLS' Registration Statement on Form S-4 dated December 19, 1995, Commission File No. 33-80593).
* 4.4	Pledge and Security Agreement, dated as of January 1, 1996, between New Valley Holdings, Inc. and Fleet, as Trustee, under the Series A and Series B Indenture (incorporated by reference to exhibit 4.4 in BGLS' Registration Statement on Form S-4 dated December 19, 1995, Commission File No. 33-80593).
* 4.5	Indenture, dated as of September 30, 1994, between BGLS and Shawmut Bank, N.A. ("Shawmut"), as Trustee, relating to the 13.75% Series 2 Senior Secured Notes due 1995 (the "Series 2 Notes"), including the form of Series 2 Note (the "Series 2 Indenture") (incorporated by reference to exhibit 4(ii) in the Company's Form 8-K dated September 2, 1994, Commission File Number 1-5759).
* 4.6	Pledge Agreement, dated as of September 30, 1994, between BGLS and Shawmut, as Trustee, under the Series 2 Indenture (incorporated by reference to exhibit 10(ae) in the Company's Form 8-K dated September 2, 1994, Commission File No. 1-5759).

EXHIBIT NO.	DESCRIPTION
* 4.7	Indenture, dated April 1, 1988, between BGLS and First Trust National Association ("First Trust"), as Trustee, relating to the Subordinated Debentures (the "14.5% Debenture Indenture") (incorporated by reference to exhibit 4(ff) in the Company's Form 10-Q for the quarter ended September 30, 1990, Commission File No. 1-5759).
* 4.8	First Supplemental Indenture, dated September 4, 1990, to the 14.5% Debenture Indenture, between BGLS and First Trust, as Trustee (incorporated by reference to exhibit 4(f) in the Company's Form 10-K for the year ended December 31, 1990, Commission File No. 1-5759).
* 4.9	Second Supplemental Indenture, dated November 19, 1990, to the 14.5% Debenture Indenture, between BGLS and First Trust, as Trustee (incorporated by reference to exhibit 4(g) in the Company's Form 10-K for the year ended December 31, 1990, Commission File No. 1-5759).
* 4.10	Third Supplemental Indenture, dated November 19, 1990, to the 14.5% Debenture Indenture, between BGLS and First Trust, as Trustee (incorporated by reference to exhibit 4(i) in the Company's Form 10-K for the year ended December 31, 1990, Commission File No. 1-5759).
* 4.11	Fourth Supplemental Indenture, dated October 22, 1993, to the 14.5% Debenture Indenture, between BGLS and First Trust, as Trustee (incorporated by reference to exhibit 4(y) in the Company's Form 10-Q for the quarter ended September 30, 1993, Commission File No. 1-5759).
* 4.12	Fifth Supplemental Indenture, dated January 18, 1995, to the 14.5% Debenture Indenture, between BGLS and First Trust, as Trustee (incorporated by reference to exhibit 4(e) in the Company's Form 10-K for the year ended December 31, 1994, Commission File No. 1-5759).
* 4.13	Sixth Supplemental Indenture, dated as of January 26, 1996, to the 14.5% Debenture Indenture, between BGLS and First Trust, as Trustee (incorporated by reference to exhibit 4.13 in BGLS' Registration Statement on Form S-4 dated December 19, 1995, Commission File No. 33-80593).
* 4.14	Indenture, dated February 14, 1992, among Liggett Group Inc. ("Liggett"), Eve Holdings Inc. ("Eve") and Bankers Trust Company, as Trustee ("Bankers Trust"), including the Forms of Series A Notes and Series B Notes and the Guaranty thereon (the "Liggett Indenture") (incorporated by reference to exhibit 4(m) in the Company's Form 10-K for the year ended December 31, 1991, Commission File No. 1-5759).

EXHIBIT NO.	DESCRIPTION
* 4.15	First Supplemental Indenture, dated January 26, 1994, including the Form of Series C Variable Rate Senior Secured Note and the Guaranty thereon (incorporated by reference to exhibit 4.2 in Liggett's Registration Statement on Form S-1, Commission File No. 33-75224).
* 4.16	Security Agreement, dated February 14, 1992, among Liggett, Eve and Bankers Trust (the "Security Agreement") (incorporated by reference to exhibit 4(n) in the Company's Form 10-K for the year ended December 31, 1991, Commission File No. 1-5759).
* 4.17	Amendment No. 1 to the Security Agreement, dated January 26, 1994 (incorporated by reference to exhibit 4.4 in Liggett's Registration Statement on Form S-1, Commission File No. 33-75224).
* 4.18	Deed of Trust and Assignment of Rents, Leases and Leasehold Interests, dated February 14, 1992, by Liggett to Bankers Trust relating to each of the Virginia and North Carolina properties (the "Deed of Trust") (incorporated by reference to exhibit 4(o) in the Company's Form 10-K for the year ended December 31, 1991, Commission File No. 1-5759).
* 4.19	Amendment No. 1 to the Deed of Trust (North Carolina), dated January 26, 1994 (incorporated by reference to exhibit 4.6 in Liggett's Registration Statement on Form S-1, Commission File No. 33-75224).
* 4.20	Amendment No. 1 to the Deed of Trust (Virginia), dated January 26, 1994 (incorporated by reference to exhibit 4.7 in Liggett's Registration Statement on Form S-1, Commission File No. 33-75224).
* 4.21	Loan and Security Agreement, dated as of March 8, 1994, in the amount of $40,000,000 between Liggett and Congress Financial Corporation (incorporated by reference to exhibit 10(xx) in the Company's Form 10-K for the year ended December 31, 1993, Commission File No. 1-5759).
* 4.22	First Amended Joint Chapter 11 Plan of Reorganization for New Valley Corporation ("New Valley") dated September 27, 1994, Notice of Modification to the First Amended Joint Chapter 11 Plan of Reorganization dated October 20, 1994 and Plan Amendment dated October 28, 1994, as confirmed by the United States Bankruptcy Court for the District of New Jersey, Newark Division, on November 1, 1994 (incorporated by reference to exhibit 2 in New Valley's Form 10-Q for the quarter ended September 30, 1994, Commission File No. 1-2493).

EXHIBIT NO.	DESCRIPTION
* 4.23	Order Confirming First Amended Joint Chapter 11 Plan of Reorganization for New Valley entered by the Bankruptcy Court on November 1, 1994 (incorporated by reference to exhibit 99(b) in New Valley's Form 10-Q for the quarter ended September 30, 1994, Commission File No. 1-2493).
* 10.1	Corporate Services Agreement, dated as of June 29, 1990, between the Company and Liggett (incorporated by reference to exhibit 10.10 in Liggett's Registration Statement on Form S-1, Commission File No. 33-47482).
* 10.2	Corporate Services Agreement, dated June 29, 1990, between the Company and Liggett (incorporated by reference to exhibit 10.11 in Liggett's Registration Statement on Form S-1, Commission File No. 33-47482).
* 10.3	Services Agreement, dated as of February 26, 1991, between Brooke Management Inc. ("BMI") and Liggett (the "Liggett Services Agreement") (incorporated by reference to exhibit 10.5 in BGLS' Registration Statement on Form S-1, Commission File No. 33-93576).
* 10.4	First Amendment to Liggett Services Agreement, dated as of November 30, 1993, between Liggett and BMI (incorporated by reference to exhibit 10.6 of BGLS' Registration Statement on Form S-1, Commission File No. 33-93576).
* 10.5	Second Amendment to Liggett Services Agreement, dated as of October 1, 1995, between BMI, the Company and Liggett (incorporated by reference to exhibit 10(c) in the Company's Form 10-Q for the quarter ended September 30, 1995, Commission File No. 1-5759).
* 10.6	Corporate Services Agreement, dated January 1, 1992, between BGLS and Liggett (the "Liggett Services Agreement") (incorporated by reference to exhibit 10.13 of Liggett's Registration Statement on Form S-1, Commission File No. 33-47482).
* 10.7	Employment Agreement, dated February 21, 1992, between the Company and Bennett S. LeBow (incorporated by reference to exhibit 10(xx) in the Company's Form 10-K for the year ended December 31, 1991, Commission File No. 1-5759).
* 10.8	Employment Agreement, dated June 1, 1994, between Liggett and Rouben V. Chakalian (incorporated by reference to exhibit 10.13 of Liggett's Registration Statement on Form S-1, Commission File No. 33-75224).
* 10.9	Amended Employment Agreement, dated January 9, 1996, between Rouben V. Chakalian and Liggett (incorporated by reference to exhibit 10.20 in Liggett's Form 10-K for the year ended December 31, 1996, Commission File No. 33-75224).

EXHIBIT NO.	DESCRIPTION
* 10.10	Tax-Sharing Agreement, dated June 29, 1990, among the Company, Liggett and certain other entities (incorporated by reference to exhibit 10.12 in Liggett's Registration Statement on Form S-1, Commission File No. 33-47482).
* 10.11	Lease with respect to Liggett's distribution center in Durham, North Carolina, including letter agreement extending term of Lease (incorporated by reference to exhibit 10.15 in Liggett's Registration Statement on Form S-1, Commission File No. 33- 47482).
* 10.12	Tax Indemnity Agreement, dated as of October 6, 1993, among the Company, Liggett and certain other entities (incorporated by reference to exhibit 10.2 in SkyBox International Inc.'s Form 10-Q for the quarter ended September 30, 1993, Commission File No. 0-22126).
* 10.13	Exchange and Termination Agreement, dated as of September 30, 1994, among the Company, BGLS, AIF, Artemis America LLC and Mainstay (incorporated by reference to exhibit 10(ac) in the Company's Form 8-K dated September 2, 1994, Commission File No. 1-5759).
* 10.14	Exchange Agreement, dated as of November 21, 1995, among the Company, BGLS, AIF, Artemis Partnership, Tortoise, Starfire Holding Corporation and Mainstay (incorporated by reference to exhibit 10.13 in BGLS' Registration Statement on Form S-4 dated December 19, 1995, Commission File No. 33-80593).
* 10.15	Registration Rights Agreement, dated as of January 1, 1996, among the Company, New Valley, BGLS and Fleet, as Trustee (incorporated by reference to exhibit 10.14 in BGLS' Registration Statement on Form S-4 dated December 19, 1995, Commission File No. 33-80593).
* 10.16	Agreement among BGLS, the Company and High River Limited Partnership ("High River"), dated October 17, 1995 (incorporated by reference to exhibit 10(b) in the Company's Form 10-Q for the quarter ended September 30, 1995, Commission File No. 1-5759).
* 10.17	Letter Agreement among BGLS, the Company and High River dated November 5, 1995 (incorporated by reference to exhibit 10(a) in the Company's Form 10-Q for the quarter ended September 30, 1995, Commission File No. 1-5759).
* 10.18	Termination and Release Agreement, dated as of December 13, 1995, by and between BGLS, Gary Winnick Trust No. 3, CAL-W Associates and M.D.C. Holdings, Inc. (incorporated by reference to exhibit 10.18 in BGLS' Registration Statement on Form S-4 dated December 19, 1995, Commission File No. 33-80593).

EXHIBIT NO.	DESCRIPTION
* 10.19	Agreement between New Valley and the Company, dated as of December 27, 1995 (incorporated by reference to exhibit 10.19 in BGLS' Registration Statement on Form S-4 dated December 19, 1995, Commission File No. 33-80593).
* 10.20	Expense Sharing Agreement, dated as of January 18, 1995, between the Company and New Valley (incorporated by reference to exhibit 10(d) in the Company's Form 10-Q for the quarter ended September 30, 1995, Commission File No. 1-5759).
* 10.21	Stock Option Agreement, dated January 25, 1995, between the Company and Howard M. Lorber (incorporated by reference to exhibit 10(g) in the Company's Form 10-K for the year ended December 31, 1994, Commission File No. 1-5759).
* 10.22	Agreement among New Valley, ALKI and High River, dated October 17, 1995 (the "High River Agreement") (incorporated by reference to exhibit 10(d) in New Valley's Form 10-Q for the quarter ended September 30, 1995, Commission File No. 1-2493).
* 10.23	Letter Amendment, dated October 17, 1995, to the High River Agreement (incorporated by reference to exhibit 10(e) in the New Valley's Form 10-Q for the quarter ended September 30, 1995, Commission File No. 1-2493).
* 10.24	Letter Amendment, dated November 5, 1995, to the High River Agreement (incorporated by reference to exhibit 10(f) in New Valley's Form 10-Q for the quarter ended September 30, 1995, Commission File No. 1-2493).
* 10.25	Agreement, dated December 28, 1995, between Jefferies, the Company, BGLS and Liggett (the "Jefferies Agreement") (incorporated by reference to exhibit 7 in the Schedule 13D filed by, among others, the Company with the Commission on March 11,1996, as amended, with respect to the common stock of RJR Nabisco Holdings Corp. (the "Schedule 13D")).
* 10.26	Letter Amendment, dated February 28, 1996, to the Jefferies Agreement (incorporated by reference to Exhibit 7 in the Schedule 13D).
* 10.27	Agreement of Termination, dated June 5, 1996, between New Valley, ALKI, High River, the Company and BGLS (incorporated by reference to exhibit 16 in the Schedule 13D).
* 10.28	Amended and Restated Consulting Agreement, dated as of March 1, 1996, between the Company and Howard M. Lorber (incorporated by reference to exhibit 10.25 in the Company's Form 10-K for the year ended December 31, 1995, Commission File No. 1-5759).

EXHIBIT NO.	DESCRIPTION
* 10.29	Settlement Agreement, dated March 12, 1996, by and between Dianne Castano and Ernest Perry, the putative representative plaintiffs in Dianne Castano, et al. v. The American Tobacco Company, Inc. et al., Civil No. 94-1044, United States District Court for the Eastern District of Louisiana, for themselves and on behalf of the plaintiff settlement class, and the Company and Liggett, as supplemented by the letter agreement dated March 14, 1996 (incorporated by reference to exhibit 13 in the Schedule 13D).
* 10.30	Settlement Agreement, dated March 15, 1996, by and among the State of West Virginia, State of Florida, State of Mississippi, Commonwealth of Massachusetts, and State of Louisiana, the Company and Liggett (incorporated by reference to exhibit 15 in the Schedule 13D).
* 10.31	Stock Purchase Agreement, dated April 3, 1996, among Liggett-Ducat Ltd. ("Liggett-Ducat"), Belgrave Limited ("Belgrave"), Eduard Z. Nakhamkin ("Nakhamkin") and BOL (incorporated by reference to exhibit 10.28 in the Company's Form 10-K for the year ended December 31, 1995, Commission File No. 1-5759).
* 10.32	Consulting Agreement, dated April 3, 1996, among BOL, Belgrave and Nakhamkin (incorporated by reference to exhibit 10.29 in the. Company's Form 10-K for the year ended December 31, 1995, Commission File No. 1-5759).
* 10.33	Pledge Agreement, dated April 3, 1996, between BOL and Belgrave (incorporated by reference to exhibit 10.30 in the Company's form 10-K for the year ended December 31, 1995, Commission File No. 1-5759).
10.34	Stock Option Agreement, dated December 16, 1996, between the Company and Howard M. Lorber.
10.35	Stock Option Agreement, dated January 1, 1997 between the Company and Richard J. Lampen
* 10.36	Letter Agreement dated September 5, 1996 between Ronald S. Fulford and Liggett (incorporated by reference to exhibit 10.23 in Liggett's Form 10-K for the year ended December 31, 1996, Commission File No. 33-75224).
* 10.37	Promissory Note of New Valley dated January 31, 1997 in favor of BOL (incorporated by reference to exhibit 10.1 in the New Valley Form 8-K).
* 10.38	Pledge Agreement dated as of January 31, 1997 entered into by and between BOL and New Valley (incorporated by reference to exhibit 10.2 in the New Valley Form 8-K).
* 10.39	Use Agreement dated as of January 31, 1997, entered into by and between BML and Liggett-Ducat Joint Stock Company (incorporated by reference to exhibit 10.3 in the New Valley Form 8-K).

EXHIBIT NO.	DESCRIPTION
10.40	Settlement Agreement, dated March 20, 1997, by and among the States listed in Appendix A thereto, the Company and Liggett.
10.41	Settlement Agreement, dated March 20, 1997, by and between the named and representative plaintiffs in Fletcher, et al. v. Brooke Group Ltd., et al., for themselves and on behalf of the plaintiff settlement class, and the Company and Liggett.
21	Subsidiaries of the Company.
23.1	Consent of Coopers and Lybrand L.L.P. relating to the Company's Registration Statements on Form S-3 (Commission File No. 33-38869 and Commission File No. 33-63119).
23.2	Consent of Price Waterhouse LLP relating to the Company's Registration Statements on Form S-3 (Commission File No. 33-38869 and Commission File No. 33-63119).
23.3	Consent of KPMG Peat Marwick LLP relating to the Company's Registration Statements on Form S-3 (Commission File No. 33-38869 and Commission File No. 33-63119).
23.4	Consent of Arthur Anderson LLP relating to the Company's Registration Statements on Form S-3 (Commission File No. 33-38869 and Commission File No. 33-63119).
27.1	Financial Data Schedule of the Company.
27.2	Financial Data Schedule of BGLS.
* 99.1	Stipulation and Agreement of Compromise and Settlement in connection with an action in the Court of Chancery of the State of Delaware in and for New Castle County entitled Gyetyan v. Bennett S. LeBow et al., Civil Action No. 12998 (incorporated by reference to exhibit A in the Company's Form 8-K dated June 2, 1994, Commission File No. 1-5759).
99.2	Liggett Group Inc.'s Consolidated Financial Statements for the fiscal year ended December 31, 1996.
99.3	New Valley Holdings, Inc.'s Financial Statements for the fiscal year ended December 31, 1996.

EXHIBIT NO.	DESCRIPTION
99.4	Brooke (Overseas) Ltd.'s Consolidated Financial Statements for the fiscal year ended December 31, 1996.

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* Incorporated by reference

Each management contract or compensatory plan or arrangement required to be filed as an exhibit to this report pursuant to Item 14(c) is listed in exhibit nos. 10.7, 10.8, 10.9, 10.35 and 10.36.

(B) REPORTS ON FORM 8-K:

No current reports on Form 8-K were filed by either the Company or BGLS during the fourth quarter of 1996.

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/ Bennett S. LeBow

Bennett S. LeBow
Chairman of the Board, President
and Chief Executive Officer

Date: March 28, 1997

BGLS INC.
(Registrant)

By: /s/ Bennett S. LeBow

Bennett S. LeBow
Chairman of the Board, President
and Chief Executive Officer

Date: March 28, 1997

POWER OF ATTORNEY

The undersigned directors and officers of Brooke Group Ltd. and BGLS Inc. hereby constitute and appoint Richard J. Lampen, Joselynn D. Van Siclen and Marc N. Bell, and each of them, with full power to act without the other and with full power of substitution and resubstitution, our true and lawful attorneys-in-fact with full power to execute in our name and behalf in the capacities indicated below, this Annual Report on Form 10-K and any and all amendments thereto and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, and hereby ratify and confirm all that such attorneys-in-fact, or any of them, or their substitutes shall lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on March 28, 1997.

SIGNATURE	TITLE
/s/ Bennett S. LeBow --------------------------- Bennett S. LeBow	Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer)
/s/ Joselynn D. Van Siclen --------------------------- Joselynn D. Van Siclen	Vice President and Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)
/s/ Robert J. Eide --------------------------- Robert J. Eide	Director
/s/ Jeffrey S. Podell --------------------------- Jeffrey S. Podell	Director

BROOKE GROUP LTD.
BGLS INC.
FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 1996
ITEMS 8, 14(a) (1) AND (2), AND 14(d)

INDEX TO FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULE

Financial Statements and Schedule of the Registrant and its subsidiaries, required to be included in Items 8, 14(a) (1) and (2), and 14(d) are listed below:

Financial Statement Schedules not listed above have been omitted because they are not applicable or the required information is contained in the Company's Consolidated Financial Statements or accompanying Notes.

Liggett Group Inc.

The consolidated financial statements of Liggett Group Inc. are incorporated herein by reference from Liggett Group Inc.'s Form 10-K for the year ended December 31, 1996, and are filed as exhibit 99.2 to this report.

New Valley Holdings, Inc.

The financial statements of New Valley Holdings, Inc. are filed as exhibit 99.3 to this report and are incorporated herein by reference.

Brooke (Overseas) Ltd.

The consolidated financial statements of Brooke (Overseas) Ltd. are filed as exhibit 99.4 to this report and are incorporated herein by reference.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Shareholders
of Brooke Group Ltd. and BGLS Inc.

We have audited the accompanying consolidated balance sheets of Brooke Group Ltd. and Subsidiaries (the "Company") and BGLS Inc. and Subsidiaries ("BGLS") as of December 31, 1996 and 1995 and the related consolidated statements of operations, stockholders equity (deficit) and cash flows for each of the three years in the period ended December 31, 1996. These financial statements are the responsibility of the the Company's and BGLS' management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of MAI Systems Corporation ("MAI"), a discontinued subsidiary (Note 5), which statements reflect net income comprising 4% of the Company's and BGLS' consolidated net income for the year ended December 31, 1994. Further, we did not audit the financial statements of New Valley Corporation ("New Valley") for the year ended December 31, 1994, the investment in which is being accounted for by the Company and BGLS using the equity method of accounting (Note 2). The equity in the net income of New Valley represents 85% and 88% of the Company's and BGLS' consolidated net income for the year ended December 31, 1994, respectively. Those statements were audited by other auditors whose reports have been furnished to us and our opinion on the consolidated financial statements, insofar as it relates to the amounts included for MAI and New Valley, are based solely upon the reports of the other auditors.

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

In our opinion, based on our audits and the reports of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Brooke Group Ltd. and Subsidiaries and BGLS Inc. and Subsidiaries at December 31, 1996 and 1995 and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 1996 in conformity with generally accepted accounting principles.

COOPERS & LYBRAND L.L.P.

Miami, Florida
March 27, 1997

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Shareholders
of Brooke Group Ltd. and BGLS Inc.

Our report on the consolidated financial statements of Brooke Group Ltd. and Subsidiaries and BGLS Inc. and Subsidiaries is included on Page F-3 of this Form 10-K. In connection with our audits of such financial statements, we have also audited the related financial statement schedule on page F-50 of this Form 10-K.

In our opinion, the financial statement schedule referred to above, when considered in relation to the basic financial statements taken as a whole, present fairly, in all material respects, the information required to be included therein.

COOPERS & LYBRAND L.L.P.

Miami, Florida
March 27, 1997

BROOKE GROUP LTD. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in Thousands, Except Per Share Amounts)

	December 31, 1996	December 31, 1995
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 1,941	$ 3,370
Accounts receivable - trade	19,475	23,844
Other receivables	1,217	1,448
Receivables from affiliates	47	1,502
Inventories	53,691	60,522
Deferred tax assets		1,061
Other current assets	4,181	4,868
Total current assets	80,552	96,615
Property, plant and equipment, at cost, less accumulated depreciation of $31,047 and $27,323	80,282	48,352
Intangible assets, at cost, less accumulated amortization of $17,457 and $15,679	4,421	5,453
Investment in affiliate	3,051	63,901
Other assets	9,371	11,299
Total assets	$177,677	$225,620
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT):		
Current liabilities:		
Notes payable and current portion of long-term debt	$ 55,242	$ 2,387
Accounts payable	32,461	22,762
Due to affiliates	990	
Dividends payable	1,387	
Cash overdraft	6	4,266
Accrued promotional expenses	30,257	25,519
Accrued taxes payable	26,379	22,846
Accrued interest	24,354	16,863
Other accrued liabilities	33,387	24,534
Total current liabilities	204,463	119,177
Notes payable, long-term debt and other obligations, less current portion	378,243	406,744
Noncurrent employee benefits	31,256	31,672
Other liabilities	18,704	24,131
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 18,497,096 shares	1,850	1,850
Additional paid-in capital	94,169	93,186
Deficit	(490,706)	(428,173)
Other	(27,963)	9,372
Less: 6,500,947 shares of common stock in treasury, at cost	(32,339)	(32,339)
Total stockholders' equity (deficit)	(454,989)	(356,104)
Total liabilities and stockholders' equity (deficit)	$177,677	$225,620

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

BGLS INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars In Thousands, Except Per Share Amounts)

	December 31, 1996	December 31, 1995
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 1,940	$ 3,370
Accounts receivable - trade	19,475	23,844
Other receivables	1,166	1,481
Receivables from affiliates	47	1,130
Inventories	53,691	60,522
Deferred tax assets		4,861
Other current assets	3,878	4,435
Total current assets	80,197	99,643
Property, plant and equipment, at cost, less accumulated depreciation of $30,762 and $27,181	79,972	47,900
Intangible assets, at cost, less accumulated amortization of $17,457 and $15,679	4,421	5,453
Investment in affiliate	3,051	63,901
Other assets	10,467	12,345
Total assets	$178,108	$229,242
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT):		
Current liabilities:		
Notes payable and current portion of long-term debt	$ 53,945	$ 2,132
Accounts payable	32,336	22,637
Cash overdraft	6	3,761
Due to parent	29,598	26,054
Accrued promotional expenses	30,257	25,519
Accrued taxes payable	26,379	22,846
Accrued interest	24,354	16,863
Other accrued liabilities	32,861	23,073
Total current liabilities	229,736	142,885
Notes payable, long-term debt and other obligations, less current portion	378,243	420,449
Noncurrent employee benefits	31,256	31,672
Other liabilities	21,958	24,131
Commitments and contingencies		
Stockholder's equity (deficit):		
Common stock, par value $0.01 per share; authorized 100 shares, issued 100 shares, outstanding 100 shares		
Additional paid-in capital	39,081	23,594
Deficit	(499,264)	(423,424)
Other	(22,902)	9,935
Total stockholder's equity (deficit)	(483,085)	(389,895)
Total liabilities and stockholder's equity (deficit)	$178,108	$229,242

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

BROOKE GROUP LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in Thousands, Except Per Share Amounts)

	Year Ended December 31,		
	1996	1995	1994
Revenues*	$452,656	$461,459	$479,343
Cost of goods sold*	235,633	216,187	229,807
Gross profit	217,023	245,272	249,536
Operating, selling, administrative and general expenses	220,950	237,212	235,374
Operating (loss) income	(3,927)	8,060	14,162
Other income (expenses):			
Interest income	220	989	533
Interest expense	(60,556)	(57,505)	(55,952)
Equity in (loss) earnings of affiliate	(7,211)	678	
Sale of assets	6,716		
Other, net	1,242	2,776	(1,221)
(Loss) from continuing operations before income taxes	(63,516)	(45,002)	(42,478)
Provision (benefit) for income taxes	1,402	342	(24,487)
(Loss) from continuing operations	(64,918)	(45,344)	(17,991)
Discontinued operations:			
(Loss) income from discontinued operations	(1,591)	2,860	23,693
Gain on disposal	3,976	18,369	150,990
Income from discontinued operations	2,385	21,229	174,683
(Loss) income before extraordinary items	(62,533)	(24,115)	156,692
Extraordinary items:			
(Loss) resulting from the early extinguishment of debt.		(9,810)	(47,513)
Gain on reorganization of MAI			916
(Loss) from extraordinary items		(9,810)	(46,597)
Net (loss) income	(62,533)	(33,925)	110,095
Proportionate share of New Valley capital transactions, retirement of Class A Preferred Shares	1,782	16,802	
Net (loss) income applicable to common shares	$ (60,751)	$ (17,123)	$110,095
Per common share:			
(Loss) from continuing operations	$(3.41)	$(1.56)	$(1.02)
Income from discontinued operations	$ 0.13	$ 1.16	$ 9.92
Extraordinary items	$	$(0.54)	$(2.65)
Net (loss) income applicable to common shares	$(3.28)	$(0.94)	$ 6.25
Weighted average common shares and common stock equivalents outstanding	18,497,096	18,301,186	17,610,898

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* Revenues and Cost of goods sold include federal excise taxes of $104,518, $123,420 and $131,877 for the years ended December 31, 1996, 1995 and 1994, respectively.

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

BGLS INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in Thousands, Except Per Share Amounts)

	Year Ended December 31,		
	1996	1995	1994
Revenues*	$452,656	$461,459	$479,341
Cost of goods sold*	235,633	216,187	229,803
Gross profit	217,023	245,272	249,538
Operating, selling, administrative and general expenses	219,039	236,961	235,792
Operating (loss) income	(2,016)	8,311	13,746
Other income (expenses):			
Interest income	157	989	225
Interest expense	(64,417)	(61,036)	(58,625)
Equity in (loss) earnings of affiliate	(7,211)	678	
Sale of assets	6,716		
Other, net	(2,579)	2,292	(2,136)
(Loss) from continuing operations before income taxes	(69,350)	(48,766)	(46,790)
Provision (benefit) for income taxes	5,254	1,736	(24,943)
(Loss) from continuing operations	(74,604)	(50,502)	(21,847)
Discontinued operations:			
(Loss) income from discontinued operations	(1,591)	2,860	23,693
Gain on disposal	3,976	18,369	150,990
Income from discontinued operations	2,385	21,229	174,683
(Loss) income before extraordinary items	(72,219)	(29,273)	152,836
Extraordinary items:			
(Loss) resulting from the early extinguishment of debt		(9,810)	(47,513)
Gain on reorganization of MAI			916
(Loss) from extraordinary items		(9,810)	(46,597)
Net (loss) income	$(72,219)	$(39,083)	$106,239

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* Revenues and Cost of goods sold include federal excise taxes of $104,518, $123,420 and $131,877 for the years ended December 31, 1996, 1995 and 1994, respectively.

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

BROOKE GROUP LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
(Dollars in Thousands, Except Per Share Amounts)

	Preferred Stock Series G Shares	Preferred Stock Series G Amount	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Deficit	Treasury Stock	Other	Total
Balance, December 31, 1993	2,184,834	$ 2	15,259,762	$ 1,526	$ 60,578	$(540,942)	$(35,846)		$(514,682)
Foreign currency adjustment								$ 201	201
Preferred stock exchanged for common .	(2,184,834)	(2)	2,184,834	218	(216)				
Reclassification of former Vice Chairman's loan to other receivables						1,500			1,500
Contingent Value Rights settlement ...						1,875			1,875
Repayment by Chairman of interest						1,163			1,163
Waiver of dividends, shareholder settlement					6,250	3,200			9,450
Transfer of pension liability to SkyBox						4,305			4,305
Stock grant to consultant			250,000	25		(739)	1,182		468
Contract settlement					(371)				(371)
Exercise of warrant			607,889	61		(2,875)	2,875		61
Net income						110,095			110,095
Unrealized holding gain on investment in New Valley............								11,164	11,164
Treasury stock, at cost..............			(41,641)	(4)	4	1,672	(1,753)		(81)
Balance, December 31, 1994			18,260,844	1,826	66,245	(420,746)	(33,542)	11,365	(374,852)
Net loss						(33,925)			(33,925)
Consolidation of foreign subsidiary ..					14,435				14,435
Distributions on common stock ($0.30 per share)....................					(5,474)				(5,474)
Stock grant to directors			20,000	2	(2)		94		94
Stock grant to consultant			250,000	25		(800)	1,244		469
Stock options granted to consultant ..					938			(563)	375
MAI spin-off						27,286		(201)	27,085
Unrealized holding loss on investment in New Valley								(2,332)	(2,332)
Effect of New Valley capital transactions					17,043			1,103	18,146
Treasury stock, at cost			(33,748)	(3)	3		(135)		(135)
Other, net					(2)	12			10
Balance, December 31, 1995			18,497,096	1,850	93,186	$(428,173)	(32,339)	9,372	(356,104)
Net loss						(62,533)			(62,533)
Distributions on common stock ($0.30 per share)					(5,549)				(5,549)
Amortization of deferred compensation								252	252
Stock options granted to consultant ..					4,750			(4,750)	
Unrealized holding loss on investment in New Valley								(33,936)	(33,936)
Effect of New Valley capital transactions					1,782			1,099	2,881
Balance, December 31, 1996		$	18,497,096	$1,850	$94,169	$(490,706)	$(32,339)	$(27,963)	$(454,989)

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

BGLS INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDER'S EQUITY (DEFICIT)
(Dollars in Thousands, Except Per Share Amounts)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Deficit	Other	Total
Balance, December 31, 1993	100			$(508,675)		$(508,675)
Distributions paid to parent				(9,212)		(9,212)
Reclassification of former Vice Chairman's loan to other receivables				1,500		1,500
Transfer of pension liability to SkyBox				4,305		4,305
Repayment of loan				3,200		3,200
Net income				106,239		106,239
Unrealized holding gain on investment in New Valley					$11,164	11,164
Foreign currency adjustment					201	201
Balance, December 31, 1994	100			(402,643)	11,365	(391,278)
Distributions paid to parent				(5,872)		(5,872)
Distribution of MAI to parent				24,942	(201)	24,741
Net loss				(39,083)		(39,083)
Unrealized loss on investment in New Valley					(2,332)	(2,332)
Effect of New Valley capital transactions			$17,043		1,103	18,146
Forgiveness of debt by parent			4,565			4,565
Capital contribution			1,986			1,986
Other, net				(768)		(768)
Balance, December 31, 1995	100		23,594	(423,424)	9,935	(389,895)
Distributions paid to parent				(3,621)		(3,621)
Net loss				(72,219)		(72,219)
Unrealized holding loss on investment in New Valley					(33,936)	(33,936)
Effect of New Valley capital transactions			1,782		1,099	2,881
Forgiveness of debt by parent			13,705			13,705
Balance, December 31, 1996	100	$	$39,081	$(499,264)	$(22,902)	$(483,085)

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

BROOKE GROUP LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Thousands, Except Per Share Amounts)

	Year Ended December 31,		
	1996	1995	1994
Cash flows from operating activities:			
Net (loss) income	$(62,533)	$(33,925)	$110,095
Adjustments to reconcile net income (loss) to net cash used in operating activities:			
Depreciation and amortization	8,819	9,076	6,821
Noncash compensation expense	252	559	8,463
Deferred income taxes	1,061		(24,487)
Gain on sale of assets	(6,716)	(1,042)	(11,925)
Extraordinary item		9,810	
Impact of discontinued operations	(2,385)	(21,229)	(117,275)
Other, net	7,211	4,167	6,265
Changes in assets and liabilities, net:			
Receivables	6,222	6,561	(4,002)
Inventories	6,830	(7,490)	(9,574)
Accounts payable and accrued liabilities	27,716	(5,445)	(8,576)
Other assets and liabilities, net	9,818	15,972	135
Net cash used in operating activities	(3,705)	(22,986)	(44,060)
Cash flows from investing activities:			
Proceeds from sale of business and assets	8,040	14,152	29,542
Impact of discontinued operations			(4,555)
Investments	(2,811)	(1,965)	
Capital expenditures	(34,241)	(8,805)	(3,023)
Dividends from New Valley	24,733	61,832	
Other, net		1,660	1,897
Net cash (used in) provided by investing activities	(4,279)	66,874	23,861

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

BROOKE GROUP LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS, Continued
(Dollars in Thousands, Except Per Share Amounts)

	Year Ended December 31,		
	1996	1995	1994
Cash flows from financing activities:			
Proceeds from debt	20,702	2,568	9,261
Repayments of debt	(8,864)	(37,196)	(2,027)
Borrowings under revolver	353,365	397,873	369,806
Repayments on revolver	(350,105)	(401,703)	(366,544)
(Decrease) increase in cash overdraft	(4,256)	(594)	(12,669)
Series G preferred dividend		(75)	(5,923)
Distributions on common stock	(4,162)	(5,475)	
CVR settlement			1,875
Treasury stock purchases		(135)	(21)
Deferred financing costs			(2,705)
Stockholder loan and interest repayments			17,774
Impact of discontinued operations			(437)
Other, net		(57)	375
Net cash provided by (used in) financing activities	6,680	(44,794)	8,765
Effect of exchange rate changes on cash and cash equivalents	(125)		(63)
Net decrease in cash and cash equivalents	(1,429)	(906)	(11,497)
Cash and cash equivalents, beginning of period	3,370	4,276	15,773
Cash and cash equivalents, end of period	$ 1,941	$ 3,370	$ 4,276

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

BGLS INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Thousands, Except Per Share Amounts)

	Year Ended December 31,		
	1996	1995	1994
Cash flows from operating activities:			
Net (loss) income	$(72,219)	$(39,083)	$106,239
Adjustments to reconcile net income (loss) to net cash used in operating activities:			
Depreciation and amortization	8,677	8,946	6,807
Noncash compensation expense			8,268
Gain on sale of assets	(6,716)		
Deferred income taxes	4,861		(26,334)
Extraordinary item		9,810	
Impact of discontinued operations	(2,385)	(21,229)	(128,998)
Other, net	7,211	(558)	6,014
Changes in assets and liabilities:			
Receivables	5,863	7,261	(5,768)
Inventories	6,830	(7,489)	(9,573)
Accounts payable and accrued liabilities	34,461	1,001	9,518
Other assets and liabilities, net	9,712	16,970	(1,970)
Net cash used in operating activities	(3,705)	(24,371)	(35,797)
Cash flows from investing activities:			
Proceeds from sale of business and assets	8,040	13,852	29,317
Impact of discontinued operations			(4,408)
Investments	(2,811)	(2,765)	
Capital expenditures	(34,241)	(8,569)	(2,652)
Dividends from New Valley	24,733	61,832	
Other, net		1,660	1,897
Net cash (used in) provided by investing activities	(4,279)	66,010	24,154

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

BGLS INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS, Continued
(Dollars in Thousands, Except Per Share Amounts)

	Year Ended December 31,		
	1996	1995	1994
Cash flows from financing activities:			
Proceeds from debt	19,060	2,568	8,261
Repayments of debt	(8,265)	(37,166)	(1,790)
Borrowings under revolver	353,365	397,873	369,806
Repayments on revolver	(350,105)	(401,703)	(366,544)
(Decrease) increase in cash overdraft	(3,755)	(215)	1,331
Deferred financing costs			(2,705)
Distributions paid to parent	(3,621)	(5,871)	(6,012)
Repayment to parent			(16,357)
Repayment from parent			12,500
Stockholder loan and interest repayments			1,911
Impact of discontinued operations			(437)
Other, net		1,986	375
Net cash provided by (used in) financing activities	6,679	(42,528)	339
Effect of exchange rate changes on cash and cash equivalents	(125)		(63)
Net decrease in cash and cash equivalents	(1,430)	(889)	(11,367)
Cash and cash equivalents, beginning of period	3,370	4,259	15,626
Cash and cash equivalents, end of period	$ 1,940	$ 3,370	$ 4,259

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

BROOKE GROUP LTD.
BGLS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in Thousands, Except Per Share Amounts)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation:

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") and other less significant subsidiaries. Based on the Company's ability to assert sufficient control, the Company consolidated the accounts of Liggett-Ducat Ltd. ("Liggett-Ducat") at December 31, 1995. (Refer to Note 4.) 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.

(b) Liquidity:

The Company believes it will have sufficient liquidity for 1997. This is based on, among other things, forecasts of cash flow for the principal operating companies which indicate that they will be self-sufficient, 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. Liggett had net capital and working capital deficiencies of $176,478 and $40,694, respectively, at December 31, 1996, is highly leveraged and has substantial near-term debt service requirements. These matters raise substantial doubt about Liggett meeting its liquidity needs and its ability to continue as a going concern. (Refer to Notes 2, 4 and 9.)

(c) 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, 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 return and allowances, actuarial assumptions of pension plans and litigation and defense costs. Actual results could differ from those estimates.

(d) Cash and Cash Equivalents:

For purposes of the statements of cash flows, cash includes cash on hand, cash on deposit in banks and cash equivalents, comprised of short-term investments which have an original maturity of 90 days or less. Interest on short-term investments is recognized when earned.

(e) Financial Instruments:

The estimated fair value of the Company's long-term debt is as follows:

At December 31,	1996		1995	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term debt	$433,485	$294,451	$409,131	$343,517

SHORT-TERM DEBT - The carrying amounts reported in the Consolidated Balance Sheets approximate fair value because of the variable interest rates and the short maturity of these instruments.

LONG-TERM DEBT - Fair value is estimated based on current market quotations, where available or based on an evaluation of the debt in relation to market prices of the Company's publicly traded debt.

The methods and assumptions used by the Company's management in estimating fair values for financial instruments as required by Statement of Financial Accounting Standards ("SFAS") No. 107, "Disclosures About Fair Value of Financial Instruments," presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair values.

(f) Significant Concentrations of Credit Risk:

Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents and trade receivables. The Company places its temporary cash in money market securities (investment grade or better) with what management believes are high credit quality financial institutions.

Liggett's customers are primarily candy and tobacco distributors, the military and large grocery, drug and convenience store chains. One customer accounted for approximately 13.7% of net sales for the year ended December 31, 1996 and 11.6% of net sales for the year ended December 31, 1995, the majority of which were in the private label discount segment. No single customer accounted for more than 10% of the Company's net sales in 1994. Concentrations of credit risk with respect to trade receivables are limited due to the large number of customers, located primarily throughout the United States, comprising Liggett's customer base. Ongoing credit evaluations of customers' financial condition are performed and, generally, no collateral is required. Liggett maintains reserves for potential credit losses and such losses, in the aggregate, have generally not exceeded management's expectations.

(g) Accounts Receivable:

The allowance for doubtful accounts and cash discounts was $1,280 and $1,536 at December 31, 1996 and 1995, respectively.

(h) Inventories:

Liggett tobacco inventories, which comprise 93.4% and 83.3% of total inventory in 1996 and 1995, respectively, are stated at the lower of cost or market and are determined primarily by the last-in, first-out (LIFO) method. Although portions of leaf tobacco inventories may not be used or sold within one year because of the time required for aging, they are included in current assets, which is common practice in the industry. It is not practicable to determine the amount that will not be used or sold within one year.

Remaining inventories are determined primarily on a first-in, first-out (FIFO) basis.

(i) Property, Plant and Equipment:

Property, plant and equipment are depreciated using the straight-line method over the estimated useful lives of the respective assets, which are 20 years for buildings and 3 to 10 years for machinery and equipment.

Interest costs are capitalized in connection with the construction of major facilities. Capitalized interest is recorded as part of the asset to which it relates and is amortized over the asset's estimated useful life. In 1996 and 1995, interest costs of $6,387 and $1,004, respectively, were capitalized. No interest was capitalized in 1994.

Expenditures for repairs and maintenance are charged to expense as incurred. The costs of major renewals and betterments are capitalized. The cost and related accumulated depreciation of property, plant and equipment are removed from the accounts upon retirement or other disposition and any resulting gain or loss is reflected in operations.

(j) Intangible Assets:

Intangible assets, consisting principally of trademarks and goodwill, are amortized using the straight-line method over 10-12 years. Amortization expense for the years ended December 31, 1996, 1995 and 1994 was $1,778, $1,725 and $1,722, respectively. Management periodically reviews the carrying value of such assets to determine whether asset values are impaired.

(k) Other Assets:

Other assets consist primarily of debt issuance costs. Such costs are being amortized over the life of the debt.

(l) Impairment of Long-Lived Assets:

Effective January 1, 1996, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of". The Statement establishes accounting standards for the impairment of long-lived assets, certain identifiable intangibles, and goodwill related to those assets. There was no material effect on the financial position or results of operations from the adoption because the Company's prior impairment recognition practice was consistent with the major provisions of the Statement. Under provisions of the Statement, impairment losses are recognized when expected future cash flows are less than the assets' carrying value. Accordingly, when indicators of impairment are present, the Company evaluates the carrying value of property, plant and equipment and intangibles in relation to the operating performance and estimates of future discounted cash flows of the underlying business.

(m) Employee Benefits:

Liggett sponsors self-insured health and dental insurance plans for all eligible employees. As a result, the expense recorded for such benefits involves an estimate of unpaid claims as of December 31, 1996 and 1995 which are subject to significant fluctuations in the near term.

(n) Postretirement Benefits other than Pensions:

Under SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions", the cost of providing retiree health care and life insurance benefits is actuarially determined and accrued over the service period of the active employee group.

(o) Postemployment Benefits:

SFAS No. 112, "Employers' Accounting for Postemployment Benefits", establishes standards of financial accounting and reporting for the estimated cost of benefits provided by an employer to former or inactive employees after employment but before retirement. No expense was associated with the adoption since the Company's previous policies accounted for all items required by SFAS No. 112.

(p) Stock Options:

Effective January 1, 1996, SFAS No. 123, "Accounting for Stock-Based Compensation", was adopted by the Company as required for its fiscal 1996 financial statements. The Company has elected to continue to measure compensation expense for stock-based employee compensation plans using the intrinsic value method prescribed by APB Opinion No. 25, "Accounting for Stock Issued to Employees," and will provide pro forma disclosures of net income as if the fair value-based method prescribed by SFAS No. 123 had been applied in measuring compensation expense.

(q) Income Taxes:

Under SFAS No. 109, "Accounting for Income Taxes", deferred taxes reflect the impact of temporary differences between the amounts of assets and liabilities recognized for financial reporting purposes and the amounts recognized for tax purposes as well as tax credit carryforwards and loss carryforwards. These deferred taxes are measured by applying currently enacted tax rates. A valuation allowance reduces deferred tax assets when it is deemed more likely than not that some portion or all of the deferred tax assets will not be realized.

(r) Revenue Recognition:

Revenues from sales are recognized upon the shipment of finished goods to customers. The Company provides an allowance for expected sales returns, net of related inventory cost recoveries. Since the Company's primary line of business is tobacco, the Company's financial position and its results of operations and cash flows could be materially adversely affected by significant unit sales volume declines, litigation and defense costs, increased tobacco costs or reductions in the selling price of cigarettes in the near term.

(s) Earnings Per Share:

Per share calculations are based on the weighted average shares of common stock outstanding and dilutive common stock equivalents. For the years ended December 31, 1996 and 1995, per share calculations include the Company's proportionate share of excess carrying value of New Valley redeemable preferred shares over the cost of shares repurchased of $1,782 and $16,802, respectively.

New Accounting Pronouncement. In February 1997, the Financial Accounting Standards Board issued SFAS No. 128, "Earnings Per Share". SFAS No. 128 specifies new standards designed to improve the earnings per share ("EPS") information provided in financial statements by simplifying the existing computational guidelines, revising the disclosure requirements and increasing the comparability of EPS data on an international basis. Some of the changes made to simplify the EPS computations include: (a) eliminating the presentation of primary EPS and replacing it with basic EPS, with the principal difference being that common stock equivalents are not considered in computing basic EPS, (b) eliminating the modified treasury stock method and the three percent materiality provision and (c) revising the contingent share provisions and the supplemental EPS data requirements. SFAS No. 128 also makes a number of changes to existing disclosure requirements. SFAS No. 128 is effective for financial statements issued for periods ending after December 15, 1997, including interim periods. The Company has not yet determined the impact of the implementation of SFAS No. 128.

(t) Foreign Currency Translation:

The Company accounts for translation of foreign currency in accordance with SFAS No. 52, "Foreign Currency Translation." The Company's Russian subsidiary operates in a "highly inflationary" economy and uses the U.S. dollar as the functional currency. Therefore, certain assets of this entity (principally inventories and property and equipment) are translated at historical exchange rates with all other assets and liabilities translated at year end exchange rates and all translation adjustments are reflected in the consolidated statements of operations.

(u) Reclassifications:

Certain amounts in prior years' financial statements have been reclassified to conform to the current year's presentation.

2. INVESTMENT IN NEW VALLEY CORPORATION

The Company's and BGLS' investment in New Valley at December 31, 1996 and 1995, respectively, is summarized below:

	Number of Shares	Fair Value	Carrying Amount	Unrealized Holding Gain (Loss)
1996				
Class A Preferred Shares.......	618,326	$ 72,962	$ 72,962	$(24,881)
Class B Preferred Shares.......	250,885	1,631	1,631	(223)
Common Shares..................	3,989,710(A)	5,985	(71,542)	
		$ 80,578	$ 3,051	$(25,104)
1995				
Class A Preferred Shares.......	618,326	$109,386	$109,386	$ 7,424
Class B Preferred Shares.......	250,885	3,262	3,262	1,408
Common Shares..................	79,794,229	21,544	(48,747)	
		$134,192	$ 63,901	$ 8,832

(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. Prior to January 1, 1996, the Class A Preferred Shares' fair value had been estimated with reference to the securities' preference features, including dividend and liquidation preferences, and the composition and nature of the underlying net assets of New Valley. During 1996, however, New Valley became engaged in the ownership and management of commercial real estate and acquired a controlling interest in Thinking Machines Corporation ("Thinking Machines"). Because these businesses affected the composition and nature of the underlying net assets of New Valley, the Company determined the fair value of the Class A and Class B Preferred Shares based on the quoted market price commencing with the quarter ended March 31, 1996. 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.

In November 1994, New Valley's First Amended Joint Chapter 11 Plan of Reorganization, as amended ("Joint Plan"), was confirmed by order of the United States Bankruptcy Court for the District of New Jersey and on January 18, 1995, New Valley emerged from bankruptcy reorganization proceedings and completed substantially all distributions to creditors under the Joint Plan. Pursuant to the Joint Plan, among other things, the Class A Preferred Shares, the Class B Preferred Shares and the Common Shares, and other equity interests, were reinstated and retained all of their legal, equitable and contractual rights.

At December 31, 1996 and 1995, the Company's investment in New Valley consisted of an approximate 42% voting interest. The Company's investment in 1996 and 1995 was represented by 618,326 Class A Preferred Shares, 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%). At December 31, 1996, the Company owns 57.7% of the outstanding Class A Preferred Shares.

In February 1995, New Valley repurchased 54,445 Class A Preferred Shares pursuant to a tender offer made as part of the Joint Plan. During 1995, New Valley repurchased 339,400 additional Class A Preferred Shares on the open market at an aggregate cost of $43,405. During 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 and $16,802, along with other New Valley capital transactions of $0 and $241, for the years ended December 31, 1996 and December 31, 1995, respectively.

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. At December 31, 1996 and 1995, respectively, the accrued and unpaid dividends arrearage was $117,117 ($109.31 per share) and $121,893 ($110.06 per share). The Company received $24,733 ($40.00 per share) and $61,832 ($100.00 per share) in dividend distributions in 1996 and 1995, respectively.

BROOKE GROUP LTD.
BGLS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in Thousands, Except Per Share Amounts) - (Continued)

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 December 31, 1996 and 1995, respectively, the accrued and unpaid dividends arrearage was $115,944 ($41.55 per share) and $95,118 ($34.08 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 follows:

	1996	1995	1994
Current assets, primarily cash and marketable securities	$183,720	$333,485	
Noncurrent assets	222,820	52,337	
Current liabilities	98,110	177,920	
Noncurrent liabilities	170,223	11,967	
Redeemable preferred stock	210,571	226,396	
Shareholders' equity (deficit)	(72,364)	(30,461)	
Revenues	111,954	67,730	$ 10,381
Costs and expenses	128,209	66,064	26,146
(Loss) income from continuing operations	(13,216)	1,374	(15,265)
Income from discontinued operations	5,726	16,873	1,135,706(A)
Extraordinary items			(110,500)
Net (loss) income applicable to Common Shares(C)	(65,160)	(13,714)	929,904
Company's share of discontinued operations	2,385	7,031	139,935(B)
Company's share of extraordinary item			(46,487)(B)

(A) Includes gain on sale of New Valley's money transfer business of $1,056,081, net of income taxes of $52,000.
(B) The Company's share of the extraordinary item ($46,487) was related to extinguishment of debt in 1994. The Company's share of income from discontinued operations in 1994 was determined after accounting for losses not recognized in prior years as follows:

42.1% of income from discontinued operations	$ 477,791
Losses not recognized in prior periods	(337,856)
Company's share of equity in discontinued operations of New Valley	$ 139,935

(C) Considers all preferred accrued dividends, whether or not declared and, in 1995 and 1996, the excess of carrying value of redeemable preferred shares over cost of shares purchased.

On January 31, 1997, New Valley acquired substantially all the common shares of BML from BOL for $55,000. (Refer to Note 4.)

3. RJR NABISCO HOLDINGS CORP.

On October 17, 1995, New Valley and its subsidiary, ALKI Corp. ("ALKI"), entered into an agreement, as amended (the "New Valley Agreement"), with High River Limited Partnership ("High River"), an entity owned by Carl C. Icahn. Pursuant to the New Valley Agreement, New Valley sold approximately 1,600,000 shares of common stock of RJR Nabisco Holdings Corp. ("RJR Nabisco") to

High River for an aggregate purchase price of $51,000. The New Valley Agreement also provided for the parties to pay certain other fees to each other under certain circumstances, including a payment to High River equal to 20% of New Valley's profit on its RJR Nabisco common stock, after certain expenses as defined in the New Valley Agreement.

On October 17, 1995, the Company and BGLS entered into a separate agreement, as amended (the "High River Agreement"), with High River. Pursuant to each of these agreements, the parties agreed to take certain actions designed to cause RJR Nabisco to effectuate a spinoff of its food business, Nabisco Holdings Corp. ("Nabisco"), at the earliest possible date. Among other things, the Company agreed to solicit the holders of RJR Nabisco common stock to adopt the Spinoff Resolution, which was an advisory resolution to the Board of Directors of RJR Nabisco seeking a spinoff of the 80.5% of Nabisco held by RJR Nabisco to stockholders. The High River Agreement also provided that BGLS pay certain other fees to High River under certain circumstances.

As of June 5, 1996, High River, the Company and BGLS terminated the High River Agreement and New Valley, ALKI and High River terminated the New Valley Agreement by mutual consent. The terminations leave in effect for one year certain provisions of both the High River and New Valley Agreements concerning payments to be made to High River in the event New Valley achieves a profit (after deducting certain expenses) on the sale of the shares of RJR Nabisco common stock which are held by it or they are valued at the end of such year at higher than their purchase price or in the event the Company or its affiliates engage in certain transactions with RJR Nabisco.

On December 27, 1995, New Valley entered into an agreement with the Company pursuant to which New Valley agreed to pay directly or reimburse the Company and its subsidiaries for reasonable out-of-pocket expenses incurred in connection with the Company's solicitation of consents and proxies from the stockholders of RJR Nabisco. New Valley has also agreed to pay to BGLS a fee of 20% of the net profit received by New Valley or its subsidiaries from the sale of shares of RJR Nabisco common stock after New Valley and its subsidiaries have achieved a rate of return of 20% and after deduction of certain expenses incurred by New Valley and its subsidiaries, including the costs of the consent and proxy solicitations and of acquiring the shares of common stock. New Valley has also agreed to indemnify the Company and its affiliates against certain liabilities arising out of the solicitations. During 1996, New Valley has reimbursed the Company and its subsidiaries $2,370 pursuant to this agreement.

On December 28, 1995, New Valley, the Company and Liggett engaged Jefferies & Company, Inc. ("Jefferies") to act as financial advisor in connection with New Valley's investment in RJR Nabisco and the Company's solicitation of consents and proxies. In connection with this engagement, New Valley paid Jefferies $1,500 in 1995 and $1,538 in 1996. These companies also have agreed to pay Jefferies 10% of the net profit (up to a maximum of $15,000) with respect to RJR Nabisco common stock (including any distributions made by RJR Nabisco) held or sold by these companies and their affiliates after deduction of certain expenses, including the costs of the solicitations and the costs of acquiring the shares of the common stock.

On December 29, 1995, the Company commenced solicitation of consents from stockholders of RJR Nabisco seeking, among other things, the approval of the Spinoff Resolution. In March 1996, the Company was informed that the Spinoff Resolution was approved by the holders of a majority of RJR Nabisco common stock.

On February 29, 1996, New Valley entered into a total return equity swap transaction (the "Swap") with an unaffiliated company relating to 1,000,000 shares of RJR Nabisco common stock. During the third quarter of 1996, the Swap was terminated. New Valley recognized a loss on the Swap of $7,305 for the year ended December 31, 1996.

On March 4, 1996, the Company commenced solicitation of proxies in favor of its previously nominated slate of directors to replace RJR Nabisco's incumbent Board of Directors at its 1996 annual meeting of stockholders. On April 16, 1996, the Company announced that, based on the analysis of its proxy solicitors, its nominees for election to the RJR Nabisco Board of Directors would not be elected at RJR Nabisco's 1996 annual meeting of stockholders. On November 5, 1996, the Company submitted to RJR Nabisco, in order to comply with the requirements of RJR Nabisco's by-laws, a notice of intent to nominate a slate of directors for election at the RJR Nabisco 1997 annual meeting of stockholders.

As of December 31, 1996, New Valley held approximately 1,700,000 shares of RJR Nabisco common stock with a market value of $59,200 (cost of approximately $53,400). As of March 14, 1997, New Valley held approximately 1,063,000 shares of RJR Nabisco common stock with a market value of $35,997 (cost of $32,574). During 1996 and 1995, New Valley expensed $11,724 and $3,879, respectively, for costs relating to its RJR Nabisco investment. Based on the market price of RJR Nabisco common stock at March 14, 1997, 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 discussed above.

4. INVESTMENT IN BROOKE (OVERSEAS) LTD.

Prior to December 29, 1995, the Company did not consolidate Liggett-Ducat, a Russian joint stock company, due to certain events continuing through 1995 which impaired the Company's ability to control the operations of Liggett-Ducat. The amount invested in Russian ventures of $5,723 in 1994 was expensed, based on the determination that there was significant uncertainty as to the recoverability of these amounts. The Company reexamined the issue of consolidating Liggett-Ducat and at December 29, 1995 determined that a series of events in the latter part of 1995 (see below) enabled the Company to exert sufficient control so that the recoverability of its investment appeared reasonable.

During 1995, the Company increased its investment in Liggett-Ducat from approximately 58% to 68% through a direct purchase of stock from other shareholders. The Company recorded goodwill in the amount of $435 which is being amortized over a ten-year period.

In October 1995, Liggett-Ducat entered into a loan agreement with Vneshtorgbank, Moscow, Russia, pursuant to which Liggett-Ducat borrowed $20,400 to fund real estate development. Interest on the note is based on the London Interbank Offered Rate ("LIBOR") plus 10%. Principal repayments are due from April through October of 1997. At December 31, 1996, approximately $20,418 had been drawn down under the loan.

Also in October 1995, BML purchased certain buildings, which it had previously leased from the Moscow Property Committee, for $4,369 excluding related transaction costs. BML has developed, or is in the process of developing, these buildings for commercial use.

On December 29, 1995, Liggett-Ducat relinquished its 59.4% ownership in a joint real estate venture in exchange for 100% ownership of a partially constructed manufacturing facility owned by the venture on the outskirts of Moscow where Liggett-Ducat plans to build a new cigarette factory. In connection with this exchange, a 49-year land lease was renegotiated in 1996 for the site on which

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the factory is to be built. Liggett-Ducat's cost basis in the joint real estate venture of $2,675 was transferred to its basis in the new manufacturing facility.

The additional amounts included in the financial statements as a result of consolidating Liggett-Ducat at December 31, 1995 are as follows:

Current assets....................	$12,321
Total assets......................	35,359
Current liabilities...............	10,602
Total liabilities.................	20,924
Stockholders' equity..............	14,435

Revenues during 1995 from the date of consolidation (December 29, 1995) are not material.

During the second quarter of 1996, the Company entered into stock purchase agreements with the chairman of Liggett-Ducat and the former Director of Liggett-Ducat's tobacco operations (the "Sellers"). Under the stock purchase agreements, the Company acquired 142,558 shares held by the Sellers for $2,143. The purchase price was payable in installments during 1996 and certain shares of Liggett-Ducat collateralize the Company's obligation under both the purchase agreements and the consulting agreements (described below).

Concurrently, the Company entered into consulting and non-compete agreements with the Sellers. Under the terms of these agreements, the Company will pay the Sellers a total of approximately $8,357 over five years.

In December 1996, the Company purchased 46,337 additional shares of Liggett-Ducat stock from other shareholders for $695. At December 31, 1996, the Company's subsidiaries owned 95% of the stock of Liggett-Ducat.

In 1996, Russian tax authorities assessed Liggett-Ducat $7,600 for outstanding tax liabilities, which amount was accrued in 1996. The liability is payable in two parts, 50% within 2 1/2 years, the remaining 50% over the succeeding five years.

The performance of Liggett-Ducat's cigarette operations in Russia is affected by uncertainties in Russia which may 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.

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SUBSEQUENT EVENT:

Sale of BrookeMil:

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 its investment in BML by $43,700. The Company expects to recognize a gain on the sale in 1997 in the amount of $21,300. The remaining $22,400 will be 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.

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 $20,419, remained with BML, and New Valley indemnified the Company and its subsidiaries with respect to such liabilities.

On or about March 13, 1997, a shareholder derivative suit was filed against New Valley, as a nominal defendant, its directors and the Company in the Delaware Chancery Court, by a shareholder of New Valley. The suit alleges that New Valley's purchase of the BML Shares constituted a self-dealing transaction which involved the payment of excessive consideration by New Valley. The plaintiff seeks (i) a declaration that New Valley's directors breached their fiduciary duties, the Company aided and abetted such breaches and such parties are therefore liable to New Valley, and (ii) unspecified damages to be awarded to New Valley. 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.

5. DISCONTINUED OPERATIONS

A summary of discontinued operations follows:

	Year Ended December 31, 1996	1995	1994
(Loss) income from discontinued operations:			
New Valley	$(1,591)	$ 1,800	
MAI		698	$ 3,628
SkyBox		362	20,065
	(1,591)	2,860	23,693
Gain from disposal of operations:			
New Valley	3,976	5,231	139,935
SkyBox		13,138	11,055
	3,976	18,369	150,990
Income from discontinued operations	$ 2,385	$21,229	$174,683

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Net revenues of MAI Systems Corporation ("MAI") for the period January 1, 1995 to February 6, 1995 were $6,652 and for the year ended December 31, 1994 was $66,095.

New Valley:

During the fourth quarter of 1994, New Valley sold or was in the process of selling virtually all of its current operations. In connection with the implementation of the provisions of the Joint Plan, New Valley completed the sale of Western Union Financial Services Inc. and certain other assets to First Financial Management Corporation ("FFMC"). Accordingly, the financial statements of the Company reflect its portion of the gain ($139,935) in gain on disposal of discontinued operations in 1994.

On October 31, 1995, New Valley sold substantially all the assets of its wholly-owned subsidiary, Western Union Data Services Company, Inc. (the "Messaging Service Business"), and conveyed substantially all of the liabilities of the Messaging Service Business to FFMC for $17,540 in cash and $2,460 in cancellation of intercompany indebtedness. The financial statements of the Company reflect its portion of the gain ($5,231) in gain on disposal of discontinued operations in 1995.

In October 1996, Thinking Machines adopted a plan to terminate its parallel processing computer sales and service business. Consequently, the operating results of this segment, including the write-down of certain assets, principally inventory, to their net realizable value by $6,100 have been classified as discontinued operations. The financial statements of the Company reflect its portion of the loss from operations ($1,591) and the gain on disposal ($3,976) in discontinued operations.

MAI:

On February 1, 1994, the Company renegotiated a December 21, 1992 agreement with an unrelated third party which enabled the Company to purchase additional MAI equity for $3,565 in the reorganized entity which had emerged from bankruptcy on November 18, 1993. When combined with the interest originally received in the MAI reorganization, total common ownership held by the Company at December 31, 1994 was approximately 65.2%.

In addition, in connection with a transaction wherein MAI's United States and Canadian bank lenders took title to the stock of MAI's European subsidiaries in satisfaction of a total of approximately $84,000 of indebtedness owed by MAI to such bank lenders, the Company may be required, under certain limited circumstances, to purchase an equity interest of up to $7,500 in a holding company controlled by the bank lenders. The $7,500 is recorded as a liability.

On January 25, 1995, the Board of Directors of BGLS determined to declare a dividend of the stock of MAI to the Company with the intention of the Company distributing a special dividend of MAI common stock to its stockholders (the "MAI Distribution"). Accordingly, the Company approved the MAI Distribution of the 65.2% equity interest in MAI through a special dividend to its stockholders of one share of MAI for every six shares of the Company's common stock. The distribution occurred on February 13, 1995. As a result, MAI has been treated as a discontinued operation in the financial statements for all periods presented. The MAI Distribution reduced the Company's stockholders' equity (deficit) by $27,085 in the first quarter of 1995.

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SkyBox:

During 1994 and the first quarter of 1995, the Company sold all of its remaining common stock of its former subsidiary, SkyBox International Inc. ("SkyBox"), for approximately $20,000. In addition, during the same period SkyBox redeemed the 220 shares of SkyBox Series A Preferred Stock which the Company held for $22,000.

6. INVENTORIES

Inventories consist of:

	December 31, 1996	December 31, 1995
Finished goods	$15,304	$19,129
Work-in-process	4,435	3,570
Raw materials	34,002	29,021
Replacement parts and supplies	4,406	4,903
Inventories at current cost	58,147	56,623
LIFO adjustments	(4,456)	3,899
	$53,691	$60,522

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. At December 31, 1996, Liggett had leaf tobacco purchase commitments of approximately $20,116.

7. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of:

	December 31, 1996	December 31, 1995
Land and improvements	$ 455	$ 542
Buildings	14,205	13,661
Machinery and equipment	49,401	42,877
Leasehold improvements	302	309
Construction-in-progress	46,966	18,286
	111,329	75,675
Less accumulated depreciation	(31,047)	(27,323)
	$ 80,282	$ 48,352

The amounts provided for depreciation for the years ended December 31, 1996, 1995 and 1994 were $4,412, $4,699 and $4,609, respectively.

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The amount of capitalized interest included in property, plant and equipment is $6,387 and $1,004 in 1996 and 1995, respectively.

8. SALE OF ASSETS

On July 15, 1996, the Company sold substantially all of the non-cash assets and certain liabilities of COM Products, Inc. ("COM"), a subsidiary engaged in the business of selling micrographics equipment and supplies, for approximately $3,700 cash and a promissory note for $500. The Company recognized a gain of approximately $3,000 on this transaction.

On May 14, 1996, Liggett sold to the County of Durham certain surplus realty for $4,300. The Company recognized a gain of approximately $3,600.

Subsequent Event:

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 4.)

On March 11, 1997, Liggett sold to Blue Devil Ventures, a North Carolina limited liability partnership, additional surplus realty for $2,200. A gain of approximately $1,600 is expected to be recognized in 1997.

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

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

	December 31, 1996	December 31, 1995
15.75% Series B Senior Secured Notes due 2001, net of unamortized discount of $1,511	$231,353	
13.75% Series 2 Senior Secured Notes due 1997		$ 91,179
16.125% Senior Subordinated Reset Notes due 1997		5,670
14.500% Subordinated Debentures due 1998	800	126,295
Notes payable - Foreign	22,668	11,122
Other	2,425	2,084
Liggett:		
11.500% Senior Secured Series B Notes due 1999, net of unamortized discount of $0 and $424, respectively	119,688	119,485
Variable Rate Series C Senior Secured Notes due 1999	32,279	32,279
Revolving credit facility	24,272	21,017
Total notes payable and long-term debt	433,485	409,131
Less:		
Current maturities	55,242	2,387
Amount due after one year	$378,243	$406,744

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OFFER TO EXCHANGE:
15.75% SERIES A SENIOR SECURED NOTES DUE 2001 FOR 13.75% SERIES 2 SENIOR SECURED NOTES DUE 1997, AND
15.75% SERIES B SENIOR SECURED NOTES DUE 2001 FOR 16.125% SENIOR SUBORDINATED RESET NOTES DUE 1997 AND 14.500% SUBORDINATED DEBENTURES:

On November 27, 1995, BGLS commenced an offer to exchange a total of $232,864 principal amount of 15.75% Senior Secured Notes due January 31, 2001, for all its outstanding Series 2 Notes, Reset Notes and Subordinated Debentures. The exchange ratio was $1,087.47 principal amount of new 15.75% Series A Senior Secured Notes ("Series A Notes") for each $1,000 principal amount of Series 2 Notes exchanged, $1,132.28 principal amount of new Series B Notes for each $1,000 principal amount of Reset Notes exchanged and $1,000 principal amount of new Series B Notes for each $1,000 principal amount of Subordinated Debentures exchanged. The new Series A Notes and the new Series B Notes were identical except that the Series B Notes were not subject to restrictions on transfer.

The exchange offer closed on January 30, 1996. All $91,179 of the Series 2 Notes and $125,495 of the Subordinated Debentures were exchanged. In addition, BGLS cancelled all of the Subordinated Debentures ($13,705) held by the Company. Subordinated Debentures in the amount of $800 remain outstanding. As part of the exchange offer, substantially all of the covenants and events of default were eliminated pertaining to the Subordinated Debentures.

Holders of Reset Notes did not exchange, and the Reset Notes were redeemed on March 29, 1996 for a total amount of $5,785, including premium, together with accrued interest of $452. On March 7, 1996, an additional $7,397 face amount of Series A Notes were sold for $6,300 including accrued interest with the proceeds being used for the redemption of the Reset Notes.

Pursuant to a registered exchange offer, holders of the Series A Notes exchanged all of the $107,373 outstanding principal amount for an equal principal amount of Series B Notes. The exchange closed March 21, 1996. The Company has cancelled all the Series A Notes.

The new Series B Notes are collateralized by substantially all of BGLS' assets, including a pledge of BGLS' equity interests in Liggett, BOL and NV Holdings as well as a pledge of all of the New Valley securities held by BGLS and NV Holdings. The BGLS Series B Notes Indenture contains certain covenants, which among other things, limit the ability of BGLS to make distributions to the Company to $6,000 per year ($12,000 if less than 50% of the Series B Notes remain outstanding), limit additional indebtedness of BGLS to $10,000, limit guaranties of subsidiary indebtedness by BGLS to $50,000, and restrict certain transactions with affiliates that exceed $2,000 in any year subject to certain exceptions which include payments to the Company not to exceed $6,500 per year for permitted operating expenses, payment of the Chairman's salary and bonus and certain other expenses, fees and payments. In addition, the Indenture contains certain restrictions on the ability of the Chairman and certain of his affiliates to enter into certain transactions with, and receive payments above specified levels from, New Valley. The Series B Notes may be redeemed, in whole or in part, through December 31, 1999 at a price of 101% of the principal amount and thereafter at 100%. Interest is payable at the rate of 15.75% per annum on January 31 and July 31 of each year, except for the period ended July 31, 1996 when interest was payable at 13.75% from October 1, 1995 to January 30, 1996 and at 15.75% from January 31, 1996 through July 31, 1996.

The Company recorded an extraordinary charge of approximately $9,700 for the year ended December 31, 1995 relating to the exchanged debt securities discussed above.

13.75% SERIES 1 SENIOR SECURED NOTES DUE 1995
13.75% SERIES 2 SENIOR SECURED NOTES DUE 1997:

An Exchange and Termination Agreement (the "1994 Exchange Agreement") was entered into as of September 30, 1994 among the Company, BGLS and certain holders ("Participating Holders") of the 16.125% Senior Subordinated Reset Notes due 1997 ("Reset Notes") and the 14.500% Subordinated Debentures due 1998 ("Subordinated Debentures") pursuant to which certain prior agreements among the parties were terminated. The Participating Holders had advanced $13,702 to BGLS under the prior agreements. In related transactions with the same Participating Holders, BGLS issued $23,594 of 13.75% Series 1 Senior Secured Notes due 1995 ("Series 1 Notes") to the same Participating Holders in consideration of the transfer to BGLS of previously issued Senior Secured Notes, on account of new loans by the same holders in respect of certain interest payable and to cover certain expenses of the Participating Holders. On June 12, 1995, BGLS redeemed all the Series 1 Notes in the amount of $23,594 plus accrued interest of $670.

Under the 1994 Exchange Agreement, on October 3, 1994 BGLS exchanged an aggregate of $49,900 of new BGLS 13.75% Series 2 Senior Secured Notes due 1997 ("Series 2 Notes") for an equal principal amount of Reset Notes. In connection with the 1995 Exchange Offer, all of the Series 2 Notes were exchanged for Senior Secured Notes and no Series 2 Notes remain outstanding. BGLS and the Company also agreed, subject to applicable securities laws, to offer the other holders of the Reset Notes the opportunity to exchange the Reset Notes for the Series 2 Notes. That offer commenced October 21, 1994 and was closed December 12, 1994. An additional $33,675 of the Reset Notes were exchanged.

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 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 Liggett 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. While Liggett management currently intends to seek to refinance and/or restructure with Liggett's note holders the February 1, 1998 mandatory redemption payment of $37,500 and the $107,400 payment due on February 1, 1999 on maturity of the Liggett Notes and to extend its revolving credit facility, there are no refinancing or restructuring arrangements for the notes or commitments to extend the facility at this time, and no assurances can be given in this regard.

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. Liggett had received the necessary consents from the required percentage of holders of Liggett Series B Notes allowing for an aggregate principal amount up to but not exceeding $32,850 of Liggett Series C Notes to be issued under the Liggett Series C Notes indenture. The Series C Notes have the same terms (other than interest rate) and stated maturity as the Liggett Series B Notes. In connection with the consents, holders of Liggett Series B Notes received Liggett Series C Notes totaling $2,842 or 2% of their then current Liggett Series B Notes holdings. Liggett issued the remaining $7,508 of Series C Notes in November 1994.

On January 26, 1995, the Company sold the Series C Notes it held in face amount of $2,935.

REVOLVING CREDIT FACILITY - LIGGETT:

On March 8, 1994, Liggett entered into a revolving credit facility (the "Facility") for $40,000 with a syndicate of commercial banks. The Facility is collateralized by all inventories and receivables of Liggett. At December 31, 1996, $24,272 was outstanding and $13,098 was available under the Facility. Borrowings under the Facility bore interest at the rate of 9.75%, a rate which is equal to 1.5% above the Philadelphia National Bank's prime rate (8.25%) at December 31, 1996. 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. In addition, the Facility imposes requirements with respect to Liggett's adjusted net worth (not to fall below a deficit of $175,000 as computed in accordance with the agreement) and working capital (not to fall below a deficit of $35,000 as computed in accordance with the agreement). The Facility is classified as short-term at December 31, 1996, as it was due on March 8, 1997. In January 1997, the Facility was extended for a one-year period ending March 8, 1998. 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 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 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.

FOREIGN LOANS:

In October, 1995, Liggett-Ducat, a subsidiary of BOL, entered into a construction loan agreement with Vneshtorgbank, Moscow, Russia for a period of two years on behalf of BML for $20,400. The interest rate is the London Interbank Offered Rate, which was 5.55% and 5.66% at December 31, 1996 and 1995, respectively, plus 10%. The outstanding balance at December 31, 1996 on the loan, which was assigned to BML on December 19, 1996, was $20,400. Deferred financing fees of approximately $4,044 were recorded and are being amortized over the term of the loan. (Refer to Note 4.)

In January 1996, Liggett-Ducat entered into a revolving credit facility for $1,667 with the same bank. The facility was denominated in rubles and is due within 180 days with an automatic renewal. Because the credit facility exists in a hyperinflationary economy, it bore interest at a rate of 85% per annum. During September 1996, this facility was fully retired.

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Scheduled Maturities:

Scheduled maturities of long-term debt for each of the next five years are as follows:

1997	$55,242
1998	39,516
1999	107,374
2000	
2001	231,353
Thereafter	
	$433,485

10. RESTRUCTURING CHARGES

Liggett:

During the years ended December 31, 1996 and 1995, Liggett offered severance and benefit programs to reduce personnel costs on an ongoing basis. These programs resulted in a charge to operations of $3,428 and $2,548, respectively.

11. EMPLOYEE BENEFIT PLANS

Defined Benefit Retirement Plans:

The Company sponsors several defined benefit pension plans, covering virtually all of Liggett's full-time employees. These plans provide pension benefits for eligible employees based primarily on their compensation and length of service. Contributions are made to the pension plans in amounts necessary to meet the minimum funding requirements of the Employee Retirement Income Security Act of 1974 ("ERISA").

In a continuing effort to reduce operating expenses, all defined benefit plans were frozen between 1993 and 1995 and several early retirement windows were offered in 1995 and 1996. As a result of these actions, the Company recorded a curtailment charge (see table below).

The Company's net pension expense consists of the following components:

	Year Ended December 31,		
	1996	1995	1994
Service cost - benefits earned during the period	$ 350	$ 454	$ 1,140
Interest cost on projected benefit obligation	12,241	12,850	12,363
Actual return on assets	(21,143)	(23,501)	(5,144)
Curtailment related to plan restructuring	1,463	1,550	691
Net amortization and deferral	7,384	9,547	(8,337)
	$ 295	$ 900	$ 713

In accordance with SFAS No. 87, "Employers' Accounting for Pensions," the overfunded and underfunded plans with respect to the accumulated benefit obligation at December 31, 1996 have been segregated for financial statement presentation. All plans were underfunded with respect to the

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accumulated benefit obligation at December 31, 1995. An analysis of the funded status of the Company's defined benefit pension plans and amounts recognized in the balance sheets at December 31, 1996 and 1995 for the pension plans are as follows:

	December 31, 1996		December 31, 1995
	Assets Exceed Accumulated Benefits	Accumulated Benefits Exceed Assets	Accumulated Benefits Exceed Assets
Actuarial present value of benefit obligations:			
Vested benefit obligation..............	$155,612	$2,900	$166,448
Accumulated benefit obligation..........	$160,587	$2,915	$172,317
Projected benefit obligation............	$160,587	$2,915	$172,317
Plan assets at fair value.....................	169,845		163,913
Projected benefit obligation (less than) in excess of plan assets..................	(9,258)	2,915	8,404
Unrecognized net gain (loss)..................	28,221	(976)	14,449
Curtailment liability.........................	1,463		
Adjustment required to recognize minimum liability..............................		976	976
Pension liability before purchase accounting valuation adjustments...................	20,426	2,915	23,829
Purchase accounting valuation adjustments related to income taxes................	(3,425)		(3,773)
Net pension liability included in the balance sheets.................................	$ 17,001	$2,915	$ 20,056

Assumptions used in the determination of net pension expense and the actuarial present value of benefit obligations were as follows:

	1996	1995
Discount rates...	6.25 - 8.00%	6.25 - 8.50%
Accrued rates of return on invested assets...............	9.0%	9.0%
Salary increase assumptions..............................	N/A per annum	N/A per annum

Plan assets consist of commingled funds, marketable equity securities and corporate and government debt securities.

Postretirement Medical and Life Insurance Plans:

BGLS and Liggett

Substantially all of Liggett's United States employees are eligible for certain postretirement benefits if they reach retirement age while working for the Company. Effective January 1, 1995, retirees are required to fund 100% of participant medical premiums.

The components of net periodic postretirement benefit cost for the years ended December 31, 1996, 1995 and 1994 are as follows:

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	1996	1995	1994
Service cost, benefits attributed to employee service during the year	$ 68	$ 68	$ 63
Interest cost on accumulated postretirement benefit obligation	829	970	1,037
Charge for special termination benefits		489	
Amortization of net (gain) loss	(92)	(26)	33
Net periodic postretirement benefit expense	$805	$1,501	$1,133

The following sets forth the actuarial present value of the Accumulated Postretirement Benefit Obligation ("APBO") at December 31, 1996 and 1995 applicable to each employee group for benefits:

	1996	1995
Retired employees	$ 7,899	$ 8,673
Active employees - fully eligible	674	1,707
Active employees - not fully eligible	515	1,078
APBO	9,088	11,458
Unrecognized net gain	3,324	1,339
Purchase accounting valuation adjustment related to income taxes	(1,072)	(1,181)
Postretirement liability	$11,340	$11,616

The APBO at December 31, 1996 was determined using a discount rate of 8% and health care cost trend rates of 4%. A 1% increase in the trend rate for health care costs would have increased the APBO and net periodic postretirement benefit cost by $419 and $32, respectively, for the year ended December 31, 1996. The Company does not hold any assets reserved for use in the plan.

Profit Sharing Plan:

Liggett

The 401(k) plans originally called for Liggett contributions matching up to a 3% employee contribution, plus additional Liggett contributions of up to 6% of salary based on the achievement of Liggett's profit objectives. Effective January 1, 1994, Liggett suspended the 3% match for the salaried employees' 401(k) Plan, but reinstated it on April 1, 1996. Liggett contributed and expensed $2,712, $900 and $420 to the 401(k) plans for the years ended December 31, 1996, 1995 and 1994, respectively.

12. INCOME TAXES

The Company files a consolidated federal income tax return that includes its more than 80%-owned United States subsidiaries. At December 31, 1996, the Company had $90,646 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 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.

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The amounts provided for income taxes are as follows:

	Year Ended December 31,		
	1996	1995	1994
Current:			
U.S. Federal	$		$(24,714)
Foreign	1,454		
State	(52)	$ 342	227
Total provision (benefit) for continuing operations	$ 1,402	$ 342	$(24,487)

The tax effect of temporary differences which give rise to a significant portion of deferred tax assets and liabilities are as follows:

	December 31, 1996		December 31, 1995	
	Deferred Tax Assets	Deferred Tax Liabilities	Deferred Tax Assets	Deferred Tax Liabilities
Sales and product allowances	$ 2,504		$ 2,337	
Inventory	1,270	683	831	$ 1,280
Coupon accruals	4,492		3,198	
Property, plant and equipment		5,218		6,200
Employee benefit plan accruals	13,193		13,249	
Debt restructuring charges	22,334		5,702	
Excess of tax basis over book basis-non-consolidated entities	9,467		4,327	
Excess of book basis over tax basis-non-consolidated entities		5,166		5,564
Legal settlements	2,910		3,556	
Net operating loss carryforwards	45,543		54,860	
Valuation allowance	(90,646)		(73,955)	
Reclassifications	(11,067)	(11,067)	(13,044)	(13,044)
	$	$	$ 1,061	$

Differences between the amounts provided for income taxes and amounts computed at the federal statutory tax rate are summarized as follows:

	Year Ended December 31,		
	1996	1995	1994
(Loss) from continuing operations before income taxes	$(63,516)	$(45,002)	$(42,478)
Federal income tax (benefit) at statutory rate	(22,231)	(15,751)	(14,867)
Increases (decreases) resulting from:			
State income taxes, net of federal income tax benefits	(34)	342	148
Foreign taxes	1,454		
Changes in valuation allowance	21,471	11,810	14,432
Other	742	3,941	
Reduction of reserves			(24,200)
Provision (benefit) for income tax	$ 1,402	$ 342	$(24,487)

The Company favorably settled an audit with the Internal Revenue Service in the third quarter of 1994 and has adjusted its reserves accordingly.

At December 31, 1996, the Company and its consolidated group had net operating loss carryforwards for tax purposes of approximately $114,000 which may be subject to certain restrictions and limitations and which will expire in the years 2006 to 2009.

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13. COMMITMENTS

Certain of the Company's subsidiaries lease certain facilities and equipment used in its operations under both month-to-month and fixed-term agreements. The aggregate minimum rentals under operating leases with noncancelable terms for one year or more are as follows:

Year ending December 31:	
1997	$ 5,578
1998	4,130
1999	2,120
2000	1,310
2001	650
2002 and thereafter	33,918
	$47,706

Lease commitments for 2002 and thereafter relate primarily to the remaining 45 years of a land lease and 23 years of an equipment lease in Russia.

The total of minimum rentals to be received in the future by certain of the Company's subsidiaries under noncancelable subleases are $126 for the year ending December 31, 1997.

The Company's rental expense for the years ended December 31, 1996, 1995 and 1994 was $5,471, $4,449 and $4,808, respectively.

14. EQUITY

Series G Preferred Stock:

During 1993 and 1994, special dividends payable on the Series G Preferred Stock in connection with the distribution of SkyBox shares to the Company's shareholders were accelerated and paid in two parts. To the extent that such dividends were utilized to facilitate the repayment or defrayal of certain debt obligations to the Company, cash dividends were disbursed or dividends were waived to satisfy such obligations. The remaining portion of the special dividend was payable in four installments on January 1, April 1, July 1 and October 1, 1994 payable in cash or shares of common stock at the option of the Company using the prime rate announced by Citibank, N.A. discounted by the number of days between the installment payment date and October 6, 1994, the date the special dividend was to have been paid out. (Refer to Note 17.) At December 31, 1994, all Series G Preferred Stock had been converted into Company common stock.

Treasury Stock:

For information concerning the exercise in 1994 of a warrant for 607,889 shares of the Company's common stock. (Refer to Note 17.)

In 1995 and 1994, pursuant to a Stock Grant Agreement, the Company purchased 33,748 and 41,641 shares of common stock, respectively, from two former employees at market price. During 1995, the Company issued, in the aggregate, 270,000 shares from treasury.

15. STOCK PLANS

The Company's Stock Option Plan (the "Plan") provides that options and stock appreciation rights ("SAR's") for up to 400,000 shares of common stock may be granted to officers and other key employees of the Company. All options must be granted on or before the tenth anniversary of the effective date of the Plan (September 1, 1997) and at prices not less than the fair market value of the stock on the date of grant. The exercise price may be paid in cash or in shares of the Company's common stock having a fair market value equal to the cash amount for which it was substituted. Shares received upon exercise of a portion of an option may be applied automatically at their fair market value to purchase additional portions of the option. Shares relating to options that expire or are canceled are added back to shares authorized for future grants. At December 31, 1996, 1995 and 1994, no options were outstanding; however, there were 212,400 shares available to be granted under this Plan.

On December 16, 1996, the Company entered into a Stock Option Agreement (the "Agreement") with a consultant who serves as a director and President of New Valley. The Agreement granted such consultant non-qualified stock options to purchase 1,000,000 shares of the Company's common stock at an exercise price of $1.00 per share. The options, which will become exercisable over a ten-year term, vest in six equal annual installments beginning on July 1, 1997. Pursuant to the Agreement, common stock dividend equivalents are paid on each vested and unexercised option. The Company estimated the fair value of such grants on the date of grant using the Black-Scholes option-pricing model with the following assumptions: a risk-free interest rate of 6.4%, expected life of 10 years, volatility of 81.4% and no expected dividends or forfeiture. Under this model the fair value of stock options granted in 1996 was $4,750. The Company recognized expense of $64 for the year ended 1996.

As of January 1, 1994, the Company had granted 500,000 shares of restricted common stock to the same consultant. Of the total number of shares granted, 250,000 were immediately vested and issued during the third quarter. The remaining 250,000 shares were issued in 1995 and will vest in 1997. In addition, on January 25, 1995, the Company entered into a nonqualified stock option agreement with the same consultant. Under the agreement, options to purchase 500,000 shares were granted at $2.00 per share. The options are exercisable over a ten-year period, beginning with 20% on the grant date and 20% on each of the four anniversaries of the grant date. The grant provides for dividend equivalent rights on all the shares underlying the options.

During 1996, 1995 and 1994, the Company recorded charges to income of $222, $557 and $781, respectively, for compensation based on estimates of the fair market value for the shares and options granted. In 1996 and 1995, the Company also recorded charges to income of $150 and $150 for the dividend equivalent rights.

Subsequent Event:

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 a ten-year term, vest in six equal annual installments.

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16. CONTINGENCIES

Tobacco-Related Litigation:

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 actually were commenced against the Company or Liggett). New cases continue to be commenced against Liggett and other cigarette manufacturers. 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 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 below is not quantifiable at this time.

As of March 14, 1997, there were 108 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, 58 are pending in the State of Florida and 19 are pending in the State of New York. The balance of individual cases are pending in 13 different states. The next individual case scheduled for trial where Liggett is a defendant is CHUTZ-REYMERS V. LIGGETT GROUP INC., ET AL, United States District Court, Middle District of Florida, Tampa Division, which is scheduled for trial in June 1997. In light of the settlements discussed below, this case will not proceed against Liggett on that date. In addition to the foregoing, there are four individual cases scheduled for trial in 1997 where Liggett is a defendant, although trial dates are subject to change.

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, strict liability, fraud, misrepresentation, design defect, failure to warn, breach of express and implied warranties, conspiracy, concert of action, unjust enrichment, common law public nuisance, indemnity, market share liability, and violations of deceptive trade practices laws 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 preemption by the Federal Cigarette Labeling and Advertising Act, as amended (the "Act"). Several representative cases are described below.

On June 24, 1992, in the action entitled CIPOLLONE V. LIGGETT GROUP INC., ET AL., the United States Supreme Court issued an opinion concluding that the 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 YVONNE 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. A Notice of Appeal has been filed by the plaintiff.

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. Plaintiff's motion to certify the action as a class action was granted. The suit is scheduled to go to trial on June 2, 1997. In addition to Broin, as of March 25, 1997 there were 12 actions which have either been certified as a class or are seeking class certification. One of these actions, ENGLE, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Circuit Court of the Eleventh Judicial Circuit in and for Dade County, Florida, involving a certified class of smokers in the State of Florida, is scheduled to commence trial on September 8, 1997.

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. The case is presently in the discovery phase. This action is scheduled for trial on December 12, 1997. A similar action has been filed in the Superior Court for the State of California, City of San Francisco.

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 plaintiffs' fraud and breach of warranty claims. In addition, the District Court vacated the Magistrate's March 19, 1996 order compelling Liggett to produce certain CTR documents with respect to which Liggett had asserted various privilege claims, and allowed the other cigarette manufacturers and the CTR to intervene in order to assert their interests and privileges with respect to those same documents. The Magistrate Judge is presently reconsidering plaintiffs' motion to compel production of documents. No trial date has been set.

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 May 23, 1996, the Fifth Circuit Court of Appeals decertified the class and instructed the District Court to dismiss the class complaint. On March 12, 1996, the Company and Liggett entered into an agreement, subject to court approval, to settle the CASTANO class action tobacco litigation, however, this settlement is no longer in effect. See "Subsequent Events" below.

In February 1995, an action entitled GRADY 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 Corp., in the amount of $750. Brown & Williamson has filed a Notice of Appeal.

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. In addition to the foregoing, similar actions have been filed on behalf of 20 states and several municipalities. The Mississippi, Florida and Texas Medicaid recovery actions are scheduled for trial in 1997. Legislation similar to that enacted in Florida has been introduced in the Massachusetts and New Jersey legislatures.

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 the Federal Racketeer Influenced and Corrupt Organization Act.

On March 15, 1996, 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 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 sixty 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.

Settlement funds received by the Attorneys General will be used to reimburse the states' smoking-related healthcare costs. While neither consenting to FDA jurisdiction nor waiving their objections thereto, 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.

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. 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.

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. An unfavorable outcome of a pending smoking and health case could encourage the commencement of additional similar litigation. The Company is not 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 and cash flows could be materially adversely affected by an ultimate unfavorable outcome in any of such pending 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

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other proceedings, lawsuits and claims should not materially affect the Company's financial position, results of operations or cash flows.

Subsequent Events:

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. The Company and Liggett have now obtained settlements with each of the 22 states that have commenced suit against them. The settlements cover all smoking-related claims, including both addiction-based and tobacco injury claims against the Company and Liggett, brought by the 22 states and, upon court approval, the nationwide class.

The settlement with the Attorneys General, which does not require court approval, includes the states of Arizona, Connecticut, Hawaii, Illinois, Indiana, Iowa, Kansas, Maryland, Michigan, Minnesota, New Jersey, New York, Oklahoma, 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.

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. 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. In light of this, the March 1996 CASTANO settlement is no longer in effect.

Pursuant to the settlements, the Company and Liggett have agreed to cooperate fully with the Attorneys General and the nationwide class in their lawsuits against the tobacco industry. The Company and Liggett have 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 have 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 have agreed to offer their employees for witness interviews and testimony at deposition and trial. Pursuant to both settlement agreements, Liggett has 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.

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 has 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 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 million. Both the Attorneys General and the nationwide class have also 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 have 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.

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. 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 these four companies from interfering with Liggett's filing with the courts, under seal, those documents.

Legislation and Regulation:

On August 28, 1996, the FDA filed in the Federal Register a Final 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 has been 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. A hearing on the tobacco industry's motion for summary judgment in that case was held on February 10, 1997, and a decision by the Court is expected soon. The FDA's proposed restrictions, some of which became effective as early as February 28, 1997, purport to (i) limit access to tobacco products and (ii) limit advertising and marketing. Management is unable to predict whether the Final Rule will be upheld as enforceable against the industry. Management is also unable to predict the effects of the proposed restrictions, if implemented, on Liggett's operations, but such actions could have an unfavorable impact thereon.

The Company and Liggett, while neither consenting to FDA jurisdiction nor waiving their objections thereto, agreed to withdraw their objections and opposition to the proposed rule making and 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. Regulations adopted pursuant to this legislation are scheduled to become effective on July 1, 1997. 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.

In 1993, the United States Congress amended the Agricultural Adjustment Act of 1938 to require each United States cigarette manufacturer to use at least 75% domestic tobacco in the aggregate of the cigarettes manufactured by it in the United States, effective January 1, 1994, on an annualized basis or pay a domestic marketing assessment ("DMA") based upon price differentials between foreign and domestic tobacco and, under certain circumstances, make purchases of domestic tobacco from the tobacco stabilization cooperatives organized by the United States government.

After an audit, the USDA informed Liggett that it did not satisfy the 75% domestic tobacco usage requirement for 1994 and was subject to a DMA of approximately $5,500. Liggett has agreed to pay this assessment in quarterly installments with interest over a five-year period, and $4,900 was accrued for the assessment in 1995. Since the levels of domestic tobacco inventories on hand at the tobacco stabilization organizations are below reserve stock levels, the Company was not obligated to make purchases of domestic tobacco from the tobacco stabilization cooperatives.

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. In addition the Presidential Proclamation served to limit the application of the DMA to only those activities occurring in calendar year 1994.

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.

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 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.

The Company has been involved in certain environmental proceedings, none of which, either individually or in the aggregate, rise to the level of materiality. The Company'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.

Other Matters:

As a conclusion to the litigation commenced by a group of Contingent Value Right ("CVR") Holders on September 20, 1993, the Delaware Court of Chancery approved a settlement at a hearing conducted on June 4, 1996. The settlement became final and nonappealable on or about July 8, 1996. Distributions to the Company and to CVR Holders, pursuant to the settlement, have been substantially completed. Under the terms of the settlement, both the Company and the plaintiff CVR Holders may pursue claims, in certain circumstances, against the CVR trustee. In connection with the settlement, the Company recognized a gain of $2,263 during the third quarter 1996.

At December 31, 1996, there were several other proceedings, lawsuits and claims pending against the Company and its subsidiaries. The Company is of the opinion that the liabilities, if any, ultimately resulting from such other proceedings, lawsuits and claims should not materially affect its consolidated financial position, results of operations or cash flows.

Subsequent Events:

In June 1993, the Company obtained expropriation and forced abandonment insurance coverage for its investment in its Ducat Place I real estate project in Moscow, Russia. Shortly thereafter, the Company submitted a Notice of Loss to the insurer, under and pursuant to the policy. The insurer denied the claim and, in July 1994, arbitration proceedings were commenced in the United Kingdom. In January 1997, the Company recognized a gain of $4,125 in settlement of the dispute.

17. RELATED PARTY TRANSACTIONS

On January 5, 1994, the Company's Chairman, President and Chief Executive Officer and controlling stockholder (the "Chairman") repaid his principal indebtedness of $14,692 and that of certain of his affiliates in the total amount of $15,695 with the use of dividends paid on December 31, 1993 on Series G Preferred Stock. (Refer to Note 14.) On March 21, 1994, the Chairman repaid all interest due on the various debts in the amount of $1,163 and accordingly, the stock collateralizing the loans was released.

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 had 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.

In conjunction with the transfer of 607,889 shares of the Company's common stock in 1992, the former Vice Chairman of the Company was granted a warrant (the "Warrant") to purchase 607,889 shares of common stock for an exercise price of $7.60 a share, subsequently reduced to $0.10 per share as a result of the SkyBox distribution. The Warrant was exercised in November 1994. The former Vice Chairman has served on the Board of Directors of New Valley since 1990 and has been a consultant to Liggett in 1996 for which he received $220 of consulting fees.

On December 16, 1996, the Company entered into a Stock Option Agreement relating to 1,000,000 shares of the Company's common stock with a consultant who serves as a director and President of New Valley. In addition, the Company granted the same consultant 500,000 shares of restricted common stock in 1994 and options to purchase 500,000 shares in 1995. (Refer to Note 15.) During 1996, the consultant received $480 of consulting fees from the Company and a subsidiary.

An outside director of the Company is a stockholder of and serves as the secretary and treasurer of a registered broker-dealer that has performed services for the Company and its affiliates since before December 31, 1993. The broker-dealer received brokerage commissions and other income of approximately $317, $584 and $121 from the Company and/or its affiliates during 1996, 1995, and 1994, respectively. The broker-dealer, in the ordinary course of its business, engages in brokerage activities with New Valley's broker-dealer subsidiary on customary terms. In connection with the acquisition of certain office buildings by New Valley on January 10, 1996, this director received a commission of $220 from the seller.

During 1995, the Company and New Valley entered into an expense sharing agreement whereby certain lease, legal and administrative expenses are allocated to the entity incurring the expense. Expense reimbursements amounted to $462 and $571 for the years ended December 31, 1996 and 1995, respectively.

During 1996, the Company and BGLS entered into a court-approved Stipulation and Agreement (the "Settlement") with New Valley relating to the Company's and BGLS' application under the Federal Bankruptcy Code for reimbursement of legal fees and expenses incurred by them in connection with New Valley's bankruptcy reorganization proceedings. Pursuant to the Settlement, New Valley reimbursed the Company and BGLS $655,217 for such legal fees and expenses. The terms of the Settlement were substantially similar to the terms of previous settlements between New Valley and other applicants who had sought reimbursement of reorganization-related legal fees and expenses.

On December 18, 1996, New Valley loaned BGLS $990 under a short-term promissory note due January 31, 1997 and bearing interest at 14%. On January 2, 1997, New Valley loaned BGLS an additional $975 under another short-term promissory note due January 31, 1997 and bearing interest at 14%. Both loans including interest were repaid on January 31, 1997. At December 31, 1996, the loan and accrued interest thereon of $996 was included in current liabilities as notes payable.

In connection with their agreement to serve as the Company's nominees at RJR Nabisco's Annual Meeting, two directors of New Valley were each paid $30 by the Company during the fourth quarter of 1995. In addition, the Company also entered into an agreement with each of the Company nominees whereby it has agreed to indemnify such nominees against certain liabilities arising out of the solicitation of proxies in support of the nominees' election at the annual meeting. As discussed in

BROOKE GROUP LTD.
BGLS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in Thousands, Except Per Share Amounts) - (Continued)

Note 3, the Company has entered into certain other agreements with New Valley in connection with RJR Nabisco.

Subsequent Events:

On January 31, 1997, New Valley entered into a stock purchase agreement with BOL pursuant to which New Valley acquired 10,483 shares of BML common stock (99.1%) for a purchase price of $55,000, consisting of $21,500 in cash and a $33,500 promissory note with an interest rate of 9%. (Refer to Note 4.)

18. SEGMENT INFORMATION

The Company's major operations are in tobacco products, principally cigarettes, and real estate development. The tobacco segment operates in the United States and in Russia; real estate activities are conducted in Russia. Total assets of the foreign real estate and tobacco operations included in the consolidated balance sheet at December 31, 1996 and 1995 were approximately $72,296 and $45,400, respectively. (Refer to Note 4.)

Industry Segment:

1996	Tobacco	Real Estate	Corporate and Others	Consolidated
Net sales..................	$447,522	$ 2,675	$ 2,459	$452,656
Operating income...........	4,805	99	(8,831)	(3,927)
Identifiable assets........	114,648	55,012	8,017	177,677
Capital expenditures.......	8,861	25,318	62	34,241
Depreciation and amortization.............	8,185	253	381	8,819

1995	Tobacco	Real Estate	Corporate and Others	Consolidated
Net sales..................	$455,666		$ 5,793	$461,459
Operating income...........	16,725	$ (1,990)	(6,675)	8,060
Identifiable assets........	123,144	31,149	71,327	225,620
Capital expenditures.......	1,104	7,229	472	8,805
Depreciation and amortization.............	7,972		1,104	9,076

BROOKE GROUP LTD.
BGLS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in Thousands, Except Per Share Amounts) - (continued)

Geographic Area:

1996	United States	Russia	Consolidated
Net sales	$403,521	$49,135	$452,656
Operating income	6,045	(9,972)	(3,927)
Identifiable assets	105,381	72,296	177,677

19. SUPPLEMENTAL CASH FLOW INFORMATION

In accordance with the requirements of SFAS No. 95, "Statement of Cash Flows," supplemental cash flow information is disclosed below:

	Year Ended December 31,		
	1996	1995	1994
I. Cash paid during the period for:			
Interest	$57,362	$60,158	$39,429
Income taxes, net of refunds	582	1,735	605
II. Non-cash investing and financing activities:			
Dividends payable	$ 1,387		$ 131
Issuance and exchange of long-term debt			114,888
Distribution of MAI to stockholders		$27,085	
Series G dividend			3,200
Shareholder settlement			6,250
Transfer of pension liability to SkyBox			4,305
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		

BROOKE GROUP LTD.
BGLS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in Thousands, Except Per Share Amounts) - (continued)

20. QUARTERLY FINANCIAL RESULTS (UNAUDITED)

Quarterly data for the years ended December 31, 1996 and 1995 are as follows:

	December 31, 1996	September 30, 1996	June 30, 1996	March 31, 1996
Revenues	$122,292	$114,635	$125,213	$90,516
Gross profit	55,590	56,274	61,691	43,468
Loss from continuing operations	(22,732)	(13,737)	(10,672)	(17,777)
Income from discontinued operations	2,385			
Net loss applicable to common shares	(20,347)	(13,737)	(10,672)	(15,995)
Per share data:				
Loss from continuing operations	$(1.23)	$(0.74)	$(0.58)	$(0.86)
Income from discontinued operations	$ 0.13	$	$	$
Net loss applicable to common shares	$(1.10)	$(0.74)	$(0.58)	$(0.86)
SHARE PRICES:				
High	5 3/4	6 1/4	8 7/8	10 1/8
Low	4 1/4	4 5/8	5 5/8	7 3/4

	December 31, 1995	September 30, 1995	June 30, 1995	March 31, 1995
Revenues	$119,741	$124,100	$122,328	$95,290
Gross profit	62,320	69,474	64,566	48,912
Loss from continuing operations	(17,671)	(1,124)	(13,639)	(12,910)
Income from discontinued operations	5,231	98	1,114	14,786
Extraordinary items	(9,810)			
Net (loss) income applicable to common shares	(22,269)	1,772	(1,571)	4,945
Per share data:				
(Loss) income from continuing operations	$(0.97)	$ 0.09	$(0.15)	$(0.53)
Income from discontinued operations	$ 0.29	$ 0.01	$ 0.06	$ 0.80
Extraordinary items	$(0.54)	$	$	$
Net (loss) income applicable to common shares	$(1.22)	$ 0.10	$(0.09)	$ 0.27
SHARE PRICES:				
High	9 7/8	11 3/8	5 1/2	4 1/4
Low	6 5/8	4 3/8	3 1/8	3 15/64

BROOKE GROUP LTD.
BGLS INC.
SCHEDULE II -- VALUATION AND QUALIFYING ACCOUNTS

(Dollars in Thousands)

Description	Balance at Beginning of Period	Additions: Charged to Costs and Expenses	Additions: Charged to Other Accounts	Deductions	Balance at End of Period
YEAR ENDED DECEMBER 31, 1996					
Allowances for:					
Doubtful accounts	$ 921	$ 903		$ 1,074	$ 750
Cash discounts	615	13,929		14,014	530
Sales returns	5,000				5,000
Total	$ 6,536	$14,832	$	$ 15,088	$ 6,280
Provision for inventory obsolescence	$ 2,641	$ 1,341	$	$ 764	$ 3,218
YEAR ENDED DECEMBER 31, 1995					
Allowances for:					
Doubtful accounts	$ 249	$ 260	$ 692(b)	$ 280	$ 921
Cash discounts	720	14,579		14,684	615
Sales returns	5,800	1,030	(800)(a)	1,030	5,000
Total	$ 6,769	$15,869	$ (108)	$15,994	$ 6,536
Provision for inventory obsolescence	$ 1,369	$ 1,072	$ 630(b)	$ 430	$ 2,641
YEAR ENDED DECEMBER 31, 1994					
Allowances for:					
Doubtful accounts	$ 235	$ 21		$ 7	$ 249
Cash discounts	745	12,337		12,362	720
Sales returns	6,300		$ 2,800(a)	3,300	5,800
Total	$ 7,280	$ 12,358	$ 2,800	$15,669	$ 6,769
Provision for inventory obsolescence	$ 1,418	$ 520	$	$ 569	$ 1,369

(a) Charged to net sales.

(b) Amounts include impact of consolidating Liggett-Ducat.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and the
Shareholders of New Valley Corporation

We have audited the accompanying consolidated balance sheets of New Valley Corporation and subsidiaries as of December 31, 1996 and 1995, and the related consolidated statements of operations, changes in shareholders' equity (deficit), and cash flows for the years then ended. We have also audited the financial statement schedule of New Valley Corporation (Schedule III - Real Estate and Accumulated Depreciation as of December 31, 1996) listed in the index on page 26 of this Form 10-K. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We did not audit the financial statements of Thinking Machines Corporation, a consolidated subsidiary, which statements reflect total assets constituting 3% of consolidated total assets at December 31, 1996 and a net loss (net of minority interest therein) constituting 90% of the consolidated net loss for the year ended December 31, 1996. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Thinking Machines Corporation, are based solely on the report of the other auditors.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of the other auditors provides a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of New Valley Corporation and subsidiaries at December 31, 1996 and 1995, and the consolidated results of their operations and their cash flows for the years then ended in conformity with generally accepted accounting principles. In addition, in our opinion, the financial statement schedule referred to above, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information required to be included therein.

/s/ Coopers & Lybrand L.L.P.

COOPERS & LYBRAND L.L.P.

Miami, Florida
March 24, 1997

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and the
Shareholders of New Valley Corporation

In our opinion, the consolidated financial statements for the year ended December 31, 1994, appearing under Item 14(a)(1) and (2) present fairly, in all material respects, the results of operations and cash flows of New Valley Corporation and its subsidiaries (the "Company"), for the year, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for the opinion expressed above.

/s/ Price Waterhouse LLP

PRICE WATERHOUSE LLP

Morristown, New Jersey
March 24, 1995

NEW VALLEY CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	DECEMBER 31, 1996	DECEMBER 31, 1995
ASSETS		
Current assets:		
Cash and cash equivalents	$ 57,282	$ 51,742
Investment securities available for sale	61,454	210,315
Trading securities owned	29,761	31,211
Restricted assets	2,080	22,919
Receivable from clearing brokers	23,870	13,752
Other current assets	9,273	3,546
Total current assets	183,720	333,485
Investment in real estate	179,571	--
Investment securities available for sale	2,716	517
Restricted assets	6,766	15,086
Long-term investments, net	13,270	29,512
Other assets	20,497	7,222
Total assets	$406,540	$385,822
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable and accrued liabilities	$ 44,888	$ 27,712
Prepetition claims and restructuring accruals	15,526	33,392
Income taxes	18,243	20,283
Securities sold, not yet purchased	17,143	13,047
Margin loan payable	--	75,119
Current portion of notes payable and long-term obligations	2,310	8,367
Total current liabilities	98,110	177,920
Notes payable	157,941	--
Other long-term liabilities	12,282	11,967
Redeemable preferred shares	210,571	226,396
Commitments and contingencies		
Shareholders' equity (deficit):		
Cumulative preferred shares; liquidation preference of $69,769, dividends in arrears: 1996 -- $115,944; 1995 -- $95,118	279	279
Common Shares, $.01 par value; 850,000,000 shares authorized; 9,577,624 and 191,551,586 shares outstanding	96	1,916
Additional paid-in capital	644,789	679,058
Accumulated deficit	(721,854)	(714,364)
Unearned compensation on stock options	(731)	--
Unrealized gain on investment securities, net of taxes of $294 in 1995	5,057	2,650
Total shareholders' equity (deficit)	(72,364)	(30,461)
Total liabilities and shareholders' equity (deficit)	$406,540	$385,822

See accompanying Notes to Consolidated Financial Statements

NEW VALLEY CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	YEAR ENDED DECEMBER 31,		
	1996	1995	1994
Revenues:			
Principal transactions, net	$ 28,344	$ 18,237	
Commissions	17,755	9,888	
Real estate leasing	23,559	--	
Interest and dividends	16,951	21,047	$ 7,104
Other income	25,345	18,558	3,277
Total revenues	111,954	67,730	10,381
Costs and expenses:			
Employee compensation and benefits	60,884	30,994	219
Interest	17,760	2,102	643
Provision for (recovery of) restructuring charges	(9,706)	(2,044)	22,734
Write-down of long-term investments (Note 8)	1,001	11,790	--
Other expenses	58,270	23,222	2,550
Total costs and expenses	128,209	66,064	26,146
Income (loss) from continuing operations before income taxes, minority interests and extraordinary item	(16,255)	1,666	(15,765)
Income tax provision (benefit)	300	292	(500)
Minority interests in loss from continuing operations of consolidated subsidiary	3,339	--	--
Income (loss) from continuing operations before extraordinary item	(13,216)	1,374	(15,265)
Discontinued operations (Note 4):			
Income (loss) from discontinued operations, net of minority interests of $2,404 in 1996, and income taxes of $480 in 1995 and $5,500 in 1994	(3,818)	4,315	79,625
Gain on disposal of discontinued operations, net of minority interests of $1,502 in 1996, and income taxes of $1,400 in 1995 and $52,000 in 1994	9,544	12,558	1,056,081
Income from discontinued operations	5,726	16,873	1,135,706
Income (loss) before extraordinary item	(7,490)	18,247	1,120,441
Extraordinary loss on extinguishment of debt, net of income taxes of $3,475 (Note 17)	--	--	(110,500)
Net income (loss)	(7,490)	18,247	1,009,941
Dividend requirements on preferred shares	(61,949)	(72,303)	(80,037)
Excess of carrying value of redeemable preferred shares over cost of shares purchased	4,279	40,342	--
Net income (loss) applicable to Common Shares	$ (65,160)	$ (13,714)	$ 929,904
Income (loss) per common share:			
Continuing operations before extraordinary item	$ (7.40)	$ (3.20)	$ (10.12)
Discontinued operations	.60	1.77	120.63
Before extraordinary item	(6.80)	(1.43)	110.51
Extraordinary item	--	--	(11.74)
Net income (loss)	$ (6.80)	$ (1.43)	$ 98.77
Number of shares used in computation	9,578,000	9,554,000	9,415,000
Income (loss) per common share assuming full dilution:			
Continuing operations before extraordinary item	$ (7.40)	$ (3.20)	$ (9.00)
Discontinued operations	.60	1.77	107.36
Before extraordinary item	(6.80)	(1.43)	98.36
Extraordinary item	--	--	(10.45)
Net income (loss)	$ (6.80)	$ (1.43)	$ 87.91
Number of shares used in computation	9,578,000	9,554,000	10,578,000
Supplemental information:			
Additional interest expense, absent the Chapter 11 filing		$ 2,314	$ 46,927

See accompanying Notes to Consolidated Financial Statements.

NEW VALLEY CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIT)
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	CLASS B PREFERRED SHARES	COMMON SHARES	ADDITIONAL PAID-IN CAPITAL	ACCUMULATED DEFICIT	UNEARNED COMPENSATION ON STOCK OPTIONS	UNREALIZED GAINS
Balance December 31, 1993	$279	$1,881	$755,521	$(1,742,552)		
Net income				1,009,941		
Undeclared dividends and accretion on redeemable preferred shares			(63,635)			
Conversion of preferred shares						
Exercise of stock options		6	115			
Balance, December 31, 1994	279	1,887	692,001	(732,611)		
Net income				18,247		
Undeclared dividends and accretion on redeemable preferred shares			(53,821)			
Purchase of redeemable preferred shares			40,342			
Exercise of stock options		29	536			
Unrealized gain on investment securities, net of taxes						$2,650
Balance, December 31, 1995	279	1,916	679,058	(714,364)		2,650
Net loss				(7,490)		
Undeclared dividends and accretion on redeemable preferred shares			(41,123)			
Purchase of redeemable preferred shares			4,279			
Effect of 1-for-20 reverse stock split		(1,820)	1,820			
Issuance of stock options			755		$(755)	
Compensation expense on stock option grants					24	
Unrealized gain on investment securities						2,407
Balance, December 31, 1996	$279	$ 96	$644,789	$ (721,854)	$(731)	$5,057

See accompanying Notes to Consolidated Financial Statements

NEW VALLEY CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	YEAR ENDED DECEMBER 31,		
	1996	1995	1994
Cash flows from operating activities:			
Net income (loss)	$ (7,490)	$ 18,247	$ 1,009,941
Adjustments to reconcile net income (loss) to net cash used for operating activities:			
Gain on disposal of business	(9,544)	(12,558)	(1,056,081)
Loss (income) from discontinued operations	3,818	(4,315)	(79,625)
Depreciation and amortization	4,757	608	--
Provision for loss on long-term investments	1,001	11,790	--
Reversal of restructuring accruals	(9,706)	(2,044)	(318)
Extraordinary loss	--	--	110,500
Financial restructuring costs	--	--	23,052
Changes in assets and liabilities, net of effects from acquisition:			
Decrease (increase) in receivables and other assets	(16,069)	11,684	(7,571)
Decrease in income taxes payable and deferred taxes	(2,040)	(32,517)	--
Increase (decrease) in securities sold not yet purchased	4,096	(9,359)	--
Increase (decrease) in accounts payable and accrued liabilities	6,437	5,223	(16,896)
Net cash used for continuing operations	(24,740)	(13,241)	(16,998)
Net cash provided from discontinued operations	2,041	6,105	139,410
Net cash used for operating activities	(22,699)	(7,136)	122,412
Cash flows from investing activities:			
Sale or maturity of investment securities	160,088	250,129	--
Purchase of investment securities	(12,825)	(458,017)	--
Sale or liquidation of long-term investments	18,292	36,109	--
Purchase of long-term investments	(3,051)	(77,411)	--
Decrease (increase) in restricted assets	29,159	341,634	(367,378)
Purchase of furniture and equipment	(5,240)	--	--
Purchase of and additions to real estate	(24,496)	--	--
Payment of prepetition claims and restructuring accruals	(8,160)	(584,397)	--
Payment for acquisitions, net of cash acquired	1,915	(25,750)	--
Collection of contract receivable	--	300,000	--
Net proceeds from disposal of business	10,174	17,540	467,822
Net cash provided from (used for) investing activities	165,856	(200,163)	100,444
Cash flows from financing activities:			
Payment of preferred dividends	(41,419)	(132,162)	
Purchase of redeemable preferred shares	(10,530)	(47,761)	
Increase (decrease) in margin loan payable	(75,119)	75,119	
Payment of long-term notes and other liabilities	(10,549)	(12,890)	
Exercise of stock options	--	565	
Net cash used for financing activities	(137,617)	(117,129)	
Expenses of financial restructuring	--	--	(23,052)
Net increase (decrease) in cash and cash equivalents	5,540	(324,428)	199,804
Cash and cash equivalents, beginning of year	51,742	376,170	176,366
Cash and cash equivalents, end of year	$ 57,282	$ 51,742	$ 376,170
Supplemental cash flow information:			
Cash paid during the year for:			
Interest	$ 17,482	$ 2,105	$ 476
Income taxes	2,341	33,662	882
Non-cash investing and financing activities:			
Contract receivable			300,000
Pension liability discharge			245,000
Detail of acquisitions:			
Fair value of assets acquired	$ 27,301	$ 59,066	
Liabilities assumed	16,701	32,316	
Cash paid	10,600	26,750	
Less cash acquired	12,515	1,000	
Net cash paid (received) for acquisition	$ (1,915)	$ 25,750	

See accompanying Notes to Consolidated Financial Statements.

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

1. BASIS OF PRESENTATION

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of New Valley Corporation and its majority owned subsidiaries (the "Company"). All significant intercompany transactions are eliminated in consolidation.

Certain amounts in the 1994 and 1995 financial statements have been reclassified to conform to the 1996 presentation.

NATURE OF OPERATIONS

The Company and its subsidiaries are engaged in the investment banking and brokerage business, in the ownership and management of commercial real estate, and in the acquisition of operating companies.

REORGANIZATION

On November 15, 1991, an involuntary petition under Chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code") was commenced against the Company in the United States Bankruptcy Court for the District of New Jersey (the "Bankruptcy Court"). On March 31, 1993, the Company consented to the entry of an order for relief placing it under the protection of Chapter 11 of the Bankruptcy Code.

On November 1, 1994, the Bankruptcy Court entered an order confirming the First Amended Joint Chapter 11 Plan of Reorganization, as amended (the "Joint Plan"). The terms of the Joint Plan provided for, among other things, the sale of Western Union Financial Services Company, Inc. ("FSI"), a wholly-owned subsidiary of the Company, and certain other Company assets related to FSI's money transfer business, payment in cash of all allowed claims, payment of postpetition interest in the amount of $178,000 to certain creditors, a $50 per share cash dividend to the holders of the Company's $15.00 Class A Increasing Rate Cumulative Senior Preferred Shares ($100 Liquidation Value), $.01 par value per share (the "Class A Senior Preferred Shares"), a tender offer by the Company for up to 150,000 shares of the Class A Senior Preferred Shares, at a price of $80 per share, and the reinstatement of all of the Company's equity interests.

On November 15, 1994, pursuant to the Asset Purchase Agreement, dated as of October 20, 1994, as amended (the "Purchase Agreement"), by and between the Company and First Financial Management Corporation ("FFMC"), FFMC purchased all of the common stock of FSI and other assets relating to FSI's money transfer business for $1,193,000 (the "Purchase Price"). The Purchase Price consisted of $593,000 in cash, $300,000 representing the assumption of the Western Union Pension Plan obligation, and $300,000 paid on January 13, 1995 for certain intangible assets of FSI. The Purchase Agreement contained various terms and conditions, including the escrow of $45,000 of the Purchase Price, a put option by the Company to sell to FFMC, and a call option by FFMC to purchase, Western Union Data Services Company, Inc., a wholly-owned subsidiary of the Company engaged in the messaging service business (the "Messaging Services Business"), for $20,000, exercisable during the first quarter of 1996, and various services agreements between the Company and FFMC.

On January 18, 1995, the effective date of the Joint Plan, the Company paid approximately $550,000 on account of allowed prepetition claims and emerged from bankruptcy. At December 31, 1996, the Company had accrued $15,526 for unsettled prepetition claims and restructuring accruals (see Note 17).

On October 31, 1995, the Company completed the sale of substantially all of the assets (exclusive of certain contracts), and conveyed substantially all of the liabilities of the Messaging Services Business to FFMC for $20,000, which consisted of $17,540 in cash and $2,460 in cancellation of intercompany indebtedness. The sale of the Messaging Services Business was effective as of October 1, 1995, and the Company recognized a gain on the sale of such business of $12,558, net of income taxes of $1,400.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Estimates. 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.

Reincorporation and Reverse Stock Split. On July 29, 1996, the Company completed its reincorporation from the State of New York to the State of Delaware and effected a one-for-twenty reverse stock split of the Company's Common Shares. In connection with the reverse stock split, all per share data have been restated to reflect retroactively the reverse stock split.

Cash and Cash Equivalents. The Company considers all highly liquid financial instruments with an original maturity of less than three months to be cash equivalents.

Fair Value of Financial Instruments. Investments in securities and securities sold, not yet purchased traded on a national securities exchange or listed on NASDAQ are valued at the last reported sales prices of the reporting period. Futures contracts are valued at their last reported sales price. Investments in securities, principally warrants, which have exercise or holding period restrictions, are valued at fair value as determined by the Company's management based on the intrinsic value of the warrants discounted for such restrictions. For cash and cash equivalents, restricted assets, receivable from clearing brokers, and short-term loan, the carrying value of these amounts is a reasonable estimate of their fair value. The fair value of long-term debt, including current portion, is estimated based on current rates offered to the Company for debt of the same maturities. The fair value of the Company's redeemable preferred shares is based on their last reported sales price.

Investment Securities. The Company follows the provisions of Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities", which requires certain investments in debt and marketable equity securities be classified as either trading, available for sale, or held to maturity. Trading securities are carried at fair value, with unrealized gains and losses included in income. Investments classified as available for sale are carried at fair value, with net unrealized gains and losses included as a separate component of shareholders' equity (deficit). Debt securities classified as held to maturity are carried at amortized cost. Realized gains and losses are included in other income, except for those relating to the Company's broker-dealer subsidiary which are included in principal transactions revenues. The cost of securities sold is determined based on average cost.

Restricted Assets. Restricted assets at December 31, 1996 consisted primarily of $5,266 pledged as collateral for a $5,000 letter of credit which is used as collateral for a long-term lease of commercial office space, and $3,275 pledged as collateral for a letter of credit which is used as collateral for an insurance policy. At December 31, 1995, the current and noncurrent portions of restricted assets consisted primarily of $28,200 held in escrow pursuant to the sale of FSI to FFMC, which have been classified based on the terms of the Purchase Agreement and the anticipated release of the escrow. Restricted assets consisted of investments in U.S. government bonds. In 1996, the Company reached an agreement with FFMC whereby FFMC released all of the remaining restricted assets held in escrow. In addition, the agreement required the Company to pay FFMC $7,000 in connection with the termination of the various service agreements the Company had with FFMC. The Company recognized a gain on the termination of these service agreements of $1,285, which amount is included in other income.

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

Property and Equipment. Buildings are depreciated over periods approximating 40 years, the estimated useful life, using the straight-line method (see Note 7). Furniture and equipment (including equipment subject to capital leases) is depreciated over the estimated useful lives, using the straight-line method. Leasehold improvements are amortized on a straight-line basis over their estimated useful lives or the lease term, if shorter. The cost and the related accumulated depreciation are eliminated upon retirement or other disposition and any resulting gain or loss is reflected in operations. As of December 31, 1996 and 1995, furniture, equipment and leasehold improvements had a carrying value of $9,225 and $1,032, respectively. Depreciation and amortization expense was $4,757, $608 and $9,000 in 1996, 1995 and 1994, respectively. Depreciation and amortization expense for 1994 is included in discontinued operations.

Income Taxes. Under SFAS 109, "Accounting for Income Taxes", deferred taxes reflect the impact of temporary differences between the amounts of assets and liabilities recognized for financial reporting purposes and the amounts recognized for tax purposes as well as tax credit carryforwards and loss carryforwards. These deferred taxes are measured by applying currently enacted tax rates. A valuation allowance reduces deferred tax assets when it is deemed more likely than not that some portion or all of the deferred tax assets will not be realized.

Securities Sold, Not Yet Purchased. Securities sold, not yet purchased represent obligations of the Company to deliver a specified security at a contracted price and thereby create a liability to repurchase the security in the market at prevailing prices. Accordingly, these transactions involve, to varying degrees, elements of market risk, as the Company's ultimate obligation to satisfy the sale of securities sold, not yet purchased may exceed the amount recognized in the consolidated balance sheet.

Real Estate Leasing Revenues. The real estate properties are being leased to tenants under operating leases. Base rental revenue is generally recognized on a straight-line basis over the term of the lease. The lease agreements for certain properties contain provisions which provide for reimbursement of real estate taxes and operating expenses over base year amounts, and in certain cases as fixed increases in rent. In addition, the lease agreements for certain tenants provide additional rentals based upon revenues in excess of base amounts, and such amounts are accrued as earned. The future minimum rents on non-cancelable operating leases at December 31, 1996 are $18,620, $18,492, $14,827, $12,073, $9,319 for the years 1997, 1998, 1999, 2000, 2001, respectively, and $38,246 for subsequent years.

Income (Loss) Per Common Share. Net income (loss) per common share is based on the weighted average number of Common Shares outstanding. Net income (loss) per common share represents net income (loss) after dividend requirements on redeemable and non-redeemable preferred shares (undeclared) and any adjustment for the difference between excess of carrying value of redeemable preferred shares over the cost of the shares purchased. Net income (loss) per common share assuming full dilution is based on the weighted average number of Common Shares outstanding plus the additional common shares resulting from the conversion of convertible preferred shares if such conversion was dilutive.

Recoverability of Long-Lived Assets. An impairment loss is recognized whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Beginning in 1995 with the adoption of SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of", assets are grouped and evaluated at the lowest level for which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets. The Company considers historical performance and future estimated results in its evaluation of potential impairment and then compares the carrying amount of the asset to the estimated future cash flows expected to result from the use of the asset. If the carrying amount of the asset exceeds estimated expected undiscounted future cash flows, the Company measures the amount of the impairment by comparing the carrying amount of the asset to its fair value. The estimation of fair value is generally measured by discounting expected future cash flows at the rate the Company utilizes to evaluate potential investments. The Company estimates fair value based on the best information available making whatever estimates, judgments and projections are considered necessary.

New Accounting Pronouncements. In February 1997, the Financial Accounting Standards Board issued SFAS No. 128, "Earnings Per Share". SFAS 128 specifies new standards designed to improve the earnings per share ("EPS") information provided in financial statements by simplifying the existing computational guidelines, revising the disclosure requirements, and increasing the comparability of EPS data on an international basis. Some of the changes made to simplify the EPS computations include: (a) eliminating the presentation of primary EPS and replacing it with basic EPS, with the principal difference being that common stock equivalents (CSEs) are not considered in computing basic EPS, (b) eliminating the modified treasury stock method and the three percent materiality provision, and (c) revising the contingent share provisions and the supplemental EPS data requirements. SFAS 128 also makes a number of changes to existing disclosure requirements. SFAS 128 is effective for financial statements issued for periods ending after December 15, 1997, including interim periods. The Company has not yet determined the impact of the implementation of SFAS 128.

3. ACQUISITIONS

On May 31, 1995, the Company consummated its acquisition of Ladenburg, Thalmann & Co. Inc. ("Ladenburg"), a registered broker-dealer and investment bank, for $25,750, net of cash acquired. The acquisition was treated as a purchase for financial reporting purposes and, accordingly, these consolidated financial statements include the operations of Ladenburg from the date of acquisition. The excess of the consideration paid over the estimated fair value of net assets acquired of $1,342 has been recorded as goodwill to be amortized on a straight-line basis over 15 years.

On January 10 and January 11, 1996, the Company acquired four commercial office buildings (the "Office Buildings") and eight shopping centers (the "Shopping Centers") for an aggregate purchase price of $183,900, consisting of $23,900 in cash and $160,000 in non-recourse mortgage financing. In addition, the Company has capitalized approximately $800 in costs related to the acquisitions. The Company paid $11,400 in cash and executed four promissory notes aggregating $100,000 for the Office Buildings. The Shopping Centers were acquired for an aggregate purchase price of $72,500, consisting of $12,500 in cash and $60,000 in eight promissory notes.

On January 11, 1996, the Company provided a $10,600 convertible bridge loan to finance Thinking Machines Corporation ("Thinking Machines"), a developer and marketer of data mining and knowledge discovery software and services. In February 1996, the bridge loan was converted into a controlling interest in a partnership which holds 3.3 million common shares of Thinking Machines which represent 61.4% of Thinking Machines' outstanding common shares. The acquisition of Thinking Machines through the conversion of the bridge loan was accounted for as a purchase for financial reporting purposes, and accordingly, the operations of Thinking Machines subsequent to January 31, 1996 are included in the operations of the Company. The fair value of assets acquired, including goodwill of $1,726, was $27,301 and liabilities assumed totaled $7,613. In addition, minority interests in the amount of $9,088 were recognized at the time of acquisition. Thinking Machines is also subject to uncertainties relating to, without limitation, the development and marketing of computer products, including customer acceptance and required funding, technological changes, capitalization, and the ability to utilize and exploit its intellectual property and propriety software technology.

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

The following table presents unaudited pro forma and actual results of continuing operations as if the acquisitions of Ladenburg, Thinking Machines, and the Office Buildings and Shopping Centers, had occurred on January 1, 1995. These pro forma results have been prepared for comparative purposes only and do not purport to be indicative of what would have occurred had each of these acquisitions been consummated as of such date.

	YEAR ENDED DECEMBER 31,	
	1996	1995
Revenues	$ 111,954	$116,315
Loss from continuing operations	$ (13,532)	$ (3,715)
Loss from continuing operations applicable to common shares	$ (71,202)	$(35,676)
Loss from continuing operations per common share	$ (7.43)	$ (3.73)

4. DISCONTINUED OPERATIONS

As noted above, the Company sold FSI during the fourth quarter of 1994 and sold the Messaging Services Business effective October 1, 1995. During the fourth quarter of 1996, 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. Thinking Machines wrote-down certain assets, principally inventory, related to these operations to their net realizable value and recorded a charge of $6,100 for these reserves, which is included in the loss on discontinued operations. Accordingly, the financial statements reflect the financial position and the results of operations of the discontinued operations of FSI, the Messaging Services Business, and Thinking Machines separately from continuing operations.

Summarized operating results of the discontinued operations, as shown below, include the discontinued operations of Thinking Machines for the eleven months ended December 31, 1996, the Messaging Services Business for the nine months ended September 30, 1995 and the operations of FSI and Messaging Services Business for the year ended December 31, 1994.

	YEAR ENDED DECEMBER 31,		
	1996	1995	1994
Revenues	$15,017	$37,771	$489,916
Operating (loss) income	$(6,222)	$ 4,795	$ 85,125
Income before income taxes and minority interests	$(6,222)	$ 4,795	$ 85,125
Provision for income taxes	--	480	5,500
Minority interests	2,404	--	--
Net (loss) income	$(3,818)	$ 4,315	$ 79,625

In December 1996, Thinking Machines sold part of its discontinued operations for $4,300 in cash which resulted in the Company recording a gain on disposal of discontinued operations of $2,386, net of minority interests of $1,502. No material gain or loss in the disposal of Thinking Machines' remaining discontinued operations is anticipated.

During the fourth quarter of 1996, the Company received $5,774 in cash and $600 in a promissory note in settlement of a receivable claim originally began by Western Union Telegraph Company. The promissory note is payable $100 per month for six months. In addition, the Company reduced its liability related to certain Western Union retirees by $784. The Company recorded the gain on settlement of $6,374 and liability reduction of $784 as gain on disposal of discontinued operations.

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

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 net realized gains on sales of investment securities available for sale of $1,347 ($6,114 of realized gains and $4,767 of realized losses) for the year ended December 31, 1996, and $6,736 ($9,223 of realized gains and $2,487 of realized losses) for the year ended December 31, 1995.

The components of investment securities available for sale are as follows:

	COST	GROSS UNREALIZED GAIN	GROSS UNREALIZED LOSS	FAIR VALUE
1996				
Marketable equity securities:				
RJR Nabisco common stock....................	$ 53,372	$5,827		$ 59,199
Other marketable securities.................	2,057	674	$ 476	2,255
Total marketable equity securities........................	55,429	6,501	476	61,454
Marketable debt securities (long-term)........	3,685		969	2,716
Total securities available for sale...........	59,114	6,501	1,445	64,170
Less long-term portion of investment securities.................................	(3,685)		(969)	(2,716)
Investment securities -- current portion......	$ 55,429	$6,501	$ 476	$ 61,454
1995				
Marketable equity securities:				
RJR Nabisco common stock....................	$149,005	$1,441		$150,446
Other marketable securities.................	9,147	1,667	$ 308	10,506
Total marketable equity securities........................	158,152	3,108	308	160,952
U.S. government securities....................	49,219	144	--	49,363
Marketable debt securities (long-term)........	517	--	--	517
Total investment securities..................	207,888	3,252	308	210,832
Less long-term portion of investment securities.................................	(517)	--	--	(517)
Investment securities -- current portion......	$207,371	$3,252	$ 308	$210,315

As of December 31, 1996, the long-term portion of investment securities available for sale consisted of marketable debt securities which mature in two years. In December 1996, the Company acquired marketable debt securities with a face amount of $14,900 for a cost of $3,185 of a company that was in default at the time of purchase and is currently in default under its various debt obligations.

As of December 31, 1996, the Company, through a wholly-owned subsidiary, held approximately 1.7 million shares of RJR Nabisco Holdings Corp. ("RJR Nabisco") common stock with a market value of $59,199 (cost of $53,372). On December 31, 1995, the Company held approximately 4.9 million shares of RJR Nabisco common stock which collateralized margin loan financing of $75,119.

On October 17, 1995, the Company entered into an agreement, as amended (the "Agreement"), with High River Limited Partnership ("High River"), an entity owned by Carl C. Icahn. Pursuant to the Agreement, the Company sold approximately 1.6 million shares of RJR Nabisco common stock to High River for an aggregate purchase price of $51,000. The Agreement also provided for the parties to pay certain other fees to each other under certain circumstances, including a fee to High River equal to 20% of the Company's profit on its RJR Nabisco common stock, after certain expenses as defined in the Agreement.

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

On December 27, 1995, the Company entered into an agreement with Brooke Group Ltd. ("Brooke"), an affiliate of the Company, pursuant to which it agreed to pay directly or reimburse Brooke and its subsidiaries for reasonable out-of-pocket expenses incurred in connection with Brooke's solicitation of consents and proxies from the shareholders of RJR Nabisco. The Company also agreed to pay to a wholly-owned subsidiary of Brooke a fee of 20% of the net profit received by the Company or its subsidiaries from the sale of shares of RJR Nabisco common stock after the Company and its subsidiaries have achieved a rate of return of 20% and after deduction of certain expenses incurred by the Company and its subsidiaries, including the cost of the consent and proxy solicitations and of acquiring the shares of common stock. The Company has also agreed to indemnify Brooke and its affiliates against certain liabilities arising out of the solicitations.

On December 28, 1995, the Company, Brooke and Liggett, a wholly-owned subsidiary of Brooke, engaged Jefferies & Company, Inc. ("Jefferies") to act as a financial advisor in connection with the Company's investment in RJR Nabisco and Brooke's solicitation of consents and proxies. In connection with this engagement, the Company paid Jefferies $1,538 and $1,500 in 1996 and 1995, respectively. The companies also have agreed to pay Jefferies 10% of the net profit (up to a maximum of $15,000) with respect to RJR Nabisco common stock (including the distributions made by RJR Nabisco) held or sold by these companies and their affiliates after deduction of certain expenses, including the costs of the solicitations and the costs of acquiring the RJR Nabisco common stock.

As of June 5, 1996, the Company and High River terminated the Agreement by mutual consent. The termination leaves in effect for one year certain provisions of the Agreement concerning payments to be made to High River in the event the Company achieves a profit (after deducting certain expenses) on its shares of RJR Nabisco common stock or such shares are valued at the end of such year at higher than their purchase price or in the event the Company or Brooke engage in certain transactions with RJR Nabisco.

The Company expensed $11,724 in 1996 and $3,879 in 1995 relating to the RJR Nabisco investment. Included in this amount is $2,370 in out-of-pocket expenses paid to Brooke in 1996 pursuant to the Brooke agreement. At March 14, 1997, the Company held approximately 1,063,000 shares of RJR Nabisco common stock with a market value of $35,997 (cost of $32,574). The Company's investment in RJR Nabisco decreased from a $5,827 unrealized gain at December 31, 1996 to a $3,423 unrealized gain at March 14, 1997. Based on the market price of the RJR Nabisco common stock at March 14, 1997, no amounts are payable by the Company under any of its net profit-sharing arrangements with respect to the RJR Nabisco common stock discussed above.

On February 29, 1996, the Company entered into a total return equity swap transaction (the "Swap") with an unaffiliated company relating to 1,000,000 shares of RJR Nabisco common stock. The Swap was for a period of six months and the Company realized a loss on the Swap of $7,305 for the year ended December 31, 1996.

6. TRADING SECURITIES OWNED AND SECURITIES SOLD, NOT YET PURCHASED

The components of trading securities owned and securities sold, not yet purchased are as follows:

	DECEMBER 31, 1996		DECEMBER 31, 1995	
	TRADING SECURITIES OWNED	SECURITIES SOLD, NOT YET PURCHASED	TRADING SECURITIES OWNED	SECURITIES SOLD, NOT YET PURCHASED
Common stock	$21,248	$ 5,900	$21,828	$ 2,754
Equity and index options	6,241	11,243	6,134	10,293
Other	2,272	--	3,249	--
	$29,761	$17,143	$31,211	$13,047

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

7. INVESTMENT IN REAL ESTATE AND NOTES PAYABLE

The components of the Company's investment in real estate and the related non-recourse notes payable collateralized by such real estate at December 31, 1996 are as follows:

	OFFICE BUILDINGS	SHOPPING CENTERS	TOTAL
Land	$ 19,450	$16,710	$ 36,160
Buildings	92,332	54,468	146,800
Construction-in-progress	--	233	233
Total	111,782	71,411	183,193
Less accumulated depreciated	(2,308)	(1,314)	(3,622)
Net investment in real estate	$109,474	$70,097	$179,571
Notes payable	$ 99,704	$58,547	$158,251
Current portion of notes payable	310	--	310
Notes payable -- long-term portion	$ 99,394	$58,547	$157,941

At December 31, 1996, the Company's investment in real estate collateralized four promissory notes aggregating $99,704 related to the Office Buildings and eight promissory notes aggregating $58,547 related to the Shopping Centers. The Office Building notes bear interest at 7.5%, require principal amortization over approximately 40 years, with maturity dates ranging from 2006 to 2011. The Office Building notes have fixed monthly principal and interest payments aggregating $648. Each Shopping Center note has a term of five years, requires no principal amortization, and bears interest payable monthly at the rate of 8% for the first two and one-half years and at the rate of 9% for the remainder of the term.

Required principal payments on the notes payable over the next five years are $310 in 1997, $336 in 1998, $361 in 1999, $390 in 2000, and $58,967 in 2001.

8. LONG-TERM INVESTMENTS

Long-term investments consisted of investments in the following:

	DECEMBER 31, 1996		DECEMBER 31, 1995	
	CARRYING VALUE	FAIR VALUE	CARRYING VALUE	FAIR VALUE
Limited partnerships	$ 7,054	$ 7,914	$18,715	$23,200
Foreign corporations	2,000	2,000	6,000	6,000
Joint venture	3,796	3,796	3,796	3,796
Other	420	420	1,001	1,001
Total	$13,270	$14,130	$29,512	$33,997

The principal business of the limited partnerships is investing in investment securities. The estimated fair value of the limited partnerships was provided by the partnerships based on the indicated market values of the underlying investment portfolio. During 1996, the Company liquidated its position in two limited partnerships with an aggregate carrying amount of $14,500 and recognized a gain on such liquidations of $4,201. At December 31, 1996, the Company had committed to fund one of the limited partnerships up to an additional $17,000. At December 31, 1995, the investment in foreign corporations was comprised of an indirect ownership of a 1.9% interest in a Brazilian airplane manufacturer acquired for $12,698, and a 10% equity interest in a company that owns an interest in a Russian commercial bank acquired for $2,000 (which the Company has sold subsequent to December 31, 1996 for an amount approximating its cost). The joint venture represents an investment of $6,888 in bonds of a foreign republic with a face amount of approximately

$12,000. The joint venture partner is in the process of litigation to collect the amounts owed under these bonds. During 1995, the Company determined that an other than temporary impairment in the value of its Brazilian investment and its investment in the joint venture had occurred. Accordingly, $11,790 was provided for the Brazilian investment and for the investment in the joint venture as an impairment charge in 1995.

During 1996, the Company sold its Brazilian investment for $8,285 in cash, which included $1,300 as reimbursement of the Company's expenses related to this investment. The Company, after writing down this investment by $8,698 in 1995, recognized a gain on the sale of the Brazilian investment of $4,285 in 1996 representing a partial recovery of the impaired carrying value. In 1996, the Company determined that an other than temporary impairment in the value of its equity interest in a computer software company had occurred and, accordingly, $1,001 was provided as an impairment charge.

The fair value of the Company's long-term investments approximates its carrying amount. The Company's estimate 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.

9. PENSIONS AND RETIREE BENEFITS

Ladenburg has a Profit Sharing Plan (the "Plan") for substantially all its employees. The Plan includes two features: profit sharing and a deferred compensation vehicle. Contributions to the profit sharing portion of the Plan are made by Ladenburg on a discretionary basis. The deferred compensation feature of the Plan enables non-salaried employees to invest up to 15% of their pre-tax annual compensation. For the years ended December 31, 1996 and 1995, employer contributions to the Plan were approximately $200 in each year, excluding those made under the deferred compensation feature described above.

The Company maintains 401(k) plans for substantially all employees, except those employees of Thinking Machines. These 401(k) plans allow eligible employees to invest a percentage of their pre-tax compensation. The Company made no discretionary contributions to these 401(k) plans in 1996.

During 1994, the Company maintained a suspended defined benefit plan and two defined contribution plans which covered virtually all full-time employees. Total pension costs accrued under all plans were $18,900 in 1994 and are included in the results of the discontinued operations. Contributions were made to the pension plans in amounts necessary to meet the minimum funding requirements of the Employee Retirement Income Security Act of 1974 ("ERISA"). As discussed in Note 1, the liabilities related to these pension plans were assumed by FFMC on November 15, 1994. These liabilities aggregated approximately $245,000 at the date of sale.

Net pension cost accrued under defined benefit plans for 1994 was:

	YEAR ENDED DECEMBER 31, 1994
Service cost	$ 1,250
Interest cost	35,490
Return on assets	(21,448)
Net amortization and deferral	--
Net pension cost	$ 15,292

Actuarial assumptions underlying the above data for financial statement purposes were as follows:

	1994
Discounted rates	7.5-8.5%
Assumed rates of return on invested assets	10.0%

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

The change in discount rates from 7.5% to 8.5% as of March 31, 1994 resulted in a $29,200 decrease in the minimum pension liability.

The Company made contributions to its suspended defined benefit pension plans in amounts necessary to meet minimum funding requirements under ERISA. Cash contributions to such suspended plans were $20,300 in 1994. Pension expense for defined contribution plans was $3,100 in 1994. Effective November 15, 1994, sponsorship of these defined contribution plans were assumed by FFMC.

10. COMMITMENT AND CONTINGENCIES

Leases

The Company and Ladenburg are currently obligated under two noncancelable lease agreements for office space, expiring in September 2000 and December 2015, respectively. The following is a schedule by fiscal year of future minimum rental payments required under the agreements that have noncancelable terms of one year or more at December 31, 1996:

1997	$ 5,098
1998	5,095
1999	4,831
2000	4,661
2001	3,234
2002 and thereafter	52,973
	$75,892

During 1994, the Company leased certain real properties for use as customer service centers, corporate headquarters and sales offices. It also leased certain data communications terminals, electronic data processing equipment and automobiles. Effective November 15, 1994, virtually all of these leases were assumed by FFMC as part of the sale of FSI.

Rental expense for operating leases for the years ended 1996, 1995, and 1994 was $3,914, $1,677, and $3,600, respectively. Virtually all of the rental expense for the year ended 1994 is included in the results of the discontinued operations.

Lawsuits

The Company is a defendant in various 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.

11. FEDERAL INCOME TAX

At December 31, 1996, the Company had $91,272 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 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 income taxes, which represented the effect of the Alternative Minimum Tax and state income taxes, for the three years ended December 31, 1996, 1995 and 1994, does not bear a customary relationship with pre-tax accounting income from continuing operations principally as a consequence of the change in the valuation allowance relating to deferred tax assets. The provision for income taxes on continuing operations differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate (35%) to pretax income from continuing operations as a result of the following differences:

	1996	1995	1994
(Loss) income from continuing operations	$(13,216)	$ 1,374	$(15,265)
(Credit) provision under statutory U.S. tax rates	(4,626)	583	(5,518)
(Decrease) increase in taxes resulting from:			
Nontaxable items	(119)	543	2,100
State taxes, net of Federal benefit	195	180	(122)
Increase (decrease) in valuation reserve	4,850	(1,014)	3,040
Income tax provision (benefit)	$ 300	$ 292	$ (500)

Income taxes associated with discontinued operations and extraordinary items have been shown net of the utilization of the net operating loss carryforward and the change in other deferred tax assets.

Deferred tax amounts are comprised of the following at December 31:

	1996	1995
Deferred tax assets:		
Net operating loss carryforward:		
Restricted net operating loss	$ 18,675	$ 21,786
Unrestricted net operating loss	65,237	51,156
Other	10,399	14,592
Total deferred tax assets	94,311	87,534
Deferred tax liabilities:		
Other	(3,039)	(2,856)
Total deferred tax liabilities	(3,039)	(2,856)
Net deferred tax assets	91,272	84,678
Valuation allowance	(91,272)	(84,678)
Net deferred taxes	$ --	$ --

In December 1987, the Company consummated certain restructuring transactions that included certain changes in the ownership of the Company's stock. The Internal Revenue Code restricts the amount of future income that may be offset by losses and credits incurred prior to an ownership change. The Company's annual limitation on the use of its net operating losses is approximately $7,700, computed by multiplying the "long-term tax exempt rate" at the time of change of ownership by the fair market value of the company's outstanding stock immediately before the ownership change. The limitation is cumulative; any unused limitation from one year may be added to the limitation of a following year. Operating losses incurred subsequent to an ownership change are generally not subject to such restrictions.

As of December 31, 1996, the Company had consolidated net operating loss carryforwards of approximately $208,000 for tax purposes, which expire at various dates through 2007. Approximately $46,000 of net operating loss carryforwards constitute pre-change losses and $162,000 of net operating losses were unrestricted.

12. OTHER LONG-TERM LIABILITIES

The components of other long-term liabilities, excluding notes payable, are as follows:

	DECEMBER 31, 1996 LONG-TERM PORTION	DECEMBER 31, 1996 CURRENT PORTION	DECEMBER 31, 1995 LONG-TERM PORTION	DECEMBER 31, 1995 CURRENT PORTION
Amount payable to FFMC pursuant to the purchase contract			$ 3,500	$6,567
Retiree and disability obligations	$ 6,774	$1,700	8,467	1,800
Minority interests	4,775	--	--	--
Other long-term liabilities	733	300	--	--
Total other long-term liabilities	$12,282	$2,000	$11,967	$8,367

13. REDEEMABLE PREFERRED SHARES

At December 31, 1996, the Company had authorized and outstanding 2,000,000 and 1,071,462, respectively, of its Class A Senior Preferred Shares. At December 31, 1995, there were 1,107,566 Class A Senior Preferred Shares outstanding. At December 31, 1996 and 1995, respectively, the carrying value of such shares amounted to $210,571 and $226,396, including undeclared dividends of $117,117 and $121,893, or $109.31 and $110.06 per share.

The holders of Class A Senior Preferred Shares are currently entitled to receive a quarterly dividend, as declared by the Board, payable at the rate of $19.00 per annum. The Class A Senior Preferred Shares are mandatorily redeemable on January 1, 2003 at $100 per share plus accrued dividends. The Class A Senior Preferred Shares were recorded at their market value ($80 per share) at December 30, 1987, the date of issuance. The discount from the liquidation value is accreted, utilizing the interest method, as a charge to additional paid-in capital and an increase to the recorded value of the Class A Senior Preferred Shares, through the redemption date. As of December 31, 1996, the unamortized discount on the Class A Senior Preferred Shares was $5,430.

In the event a required dividend or redemption is not made on the Class A Senior Preferred Shares, no dividends shall be paid or declared and no distribution made on any junior stock other than a dividend payable in junior stock. If at any time six quarterly dividends payable on the Class A Senior Preferred Shares shall be in arrears or such shares are not redeemed when required, the number of directors will be increased by two and the holders of the Class A Senior Preferred Shares, voting as a class, will have the right to elect two directors until full cumulative dividends shall have been paid or declared and set aside for payment. Such directors were designated pursuant to the Joint Plan in November 1994.

Pursuant to the Joint Plan, the Company made an $80 per share cash tender offer for a maximum of 150,000 Class A Senior Preferred Shares. This tender offer expired February 17, 1995 and resulted in a payment of $4,355 for 54,445 shares tendered and increased the Company's additional paid-in capital by $7,358.

Pursuant to the Joint Plan, the Company declared a cash dividend in December 1994 on the Class A Senior Preferred Shares of $50 per share which was paid in January 1995. The Company declared and paid cash dividends on the Class A Senior Preferred Shares of $40 per share in 1996 and $50 per share in 1995. Undeclared dividends are accrued quarterly and such accrued and unpaid dividends shall accrue additional dividends in respect thereof compounded monthly at the rate of 19% per annum, both of which accruals are included in the carrying amount of redeemable preferred shares, offset by a charge to additional paid-in capital.

On April 6, 1995, the Company's Board of Directors (the "Board") authorized the Company to repurchase as many as 200,000 shares of its Class A Senior Preferred Shares. The Company completed the repurchase for an aggregate consideration of $18,674 and thereafter, on June 21, 1995, the Board authorized the Company to repurchase as many as 300,000 additional shares. The Company repurchased in the open market 33,000 of such shares in July 1995 and 106,400 of such shares in September 1995 for an aggregate consideration of $24,732. During the first quarter of 1996, the Company repurchased 72,104 of such shares for an aggregate consideration of $10,530. The repurchase of the Class A Senior Preferred Shares increased the Company's additional paid-in capital by $4,279 for the 72,104 shares acquired in 1996 and by $32,984 for the 339,400 shares acquired in 1995 based on the difference between the purchase price and the carrying values of the shares.

On November 18, 1996, the Company granted to an officer of the Company 36,000 Class A Senior Preferred Shares (the "Award Shares"). The Award Shares are identical with all other Class A Senior Preferred Shares issued and outstanding as of July 1, 1996, including undeclared dividends of $3,776 and declared dividends of $1,080. The Award Shares vest one-sixth on July 1, 1997 and one-sixth on each of the five succeeding one-year anniversaries thereof through and including July 1, 2002. The Company recorded deferred compensation of $5,436 representing the fair market value of the Award Shares on November 18, 1996 and $3,020 of original issue discount representing the difference between the book value of the Award Shares on November 18, 1996 and their fair market value. The deferred compensation will be amortized over the vesting period and the original issue discount will be accreted, utilizing the interest method, through the redemption date, both through a charge to compensation expense. During 1996, the Company recorded $359 in compensation expense related to the Award Shares and, at December 31, 1996, the balance of the deferred compensation and the unamortized discount related to the Award Shares was $8,097.

For information on Class A Senior Preferred Shares owned by Brooke, see Note 18.

14. PREFERRED SHARES NOT SUBJECT TO REDEMPTION REQUIREMENTS

The holders of the $3.00 Class B Cumulative Convertible Preferred Shares ($25 Liquidation Value), $.10 par value per share (the "Class B Preferred Shares"), 12,000,000 shares authorized and 2,790,776 shares outstanding as of December 31, 1996 and 1995, are entitled to receive a quarterly dividend, as declared by the Board, at a rate of $3.00 per annum. Undeclared dividends are accrued quarterly at a rate of 12% per annum, and such accrued and unpaid dividends shall accrue additional dividends in respect thereof, compounded monthly at the rate of 12% per annum.

Each Class B Preferred Share is convertible at the option of the holder into .41667 Common Shares based on a $25 liquidation value and a conversion price of $60 per Common Share. During 1994, 155 Common Shares were issued upon conversion of 372 Class B Preferred Shares.

At the option of the Company, the Class B Preferred Shares are redeemable in the event that the closing price of the Common Shares equals or exceeds 140% of the conversion price at a specified time prior to the redemption. If redeemed by New Valley, the redemption price would equal $25 per share plus accrued dividends.

In the event a required dividend is not paid on the Class B Preferred Shares, no dividends shall be paid or declared and no distribution made on any junior stock other than a dividend payable in junior stock. If at any time six quarterly dividends on the Class B Preferred Shares are in arrears, the number of directors will be increased by two, and the holders of Class B Preferred Shares and any other classes of preferred shares similarly entitled to vote for the election of two additional directors, voting together as a class, will have the right to elect two directors to serve until full cumulative dividends shall have been paid or declared and set aside for payment. Such directors were designated pursuant to the Joint Plan in November 1994.

No dividends on the Class B Preferred Shares have been declared since the fourth quarter of 1988. The undeclared dividends, as adjusted for conversions of Class B Preferred Shares into Common Shares, cumulatively amounted to $115,944 and $95,100 at December 31, 1996 and 1995, respectively. These undeclared dividends represent $41.55 and $34.08 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.

15. COMMON SHARES

Stock Warrants. In 1996, 1995 and 1994, no warrants were exercised. Stock warrants outstanding at December 31, 1996 are as follows:

DATE ISSUED	COMMON SHARES SUBJECT TO WARRANTS	EXERCISE PRICE	EXPIRATION DATE
September 30, 1987	11,000	$50.00	November 13, 1997
October 30, 1987	11,000	$50.00	November 13, 1997
	22,000		

Stock Options. Under the 1987 Stock Option Plan (the "1987 Plan"), options to purchase up to 1,500,000 Common Shares may be offered to key employees, including officers, and non-employee directors. Options may be issued at an exercise price of not less than 35% of the fair market value of the Common Shares at date of grant.

A summary of transactions during 1995 with respect to options is as follows:

	NUMBER OF SHARES OPTIONED	PRICE RANGE
Outstanding at January 1, 1995	849,298	$4.00-$9.60
Exercised	(141,250)	$4.00
Canceled, expired or terminated	(708,048)	$4.00-$9.60
Outstanding at December 31, 1995	--	

On November 18, 1996, the Company granted an officer of the Company nonqualified options to purchase 330,000 Common Shares at a price of $.58 per share and 97,000 Class B Preferred Shares at a price of $1.85 per share. These options may be exercised on or prior to July 1, 2006 and vest one-sixth on July 1, 1997 and one-sixth on each of the five succeeding anniversaries thereof through and including July 1, 2002. The Company recognized compensation expense of $24 in 1996 from these option grants and recorded deferred compensation of $755 representing the intrinsic value of these options on December 31, 1996.

The Company applies APB Opinion No. 25 and related Interpretations in accounting for its stock options. In 1995, the FASB issued SFAS No. 123, "Accounting for Stock-Based Compensation", which, if fully adopted, changes the methods of recognition of cost on certain stock options. Had compensation cost for the nonqualified stock options been determined based upon the fair value at the grant date consistent with SFAS 123, the Company's net loss in 1996 would have been increased by $33. The fair value of the nonqualified stock options was estimated at $1,774 using the Black-Scholes option-pricing model with the following assumptions: volatility of 171% for the Class B Preferred Shares and 101% for the Common Shares, a risk free interest rate of 6.2%, an expected life of 10 years, and no expected dividends or forfeiture.

16. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

The composition of accounts payable and accrued liabilities is as follows:

	DECEMBER 31, 1996	DECEMBER 31, 1995
Accounts payable and accrued liabilities:		
Accrued compensation	$10,378	$ 6,981
Excise tax payable(a)	6,000	6,000
Subordinated loan payable(b)	4,000	--
Deferred rent	4,388	--
Taxes (property and miscellaneous)	2,637	2,637
Accrued expenses and other liabilities	17,485	10,675
Due to affiliates	--	1,419
Total	$44,888	$27,712

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(a) Represents an estimated liability related to excise taxes imposed on annual contributions to retirement plans that exceed a certain percentage of annual payroll. The Company intends to vigorously contest this tax liability. Management's estimate of such amount is potentially subject to material change in the near term.

(b) Represents a subordinated note payable held by Ladenburg's clearing broker. The note paid interest at the rate of prime plus two percent and was paid in full on January 14, 1997.

17. PREPETITION CLAIMS UNDER CHAPTER 11 AND RESTRUCTURING ACCRUALS

On January 18, 1995, approximately $550,000 of the approximately $620,000 of prepetition claims were paid pursuant to the Joint Plan. Another $54,000 of prepetition claims and restructuring accruals have been settled and paid since January 18, 1995. The remaining prepetition claims may be subject to future adjustments depending on pending discussions with the various parties and the decisions of the Bankruptcy Court.

	DECEMBER 31, 1996	DECEMBER 31, 1995
Restructuring accruals(a)	$ 9,024	$18,759
Money transfer payable(b)	6,502	7,444
Accrued interest -- postpetition(c)	--	3,634
Payable to connecting carriers	--	3,405
Other, miscellaneous	--	150
Total	$15,526	$33,392

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(a) Restructuring accruals at December 31, 1996 consisted of $7,972 of disputed claims, primarily related to leases and former employee benefits, and $1,052 of other restructuring accruals. In 1996, 1995 and 1994, the Company reversed $9,706, $2,044 and $300, respectively, of prior year restructuring accruals as a result of settlements on certain of its prepetition claims and vacated real estate lease obligations. In 1994, the Company incurred financial restructuring costs of $23,100 which consisted of professional fees related to its financial restructuring.

(b) Represents unclaimed money transfers issued by the Company prior to January 1, 1990. The Company is currently in litigation in Bankruptcy Court seeking a determination that these monies are not an obligation of the Company. There can be no assurance as to the outcome of the litigation.

(c) Prior to the Joint Plan being confirmed on November 1, 1994, no interest expense had been accrued on prepetition claims since December 31, 1992. The terms of the Joint Plan provided for the payment of postpetition interest in the amount of $178,000 of which $174,366 was paid in 1995 and $3,634 was paid in 1996. An extraordinary loss of $110,500 was recorded for the extinguishment of this debt in 1995.

18. RELATED PARTY TRANSACTIONS

At December 31, 1996, Brooke, a company under the control of Bennett S. LeBow, Chairman of the Company's Board of Directors, held 3,989,710 Common Shares (approximately 41.7% of such class), 618,326 Class A Senior Preferred Shares (approximately 57.7% of such class), and 250,885 Class B Preferred Shares (approximately 8.9% of such class) which represented in the aggregate 42.1% of all voting power. Several of the other officers and directors of the Company are also affiliated with Brooke. In 1995, the Company signed an expense sharing agreement with Brooke pursuant to which certain lease, legal and administrative expenses are allocated to the entity incurring the expense. The Company expensed approximately $462 and $571 under this agreement in 1996 and 1995, respectively.

The Joint Plan imposes a number of restrictions on transactions between the Company and certain affiliates of the Company, including Brooke, and establishes certain restrictions on proposed investments.

On December 18, 1996, the Company loaned BGLS Inc. ("BGLS"), a wholly-owned subsidiary of Brooke, $990 under a short-term promissory note due January 31, 1997 and bearing interest at 14%. On January 2, 1997, the Company loaned BGLS an additional $975 under another short-term promissory note due January 31, 1997 and bearing interest at 14%. Both loans including interest were repaid on January 31, 1997. At December 31, 1996, the loan and accrued interest thereon of $996 was included in other current assets.

Two directors of the Company are affiliated with law firms that rendered legal services to the Company. The Company paid these firms $4,141 and $1,083 during 1996 and 1995, respectively, for legal services. An executive officer and director of the Company is a shareholder and registered representative in a broker-dealer to which the Company paid $317 and $584 in 1996 and 1995, respectively, in brokerage commissions and other income, and is also a shareholder in an insurance company that received ordinary and customary insurance commissions of $43 in 1996. The broker-dealer, in the ordinary course of its business, engages in brokerage activities with Ladenburg on customary terms. In 1995, a director of the Company received a commission of $800 on the purchase of Ladenburg, of which $400 was paid by the Company and $400 was paid by the selling shareholders.

In connection with their agreement to serve as Brooke nominees at RJR Nabisco's 1996 annual meeting, two directors of the Company were each paid $30 by Brooke during the fourth quarter of 1995. In addition, Brooke also entered into an agreement with each of the Brooke nominees whereby it agreed to indemnify them against certain liabilities arising out of the solicitation of proxies in support of the nominees' election at the annual meeting. As discussed in Note 5, the Company has entered into certain other agreements with Brooke in connection with its investment in RJR Nabisco.

During 1996, the Company entered into a court-approved Stipulation and Agreement (the "Settlement") with Brooke and BGLS relating to Brooke's and BGLS's application under the Federal Bankruptcy code for reimbursement of legal fees and expenses incurred by them in connection with the Company's bankruptcy reorganization proceedings. Pursuant to the Settlement, the Company reimbursed to Brooke and BGLS $655 for such legal fees and expenses. The terms of the Settlement were substantially similar to the terms of previous settlements between the Company and other applicants who had sought reimbursement of reorganization-related legal fees and expenses.

In connection with the acquisition of the Office Buildings by the Company in 1996, a director of Brooke received a commission of $220 from the seller.

See Note 22 for information concerning the purchase by the Company on January 31, 1997 of BrookeMil Ltd. from a subsidiary of Brooke.

19. OFF-BALANCE-SHEET RISK AND CONCENTRATIONS OF CREDIT RISK

Ladenburg -- As a nonclearing broker, Ladenburg's transactions are cleared by other brokers and dealers in securities pursuant to clearance agreements. Although Ladenburg clears its customers through other brokers and dealers in securities, Ladenburg is exposed to off-balance-sheet risk in the event that customers or other parties fail to satisfy their obligations. In accordance with industry practice, agency securities transactions are recorded on a settlement-date basis. Should a customer fail to deliver cash or securities as agreed, Ladenburg may be required to purchase or sell securities at unfavorable market prices.

The clearing operations for Ladenburg's securities transactions are provided by several brokers. At December 31, 1996, substantially all of the securities owned and the amounts due from brokers reflected in the consolidated balance sheet are positions held at and amounts due from one clearing broker. Ladenburg is subject to credit risk should this broker be unable to fulfill its obligations.

In the normal course of its business, Ladenburg enters into transactions in financial instruments with off-balance-sheet risk. These financial instruments consist of financial futures contracts and written index option contracts. Financial futures contracts provide for the delayed delivery of a financial instrument with the seller agreeing to make delivery at a specified future date, at a specified price. These futures contracts involve elements of market risk in excess of the amounts recognized in the consolidated statement of financial condition. Risk arises from changes in the values of the underlying financial instruments or indices. At December 31, 1996, Ladenburg had commitments to purchase and sell financial instruments under futures contracts of $738 and $3,120, respectively.

Equity index options give the holder the right to buy or sell a specified number of units of a stock market index, at a specified price, within a specified time from the seller ("writer") of the option and are settled in cash. Ladenburg generally enters into these option contracts in order to reduce its exposure to market risk on securities owned. Risk arises from the potential inability of the counterparties to perform under the terms of the contracts and from changes in the value of a stock market index. As a writer of options, Ladenburg receives a premium in exchange for bearing the risk of unfavorable changes in the price of the securities underlying the option. Financial instruments have the following notional amounts as December 31, 1996:

	LONG	SHORT
Equity and index options	$351,126	$406,355
Financial futures contracts	561	3,120

The table below discloses the fair value at December 31, 1996 of these commitments, as well as the average fair value during the period, based on monthly observations.

	DECEMBER 31, 1996		AVERAGE	
	LONG	SHORT	LONG	SHORT
Equity and index options	$6,241	$11,243	$9,967	$14,578
Financial futures contracts	33	25	15	31

For the year ended December 31, 1996, the net loss arising from options and futures contracts included in net gain on principal transactions was $6,012. The measurement of market risk is meaningful only when related and offsetting transactions are taken into consideration.

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

20. FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value of the Company's financial instruments have been determined by the Company using available market information and appropriate valuation methodologies described below. However, considerable judgment is required to develop the estimates of fair value and, accordingly, the estimates presented herein are not necessarily indicative of the amounts that could be realized in a current market exchange.

	DECEMBER 31, 1996		DECEMBER 31, 1995	
	CARRYING AMOUNT	FAIR VALUE	CARRYING AMOUNT	FAIR VALUE
Financial assets:				
Cash and cash equivalents	$ 57,282	$ 57,282	$ 51,742	$ 51,742
Investments available for sale	64,170	64,170	210,832	210,832
Trading securities owned	29,761	29,761	31,211	31,211
Restricted assets	8,846	8,846	38,005	38,005
Receivable from clearing brokers	23,870	23,870	13,752	13,752
Long-term investments (Note 8)	13,270	14,130	29,512	33,997
Financial liabilities:				
Short-term loan	--	--	75,119	75,119
Notes payable	158,251	158,251		
Redeemable preferred shares	210,571	132,908	226,396	161,704

21. BUSINESS SEGMENT INFORMATION

Prior to the acquisition of Ladenburg on May 1, 1995, virtually all of the Company's operating businesses were reported as discontinued operations. The following table presents certain financial information of the Company's continuing operations before taxes and minority interests as of and for the years ended December 31, 1996 and 1995:

	BROKER-DEALER	REAL ESTATE OPERATIONS	SOFTWARE SALES AND SERVICES	CORPORATE AND OTHER	TOTAL
1996					
Revenues	$71,960	$ 23,559	$ --	$ 16,435	$111,954
Operating income (loss)	(345)	(745)	(8,860)	(6,305)	(16,255)
Identifiable assets	76,302	182,645	11,686	135,787	406,540
Depreciation and amortization	600	3,622	532	3	4,757
Capital expenditures	3,644	183,193	1,596	18	188,451
1995					
Revenues	$40,418			$ 27,312	$ 67,730
Operating income	1,475			191	1,666
Identifiable assets	61,175			324,647	385,822
Depreciation and amortization	608			--	608
Capital expenditures	372			--	372

22. SUBSEQUENT EVENTS

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, pursuant to which 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 is payable $21,500 on June 30, 1997 and $12,000 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 98-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 February 5, 1997, BML entered into an agreement to sell Ducat Place I to one of its tenants for approximately $7,500, which purchase price has been reduced to reflect prepayments of rent. The closing of the sale is subject to a number of contingencies. If the transaction does not occur by April 5, 1997, the tenant has the right to terminate the agreement and apply its $1,000 down payment to its future rental obligations. In 1995, BML began construction of Ducat Place II, a 150,000 sq. ft. office building. Ducat Place II has been pre-leased to a number of leading international companies. The third phase, Ducat Place III, is planned as a 400,000 sq. ft. mixed-use complex, with construction anticipated to commence in 1998.

In connection with the Purchase Agreement, certain specified liabilities of BML aggregating approximately $40,000 remained as liabilities of BML after the purchase of the BML Shares of the Company. These liabilities include a $20,400 loan to a Russian bank for the construction of Ducat Place II. The loan, which matures $6,100 in April 1997, $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 include approximately $13,800 of rents and related payments prepaid by tenants of Ducat Place II for periods generally ranging from 15 to 18 months.

The Company is currently seeking long-term financing to replace the $20,400 construction loan related to Ducat Place II due in 1997 and for the development of Ducat Place III. There is no assurance that the Company can obtain such financing particularly in light of the political and economic risks associated with investments in real estate in Russia.

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 following unaudited pro forma condensed balance sheet gives effect to the purchase of BML as if it had occurred on December 31, 1996.

	AS REPORTED	PRO FORMA
Assets:		
Current assets	$183,720	$172,867
Investment in real estate, net	179,571	258,771
Other non-current assets	43,249	49,035
	$406,540	$480,673
Liabilities:		
Current liabilities	$ 98,110	$165,394
Long-term debt	157,942	157,942
Other long-term liabilities	12,282	19,130
Redeemable preferred shares	210,571	210,571
Shareholders' equity (deficit)	(72,364)	(72,364)
	$406,540	$480,673

SCHEDULE II

NEW VALLEY CORPORATION

VALUATION AND QUALIFYING ACCOUNTS
FOR THE THREE YEARS ENDED DECEMBER 31, 1996
(THOUSANDS)

DESCRIPTION	BALANCE AT JANUARY 1,	ADDITIONS CHARGED TO EXPENSES	LOSSES CHARGED TO RESERVE, NET OF COLLECTIONS	OTHER CHARGES(A)	BALANCE AT DECEMBER 31,
Year 1994					
Allowance for uncollectible receivables	$8,820	$4,614	$(4,946)	$(8,488)	$ --

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(a) The receivable and related allowance for uncollectible receivables were sold to FFMC on November, 1994.

SCHEDULE III

NEW VALLEY CORPORATION

REAL ESTATE AND ACCUMULATED DEPRECIATION
AS OF DECEMBER 31, 1996
(AMOUNTS IN THOUSANDS)

DESCRIPTION AND LOCATION	ENCUMBRANCES	INITIAL COST LAND	INITIAL COST BUILDING	COST CAPITALIZED NET OF DELETIONS	GROSS AMOUNT CARRIED AT CLOSE OF PERIOD LAND	GROSS AMOUNT CARRIED AT CLOSE OF PERIOD BUILDINGS AND IMPROVEMENTS	GROSS AMOUNT CARRIED AT CLOSE OF PERIOD TOTAL
Office Buildings:							
Bernards Township, NJ..............	$ 43,960	$ 10,059	$ 38,432	--	$10,059	$ 38,432	$ 48,491
Bernards Township, NJ..............	10,312	2,342	9,172	--	2,342	9,172	11,514
Troy, MI............................	22,447		23,581	--	--	23,581	23,581
Troy, MI............................	22,985	7,049	21,147	--	7,049	21,147	28,196
	99,704	19,450	92,332	--	19,450	92,332	111,782
Shopping Centers:							
Tri Cities, WA......................	7,957	2,981	7,692	--	2,981	7,692	10,673
Santa Fe, NM........................	8,073	3,233	6,423	4	3,233	6,427	9,660
Portland, OR........................	4,669	949	6,374	$(1,725)	722	4,876	5,598
Marathon, FL........................	3,279	624	3,299	37	624	3,336	3,960
Seattle, WA.........................	10,386	3,354	9,069	35	3,354	9,104	12,458
Charleston, WV......................	10,886	2,510	10,516	132	2,510	10,648	13,158
Royal Palm Beach, FL................	8,274	2,032	7,867	1	2,032	7,868	9,900
Lincoln, NE.........................	5,020	1,254	4,750	--	1,254	4,750	6,004
	58,547	16,937	55,990	(1,516)	16,710	54,701	71,411
Total................................	$158,251	$ 36,387	$148,322	$(1,516)	$36,160	$147,033	$183,193

DESCRIPTION AND LOCATION	ACCUMULATED DEPRECIATION	DATE CONSTRUCTED	DATE ACQUIRED	DEPRECIABLE LIFE
Office Buildings:				
Bernards Township, NJ..............	$ 961	1991	Jan 1996	40
Bernards Township, NJ..............	229	1994	Jan 1996	40
Troy, MI............................	590	1987	Jan 1996	40
Troy, MI............................	528	1990	Jan 1996	40
	$ 2,308			
Shopping Centers:				
Tri Cities, WA......................	192	1980	Jan 1996	40
Santa Fe, NM........................	152	1964	Jan 1996	40
Portland, OR........................	135	1978	Jan 1996	40
Marathon, FL........................	79	1972	Jan 1996	40
Seatle, WA..........................	187	1988	Jan 1996	40
Charleston, WV......................	256	1985	Jan 1996	40
Royal Palm Beach, FL................	195	1985	Jan 1996	40
Lincoln, NE.........................	118	1964	Jan 1996	40
	1,314			
Total................................	$ 3,622			

(1) The Office Buildings were acquired on January 10, 1996 and the Shopping Centers were acquired on January 11, 1996.
(2) The amounts shown for accumulated depreciation represents depreciation expense for the year ended December 31, 1996.
(3) The only sale occurred at the shopping center located at Portland, OR. The sale was for $1,750 and no gain or loss was recognized on the sale.
(4) Capital expenditures were approximately $234 for the year ended December 31, 1996.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors of
Thinking Machines Corporation:

We have audited the accompanying consolidated balance sheet of Thinking Machines Corporation and subsidiaries as of December 31, 1996, and the related consolidated statements of operations, stockholders' investment and cash flows for the period February 8, 1996 (Inception) to December 31, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the consolidated financial statements referred to above presents fairly, in all material respects, the financial position of Thinking Machines Corporation and subsidiaries as of December 31, 1996, and the results of their operations and their cash flows for the period February 8, 1996 (Inception) to December 31, 1996, in conformity with generally accepted accounting principles.

/s/ Arthur Andersen LLP
ARTHUR ANDERSEN LLP

Boston, Massachusetts
February 11, 1997

Independent Auditors' Report

The Board of Directors
MAI Systems Corporation:

We have audited the accompanying consolidated statements of operations, shareholders' deficiency and cash flows of MAI Systems Corporation and subsidiaries for the year ended December 31, 1994. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the results of operations and cash flows of MAI Systems Corporation and subsidiaries for the year ended December 31, 1994, in conformity with generally accepted accounting principles.

KPMG PEAT MARWICK LLP
- ------------------------
KPMG Peat Marwick LLP

Orange County, California
March 9, 1995

Exhibit 10.34

BROOKE GROUP LTD.
100 S.E. Second Street, 32nd Floor
Miami, Florida 33131

December 16, 1996

Mr. Howard M. Lorber
70 East Sunrise Highway
Suite 411
Valley Stream, New York 11581

Dear Mr. Lorber:

We are pleased to inform you that Brooke Group Ltd. (the "Company") has granted you a nonqualified option (the "Option") to purchase 1,000,000 shares of the Company's common stock, par value $.10 per share (the "Common Stock"), at a price of $1.00 per share (any of the underlying shares of Common Stock to be issued upon exercise of the Option are referred to hereinafter as the "Shares"), subject to the following terms and conditions:

1. The Option may be exercised on or prior to July 1, 2006 (at which date the Option will, to the extent not previously exercised, expire), as follows: (a) as to 166,666 of the Shares, on and after July 1, 1997; (b) as to 166,666 of the Shares, on and after July 1, 1998; (c) as to 166,667 of the Shares, on and after July 1, 1999; (d) as to 166,667 of the Shares, on and after July 1, 2000; (e) as to 166,667 of the Shares, on and after July 1, 2001; and (f) as to the final 166,667 of the Shares, on and after July 1, 2002. Each such installment shall be cumulative and your right of purchase thereunder shall continue, unless exercised or terminated as herein provided through the expiration date of the Option.

2. Any installment of the Option, from and after the date it becomes exercisable pursuant to Section 1 hereof, may be exercised in whole or in part by delivering to the Company a written notice of exercise in the form attached hereto as Exhibit A, specifying the number of the Shares to be purchased, together with payment of the purchase price of the Shares to be purchased. The purchase price is to be paid in cash or by delivering shares of Common Stock already owned by you and having a fair market value on the date of exercise equal to the exercise price of the Option, or a combination of such shares and cash.

3. Except to the extent provided in Section 4 hereof, in the event your consulting arrangement with the Company is terminated for any reason, other than as a result of your death or Disability (as such term is defined in Section 6(c) of that certain Employment Agreement entered into between you and New Valley Corporation dated as of January 1, 1995 and as

amended effective as of January 1, 1996 [the "Employment Agreement"]) prior to July 1, 1999, the Option shall forthwith terminate, provided that you may exercise any then unexercised installments of the Option then exercisable at any time prior to the earlier of three months after the termination of your consulting arrangement or the expiration of the Option. Except to the extent provided in Section 4 hereof, in the event your consulting arrangement is terminated as a result of your death or Disability prior to July 1, 1999, one-half of the Option (to the extent not previously exercised) shall become immediately exercisable at any time prior to three months after the termination of your consulting arrangement and any remaining Option shall forthwith terminate.

4. In the event of the occurrence of any Change of Control of the Company or of New Valley Corporation (as the term "Change of Control" is defined in Section 6(f) of the Employment Agreement), other than any Change of Control arising by reason of a testamentary bequest by Bennett S. LeBow to or for the benefit of his surviving spouse of any or all securities of the Company or of New Valley Corporation beneficially owned by him as of his date of death so long as, following the bequest, the event referenced in Section 6(f)(ii) of the Employment Agreement shall not have occurred, all installments of the Option (to the extent not previously exercised) shall become immediately exercisable at any time prior to the earlier of three months after the termination of your consulting arrangement or the expiration of the Option.

5. In the event of the payment of any dividends or other distributions in respect of the Common Stock on or after the date hereof through and including July 1, 2006, you shall receive, within ten days of the payment of such dividend or distribution, a payment equal to the amount of any such dividends or other distributions that would have been paid to you had you been at the record date for such dividends or other distributions a shareholder of the Shares, provided that dividends or distributions in respect of Shares that are not exercisable on such record date shall only be paid to you at the time such Shares become exercisable.

6. The Option is not transferable otherwise than by will or by the applicable laws of descent and distribution and may be exercised during your lifetime only by you (or in the event of your Disability, by your personal representative or representatives).

7. In the event of your death, the Option may be exercised by your personal representative or representatives or by the person or persons to whom your rights under the Option shall pass by will or by the applicable laws of descent or distribution.

8. In the event of any change in the outstanding Common Stock by reason of a stock dividend, recapitalization, merger, consolidation, split-up, subdivision, combination or exchange of shares, or the like, the aggregate number and kind of shares subject to the Option and the exercise price thereof shall be proportionately adjusted by the Company.

9. Unless at the time of the exercise of the Option a registration statement under the Securities Act of 1933, as amended (the "Act"), is in effect as to the Shares, the Shares shall be acquired for investment and not for sale or distribution, and if the Company so requests, upon any exercise of the Option, in whole or in part, you agree to execute and deliver to the Company a certificate to such effect.

10. You understand and acknowledge that, under existing law, unless at the time of the exercise of the Option a registration statement under the Act is in effect as to the Shares so issuable: (i) any Shares purchased by you upon exercise of the Option may be required to be held indefinitely unless such Shares are subsequently registered under the Act or an exemption from such registration is available; (ii) any sales of such Shares made in reliance upon Rule 144 promulgated under the Act may be made only in accordance with the terms and conditions of that Rule (which, under certain circumstances, restrict the number of shares which may be sold and the manner in which shares may be sold); (iii) in the case of securities to which Rule 144 is not applicable, compliance with Regulation A promulgated under the Act or some other disclosure exemption shall be required; (iv) certificates for Shares to be issued to you hereunder shall bear a legend to the effect that the Shares have not been registered under the Act and that the Shares may not be sold, hypothecated or otherwise transferred in the absence of an effective registration statement under the Act relating thereto or an opinion of counsel satisfactory to the Company that such registration is not required; and (v) the Company shall place an appropriate "stop transfer" order with its transfer agent with respect to such Shares.

11. Promptly following the date hereof, the Company shall use its best efforts to file and keep in effect a Registration Statement on Form S-8, Form S-3 or other applicable form to register under the Act the Shares issuable to you upon exercise of the Option and the resale thereof by you.

Would you kindly evidence your acceptance of the Option and your agreement to comply with the provisions hereof by executing this letter in the space provided below.

Very truly yours,

BROOKE GROUP LTD.

By: ______________________________
Bennett S. LeBow
Chairman, President
and Chief Executive Officer

AGREED TO AND ACCEPTED:

- -----------------------------
Howard M. Lorber

EXHIBIT A

Brooke Group Ltd.
100 S.E. Second Street, 32nd Floor
Miami, Florida 33131

Gentlemen:

Notice is hereby given of my election to purchase __________ shares of Common Stock, $.10 par value (the "Shares"), of Brooke Group Ltd., at a price of $1.00 per Share, pursuant to the provisions of the stock option granted to me on November _____, 1996. Enclosed in payment for the Shares is:

|_| my check in the amount of $ ____________________.

|_| ___________________ Shares having a total value of $______________, such value being based on the closing price(s) of the Shares on the date hereof.

The following information is supplied for use in issuing an registering the Shares purchased hereby:

Number of Certificates and Denominations	________________________________
Name	________________________________
Address	________________________________
	________________________________
	________________________________
Social Security	________________________________

Dated:

Very truly yours,

Howard M. Lorber

Exhibit 10.35

BROOKE GROUP LTD.
100 S.E. Second Street, 32nd Floor
Miami, Florida 33131

January 1, 1997

Mr. Richard J. Lampen
350 Costa Brava Court
Coral Gables, Florida 33143

Dear Mr. Lampen:

We are pleased to inform you that Brooke Group Ltd. (the "Company") has granted you a nonqualified option (the "Option") to purchase 260,000 shares of the Company's common stock, par value $.10 per share (the "Common Stock"), at a price of $5.00 per share (any of the underlying shares of Common Stock to be issued upon exercise of the Option are referred to hereinafter as the "Shares"), subject to the following terms and conditions:

1. The Option may be exercised on or prior to December 31, 2006 (at which date the Option will, to the extent not previously exercised, expire), as follows: (a) as to 43,333 of the Shares, on and after January 1, 1998; (b) as to 43,333 of the Shares, on and after January 1, 1999; (c) as to 43,333 of the Shares, on and after January 1, 2000; (d) as to 43,333 of the Shares, on and after January 1, 2001; (e) as to 43,334 of the Shares, on and after January 1, 2002; and (f) as to the final 43,334 of the Shares, on and after January 1, 2003. Each such installment shall be cumulative and your right of purchase thereunder shall continue, unless exercised or terminated as herein provided, through the expiration date of the Option.

2. Any installment of the Option, from and after the date it becomes exercisable pursuant to Section 1 hereof, may be exercised in whole or in part by delivering to the Company a written notice of exercise in the form attached hereto as Exhibit A, specifying the number of the Shares to be purchased, together with payment of the purchase price of the Shares to be purchased. The purchase price is to be paid in cash or by delivering shares of Common Stock already owned by you and having a fair market value on the date of exercise equal to the exercise price of the Option, or a combination of such shares and cash.

3. Except to the extent provided in Section 4 hereof, in the event your employment with the Company is terminated for any reason, the Option shall forthwith terminate, provided that you may exercise any then unexercised installments of the Option then exercisable at any time prior to the earlier of three months after the termination of your employment or the expiration of the Option.

4. In the event of the occurrence of any Change of Control of the Company or of New Valley Corporation (as the term "Change of Control" is defined in Section 6(f) of the Employment Agreement, dated as of January 1, 1995, as amended as of January 1, 1996, between Howard M. Lorber and New Valley Corporation), other than any Change of Control arising by reason of a testamentary bequest by Bennett S. LeBow to or for the benefit of his surviving spouse of any or all securities of the Company or of New Valley Corporation beneficially owned by him as of his date of death so long as, following the bequest, the event referenced in Section 6(f)(ii) of such Employment Agreement shall not have occurred, all installments of the Option (to the extent not previously exercised) shall become immediately exercisable at any time prior to the earlier of three months after the termination of your employment or the expiration of the Option.

5. The Option is not transferable otherwise than by will or by the applicable laws of descent and distribution and may be exercised during your lifetime only by you (or in the event of your Disability, by your personal representative or representatives).

6. In the event of your death, the Option may be exercised by your personal representative or representatives or by the person or persons to whom your rights under the Option shall pass by will or by the applicable laws of descent or distribution.

7. In the event of any change in the outstanding Common Stock by reason of a stock dividend, recapitalization, merger, consolidation, split-up, subdivision, combination or exchange of shares, or the like, the aggregate number and kind of shares subject to the Option and the exercise price thereof shall be proportionately adjusted by the Company.

8. Unless at the time of the exercise of the Option a registration statement under the Securities Act of 1933, as amended (the "Act"), is in effect as to the Shares, the Shares shall be acquired for investment and not for sale or distribution, and if the Company so requests, upon any exercise of the Option, in whole or in part, you agree to execute and deliver to the Company a certificate to such effect.

9. You understand and acknowledge that, under existing law, unless at the time of the exercise of the Option a registration statement under the Act is in effect as to the Shares so issuable: (i) any Shares purchased by you upon exercise of the Option may be required to be held indefinitely unless such Shares are subsequently registered under the Act or an exemption from such registration is available; (ii) any sales of such Shares made in reliance upon Rule 144 promulgated under the Act may be made only in accordance with the terms and conditions of that Rule (which, under certain circumstances, restrict the number of shares which may be sold and the manner in which shares may be sold); (iii) in the case of securities to which Rule 144 is not

applicable, compliance with Regulation A promulgated under the Act or some other disclosure exemption shall be required; (iv) certificates for Shares to be issued to you hereunder shall bear a legend to the effect that the Shares have not been registered under the Act and that the Shares may not be sold, hypothecated or otherwise transferred in the absence of an effective registration statement under the Act relating thereto or an opinion of counsel satisfactory to the Company that such registration is not required; and (v) the Company shall place an appropriate "stop transfer" order with its transfer agent with respect to such Shares.

10. Promptly following the date hereof, the Company shall use its best efforts to file and keep in effect a Registration Statement on Form S-8, Form S-3 or other applicable form to register under the Act the Shares issuable to you upon exercise of the Option and the resale thereof by you.

Would you kindly evidence your acceptance of the Option and your agreement to comply with the provisions hereof by executing this letter in the space provided below.

Very truly yours,

BROOKE GROUP LTD.

By: ______________________________
Bennett S. LeBow
Chairman, President
and Chief Executive Officer

AGREED TO AND ACCEPTED:

- ----------------------------
Richard J. Lampen

EXHIBIT A

Brooke Group Ltd.
100 S.E. Second Street, 32nd Floor
Miami, Florida 33131

Gentlemen:

Notice is hereby given of my election to purchase __________ shares of Common Stock, $.10 par value (the "Shares"), of Brooke Group Ltd., at a price of $5.00 per Share, pursuant to the provisions of the stock option granted to me on January 1, 1997. Enclosed in payment for the Shares is:

|_| my check in the amount of $ ____________________.

|_| ___________________ Shares having a total value of $______________, such value being based on the closing price(s) of the Shares on the date hereof.

The following information is supplied for use in issuing an registering the Shares purchased hereby:

Number of Certificates and Denominations ________________________________

Name ________________________________

Address ________________________________

____

____

Social Security ________________________________

Dated:

Very truly yours,

Richard J. Lampen

Exhibit 10.40

ATTORNEYS GENERAL SETTLEMENT AGREEMENT

This SETTLEMENT AGREEMENT is entered into this 20th day of March, 1997 by and among the States listed in Appendix A hereto (collectively, "Plaintiffs") 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,

The Plaintiffs, by and through their respective Attorneys General (the "Attorneys General"), have brought [or are contemplating bringing] civil actions ("Actions") in various jurisdictions across the nation ("Actions") against, among others, the American Tobacco Company, Inc., BAT Industries, Plc, British American Tobacco Company, R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation, Philip Morris, Inc., Liggett & Myers, Inc., Lorillard Tobacco Company, Inc., and United States Tobacco Company and their various parent and related companies ("Defendants"), asserting claims for, among other things, expenses allegedly arising from tobacco-related matters and injunctive relief concerning sales of cigarettes to minors.

Because of the importance of the agreements and undertakings by Liggett and Brooke Group herein to the goals of the Plaintiffs and the Attorneys General, including the prosecution of the Actions against non-settling defendants, Plaintiffs have agreed to extend financial settlement terms to Liggett and Brooke Group which will not be offered to any other defendants, all as set forth in this Settlement Agreement.

On March 15, 1996, the Commonwealth of Massachusetts, the State of Florida, the State of Louisiana, the State of Mississippi and the State of West Virginia and Liggett and Brooke Group entered into a settlement (the "Initial Settlement") of the Actions brought by the foregoing States, pursuant to which Liggett agreed to make certain payments, comply with certain proposed regulations restricting the marketing and sale of cigarettes to minors and to offer certain cooperation in connection with the prosecution of such Actions against the other Defendants; all in accordance with the terms of the Initial Settlement, a copy of which is annexed hereto as Appendix B.

The Attorneys General, the Initial Settling States and Liggett and Brooke Group wish to expand upon the Initial Settlement, through this Settlement Agreement to cover all of the Actions and to provide for, among other things, significantly greater cooperation by the Settling Defendants with the Attorneys General, all in accordance with the terms of this Settlement Agreement.

The Attorneys General acknowledge and agree that this Settlement Agreement, including the cooperation provisions thereof, are important to the prosecution of their Actions against the non-settling Defendants.

The Attorneys General and Liggett and Brooke Group recognize and support the public interest in preventing smoking by, or promotion of smoking to, children and adolescents.

Liggett and Brooke Group have denied, and continue to deny any wrongdoing or any legal liability of any kind in all of the above-mentioned actions.

The Settling States and the Attorneys General recognize and acknowledge that the cooperation being provided is valuable to the continued prosecution of the claims against the tobacco industry. Further, the Settling States and the Attorneys General acknowledge that the change in warning labels provided for in this Settlement Agreement is a step towards properly informing consumers more fully of the truth about cigarettes and the consequences of smoking, as is the statement by Liggett also provided for herein.

NOW, THEREFORE, in consideration of the foregoing and of the promises and covenants set forth in this Agreement, the undersigned Attorneys General, on their own behalf and on behalf of their respective States, and Liggett and Brooke Group hereby stipulate and agree that the Attorney General Actions shall be settled as against Liggett and Brooke Group, and that all claims asserted in the Attorney General Actions against Liggett and Brooke Group shall be dismissed, all on the terms contained herein, as follows:

Definitions.

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

"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 their counsel, or appointed by the Class Action 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 to
resolve disputes of the Oversight Committee. With respect to the Settlement Fund, in the event that the Settling States and the Settlement Class, and/or their respective counsel, cannot agree on an allocation of the Settlement Fund between the Settling States and the Settlement Class, the Settling States and the Settlement Class will petition the Court for appointment of an arbitrator. In so doing, the parties do not consent, nor should it be inferred, that the Multidistrict Litigation Panel has jurisdiction over any of the parties.

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

"Attorney General Actions" or "Actions" means the actions listed in Appendix A hereto, including those actions brought on behalf of the State as taxpayer actions.

"Attorney General Settlement Fund Board" or "Attorney General Board" means, the entity established pursuant to Section 5 of the Initial Settlement.

"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 described in subparagraph (1).

"Cigarette Pack" means a unit of twenty Cigarettes or one ounce of Tobacco Snuff, or any other similar method of delivery to consumers.

"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.

"Defendants" means The American Tobacco Company, Inc., BAT Industries, Plc, British American Tobacco Company, R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation, Philip Morris, Inc., Liggett & Myers, Inc., Lorillard Tobacco Company, Inc., and United States Tobacco Company and their various parent and related companies.

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

"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 plaintiffs for the types of claims released under the terms of this Agreement.

"Initial Settlement" means the settlement agreement entered into by the Initial Settling States and the Settling Defendants on March 15, 1996.

"Initial Settling States" means the States of Mississippi, West Virginia, Florida, and Louisiana, the Commonwealth of Massachusetts, and the respective Attorneys General thereof.

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

"Mandatory Class Settlement Agreement" or "Mandatory Class Agreement" means the agreement entered into on or about March 20, 1997 between Brooke Group and Liggett and a nationwide class.

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

"Mandatory Settlement Class" means the Settlement Class defined in the Mandatory Class Agreement.

"Mandatory Class 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 Defendant and a specified year, the Domestic Tobacco Operations market share in that year of all of such Defendant's cigarettes and other tobacco products, as determined by The Maxwell Consumer Report published by Wheat First Butcher Singer or a similar or successor report.

"Medicaid Population" means, with respect to a Settling State and a specified date, the Medicaid population of such Settling State as reported by the most recent United States Census.

"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 an 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 Section 4.3.1 and 4.3.2 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.

"Present Affiliate" means, with respect to a specified corporation or entity, 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 reported 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 in an Attorney General Action, an order in that Action: (a) protecting the confidentiality of such documents; (b) providing that such documents may be used only in that Attorney General Action 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 the 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 Attorney General to whom the documents are produced subject to the order. The provisions of the order shall not apply to documents claimed to be privileged but which are determined by the court in any Action or by the Settlement Court not to be privileged for reasons other than waiver due to production pursuant to this Agreement.

"Settlement Class" means the settlement class provided for in the Mandatory Class Agreement.

"Settlement Class Counsel" means the firms listed as Settlement Class Counsel in Section 25.8 of the Mandatory Class Settlement Agreement.

"Settlement Fund" means the fund established in accordance with the terms of Section 6 of this Agreement, which shall be established in a reputable bank or other financial institution, to provide a secure and interest

- -bearing fund, and which shall be jointly controlled by the Settling States and the Mandatory Settlement Class.

"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 the States listed in Appendix A hereto and Subsequent Settling States, if any.

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

"Subsequent Settling States" means States other than the States listed in Appendix A hereto which commence an Attorney General Action and which execute this Agreement within six months from the date of this Agreement (unless such six-month period is extended or reopened at the option of the Settling Defendants).

"Tobacco Companies" means the Defendants.

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

Settlement Purposes Only.

This Agreement is for settlement purposes only, and neither the fact of, or 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 as to their standing or as to any jurisdictional, constitutional or any other legal or factual issue in any Attorney General 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 any Attorney General Action or in any other action or proceeding of any kind, or as an admission by any of the Plaintiffs of the validity of any fact or defense asserted against them in any Attorney General Action or in any other action or proceeding of any kind.

I. Parties.

A. This Agreement shall be binding, in accordance with the terms hereof, upon Brooke Group, Liggett and the Settling States; provided that, notwithstanding anything else contained in this Agreement, the payment obligations of this Agreement shall be binding only upon Liggett.

B. No Settling Defendant shall sell, use, 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

4.2 and 4.4 through 4.8 hereunder as to such transferred brands or businesses; provided that this Section 3.2 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.

Public Statement; Cooperation; Advertising Limitations.

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:

I am, and have been for a number of years, a Director of Liggett Group Inc., a manufacturer of cigarettes. Cigarettes were identified as a cause of lung cancer and other diseases as early as 1950. I, personally, am not a scientist. But, like all of you, I am aware of the many reports concerning the ill-effects of cigarette smoking. We at Liggett know and acknowledge that, as the Surgeon General and respected medical researchers have found, cigarette smoking causes health problems, including lung cancer, heart and vascular disease and emphysema. We at Liggett also know and acknowledge that, as the Surgeon

General, the Food and Drug Administration and respected medical researchers have found, nicotine is addictive.

Liggett will continue to engage in the legal activity of selling cigarettes to adults, but will endeavor to ensure that these adult smokers are aware of the health risks and addictive nature of smoking. As part of our efforts, we will do the following:

1. In accordance with a court-approved settlement, Liggett will set up a fund to compensate equitably those who claim to have been injured by our products.

2. Liggett will add a prominent warning to each of our packages of cigarettes and all of our cigarette advertising stating that "Smoking is Addictive".

3. Liggett supports and will not challenge Food and Drug Administration regulations concerning the sale and distribution of nicotine-containing cigarettes and smokeless tobacco products to children and adolescents. Accordingly, Liggett has agreed to comply with many of these regulations even before they apply to the tobacco industry generally.

4. Liggett has instructed its advertising and marketing people to scrupulously avoid any and all advertising or marketing which would appeal to children or adolescents. Liggett acknowledges that the tobacco

industry markets to "youth," which means those under 18 years of age, and not just those 18-24 years of age. Liggett condemns this practice and will not market to children. Liggett agrees that if it sees industry advertisements which in its view are aimed at children, it will bring this to the attention of the Attorneys General.

5. In accordance with our settlement agreements, Liggett agrees to fully cooperate with the Attorneys General and Settlement Class Counsel in their lawsuits against the other tobacco companies. To that end, Liggett will make available to the Attorneys General, Settlement Class Counsel and other parties with whom we have settled all relevant documents and information, including documents subject to Liggett's own attorney-client privileges and work product protections, and will assist those parties in obtaining prompt court adjudication of the rest of the industry's joint privilege claims.

As promptly as reasonably practicable, but no later than six months after execution of this 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.

1. With respect to each Settling State, upon execution of this Agreement, each Settling Defendant shall:

(1) cooperate with such Attorney General, and the attorneys representing such Attorney General, in that such Settling Defendant will take no steps to impede or frustrate these counsels' civil investigations into, or civil prosecutions of, any of the Non-settling Tobacco Companies in those 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 such Attorney General Action;

(3) actively assist the attorneys representing the Attorneys General in identifying and locating any and all persons known to such Settling Defendant to have documents or

information that is discoverable in such proceedings, to actively assist said counsel in interviewing and obtaining documents and information from all such persons, and to encourage such person to cooperate with the Attorneys General; and shall actively assist counsel in interpreting documents relating to litigation against Non-settling Tobacco Companies; and

(4) 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, or their co-defendants designed to frustrate or defeat the claims of the plaintiffs against such parties, companies, agents 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.

4.3.2. With respect to each Settling State, subject to, and promptly after, the entry of a Protective Order or a Stipulation Regarding Liggett Documents by the court in which the respective Attorney General Action is pending or the Settlement Court, 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 any of the Actions, subject to the provisions of Section 4.3.2(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 the Actions or not likely to lead to admissible evidence in connection with claims asserted in any of the Actions or (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 4.3.2(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 Settlement Court or a court in which a Settling State's Attorney General Action is pending, together with a statement to such 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 such 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, and help locate former employees, 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; and

(4) demand from its past or current national legal counsel all documents and information

obtained by them in the course of representation of any Settling Defendant which in any way relates to the cooperation required in paragraphs 4.3.1(1) - 4.3.2(3) above, which should be provided to the Settling States as provided under this paragraph.

4.3.3. With respect to the cooperation set forth in subsections 4.3.1 and 4.3.2 above, the Attorneys General and Settlement 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 the Attorneys General to obtain discovery of Liggett as required by a court order or case management order in any Attorneys General Action, provided that no order is sought that is inconsistent with this Agreement.

4.3.4. 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.

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.

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 4.5.1 - 4.5.4 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.

FDA Rule Section 897.16(b), as proposed.

FDA Rule Section 897.16(d), as proposed.

FDA Rule Section 897.30(a), as proposed.

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.

Notwithstanding anything to the contrary in the Proposed Rule or in this Agreement, Liggett will commence compliance with Section 4.5 of this Agreement as soon as reasonably practicable, according priority as to compliance to the States listed in Appendix A hereto 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 4.5 (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 4.5, 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 4.5.

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 4.5.

A. 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.

4.9. Each Settling Defendant may, after becoming bound by this Settlement Agreement, continue in the lawful manufacture, advertising and/or sale of tobacco products. This Settlement Agreement does not in any way abrogate or restrict the authority or ability of the Attorneys General to enforce future compliance with the laws of their respective States.

Global Settlement.

Effective upon the execution hereof, the Attorneys General and their respective 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 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 Attorneys General 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.

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 further performance of this Agreement.

Settlement Fund.

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 Settling States in accordance with this and the Mandatory Class Settlement Agreement. In the event that the Settling States and Settlement Class Counsel cannot agree to an equitable allocation of the Settlement Fund between the Settling States and the Settlement Class, the Settling States and Settlement 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 cannot agree on the selection of an Arbitrator, the Settling States and Settlement Class Counsel will petition the Class Action Court to determine such allocation; it being understood that some portion of the Settlement Fund will be allocated to counter-market advertising.

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 6.1 above.

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

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

6.3.2. Subject to the provisions of Sections 6.6 - 6.12, 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.

6.4. 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.

6.5. Since the Settling Defendants are providing historic and valuable cooperation and other considerations under this Agreement and the Mandatory Class Agreement, the amounts payable hereunder to the Settlement Fund shall represent the maximum amounts payable to the Settlement Fund under this Agreement and the Mandatory Class Agreement.

6.6. With respect to each Settling State, in the event of the entry of any final non-appealable monetary judgment in such Settling State's Attorney General Action (other than by way of settlement) against any one or more of the Non-settling Tobacco Companies, then the Settling Defendants shall have the right to reduce the payments they are obligated to make pursuant to this Agreement to the extent necessary to make (i) the then Present Value of all amounts theretofore paid and thereafter payable to that Settling State pursuant to this Agreement by the Settling Defendants (such amounts being calculated for purposes of this Section 6.6 by multiplying (a) the total amount of the Settlement Fund allocated to all of the Settling States in that year by (b) a quotient equal to the Medicaid Population of such Settling State in that year divided by the total

Medicaid Population of all Settling States) per percentage point of the then Market Share of such Settling Defendant no more than seventy-five percent (75%) of (ii) the then Present Value of the dollar amount of such judgment per percentage point of the then Market Share of each such Non-settling Tobacco Company;[1] provided that such Settling Defendant give written notice of such reduction and the method of calculating such reduction to the Settling State's Attorney General as soon as practicable after the entry of judgment.

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1 Example: For purposes of this example of Section 6.6, assume:

Liggett has a 2% Market Share (i.e., 2 points).

A Non-settling Tobacco Company has an 8% Market Share (i.e., 8 points), and in 1998 has a final judgment entered against it in an Attorney General Action that requires payments by such Non-settling Tobacco Company with a then Present Value of $20 million.

The Present Value of the amount allocable by Liggett to the Settling State in 1998 is $5 million.

Result: In 1998, Liggett would be permitted to reduce its future payments to the extent necessary to make the Present Value of its past and future payments $3.75 million -- i.e., no more than 75% of the Present Value of the judgment, all as adjusted for relative Market Share. The calculation would be as follows:

Present Value of Liggett payment/2 points

= .75 X judgment/8 points

Present Value of Liggett Payments

= .75 X $20 million/4 = $3,750,000.

Thus, the larger the judgment, the less the reduction. Under this example, if the judgment is $26,670,000 or more, there would be no reduction.

6.7. In each year beginning with the second year after execution of this Agreement, the annual payment amount due under Section 6.3.2 of this Agreement from a 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.2

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2 Example: For purposes of this example of Section 6.7, assume:

Liggett's Pretax Income is $11 million each year, thus making Liggett's obligation under the settlement $2,750,000 per year.

Liggett's Market Share drops from 2% in 1996 and 1997 to 1.75% in 1998, but recovers to 1.9% in 1999, and then back to 2.0% in 2000.

Reduction: In 1998, Liggett's amount due will be reduced by $343,750 to $2,406,250. Since Liggett's Market Share fell by .25 points or 12.5%, its payments would be reduced by 12.5% or $343,750 [$2,750,000 x .125]

Recapture of Market Share: In 1999, Liggett's payments will climb commensurate to its increase of .15 in Market Share (1.75 to 1.9%) to $2,612,500 [$2,406,250 + (2,406,250 x .15/1.75)].

In 2000, Liggett's payment would again increase commensurate to its increase of .1 in Market Share to $2,750,000 [$2,612,500 + ($2,612,500 x .1/1.90)].

Liggett would not be entitled to a "double reduction" for a decrease in both Pretax Income and Market Share. Thus, if Liggett's .25 point drop in market Share in 1998 were accompanied by a drop in Pretax Income between 1997 and 1998 from $11 million to $8 million, there would be no Market Share reduction, as Liggett's payment obligations (25% of Pretax Income) would have already fallen from $2,750,000 to $2,000,000.

6.8. 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).

6.9. 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.

6.10. In the event that one or more States elect to opt out of the Mandatory Settlement Class and action(s) are brought against any Settling Defendant on behalf of such State(s), the annual payment amount due under Sections 6.3.2 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 Mandatory Settlement Class then bears to the total Medicaid Population and (ii) 20% of Liggett's Pretax Income.

6.11. Insofar as the Mandatory Class Settlement Agreement is not approved or is otherwise terminated, the Settlement Fund shall be administered solely thereafter by the Attorney General Board for the benefit of the Settling States, and the percentage of Liggett's Pretax Income payable under Section 6.3.2 shall, in the event there is no Global Settlement, be reduced to an amount equal to the product of (i) the ratio that the Medicaid Population of the Settling States then bears to the total Medicaid Population and (ii) 20% of Liggett's Pretax Income.

6.12. Any allocations set forth in this Section 6 among the Settling States and Settlement Class are solely for the purposes of making the calculations set forth in this Section 6 and are in no way binding upon or evidence for the allocations of payments from the Settlement Fund to any recipients thereof.

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

Release.

Upon the date each Settling State becomes bound by this Agreement, for good and sufficient consideration as described herein, each Settling State and each Attorney General thereof shall for the duration or term of this

Agreement (whichever is shorter) be deemed to and hereby does release, dismiss and discharge each and every civil claim, right, and cause of action (including, without limitation, all claims for damages, restitution, medical monitoring, or any other legal or equitable relief), 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 and present parents, subsidiaries, present affiliates, employees, directors and shareholders, but only in such capacities, vis-a-vis, each such Settling Defendant, and downstream distribution entities of Settling Defendant, but only to the extent that such downstream distribution entities would have cross-claims against Settling Defendant), but does not in any fashion release any Non-settling Tobacco Companies or other defendants in any Attorney General Action except as provided for in Section 17 hereof, (i) which was asserted in that State's Attorney General Action, and/or (ii) which was not asserted in said Action but which is smoking-related or otherwise arises out of, or concerns, the acts, facts, transactions, occurrences, representations, or omissions set forth, alleged, referred to or otherwise embraced in the complaint of that Settling State's Attorney General Action.

Upon the date each Settling State becomes bound by this Agreement, for good and sufficient consideration as described herein, each such Settling Defendant shall for the duration or term of this Agreement (whichever is shorter) be deemed to and hereby does release, dismiss and discharge each and every claim, right, and cause of action (including, without limitation, all claims for damages, restitution, fees, expenses, or any other legal or equitable relief), whether known or unknown, asserted or unasserted, which they had, now have or may hereafter have as of the effective date of this Agreement against each such Settling State, its public officials and employees in connection with, arising out of or related to the acts, facts, transactions, occurrences, representations, or omissions set forth, alleged or referred to or otherwise embraced in the complaints of the Settling States' Attorney General Actions.

Provided, however, as follows:

1) If this Agreement expires upon completion of its full term, these releases set forth in this Section 7.1 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, these releases 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, these releases set forth in this Section 7.1 do not pertain or apply to any other existing or potential party in any present or future Attorney General Action.

3) These releases set forth in this Section 7.1 do not in any way release any releasee from claims which may be asserted by a releasor involving conduct unrelated to the manufacture and/or sale of tobacco products.

4) With respect to the claims of any county, municipality or subdivision within a Settling State that, as of the date of this agreement, has brought an action against Settling Defendants separate and apart from the action brought against Settling Defendants by the Settling State encompassing such county, municipality or subdivision, these releases set forth in this Section 7.1 do not release the claims of such county, municipality or subdivision except for the exclusively State share of the Medicaid funds claimed in any such action.

5) The provisions of this Section 7.1 apply to all States except the State of Connecticut. With respect

to the State of Connecticut only, the claims described herein as having been released shall not be released and shall remain in existence; provided, however, that the State of Connecticut and the Attorney General of Connecticut shall, upon entering into this agreement, covenant not to bring or prosecute any suit or action with respect to such claims against each Settling Defendant, and the beneficiaries of this covenant shall be the same beneficiaries of the release provided by all other States pursuant to Section 7.1. It is expressly understood that this covenant is not intended to and does not release or affect any claims that the State of Connecticut has or may have against any other persons or entities, and in particular is not intended to and does not release or affect any claims that the State of Connecticut has asserted or may assert against any Non-settling Tobacco Companies or any other defendants in its Attorney General Action.

Except as specifically provided herein, nothing in this Agreement shall prejudice or in any way interfere with the rights of Settling States or Settling Defendants to pursue any or all of their rights and remedies against Non-settling Tobacco Companies or other parties not released hereunder.

7.3. With respect to the State of Maryland, this Section 7 is deemed to include the additional statements set forth in Sections 11.5 and 11.6.

I. Exclusive Remedy; Dismissal of Action;

Jurisdiction of Court.

Except as otherwise provided in this Agreement, this Agreement shall be the sole and exclusive remedy for any and all claims of Settling States released hereby against the Settling Defendants, and upon the date a Settling State becomes bound by this Agreement, each such Settling State shall be barred from initiating, asserting, or prosecuting any claims released hereby against each such Settling Defendant.

Promptly after each Settling State becomes bound by this Agreement, each such Settling State shall dismiss without prejudice its corresponding Attorney General Action as against such Settling Defendant, or if defendants have not yet responded to a complaint, the Settling State may amend the complaint to delete the Settling Defendant from the Action.

Promptly after the date each Settling State becomes bound by this Agreement, each such Settling Defendant shall withdraw without prejudice from any action brought against any Settling State with respect to claims released hereby.

Term.

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

Each Settling Defendant shall have the right to terminate this Agreement with respect to that Settling Defendant and with respect to the Settling State in which there is a full and final dismissal on the merits as to any of the Non-settling Tobacco Companies in that Settling State's Attorney General Action; provided that in the event of any such termination, the payments due from such Settling

Defendant pursuant to this Agreement shall be thereafter reduced by an amount equal to the product of (a) the total amount of the Settlement Fund allocated to all of the Settling States at the time of such dismissal and (b) a quotient equal to the Medicaid Population of such Settling State at the time of such dismissal divided by the total Medicaid Population of all Settling States at the time of such dismissal); provided further that any and all payments made pursuant to this Agreement prior to any such termination by such Settling Defendant shall be retained by the Settlement Fund. The Attorneys General shall provide the Settling Defendant with the information necessary to determine the amount referred to in subpart (a) hereof. Termination under this section does not in any fashion reduce Settling Defendants' obligations in any other Attorney General Actions.

Each Settling Defendant shall have the right at any time during the term of this Agreement to terminate this Agreement with respect to such Settling Defendant in the event that, in its sole and exclusive discretion, it determines that too many states have opted out of the Mandatory Settlement Class and have not resolved such cases with respect to the Settling Defendant by becoming bound by this Agreement in accordance with the terms hereof; provided that such Settling Defendant give written notice of such termination to the Attorneys General of the Settling States and provided further that any and all payments due up to the date of such termination made pursuant to this Agreement prior to the giving of such notice by such Settling Defendant shall be retained by the Settlement Fund. Such termination must be exercised no later than sixty days after the date that Settling Defendants determine how many states have opted out of the Mandatory Settlement Class.

In the event of a termination of this Agreement with respect to any Settling State, such Settling Defendant shall be entitled to offset any payments made to such Settling State prior thereto against any judgments thereafter obtained by such Settling State against such Settling Defendant in an Attorney General Action.

If any Settling Defendant subsequently withdraws from this Agreement, or this Agreement, for whatever reason, is terminated other than by reason of expiration of its term, then the applicable statute of limitations or any similar time requirement for a Settling

State or a terminating Settling Defendant to file a claim that would otherwise be released hereunder against, or by any Settling Defendant shall be tolled from the date such Settling State became bound by this Agreement until the later of the time permitted by applicable law or for one year from the date of such termination with the effect that the parties shall be in the same position as they were at the time the Settling State filed its original Attorney General Action with respect to the statute of limitations.

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 Settling State pursuant to this Agreement.

Continuing Enforceability

Unless earlier terminated, as to the Settling States, 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, 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"). The Settling States acknowledge and agree that 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 in Section 6.3.2 hereof, and so long as the Brooke Group is paying all amounts due hereunder and no such payments are voidable, then the Settling States waive any and all rights they may have not to accept such cure or performance in any Bankruptcy Proceeding.

Entry of Good Faith Bar Order on Contribution and Indemnity Claims

It is the intent of the parties that the payments to be made by Liggett with respect to the Attorneys General Actions settled hereby, be limited to those payments set forth in this Settlement Agreement, and that Settling Defendants not be responsible for any payments relating to any contribution or indemnity claim asserted, or to be asserted, by any non-settling defendant that may arise from any of such Attorneys General Actions. It is further the intent of the parties to this Agreement that in Minnesota and Wisconsin the release of the Settling Defendants and any rights of non-settling defendants to contribution or indemnity shall be construed as a PIERRINGER release, as used in PIERRINGER V. ROGER, 21 Wisc.2d 182, 124 N.W.2d 106 (1963); FREY V. SNELGROVE, 269 N.W.2d 918 (Minn. 1978). In order to effectuate this intent of the parties, and only in order to effectuate such intent, the parties agree as follows in this Section 11.

Subject to, and as promptly as reasonably practicable, under applicable law, the Parties shall request that the respective courts in the Attorney General Actions enter orders barring and prohibiting the commencement and prosecution of any claim or action by any non-settling defendant against any Settling Defendant, including but not limited to any contribution, indemnity and/or subrogation claim seeking reimbursement for payments made or to be made to any Settling State for claims settled under this Agreement. Settling Defendants shall be entitled to dismissal with prejudice of any non-settling defendants' claims against them which violate or are inconsistent with this bar, if granted.

The Settling States shall not seek to collect any amount on any judgment against a non-settling defendant to the extent, and only to the extent, that such non-settling defendant has a right under applicable law of contribution or indemnification against the Settling Defendants. This section will not apply to any agreement or understanding, known or unknown, written or otherwise, with any non-settling defendant or any other party that entitles any non-settling defendant to indemnity or contribution from Brooke Group or Liggett.

Should a Settling State receive a final monetary judgment against a non-settling defendant which then results in the non-settling defendant being legally entitled to require a Settling Defendant to make payment toward that judgment, the Settling States shall seek Court approval to reduce the judgment by an amount sufficient to result in the Settling Defendant having no obligation toward the judgment.

The provisions of Sections 11.1 - 11.4 apply to all States except for the State of Maryland. With respect to the State of Maryland only, the State of Maryland shall, upon entering into this Agreement, execute a release of Settling Defendants which shall state, among other things provided for in this Agreement: "In the event of a verdict against non-settling defendants in this Action, and in the event that with respect to such verdict, any Settling Defendant is adjudicated a joint tortfeasor in any manner in this Action, there shall be a judgment reduction from such verdict accounting for the status of Settling Defendants as a joint tortfeasor in the amount of $[the Present Value of Settling Defendants' total aggregate payments allocable to the State of Maryland as calculated pursuant to provisions of the Attorneys General Settlement Agreement]. It is the intention of the parties that this Release provide for a PRO TANTO reduction of any damages recoverable against all other tortfeasors in this action, and only if Settling Defendants, or any of them, are adjudicated a joint tortfeasor. This Release does not provide, and shall not be construed to provide, for a reduction, to the extent of the PRO RATA share of Settling Defendants, or any of them, of the damages recoverable in this action against all other tortfeasors. If a judgment reduction occurs on a PRO TANTO basis as provided in this Release and if a non-settling joint tortfeasor pays more than its PRO RATA share of the judgment, that joint tortfeasor shall receive that portion of any future payment made thereafter by Settling Defendants in accordance with the Attorneys General Settlement Agreement that is (1) beyond the amount of the PRO TANTO setoff provided for in this Release, and (2) attributable to that part of claims against that joint tortfeasor for which Settling Defendants are jointly and severally liable."

With respect to the State of Maryland only, the Attorney General of Maryland shall cause a competent appraiser to make a calculation of Present Value of Settling Defendants' total aggregate payments allocable to the State of Maryland as provided for under this Settlement Agreement, which valuation is referenced and bracketed in Section 11.4 hereof. Such calculation of Present Value of payments allocable to the State of Maryland under this Agreement shall be the amount stated in the bracketed portion of the language quoted in Section 11.4 above.

Tax Status of Settlement Fund.

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, 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 any changes to the Agreement which may be necessary to obtain IRS approval of the Settlement Fund as a QSF.

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 Attorney General 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.

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.

Effect of Default of Settling Defendant.

In the event a 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, Plaintiffs' Counsel shall so notify the defaulting Settling Defendant, which shall then be given 60 calendar days to "cure" the default. If the defaulting Settling Defendant does not "cure" the default in the time provided in this Section 13, Plaintiffs' Counsel may apply to the Court for relief, in addition to any other remedies it may have hereunder.

I. Representations and Warranties.

A. Each Settling Defendant represents and warrants that it (i) 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; (iii) the Agreement has been duly and validly executed and delivered by such Settling Defendant and constitutes its legal, valid and binding obligation; and (iv) this Agreement does not violate the charter of bylaws of such Settling Defendants or any Agreement to which the Settling Defendant is a party.

Each Settling State represents and warrants that pursuant to its statutory and/or common law authority

(i) it has all requisite 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 State of this Agreement and the consummation by it of the actions contemplated herein have been duly authorized by all necessary action on the part of such Settling State; and (iii) the Agreement has been duly executed and authorized by such Settling State and constitutes its legal, valid and binding obligation.

Arbitration.

In the event that the Parties are unable to agree, after good faith efforts, as to the determination or calculation for any applicable year of Market Share or Pretax Income hereunder, such determination or calculation shall be submitted to binding arbitration in accordance with the rules of the American Arbitration Association.

Most Favored Nation.

It is the intent of the parties hereto that the Settling Defendants enjoy a preferred position with respect to Non-Settling Tobacco Companies, in recognition of the Settling Defendants' willingness to enter into this Agreement. Accordingly, it is generally contemplated that settlements which involve all Settling States and a Non-Settling Tobacco Company (a "Group Other Settlement") or involving one Settling State and a Non-Settling Tobacco Company (a "Single State Other Settlement") shall meet certain minimum requirements in terms of the initial, periodic or lump sum payments to be made by the Non-Settling Tobacco Company (each a "Benchmark Figure"). The recital of these Benchmark Figures herein is solely for the purposes of insuring that the Settling Defendants enjoy a preferred position with respect to Non-Settling Tobacco Companies and is not intended in any way to reflect the value of the Settling States claims against Non-Settling Tobacco Companies, and nothing in this Agreement is intended to reflect the value of those claims. For purposes of this Section 16, a settlement involving a Non-Settling Tobacco Company and some, but not all, Settling States shall be deemed a Single Other Settlement, and the preferred position of the Settling Defendant shall be governed by Subsections 16.1.3 and 16.1.4 hereof, and determined on a state-by-state basis.

In the case of a Group Other Settlement which includes an initial payment such as that provided for in Section 6.3.1 hereof, the Benchmark Figure shall be that figure which represents three times the Present Value of the initial payment made hereunder, adjusted for Market Share at the time of such payment. Thus, if at the time of the initial payment hereunder, the Settling Defendant had a market share of 2 percent, and made a payment the Present Value of which is $15 million, and the Settling States subsequently enter into a Group Other Settlement with a Non-Settling Tobacco Company which has a market share of 10 percent, the Benchmark Figure for the initial payment shall be $225 million. To the extent that the initial payment actually provided for in such Group Other Settlement is less than the Benchmark Figure, the Settling Defendant shall receive a credit in like amount, up to the amount of the present value of the initial payment made hereunder, against all future payment obligations hereunder.

In the case of a (i) Group Other Settlement which included only a lump sum or periodic payments, and (ii) with respect to the periodic payments included in a Group Other Settlement which also includes an initial payment, the Benchmark Figure shall be that amount which constitutes three times the Present Value of all amounts paid or payable by the Settling Defendant hereunder (excluding, if the Group Other Settlement contains an initial payment, the initial payment hereunder), assuming, in the case of future payments, no increase or decrease in Market Share but assuming Inflation in revenues, all adjusted for Market Share. Thus, if the Present Value of a Settling Defendant's payments made or to be made hereunder is $60 million and such Settling Defendant enjoys a Market Share of 2%, the Benchmark Figure for a non-settling defendant which at the time of a Group Other Settlement enjoys a Market Share of 15% would be $1,350 million. Similarly, the Benchmark Figure for a Non-Settling Defendant which at the time of a Group Other Settlement enjoys a

Market Share of 5% would be $450 million. To the extent that the Present Value of the lump sum or periodic payments to be made under a Group Other Settlement is less than the Benchmark Figure, the Settling Defendant shall receive a credit in like amount, up to the amount of any remaining payment obligations hereunder.

In the case of a Single State Other Settlement which includes an initial payment such as that provided for in Section 6.3.2 hereof, the Benchmark Figure shall be that figure which represents three times the Present Value of the initial payment made hereunder to such Settling State, adjusted for Market Share at the time of such payment, computed in accordance with Section 16.1.1. To the extent that the initial payment actually provided for in such Single State Other Settlement is less than the Benchmark Figure, the Settling Defendant shall receive a credit in like amount, up to the amount of the present value of the initial payment made to the Settling State hereunder, against all future payment obligations to the Settling State hereunder.

In the case of a Single Other Settlement which includes only a lump sum or periodic payments, and with respect to the periodic payments included in a Single State Other Settlement which also includes an initial payment, the Benchmark Figure shall be that amount which constitutes three times the Present Value of all amounts paid or payable by the Settling Defendant to the Settling State hereunder (excluding, if the Single State Other Settlement contains an initial payment, the Initial Payment hereunder), assuming, in the case of future payments, no increase or decrease in Market Share but assuming Inflation in revenues, all adjusted for Market Share, computed as set forth in Section 16.1.2. To the extent that the Present Value of the lump sum or periodic payments to be made under a Single State Other Settlement is less than the Benchmark Figure, the Settling Defendant shall receive a credit in like amount, up to the amount of any remaining payment obligations to the Settling State hereunder.

Solely for the purposes of Sections 16.1, the payments due to each of the Settling States in a year shall be deemed to be equivalent to the product of (a) 10% of the Settling Defendant's Pretax Income and (b) a quotient equal to the Medicaid Population of the Settling State divided by the total Medicaid Population of all Settling States.

The Benchmark Figure set forth in Sections 16.1.1 - 16.1.4 does not reflect in any fashion the Settling States' views as to an appropriate settlement or resolution with any Non-Settling Tobacco Company.

Except as provided in Section 16.1 hereof, in the event that, subsequent to the date of this Agreement, any settlement of any Settling State's Attorney General Action is reached with any non-settling defendant which is not a Party hereto and such settlement is on any terms more favorable to such non-settling defendant than are the terms of this Agreement to a Settling Defendant, such Settling Defendant shall each have the right to replace or modify any or all of the terms of this Agreement with, or add to this Agreement, any or all such more favorable terms.

A. In the event that, subsequent to the date of this Agreement, any of the Settling Defendants enters into a settlement agreement with any State other than a Settling State on terms (relating to the then Present Value of amounts payable under such settlement agreement, compliance with the Proposed Rule or cooperation) that are more favorable to the State than those contained herein (as adjusted for relative Medicaid Population), the Settling States shall have the right with respect to such Settling Defendant to replace or modify any or all of the terms of this Agreement with, or add to this Agreement, any or all such more favorable terms (adjusted for relative Medicaid Populations).

II. Future Affiliate.

A. 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 17.

B. (a) In the event of a Future Affiliate Transaction, the Settling States 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

Settling States reserve 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 Settling States each release (pursuant to, MUTATIS MUTANDIS, Section 7.1 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 Settling State shall have obtained a verdict or judgment in its Attorney General Action, against an Affiliate (including the Parent) of the Future Affiliate, other than against the Affiliate engaged in Domestic Tobacco Operations, such Settling State shall not seek to enforce such verdict or judgment against any such Affiliate other than the Affiliate engaged in Domestic Tobacco Operations.

In the event a Settling State obtains a verdict or judgment against a Non-settling Tobacco Company in an Attorney General 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 Settling State 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.

In the event that subsequent to a Future Affiliate Transaction, and in conformity with Section 17.2(b) hereof, a Settling State obtains a verdict or judgment against a Future Affiliate in an Attorney General Action, such Future Affiliate will not be required to post a bond in order to stay enforcement of such verdict or judgment, and such Settling State 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.

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, Settling States reserve all of their rights to prevent the Future Affiliate from diminishing or impairing the Future Affiliate's Tobacco assets, other than in the established and/or ordinary course of business of such Future Affiliate.

With respect to subsections 17.1 - 17.5 above, nothing in these provisions, or elsewhere in this Agreement, limits the authority of the Attorneys General to challenge any transaction which they reasonably believe is in violation of federal or state antitrust law.

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 6.3.2 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 6.3.2. Nothing in this Section 17.7 affects in any way Liggett's payment obligations under Section 6.3.1 hereof.

Promptly after a Future Affiliate Transaction, a Future Affiliate shall abide by Sections 4.4 - 4.7 hereof.

Promptly after 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 settlement of all Attorney General Actions against a Future Affiliate's Domestic Tobacco Operations.

17.9. 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.

Miscellaneous.

All terms of this Agreement and/or obligations created thereby shall be deemed to include a covenant of good faith and fair dealing on behalf of all parties.

Brooke Group shall provide to the Settling States at the time of execution of this Agreement, an opinion in form satisfactory to the Settling States from legal counsel for the Brooke Group as to the due execution of the Settlement Agreement by the Brooke Group and Liggett and its enforceability against the Brooke Group and Liggett and such other matters contemplated by Section 14.1 (other than the "agreements" referenced in clause (iv)).

In the event that a termination occurs pursuant to any sections of this Agreement, no Settling State shall be required to return any payment.

Subject to the provisions of Section 18 herein, this Agreement, including all Appendices attached hereto, if any, shall constitute the entire Agreement among the parties with regard to the subject 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.

With respect to each Settling State, this Agreement shall be construed under and governed by the laws of such State applied without regard to its laws applicable to choice of law.

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.

Any judgment by a court that any provision of this Agreement, as applied to any party or to any circumstance, is invalid or unenforceable shall in no way affect any other provision of this Agreement or the application thereof in any other circumstance, and such provision so adjudged invalid or unenforceable shall be enforced to the maximum extent permitted by law.

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

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.

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. . Any notice, request, instruction, 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 Plaintiffs' Counsel on behalf of the Settling States.

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.

BROOKE GROUP LTD.	STATE OF ARIZONA
By______________________________	By______________________________
Bennett S. LeBow	Grant Woods Attorney General

Date:__________________________

LIGGETT GROUP, INC.

By_____________________________
Bennett S. LeBow

Date:__________________________

KASOWITZ, BENSON, TORRES
& FRIEDMAN LLP

By_____________________________
Marc E. Kasowitz
Attorneys for
BROOKE GROUP LTD. and
LIGGETT GROUP, INC.

Date:____________________________

STATE OF CONNECTICUT

By______________________________
Richard Blumenthal
Attorney General

Date:___________________________

STATE OF HAWAII

By_____________________________
Margery Bronster
Attorney General

Date:__________________________

STATE OF ILLINOIS

By_____________________________
Jim Ryan
Attorney General

Date:__________________________

STATE OF INDIANA

By_____________________________
Jeffrey Modisett
Attorney General

Date:__________________________

STATE OF IOWA

By_____________________________
Tom Miller

Attorney General

Date:______________________________

STATE OF KANSAS

By_________________________________
Carla Stovall
Attorney General

Date:______________________________

STATE OF MARYLAND

By_________________________________
Joseph Curran
Attorney General

Date:______________________________

STATE OF MICHIGAN

By_________________________________
Frank Kelley
Attorney General

Date:______________________________

STATE OF MINNESOTA

By____________________________________
Hubert H. Humphrey, III
Attorney General

Date:________________________________

STATE OF NEW JERSEY

By___________________________________
Peter Verniero
Attorney General

Date:________________________________

STATE OF NEW YORK

By___________________________________
Dennis Vacco
Attorney General

Date:________________________________

STATE OF OKLAHOMA

By___________________________________
Drew Edmondson
Attorney General

Date:________________________________

STATE OF TEXAS

By___________________________________
Dan Morales
Attorney General

Date:________________________________

STATE OF UTAH

By_______________________________
Jan Graham
Attorney General

Date:____________________________

STATE OF WASHINGTON

By_______________________________
Christine Gregoire
Attorney General

Date:____________________________

STATE OF WISCONSIN

By_______________________________
Jim Doyle
Attorney General

Date:____________________________

Exhibit 10.41

CLASS SETTLEMENT AGREEMENT

This CLASS SETTLEMENT AGREEMENT is entered into this 20th day of March 1997 by and between the named and representative plaintiffs (collectively, "Plaintiffs") in CAROL FLETCHER, ET AL. V. LIGGETT GROUP INC., ET AL., Civil No. _____, In the Circuit Court of Mobile, Alabama (the "FLETCHER Action"), for themselves 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,

On March 19, 1997 Plaintiffs filed a complaint to commence the FLETCHER Action 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, 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.

The primary purpose of this Class Settlement Agreement is to provide certain injunctive relief sought by Plaintiffs and other settlement class members, including the cooperation of Liggett and Brooke Group, and to create a fund for the equitable settlement of the claims of the settlement class members, free of the risks and costs of prolonged litigation. The mechanism for accomplishing this purpose 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 injunctive relief, cooperation, and monetary settlement are components of an integrated settlement set forth in this Class Settlement Agreement. Liggett and Brooke Group agree to provide cooperation and to submit to the injunctive relief set forth herein in the context of a mandatory class settlement.

Apart from the FLETCHER Action, hundreds of individual actions and putative class actions, as well as numerous 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. In addition to the hundreds of smoking-related claims that have already been filed against these defendants in jurisdictions throughout the United States, 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.

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

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.

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 of the Alabama Rules of Civil Procedure in the context of this settlement.

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

Liggett has made available relevant information, and Plaintiffs, through counsel, have investigated such information and other relevant information and conducted discovery, as to the nature, extent and availability of Liggett's financial resources, and have concluded that the criteria of Alabama

Rule of Civil Procedure 23(b)(1) apply to Liggett and its affiliates in the context of this settlement.

Plaintiffs 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 disclosures of material facts relating to tobacco products.

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

Liggett and Brooke Group recognize and acknowledge that defending the continued prosecution of the FLETCHER 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 constitute circumstances under which the available assets of Liggett and Brooke Group 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 FLETCHER Action against them will be beneficial to them 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.

Plaintiffs recognize and acknowledge that the continued prosecution of the FLETCHER 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 and Brooke Group. Plaintiffs and Liggett and Brooke Group recognize that this settlement with Liggett provides uniquely favorable terms to Liggett in recognition of its unique situation, including its willingness to be the first tobacco industry defendant to settle with any of the public or private plaintiffs, its agreement to provide documents and cooperation expected to be of material benefit to the litigation against the other, much larger tobacco defendants, Liggett's small market share, and its precarious financial situation. Plaintiffs have determined that the settlement, in accordance with this Class Settlement Agreement, of the claims asserted in the FLETCHER Action against Liggett and Brooke Group will be beneficial to the settlement class by providing all settlement class members with substantial and critical non-monetary equitable relief, as well as the opportunity to share equitably in the common fund created by this Class Settlement Agreement.

NOW, THEREFORE, in consideration of the foregoing and of the promises and covenants set forth in this Class Settlement Agreement, Plaintiffs, on their 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 Alabama Rules of Civil Procedure and as provided herein, the Action shall be settled as against Liggett and Brooke Group and that all claims asserted by or on behalf of the putative class members in the FLETCHER Action against the Settling Defendants shall be dismissed with prejudice, all on the terms and conditions contained herein, as follows:

DEFINITIONS.

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

"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 their counsel, or appointed by the 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 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 A.

"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 Circuit Court of Mobile County, Alabama.

"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.

"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 Alabama 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 Alabama 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 Section 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.

"Personal Injury Subclass" means a settlement subclass 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, prior to or during the term of this Agreement, have been exposed to environmental or second-hand tobacco smoke and have suffered or claim to have suffered Injury as a consequence thereof;

provided that excluded from such settlement subclass are (i) officers and directors of any of the Settling Defendants and (ii) any person or entity which has entered into any prior or contemporaneous settlement with Liggett of a Tobacco Action.

"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 Alabama 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 on 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.

"Recoupment Subclass" means a settlement subclass composed of: all persons or entities not in the Personal Injury Subclass (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, directly or indirectly, economic loss as a result of paying for the treatment of diseases, illnesses, or medical conditions allegedly caused by Cigarettes (or exposure thereto, including by way of environmental or second hand smoke); provided that excluded from such settlement subclass 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" means a settlement class composed of the Personal Injury Subclass and the Recoupment Subclass as herein defined.

"Settlement Class Counsel" means the firms listed as Personal Injury Settlement Subclass Counsel and Recoupment Settlement Subclass Counsel in Section 26.8 of this Agreement.

"Settlement Class Representatives" means the Plaintiffs approved by the Court to serve as Settlement Class representatives for their respective settlement subclasses.

"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.

"Settlement Fund Board" or "Board" means the board which shall be established pursuant to this Agreement to administer that portion of the Settlement Fund allocated to the Settlement Class pursuant to this Agreement. The Settlement Class 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 and have suffered or claim to have suffered Injury as a consequence thereof.

"State Opt Out Period" means the period commencing on the Initial Notice Date and extending for a period of time as provided in Section 9 hereof.

"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, putative or certified class action lawsuit or action on behalf of a governmental entity brought against one or more Tobacco Companies in connection with smoking-related claims such as (without limitation) those asserted in the FLETCHER Action or any Attorney General 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.

2.1. 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.

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:

I am, and have been for a number of years, a Director of Liggett Group, Inc., a manufacturer of cigarettes. Cigarettes were identified as a cause of lung cancer and other diseases as early as 1950. I, personally, am not a scientist. But, like all of you, I am aware of the many reports concerning the ill-effects of cigarette smoking. We at Liggett know and acknowledge that, as the Surgeon General, the FDA and respected medical researchers have found, cigarette smoking causes health problems, including lung cancer, heart and vascular disease and emphysema. We at Liggett also know and acknowledge that, as the Surgeon General, the Food and Drug Administration and respected medical researchers have found, nicotine is addictive.

Liggett will continue to engage in the legal activity of selling cigarettes to adults, but will endeavor to ensure that these adults are aware of the health risks and addictive nature of smoking. As part of our efforts, we will do the following:

1. In accordance with a court-approved settlement, Liggett will set up a fund to compensate equitably those who claim to have been injured by our products.

2. Liggett will add a prominent warning to each of our packages of cigarettes and all of our cigarette advertising stating that "Smoking is Addictive".

3. Liggett supports and will not challenge Food and Drug Administration regulations concerning the sale and distribution of nicotine-containing cigarettes and smokeless tobacco products to children and adolescents. Accordingly, Liggett has agreed to comply with many of these regulations even before they apply to the tobacco industry generally.

4. Liggett has instructed its advertising and marketing people to scrupulously avoid any and all advertising or marketing which would appeal to children or adolescents. Liggett acknowledges that the tobacco industry markets to "youth," which means those under 18 years of age, and not just those 18-24 years of age. Liggett condemns this practice and will not market to children. Liggett agrees that if it sees industry advertisements which in its view are aimed at children, it will bring this to the attention of the Attorneys General.

5. In accordance with our settlement agreements, Liggett agrees to fully cooperate with the Attorneys General and Settlement Class Counsel in their lawsuits against the other tobacco companies. To that end, Liggett will make available to the Attorneys General, Settlement Class Counsel and other parties with whom we have settled all relevant documents and information, including documents subject to Liggett's own attorney-client privileges and work product protections and will assist those parties in obtaining prompt court adjudication of the rest of the industry's joint privilege claims.

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) 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, or their co-defendants designed to frustrate or defeat the claims of the plaintiffs against such parties, companies, agents 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.

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 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 Attorneys General 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.

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

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

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

5.5.. 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.

5.9. Each Settling Defendant may, after becoming bound by this Settlement Agreement, continue in the lawful manufacture, advertising and/or sale of tobacco products. This Settlement Agreement does not in any way abrogate or restrict the authority or ability of the Recoupment Subclass members, to the extent such members possess such authority or ability, to enforce compliance with the laws of their respective jurisdictions.

6. GLOBAL SETTLEMENT.

6.. 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.

6.. 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 Settling States in accordance with this and the Attorneys General Settlement Agreement. In the event that the Settling States and Settlement Class Counsel cannot agree to an equitable allocation of the Settlement Fund between the Settling States and the Settlement Class, the Settling States and Settlement 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 cannot agree on the selection of an Arbitrator, the Settling States and Settlement 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 the Attorneys General Settlement Agreements. Subject to the approval of the 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 Mandatory 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 Mandatory 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.

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. STATES' RIGHT OF EXCLUSION/INCLUSION.

A Settlement Class member that is a State may opt out at any time during the thirty day period from the Initial Notice Date. In order to exercise the opt out right set forth in this Section 9, such State must complete and return a request for exclusion in a form to be agreed upon by the Parties and approved by the Court. Such request must be postmarked on or before the end of the thirty day period. Any such State that has not so elected will be a Settlement Class member for all purposes under this Agreement. Any State that elects to opt out of the Settlement Class pursuant to this Section 9 shall not be entitled to relief under or be affected as to a Settling Defendant by this Agreement.

10. 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 Alabama 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.

11. FUTURE AFFILIATE.

11.1. 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 11.

11.2. (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 13.1 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.

11.3. 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.

11.4. In the event that subsequent to a Future Affiliate Transaction, and in conformity with Section 17.2(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.

11.5. 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, Settling States reserve 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.

11.6. With respect to subsections 11.1 - 11.5 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.

11.7. 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 6.3.2 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 6.3.2. Nothing in this Section 17.7 affects in any way Liggett's payment obligations under Section 7.3.1 hereof.

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

11.9. 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.

11.10. 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.

12. RELEASE.

12.1. 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 or any other smoking-related 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.

12.2. 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.

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

13.1. Except as otherwise provided in this Agreement, his 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.

13.2. 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.

13.3. 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.

14. TERM.

14.1. 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.

14.2. 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.

14.3. 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.

15. CONTINUING ENFORCEABILITY.

15.1. 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.

15.2. 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.

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

16.1. 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.

16.2. 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.

16.3. 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.

17. EXPENSES AND FEES.

17.1. Subject to Section 7.5 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.

17.2. 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.

17.3. 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 15 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.)

18. TAX STATUS OF SETTLEMENT FUND.

18.1. 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.

18.2. 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.

18.3. 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.

19. 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 Liggett Final Order and Judgment.

20. 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 20, the Settlement Class Counsel may apply to the Court for relief, including withdrawal from the agreement.

21. REPRESENTATIONS AND WARRANTIES; COVENANTS.

21.1. 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.

21.2. 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.

22. ARBITRATION.

22.1. 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.

22.2. 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.

23. MOST FAVORED NATION.

23.1. 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 23.1 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.

23.2. 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.

23.3. 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.

23.4. 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").

23.5. The rights and remedies of each Settling Defendant under this Section 23 are cumulative and not exclusive of each other and shall survive the termination of this Agreement.

24. 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.

25. MISCELLANEOUS.

25.1. 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.

25.2. This Agreement shall be construed under and governed by the laws of the State of Alabama.

25.3. 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.

25.4. 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.

25.5. 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.

25.6. 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.

25.7. 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.

25.8. 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:

Personal Injury Settlement Subclass Counsel

Steven A. Martino
JACKSON, TAYLOR, MARTINO, PC
South Trust Bank Building
61 St. Joseph St., Suite 1600
Mobile, Alabama 33602

Howard M. Acosta
LAW OFFICES OF HOWARD M. ACOSTA
300 First Avenue North
St. Petersburg, Florida 33701

Norwood S. Wilner
SPOHRER WILNER MACIEJEWSKI &
STANFORD P.A.
444 E. Duval Street
Jacksonville, Florida 32202

Recoupment Settlement Subclass Counsel

Russell Jackson Drake
COOPER MITCH
505 20th Street North
1100 Financial Center
Birmingham, Alabama 35203-2605

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.

26.9. 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

BROOKE GROUP LTD.

By:

Bennett S. LeBow

Date:

LIGGETT GROUP INC.

By:

Bennett S. LeBow

Date:

Exhibit 21

SUBSIDIARIES OF THE COMPANY

The following is a list of the active subsidiaries of the Company as of March 27, 1997, indicating the jurisdiction of incorporation of each and the names under which such subsidiaries conduct business. In the case of each subsidiary which is indented, its immediate parent owns beneficially all of the voting securities, except New Valley Corporation, of which BGLS Inc. and New Valley Holdings, Inc. collectively own approximately 42% of such voting securities.

NAME OF SUBSIDIARY	JURISDICTION OF INCORPORATION
BGLS Inc.	Delaware
Liggett Group Inc.	Delaware
Brooke (Overseas) Ltd.	Delaware
New Valley Holdings, Inc.	Delaware
New Valley Corporation	Delaware

Not included above are other subsidiaries which, if considered in the aggregate as a single subsidiary, would not constitute a significant subsidiary, as such term is defined by Rule 1-02(w) of Regulation S-X.

EXHIBIT 23.1

CONSENT OF INDEPENDENT ACCOUNTANTS

We consent to the incorporation by reference in the registration statements of Brooke Group Ltd. on Form S-3 (No. 33-38869 and 33-63119) of: (i) our report, dated March 27, 1997, on our audits of the consolidated financial statements and financial statement schedule of Brooke Group Ltd. and Subsidiaries as of December 31, 1996 and 1995, and for the years ended December 31, 1996, 1995, and 1994, and (ii) of our report, dated March 24, 1997, on our audits of the consolidated financial statements of New Valley Corporation and Subsidiaries as of December 31, 1996 and December 31, 1995, and for the years ended December 31, 1996 and 1995, which reports are included in the Annual Report on Form 10-K of Brooke Group Ltd. for the year ended December 31, 1996.

Coopers & Lybrand L.L.P.

Miami, Florida
March 27, 1997

EXHIBIT 23.2

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Prospectus constituting part of the Registration Statements on Form S-3 (No. 33-38869 and No. 33-63119) of our report dated March 24, 1995, relating to the financial statements of New Valley Corporation and its subsidiaries, which appears on page F-52 of the Brooke Group Ltd. Annual Report on Form 10-K for the year ended December 31, 1996.

Price Waterhouse LLP

Morristown, New Jersey
March 24, 1997

EXHIBIT 23.3

CONSENT OF INDEPENDENT AUDITORS

The Board of Directors
Brooke Group Ltd.

We consent to the incorporation by reference of our report dated March 9, 1995 in the registration statements on Form S-3 (No. 33-38869 and No. 33-63119) of Brooke Group Ltd., relating to the consolidated statements of operations, stockholders' deficiency and cash flows of MAI Systems Corporation for the year ended December 31, 1994, and related schedule, which report appears in the December 31, 1996 annual report on Form 10-K of Brooke Group Ltd.

KPMG Peat Marwick LLP

Orange County, California
March 27, 1997

EXHIBIT 23.4

CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

The Board of Directors
Brooke Group Ltd.

We consent to the incorporation by reference of our report dated February 11, 1997 in the registration statements on Form S-3 (No. 33-38869 and No. 33-63119) of Brooke Group Ltd., relating to the consolidated balance sheets of Thinking Machines Corporation and subsidiaries as of December 31, 1996, and the related consolidated statements of operations, stockholders' investment and cash flows for the years then ended, which report appears in the December 31, 1996 annual report on Form 10-K of New Valley Corporation.

Arthur Anderson LLP

Boston, Massachusetts
March 27, 1997

5
0000059440
BROOKE GROUP, LTD.
1,000

YEAR
DEC-31-1996
JAN-01-1996
DEC-31-1996
1,941
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19,475
0
53,691
80,552
80,282
0
177,677
204,463
378,243
0
0
1,850
(456,839)
177,677
452,656
452,656
253,633
253,633
7,211
0
60,556
(63,516)
1,402
(64,918)
2,385
0
0
(62,533)
(3.28)
(3.28)

5
0000927388
BGLS INC.
1,000

YEAR
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JAN-01-1996
DEC-31-1996
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0
53,691
80,197
79,972
0
178,108
229,736
378,243
0
0
0
(483,085)
178,108
452,656
452,656
235,633
235,633
9,790
0
64,417
(69,350)
5,254
(74,604)
2,385
0
0
(72,219)
0
0

Exhibit 99.2

LIGGETT GROUP INC.

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 1996

LIGGET GROUP, INC.
INDEX TO
FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULES

REPORT OF INDEPENDENT ACCOUNTANTS

Board of Directors
Liggett Group, Inc.

We have audited the consolidated financial statements and the financial statement schedule of Liggett Group Inc. listed in the index on page 15 of this Form 10-K. These financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and the financial statement schedule based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Liggett Group, Inc. as of December 31, 1996 and 1995 and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1996 in conformity with generally accepted accounting principles. In addition, in our opinion, the financial statement schedule referred to above, when considered in relation to the basic financial statements taken as a whole, present fairly, in all material respects, the information required to be included therein.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2a to the financial statements, the Company suffered a loss of $18,372,000 for the year ended December 31, 1996 and had net capital and working capital deficiencies of $176,478,000 and $40,694,000, respectively, at December 31, 1996. The Company also has a $37,500,000 principal payment due on its Senior Secured Notes on February 1, 1998 and payment due at maturity of the Senior Secured Notes on February 1, 1999 of $107,400,000 and the Company's revolving credit facility (the "Facility"), which had a balance of $24,272,000 at December 31, 1996, is due on March 8, 1998. The Company's financial resources are not sufficient to repay the Senior Secured Notes when they become due, nor will the Company be able to repay the Facility when it becomes due. These facts raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2a. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

COOPERS & LYBRAND L.L.P.
Miami, Florida
March 20, 1997

LIGGETT GROUP INC.

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share amounts)

ASSETS

	December 31, 1996	December 31, 1995
Current assets:		
Accounts receivable:		
Trade, less allowances of $1,280 and $815, respectively. . .	$19,316	$ 22,279
Other	644	1,367
Affiliates	100	1,105
Inventories	50,122	54,342
Deferred income taxes	-	3,800
Other current assets (Note 6)	1,205	1,703
Total current assets	71,387	84,596
Property, plant and equipment, at cost, less accumulated depreciation of $29,511 and $26,545, respectively	18,705	18,352
Intangible assets, at cost, less accumulated amortization of $17,388 and $15,661, respectively	3,327	5,036
Other assets and deferred charges, at cost, less accumulated amortization of $7,410 and $5,440, respectively	4,258	5,330
Total assets	$97,677	$113,314

(continued)

LIGGETT GROUP INC.

CONSOLIDATED BALANCE SHEETS (Continued)

(Dollars in thousands, except per share amounts)

LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)

	December 31, 1996	December 31, 1995
Current liabilities:		
Current maturities of long-term debt	$ 31,807	$ 50
Cash overdraft	6	3,761
Accounts payable, principally trade	18,949	18,921
Accrued expenses:		
Promotional	30,257	25,519
Compensation and related items	682	1,175
Taxes, principally excise taxes	7,565	7,006
Estimated allowance for sales returns	5,000	5,000
Interest	8,435	8,412
Other	9,380	5,728
Total current liabilities	112,081	75,572
Long-term debt, less current maturities	144,698	173,251
Non-current employee benefits and other long-term liabilities	17,376	19,197
Commitments and contingencies (Notes 5 and 12)		
Stockholder's equity (deficit):		
Redeemable preferred stock (par value $1.00 per share; authorized 1,000 shares; no shares issued and outstanding)(Note 14)		
Common stock (par value $0.10 per share; authorized 2,000 shares; issued and outstanding 1,000 shares) and contributed capital	49,840	53,240
Accumulated deficit	(226,318)	(207,946)
Total stockholder's deficit	(176,478)	(154,706)
Total liabilities and stockholder's equity (deficit)	$ 97,677	$ 113,314

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

LIGGETT GROUP INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands)

	Year Ended December 31, 1996	1995	1994
Net sales*	$401,062	$455,666	$465,676
Cost of sales*	187,799	212,314	222,774
Gross profit	213,263	243,352	242,902
Selling, general and administrative expenses	203,214	216,806	209,306
Restructuring	3,296	1,927	-
Operating income	6,753	24,619	33,596
Other income (expense):			
Interest income	23	3	-
Interest expense	(23,901)	(23,449)	(21,704)
Equity in loss of affiliate	(1,116)	-	-
Sale of assets	3,669	-	-
Miscellaneous, net	-	1,133	(458)
Income (loss) before income taxes and extra-ordinary item	(14,572)	2,306	11,434
Income tax provision (benefit)	3,800	1,751	(5,000)
Income (loss) before extraordinary item	(18,372)	555	16,434
Extraordinary loss from the early extinguishment of debt	-	-	(1,028)
Net income (loss)	$(18,372)	$ 555	$ 15,406

*Net sales and cost of sales include federal excise taxes of $104,518, $123,420 and $131,877 respectively.

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

LIGGETT GROUP INC.

STATEMENTS OF STOCKHOLDER'S EQUITY (DEFICIT)

(Dollars in thousands)

	Common Stock and Contributed Capital	Retained Earnings (Accumulated Deficit)	Translation Adjustments	Total Stockholder's Equity (Deficit)
Balance at December 31, 1993	$53,240	$(223,109)	$ (3)	$(169,872)
Net income	-	15,406	-	15,406
Translation adjustments	-	-	3	3
Balance at December 31, 1994	53,240	(207,703)	-	(154,463)
Net income	-	555	-	555
Excess of investment over cost basis of net assets acquired from indirect parent	-	(798)	-	(798)
Balance at December 31, 1995	53,240	(207,946)	-	(154,706)
Net loss	-	(18,372)	-	(18,372)
Consideration for option to acquire affiliate stock in excess of its net assets (Note 13)	(3,400)	-	-	(3,400)
Balance at December 31, 1996	$49,840	$(226,318)	$ -	$(176,478)

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

LIGGETT GROUP INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	Year Ended December 31, 1996	1995	1994
Cash flows from operating activities:			
Net income (loss)	$ (18,372)	$ 555	$ 15,406
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	7,969	7,972	8,310
Deferred income taxes	3,800	1,259	(5,781)
(Gain) loss on sale of property, plant and equipment	(3,669)	(375)	114
(Gain) on retirement of notes	-	(1,273)	(375)
Deferred finance charges and debt discount written off	-	160	1,404
Equity in loss of affiliate	1,116	-	-
Changes in assets and liabilities:			
Accounts receivable	4,691	7,060	(3,381)
Inventories	4,220	(7,658)	(9,712)
Accounts payable	(330)	7,671	(480)
Accrued expenses	8,479	(10,638)	(10,474)
Non-current employee benefits	(276)	(225)	(290)
Other, net	(1,461)	9,079	1,492
Net cash provided by (used in) operating activities	6,167	13,587	(3,767)
Cash flows from investing activities:			
Proceeds from sale of property, plant and equipment	4,424	570	78
Capital expenditures	(4,319)	(1,104)	(1,036)
Investment in affiliates	(5,500)	(800)	-
Net cash used in investing activities	(5,395)	(1,334)	(958)
Cash flows from financing activities:			
Repayments of long-term debt	(254)	(8,208)	(1,690)
Issuance of Senior Secured Notes	-	-	15,000
Borrowings under revolving credit facility	351,428	397,873	362,955
Repayments under revolving credit facility	(348,173)	(401,703)	(366,544)
Proceeds from retirement of notes	-	-	375
Deferred finance charges	(18)	-	(2,705)
Cumulative translation adjustment	-	-	3
Changes in advances to affiliate	-	-	(4,000)
Increase (decrease) in cash overdraft	(3,755)	(215)	1,331
Net cash provided by (used in) financing activities	(772)	(12,253)	4,725
Net change in cash and cash equivalents	-	-	-
Cash and cash equivalents:			
Beginning of period	-	-	-
End of period	$ -	$ -	$ -
Supplemental cash flow information:			
Cash payments during the period for:			
Interest	$ 23,228	$ 23,196	$ 20,287
Income taxes	$ 189	$ 130	$ 123

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

LIGGETT GROUP INC.

Notes to Consolidated Financial Statements

(Dollars in thousands, except per share amounts)

1. Basis of Presentation

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 13).

2. Summary of Significant Accounting Policies

a. Going Concern

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 $176,478 as of December 31, 1996, is highly leveraged and has substantial near-term debt service requirements. Due to the many risks and uncertainties associated with the cigarette industry, the impact of recent tobacco litigation settlements (see Note 12) and the anticipated increased tobacco costs, there can be no assurance that the Company will be able to meet its future earnings goals. Consequently, the Company could be in violation of certain debt covenants, and if its lenders were to exercise acceleration rights under the revolving credit facility or senior secured notes indentures or refuse to lend under the revolving credit facility, the Company would not be able to satisfy such demands or its working capital requirements.

Further, the Company's senior secured 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 its revolving credit facility expires on March 8, 1998 unless extended by its lenders. The revolving credit facility is classified as a short-term debt thereby creating a working capital deficit of approximately $40,694 at December 31, 1996.

While management currently intends to seek to refinance and/or restructure with the Company's note holders the redemption and maturity requirements on the Senior Secured Notes and to extend the revolving credit facility, there are no refinancing or restructuring arrangements for the notes or commitments 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. If the Company is unable to refinance or restructure such obligations, renegotiate the payment terms of the senior secured notes, extend the revolving credit facility or otherwise make such payments, substantially all of its long-term debt and revolving credit 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.

b. Principles of Consolidation

The consolidated financial statements include the accounts of Liggett and its wholly-owned subsidiaries, Eve Holdings Inc. ("Eve"), Cigarette Exporting Company of America Ltd. ("CECOA") and Carolina Tobacco Express Company ("CTEC"). Intercompany accounts and transactions have been eliminated.

c. 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 at December 31, 1996 and 1995 and the reported amounts of revenues and expenses during the three year period ended December 31, 1996. 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.

d. 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.

e. Inventories

Inventories are valued at the lower of cost (LIFO) or market. Although portions of leaf tobacco inventories may not be used or sold within one year because of the time required for aging, they are included in current assets, which is common practice in the industry. It is not practicable to determine the amount that will not be used or sold within one year.

f. Property, Plant and Equipment

Property, plant and equipment are depreciated using the straight-line method over the estimated useful lives of the respective assets which are twenty years for buildings and four to ten years for machinery and equipment.

Expenditures for repairs and maintenance are charged to expense as incurred. The costs of major renewals and betterments are capitalized. The cost and related accumulated depreciation of property, plant and equipment are removed from the accounts upon retirement or other disposition and any resulting gain or loss is reflected in operations.

The Company is required to review long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable, in accordance with the provisions of Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" ("SFAS 121"). Accordingly, when indicators of impairment are present, the Company evaluates the carrying value of property, plant and equipment and intangibles in relation to the operating performance and estimates of future discounted cash flows of the underlying business.

g. Trademarks

Trademarks are amortized using the straight-line method over twelve years. Amortization expense for the years ended December 31, 1996, 1995 and 1994 amounted to $1,727, $1,725 and $1,722, respectively. Management periodically reviews the carrying value of trademarks to determine whether asset values are impaired.

h. Sales and Sales Returns

Revenue from sales is recognized upon the shipment of finished goods to customers. The Company provides for expected sales returns, net of related inventory cost recoveries. As Liggett does not have any other lines of business, the Company's financial position and its results of operations could be materially adversely affected by significant unit sales volume declines, increased tobacco costs or reductions in the selling price of cigarettes.

i. Employee Benefits

The Company sponsors self-insured health and dental insurance plans for all eligible employees. As a result, the expense recorded for such benefits involves an estimate of unpaid claims as of December 31, 1996 and 1995 which are subject to significant fluctuations in the near term.

BGLS maintains defined benefit retirement plans for substantially all of the Company's employees. The Company records as an expense the portion of BGLS' annual funding requirements applicable to the Company.

The Company sponsors a postretirement benefit plan and, in accordance with Statement of Financial Accounting Standards No. 106, "Employers Accounting for Postretirement Benefits Other than Pensions" ("SFAS 106"), records an actuarially determined liability and charges operations for the estimated cost of postretirement benefits for current employees and retirees.

j. Income Taxes

Under SFAS No. 109, "Accounting for Income Taxes", deferred taxes reflect the impact of temporary differences between the amounts of assets and liabilities recognized for financial reporting purposes and the amounts recognized for tax purposes as well as tax credit carryforwards and loss carryforwards. These deferred taxes are measured by applying currently enacted tax rates. A valuation allowance reduces deferred tax assets when it is deemed more likely than not that future taxable income will be insufficient to realize some portion or all of the deferred tax assets.

k. Legal Costs

The Company's accounting policy is to accrue legal and other costs related to contingencies as services are performed.

l. Fair Value of Financial Instruments

The fair values of the Company's Senior Secured Notes have been based upon market quotations (see Note 10). The carrying amount of borrowings outstanding under the revolving credit facility and other long-term debt is a reasonable estimate of fair value, based upon estimated current borrowing rates for loans with similar terms and maturities. The estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair values.

3. Changes in Accounting Estimates

In September 1995, the Company adjusted an accrual estimate recorded in prior years which had the effect of increasing operating income by approximately $1,214 for the year ended December 31, 1995.

As a consequence of certain litigation settlements and marketing assessment contingencies (see Note 12), Liggett charged approximately $8,846 to operations in the fourth quarter of 1995. Possible future payments under the litigation settlements which are based on a percentage of Liggett's pretax income, if any, will be charged to operations in the period that the Company's operating results are known. Liggett increased its valuation allowance for deferred tax assets by $443 in the fourth quarter of 1995.

Liggett increased its valuation allowance for deferred tax assets by $3,800 in the third quarter of 1996. In December 1996, Liggett increased its estimate of coupon promotions which resulted in a decrease in the Company's operating income of $1,800 for the year ended December 31, 1996.

4. Concentrations of Credit Risk

Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of trade receivables.

Liggett's customers are primarily candy and tobacco distributors, the military and large grocery, drug and convenience store chains. Liggett's largest single customer accounted for approximately 13.7% of net sales in 1996, and approximately 11.6% of net sales in 1995, the majority of which were in the private label discount market segment. No single customer accounted for more than 10% of the Company's net sales in 1994. Concentrations of credit risk with respect to trade receivables are limited due to the large number of customers comprising the remainder of the Company's customer base. Ongoing credit evaluations of customers' financial condition are performed and, generally, no collateral is required. The Company maintains reserves for potential credit losses and such losses, in the aggregate, have not exceeded management's estimates.

5. Inventories

Inventories consist of:

	December 31, 1996	December 31, 1995
Finished goods	$15,304	$18,240
Work-in-process	4,382	3,331
Raw materials	31,338	24,946
Replacement parts and supplies	3,554	3,926
Inventories at current cost	54,578	50,443
LIFO adjustment	(4,456)	3,899
Inventories at LIFO cost	$50,122	$54,342

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 $20,116 at December 31, 1996.

6. Assets Under Agreement for Sale

On April 9, 1996, Liggett executed a definitive agreement with the County of Durham for the sale by Liggett to the County of Durham of certain surplus realty in Durham, North Carolina, for a sale price of $4,300. The net book value of those assets ($713) for which the agreement was signed is classified as current assets on the Company's Consolidated Balance Sheet as of December 31, 1995. The transaction closed on May 14, 1996, at which time a gain of approximately $3,600 was recognized.

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 net book value of those assets ($309) for which the agreement was signed is classified as current assets on the Company's Consolidated Balance Sheet as of December 31, 1996. The transaction closed on March 11, 1997. A gain of approximately $1,600 is expected to be recognized in 1997.

7. Property, Plant and Equipment

Property, plant and equipment consists of the following:

	December 31, 1996	December 31, 1995
Land and improvements	$ 455	$ 542
Buildings	5,848	6,011
Machinery and equipment	41,913	38,344
Property, plant and equipment	48,216	44,897
Less accumulated depreciation	(29,511)	(26,545)
Property, plant and equipment, net	$18,705	$18,352

8. Employee Benefits Plans

Defined Benefit Retirement Plans

Prior to 1994, substantially all of Liggett's employees participated in two noncontributory defined benefit retirement plans sponsored by BGLS. The Company records as an expense the portion of BGLS' annual funding requirements applicable to the Company. There was no pension expense recorded in 1996, 1995 or 1994.

Future Pension Benefits to be Funded by BGLS

Actuarial estimates of the total future minimum pension benefits to be funded by BGLS, prior to the effect of unamortized purchase accounting adjustments, are as follows:

1997	$ 350
1998	350
1999	350
2000	250
2001	150
Thereafter	1,500
Total	$2,950

Postretirement Medical and Life Insurance Plans

The components of net periodic postretirement benefit cost are as follows:

	Year Ended December 31,		
	1996	1995	1994
Service cost, benefits attributed to employee service during the year	$ 68	$ 68	$ 63
Interest cost on accumulated postretirement benefit obligation	829	970	1,037
Charge for special termination benefits	--	489	--
Amortization of net (gain) loss	(92)	(26)	33
Net periodic postretirement benefit expense	$ 805	$ 1,501	$1,133

The following sets forth the actuarial present value of the Accumulated Postretirement Benefit Obligation ("APBO") applicable to each employee group for benefits:

	December 31,	
	1996	1995
Retired employees	$ 7,899	$ 8,673
Active employees - fully eligible	674	1,707
Active employees - not fully eligible	515	1,078
APBO	9,088	11,458
Unrecognized net gain	3,324	1,339
Purchase accounting valuation adjustment related to income taxes	(1,072)	(1,181)
Postretirement liability	$11,340	$11,616

The APBO at December 31, 1996 was determined using a discount rate of 8% and health care cost trend rates of 4%. A 1% increase in the trend rate for health care costs would have increased the APBO and net periodic postretirement benefit cost by $419 and $32, respectively, for the year ended December 31, 1996. The Company does not hold any assets reserved for use in the plan.

Profit Sharing Plans

Liggett's 401(k) plans originally called for Company contributions matching up to a 3% employee contribution, plus additional Company contributions of up to 6% of salary based on the achievement of Company profit objectives. Effective January 1, 1994, the Company suspended the 3% match for the salaried employees' 401(k) Plan, but reinstated it on April 1, 1996. The Company contributed and expensed $2,712, $900 and $420 to the 401(k) plans for the years ended December 31, 1996, 1995 and 1994, respectively.

9. Income Taxes

Liggett's operations are included in the consolidated federal income tax return of its indirect parent, BGL. Pursuant to a tax allocation agreement, the Company's federal income tax provision is calculated as if the Company filed a separate federal income tax return except that the tax sharing agreement with BGL effectively limits the ability of the Company to carry back losses for refunds.

The amounts provided for income taxes are as follows:

	Year Ended December 31,		
	1996	1995	1994
Current:			
Federal	$ --	$ (233)	$ 341
State	--	216	227
Deferred:			
Federal	3,800	1,768	(5,568)
State	--	--	--
Total tax provision (benefit)	$ 3,800	$ 1,751	$(5,000)

Temporary differences which give rise to a significant portion of deferred tax assets and liabilities are as follows:

	1996		1995	
	Deferred Tax		Deferred Tax	
	Asset	Liability	Asset	Liability
Sales and product allowances	$ 2,504	$ --	$ 2,293	$ --
Inventory	1,269	683	816	1,256
Coupon accruals	4,492	--	3,138	--
Property, plant and equipment	--	4,890	--	5,778
Employee benefit plan accruals	5,303	--	4,886	--
USDA marketing assessment	1,681	--	1,920	--
Tobacco litigation settlements	1,229	--	1,568	--
Difference in basis in investment	1,864	--	--	--
Net operating loss carryforward	7,244	--	5,022	--
Valuation allowance	(20,013)	--	(8,809)	--
Reclassifications	(5,573)	(5,573)	(7,034)	(7,034)
Total deferred taxes	$ --	$ --	$ 3,800	$ ----

The $20,013 net valuation allowance at December 31, 1996 is composed of $18,590 for net deferred assets arising from items which have been reflected in book income or loss and $1,423 for deferred assets arising for basis differences in the investments which were reflected as direct entries to equity.

Differences between the amounts provided for income taxes and amounts computed at the federal statutory tax rates are summarized as follows:

	Year Ended December 31,		
	1996	1995	1994
Income before taxes	$ (14,572)	$ 2,306	$ 11,434
Federal income tax at statutory rates	$ (5,100)	$ 807	$ 4,002
Increases (decreases) resulting from:			
State income tax expense (benefit) net of federal income tax benefit (expense)	(634)	216	743
Other, net	(247)	285	516
Change in valuation allowance	9,781	443	(10,261)
Total tax provision (benefit)	$ 3,800	$ 1,751	$ (5,000)

As of December 31, 1996, the Company's net operating loss ("NOL") carryforward pursuant to its tax sharing agreement with BGL is approximately $18,250 which expires from 2008 to 2011. However, if the Company were deconsolidated from BGL, its allocable share of NOL could be significantly different. In 1993 a valuation allowance was established for the net deferred tax assets because of the lack of recoverability of NOLs against prior years' taxable income and the Company's 1993 loss. The Company has adjusted its valuation allowance in subsequent years based upon its assessment of whether it is more likely than not that taxable income will be sufficient to realize the deferred tax assets.

10. Long-Term Debt

Long-term debt consists of the following:

	December 31, 1996		1995
	Estimated Fair Value	Carrying Value	Carrying Value
11.5% Senior Secured Notes due February 1, 1999 net of unamortized discount of $0, $424 and $627, respectively	$ 74,805	$ 119,688	$ 119,485
Variable Rate Series C Senior Secured Notes due February 1, 1999	23,402	32,279	32,279
Borrowings outstanding under revolving credit facility	24,272	24,272	21,017
Other	266	266	520
	122,745	176,505	173,301
Current portion	(31,807)	(31,807)	(50)

Amount due after one year	$ 90,938	$ 144,698	$ 173,251
	=========	=========	=========

Maturities of long-term debt, net of discount, at December 31, 1996 are as follows:

1997	$ 31,807
1998	37,324
1999	107,374

Total	$176,505
	========

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 "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 Notes due on February 1, 1999. In February 1997, $7,500 of 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 Notes are collateralized by substantially all of the assets of the Company, excluding inventories and receivables. Eve is a guarantor for the Notes. The 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 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.

BGLS purchased $4,500 of the Series C Notes which were subsequently sold.

Revolving Credit Facility

On March 8, 1994, Liggett entered into a revolving credit facility (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 $13,098 based upon eligible collateral at December 31, 1996. 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 December 31, 1996. The Facility contains certain financial covenants similar to those contained in the Note 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 imposes requirements with respect to the Company's adjusted net worth (not to fall below a deficit of $175,000 as computed in accordance with the agreement) and working capital (not to fall below a deficit of $35,000 as computed in accordance with the agreement). The Facility is classified as short-term debt as of December 31, 1996, as it was due on March 8, 1997. On January 7, 1997, the Facility was extended for a one-year period ending March 8, 1998.

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 Senior Secured 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 Senior Secured Notes; (ii) the maximum permitted working capital deficit 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. (See Note 2a).

11. Operating Leases

At December 31, 1996, the Company has operating leases for building space and computer equipment. The future minimum lease payments are as follows:

1997	$ 1,672
1998	1,118
1999	361
2000	6
Total	$ 3,157

Rental expense for the years ended December 31, 1996, 1995 and 1994 amounted to approximately $3,121, $3,112 and $2,854, respectively.

12. Commitments and Contingencies

Litigation

Since 1954, Liggett and other United States cigarette manufacturers have been named as defendants 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 actually were commenced against Brooke Group Ltd. in its former name or in its present name or against Liggett). New cases continue to be commenced against Liggett and other cigarette manufacturers. 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 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 below is not quantifiable at this time.

As of March 14, 1997, there were 108 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, 58 are pending in the State of Florida and 19 are pending in the State of New York. The balance of individual cases are pending in 13 different states. The next individual case scheduled for trial where Liggett is a defendant is Chutz-Reymers v. Liggett Group Inc., et al. United States District Court, Middle District of Florida, Tampa Division, which is scheduled for trial in June 1997. In light of the settlements discussed below, this case will not proceed against Liggett on that date. In addition to the foregoing, there are four individual cases scheduled for trial in 1997 where Liggett is a defendant, although trial dates are subject to change.

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, strict liability, fraud, misrepresentation, design defect, failure to warn, breach of express and implied warranties, conspiracy, concert of action, unjust enrichment, common law public nuisance, indemnity, market share liability, and violations of deceptive trade practices laws 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 preemption by the Federal Cigarette Labeling and Advertising Act, as amended (the "Act"). Several representative cases are described below.

On June 24, 1992, in the 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 Yvonne 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. A Notice of Appeal has been filed by the plaintiff.

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. Plaintiffs' motion to certify the action as a class action was granted. The suit is scheduled to go to trial on June 2, 1997. In addition to Broin, as of March 25, 1997 there were 12 other actions which have either been certified as a class or are seeking class certification. One of these actions, Engle, et al. v. R. J. Reynolds Tobacco Company, et al., Circuit Court of the Eleventh Judicial Circuit in and for Dade County, Florida, involving a certified class of smokers in the State of Florida, is scheduled to commence trial on September 8, 1997.

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. The case is presently in the discovery phase. This action is scheduled for trial on December 12, 1997. A similar action has been filed in the Superior Court for the State of California, City of San Francisco.

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 plaintiffs' fraud and breach of warranty claims. In addition, the District Court vacated the Magistrate's March 19, 1996 order compelling Liggett to produce certain CTR documents with respect to which Liggett had asserted various privilege claims, and allowed the other cigarette manufacturers and the CTR to intervene in order to assert their interests and privileges with respect to those same documents. The Magistrate Judge is presently reconsidering plaintiffs' motion to compel production of documents. No trial date has been set.

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 May 23, 1996, the Fifth Circuit Court of Appeals decertified the class and instructed the District Court to dismiss the class complaint. On March 12, 1996, Liggett and BGL entered into an agreement, subject to court approval, to settle the Castano class action tobacco litigation, however, this settlement is no longer in effect. See "Subsequent Events" below.

In February 1995, an action entitled Grady 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 Corp., in the amount of $750. Brown & Williamson has filed a Notice of Appeal.

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. In addition to the foregoing, similar actions have been filed on behalf of 20 states and several municipalities. The Mississippi, Florida and Texas Medicaid recovery actions are scheduled for trial in 1997. Legislation similar to that enacted in Florida has been introduced in the Massachusetts and New Jersey legislatures.

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 the Federal Racketeer Influenced and Corrupt Organization Act.

On March 15, 1996, 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 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 sixty 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 with in 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. While neither consenting to FDA jurisdiction nor waiving their objections thereto, 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, 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 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 occurrence of a business combination, will be expensed when considered probable.

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. The Company 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. Liggett is in the process of responding to that subpoena. Liggett and BGL are 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. A notice of appeal has been filed by the plaintiff.

Litigation is subject to many uncertainties, and it is possible that some of aforementioned actions could be decided unfavorably against the Company. An unfavorable outcome of a pending smoking and health case could encourage the commencement of additional similar litigation. The Company is not able 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.

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 Liggett and BGL. 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.

Subsequent Events:

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 states and with a nationwide class of individuals and entities that allege smoking-related claims. Liggett and BGL have now obtained settlements with each of the 22 states have commenced suit against them. The settlements cover all smoking-related claims, including both addiction-based and tobacco injury claims against Liggett and BGL, brought by the 22 states, and upon court approval, the nationwide class.

The settlement with the Attorneys General, which does not require court approval, includes the states of Arizona, Connecticut, Hawaii, Illinois, Indiana, Iowa, Kansas, Maryland, Michigan, Minnesota, New Jersey, New York, Oklahoma, Texas, Utah, Washington and Wisconsin. Liggett 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.

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. 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. In light of this, the March 1996 Castano settlement is no longer in effect.

Pursuant to the settlements, Liggett and BGL have agreed to cooperate fully with the Attorneys General and the nationwide class in their lawsuits against the tobacco industry. Liggett and BGL have 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 have 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 have agreed to offer their employees for witness interviews and testimony at deposition and trial. Pursuant to both settlement agreements, Liggett has 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.

Under the terms of the new settlement agreements, Liggett will pay on a 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 has 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 further adverse judgment. In addition, within 120 days following such a combination, Liggett would be required to pay the settlement fund of $25 million. Both the Attorneys General and the nationwide class have also 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 have 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.

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. 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 these four companies from interfering with Liggett's filing with the courts, under seal, those documents.

Legislation and Regulation

On August 28, 1996, the Food and Drug Administration ("FDA") filed in the Federal Register a Final 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 has been 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. A hearing on the tobacco industry's motion for summary judgment in that case was held on February 10, 1997 and a decision by the Court is expected soon. The FDA's proposed restrictions, some of which became effective as early as February 28, 1997, purport to: (i) limit access to tobacco products and (ii) limit advertising and marketing. Management is unable to predict whether the Final Rule will be upheld as enforceable against the industry. Management is also unable to predict the effects of the proposed restrictions, if implemented, on Liggett's operations, but such actions could have an unfavorable impact thereon.

Liggett and BGL, while neither consenting to FDA jurisdiction nor waiving their objections thereto, agreed to withdraw their objections and opposition to the proposed rule making and 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. Regulations adopted pursuant to this legislation are scheduled to become effective on July 1, 1997. 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.

In 1993, the United States Congress amended the Agricultural Adjustment Act of 1938 to require each United States cigarette manufacturer to use at least 75% domestic tobacco in the aggregate of the cigarettes manufactured by it in the United States, effective January 1, 1994, on an annualized basis or pay a domestic marketing assessment ("DMA") based upon price differentials between foreign and domestic tobacco and, under certain circumstances, make purchases of domestic tobacco from the tobacco stabilization cooperatives organized by the United States government.

After an audit, the United States Department of Agriculture ("USDA") informed Liggett that it did not satisfy the 75% domestic tobacco usage requirement for 1994 and was subject to a DMA (the "USDA marketing assessment") of approximately $5,500. Liggett has agreed to pay this assessment in quarterly installments, with interest, over a five-year period, and $4,900 was accrued for the assessment in 1995. Since the levels of domestic tobacco inventories on hand at the tobacco stabilization organizations are below reserve stock levels, the Company was not obligated to make purchases of domestic tobacco from the tobacco stabilization cooperatives.

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. In addition, the Presidential Proclamation served to limit the application of the legislation establishing the DMA to only those activities occurring in calendar year 1994.

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.

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.

The Company has been involved in certain environmental proceedings, none of which, either individually or in the aggregate, rise to the level of materiality. The Company'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.

13. Related Party Transactions

On July 5, 1996, Liggett purchased 140,000 shares (19.97%) of Liggett-Ducat Ltd.'s ("Liggett-Ducat") tobacco operations from Brooke (Overseas) Ltd. ("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 loss of Liggett-Ducat amounted to $1,116 for the year ended December 31, 1996. 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.

Since October 1990, Liggett has provided certain administrative and technical support to Liggett-Ducat in exchange for which Liggett-Ducat provides assistance to Liggett in its pursuit of selling cigarettes in the Russian Republic. The expenses associated with Liggett's activities amounted to $76, $229 and $230 for the years ended December 31, 1996, 1995 and 1994, respectively.

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 $3,160 in 1996, $3,010 in 1995 and $2,866 in 1994. This fee is in addition to the management fee and overhead reimbursements described above.

In prior years, BGLS assumed specified Liggett liabilities from time to time and Liggett repaid these amounts from time to time. During 1994, Liggett satisfied all amounts due ($8,000) in full.

Since April 1994, the Company has leased equipment from BGLS for $50 per month.

The Company acquired CTEC from its indirect parent during 1995 for $800. The excess of cost over the carrying amount of the net assets acquired has been charged to stockholder's equity (deficit). The effect of the accounting treatment presents the investment in CTEC at carryover basis. Accounts receivable from affiliates relate principally to advances for expenses paid by the Company on behalf of its affiliates.

14. Supplemental Disclosure of Non-Cash Financing and Investing Activities

During 1994, the Company issued $17,850 in Series C Notes in exchange for Series B Notes and in connection with indenture consent of which $15,008 were credited against the mandatory redemption of Series B Notes for February 1, 1994 and 1995, and $2,842 were recorded as deferred finance charges.

During 1994, the Company transferred equipment with a net book value of $2,161 to BGLS in return for assumption of Liggett's note payable of $1,988.

15. Restructuring Charges

During 1996, the Company reduced its headcount by 38 positions and recorded a $3,428 restructuring charge to operations ($132 of which was included in cost of sales) for severance programs, primarily salary continuation and related benefits for terminated employees. Of the total restructuring recorded during 1996, $1,416 was funded during 1996, leaving $2,012 remaining to be funded in subsequent years. The Company expects to continue its cost reduction programs.

During 1995, Liggett continued its efforts towards reducing costs by, among other things, offering voluntary retirement programs to eligible employees. The Company's 1995 cost reduction programs reduced the Company's headcount by approximately 120 positions. In connection therewith, the Company recorded charges totaling $2,548 to operating income including $621 relating to manufacturing operations which has been charged to cost of sales.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholder
of Eve Holdings Inc.

We have audited the accompanying balance sheets of Eve Holdings Inc. (the "Company") as of December 31, 1996 and 1995 and the related statements of operations, stockholder's equity (deficit) and cash flows for each of the three years in the period ended December 31, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Eve Holdings Inc. at December 31, 1996 and 1995 and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1996 in conformity with generally accepted accounting principles.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2a to the financial statements, the Company's revenues are comprised solely of royalties and interest income from Liggett Group Inc. ("Liggett"). Liggett had a working capital deficit of $40,694 and a net capital deficiency of $176,478 as of December 31, 1996, is highly leveraged and has substantial near-term debt service requirements. These matters raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

COOPERS & LYBRAND L.L.P.

Miami, Florida
March 27, 1997

EVE HOLDINGS INC.

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

	December 31, 1996	December 31, 1995
ASSETS		
Cash	$ --	$ 8
Office equipment	2	2
Trademarks, at cost, less accumulated amortization of $17,294 and $15,593, respectively	3,119	4,820
Total assets	$ 3,121	$ 4,830
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Federal income taxes currently payable to parent	$ --	$ 164
Dividends payable	4,623	2,536
Cash overdraft	92	--
Other current liabilities	19	--
Deferred income taxes	1,092	1,687
Total liabilities	5,826	4,387
Stockholder's equity (deficit):		
Common stock (par value $1 00 per share; authorized, issued and outstanding 100 shares) and contributed capital	46,548	47,653
Receivables from parent:		
Note receivable - interest at 14%, due no sooner than February 1, 1999	(44,520)	(44,520)
Other	(4,733)	(2,690)
Total stockholder's equity (deficit)	(2,705)	443
Total liabilities and stockholder's equity (deficit)	$ 3,121	$ 4,830

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

EVE HOLDINGS INC.

STATEMENTS OF OPERATIONS

(Dollars in thousands)

	Year Ended December 31, 1996	1995	1994
Revenues:			
Royalties - parent	$ 8,608	$ 10,452	$ 10,647
Interest - parent	6,306	6,306	6,306
	14,914	16,758	16,953
Expenses:			
Amortization of trademarks	1,701	1,702	1,701
Miscellaneous	129	93	70
Operating income	13,084	14,963	15,182
Interest expense	49	--	--
Income before income taxes	13,035	14,963	15,182
Income tax provision	2,480	5,237	5,314
Net income	$ 10,555	$ 9,726	$ 9,868

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

EVE HOLDINGS INC.

STATEMENTS OF STOCKHOLDER'S EQUITY (DEFICIT)

(Dollars in thousands)

	Common Stock and Capital in Excess of Par	Retained Earnings	Receivables From Parent	Total Stockholder's Equity
Balance at December 31, 1993	$ 49,866	$ --	$ (45,219)	$ 4,647
Net income	--	9,868	--	9,868
Dividends/capital distributions	(1,107)	(9,868)	--	(10,975)
Net change in receivable from Parent ..	--	--	(2,053)	(2,053)
Balance at December 31, 1994	48,759	--	(47,272)	1,487
Net income	--	9,726	--	9,726
Dividends/capital distributions	(1,106)	(9,726)	--	(10,832)
Net change in receivable from Parent ..	--	--	62	62
Balance at December 31, 1995	47,653	--	(47,210)	443
Net income	--	10,555	--	10,555
Dividends/capital distributions	(1,105)	(10,555)	--	(11,660)
Net change in receivable from Parent ..	--	--	(2 043)	(2,043)
Balance at December 31, 1996	$ 46,548	$ --	$ (49,253)	$ (2,705)

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

EVE HOLDINGS INC.

STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	Year Ended December 31,		
	1996	1995	1994
Cash flows from operating activities:			
Net income	$ 10,555	$ 9,726	$ 9,868
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	1,701	1,703	1,701
Deferred income taxes	(595)	(596)	(595)
Changes in assets and liabilities:			
Federal income taxes currently payable to parent	(164)	157	(691)
Other current liabilities	19	--	--
Net cash provided by operating activities	11,516	10,990	10,283
Cash flows from investing activities:			
Capital expenditures	--	--	(3)
Net cash used in investing activities	--	--	(3)
Cash flows from financing activities:			
Increase in cash overdraft	92	--	--
Dividends/capital distributions	(9,573)	(11,046)	(8,225)
Increase (decrease) in due from parent	(2,043)	62	(2,053)
Net cash used in financing activities	(11,524)	(10,984)	(10,278)
Net (decrease) increase in cash	(8)	6	2
Cash:			
Beginning of period	8	2	--
End of period	$ 0	$ 8	$ 2
Supplemental cash flow information:			
Payments of income taxes through receivable from parent	$ 5,159	$ 5,676	$ 6,600
Dividends/capital distributions declared but not paid	$ 4,623	$ 2,536	$ 2,750

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

EVE HOLDINGS INC.

Notes to Financial Statements

(Dollars in thousands, except per share amounts)

1. The Company

Eve Holdings Inc. ("Eve" or the "Company") is a wholly-owned subsidiary of Liggett Group Inc. ("Liggett"). Eve's predecessor, Chesterfield Assets Inc., was organized in March 1987. 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 of $296, 544, $332,246 and $333,799 for the years ended December 31, 1996, 1995 and 1994, respectively. Generally, royalties are earned based on a rate of either 2% of sales for generic product trademarks and 5% of sales for branded product trademarks. In recent fiscal years, Liggett has experienced greater growth in the sales of generic rather than branded products resulting in a lower overall royalty rate. The Trademarks are pledged as collateral for borrowings under the Liggett notes (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 $40,694 and a net capital deficiency of $176,478 as of December 31, 1996, 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. Basis of Presentation

On February 11, 1992, Eve consummated an Agreement and Plan of Merger (the "Merger Agreement") with LGC Corp. (a wholly-owned subsidiary of Liggett) whereby the operations of LGC Corp., consisting primarily of holding an unsecured $44,250 note receivable (bearing interest at 14%, due November 2, 1996) from Liggett and related interest thereon, were merged into those of Eve. The merger was accounted for at historical cost similar to that in pooling of interests accounting. On March 7, 1994, Liggett and Eve agreed to extend the due date of the note to no sooner than February 1, 1999 from November 2, 1996. All other terms of the note remained the same.

c. 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.

d. Trademarks

Trademarks are amortized using the straight-line method over 12 years. Management periodically reviews the carrying value of trademarks to determine whether asset values are impaired.

e. 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.

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.

4. Income Taxes

Eve's operations are included in the consolidated federal income tax return of its indirect parent, Brooke Group Ltd. ("Brooke"). Eve's federal income tax provisions are calculated as if it filed a separate federal income tax return. Statement of Financial Accounting Standards No. 109 "Accounting for Income Taxes" ("SFAS 109") requires that deferred taxes be recorded under the liability method.

The amounts provided for income taxes are as follows:

	1996	1995	1994
Current:			
U.S. Federal	$2,883	$5,832	$5,909
State	192	--	--
Deferred:			
U.S. Federal........................	(595)	(595)	(595)
State...............................	-	-	-
Total provision for continuing operations	$2,480	$5,237	$5,314

Eve's deferred tax liability relates entirely to the difference in the basis of the Trademarks for book and tax purposes. As permitted in SFAS 109, Eve has not adjusted the basis of the Trademarks that were previously adjusted to net of tax amounts to be consistent with the accounting treatment adopted by Liggett.

Differences between the amounts provided for income taxes and amounts computed at the federal statutory rate are summarized as follows:

	1996	1995	1994
Income from continuing operations before income taxes	$ 13,035	$ 14,963	$ 15,182
Federal income tax (benefit) at statutory rate	4,563	5,237	5,314
Decreases resulting from:			
Exclusion of interest income between related parties.................	(2,207)	--	--
State income taxes, net of federal	124	--	--
Total	$ 2,480	$ 5,237	$ 5,314

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.

LIGGETT GROUP INC.

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

(Dollars in thousands)

	Balance at Beginning of Period	Additions: Charged to Costs and Expenses	Additions: Charged to Net Sales	Deductions		Balance at End of Period
Year ended December 31, 1996						
Allowances for:						
Doubtful accounts	$ 200	$ 903	$ --	$ 353	(a)	$ 750
Cash discounts	615	13,929	--	14,014	(b)	530
Total	$ 815	$ 14,832	--	$ 14,367		$ 1,280
Sales returns allowance	$ 5,000	$ --	$ --	$ --	(c)	$ 5,000
Provision for inventory obsolescence	$ 2,069	$ 1,341	$ --	$ 192	(d)	$ 3,218
Year ended December 31, 1995						
Allowances for:						
Doubtful accounts	$ 249	$ 231	$ --	$ 280	(a)	$ 200
Cash discounts	720	14,579	--	14,684	(b)	615
Total	$ 969	$ 14,810	--	$ 14,964		$ 815
Sales returns allowance	$ 5,800	$ 1,030	$ (800)	$ 1,030	(c)	$ 5,000
Provision for inventory obsolescence	$ 1,369	$ 911	$ --	$ 211	(d)	$ 2,069
Year ended December 31, 1994						
Allowances for:						
Doubtful accounts	$ 235	$ 21	$ --	$ 7	(a)	$ 249
Cash discounts	745	12,337	--	12,362	(b)	720
Total	$ 980	$ 12,358		$ 12,369		$ 969
Sales returns allowance	$ 6,300	$ --	$ 2,800	$ 3,300	(c)	$ 5,800
Provision for inventory obsolescence	$ 1,418	$ 520	$ --	$ 569	(d)	$ 1,369

(a) Represents uncollectible accounts written off.
(b) Represents cash discounts taken.
(c) Represents adjustments to lower the allowance based on revised estimates of sales returns by management.
(d) Represents inventory written off, disposed of, or written down to lower of cost or market value.

Exhibit 99.3

NEW VALLEY HOLDINGS, INC.

FINANCIAL STATEMENTS

DECEMBER 31, 1996

NEW VALLEY HOLDINGS, INC.

FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholder
of New Valley Holdings, Inc.

We have audited the accompanying balance sheets of New Valley Holdings, Inc. (the "Company") as of December 31, 1996 and 1995 and the related statements of operations, stockholder's equity (deficit) and cash flows for the years ended December 31, 1996 and 1995 and the period September 9, 1994 (date of inception) through December 31, 1994. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of New Valley Corporation ("New Valley") for the year ended December 31, 1994, the investment which is being accounted for by the Company using the equity method of accounting (Note 2). Those financial statements were audited by other auditors whose report has been furnished to us and our opinion on the financial statements, insofar as it relates to the amounts included for New Valley, are based solely upon the report of the other auditors.

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

In our opinion, based on our audits and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of New Valley Holdings, Inc. at December 31, 1996 and 1995 and the results of its operations and its cash flows for the years ended December 31, 1996 and 1995 and the period September 9, 1994 (date of inception) through December 31, 1994 in conformity with generally accepted accounting principles.

COOPERS & LYBRAND L.L.P.

Miami, Florida
March 27, 1997

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

	December 31, 1996	December 31, 1995
ASSETS		
Cash and cash equivalents	$ 1	$ 738
Investment in New Valley:		
Redeemable preferred stock	72,962	109,386
Common stock	(72,962)	(52,045)
Total investment in New Valley		57,341
Total assets	$ 1	$ 58,079
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Payable to parent	$ 4	
Accrued expenses	7	
Current income taxes payable to parent	6,312	$ 4,472
Deferred income taxes		4,918
Total liabilities	6,323	9,390
Commitments and contingencies		
Common stock, $0.01 par value, 100 shares authorized, issued and outstanding		
Additional paid-in capital	7,633	11,020
Retained earnings (deficit)	(727)	32,128
Other	(13,228)	5,541
Total stockholder's equity (deficit)	(6,322)	48,689
Total liabilities and stockholder's equity (deficit)	$ 1	$ 58,079

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)

	For the year ended December 31, 1996	For the year ended December 31, 1995	For the period Sept. 9, 1994 (date of inception) through Dec. 31, 1994
Equity in (loss) earnings of New Valley	$ (7,877)	$ 330	
Interest income	55	429	
General and administrative expenses	(28)	(20)	
(Loss) income from continuing operations before income taxes	(7,850)	739	
Provision (benefit) for income taxes:			
Current	1,840	4,472	
Deferred	(800)	(12,799)	
Income tax provision (benefit)	1,040	(8,327)	
(Loss) income from continuing operations	(8,890)	9,066	
Income from discontinued operations of New Valley, net of taxes of $800 and $2,452 in 1996 and 1995, respectively	1,542	4,553	$114,839
(Loss) income before extraordinary item	(7,348)	13,619	114,839
Extraordinary item:			
Equity in extraordinary loss of New Valley on extinguishment of debt, net of tax			(30,217)
Net (loss) income	$ (7,348)	$ 13,619	$ 84,622

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

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

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings (Deficit)	Other	Stock Subscription Receivable	Total
Balance, September 9, 1994 (date of inception)							
Capital contribution	100		$ 10				$ 10
Unrealized holding gain on investment in New Valley, net of tax					$ 7,257		7,257
Net income				$ 84,622			84,622
Capital distribution, net of tax				(4,610)			(4,610)
Stock subscription receivable						$ (10)	(10)
Balance, December 31, 1994	100		10	80,012	7,257	(10)	87,269
Increase in capital from New Valley's repurchase of Class A Shares and other capital transactions, net of tax			11,020				11,020
Reduction of unrealized holding gain on investment in New Valley, net of tax					(2,432)		(2,432)
Proportionate share of New Valley's unrealized appreciation in investments, net of tax					716		716
Net income				13,619			13,619
Dividends				(61,503)			(61,503)
Satisfaction of stock subscription receivable			(10)			10	
Balance, December 31, 1995	100		11,020	32,128	5,541		48,689
Increase in capital from New Valley's repurchase of Class A Shares, net of tax			1,152				1,152
Proportionate share of New Valley's unrealized appreciation in investments, net of tax					2,227		2,227
Increase in unrealized holding loss on investment in New Valley, net of tax					(20,996)		(20,996)
Net loss				(7,348)			(7,348)
Increase in valuation allowance on deferred tax assets			(4,539)				(4,539)
Dividends				(25,507)			(25,507)
Balance, December 31, 1996	100	$	$ 7,633	$ (727)	$(13,228)	$	$ (6,322)

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)

	December 31, 1996	December 31, 1995
Cash flows from operating activities:		
Net (loss) income	$ (7,348)	$ 13,619
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Equity in (loss) earnings of New Valley	7,877	(330)
Deferred income taxes	(800)	(12,799)
Income from discontinued operations of New Valley	(1,542)	(4,553)
Increase in income taxes payable	1,840	4,472
Other	10	
Net cash provided by operating activities	37	409
Cash flows from investing activities:		
Dividends received from New Valley	24,733	61,832
Net cash provided by investing activities	24,733	61,832
Cash flows from financing activities:		
Distributions paid to parent	(25,507)	(61,503)
Net cash used in financing activities	(25,507)	(61,503)
Net (decrease) increase in cash and cash equivalents	(737)	738
Cash and cash equivalents at beginning of period	738	
Cash and cash equivalents at end of period	$ 1	$ 738

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)

1. BASIS OF PRESENTATION OF FINANCIAL STATEMENTS

ORGANIZATION. New Valley Holdings, Inc. (the "Company") was formed on September 9, 1994, pursuant to the laws of Delaware, by BGLS Inc. ("BGLS") to act as a holding company for certain stock investments in New Valley Corporation ("New Valley"). On July 29, 1996, New Valley completed its reincorporation from the State of New York to the State of Delaware. BGLS, also a Delaware corporation, owns 100% of the authorized, issued and outstanding common stock of the Company. BGLS is a wholly-owned subsidiary of Brooke Group Ltd. ("Brooke"), a Delaware corporation whose stock is traded on the New York Stock Exchange.

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, disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses. Actual results could differ from those estimates.

STATEMENT OF CASH FLOWS. A statement of cash flows was not presented for the period September 9, 1994 through December 31, 1994 as the Company had no cash flows from operating, investing or financing activities. Cash and cash equivalents are stated at cost, which approximates market value. For purposes of statements of cash flows, cash includes cash on deposit in banks and cash equivalents, comprised of short-term investments which have an original maturity of 90 days or less. Interest on short-term investments is recognized when earned.

2. INVESTMENT IN NEW VALLEY CORPORATION

Upon incorporation of the Company in 1994, BGLS contributed all of its then owned shares in New Valley in exchange for the Company's stock.

The Company's investment in New Valley at December 31, 1996 and 1995, respectively, is summarized below:

	Number of Shares	Fair Value	Carrying Amount	Unrealized Holding Gain (Loss)
1996				
Class A Preferred Shares	618,326	$ 72,962	$ 72,962	$ (24,881)
Common Shares	3,969,962(A)	5,955	(72,962)	
		$ 78,917	$	$ (24,881)
1995				
Class A Preferred Shares	618,326	$ 109,386	$ 109,386	$ 7,424
Common Shares	79,399,254	21,437	(52,045)	
		$ 130,823	$ 57,341	$ 7,424

- ----------
(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. Prior to January 1, 1996, the Class A Preferred Shares' fair value had been estimated with reference to the securities' preference features, including dividend and liquidation preferences, and the composition and nature of the underlying net assets of New Valley. During 1996, however, New Valley became engaged in the ownership and management of commercial real estate and acquired a controlling interest in Thinking Machines Corporation ("Thinking Machines"). Because these businesses affected the composition and nature of the underlying net assets of New Valley, the Company determined the fair value of the Class A Preferred Shares based on the quoted market price commencing with the quarter ended March 31, 1996. 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. Also, during the fourth quarter of 1996, the Company did not record $2,428 of its proportionate interest in New Valley's SFAS No. 115 unrealized holding losses because the carrying value of the Company's investment in affiliate would have been reduced below zero.

In November 1994, New Valley's First Amended Joint Chapter 11 Plan of Reorganization, as amended ("Joint Plan"), was confirmed by order of the United States Bankruptcy Court for the District of New Jersey and on January 18, 1995, New Valley emerged from bankruptcy reorganization proceedings and completed substantially all distributions to creditors under the Joint Plan. Pursuant to the Joint Plan, among other things, the Class A Preferred Shares, the Common Shares and other equity interests, were reinstated and retained all of their legal, equitable and contractual rights.

At December 31, 1996 and 1995, the Company's investment in New Valley consisted of an approximate 42% voting interest. The Company's investment in 1996 and 1995 was represented by 618,326 Class A Preferred Shares 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. At December 31, 1996, the Company owns 57.7% of the outstanding Class A Preferred Shares.

In February 1995, New Valley repurchased 54,445 Class A Preferred Shares pursuant to a tender offer made as part of the Joint Plan. During 1995, New Valley repurchased 339,400 additional Class A Preferred Shares on the open market at an aggregate cost of $43,405. During 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 and $16,802, along with other New Valley capital transactions of $0 and $241, for the years ended December 31, 1996 and December 31, 1995, respectively.

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

(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) - (CONTINUED)

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. At December 31, 1996 and 1995, respectively, the accrued and unpaid dividends arrearage was $117,117 ($109.31 per share) and $121,893 ($110.06 per share). The Company received $24,733 ($40.00 per share) and $61,832 ($100.00 per share) in dividend distributions in 1996 and 1995, respectively.

3. NEW VALLEY CORPORATION

Summarized financial information for New Valley as of and for the years ended December 31, 1996, 1995 and 1994 follows:

	1996	1995	1994
Current assets, primarily cash and marketable securities...	$183,720	$333,485	
Noncurrent assets..	222,820	52,337	
Current liabilities..	98,110	177,920	
Noncurrent liabilities.....................................	170,223	11,967	
Redeemable preferred stock.................................	210,571	226,396	
Shareholders' equity (deficit).............................	(72,364)	(30,461)	
Revenues...	111,954	67,730	$ 10,381
Costs and expenses...	128,209	66,064	26,146
(Loss) income from continuing operations...................	(13,216)	1,374	(15,265)
Income from discontinued operations........................	5,726	16,873	1,135,706 (A)
Extraordinary items..			(110,500)
Net (loss) income applicable to common shares(C)...........	(65,160)	(13,714)	929,904
Company's share of discontinued operations.................	2,373	7,005	139,935 (B)
Company's share of extraordinary item......................			(46,487)(B)

- ----------

(A) Includes gain on sale of New Valley's money transfer business of $1,056,081, net of income taxes of $52,000.

(B) The Company's share of the extraordinary item ($46,487) was related to extinguishment of debt in 1994. The Company's share of income from discontinued operations in 1994 was determined after accounting for losses not recognized in prior years as follows:

42.1% of income from discontinued operations................	$ 477,791
Losses not recognized in prior periods......................	(337,856)

Company's share of equity in discontinued operations of New Valley...............................	$ 139,935
	=========

(C) Considers all preferred accrued dividends, whether or not declared and, in 1995 and 1996, the excess of carrying value of redeemable preferred shares over cost of shares purchased.

On January 11, 1996, a subsidiary of New Valley made a $10,600 convertible bridge loan to finance Thinking Machines, a developer and marketer of parallel software for high-end and networked computer systems. The loan was converted in February 1996 into a controlling interest in a partnership which holds approximately 61% of the outstanding common stock of Thinking Machines Corporation.

In October 1996, Thinking Machines adopted a plan to dispose of its parallel processing computer segment. The Company recorded its proportionate gain on disposal of $3,956 which was offset by a net loss from discontinued operations of $1,583 for the year ended December 31, 1996, net of minority interests benefit.

On January 10 and January 11, 1996, New Valley acquired four commercial office buildings (the "Office Buildings") and eight shopping centers (the "Shopping Centers"), respectively, for an aggregate purchase price of $183,900, consisting of $23,900 in cash and $160,000 in mortgage financing.

SUBSEQUENT EVENT:

On January 31, 1997, New Valley entered into a stock purchase agreement with Brooke (Overseas) Ltd. ("BOL"), a wholly-owned subsidiary of BGLS, and acquired all of BOL's shares (the "BML Shares") in BrookeMil Ltd. ("BML"), representing 99.1% of the common stock of BML, which is engaged in real estate development in Russia. New Valley paid to BOL a purchase price of $55,000 for the BML Shares, consisting of $21,500 in cash and a New Valley $33,500 9% promissory note. The Note is secured by the BML Shares and is payable $21,500 on June 30, 1997 and $12,000 on December 31, 1997.

4. RJR NABISCO HOLDINGS CORP.

On October 17, 1995, New Valley and its subsidiary, ALKI Corp. ("ALKI"), entered into an agreement, as amended (the "New Valley Agreement"), with High River Limited Partnership ("High River"), an entity owned by Carl C. Icahn. Pursuant to the New Valley Agreement, New Valley sold approximately 1,600,000 shares of common stock of RJR Nabisco Holdings Corp. ("RJR Nabisco") to High River for an aggregate purchase price of $51,000. The New Valley Agreement also provided for the parties to pay certain other fees to each other under certain circumstances, including a payment to High River equal to 20% of New Valley's profit on its RJR Nabisco common stock, after certain expenses as defined in the New Valley Agreement.

On October 17, 1995, Brooke and BGLS entered into a separate agreement, as amended (the "High River Agreement"), with High River. Pursuant to each of these agreements, the parties agreed to take certain actions designed to cause RJR Nabisco to effectuate a spinoff of its food business, Nabisco Holdings Corp. ("Nabisco"), at the earliest possible date. Among other things, Brooke agreed to solicit the holders of RJR Nabisco common stock to adopt the Spinoff Resolution, which was an advisory resolution to the Board of Directors of RJR Nabisco seeking a spinoff of the 80.5% of Nabisco held by RJR Nabisco to stockholders. The High River Agreement also provided that BGLS pay certain other fees to High River under certain circumstances.

As of June 5, 1996, High River, Brooke and BGLS terminated the High River Agreement and New Valley, ALKI and High River terminated the New Valley Agreement by mutual consent. The terminations leave in effect for one year certain provisions of both the High River and New Valley Agreements concerning payments to be made to High River in the event New Valley achieves a profit (after deducting certain expenses) on the sale of the shares of RJR Nabisco common stock which are held by it or they are valued at the end of such year at higher than their purchase price or in the event Brooke or its affiliates engage in certain transactions with RJR Nabisco.

On December 27, 1995, New Valley entered into an agreement with Brooke pursuant to which New Valley agreed to pay directly or reimburse Brooke and its subsidiaries for reasonable out-of-pocket expenses incurred in connection with Brooke's solicitation of consents and proxies from the stockholders of RJR Nabisco. New Valley has also agreed to pay to BGLS a fee of 20% of the net profit received by New Valley or its subsidiaries from the sale of shares of RJR Nabisco common stock after New Valley and its subsidiaries have achieved a rate of return of 20% and after deduction of certain expenses incurred by New Valley and its subsidiaries, including the costs of the consent and proxy solicitations and of acquiring the shares of common stock. New Valley has also agreed to indemnify Brooke and its affiliates against certain liabilities arising out of the solicitations. During 1996, New Valley has reimbursed Brooke and its subsidiaries $2,370 pursuant to this agreement.

On December 28, 1995, New Valley, Brooke and Liggett engaged Jefferies & Company, Inc. ("Jefferies") to act as financial advisor in connection with New Valley's investment in RJR Nabisco and Brooke's solicitation of consents and proxies. In connection with this engagement, New Valley paid Jefferies $1,500 in 1995 and $1,538 in 1996. These companies also have agreed to pay Jefferies 10% of the net profit (up to a maximum of $15,000) with respect to RJR Nabisco common stock (including any distributions made by RJR Nabisco) held or sold by these companies and their affiliates after deduction of certain expenses, including the costs of the solicitations and the costs of acquiring the shares of the common stock.

On December 29, 1995, Brooke commenced solicitation of consents from stockholders of RJR Nabisco seeking, among other things, the approval of the Spinoff Resolution. In March 1996, Brooke was informed that the Spinoff Resolution was approved by the holders of a majority of RJR Nabisco common stock.

On February 29, 1996, New Valley entered into a total return equity swap transaction (the "Swap") with an unaffiliated company relating to 1,000,000 shares of RJR Nabisco common stock. During the third quarter of 1996, the Swap was terminated. New Valley recognized a loss on the Swap of $7,305 for the year ended December 31, 1996.

On March 4, 1996, Brooke commenced solicitation of proxies in favor of its previously nominated slate of directors to replace RJR Nabisco's incumbent Board of Directors at its 1996 annual meeting of stockholders. On April 16, 1996, Brooke announced that, based on the analysis of its proxy solicitors, its nominees for election to the RJR Nabisco Board of Directors would not be elected at RJR Nabisco's 1996 annual meeting of stockholders. On November 5, 1996, Brooke submitted to RJR Nabisco, in order to comply with the requirements of RJR Nabisco's by-laws, a notice of intent to nominate a slate of directors for election at the RJR Nabisco 1997 annual meeting of stockholders.

As of December 31, 1996, New Valley held approximately 1,700,000 shares of RJR Nabisco common stock with a market value of $59,200 (cost of approximately $53,400). As of March 14, 1997, New Valley held approximately 1,063,000 shares of RJR Nabisco common stock with a market value of $35,997 (cost of $32,574). During 1996 and 1995, New Valley expensed $11,724 and $3,879, respectively, for costs relating to its RJR Nabisco investment. Based on the market price of RJR Nabisco common stock at March 14, 1997, no amounts are payable by Brooke or New Valley under any of its net profit-sharing arrangements with respect to the RJR Nabisco common stock discussed above.

5. FEDERAL INCOME TAX

The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes". The Company's operations are included in the consolidated tax return of Brooke. Income taxes in these financial statements are shown as if the Company filed a separate tax return.

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

The amounts provided for income taxes are as follows:

	December 31, 1996	1995
Current:		
U.S. Federal	$1,840	$ 4,472
State		
Deferred:		
U.S. Federal	(800)	(12,799)
State		
Total provision (benefit) for continuing operations	$1,040	$ (8,327)

The tax effect of temporary differences which give rise to a significant portion of deferred tax assets and liabilities is as follows:

	December 31, 1996 Deferred Tax Asset	Deferred Tax Liability
Excess of tax basis over book basis of non-consolidated entities	$ 8,400	$
Valuation allowance	(8,400)	
Total	$	$

	December 31, 1995 Deferred Tax Asset	Deferred Tax Liability
Excess of book basis over tax basis of non-consolidated entities	$	$ 4,918
Valuation allowance		
Total	$	$ 4,918

Differences between the amounts provided for income taxes and amounts computed at the federal statutory rate of 35% are summarized as follows:

	December 31, 1996	1995
(Loss) income from continuing operations before income taxes	$ (7,850)	$ 739
Federal income tax (benefit) at statutory rate	(2,748)	259
Increase (decrease) resulting from:		
80% dividends received deduction under Internal Revenue Code Section 243		(8,586)
Establishment of valuation allowance	3,788	
Total	$ 1,040	$(8,327)

NEW VALLEY HOLDINGS, INC.
NOTES TO FINANCIAL STATEMENTS
(Dollars In Thousands, Except Per Share Amounts) - (continued)

At December 31, 1996, 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.

6. CONTINGENCIES

BGLS had pledged its ownership interest in the Company's Common Stock as collateral in connection with the BGLS 13.75% Series 2 Senior Secured Notes ("Series 2 Notes"). On November 27, 1995, BGLS commenced an offer to exchange all of its Series 2 Notes for 15.75% Senior Secured Notes due January 31, 2001. The exchange offer closed on January 30, 1996 and all of the Series 2 Notes were exchanged for 15.75% Senior Secured Notes. 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 15.75% Senior Secured Notes.

Exhibit 99.4

BROOKE (OVERSEAS) LTD.

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 1996

BROOKE (OVERSEAS) LTD. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholder
of Brooke (Overseas) Ltd.

We have audited the accompanying consolidated balance sheets of Brooke (Overseas) Ltd. and Subsidiaries (the "Company") as of December 31, 1996 and 1995 and the related consolidated statements of operations, stockholder's equity (deficit) and cash flows for each of the three years in the period ended December 31, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Brooke (Overseas) Ltd. and Subsidiaries at December 31, 1996 and 1995 and the consolidated results of their operations and their cash flows for each of three years in the period ended December 31, 1996 in conformity with generally accepted accounting principles.

COOPERS & LYBRAND L.L.P.

Miami, Florida
March 27, 1997

BROOKE (OVERSEAS) LTD. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	December 31, 1996	December 31, 1995
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,875	$ 1,660
Accounts receivable - trade, less allowances of $0 and $692	166	1,011
Inventories	3,569	5,934
Prepaid expenses	2,640	2,655
Deferred tax assets		1,061
Total current assets	8,250	12,321
Property, plant and equipment, at cost, less accumulated depreciation of $676 and $207	59,607	27,462
Goodwill	1,094	417
Deferred finance costs	2,805	5,163
Other	540	
Total assets	$ 72,296	$ 45,363
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Current liabilities:		
Current portion of long-term debt	$ 21,658	$ 1,635
Accounts payable - trade	13,074	3,484
Due to affiliates	48,875	41,266
Unearned revenue	7,406	7,637
Accrued taxes	8,474	5,500
Accrued interest	597	200
Other accrued liabilities	2,692	184
Total current liabilities	102,776	59,906
Long-term debt		9,487
Unearned revenue	9,458	
Other liabilities	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	3,400	
Deficit	(45,533)	(24,731)
Total stockholder's equity (deficit)	(41,432)	(24,030)
Total liabilities and stockholder's equity (deficit)	$ 72,296	$ 45,363

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)

	December 31, 1996	December 31, 1995	December 31, 1994
Net sales	$ 49,135	$38,752	$29,060
Cost of sales	45,099	28,304	24,387
Gross profit	4,036	10,448	4,673
Operating, selling, administrative and general expenses	14,008	5,621	8,325
Operating (loss) income	(9,972)	4,827	(3,652)
Other income (expense):			
Interest expense	(7,548)	(6,286)	(3,045)
Gain on foreign currency exchange	1,199	503	3,935
Other, net	(3,027)	(853)	(1,485)
Loss before income taxes	(19,348)	(1,809)	(4,247)
Provision for income taxes	1,454	1,669	830
Net loss	$(20,802)	$(3,478)	$(5,077)

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

BROOKE (OVERSEAS) LTD. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDER'S EQUITY (DEFICIT)
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	Common Stock		Additional Paid-in		
	Shares	Amount	Capital	Deficit	Total
Balance, December 31, 1993	701,000	$ 701		$ (7,451)	$ (6,750)
Net loss				(5,077)	(5,077)
Balance, December 31, 1994	701,000	701		(12,528)	(11,827)
Net loss				(3,478)	(3,478)
Distributions to parent				(8,725)	(8,725)
Balance, December 31, 1995	701,000	701		(24,731)	(24,030)
Net loss				(20,802)	(20,802)
Capital contribution			$3,400		3,400
Balance, December 31, 1996	701,000	$701	$3,400	$(45,533)	$(41,432)

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)

	December 31, 1996	December 31, 1995	December 31, 1994
Cash flows from operating activities:			
Net loss	$(20,802)	$ (3,478)	$(5,077)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Depreciation and amortization	1,399	870	348
Deferred taxes	1,061	(1,061)	
Provision for doubtful accounts		(495)	1,187
Provision for loss on inventory		(105)	505
Provision for obsolete equipment		47	125
Changes in assets and liabilities:			
Accounts receivable	796	852	(2,499)
Inventories	2,364	(3,046)	971
Accounts payable and accrued liabilities	12,717	2,395	7,189
Due to affiliates	7,606	15,716	8,458
Unearned revenue	9,227	4,728	(1,772)
Other assets and liabilities, net	1,490	(6,123)	(2,293)
Net cash provided by operating activities	15,858	10,300	7,142
Cash flows from investing activities:			
Capital expenditures	(29,860)	(16,755)	(2,687)
Purchase of stock in Liggett-Ducat	(2,829)	(435)	
Proceeds from sale of stock in Liggett-Ducat	2,100		
Proceeds from sale of option to purchase stock in Liggett-Ducat	3,400		
Investments			(2,682)
Net cash used in investing activities	(27,189)	(17,190)	(5,369)

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

BROOKE (OVERSEAS) LTD. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS, CONTINUED
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	December 31, 1996	December 31, 1995	December 31, 1994
Cash flows from financing activities:			
Proceeds from debt..........................	12,995	10,841	1,170
Repayments of debt..........................	(1,329)	(1,044)	
Borrowings under revolver...................	1,677	798	958
Repayments on revolver......................	(1,672)	(2,198)	(303)
Net cash provided by financing activities.....	11,671	8,397	1,825
Effect of exchange rate changes on cash and cash equivalent	(125)	(395)	(3,136)
Net increase in cash and cash equivalents.....	215	1,112	462
Cash and cash equivalents, beginning of period	1,660	548	86
Cash and cash equivalents, end of period......	$ 1,875	$ 1,660	$ 548
Supplemental cash flow information:			
Cash payments during the period for:			
Interest....................................	$ 5,573	$ 3,636	$ 1,585
Income taxes................................	393	58	755

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)

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"). Prior to October 1, 1993, Brooke and Ducat Factory were operating a Russian cigarette factory under a joint venture agreement (the "Joint Venture") in Moscow, Russia. On October 1, 1993, the parties to the Joint Venture agreed to form a Russian closed joint stock company, Liggett-Ducat Ltd. ("Liggett-Ducat"), an entity predominantly engaged in the manufacture of cigarettes. Brooke then transferred ownership of the stock it held of Liggett-Ducat to the Company. At December 31, 1996 and 1995, the Company owned 75% and 68.3%, respectively, of the stock of Liggett-Ducat. The business of Liggett-Ducat included the cigarette operations, Liggett-Ducat Tobacco ("LDT"), a wholly-owned subsidiary engaged in the construction of a new cigarette factory, and, prior to December 1996, 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 10.)

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. (Refer to Note 13.)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Basis of Presentation:

The consolidated financial statements and accompanying notes include the accounts of the Company and its subsidiaries. Significant intercompany accounts and transactions have been eliminated in consolidation.

b) Liquidity:

The Company has historically relied on Brooke and BGLS for sources of financing. At December 31, 1996 and 1995, the Company had a working capital deficiency of $94,526 and $47,585, respectively, and a net capital deficiency of $41,432 and $24,030, respectively. Management believes that it will continue to receive financing from BGLS as needed. In addition, 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. Management believes that such activities will result in improved operations and cash flow, but there can be no assurances in this regard. (Refer to Note 13.)

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

c) 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.

d) Foreign Currency Translation:

The Company accounts for translation of foreign currency in accordance with Statement of Financial Accounting Standards ("SFAS") No. 52, "Foreign Currency Translation." The Company's Russian subsidiaries operate in a "highly inflationary" economy and use the U.S. dollar as the functional currency. Therefore, certain assets of this entity (principally inventories and property, plant and equipment) are translated at historical exchange rates with all other assets and liabilities translated at year-end exchange rates and all translation adjustments are reflected in the consolidated statements of operations.

e) Cash and Cash Equivalents:

For purposes of the statements of cash flows, cash includes cash on hand, cash on deposit in banks and cash equivalents, comprised of short-term investments which have an original maturity of 90 days or less. Interest on short-term investments is recognized when earned.

f) Inventories:

Inventories are stated at the lower of cost or market. Cost is determined on a first-in, first-out (FIFO) basis.

g) Property, Plant and Equipment:

Property, plant and equipment are stated at cost. Depreciation has been calculated on the straight-line method based upon the following useful lives: buildings - 20 years, factory machinery and equipment - 10 years, office furniture and equipment - 5 years, and computers and vehicles - 3 years. Depreciation is not provided on construction-in-progress until the related assets are placed in service.

Interest costs are capitalized in connection with the construction of major facilities. Capitalized interest is recorded as part of the asset to which it relates and is amortized over the asset's estimated useful life. In 1996 and 1995 interest costs of $6,157 and $1,004, respectively, were capitalized. No interest was capitalized in 1994.

The cost of major renewals and betterments are capitalized. The cost and related accumulated depreciation of property, plant and equipment are removed from the

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

financial statements upon retirement or other disposition and any resulting gain or loss is reflected in the statement of operations. Repairs and maintenance are charged to expense as incurred.

h) Goodwill:

Goodwill is being amortized using the straight-line method over ten years and relates to the purchase by the Company of additional shares of Liggett-Ducat stock. Amortization expense for the years ended December 31, 1996, 1995 and 1994 was $51, $68 and $0, respectively.

i) Impairment of Long-Lived Assets:

Effective January 1, 1996, the Company adopted SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of". SFAS No. 121 establishes accounting standards for the impairment of long-lived assets, certain identifiable intangibles, and goodwill related to those assets. There was no material effect on the financial position or results of operations from the adoption because the Company's prior impairment recognition practice was consistent with the major provisions of SFAS No. 121. Under the provisions of SFAS No. 121, impairment losses are recognized when expected future cash flows are less than the assets' carrying value. Accordingly, when indicators of impairment are present, the Company evaluates the carrying value of property, plant and equipment and intangibles in relation to the operating performance and future undiscounted cash flows of the underlying business. The Company adjusts the net book value of the underlying assets by the excess of the assets' carrying values over the sum of expected discounted future cash flows.

j) Deferred Finance Costs:

Deferred finance costs consist of the discounts on lease prepayments which are being amortized over the life of the leases and the fees incurred in obtaining a bank loan which are being amortized over the term of the loan.

k) Revenue Recognition:

Sales, net of sales returns and discounts, are recognized upon the shipment of finished goods to customers. Rental income is recognized ratably over the life of the lease.

l) Income Taxes:

The Company has not provided for United States income tax in connection with its Russian subsidiaries since losses from continuing operations before income taxes have been incurred since inception. Applicable income and deferred taxes have been provided for based on tax rates applicable to the Company in Russia.

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A valuation allowance is provided against Russian deferred tax assets when it is deemed more likely than not that some portion or all of the deferred tax assets will not be realized.

m) Concentration of Credit and Other Risks:

The Company sells its products primarily to companies in the wholesale distribution and retail industries in the Russian Federation. Although the Company does not require collateral and, as a consequence, is exposed to credit risk with respect to its tobacco operations, the Company does perform ongoing credit evaluations of its customers and believes that its trade accounts receivable risk exposure is limited. Additionally, prepayment for goods and services is a customary business practice in Russia. At December 31, 1996 and 1995, the Company had approximately $2,141 and $2,500, respectively, in prepayments made to suppliers of raw materials.

The Company maintains its cash deposits with United States, various foreign and Russian banks. Management assesses the financial condition of the institutions on an on-going basis.

The performance of Liggett-Ducat's cigarette and real estate development operations in Russia are affected by uncertainties in Russia which may 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.

3. NON-MONETARY TRANSACTIONS

During 1996, 1995 and 1994, certain supplies and inventory purchase transactions were made whereby payment for such transactions was facilitated by the Company's customers who forwarded payment on the Company's behalf to raw material suppliers. Such transactions amounted to approximately $3,040, $8,200 and $6,800 in 1996, 1995 and 1994, respectively. Sales and purchases were priced at what management believes are normal sales price for cigarettes and the normal market price for tobacco and other raw materials. At December 31, 1996 and 1995, $1,118 and $668, respectively, were included as prepaid raw materials (Note 2m) which represents tobacco acquired in exchange for finished goods.

4. INVENTORIES

Inventories consist of:

	December 31, 1996	December 31, 1995
Finished goods	$	$ 643
Work-in-process	53	239
Raw materials	2,664	4,075
Replacement parts and supplies	852	977
	$3,569	$5,934

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5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consists of:

	December 31, 1996	December 31, 1995
Buildings..........................	$ 8,064	$ 7,357
Factory machinery and equipment....	4,419	1,511
Computers and software.............	289	189
Office furniture and equipment.....	129	126
Vehicles...........................	416	200
Construction-in-progress...........	46,966	18,286
	60,283	27,669
Less accumulated depreciation......	(676)	(207)
	$59,607	$27,462

In October 1995, BML purchased buildings for $4,369, excluding related transaction costs, which had previously been leased from the Moscow Property Committee. BML has developed, or is in the process of developing, these buildings for commercial use.

On December 29, 1995, Liggett-Ducat relinquished its 59.4% ownership in a joint real estate venture, Neftecominvest Ltd., in exchange for 100% ownership of a partially constructed manufacturing facility owned by the venture. Liggett-Ducat intends to develop this facility, located on the outskirts of Moscow, into a new cigarette factory. In connection with this exchange, a 49-year land lease was renegotiated in 1996 for the site on which the factory is to be developed. Liggett-Ducat's cost basis in the joint real estate venture of $2,675 was transferred to its basis in the new cigarette factory.

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

6. EMPLOYEE BENEFITS

The Company complies with Russian Federation regulations covering pensions, education, day care, medical and other benefits to employees. These items are funded as a percentage of gross wages and are paid on a current basis. Medical clinic and day care facilities are provided on site and related costs are expensed as incurred. All Russian citizen employees are required to participate in the pension fund. The total expense for these programs recognized in 1996, 1995 and 1994 was approximately $860, $1,050 and $770, respectively.

7. REVOLVING CREDIT FACILITY

During 1995, the Company had a revolving credit facility with Peoples Bank which allowed for total borrowings of up to Rubles ("Rbl") 6,000,000 at an annual interest rate of 90%,

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collateralized by the Company's inventories. The outstanding balance at December 31, 1995 ($155) was acquired by Sberbank and was fully repaid during the first quarter of 1996. Vneshtorgbank made available to the Company a new revolving credit facility of Rbl 8,000,000 (approximately $1,450 at the December 31, 1996 exchange rate), with an annual interest rate of 85%. This facility was collateralized by the Company's inventories and accounts receivable. During September 1996, this facility was extinguished.

Interest expense on the facility with Peoples Bank was $0 in 1996 and $1,349 in 1995. Interest expense on the facility with Vneshtorgbank was $649 in 1996.

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 24%, respectively, in order to secure tobacco commitment purchases. The lines of credit will expire in May 1997 and June 1997.

8. LONG-TERM DEBT

Current and long-term debt consist of the following:

	December 31, 1996	December 31, 1995
Bank loan........................	$20,418	$ 7,078
Deferred financing fees..........	1,240	4,044
	21,658	11,122
Less:		
Current maturities...............	21,658	1,635
Amount due after one year........	$	$ 9,487

In October 1995, Liggett-Ducat entered into a loan agreement with Vneshtorgbank to borrow up to $20,418 to fund real estate development. Interest on the note is based on the London Interbank Offered Rate, which was 5.55% and 5.66% at December 31, 1996 and 1995, respectively, plus 10%. Principal repayments are due from April through October of 1997. Deferred financing fees of $4,044 are being amortized over the term of the loan. Brooke has guaranteed the payment of the loan. BML pledged Ducat Place II, the second phase of BML's Ducat Place real estate development project, as collateral for the loan. At December 31, 1996, BML had drawn down approximately $20,418 of the loan. (Refer to Note 13.)

9. COMMITMENTS

The following is a schedule of the Company's future minimum rental payments required under operating leases with noncancelable lease terms in excess of one year as of December 31, 1996:

Year ending December 31:	
1997..	$ 735
1998..	650
1999..	649
2000..	649
2001..	649
2002 and thereafter......................................	16,959
	$20,291

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Lease commitments for 2002 and thereafter relate primarily to the remaining 45 years of a land lease and 23 years of an equipment lease.

The Company's rental expense for the years ended December 31, 1996, 1995 and 1994 was $1,026, $1,107 and $4,808, respectively.

At December 31, 1996, BML has unearned revenue of $16,864 consisting of prepayments on various Ducat Place leases. Unamortized discounts on certain prepaid leases for Ducat Place I were $1,325 and $1,377 at December 31, 1996 and 1995, respectively.

Future minimum lease payment receivables under non-cancelable leasing arrangements as of December 31, 1996 are as follows:

Year ending December 31:	
1997	$
1998	2,064
1999	6,423
2000	4,145
2001	2,664
2002 and thereafter	686
	$15,982

At March 15, 1997, approximately 90% of the space in Ducat Place II has been leased. Lease commencement is expected during the second quarter of 1997.

10. PURCHASE OF STOCK IN LIGGETT-DUCAT

In the third quarter of 1995, the Company increased its investment in Liggett-Ducat from approximately 58% to 68% through a direct purchase of 73,877 shares of Liggett-Ducat stock from other shareholders. In connection with this purchase, the Company recorded goodwill in the amount of $435.

During the second quarter of 1996, the Company further increased its ownership of Liggett-Ducat through the purchase of an additional 142,558 shares for approximately $2,143. In July 1996, the Company sold 140,000 shares (19.97%) of Liggett-Ducat's tobacco operations to Liggett Group Inc. ("Liggett"), a wholly-owned subsidiary of BGLS, for $2,100. Liggett also acquired a ten-year option to buy up to an additional 292,407 shares for $3,400, which has been accounted for as a capital contribution, thereby entitling Liggett to increase its interest in Liggett-Ducat to approximately 62%. The option fee would be credited against the purchase price. As part of the same transaction, Liggett had the right to acquire for $2,200 another ten-year option from the Company on the same terms to purchase all of the remaining shares of Liggett-Ducat owned by the Company. Currently, such shares represent approximately a 33% interest. Such option was acquired on March 13, 1997.

In December 1996, the Company purchased 46,337 additional shares of Liggett-Ducat stock from other shareholders for $695. At December 31, 1996, the Company owned 75.3% of the stock of Liggett-Ducat and Liggett owned 19.97%. In connection with 1996 purchases of Liggett-Ducat common stock, the Company recorded goodwill in the amount of $729. Unamortized goodwill is $1,094 and $417 at December 31, 1996 and 1995, respectively.

11. RELATED PARTY TRANSACTIONS

The Company has obtained funding through a revolving credit facility with Brooke 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, Brooke and BGLS have advanced funds to BML for its real estate developments projects. Amounts due to Brooke and BGLS under this facility at December 31, 1996 and 1995 were $36,150 and $34,891 including interest of $12,725 and $6,375, respectively.

On March 2, 1995, the Company dividended to Brooke and BGLS certain notes receivable of the Company from Liggett-Ducat and BML in the amount of $8,725, including interest.

On July 2, 1996, the Company repaid portions of outstanding loans to BGLS in principal amount of $3,679 together with accrued interest of $1,521.

During 1996, indebtedness relating to the real estate development business including the loan agreement between Vneshtorgbank and Liggett-Ducat (refer to Note 8) and intercompany indebtedness in the amount of $3,586 together with accrued interest of $1,270 was assigned by Liggett-Ducat to BML.

Liggett has provided certain administrative and technical support to Liggett-Ducat. It is anticipated that such support, specifically in the areas of technical blending research for product development, manufacturing and marketing expertise will continue during 1997. Liggett's expenses associated with these activities were $76, $229 and $230 for the years ended December 31, 1996, 1995 and 1994, respectively.

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On April 3, 1996, the Company entered into a stock purchase agreement (the "purchase agreement") with the chairman of Liggett-Ducat. Under the purchase agreement, the Company acquired the 84,540 shares for $15 per share ($1,268). The stock purchase price was paid in installments during 1996 and the shares of Liggett-Ducat stock collateralizing the installment payments were released, ratably, as payments were made.

Concurrently, the Company entered into a consulting and non-compete agreement with the chairman for services through December 31, 1998. Under the terms of the agreement, the Company will pay him approximately $5,232 over five years. Also, Liggett-Ducat extended his employment agreement with Liggett-Ducat for one year at $384. At December 31, 1996, 29,759 shares of Liggett-Ducat stock collateralizing the Company's obligations under the agreements had been released to the Company and 54,781 shares of Liggett-Ducat stock remain as collateral under the terms of the agreements.

On June 14, 1996, the Company entered into a second stock purchase agreement with the General Director (the "Director") of the cigarette manufacturing operations. Under this purchase agreement, the Company acquired the 58,018 shares held by the Director for approximately $15 per share ($875). The stock purchase price was paid in installments during 1996.

Concurrently, the Company entered into a consulting and non-compete agreement with the Director for services through December 31, 1998. Under the terms of the agreement, the Company will pay the Director approximately $3,125 in installments during 1997 and 1998. Also, Liggett-Ducat extended the Director's employment agreement with Liggett-Ducat until December 31, 1998 at $175 annually. At December 31, 1996, 12,683 shares of Liggett-Ducat stock collateralizing the Company's obligations under the agreements had been released; 45,335 shares of Liggett-Ducat stock remain as collateral under the terms of the agreements.

12. INCOME TAXES

The provision for income taxes is for income taxes payable pursuant to Russian statutory requirements. There were no provisions for income taxes in jurisdictions other than the Russian Federation.

Provision (benefit) for income taxes consists of the following:

	1996	1995	1994
Current............................	$ 393	$ 2,730	$830
Deferred...........................	1,061	(1,061)	
	$1,454	$ 1,669	$830

Deferred taxes have been recognized for significant temporary differences arising between the financial statement and tax basis of assets and liabilities. The principal items giving rise to temporary differences relate to management fees and interest expense

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incurred during 1996 and 1995 which are not deductible for tax purposes until paid. The tax effect of these temporary differences and net deferred taxes recorded as of December 31, 1996 and 1995 are summarized as follows:

	1996	1995
Deferred tax assets	$ 1,566	$ 4,149
Deferred tax liability	(305)	(650)
Net deferred tax asset	1,261	3,499
Valuation allowance	(1,261)	(2,438)
Net deferred taxes	$	$ 1,061

In 1996, Russian tax authorities assessed Liggett-Ducat $7,600 for outstanding tax liabilities, which amount was accrued in 1996. The liability is payable in two parts, 50% within 2 1/2 years, the remaining 50% over the succeeding five years.

13. SUBSEQUENT EVENTS

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 expects to recognize a gain on the sale in 1997 in the amount of $25,500. The remaining $27,000 will be deferred, reflecting recognition that the Company's parent, BGLS, retains an interest in BML through its 42% equity ownership in New Valley, and, 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 and anticipates distributing to BGLS proceeds from the $33,500 promissory note.

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, 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.

The following unaudited proforma summary presents the Company's financial position as if the sale of BML and the $21,500 distribution made to the Company's parent had been completed at December 31, 1996:

Current assets	$ 40,087
Total assets	50,783
Current liabilities	60,105
Total liabilities	88,129
Stockholder's deficit	(37,346)