UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

JOINT QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 1996

COMMISSION FILE NUMBER 1-5759	COMMISSION FILE NUMBER 33-93576
BROOKE GROUP LTD. (Exact name of registrant as specified in its charter)	BGLS INC. (Exact name of registrant as specified in its charter)
51-0255124 (I.R.S. Employer Identification No.)	13-3593483 (I.R.S. Employer Identification No.)
DELAWARE (State or other jurisdiction of incorporation or organization)	DELAWARE (State or other jurisdiction of incorporation or organization)
100 S.E. SECOND STREET MIAMI, FLORIDA 33131 (Address of principal executive offices including Zip Code)	100 S.E. SECOND STREET MIAMI, FLORIDA 33131 (Address of principal executive offices including Zip Code)
305/579-8000 (Registrant's telephone number, including area code)	305/579-8000 (Registrant's telephone number, including area code)

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 registrant was 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.

As of August 12, 1996, there were 18,497,096 shares of Brooke Group Ltd.'s common stock outstanding.

As of August 12, 1996, there were 100 shares of BGLS Inc.'s common stock outstanding, all of which were owned by Brooke Group Ltd.

BROOKE GROUP LTD.
BGLS INC.

FORM 10-Q

TABLE OF CONTENTS

Item 1. Financial Statements

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

	June 30, 1996	December 31, 1995
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 4,406	$ 3,370
Accounts receivable - trade	21,580	23,844
Other receivables	901	1,448
Receivables from affiliates	1,342	1,502
Inventories	54,636	60,522
Deferred tax assets	964	1,061
Other current assets	4,857	4,868
Total current assets	88,686	96,615
Property, plant and equipment, at cost, less accumulated depreciation of $29,134 and $27,323	60,332	48,352
Intangible assets, at cost, less accumulated amortization of $16,524 and $15,679	6,719	5,453
Investment in affiliate	41,804	63,901
Other assets	9,146	11,299
Total assets	$ 206,687	$ 225,620
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT):		
Current liabilities:		
Notes payable and current portion of long-term debt	$ 37,941	$ 2,387
Accounts payable	20,972	22,762
Cash overdraft		4,266
Accrued promotional expenses	25,167	25,519
Accrued taxes payable	24,273	25,928
Accrued interest	35,051	16,863
Other accrued liabilities	25,976	21,452
Total current liabilities	169,380	119,177
Notes payable, long-term debt and other obligations, less current portion	394,314	406,744
Noncurrent employee benefits	30,539	31,672
Other liabilities	12,909	24,131
Commitments and contingencies		
Stockholders' equity (deficit):		
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	92,193	93,186
Deficit	(456,622)	(428,173)
Other	(5,537)	9,372
Less: 6,500,947 shares of common stock in treasury, at cost	(32,339)	(32,339)
Total stockholders' equity (deficit)	(400,455)	(356,104)
Total liabilities and stockholders' equity (deficit)	$ 206,687	$ 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)
(UNAUDITED)

	June 30, 1996	December 31, 1995
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 4,340	$ 3,370
Accounts receivable - trade	21,580	23,844
Other receivables	868	1,481
Receivables from affiliates	1,222	1,130
Inventories	54,636	60,522
Deferred tax assets	4,764	4,861
Other current assets	4,186	4,435
Total current assets	91,596	99,643
Property, plant and equipment, at cost, less accumulated depreciation of $28,920 and $27,181	59,951	47,900
Intangible assets, at cost, less accumulated amortization of $16,524 and $15,679	6,719	5,453
Investment in affiliate	41,804	63,901
Other assets	10,241	12,345
Total assets	$ 210,311	$ 229,242
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT):		
Current liabilities:		
Notes payable and current portion of long-term debt	$ 37,299	$ 2,132
Accounts payable	20,847	22,637
Cash overdraft		3,761
Due to parent	25,521	26,054
Accrued promotional expenses	25,167	25,519
Accrued taxes payable	24,273	25,928
Accrued interest	35,051	16,863
Other accrued liabilities	24,720	19,991
Total current liabilities	192,878	142,885
Notes payable, long-term debt and other obligations, less current portion	394,314	420,449
Noncurrent employee benefits	30,539	31,672
Other liabilities	16,163	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	(457,595)	(423,424)
Other	(5,069)	9,935
Total stockholder's deficit	(423,583)	(389,895)
Total liabilities and stockholder's equity (deficit)	$ 210,311	$ 229,242

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

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

	Three Months Ended		Six Months Ended	
	June 30, 1996	June 30, 1995	June 30, 1996	June 30, 1995
Revenues*	$125,213	$122,328	$215,729	$217,618
Cost of goods sold*	63,522	57,762	110,570	104,140
Gross profit	61,691	64,566	105,159	113,478
Operating, selling, general and administrative expenses	58,264	65,196	103,156	114,504
Operating income (loss)	3,427	(630)	2,003	(1,026)
Other income (expenses):				
Interest income	110	461	128	850
Interest expense	(15,457)	(14,702)	(30,234)	(29,417)
Equity in (loss) earnings of affiliate	(1,260)	354	(2,534)	2,037
Other, net	2,219	962	2,334	1,077
(Loss) from continuing operations before income taxes	(10,961)	(13,555)	(28,303)	(26,479)
(Benefit) provision for income taxes	(289)	84	146	70
(Loss) from continuing operations	(10,672)	(13,639)	(28,449)	(26,549)
Discontinued operations:				
Income from discontinued operations		1,114		2,762
Gain on disposal				13,183
Income from discontinued operations		1,114		15,900
Net (loss)	(10,672)	(12,525)	(28,449)	(10,649)
Proportionate share of New Valley capital transactions, retirement of Class A Preferred Shares		10,954	1,782	14,023
Net (loss) income applicable to common shares	$(10,672)	$ (1,571)	$(26,667)	$ 3,374
Per common share:				
(Loss) from continuing operations	$ (0.58)	$ (0.15)	$ (1.44)	$ (0.68)
Income from discontinued operations	$	$ 0.06	$	$ 0.86
Net (loss) income applicable to common shares	$ (0.58)	$ (0.09)	$ (1.44)	$ 0.18
Weighted average common shares and common shares equivalents outstanding	18,497,096	18,247,094	18,497,096	18,249,489

* Revenues and Cost of goods sold include federal excise taxes of $29,487 and $33,203 for the three months ended June 30, 1996 and 1995, respectively, and $50,684 and $59,595 for the six months ended June 30, 1996 and 1995, 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)
(UNAUDITED)

	Three Months Ended		Six Months Ended	
	June 30, 1996	June 30, 1995	June 30, 1996	June 30, 1995
Revenues*	$125,213	$122,328	$215,729	$217,618
Cost of goods sold*	63,522	57,762	110,570	104,140
Gross profit	61,691	64,566	105,159	113,478
Operating, selling, general and administrative expenses	58,073	65,316	102,660	114,091
Operating income (loss)	3,618	(750)	2,499	(613)
Other income (expenses):				
Interest income	60	461	78	850
Interest expense	(16,395)	(15,250)	(32,063)	(30,733)
Equity in (loss) earnings of affiliate	(1,260)	354	(2,534)	2,037
Other, net	1,703	887	1,668	902
(Loss) from continuing operations before income taxes	(12,274)	(14,298)	(30,352)	(27,557)
(Benefit) provision for income taxes	(253)	60	198	(295)
(Loss) from continuing operations	(12,021)	(14,358)	(30,550)	(27,262)
Discontinued operations:				
Income from discontinued operations		1,114		2,762
Gain on disposal				13,138
Income from discontinued operations		1,114		15,900
Net (loss)	$(12,021)	$(13,244)	$(30,550)	$(11,362)

* Revenues and Cost of goods sold include federal excise taxes of $29,487 and $33,203 for the three months ended June 30, 1996 and 1995, respectively, and $50,684 and $59,595 for the six months ended June 30, 1996 and 1995, respectively.

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

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

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Deficit	Treasury Stock	Other	Total
Balance, December 31, 1995	18,497,096	$1,850	$93,186	$(428,173)	$(32,339)	$ 9,372	$(356,104)
Net (loss)				(28,449)			(28,449)
Distributions on common stock ($0.15 per share)			(2,775)				(2,775)
Stock options granted to consultant						95	95
Reduction of unrealized holding gain on investment in New Valley						(16,567)	(16,567)
Effect of New Valley capital transactions .			1,782			1,563	3,345
Balance, June 30, 1996	18,497,096	$1,850	$92,193	$(456,622)	$(32,339)	$ (5,537)	$(400,455)

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

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

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Deficit	Other	Total
Balance, December 31, 1995	100	$	$23,594	$(423,424)	$ 9,935	$(389,895)
Distributions paid to parent				(3,621)		(3,621)
Net (loss)				(30,550)		(30,550)
Reduction of unrealized holding gain on investment in New Valley					(16,567)	(16,567)
Effect of New Valley capital transactions			1,782		1,563	3,345
Forgiveness of debt by parent			13,705			13,705
Balance, June 30, 1996	100	$	$39,081	$(457,595)	$ (5,069)	$(423,583)

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

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

	Six Months Ended June 30, 1996	Six Months Ended June 30, 1995
Net cash (used in) operating activities	$ (735)	$(15,093)
Cash flows from investing activities:		
Proceeds from sale of businesses and assets	4,415	13,699
Investments	(491)	(1,965)
Capital expenditures	(14,680)	(2,752)
Dividends from New Valley	6,183	38,645
Net cash (used in) provided by investing activities	(4,573)	47,627
Cash flows from financing activities:		
Proceeds from debt	21,154	3,028
Repayments of debt	(7,769)	(26,752)
(Decrease) in cash overdraft	(4,266)	(1,582)
Distributions on common stock	(2,775)	(2,737)
Treasury stock purchases		(135)
Other, net		(48)
Net cash provided by (used in) by financing activities	6,344	(28,226)
Net increase in cash and cash equivalents	1,036	4,308
Cash and cash equivalents, beginning of period	3,370	4,276
Cash and cash equivalents, end of period	$ 4,406	$ 8,584

Supplemental non-cash investing and financing activities:

	1996	1995
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 LDL	1,643	
Distribution of MAI shares to stockholders		$ 27,085

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)
(UNAUDITED)

	Six Months Ended June 30, 1996	Six Months Ended June 30, 1995
Net cash (used in) operating activities	$ (73)	$(11,647)
Cash flows from investing activities:		
Proceeds from sale of business and assets	4,415	13,699
Investments	(491)	(2,765)
Capital expenditures	(14,680)	(2,528)
Dividends from New Valley	6,183	38,645
Other, net		(88)
Net cash (used in) provided by investing activities	(4,573)	46,963
Cash flows from financing activities:		
Proceeds from debt	20,512	2,343
Repayments of debt	(7,514)	(26,467)
(Decrease) in cash overdraft	(3,761)	(789)
Distributions paid to parent	(3,621)	(5,872)
Other, net		(206)
Net cash provided by (used in) financing activities	5,616	(30,991)
Net increase in cash and cash equivalents	970	4,325
Cash and cash equivalents, beginning of period	3,370	4,259
Cash and cash equivalents, end of period	$ 4,340	$ 8,584
Supplemental non-cash investing and financing activities:		
Exchange of Series 2 Senior Secured Notes for Series A Notes	$ 99,154	
Exchange of 14.50% Subordinated Debentures for Series B Notes	125,495	
Issuance of Series A Notes for options	822	
Exchange of Series A Notes for Series B Notes	99,976	
Forgiveness of debt by parent	13,705	
Issuance of promissory notes for shares of LDL	1,643	
Distribution of MAI to parent		$ 24,741

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)
(UNAUDITED)

1. PRINCIPLES OF REPORTING

The consolidated financial statements of Brooke Group Ltd. (the "Company") include the consolidated statements of its wholly owned subsidiary, BGLS Inc. ("BGLS"). The consolidated statements of BGLS include the accounts of Liggett Group Inc. ("Liggett"), Brooke (Overseas) Ltd. ("BOL"), New Valley Holdings, Inc. ("NV Holdings") and other less significant subsidiaries. Based on the Company's ability to assert sufficient control, the Company consolidated the accounts of Liggett-Ducat Ltd. ("LDL") at December 31, 1995 and the results of operations for the three and six months ended June 30, 1996.

The interim consolidated financial statements of the Company and BGLS are unaudited and, in the opinion of management, reflect all adjustments necessary (which are normal and recurring) to present fairly the Company's and BGLS' consolidated financial position, results of operations and cash flows. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's and BGLS' Annual Reports on Form 10-K, as amended, for the year ended December 31, 1995, as filed with the Securities and Exchange Commission ("SEC"). The consolidated results of operations for interim periods should not be regarded as necessarily indicative of the results that may be expected for the entire year.

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

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

2. INVESTMENT IN NEW VALLEY CORPORATION

Summarized financial information for New Valley Corporation ("New Valley") as of June 30, 1996 and December 31, 1995 and for the three and six months ended June 30, 1996 and 1995 is as follows:

	June 30, 1996	December 31, 1995
Current assets	$314,799	$333,485
Investment in real estate	183,122	
Other non-current assets	34,537	52,337
Current liabilities	187,361	177,920
Notes payable	159,574	
Other long-term obligations	16,366	11,967
Redeemable preferred shares	222,288	226,396
Common shareholders' deficit	(53,131)	(30,461)

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

	Three Months Ended		Six Months Ended	
	June 30, 1996	June 30, 1995	June 30, 1996	June 30, 1995
Revenues	$ 34,547	$10,032	$ 71,231	$17,701
Cost and expenses	38,909	7,455	80,577	7,753
(Loss) income from continuing operations	(4,762)	2,284	(9,646)	8,915
Income from discontinued operations		2,682		4,080
Net (loss) income applicable to common shares(A)	(20,408)	12,585	(36,475)	7,560

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

The Company's and BGLS' investment in New Valley at June 30, 1996 is summarized as follows:

	Number of Shares	Fair Value	Carrying Amount	Unrealized Holding Gain (Loss)	Earnings (Loss)
Class A Preferred Shares	618,326	$101,407	$101,407	$(8,282)	$ 13,910
Class B Preferred Shares	250,885	2,383	2,383	530	
Common Shares	79,794,229	19,151	(61,986)		(16,444)
		$122,941	$ 41,804	$(7,752)	$ (2,534)

The Class A Preferred Shares and the Class B Preferred Shares are accounted for as debt and equity securities, respectively, pursuant to the requirements of Statement of Financial Accounting Standards 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. In January 1996, however, New Valley became engaged in the ownership and management of commercial real estate and, in February 1996, acquired a controlling interest in Thinking Machines Corporation. Because these businesses affect the composition and nature of the underlying net assets of New Valley, the Company and BGLS have determined the fair value of the Class A Preferred Shares based on the quoted market price commencing with the quarter ended March 31, 1996. The New Valley common shares are accounted for under the equity method.

In the first quarter of 1996, New Valley repurchased 72,104 Class A Preferred Shares for $10,530. As a result of this transaction, the Company and BGLS now own 59.72% of the outstanding Class A Preferred Shares. The Company and BGLS have recorded their 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 of $1,782 along with their share of other New Valley capital transactions of $1,563 for the six months ended June 30, 1996.

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

On March 13, 1996, New Valley declared a cash dividend of $10.00 per share on its Class A Preferred Shares payable on March 27, 1996. NV Holdings received $6,183 from the distribution. At June 30, 1996, the accrued and unpaid dividends arrearage on the Class A Preferred Shares was $124,339 or $120.08 per share.

At June 30, 1996, the accrued and unpaid dividends arrearage on the Class B Preferred Shares was $105,170 or $37.68 per share.

As a result of asset dispositions pursuant to New Valley's First Amended Joint Chapter 11 Plan of Reorganization, as amended (the "Joint Plan"), New Valley accumulated a significant amount of cash which it was required to reinvest in operating companies by January 18, 1996 in order to avoid potentially burdensome regulation under the Investment Company Act of 1940, as amended (the "Investment Company Act"). The Investment Company Act and the rules and regulations thereunder require the registration of, and impose various substantive restrictions on, companies that engage primarily in the business of investing, reinvesting or trading in securities or engage in the business of investing, reinvesting, owning, holding or trading in securities and own or propose to acquire "investment securities" having a "value" in excess of 40% of a company's "total assets" (exclusive of Government securities and cash items) on an unconsolidated basis. Following dispositions of its then operating businesses pursuant to the Joint Plan, New Valley was above this threshold and relied on the one-year exemption from registration under the Investment Company Act provided by Rule 3a-2 thereunder, which exemption expired on January 18, 1996. Prior to such date, through New Valley's acquisition of the investment banking and brokerage business of Ladenburg, Thalmann & Co., Inc. and its acquisition of a portfolio of office buildings and shopping centers, New Valley was engaged primarily in a business or businesses other than that of investing, reinvesting, owning, holding or trading in securities, and the value of its investment securities was below the 40% threshold. Under the Investment Company Act, New Valley is required to determine the value of its total assets for purposes of the 40% threshold based on "market" or "fair" values, depending on the nature of the asset, at the end of the last preceding fiscal quarter and based on cost for assets acquired since that date. If New Valley were required to register in the future, under the Investment Company Act, it would be subject to a number of severe restrictions on its operations, capital structure and management, including without limitation, entering into transactions with affiliates. If New Valley were required to register under the Investment Company Act, the Company and BGLS may be in violation of the Investment Company Act and may be adversely affected by the restrictions of the Investment Company Act. In addition, registration under the Investment Company Act by BGLS would constitute a violation of the 15.75% Series B Senior Secured Notes due 2001 (the "Series B Notes") indenture to which BGLS is a party.

SUBSEQUENT EVENT: On July 16, 1996, New Valley declared a cash dividend of $30.00 per share on its Class A Preferred Shares payable on July 30, 1996. NV Holdings received $18,550 from the distribution.

On July 29, 1996, New Valley effected a one-for-twenty reverse stock split of New Valley's common shares. After giving effect to this split, the Company now holds 3,989,710 shares of New Valley common stock.

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

3. RJR NABISCO HOLDINGS CORP.

At June 30, 1996, New Valley held 5,161,750 shares of RJR Nabisco Holdings Corp. ("RJR Nabisco") common stock with a market value of $163,886 (cost of $158,225) collateralizing margin loan financing of $82,525. At June 30, 1996, New Valley had an unrealized gain of $5,661. At August 13, 1996, New Valley had an unrealized loss of $20,794.

On February 29, 1996, New Valley entered into a total return equity swap transaction (the "Swap") with an unaffiliated company (the "Counterparty") relating to an additional 1,000,000 shares of RJR Nabisco common stock (reduced to 750,000 shares of RJR Nabisco common stock as of August 13, 1996). The transaction is for a period of up to six months, subject to earlier termination at the election of New Valley and provided for New Valley to make payment to the Counterparty of approximately $1,537 upon commencement of the Swap. At the termination of the transaction, if the price of the common stock during a specified period prior to such date (the "Final Price") exceeds $34.42, the price of the RJR Nabisco common stock during a specified period following the commencement of the swap (the "Initial Price"), the Counterparty will pay New Valley an amount in cash equal to the amount of such appreciation with respect to the shares of RJR Nabisco common stock subject to the Swap plus the value of any dividends with a record date occurring during the Swap period. If the Final Price is less than the Initial Price, then New Valley will pay the Counterparty at the termination of the transaction an amount in cash equal to the amount of such decline with respect to the shares of RJR Nabisco common stock, offset by the value of any dividends, provided that, with respect to approximately 225,000 shares of RJR Nabisco common stock, New Valley will not be required to pay any amount in excess of an approximate 25% decline in the value of the shares. The potential obligations of the Counterparty under the Swap are being guaranteed by the Counterparty's parent, a large foreign bank, and New Valley has pledged certain collateral in respect of its potential obligations under the Swap and has agreed to pledge additional collateral under certain conditions. For the six months ended June 30, 1996, New Valley recorded a charge to operations of $3,231 representing the unrealized loss on this Swap transaction and had pledged collateral of $8,569 and $10,687 at June 30, 1996 and August 13, 1996, respectively. Based on the market price of RJR Nabisco common stock at August 13, 1996, New Valley would recognize a loss of approximately $4,000 for the three months ended September 30, 1996.

On March 4, 1996, the Company filed a definitive Proxy Statement with the SEC and 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. As of June 30, 1996, New Valley had expensed $10,367 for costs relating to its RJR Nabisco investment. 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. At June 30, 1996, New Valley owed the Company and its subsidiaries $1,200 pursuant to this agreement, which amount was paid in July 1996.

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

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.

The Company, BGLS and High River Ltd. Partnership ("High River") were parties to an agreement dated October 17, 1995, as amended by the letter agreement dated November 5, 1995 (the "High River Agreement"). New Valley, ALKI Corp. ("ALKI") and High River were parties to an agreement dated October 17, 1995, as amended by the letter agreement dated October 17, 1995, and as further amended by the letter agreement dated November 5, 1995 (the "New Valley Agreement").

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.

4. INVENTORIES

Inventories consist of:

	June 30, 1996	December 31, 1995
Finished goods	$19,216	$19,129
Work-in-process	3,376	3,570
Raw materials	25,724	29,021
Replacement parts and supplies	4,773	4,903
Inventories at current costs	53,089	56,623
LIFO adjustments	1,547	3,899
	$54,636	$60,522

At June 30, 1996, the Company had leaf tobacco purchase commitments of approximately $31,200.

5. INCOME TAXES

The provision for taxes for the six month periods ended June 30, 1996 and 1995 does not bear the customary relationship to the pretax loss/income for the Company and BGLS due principally to the effects of taxes provided for foreign operations and an increase in the valuation allowance related to U.S. operations.

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

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

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

	June 30, 1996	December 31, 1995
15.75% Series B Senior Secured Notes due 2001	$232,864	
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	20,698	11,122
Other	641	2,084
Liggett:		
11.500% Senior Secured Series B Notes due 1993 - 1999	119,587	119,485
Variable rate Series C Senior Secured Notes due 1999	32,279	32,279
Revolving credit facility.	25,386	21,017
Total notes payable and long-term debt	432,255	409,131
Less:		
Current maturities	37,941	2,387
Amount due after one year	$394,314	$406,744

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:

As a result of the Exchange Agreement, dated November 21, 1995 (the "1995 Exchange Agreement"), 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 holders of in excess of 99% of the Series 2 Notes and 88% of the Subordinated Debentures agreed, subject to certain conditions, to tender their securities in the exchange offer. 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 (see "14.500% Subordinated Debentures due 1998" in the table above).

Holders of Reset Notes did not exchange and, in accordance with the 1995 Exchange Agreement, BGLS issued an irrevocable notice of redemption for all of the outstanding Reset Notes. On March 7,

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

1996, an additional $7,397 face amount of Series A Notes were sold for $6,300 including accrued interest with proceeds being used for the redemption of the Reset Notes, which were redeemed on March, 29 1996 for a total amount of $5,785, including premium, together with accrued interest of $452.

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 Series B Notes Indenture contains certain covenants, which among other things, limit the ability of BGLS to make distributions to the Company, limit additional indebtedness to $10,000 and restrict certain transactions with affiliates. 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 is payable at 13.75% from October 1, 1995 to January 30, 1996 and 15.75% from January 31, 1996 through July 31, 1996.

7. CONTINGENCIES

Liggett:

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), since all involve the tobacco manufacturing and marketing activities currently performed by 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 has 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. The future financial benefit to the Company is not quantifiable at this time since the arrangements for assistance can be terminated under certain circumstances. Furthermore, the amount of assistance received, if any, would be a function of the level of costs incurred. Certain joint defense arrangements, and the financial benefits incident thereto, have ended. No assurances can be made that other arrangements will continue. To date a number of such actions, including several against Liggett, have been disposed of favorably to the defendants and no plaintiff has ultimately prevailed in trial for recovery of damages in any such action.

In the action entitled CIPOLLONE v. LIGGETT GROUP INC., et al., the United States Supreme Court on June 24, 1992, issued an opinion regarding federal preemption of state law damage actions. The Supreme Court in CIPOLLONE concluded that The Federal Cigarette Labeling and Advertising Act (the "1965 Act") did not preempt any state common law damage claims. Relying on The Public Health Cigarette

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

Smoking Act of 1969 (the "1969 Act"), however, the Supreme Court concluded that the 1969 Act preempted certain, but not all, common law damage claims. Accordingly, the decision bars plaintiff 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. It does permit, however, claims for fraudulent misrepresentation (other than a claim of fraudulently neutralizing the warning), concealment (other than in advertising and promotion of cigarettes), conspiracy and breach of express warranty after 1969. The Court expressed no opinion as to whether any of these claims are viable under state law, but assumed ARGUENDO that they are viable.

In addition, 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 September 10, 1993, an action entitled SACKMAN v. LIGGETT GROUP INC., United States District Court, Eastern District of New York, was filed against Liggett alone alleging as injury lung cancer. Fact discovery closed on August 31, 1995; expert discovery continues. On May 25, 1996, the District Court granted Liggett summary judgment on plaintiffs' fraud and breach of warranty claims on statute of limitations grounds, but allowed plaintiffs' personal injury claims to survive. In the same order, the District Court vacated the Magistrate's March 19, 1996 order compelling Liggett to produce certain Council for Tobacco Research ("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 Court also ordered the Magistrate to reconsider his March 19, 1996 order and the effect of the District Court's summary judgment order. Oral argument concerning the relevancy of the CTR documents in light of the District Court's summary judgment order was conducted on August 8, 1996. The Magistrate's ruling on this matter is pending.

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 CTR and its predecessor. The complaint seeks equitable relief

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

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.

On October 31, 1991, an action entitled BROIN et al v. PHILLIP MORRIS COMPANIES, INC., et al., Circuit Court of the 11th 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. On December 12, 1994, plaintiffs' motion to certify the action as a class action was granted. Defendants appealed this ruling and on January 3, 1996, the Third District Court of Appeal in Florida ("Third DCA") affirmed the class certification order. On May 8, 1996, the Third DCA denied defendants' rehearing request. On June 5, 1996, the Third DCA denied defendants' petition for a stay of its order upholding class certification, but granted defendants' motion for a stay of class notice.

On March 25, 1994, an action entitled CASTANO, et al v. THE AMERICAN TOBACCO COMPANY, et al., United States District Court, Eastern District of Louisiana, was filed against Liggett and others. The class action complaint was brought on behalf of plaintiffs and residents of the United States who claim to be addicted to tobacco products and survivors who claim their decedents were addicted. The complaint is based upon the claim that defendants manipulated the nicotine levels in their tobacco products with the intent to addict plaintiffs and the class members. The complaint also alleges causes of action sounding in fraud, deceit, negligent misrepresentation, breach of express and implied warranty, strict liability and violation of consumer protection statutes. Plaintiffs seek compensatory and punitive damages and equitable relief including disgorgement of profits from the sale of cigarettes and creation of a fund to monitor the health of class members and to pay for medical expenses allegedly caused by defendants, attorneys' fees and costs. On February 17, 1995, the District Court issued an order that granted in part plaintiffs' motion for class certification. On May 23, 1996, the Court of Appeals for the Fifth Circuit reversed the District Court's order certifying the nationwide class action and instructed the District Court to dismiss the class complaint.

On May 5, 1994, an action entitled ENGLE, et al v. R. J. REYNOLDS TOBACCO COMPANY, et al., Circuit Court of the 11th Judicial District in and for Dade County, Florida, was filed against Liggett and others. The class action complaint was brought on behalf of plaintiffs and all persons in the United States who allegedly have become addicted to cigarette products and allegedly have suffered personal injury as a result thereof. Plaintiffs seek compensatory and punitive damages together with equitable relief including but not limited to a medical fund for future health care costs, attorneys' fees and costs. On October 31, 1994, plaintiffs' motion to certify the action as a class action was granted. Defendants have appealed this ruling. On January 31, 1996, the Third DCA affirmed the ruling of the trial court certifying the action as a class action, but modified the trial court ruling to limit the class to Florida citizens and residents. On May 8, 1996, the Third DCA denied defendants' rehearing request. On June 5, 1996, the Third DCA denied defendants' petition for a stay of its order upholding class certification but granted defendants' motion for a stay of class notice.

On May 6, 1996 an action entitled NORTON, et al. v. RJR NABISCO HOLDINGS CORP., et al., Madison County, Indiana Superior Court, was filed against Liggett and others. The class action complaint was brought on behalf of plaintiffs and all persons in the State of Indiana who allegedly have become

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

addicted to cigarette products and allegedly have suffered personal injury as a result thereof. Plaintiffs seek compensatory and punitive damages together with equitable relief including but not limited to a medical fund for future health care costs, attorneys' fees and costs. On June 3, 1996, the defendant tobacco companies filed a notice of removal in the United States District Court for the Southern District of Indiana.

On May 29, 1996 an action entitled RICHARDSON, et al. v. PHILIP MORRIS INC., et al., Circuit Court for Baltimore City, was filed against Liggett and others. The class action complaint was brought on behalf of plaintiffs and all persons in the State of Maryland who allegedly have become addicted to cigarette products and allegedly have suffered personal injury as a result thereof. Plaintiffs seek compensatory and punitive damages, together with equitable relief including but not limited to a medical fund for future health care costs, attorney's fees and costs. On June 27, 1996, the defendant tobacco companies filed a notice of removal in the United States District Court for the District of Maryland.

On March 12, 1996, the Company and Liggett entered into an agreement to settle the CASTANO class action tobacco litigation. The settlement undertakes to release the Company and Liggett from all current and future addiction-based claims, including claims by a nationwide class of smokers in the CASTANO class action pending in Louisiana federal court as well as claims by a narrower statewide class in the ENGLE class action pending in Florida state court. The settlement is subject to and conditioned upon the approval of the United States District Court for the Eastern District of Louisiana. The Company is unable to determine at this time when the Court will review the settlement, and no assurance can be given that the settlement will be approved by the Court. Certain items of the settlement are summarized below.

Under the settlement, the CASTANO class would receive up to 5% of Liggett's pretax income (income before income taxes) each year (up to a maximum of $50,000 per year) for the next twenty-five years, subject to certain reductions provided for in the agreement, together with reasonable fees and expenses of the CASTANO Plaintiffs Legal Committee. Settlement funds received by the class would be used to pay half the cost of smoking-cessation programs for eligible class members. 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 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.

The Company and Liggett have the right to terminate the CASTANO settlement if the remaining defendants succeed on the merits or in the event of a full and final denial of class action certification. The terms of the settlement would still apply if the CASTANO plaintiffs or their lawyers were to institute a substantially similar new class action against the tobacco industry. The Company and Liggett may also terminate the settlement if they conclude that too many class members have chosen to opt out of the settlement. In the event of any such termination by the Company and Liggett, the named plaintiffs would be at liberty to renew their prosecution of such civil action against the Company and Liggett.

On May 11, 1996, the CASTANO Plaintiffs Legal Committee filed a motion seeking preliminary approval of the CASTANO settlement. Non-settling defendants filed a motion to stay consideration of the

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

CASTANO settlement pending the outcome of the appeal of the District Court's trial class certification order. Non-settling defendants' motion is scheduled to be heard on September 11, 1996. The motion for preliminary approval of the CASTANO settlement is scheduled to be heard on September 25, 1996.

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

An action entitled YVONNE ROGERS v. LIGGETT GROUP INC. et al., Superior Court, Marion County, Indiana, was filed by the plaintiff on March 27, 1987 against Liggett and others. The plaintiff seeks 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.

A number of proceedings have been filed against Liggett and others by state and local government entities or officials seeking restitution and indemnity for medical payments and expenses made or incurred for tobacco related illnesses. Such actions have been filed by the State of Minnesota (together with Minnesota Blue Cross-Blue Shield), the State of Mississippi, the State of West Virginia, the Commonwealth of Massachusetts, the State of Louisiana, the State of Texas, the State of Washington, the State of Maryland, the State of Connecticut, and the City and County of San Francisco. In West Virginia, the trial court, in a ruling issued on May 3, 1995, dismissed eight of the ten counts of the complaint filed therein, leaving only two counts of an alleged conspiracy to control the market and the market price of tobacco products and an alleged consumer protection claim. In a subsequent ruling, the trial court adjudged the contingent fee agreement entered into by the State of West Virginia and its counsel to be unconstitutional under the Constitution of the State of West Virginia. In Mississippi, the Governor has recently commenced an action in the Mississippi Supreme Court against the Attorney General of the state, making application for a writ of prohibition to bar further prosecution and to seek dismissal of the suit brought by the Attorney General of the state

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

----

seeking such restitution and indemnity, alleging that the commencement and prosecution of such a civil action by the Attorney General of the state was and is outside the authority of the Attorney General.

On November 28, 1995, each of the major manufacturers in the industry, including Liggett, filed suit in both the Commonwealth of Massachusetts and in the State of Texas seeking declaratory relief to the effect that the commencement of any such litigation (as had been filed by Florida, Mississippi, West Virginia and Minnesota and now by Massachusetts, Louisiana and Texas) seeking to recover Medicaid expenses against the manufacturers by either the Commonwealth of Massachusetts or the State of Texas would be unlawful. On January 22, 1996, a suit seeking substantially similar declaratory relief was filed in the State of Maryland.

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). Liggett, after initial litigation, entered into a settlement of this controversy with the State of Florida, the terms of which are described below.

The Commonwealth of Massachusetts has enacted legislation authorizing lawsuits similar to the suits filed by the States of Mississippi, Minnesota, West Virginia, Louisiana and Texas. Aside from the Florida and Massachusetts statutes, legislation authorizing the state to sue a company or individual to recover the costs incurred by the state to provide health care to persons allegedly injured by the company or individual also has been introduced in a number of other states. These bills contain some or all of the following provisions: eliminating certain affirmative defenses, permitting the use of statistical evidence to prove causation and damages, adopting market share liability and allowing class action suits without notification to class members.

On March 15, 1996, the Company and Liggett entered into a settlement of tobacco litigation with the Attorneys General of the States of Florida, Louisiana, Massachusetts, Mississippi and West Virginia. 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 $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 would range from 2-1/2% to 7-1/2% of Liggett's pretax income depending on the number of additional states joining the settlement. 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

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

transaction with another defendant in the lawsuits within three years of the date of the settlement. At December 31, 1995, Liggett accrued approximately $4,000 for the settlement with the Attorneys General.

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.

Currently, in addition to the above, approximately 125 product liability lawsuits, which have been filed in various jurisdictions, are pending and active in which Liggett is a defendant. Of these, approximately 90 are pending in the State of Florida. In most of these lawsuits, plaintiffs seek punitive as well as compensatory damages. Of the pending product liability lawsuits, the next case scheduled for trial against Liggett is JAMES T. CLARK v. LIGGETT GROUP INC. This matter is scheduled for trial in October, 1996.

A grand jury investigation presently 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.

Liggett has been responding to a civil investigative demand from the Antitrust Division of the United States Department of Justice which requests certain information from Liggett. The request appears to focus on United States tobacco industry activities in connection with product development efforts regarding, in particular, "fire-safe" or self-extinguishing cigarettes. It also requests certain general information addressing Liggett's involvement with and relationship to its competitors. The Company is unable to predict at this time the outcome of this investigation.

As to each of the cases referred to above which is pending against the Company, the Company believes, and has been advised by counsel handling the respective cases, that the Company has a number of valid defenses to the claim or claims asserted against the Company. 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 restrictive regulatory actions, adverse political decisions and other unfavorable 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. The Company is not able to evaluate the effect of these developing matters on pending litigation or the possible commencement of additional litigation.

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

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. 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.

In March and April 1994, the Health and the Environmental Subcommittee of the Energy and Commerce Committee of the House of Representatives held hearings regarding nicotine in cigarettes. On March 25, 1994, Commissioner David A. Kessler of the FDA gave testimony as to the potential regulation of nicotine under the Food, Drug and Cosmetic Act, and the potential for jurisdiction over the regulation of cigarettes to be accorded to the FDA. In response to Commissioner Kessler's allegations about manipulation of nicotine by cigarette manufacturers, the chief executive of each of the major cigarette manufacturers, including Liggett, testified before the subcommittee on April 14, 1994, denying Commissioner Kessler's claims. An FDA advisory panel has stated that it believes nicotine is addictive. On August 10, 1995, the FDA filed in the Federal Register a Notice of Proposed Rule-Making (the "Proposed Rule-Making") which would classify tobacco as a drug, assert jurisdiction by the FDA over the manufacture and marketing of tobacco products and impose 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. Liggett and the other major manufacturers in the industry responded by filing a civil action in the United States District Court for the Middle District of North Carolina challenging the legal authority of the FDA to assert such jurisdiction. In addition thereto, Liggett and the other four major cigarette manufacturers, as well as others, have filed comments in opposition to the Proposed Rule-Making. Management is unable to predict whether such a classification will be made. Management is also unable to predict the effects of such classification, were it to occur, or of such regulations, if implemented, on Liggett's operations, but such actions could have an unfavorable impact thereon.

The Omnibus Budget Reconciliation Act of 1993 ("OBRA") required 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 "marketing assessment" 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. OBRA was repealed retroactively (as of December 31, 1994) coincident in time with the issuance of a Presidential proclamation, effective September 13, 1995, imposing tariffs on imported tobacco in excess of certain quotas.

The USDA has informed Liggett that it did not satisfy the 75% domestic tobacco usage requirement for 1994 and therefore is subject to a marketing assessment of approximately $5,500. At December 31, 1995, the Company accrued approximately $4,900 representing the present value of its obligation for the USDA marketing assessment. The charge was included as a component of cost of sales in 1995. Liggett has agreed to pay this assessment in quarterly installments with interest over a five year period. Under certain circumstances, payment can be accelerated. 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.

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

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

On February 20, 1996, the United States Trade representative issued an "advance notice of rule making" concerning how tobaccos imported under the TRQ should be allocated. Currently, tobacco imported under the TRQ is allocated on a "first-come, first-served" basis, meaning that entry is allowed on an open basis to those first requesting entry in the quota year. Others in the cigarette industry have suggested an "end-user licensing" system under which the right to import tobacco under the quota would be initially assigned on the basis of domestic market share. Such an approach, if adopted, could have a material adverse effect on the Company. The Company believes it is unlikely that an end-user licensing system will be adopted, although no assurances can be given that an end-user licensing system will not be adopted.

In September 1991, the Occupational Safety and Health Administration ("OSHA") issued a Request for Information relating to indoor air quality, including ETS, in occupational settings. OSHA announced in March 1994 that it would commence formal rulemaking during the year. Hearings were completed during 1995 but it is not anticipated that any regulation will issue prior to the end of 1996. While the Company cannot predict the outcome, some form of federal regulation of smoking in workplaces may result.

In January 1993, the United State Environmental Protection Agency (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.

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

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:

On November 20, 1995, RJR Nabisco filed an action against the Company and Messrs. LeBow and Icahn in the United States District Court for the Middle District of North Carolina alleging violations of the federal securities laws. Specifically, RJR Nabisco alleges that the Company and Messrs. LeBow and Icahn violated sections 14(a) and 10(b) of the Securities Exchange Act of 1934, as amended,

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

and Rules 14a-9 and 10b-5 promulgated thereunder, by purportedly making materially false or incomplete statements concerning the purpose and background of the consent solicitation.

The Company and LeBow asserted counterclaims against RJR Nabisco, alleging that RJR Nabisco had made false statements and material omissions in its opposition to the Company's consent solicitation. On March 5, 1996, RJR Nabisco voluntarily dismissed, without prejudice, its claims asserted against Icahn, and on May 6, 1996 both RJR Nabisco and the Company filed a stipulation and order of dismissal, without prejudice, of the action.

At June 30, 1996, there were several other proceedings, lawsuits and claims pending against subsidiaries of the Company. 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.

8. SALE OF ASSETS

On April 9, 1996, Liggett executed a definitive agreement with the County of Durham for the sale of certain surplus realty in the amount of $4,300. The closing of the transaction occurred on May 14, 1996. Liggett recognized a gain of approximately $3,600.

On April 29, 1996, Liggett executed a definitive agreement with Blue Devil Ventures, a North Carolina limited liability partnership, for the sale of additional surplus realty in the amount of $2,200. While the agreement provides for the closing to occur on or before September 30, 1996, Blue Devil Ventures has the option to forfeit its deposit of $22 and not close if it determines that its development project is not feasible.

SUBSEQUENT EVENT: On July 15, 1996, the Company sold substantially all of the non-cash assets and certain liabilities of COM Products, Inc. ("COM"), a small subsidiary engaged in the business of selling micrographics equipment and supplies, for approximately $4,000 which is in excess of carrying value.

9. ACQUISITION OF MINORITY INTERESTS AND AFFILIATE TRANSACTIONS

During the second quarter of 1996, BOL entered into stock purchase agreements with the chairman of LDL (the "Chairman") and the Director of LDL's cigarette operations (the "Director", together, the "Sellers"). Under the stock purchase agreements, the Company acquired 142,558 shares held by the Sellers for a total of $2,143. The purchase price is payable in installments during 1996 and certain shares of LDL collateralize BOL's obligation under both the purchase agreements and the consulting agreements (described below). These transactions increased BOL's ownership percentage in LDL from 68% to 89%.

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

SUBSEQUENT EVENT: On July 5, 1996, Liggett purchased from BOL 140,000 shares (approximately 20%) of LDL for $2,100. Liggett also acquired a ten-year option to purchase up to 292,407 additional shares of LDL stock at the same per share price ($15.00) for $3,400, thereby entitling Liggett to increase its interest in LDL to approximately 62%. The option fee is to be credited against the purchase price. In addition, Liggett has the right on or before June 30, 1997 to acquire another ten-year option from BOL for $2,200 on the same terms to purchase the remaining 27% of the shares of LDL owned by BOL. These transactions have no impact on the consolidated financial position or results of operations of the Company or BGLS.

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

	June 30, 1996	December 31, 1995
ASSETS		
Cash and cash equivalents	$ 863	$ 738
Due from affiliate	300	
Investment in New Valley Corporation:		
Redeemable preferred stock	101,407	109,386
Common stock	(65,592)	(52,045)
Total investment in New Valley Corporation	35,815	57,341
Deferred tax assets	2,616	
Total assets	$ 39,594	$ 58,079
LIABILITIES AND STOCKHOLDER'S EQUITY		
Current income taxes payable to parent	$ 4,920	$ 4,472
Deferred income taxes		4,918
Total liabilities	4,920	9,390
Commitments and contingencies		
Common stock, $0.01 par value, 100 shares authorized, issued and outstanding		
Additional paid-in capital	12,172	11,020
Retained earnings	26,148	32,128
Unrealized holding (loss) gain, net of income tax benefit of $1,964 and income taxes of $2,983	(3,646)	5,541
Total stockholder's equity	34,674	48,689
Total liabilities and stockholder's equity	$ 39,594	$ 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)
(UNAUDITED)

	Three Months Ended June 30, 1996	Three Months Ended June 30, 1995	Six Months Ended June 30, 1996	Six Months Ended June 30, 1995
Equity in (loss) earnings of affiliate	$(1,487)	$ 311	$(2,983)	$ 1,994
Interest income	41	10	48	391
General and administrative expenses	(2)	(5)	(4)	(8)
(Loss) income from continuing operations before income taxes	(1,448)	316	(2,939)	2,377
(Benefit) provision for income taxes:				
Current	13	674	448	2,840
Deferred	(520)	(3,580)	(3,208)	(4,171)
Income tax (benefit)	(507)	(2,906)	(2,760)	(1,331)
(Loss) income from continuing operations	(941)	3,222	(179)	3,708
Income from discontinued operations of affiliate, net of income taxes		724		1,106
Net (loss) income	$ (941)	$ 3,946	$ (179)	$ 4,814

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

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

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Unrealized Holding Gain (Loss)	Total
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 and other capital transactions, net of taxes of $620			1,152			1,152
Proportionate share of New Valley's unrealized depreciation in investments, net of taxes of $550					1,022	1,022
Increase in unrealized holding loss on investment in New Valley, net of tax benefit of $5,497					(10,209)	(10,209)
Net (loss)				(179)		(179)
Dividends				(5,801)		(5,801)
Balance, June 30, 1996	100	$	$12,172	$26,148	$ (3,646)	$ 34,674

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

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

	Six Months Ended June 30, 1996	Six Months Ended June 30, 1995
Net cash (used in) provided by operating activities	$ (257)	$ 383
Cash flows from investing activities:		
Dividends received from New Valley Corporation	6,183	38,645
Net cash provided by investing activities	6,183	38,645
Cash flows from financing activities:		
Payment of dividends	(5,801)	(39,011)
Net cash used for financing activities	(5,801)	(39,011)
Net increase in cash	125	17
Cash and cash equivalents at beginning of period	738	
Cash and cash equivalents at end of period	$ 863	$ 17

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

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

1. PRINCIPLES OF REPORTING

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

The interim financial statements of the Company are unaudited and, in the opinion of management, reflect all adjustments necessary (which are normal and recurring) to present fairly the Company's financial position, results of operations and cash flows. These financial statements should be read in conjunction with the financial statements and the notes thereto included in BGLS' Annual Report on Form 10-K, as amended, for the year ended December 31, 1995, as filed with the Securities and Exchange Commission. The results of operations for interim periods should not be regarded as necessarily indicative of the results that may be expected for the entire year.

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

2. INVESTMENT IN NEW VALLEY CORPORATION

Summarized financial information for New Valley as of June 30, 1996 and December 31, 1995 and for the three and six month periods ended June 30, 1996 and 1995 follows:

	June 30, 1996	December 31, 1995
Current assets	$314,799	$333,485
Investment in real estate	183,122	
Other non-current assets	34,537	52,337
Current liabilities	187,361	177,920
Notes payable	159,574	
Other long-term obligations	16,366	11,967
Redeemable preferred shares	222,288	226,396
Common shareholders' deficit	(53,131)	(30,461)

	Three Months Ended		Six Months Ended	
	June 30, 1996	June 30, 1995	June 30, 1996	June 30, 1995
Revenues	$ 34,547	$10,032	$ 71,231	$ 17,701
Cost and expenses	38,909	7,455	80,577	7,753
(Loss) income from continuing operations	(4,762)	2,284	(9,646)	8,915
Income from discontinued operations		2,682		4,080
Net (loss) income applicable to common shares(A)	(20,408)	12,585	(36,475)	7,560

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

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

The Company's investment in New Valley at June 30, 1996 is summarized as follows:

	Number of Shares	Fair Value	Carrying Value	Unrealized Holding Loss	Earnings/ (Loss)
Class A Preferred Shares	618,326	$101,407	$101,407	$(8,282)	$ 13,910
Common Shares	79,399,254	19,056	(65,592)		(16,893)
		$120,463	$35,815	$(8,282)	$ (2,983)

The Class A Preferred Shares are accounted for as debt securities pursuant to the requirements of Statement of Financial Accounting Standards 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. In January 1996, however, New Valley became engaged in the ownership and management of commercial real estate and, in February 1996, acquired a controlling interest in Thinking Machines Corporation. Because these businesses affect the composition and nature of the underlying net assets of New Valley, the Company has determined the fair value of the Class A Preferred Shares based on the quoted market price commencing with the quarter ended March 31, 1996. The New Valley common shares are accounted for under the equity method.

In the first quarter of 1996, New Valley repurchased 72,104 Class A Preferred Shares for $10,530. As a result of this transaction, the Company now owns 59.72% of the outstanding Class A Preferred Shares. 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 of $1,152 net of a tax benefit of $621 along with its share of other New Valley capital transactions of $1,022 net of taxes of $550 for the six months ended June 30, 1996.

On March 13, 1996, New Valley declared a cash dividend of $10.00 per share on the Class A Preferred Shares payable on March 27, 1996. The Company received $6,183 from the distribution. At June 30, 1996, the accrued and unpaid dividends arrearage on the Class A Preferred Shares was $124,339 or $120.08 per share.

As a result of asset dispositions pursuant to New Valley's First Amended Joint Chapter 11 Plan of Reorganization, as amended (the "Joint Plan"), New Valley accumulated a significant amount of cash which it was required to reinvest in operating companies by January 18, 1996 in order to avoid potentially burdensome regulation under the Investment Company Act of 1940, as amended (the "Investment Company Act"). The Investment Company Act and the rules and regulations thereunder require the registration of, and impose various substantive restrictions on, companies that engage primarily in the business of investing, reinvesting or trading in securities or engage in the business of investing, reinvesting, owning, holding or trading in securities and own or propose to acquire "investment securities" having a "value" in excess of 40% of a company's "total assets" (exclusive of Government securities and cash items) on an unconsolidated basis. Following dispositions of its then operating businesses pursuant to the Joint Plan, New Valley was above this threshold and relied on the one-year exemption from registration under the Investment Company Act provided by Rule 3a-2 thereunder, which exemption expired on January 18, 1996. Prior to such date, through New Valley's acquisition of the investment banking and brokerage business of Ladenburg, Thalmann & Co., Inc. and its acquisition of a portfolio of office buildings and shopping centers, New Valley was engaged primarily in a business or businesses other than that of investing, reinvesting, owning, holding or trading in securities, and the value of its investment securities was below the 40% threshold. Under the Investment Company Act, New Valley is required to determine the value of its

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

total assets for purposes of the 40% threshold based on "market" or "fair" values, depending on the nature of the asset, at the end of the last preceding fiscal quarter and based on cost for assets acquired since that date. If New Valley were required to register in the future, under the Investment Company Act, it would be subject to a number of severe restrictions on its operations, capital structure and management, including without limitation, entering into transactions with affiliates. If New Valley were required to register under the Investment Company Act, the Company, as well as BGLS and Brooke, may be in violation of the Investment Company Act and may be adversely affected by the restrictions of the Investment Company Act. In addition, registration under the Investment Company Act by BGLS would constitute a violation of the 15.75% Series B Senior Secured Notes due 2001 (the "Series B Notes") indenture to which BGLS is a party.

SUBSEQUENT EVENT: On July 16, 1996, New Valley declared a cash dividend of $30.00 per share on its Class A Preferred Shares payable on July 30, 1996. The Company received $18,550 from the distribution.

On July 29, 1996, New Valley effected a one-for-twenty reverse stock split of New Valley's common shares. After giving effect to this split, the Company now holds 3,969,962 shares of New Valley common stock.

3. RJR NABISCO HOLDINGS CORP.

At June 30, 1996, New Valley held 5,161,750 shares of RJR Nabisco Holdings Corp. ("RJR Nabisco") common stock with a market value of $163,886 (cost of $158,225) collateralizing margin loan financing of $82,525. At June 30, 1996, New Valley had an unrealized gain of $5,661. At August 13, 1996, New Valley had an unrealized loss of $20,794.

On February 29, 1996, New Valley entered into a total return equity swap transaction (the "Swap") with an unaffiliated company (the "Counterparty") relating to 1,000,000 shares of RJR Nabisco common stock (reduced to 750,000 shares of RJR Nabisco common stock on August 13, 1996). The transaction is for a period of up to six months, subject to earlier termination at the election of New Valley and provided for New Valley to make payment to the Counterparty of approximately $1,537 upon commencement of the Swap. At the termination of the transaction, if the price of the common stock during a specified period prior to such date (the "Final Price") exceeds $34.42, the price of the RJR Nabisco common stock during a specified period following the commencement of the Swap (the "Initial Price"), the Counterparty will pay New Valley an amount in cash equal to the amount of such appreciation with respect to the shares of RJR Nabisco common stock subject to the Swap plus the value of any dividends with a record date occurring during the Swap period. If the Final Price is less than the Initial Price, then New Valley will pay the Counterparty at the termination of the transaction an amount in cash equal to the amount of such decline with respect to the shares of RJR Nabisco common stock, offset by the value of any dividends, provided that, with respect to approximately 225,000 shares of RJR Nabisco common stock, New Valley will not be required to pay any amount in excess of an approximate 25% decline in the value of the shares. The potential obligations of the Counterparty under the Swap are being guaranteed by the Counterparty's parent, a large foreign bank, and New Valley has pledged certain collateral in respect of its potential obligations under the Swap and has agreed to pledge additional collateral under certain conditions. For the six months ended June 30, 1996, New Valley recorded a charge to operations of $3,231 representing the unrealized loss on this Swap transaction and had pledged collateral of $8,569 and $10,687 at June 30, 1996 and August 13, 1996, respectively. Based on the market price of RJR Nabisco common stock at August 13, 1996, New Valley would recognize a charge of approximately $4,000 for the three months ended September 30, 1996.

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

On March 4, 1996, Brooke filed a definitive Proxy Statement with the SEC and 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. As of June 30, 1996, New Valley had expensed $10,367 for costs relating to its RJR Nabisco investment. Pursuant to a December 27, 1995 agreement New Valley agreed, among other things, to pay directly or reimburse Brooke and its subsidiaries for out-of-pocket expenses in connection with Brooke's solicitation of consents and proxies from the shareholders of RJR Nabisco. At June 30, 1996, New Valley owed Brooke and its subsidiaries $1,200 pursuant to this agreement, which amount was paid in July 1996.

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.

Brooke, BGLS and High River Ltd. Partnership ("High River") were parties to an agreement dated October 17, 1995, as amended by the letter agreement dated November 5, 1995 (the "High River Agreement"). New Valley, ALKI Corp. ("ALKI") and High River were parties to an agreement dated October 17, 1995, as amended by the letter agreement dated October 17, 1995, and as further amended by the letter agreement dated November 5, 1995 (the "New Valley Agreement").

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.

4. FEDERAL INCOME TAX

At June 30, 1996, the Company has recorded a deferred tax asset of $2,616 based on the determination that it is more likely than not that the deferred tax asset will be realized through future taxable earnings or alternative tax strategies. The provision for taxes for the six month periods ended June 30, 1996 and 1995 does not bear a customary relationship to the pretax income for the Company due principally to the effects of the 80% dividends received deduction for Federal taxes.

5. CONTINGENCIES

BGLS has pledged its ownership interest in the Company's common stock and the Company's investments in the New Valley securities as collateral in connection with the issuance of BGLS' Series B Notes.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Dollars in Thousands, Except Per Share Amounts)

INTRODUCTION

The following discussion provides an assessment of the consolidated results of operations, capital resources and liquidity of Brooke Group Ltd. (the "Company") and its subsidiaries and should be read in conjunction with the Consolidated Financial Statements and notes thereto of the Company and BGLS Inc. ("BGLS") included elsewhere in this document. BGLS is a wholly owned subsidiary of the Company. The consolidated financial statements of the Company include the accounts of BGLS, Liggett Group Inc. ("Liggett"), Brooke (Overseas) Ltd. ("BOL"), New Valley Holdings, Inc. ("NV Holdings"), other less significant subsidiaries, and as of December 31, 1995 and for the three and six months ended June 30, 1996, Liggett-Ducat Ltd. ("LDL").

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 HOLDINGS CORP.

As of August 13, 1996, New Valley Corporation ("New Valley") held 5,161,750 shares of RJR Nabisco Holdings Corp. ("RJR Nabisco") common stock. New Valley's costs for such shares and the amount of related margin loan financing were $158,225 and $82,525, respectively. As of August 13, 1996, the market value of the shares was $137,432 and the unrealized loss was $20,794. As of June 30, 1996, New Valley had expensed $10,367 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. At June 30, 1996, New Valley owed the Company and its subsidiaries $1,200 pursuant to this agreement, which amount was paid in July 1996.

On February 29, 1996, New Valley entered into a total return equity swap transaction (the "Swap") with an unaffiliated company (the "Counterparty") relating to an additional 1,000,000 shares of RJR Nabisco common stock (reduced to 750,000 shares of RJR Nabisco common stock as of August 13, 1996). The transaction is for a period of up to six months, subject to earlier termination at the election of New Valley and provided for New Valley to make payment to the Counterparty of approximately $1,537 upon commencement of the Swap. At the termination of the transaction, if the price of the common stock during a specified period prior to such date (the "Final Price") exceeds $34.42, the price of the RJR Nabisco common stock during a specified period following the commencement of the swap (the "Initial Price"), the Counterparty will pay New Valley an amount in cash equal to the amount of such appreciation with respect to the shares of RJR Nabisco common stock subject to the Swap plus the value of any dividends with a record date occurring during the Swap period. If the Final Price is less than the Initial Price, then New Valley will pay the Counterparty at the termination of the transaction an amount in cash equal to the amount of such decline with respect to the shares of RJR Nabisco common stock, offset by the value of any dividends, provided that, with respect to approximately 225,000 shares of RJR Nabisco common stock, New Valley will not be required to pay any amount in excess of an approximate 25% decline in the value of the shares. The potential obligations of the Counterparty under the Swap are being guaranteed by the Counterparty's parent, a large foreign bank, and New Valley has pledged certain collateral in respect of its potential obligations under the Swap and has agreed to pledge additional collateral under certain conditions. For the six months ended June 30, 1996, New Valley recorded a charge to operations of $3,231 representing the unrealized loss on this Swap transaction and had pledged collateral of $8,569 and $10,687 at June 30, 1996 and August 9, 1996, respectively. Based on the market price of the RJR Nabisco common stock at August 13, 1996, the Company would recognize a loss on the Swap of approximately $4,000 for the three months ended September 30, 1996.

RECENT DEVELOPMENTS (continued)

The Company, BGLS and High River Ltd. Partnership ("High River") were parties to an agreement dated October 17, 1995, as amended by the letter agreement dated November 5, 1995 (the "High River Agreement"). New Valley, ALKI Corp. ("ALKI") and High River were parties to an agreement dated October 17, 1995, as amended by the letter agreement dated October 17, 1995, and as further amended by the letter agreement dated November 5, 1995 (the "New Valley Agreement").

As of June 5, 1996, High River, the Company and BGLS terminated the 1995 High River Agreement and New Valley, ALKI and High River terminated the 1995 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.

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 common shares of New Valley.

On January 11, 1996, a subsidiary of New Valley made a $10,600 convertible bridge loan to finance Thinking Machines Corporation, 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.

On January 11, 1996, New Valley's newly formed division, New Valley Realty, 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 mortgage financing.

In the first six months of 1996, New Valley repurchased 72,104 Class A Preferred Shares for a total amount of $10,530. As a result of this transaction, the Company owns 59.72% of the New Valley Class A Preferred Shares.

RECENT DEVELOPMENTS IN THE CIGARETTE INDUSTRY

PRICING ACTIVITY.

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 May 5, 1995, RJ Reynolds Tobacco Company ("RJR") initiated a list price increase on all brands of $.30 per carton. The other manufacturers, including Liggett, matched the price increase.

LEGISLATION AND LITIGATION.

The cigarette industry continues to be challenged on numerous fronts. Several federal administrative bodies, including the United States Environmental Protection Agency and the Food and Drug Administration have issued reports or commenced regulatory proceedings which have had or could have an adverse effect on Liggett and the cigarette industry as a whole. The rate of filings of individual product liability cases has increased and Liggett's risk attendant thereto has correspondingly increased. Several purported class actions have been commenced against Liggett and other companies in the industry, one of which actions Liggett has settled. A number of states' Attorneys General have commenced litigation against the industry asserting numerous different theories of liability, five of which actions Liggett has settled. The various companies in the industry are actively engaged in defending against and responding to these initiatives. The Company is not able to evaluate the effect of these developing matters but it is possible that the Company's financial position, results of operations and cash flows could be materially adversely affected by an ultimate unfavorable outcome in any of such pending litigation and regulatory proceedings. For a description of pending litigation and regulatory proceedings see Note 7 to the Company's consolidated financial statements.

RECENT DEVELOPMENTS IN THE CIGARETTE INDUSTRY (continued)

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 the State of West Virginia, State of Florida, State of Mississippi, Commonwealth of Massachusetts and the State of Louisiana to settle certain actions brought against Liggett by such states.

Under the CASTANO settlement, the CASTANO class would receive up to 5% of Liggett's pretax income (income before income taxes) each year (up to a maximum of $50,000 per year) for the next twenty-five years, subject to certain reductions provided for in the agreement, together with reasonable fees and expenses of the CASTANO Plaintiffs Legal Committee.

Under the Attorneys General Settlement, the states would share an initial $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 would range from 2-1/2% to 7-1/2% of Liggett's pretax income, depending on the number of additional states joining the settlement. 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.

At December 31, 1995, the Company had recorded a charge of approximately $4,000 for the present value of the fixed payments under the Attorneys General settlement. 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, will be expensed when known.

RESULTS OF OPERATIONS

THREE MONTHS ENDED JUNE 30, 1996 COMPARED TO THREE MONTHS ENDED JUNE 30, 1995

Consolidated revenues were $125,213 for the three months ended June 30, 1996 compared to $122,328 for the three months ended June 30, 1995. This 2.4% increase in revenues primarily resulted from the addition of the tobacco revenues of LDL in Russia of $9,739 (which results were not included in the consolidated group in 1995) offset by a decrease of $7,523 at Liggett. The 6.2% decrease in Liggett revenues was due primarily to an 11.6% decrease in unit sales volume partially offset by the effects of the recent list price increases (see "Recent Developments in the Cigarette Industry - Pricing Activity" above). The decline in unit sales volume at Liggett was comprised of declines within the premium segment of 4.4% and discount segment (which includes generic, control label and branded discount products) of 13.9%. 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. Further, Liggett experienced a significant increase in volume at the end of the quarter, in part due to ongoing trade programs based on quarterly volume targets and in part due to consumer promotional programs consisting of coupons and variable price reductions.

Consolidated gross profit was $61,691 for the three months ended June 30, 1996 compared to $64,566 for the three months ended June 30, 1995, a decrease of $2,875 when compared to the same period last year, due primarily to the decline in unit sales volume at Liggett discussed above. Overall, the Company's gross profit as a percent of revenues decreased to 49.3% in the current period from 52.8% in the same period in the prior year because of decreased margins at Liggett and the inclusion of LDL which had negative tobacco margins of 2.6% due to increased tobacco costs and intense price competition in the Russian market. Gross profit at Liggett was $60,753 for the three months ended June 30, 1996, a decrease of $3,327 from $64,080

RESULTS OF OPERATIONS (continued)
- ---------------------

for the same period in 1995, 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 72.5% for the three months ended June 30, 1996 compared to 73.1% for the same period in 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 recent list price increases.

Consolidated operating, selling, general and administrative expenses were $58,264 for the three months ended June 30, 1996 compared to $65,196 for the same period last year. The decrease of $6,932 considers the effects of the prior year's restructuring at Liggett ($2,548 for the year ended December 31, 1995) and relates primarily to reduced payroll and benefits. Liggett, in addition, has reduced spending on promotional programs when compared to the prior period. Further, the Company's operating expenses were reduced due to lower pension expense in the three months ended June 30, 1996 and lower expenses recognized relating to LDL in 1996.

Consolidated interest expense was $15,457 for the three months ended June 30, 1996 compared to $14,702 for the same period last year due to a greater amount of debt outstanding in the current period.

Equity in earnings of affiliate was a loss of $1,260 for the three months ended June 30, 1996 compared to income of $354 for the three months ended June 30, 1995 and relates primarily to New Valley's net loss of $1,762 in 1996 compared to net income of $2,884 in 1995.

SIX MONTHS ENDED JUNE 30, 1996 COMPARED TO SIX MONTHS ENDED JUNE 30,1995

Consolidated revenues were $215,729 for the six months ended June 30, 1996 compared to $217,618 for the six months ended June 30, 1995, a decrease of $1,889 primarily due to a decline in sales at Liggett offset by tobacco revenues in Russia from LDL which was not part of the consolidated group in 1995. Net sales at Liggett were $191,774 for the six months ended June 30, 1996 versus $214,569 for the same period last year. This 10.6% decrease in revenues was primarily due to a 15.4% decline in unit sales volume, partially offset by the effects of recent list price increases. The decline in unit sales volume was comprised of declines within the premium segment of 9.9% and the discount segment of 17.0%. The decline in premium unit sales volume was due to aggressive trade programs offered by Liggett at year end 1995 and certain competitors' continuing leveraging rebate programs tied to their products and increased promotional activity by certain other manufacturers.

Consolidated gross profit of $105,159 for the six months ended June 30, 1996 decreased $8,319 from gross profit of $113,478 for the same period in 1995. The decrease in gross profit coincides with the decrease in sales revenue at Liggett. Liggett's gross profit as a percent of revenues (excluding federal excise taxes) for the period increased to 73.0% compared to 72.6% last year, due primarily to the recent list price increases and restructuring charges incurred in 1995 with no similar charges in 1996, partially offset by the increased tobacco costs discussed above. Tobacco margins at LDL for the six months ended 1996 were 0.7% for the reasons indicated above.

Consolidated operating, selling, general and administrative expenses were $103,156 for the six months ended June 30, 1996 compared to $114,504 for the same period last year, a decrease of $11,348. The decrease resulted from lower expenses recognized relating to LDL in 1996, reduced administrative expenses at Liggett resulting from the 1995 restructuring, reduced promotional expenses discussed above and reduced legal expenses due to the financial assistance Liggett has been receiving from others in the industry in defraying the costs incurred in the defense of smoking and health litigation. (See "Capital Resources and Liquidity").

RESULTS OF OPERATIONS (continued)

Consolidated interest expense was $30,234 for the six months ended June 30, 1996 compared to $29,417 for the same period last year. The increase of $817 is primarily due to additional debt issued by the Company and a full six month period of the higher reset rate at Liggett. (See Note 7 to the Company's consolidated financial statements).

Other income, net, in the amount of $2,334, reflects a gain of approximately $3,600 on the sale of surplus realty by Liggett to the County of Durham, offset by other expense of $1,500 at BOL.

The gain on disposal of discontinued operations of $15,900 for the six months ended June 30, 1995 primarily reflects the redemption/sale of SkyBox preferred and common stock. No comparable transaction occurred in the six months ended June 30, 1996.

CAPITAL RESOURCES AND LIQUIDITY

Net cash and cash equivalents increased $1,036 for the six months ended June 30, 1996 compared with an increase of $4,308 for the six months ended June 30, 1995.

Net cash used in operations for the six months ended June 30, 1996 was $735 compared to net cash used in operations of $15,093 for the comparable period of 1995.

Cash used in operations for the period ended June 30, 1996 included interest payments of $13,890 as compared to interest payments made in the same period in 1995 of $26,782. Interest payments on the Company's debt for the period from October 1, 1995 to July 31, 1996 were made on July 31, 1996 in accordance with 1995 Exchange Offer and the terms of the 15.75% Series B Senior Secured Notes due 2001 (the "Series B Notes").

Liggett believes that cash flows from operations and its revolving credit facility ("the Facility") will continue to meet its liquidity requirements for the twelve months ending June 30, 1997. Management believes that the positive effects on cash flow from operations resulting from the April 1996 price increase, estimated at approximately $7,100 on an annual basis, and the estimated savings resulting from Liggett's 1995 restructuring, estimated at approximately $6,700 on an annual basis, will enable Liggett to meet its estimated interest expense of $23,700, the sinking fund payment of $7,500 on the Notes due February 1, 1997, budgeted capital expenditures of $2,500 and payments of $1,400 on the USDA marketing assessment. However, there can be no assurance that such anticipated increases in cash flow will materialize as there are a number of factors including increased tobacco costs, litigation expenses and payments based on future income to which Liggett is committed under the CASTANO and Attorneys General settlement agreements, the amounts of which are unknown. Further, the Facility was reclassified to short-term debt because the Facility becomes due in March of 1997 thereby creating a working capital deficiency at Liggett of approximately $22,000 at June 30, 1996. Management anticipates the Facility will be refinanced on substantially similar terms in March 1997, although there can be no assurance that this will be accomplished.

Liggett has 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. The future financial benefit to Liggett is not quantifiable at this time since the arrangements for assistance can be terminated on limited notice, or under certain circumstances, certain of which have occurred, without notice, and the amount of assistance received, if any, would be a function of the level of costs incurred. Certain joint defense arrangements, and the financial benefits incident thereto, have ended. No assurances can be made that other arrangements will continue. Liggett expects that the level of financial and other assistance which it may receive, if any, will be clarified over the ensuing months.

CAPITAL RESOURCES AND LIQUIDITY (continued)

Cash used in investing activities was $4,573 for the period ended June 30, 1996 compared to cash provided of $46,963 for the same period in 1995. Cash used in 1996 includes capital expenditures of approximately $12,200 for real estate development at BOL and $2,500 for equipment modernization at Liggett. Liggett is forecasting further capital expenditures of approximately $1,100 for equipment modernization in 1996. Capital expenditures were offset by dividends from New Valley to NV Holdings of $6,183 or $10.00 per share on the Class A Preferred Shares for the six months ended June 30, 1996 and proceeds from the sale of surplus realty by Liggett. In the same period in 1995, capital expenditures of $2,752 were offset by dividends from New Valley to NV Holdings of $38,645 and proceeds from the redemption of SkyBox International Inc. ("SkyBox") preferred stock for $4,000 plus accrued dividends and the sale of SkyBox common stock for $9,282.

On May 14, 1996 Liggett sold certain surplus realty in Durham, NC to the County of Durham for a sale price of $4,300. A gain of approximately $3,600 was recognized on this sale. Further, on April 29, 1996, Liggett executed a definitive agreement with Blue Devil Ventures, a North Carolina limited liability partnership, for the sale by Liggett to Blue Devil Ventures of certain surplus realty for a sale price of $2,200. While the agreement provides for the closing to occur on or before September 30, 1996, Blue Devil Ventures has the option, if it determines that its development project is not feasible, to forfeit its deposit of $22 and not close.

On July 15, 1996, the Company sold substantially all of the non-cash assets and certain liabilities of COM Products, Inc. ("COM"), a small subsidiary engaged in the business of selling micrographics equipment and supplies, for approximately $4,000.

On July 5, 1996, Liggett purchased from BOL 140,000 shares (approximately 20%) of LDL for $2,100. Liggett also acquired a ten-year option, exercisable by Liggett in whole or in part for $3,400, to purchase from BOL at the same per-share price ($15.00) up to 292,407 additional shares of LDL, thereby entitling Liggett to increase its interest in LDL to approximately 62%. The option fee is to be credited against the purchase price.

Cash provided by financing activities for the six months ended June 30, 1996 was $6,344 while cash used in financing activities for the six months ended June 30, 1995 was $28,226.

Proceeds from debt in 1996 includes the private placement of the Series A Notes (later exchanged for Series B Notes) for cash proceeds of $6,300 including accrued interest, borrowings by BOL for real estate development of $8,454 and net borrowings of approximately $6,000 by Liggett and BOL under their revolving credit facilities. These transactions were primarily offset by the redemption for $6,237 of the 16.125% Senior Subordinated Reset Notes, including premium and accrued interest thereon, and distributions to the Company's shareholders of $2,775. In the 1995 period, proceeds from debt were $3,028, offset primarily by redemption of the Series 1 Notes of $23,594 plus accrued interest of $670 on June 12, 1995 and distributions of $2,737 to the Company's shareholders.

Availability under Liggett's Facility was approximately $15,040 based on eligible collateral at June 30, 1996. The Facility is collateralized by all accounts receivable and inventories of Liggett. Borrowings under the Facility bear interest at a rate equal to 1.5% above Philadelphia National Bank's (the indirect parent of Congress Financial Corporation, the lead lender) prime rate, which was 8.25% at June 30, 1996. The Facility contains certain financial covenants similar to those contained in the 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) and working capital (not to fall below a deficit of $35,000). At June 30, 1996, Liggett was in compliance with all covenants under the Facility. Management anticipates the Facility will be refinanced with substantially similar terms in March 1997 although there can be no assurance that this will be accomplished. In December 1995, purchases by Liggett of $7,000 of Series B Notes using revolver availability were credited against the mandatory

CAPITAL RESOURCES AND LIQUIDITY (continued)

redemption requirement for February 1, 1996. The remaining $500 mandatory redemption requirement for February 1, 1996 was met by retiring the $500 of Series C Notes held in Liggett's treasury. Liggett's management anticipates that the 1997 mandatory redemption will be funded by cash flows from operations and borrowings under the Facility. There are no definite plans for funding Liggett's 1998 mandatory redemption requirement of $37,500 at this time.

At June 30, 1996, Liggett had a net capital deficiency of $157,311 and is highly leveraged. Due to the many risks and uncertainties associated with the cigarette industry, impact of recent tobacco litigation settlements 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 their lenders were to exercise acceleration rights under the Facility or the Liggett 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.

Prior to completion of the 1995 Exchange Offer on January 30, 1996, the Company had substantial near-term debt service requirements, with aggregate required principal payments of $318,106 due in the years 1995 through 1998. Redemption of the remaining Reset Notes was effectuated on March 29, 1996 through use of proceeds from the sale of the additional $7,397 of Series A Notes on March 4, 1996 discussed above. As a result of the 1995 Exchange Offer and the redemption of the Reset Notes pursuant to the terms of the Reset Note Indenture on March 29, 1996, BGLS decreased its scheduled debt maturities to $81,942 due in the years 1996-1998; approximately $79,000 of this debt relates to Liggett and LDL. In addition, BGLS cancelled all of the subordinated debentures ($13,705) held by the Company.

The Company believes that it will continue to meet its liquidity requirements through the twelve months ending June 30, 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 June 30, 1996, the remaining amount available through December 31, 1996 in the Restricted Payment Basket related to BGLS' payment of dividends to the Company (as defined by BGLS' Series B Notes Indenture) is $3,225. Company expenditures (exclusive of Liggett and LDL) in 1996 include the $29,000 interest payment on the Series B Notes on July 31, 1996. In March and July 1996, New Valley declared and paid dividends on its Class A Preferred Shares in which NV Holdings received $6,183 and $18,550, respectively. 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 financing and distributions from New Valley. 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.

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 LDL, are subject to intense competition, changes in consumer preferences, the effects of changing prices for its raw materials and local economic

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS (continued)

conditions. Furthermore, the performance of LDL'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.

PART II
OTHER INFORMATION

Item 1. Legal Proceedings

Reference is made to information entitled "Contingencies" in Note 7 to the Consolidated Financial Statements of Brooke Group Ltd. and BGLS Inc. (collectively, the "Companies") included elsewhere in this report on Form 10-Q.

Item 3. Defaults Upon Senior Securities

As of June 30, 1996, New Valley Corporation, the Companies' affiliate, had the following respective accrued and unpaid dividend arrearages on its 1,035,462 outstanding shares of $15.00 Class A Increasing Rate Cumulative Senior Preferred Shares ($100 Liquidation Value), $.01 par value per share (the "Class A Shares") and 2,790,776 outstanding shares of $3.00 Class B Cumulative Convertible Preferred Shares ($25 Liquidation Value), $.10 par value per share (the "Class B Shares"): (1) $124.33 million or $120.08 per Class A Share; and (2) $105.17 million or $37.68 per Class B Share.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

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

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

99.1 Liggett Group Inc.'s Interim Consolidated Financial Statements for the quarterly period ended June 30, 1996.

99.2 New Valley Corporation's Interim Consolidated Financial Statements for the quarterly period ended June 30, 1996.

(b) Reports on Form 8-K

No current reports on Form 8-K were filed by either Company during the second 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/ Joselynn D. Van Siclen

Joselynn D. Van Siclen
Vice President and Chief
Financial Officer

Date: August 14, 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.

BGLS INC.
(REGISTRANT)

By: /s/ Joselynn D. Van Siclen

Joselynn D. Van Siclen
Vice President and Chief
Financial Officer

Date: August 14, 1996

5
0000059440
BROOKE GROUP
1,000
U.S. DOLLARS

6-MOS
DEC-31-1996
JAN-01-1996
JUN-30-1996
1
4,406
0
21,580
0
54,636
88,686
60,332
0
206,687
169,380
394,314
0
0
1,850
(402,305)
206,687
215,729
215,729
110,570
110,570
2,534
0
30,234
(28,303)
146
(28,449)
0
0
0
(28,449)
(1.44)
(1.44)

5
0000927388
BGLS INC.
1,000
U.S. DOLLARS

6-MOS
DEC-31-1996
JAN-01-1996
JUN-30-1996
1
4,340
0
21,580
0
54,636
91,596
59,951
0
210,311
192,878
394,314
0
0
0
(423,583)
210,311
215,729
215,729
110,570
110,570
2,534
0
32,063
(30,352)
198
(30,550)
0
0
0
(30,550)
0
0

EXHIBIT 99.1

TABLE OF CONTENTS

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

LIGGETT GROUP INC.

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

	June 30, 1996	December 31, 1995
ASSETS		
Current assets:		
Cash	$ 1,652	$ -
Accounts Receivable:		
Trade less allowances of $767 and $815, respectively	20,364	22,279
Other	837	1,367
Affiliates	1,300	1,105
Inventories	48,943	54,342
Deferred income taxes	3,800	3,800
Other current assets (Note 4)	1,050	1,703
Total current assets	77,946	84,596
Property, plant and equipment, at cost, less accumulated depreciation of $27,964 and $26,545, respectively	18,601	18,352
Intangible assets, at cost, less accumulated amortization of $16,524 and $15,661, respectively	4,180	5,036
Other assets and deferred charges, at cost, less accumulated amortization of $6,425 and $5,440, respectively	4,346	5,330
Total assets	$105,073	$113,314

(continued)

LIGGETT GROUP INC.

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

	June 30, 1996	December 31, 1995
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Current liabilities:		
Current maturities of long-term debt	$ 32,937	$ 50
Cash overdraft	-	3,761
Accounts payable:		
Principally trade	13,123	18,921
Affiliates	740	-
Accrued expenses:		
Promotional	25,167	25,519
Compensation and related items	86	1,175
Taxes, principally excise taxes	7,904	7,006
Estimated allowance for sales returns	5,000	5,000
Interest	8,420	8,412
Other	6,289	5,728
Total current liabilities	99,666	75,572
Long-term debt, less current maturities	144,708	173,251
Non-current employee benefits and other liabilities	18,010	19,197
Commitments and contingencies (Notes 5 and 8)		
Stockholder's equity (deficit):		
Redeemable preferred stock (par value $1.00 per share; authorized 1,000 shares; no shares issued and outstanding)		
Common stock (par value $0.10 per share; authorized 2,000 shares; issued and outstanding 1,000 shares) and contributed capital	53,240	53,240
Accumulated deficit	(210,551)	(207,946)
Total stockholder's equity (deficit)	(157,311)	(154,706)
Total liabilities and stockholder's equity (deficit)	$105,073	$113,314

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

LIGGETT GROUP INC.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	1996	1995	1996	1995
Net sales*	$113,286	$120,809	$191,774	$214,569
Cost of sales*	52,533	56,729	88,825	102,083
Gross profit	60,753	64,080	102,949	112,486
Selling, general and administrative expenses	55,285	57,446	97,403	100,639
Restructuring expense	-	1,041	-	1,041
Operating income	5,468	5,593	5,546	10,806
Other income (expense):				
Interest expense	(5,993)	(5,951)	(11,849)	(11,802)
Miscellaneous, net	3,710	291	3,698	(42)
Income (loss) before income taxes	3,185	(67)	(2,605)	(1,038)
Income tax provision (benefit)	-	60	-	(279)
Net income (loss)	$ 3,185	$ (127)	$ (2,605)	$ (759)

*Net sales and cost of sales include federal excise taxes of $29,487, $33,203, $50,684 and $59,595, respectively.

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

LIGGETT GROUP INC.

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

	Six Months Ended June 30, 1996	Six Months Ended June 30, 1995
Cash flows from operating activities:		
Net loss	$ (2,605)	$ (759)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	4,013	4,033
Gain on sale of property, plant and equipment	(3,698)	(285)
Changes in assets and liabilities:		
Accounts receivable	2,250	13,735
Inventories	5,399	(225)
Accounts payable	(5,043)	42
Accrued expenses	177	(11,553)
Non-current employee benefits	(371)	(97)
Other, net	(882)	(415)
Net cash provided by (used in) operating activities	(760)	4,476
Cash flows from investing activities:		
Proceeds from sale of property, plant and equipment	4,415	417
Capital expenditures	(2,484)	(528)
Acquisition of business from indirect parent	-	(800)
Net cash provided by (used in) investing activities	1,931	(911)
Cash flows from financing activities:		
Repayments of long-term debt	(127)	(458)
Net borrowings (repayments) under revolving credit facility	4,369	(2,318)
Decrease in cash overdraft	(3,761)	(789)
Net cash provided by (used in) financing activities	481	(3,565)
Net increase (decrease) in cash and cash equivalents	1,652	-
Cash and cash equivalents:		
Beginning of period	-	-
End of period	$ 1,652	$ -
Supplemental cash flow information:		
Cash payments (refunds) during the period for:		
Interest	$ 11,584	$ 11,334
Income taxes	$ 75	$ (8)

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

LIGGETT GROUP INC.

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

1. The Company

Liggett Group Inc. ("Liggett" or the "Company") is a wholly-owned subsidiary of BGLS Inc. ("BGLS"), a wholly-owned subsidiary of Brooke Group Ltd. ("BGL"). Liggett is engaged primarily in the manufacture and sale of cigarettes, principally in the United States.

The consolidated financial statements included herein are unaudited and, in the opinion of management, reflect all adjustments necessary (which are normal and recurring) to present fairly the Company's consolidated financial position, results of operations and cash flows. The December 31, 1995 balance sheet has been derived from audited financial statements. Certain amounts in the 1995 financial statements have been reclassified to conform with the 1996 presentation with no effect on previously reported net income (loss) or stockholder's equity (deficit). These consolidated financial statements should be read in conjunction with the consolidated financial statements included in the Company's Annual Report on Form 10-K (Commission File No. 33-75224) as filed with the Securities and Exchange Commission on April 16, 1996. The results of operations for interim periods should not be regarded as necessarily indicative of the results that may be expected for the entire year.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. Liggett had a net capital deficiency of $157,311 as of June 30, 1996 and is highly leveraged. Due to the many risks and uncertainties associated with the cigarette industry, impact of recent tobacco litigation settlements and 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 the 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.

2. Estimates and Assumptions

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

3. Per Share Data

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

4. Assets Under Agreements for Sale

On April 29, 1996, Liggett executed a definitive agreement 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, NC, for a sale price of $2,200. While the agreement provides for the closing to occur on or before September 30, 1996, Blue Devil Ventures has the option, if it determines that its development project is not feasible, to forfeit its deposit of $22 and not close. The net book value of those assets ($322) for which the agreement was signed have been classified as current assets on the Company's Consolidated Balance Sheet as of June 30, 1996.

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, NC, for a sale price of $4,300. The net book value of those assets ($713) for which the agreement was signed have been 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.

5. Inventories

Inventories consist of the following:

	June 30, 1996	December 31, 1995
Finished goods	$18,987	$18,240
Work-in-process	3,320	3,331
Raw materials	21,218	24,946
Replacement parts and supplies	3,871	3,926
Inventories at current cost	47,396	50,443
LIFO adjustment	1,547	3,899
Inventories at LIFO cost	$48,943	$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 $31,200 at June 30, 1996.

6. Property, Plant and Equipment

Property, plant and equipment consist of the following:

	June 30, 1996	December 31, 1995
Land and improvements	$ 455	$ 542
Buildings	5,848	6,011
Machinery and equipment	40,262	38,344
Property, plant and equipment	46,565	44,897
Less accumulated depreciation	(27,964)	(26,545)
Property, plant and equipment, net	$18,601	$18,352

7. Long-Term Debt

Long-term debt consists of the following:

	June 30, 1996	December 31, 1995
11.5% Senior Secured Notes due February 1, 1999, net of unamortized discount of $525 and $627, respectively	$119,587	$119,485
Variable Rate Series C Senior Secured Notes due February 1, 1999	32,279	32,279
Borrowings outstanding under revolving credit facility	25,386	21,017
Other	393	520
	177,645	173,301
Current portion	(32,937)	(50)
Amount due after one year	$144,708	$173,251

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. The Notes are collateralized by substantially all of the assets of the Company, excluding accounts receivable and inventory. Eve is a guarantor for the Notes. The Notes may be redeemed, in whole or in part, at a price equal to 104%, 102% and 100% of the principal amount in the years 1996, 1997 and 1998, respectively, at the option of the Company at any time on or after February 1, 1996. 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 initially 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 Note 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 $15,040 based upon eligible collateral at June 30, 1996. The Facility expires on March 8, 1997 and is collateralized by all inventories and receivables of the Company. Borrowings under the Facility bear interest at a rate equal to 1.5% above Philadelphia National Bank's (the indirect parent of Congress Financial Corporation, the lead lender) prime rate, which was 8.25% at June 30, 1996. The Facility contains certain financial covenants similar to those contained in the 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) and working capital (not to fall below a deficit of $35,000).

8. Commitments and Contingencies

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 BGL in its former name or in its present name or against Liggett), since all involve the tobacco manufacturing and marketing activities currently performed by 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. The Company has 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. The future financial benefit to the Company is not quantifiable at this time since the arrangements for assistance can be terminated on limited notice, or under certain circumstances, certain of which have occurred, without notice, and the amount of assistance received, if any, would be a function of the level of costs incurred. Certain joint defense arrangements, and the financial benefits incident thereto, have ended. No assurances can be made that other arrangements will continue. Liggett expects that the level of financial and other assistance which it may receive, if any, will be clarified over the ensuing months. To date a number of such actions, including several against Liggett, have been disposed of favorably to the defendants, and no plaintiff has ultimately prevailed in trial for recovery of damages in any such action.

In the action entitled Cipollone v. Liggett Group Inc., et al., the United States Supreme Court, on June 24, 1992, issued an opinion regarding federal preemption of state law damage actions. The Supreme Court in Cipollone concluded that The Federal Cigarette Labeling and Advertising Act (the "1965 Act") did not preempt any state common law damage claims. Relying on The Public Health Cigarette Smoking Act of 1969 (the "1969 Act"), however, the Supreme Court concluded that the 1969 Act preempted certain, but not all, common law damage claims. Accordingly, 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. It does permit, however, claims for fraudulent misrepresentation (other than a claim of fraudulently neutralizing the warning), concealment (other than in advertising and promotion of cigarettes), conspiracy and breach of express warranty after 1969. The Court expressed no opinion as to whether any of these claims are viable under state law but assumed arguendo that they are viable.

In addition, 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 September 10, 1993, an action entitled Sackman v. Liggett Group Inc., United States District Court, Eastern District of New York, was filed against Liggett alone alleging as injury lung cancer. Fact discovery closed on August 31, 1995; expert discovery continues. On May 25, 1996, the District Court granted Liggett summary judgment on plaintiffs' fraud and breach of warranty claims on statute of limitations grounds, but allowed plaintiffs' personal injury claims to survive. In the same order, the District Court vacated the Magistrate's March 19, 1996 order compelling Liggett to produce certain Council for Tobacco Research ("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 the same documents. The Court also ordered the Magistrate to reconsider his March 19, 1996 order and the effect of the District Court's summary judgment order. Oral argument concerning the relevancy of the CTR documents in light of the District Court's summary judgment order was conducted on August 8, 1996. The Magistrate's ruling on this matter is pending.

On May 11, 1993, in the case entitled Wilks v. The American Tobacco Company, No. 91-12, 355, Circuit Court of Washington County, State of Mississippi (a case in which Liggett was not a defendant), the trial court granted plaintiffs' motion to impose absolute liability on defendants for the manufacture and sale of cigarettes and struck defendants' affirmative defenses of assumption of risk and comparative fault/contributory negligence. The trial court ruled that the only issues to be tried in the case were causation and damages. No other court has ever imposed absolute liability on a manufacturer of cigarettes. After trial, the jury returned a verdict for defendants, finding no liability. The Company is or has been a defendant in other cases in Mississippi and it cannot be stated that other courts will not apply the Wilks ruling as to absolute liability.

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 for Tobacco Research 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.

On October 31, 1991, an action entitled Broin, et al. v. Philip Morris Companies, Inc., et al., Circuit Court of the 11th 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. On December 12, 1994, plaintiffs' motion to certify the action as a class action was granted. Defendants appealed this ruling and on January 3, 1996, the Third District Court of Appeal in Florida ("Third DCA") affirmed the class certification order. On May 8, 1996, the Third DCA denied defendants' rehearing request. On June 5, 1996, the Third DCA denied defendants' petition for a stay of its order upholding class certification, but granted defendants' motion for a stay of class notice.

On March 25, 1994, an action entitled Castano, et al. v. The American Tobacco Company, et al., United States District Court, Eastern District of Louisiana, was filed against Liggett and others. The class action complaint was brought on behalf of plaintiffs and residents of the United States who claim to be addicted to tobacco products and survivors who claim their decedents were addicted. The complaint is based upon the claim that defendants manipulated the nicotine levels in their tobacco products with the intent to addict plaintiffs and the class members. The complaint also alleges causes of action sounding in fraud, deceit, negligent misrepresentation, breach of express and implied warranty, strict liability and violation of consumer protection statutes. Plaintiffs seek compensatory and punitive damages and equitable relief, including disgorgement of profits from the sale of cigarettes and creation of a fund to monitor the health of class members and to pay for medical expenses allegedly caused by defendants, attorneys' fees and costs. On February 17, 1995, the District Court issued an Order that granted in part plaintiffs' motion for class certification. On May 23, 1996, the Court of Appeals for the Fifth Circuit reversed the District Court's order certifying the nationwide class action, and instructed the District Court to dismiss the class complaint.

On May 5, 1994, an action entitled Engle, et al. v. R. J. Reynolds Tobacco Company, et al., Circuit Court of the 11th Judicial District in and for Dade County, Florida, was filed against Liggett and others. The class action complaint was brought on behalf of plaintiffs and all persons in the United States who allegedly have become addicted to cigarette products and allegedly have suffered personal injury as a result thereof. Plaintiffs seek compensatory and punitive damages, together with equitable relief including but not limited to a medical fund for future health care costs, attorney's fees and costs. On October 31, 1994, plaintiffs' motion to certify the action as a class action was granted. Defendants appealed this ruling. On January 31, 1996, the Third DCA affirmed the ruling of the trial court certifying the action as a class action, but modified the trial court ruling to limit the class to Florida citizens and residents. On May 8, 1996, the Third DCA denied defendants' rehearing request. On June 5, 1996, the Third DCA denied defendants' petition for a stay of its order upholding class certification, but granted defendants' motion for a stay of class notice.

On May 6, 1996 an action entitled Norton, et al. v. RJR Nabisco Holdings Corp., et al., Madison County, Indiana Superior Court, was filed against Liggett and others. The class action complaint was brought on behalf of plaintiffs and all persons in the State of Indiana who allegedly have become addicted to cigarette products and allegedly have suffered personal injury as a result thereof. Plaintiffs seek compensatory and punitive damages, together with equitable relief including but not limited to a medical fund for future health care costs, attorney's fees and costs. On June 3, 1996, the defendant tobacco companies filed a notice of removal in the United States District Court for the Southern District of Indiana.

On May 29, 1996 an action entitled Richardson, et al. v. Philip Morris Inc., et al., Circuit Court for Baltimore City, was filed against Liggett and others. The class action complaint was brought on behalf of plaintiffs and all persons in the State of Maryland who allegedly have become addicted to cigarette products and allegedly have suffered personal injury as a result thereof. Plaintiffs seek compensatory and punitive damages, together with equitable relief including but not limited to a medical fund for future health care costs, attorney's fees and costs. On June 27, 1996, the defendant tobacco companies filed a notice of removal in the United States District Court for the District of Maryland.

On March 12, 1996, BGL and Liggett entered into an agreement to settle the Castano class action tobacco litigation. The settlement undertakes to release BGL and Liggett from all current and future addiction-based claims, including claims by a nationwide class of smokers in the Castano class action pending in Louisiana federal court as well as claims by a narrower statewide class in the Engle class action pending in Florida state court. The settlement is subject to and conditioned upon the approval of United States District Court for the Eastern District of Louisiana. The Company is unable to determine at this time when the Court will review the settlement, and no assurance can be given that the settlement will be approved by the Court. Certain of the terms of the settlement are summarized below.

Under the settlement, the Castano class would receive up to 5% of Liggett's pretax income (income before income taxes) each year (up to a maximum of $50,000 per year) for the next twenty-five years, subject to certain reductions provided for in the agreement, together with reasonable fees and expenses of the Castano Plaintiffs Legal Committee. Settlement funds received by the class would be used to pay half the cost of smoking-cessation programs for eligible class members. While neither consenting to Food and Drug Administration (the "FDA") jurisdiction nor waiving their objections thereto, BGL and Liggett also have agreed to phase in compliance with certain of the proposed interim 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.

BGL and Liggett have the right to terminate the Castano settlement if the remaining defendants succeed on the merits or in the event of a full and final denial of class action certification. The terms of the settlement would still apply if the Castano plaintiffs or their lawyers were to institute a substantially similar new class action against the tobacco industry. BGL and Liggett may also terminate the settlement if they conclude that too many class members have chosen to opt out of the settlement. In the event of any such termination by BGL and Liggett, the named plaintiffs would be at liberty to renew the prosecution of such civil action against BGL and Liggett.

On May 11, 1996, the Castano Plaintiffs Legal Committee filed a motion seeking preliminary approval of the Castano settlement. Non-settling defendants filed a motion to stay consideration of the Castano settlement pending the outcome of the appeal of the District Court's trial class certification order. Non-settling defendants' motion is scheduled to be heard on September 11, 1996. The motion for preliminary approval of the Castano settlement is scheduled to be heard on September 25, 1996.

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

An action entitled Yvonne Rogers v. Liggett Group Inc., et al., Superior Court, Marion County, Indiana, was filed by the plaintiff on March 27, 1987 against Liggett and others. The plaintiff seeks 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.

On May 23, 1994, an action entitled Mike Moore, Attorney General, ex rel. State of Mississippi v. The American Tobacco Company, et al., Chancery Court for the County of Jackson, State of Mississippi, was filed against Liggett and others. The State of Mississippi seeks restitution and indemnity for medical payments and expenses made or incurred by it on behalf of welfare patients for tobacco related illnesses. Similar actions (although not identical) have been filed by the State of Minnesota (together with Minnesota Blue Cross-Blue Shield), the State of West Virginia, the Commonwealth of Massachusetts, the State of Louisiana, the State of Texas, the State of Washington, the State of Maryland, the State of Connecticut and the City and County of San Francisco. In West Virginia, the trial court, in a ruling issued on May 3, 1995, dismissed eight of the ten counts of the complaint filed therein, leaving only two counts of an alleged conspiracy to control the market and market price of tobacco products and an alleged consumer protection claim. In a subsequent ruling, the trial court adjudged the contingent fee agreement entered into by the State of West Virginia and its counsel to be unconstitutional under the Constitution of the State of West Virginia. In Mississippi, the Governor has recently commenced an action in the Mississippi Supreme Court against the Attorney General of the state, making application for a writ of prohibition to bar further prosecution and to seek dismissal of the suit brought by the Attorney General of the state for such restitution and indemnity, alleging that the commencement and prosecution of such a civil action by the Attorney General of the state was and is outside the authority of the Attorney General.

On November 28, 1995, each of the major manufacturers in the industry, including Liggett, filed suit in both the Commonwealth of Massachusetts and in the State of Texas seeking declaratory relief to the effect that the commencement of any such litigation (as had been filed by Mississippi, West Virginia and Minnesota and now by Massachusetts, Louisiana and Texas) seeking to recover Medicaid expenses against the manufacturers by either the Commonwealth of Massachusetts or the State of Texas would be unlawful. On January 22, 1996, a suit seeking substantially similar declaratory relief was filed in the State of Maryland.

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 no limited to, diseases allegedly caused by cigarette smoking) allegedly caused by liable third parties (including, but not limited to, the tobacco industry). Liggett, after initial litigation, entered into a settlement of this controversy with the State of Florida, the terms of which are described below.

The Commonwealth of Massachusetts has enacted legislation authorizing lawsuits similar to the suits filed by the States of Mississippi, Minnesota, West Virginia, Louisiana and Texas. Aside from the Florida and Massachusetts statutes, legislation authorizing the state to sue a company or individual to recover the costs incurred by the state to provide health care to persons allegedly injured by the company or individual also has been introduced in a number of other states. These bills contain some or all of the following provisions: eliminating certain affirmative defenses, permitting the use of statistical evidence to prove causation and damages, adopting market share liability and allowing class action suits without notification to class members.

On March 15, 1996, BGL and Liggett entered into a settlement of tobacco litigation with the Attorneys General of the states of Florida, Louisiana, Massachusetts, Mississippi and West Virginia. The settlement with the Attorneys General releases BGL 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 share an initial $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 BGL 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 would range from 2-1/2% to 7-1/2% of Liggett's pretax income, depending on the number of additional states joining the settlement. 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 BGL 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. At December 31, 1995, the Company accrued approximately $4,000 for the present value of the fixed payments under the Attorneys General 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, BGL 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.

BGL 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. BGL 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.

Currently in addition to the above, approximately 125 product liability lawsuits, which have been filed in various jurisdictions, are pending and active in which Liggett is a defendant. Of these, approximately 90 are pending in the State of Florida. In most of these lawsuits, plaintiffs seek punitive as well as compensatory damages. Of the pending product liability lawsuits, the next case scheduled for trial against Liggett is James T. Clark v. Liggett Group, Inc. This matter is scheduled for trial in October 1996.

As to each of the cases referred to above which is pending against the Company, the Company believes, and has been so advised by counsel handling the respective cases, that the Company has a number of valid defenses to the claim or claims asserted against the Company. 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 restrictive regulatory actions, adverse political decisions and other unfavorable 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. 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. It is possible that the Company's financial position, results of operations and cash flows could be materially adversely affected by an ultimate unfavorable outcome in any of such pending litigation.

A grand jury investigation presently 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.

Liggett has been responding to a civil investigative demand from the Antitrust Division of the United States Department of Justice which requests certain information from Liggett. The request appears to focus on United States tobacco industry activities in connection with product development efforts regarding, in particular, "fire-safe" or self-extinguishing cigarettes. It also requests certain general information addressing Liggett's involvement with and relationship to its competitors. Liggett is unable at this time to predict the outcome of this investigation.

In March and April 1994, the Health and the Environmental Subcommittee of the Energy and Commerce Committee of the House of Representatives held hearings regarding nicotine in cigarettes. On March 25, 1994, Commissioner David A. Kessler of the FDA gave testimony as to the potential regulation of nicotine under the Food, Drug and Cosmetic Act, and the potential for jurisdiction over the regulation of cigarettes to be accorded to the FDA. In response to Commissioner Kessler's allegations about manipulation of nicotine by cigarette manufacturers, the chief executive of each of the major cigarette manufacturers, including Liggett, testified before the subcommittee on April 14, 1994, denying Commissioner Kessler's claims. An FDA advisory panel has stated that it believes nicotine is addictive. On August 10, 1995, the FDA filed in the Federal Register a Notice of Proposed Rule-Making (the "Proposed Rule-Making") which would classify tobacco as a drug, assert jurisdiction by the FDA over the manufacture and marketing of tobacco products and impose 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. Liggett and the other major manufacturers in the industry responded by filing a civil action in the United States District Court for the Middle District of North Carolina challenging the legal authority of the FDA to assert such jurisdiction. In addition thereto, Liggett and the other four major cigarette manufacturers, as well as others, have filed comments in opposition to the Proposed Rule-Making. Management is unable to predict whether such a classification will be made. Management is also unable to predict the effects of such a classification, were it to occur, or of such regulations, if implemented, on Liggett's operations, but such actions could have an unfavorable impact thereon.

On March 12, 1996, Liggett, together with BGL, entered into an agreement to settle the Castano class action tobacco litigation, and on March 15, 1996, Liggett, together with BGL, entered into an agreement with the Attorneys General of the State of West Virginia, State of Florida, State of Mississippi, Commonwealth of Massachusetts and the State of Louisiana to settle certain actions brought against Liggett by such states. In these two settlements, 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.

The Omnibus Budget Reconciliation Act of 1993 ("OBRA") required 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 "marketing assessment" 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. OBRA was repealed retroactively (as of December 31, 1994), coincident in time with the issuance of a Presidential proclamation, effective September 13, 1995, imposing tariffs on imported tobacco in excess of certain quotas.

The USDA has informed Liggett that it did not satisfy the 75% domestic tobacco usage requirement for 1994 and therefore is subject to a marketing assessment of approximately $5,500. At December 31, 1995, the Company accrued approximately $4,900 representing the present value of its obligation for the USDA marketing assessment. The charge was included as a component of cost of sales in 1995. Liggett has agreed to pay this assessment in quarterly installments with interest over a five year period. Under certain circumstances, payment can be accelerated. 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, after negotiations with the affected countries, declared a tariff rate quota ("TRQ") on certain imported tobacco, imposing extremely high tariffs on imports of flue-cured and burley tobacco in excess of certain levels which vary from country to country. Oriental tobacco is exempt from the quota as well as all tobacco originating from Canada, Mexico or Israel. Management believes that the TRQ levels are sufficiently high to allow Liggett to operate without material disruption to its business.

On February 20, 1996, the United States Trade Representative issued an "advance notice of rule making" concerning how tobaccos imported under the TRQ should be allocated. Currently, tobacco imported under the TRQ is allocated on a "first-come, first-served" basis, meaning that entry is allowed on an open basis to those first requesting entry in the quota year. Others in the cigarette industry have suggested an "end-user licensing" system under which the right to import tobacco under the quota would be initially assigned on the basis of domestic market share. Such an approach, if adopted, could have a material adverse effect on the Company. The Company believes it is unlikely that an end-user licensing system will be adopted, although no assurances can be given that an end-user licensing system will not be adopted.

In September 1991, the Occupational Safety and Health Administration ("OSHA") issued a Request for Information relating to indoor air quality, including environmental tobacco smoke ("ETS"), in occupational settings. OSHA announced in March 1994 that it would commence formal rulemaking during the year. Hearings were completed during 1995 but it is not anticipated that any regulation will issue prior to the end of 1996. 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 (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.

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. Liggett's motion to dismiss the complaint is currently pending, and the Court has stayed discovery until a hearing on Liggett's motion.

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.

9. Related Party Transactions

Since October 1990, Liggett has provided certain administrative and technical support to Liggett-Ducat Ltd. ("LDL"), a Russian cigarette producer which is majority owned by an affiliate and of which Rouben Chakalian, a director of Liggett, serves as a director, in exchange for which LDL provides assistance to Liggett in its pursuit of selling cigarettes in the Russian Republic. The expenses associated with Liggett's activities amounted to $2, $82, $4 and $108 for the three and six months ended June 30, 1996 and 1995, respectively. (See Note 11.)

Liggett is a 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. The expenses associated with Liggett's activities amounted to $441, $441, $882 and $882 for the three and six months ended June, 1996 and 1995, respectively.

Liggett has entered into an annually renewable Corporate Services Agreement with BGLS wherein BGLS provides 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 $790, $752, $1,580 and $1,505 for the three and six months ended June 30, 1996 and 1995, respectively. This fee is in addition to the management fee and overhead reimbursements described above.

Since April 1994, the Company has leased equipment from BGLS for $50 per month.

Accounts receivable from affiliates relate principally to advances for expenses paid by Liggett on behalf of its affiliates. The Company received payment of $1,200 in July 1996.

Accounts payable to affiliates relate principally to payments for expenses paid by affiliates on behalf of Liggett and overhead reimbursements due BGL. Liggett expects to pay these in the near term.

The Company acquired Carolina Tobacco Express Company ("CTEC") from its indirect parent during 1995 for $800. The excess of cost over carrying amount of 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.

10. Restructuring Charges

During the first half of 1995, Liggett, in an effort to reduce costs, offered voluntary retirement programs to eligible employees, among other things, and reduced the Company's headcount by approximately 111 positions. In connection therewith, the Company recorded a $1,662 restructuring charge to operations ($621 of which was included in cost of sales) for severance programs, primarily salary continuation and related benefits for terminated employees.

11. Subsequent Events

On July 5, 1996, Liggett purchased from Brooke (Overseas) Ltd. ("BOL"), an indirect subsidiary of BGL, 140,000 shares (approximately 20%) of LDL for $2,100. LDL, one of Russia's leading cigarette producers since 1892, manufactured and marketed 10.4 billion cigarettes in 1995. 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 LDL, thereby entitling Liggett to increase its interest in LDL to approximately 62%. The option fee would be credited against the purchase price. In addition, Liggett has 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 27% of the shares of LDL owned by BOL.

EVE HOLDINGS INC.

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

	June 30, 1996	December 31, 1995
ASSETS		
Cash	$ 8	$ 8
Office equipment	2	2
Trademarks, at cost, less accumulated amortization of $16,443 and $15,593, respectively	3,970	4,820
Total assets	$ 3,980	$ 4,830
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Federal income taxes currently payable to parent	$ 136	$ 164
Dividends payable	2,863	2,536
Deferred income taxes	1,389	1,687
Total liabilities	4,388	4,387
Stockholder's equity (deficit):		
Common stock (par value $1.00 per share; authorized, issued and outstanding 100 shares) and contributed capital	46,824	47,653
Receivables from parent:		
Note receivable - interest at 14%, due no sooner than February 1, 1999	(44,520)	(44,520)
Other	(2,712)	(2,690)
Total stockholder's equity (deficit)	(408)	443
Total liabilities and stockholder's equity (deficit)	$ 3,980	$ 4,830

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

EVE HOLDINGS INC.

STATEMENTS OF OPERATIONS
(Unaudited)
(Dollars in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	1996	1995	1996	1995
Revenues:				
Royalties - parent	$2,437	$2,753	$4,150	$4,939
Interest - parent	1,577	1,577	3,153	3,153
	4,014	4,330	7,303	8,092
Expenses:				
Amortization of trademarks	425	425	851	851
Miscellaneous, net	35	38	58	58
Income before income taxes	3,554	3,867	6,394	7,183
Income tax provision	1,244	1,353	2,238	2,514
Net income	$2,310	$2,514	$4,156	$4,669

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

EVE HOLDINGS INC.

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

	Six Months Ended June 30, 1996	Six Months Ended June 30, 1995
Cash flows from operating activities:		
Net income	$4,156	$4,669
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	851	851
Deferred income taxes	(298)	(298)
Changes in assets and liabilities:		
Federal income taxes currently payable	(29)	187
Dividends payable	-	40
Net cash provided by operating activities	4,680	5,449
Cash flows from financing activities:		
Dividends/capital distributions	(4,658)	(5,222)
Increase in due from parent	(22)	1,352
Net cash used in financing activities	(4,680)	(3,870)
Net increase (decrease) in cash	-	1,579
Cash:		
Beginning of period	8	2
End of period	$ 8	$1,581
Supplemental cash flow information:		
Payments of income taxes through receivable from parent	$2,314	$2,625
Dividends/capital distributions declared but not paid	$2,176	-

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

EVE HOLDINGS INC.

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

1. The Company

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

2. Per Share Data

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

3. Guarantee of Liggett Notes

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

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

EXHIBIT 99.2

TABLE OF CONTENTS

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

	June 30, 1996	December 31, 1995
ASSETS		
Current assets:		
Cash and cash equivalents	$ 65,621	$ 51,742
Investment securities	200,223	241,526
Restricted assets	10,391	22,919
Receivable from clearing brokers	17,582	13,752
Other current assets	20,982	3,546
Total current assets	314,799	333,485
Investment in real estate	183,122	
Investment securities	517	517
Restricted assets	7,423	15,086
Long-term investments	11,506	29,512
Other assets	15,091	7,222
Total assets	$ 532,458	$ 385,822
LIABILITIES AND CAPITAL (DEFICIT)		
Current liabilities:		
Margin loans payable	$ 82,525	$ 75,119
Accounts payable and accrued liabilities	40,331	27,712
Prepetition claims and restructuring accruals	26,737	33,392
Income taxes	16,954	20,283
Securities sold, not yet purchased	17,276	13,047
Current portion of long-term obligations	3,538	8,367
Total current liabilities	187,361	177,920
Notes payable	159,574	
Other long-term obligations	16,366	11,967
Redeemable preferred shares	222,288	226,396
Non-redeemable preferred shares, Common Shares and capital (deficit):		
Cumulative preferred shares; liquidation preference of $69,769, dividends in arrears; $105,170 and $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	664,101	679,058
Accumulated deficit	(724,010)	(714,364)
Unrealized appreciation on investment securities, net of taxes	6,403	2,650
Total non-redeemable preferred shares, Common Shares and other capital (deficit)	(53,131)	(30,461)
Total liabilities and capital (deficit)	$ 532,458	$ 385,822

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	1996	1995	1996	1995
Revenues:				
Principal transactions, net	$ 6,172	$ 2,601	$ 14,910	$ 2,601
Commissions	4,820	1,738	8,683	1,738
Real estate leasing	5,958		11,664	
Computer sales and service	4,098		8,797	
Interest and dividends	4,642	3,938	9,826	10,569
Other income	8,857	1,755	17,351	2,793
Total revenues	34,547	10,032	71,231	17,701
Cost and expenses:				
Operating, general and administrative	34,170	7,455	71,314	9,797
Interest	4,739		9,263	
Reversal of restructuring accruals				(2,044)
Total costs and expenses	38,909	7,455	80,577	7,753
Income (loss) from continuing operations before income taxes	(4,362)	2,577	(9,346)	9,948
Provision for income taxes	400	293	300	1,033
Income (loss) from continuing operations	(4,762)	2,284	(9,646)	8,915
Discontinued operations:				
Income from discontinued operations, net of income taxes		2,682		4,080
Net income (loss)	(4,762)	4,966	(9,646)	12,995
Dividends on preferred shares - undeclared	(15,646)	(18,647)	(31,108)	(39,059)
Excess of carrying value of redeemable preferred shares over cost of shares purchased		26,266	4,279	33,624
Net income (loss) applicable to Common Shares	$(20,408)	$ 12,585	$(36,475)	$ 7,560
Income (loss) per common and equivalent share:				
From continuing operations	$ (2.13)	$ 1.03	$ (3.81)	$ .36
Discontinued operations		.28		.43
Net income (loss) per Common Share	$ (2.13)	$ 1.31	$ (3.81)	$ .79
Number of shares used in computation	9,578	9,572	9,578	9,526
Supplemental information:				
Additional interest absent Chapter 11 filing				$ 2,314

See accompanying Notes to Quarterly Consolidated Financial Statements

NEW VALLEY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN NON-REDEEMABLE PREFERRED
SHARES, COMMON SHARES AND OTHER CAPITAL (DEFICIT)
(IN THOUSANDS)
(UNAUDITED)

	$3.00 Class B Preferred Shares		Common Shares		Additional		
	Shares	Amount	Shares	Amount	Paid-In Capital	Accumulated Deficit	Unrealized Appreciation
Balance, December 31, 1995	2,791	$279	191,551	$1,916	$679,058	$(714,364)	$2,650
Net loss						(9,646)	
Undeclared dividends and accretion on redeemable preferred shares					(21,056)		
Purchase of redeemable preferred shares					4,279		
Unrealized appreciation in marketable securities							3,753
Effect of 1-for-20 reverse stock split			(181,974)	(1,820)	1,820		
Conversion of preferred shares			1				
Balance, June 30, 1996	2,791	$279	9,578	$ 96	$664,101	$(724,010)	$6,403

See accompanying Notes to Quarterly Consolidated Financial Statements

NEW VALLEY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(DOLLARS IN THOUSANDS)
(UNAUDITED)

	Six Months Ended June 30, 1996	Six Months Ended June 30, 1995
Cash flows from operating activities:		
Net income (loss)	$ (9,646)	$ 12,995
Adjustments to reconcile net income to net cash used for operating activities:		
Income from discontinued operations		(4,080)
Depreciation and amortization	2,332	
Reversal of restructuring accruals		(2,044)
Changes in assets and liabilities, net of effects from acquisition:		
Decrease (increase) in receivables and other assets	(11,873)	7,170
Decrease in income taxes	(3,329)	(29,074)
Increase in accounts payable and accrued liabilities	10,234	399
Net cash used for operating activities	(12,282)	(14,634)
Cash flows from investing activities:		
Purchase of real estate and related improvements	(24,882)	
Payment of prepetition claims	(6,655)	(568,997)
Collection of contract receivable		300,000
Decrease in restricted assets	20,191	326,537
Sale or maturity of investment securities	60,899	
Purchase of investment securities	(15,843)	(198,902)
Sale or liquidation of long-term investments	14,500	
Purchase of long-term investments	(1,269)	(70,421)
Payment for acquisition, net of cash acquired	1,915	(25,853)
Net cash provided from (used for) investing activities	48,856	(237,636)
Cash flows from financing activities:		
Payment of preferred dividends	(10,354)	(90,628)
Purchase of Class A preferred stock	(10,530)	(23,029)
Increase in margin loans payable	7,406	
Repayment of other obligations	(9,217)	(7,357)
Exercise of stock options		535
Net cash used for financing activities	(22,695)	(120,479)
Net cash provided from discontinued operations		2,421
Net increase (decrease) in cash and cash equivalents	13,879	(370,328)
Cash and cash equivalents, beginning of period	51,742	376,170
Cash and cash equivalents, end of period	$ 65,621	$ 5,842
Supplemental Cash Flow Information:		
Cash payments for income taxes	$ 3,729	$ 31,194

See accompanying Notes to Quarterly Consolidated Financial Statements

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

1. PRINCIPLES OF REPORTING

The consolidated financial statements include the accounts of New Valley Corporation and Subsidiaries (the "Company"). The consolidated financial statements as of June 30, 1996 presented herein have been prepared by the Company without an audit. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the financial position as of June 30, 1996 and the results of operations and cash flows for all periods presented have been made. Results for the interim periods are not necessarily indicative of the results for the entire year.

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

These financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 1995, as filed with the Securities and Exchange Commission.

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. These changes were approved by the Company's shareholders at the annual shareholders' meeting held on June 25, 1996. In connection with the reverse stock split, all per share data have been restated to reflect retroactively the reverse stock split and a total of $1,820 was reclassified from the Company's common shares account to the Company's additional paid-in capital account.

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 generally 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.

Revenue Recognition of Computer Sales and Services. Product revenues are recognized when the equipment is shipped or, in certain circumstances, upon product acceptance by the customer if it occurs prior to shipment. Contract revenues are recognized as the related costs are incurred. Service revenues are recognized over the period in which the services are provided.

2. ACQUISITIONS

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

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

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 Office Building notes bear interest at 7.5% and have terms of ten to fifteen years. 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. Each Shopping Center note has a term of five years, and bears interest 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.

The components of the Company's investment in real estate at June 30, 1996 are as follows:

Land	$ 38,921
Buildings	145,939
Construction-in-progress	22
Total	184,882
Less: accumulated depreciation	(1,760)
Net investment in real estate	$183,122

On January 11, 1996, the Company provided a $10,600 convertible bridge loan to finance Thinking Machines Corporation ("TMC"), a developer and marketer of parallel software of high-end and networked computer systems. In February 1996, the bridge loan was converted into a controlling interest in a partnership which holds 3.3 million common shares of TMC which represent 61.4% of the outstanding shares. The acquisition of TMC through the conversion of the bridge loan was accounted for as a purchase for financial reporting purposes, and accordingly, the operations of TMC subsequent to January 31, 1996 are included in the operations of the Company. Subject to final determination, the fair value of assets acquired, including goodwill of $1,726, was $27,301 and liabilities assumed totaled $16,705, including minority interests of $9,082.

The following table presents unaudited pro forma and actual results of continuing operations as if the acquisitions of Ladenburg, Thalmann & Co., Inc., TMC, 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.

	Three Months Ended		Six Months Ended	
	June 30, 1996	June 30, 1995	June 30, 1996	June 30, 1995
	Actual	Pro Forma		
Revenues	$ 34,547	$31,795	$ 72,662	$69,504
Net (loss) income	$ (4,762)	$ 2,457	$(10,030)	$ 9,377
Net (loss) income applicable to common shares	$(20,408)	$10,076	$(36,859)	$ 3,942
Net (loss) income per common share	$ (2.13)	$ 1.05	$ (3.85)	$ .41

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

3. DISCONTINUED OPERATIONS

Effective October 1, 1995, the Company sold its messaging services business. Accordingly, the financial statements reflect the financial position and the results of operations of the messaging services business as discontinued operations for the periods prior to the sale.

Operating results of the messaging services business for the three months ended June 30, 1995 were as follows: revenues - $14,635, operating income - $2,982, and net income - $2,682. Operating results of the messaging services business for the six months ended June 30, 1995 were as follows: revenues - $26,662, operating income - $4,535, and net income - $4,080.

4. INCOME TAXES

At June 30, 1996, the Company had net operating loss carryforwards of approximately $190,000 which expire at various dates through 2007. A valuation allowance has been provided against the amount as it is deemed more likely than not that the benefit of the tax asset will not be utilized. The Company continues to evaluate the realizability of the deferred tax assets. The provision for income taxes, which represented the effects of the alternative minimum tax and state income taxes, for the three and six months ended June 30, 1996 and 1995, does not bear a customary relationship with pre-tax accounting income principally as a consequence of the change in the valuation allowance relating to deferred tax assets.

5. INVESTMENT SECURITIES

Investment securities classified as available for sale are carried at fair value, with net unrealized gains of $6,403 ($6,824 of unrealized gains and $421 of unrealized losses) included as a separate component of stockholders' equity (deficit). The Company had net realized gains on sales of investment securities available for sale of $58 and $3,192 for the three and six months ended June 30, 1996, respectively.

As of June 30, 1996, the Company, through a wholly-owned subsidiary, held approximately 5.16 million shares of RJR Nabisco Holdings Corp. ("RJR Nabisco") common stock, par value $.01 per share (the "RJR Nabisco Common Stock"), with a market value of $163,886 (cost of $158,225). The Company's investment in RJR Nabisco collateralizes margin loan financing of $82,525 at June 30, 1996. This margin loan bears interest at .25% below the broker's call rate (6.0% at June 30, 1996).

During 1996, the Company has expensed $10,367 relating to the RJR Nabisco investment. Included in this amount was $220 owed to Brooke Group Ltd. ("Brooke"), an affiliate of the Company, pursuant to the December 27, 1995 agreement with Brooke in which the Company agreed, among other things, to pay directly or reimburse Brooke and its subsidiaries for out-of-pocket expenses in connection with Brooke's solicitation of consents and proxies from the shareholders of RJR Nabisco. At June 30, 1996, the Company owed Brooke and its subsidiaries a total of $1,200 pursuant to the Brooke agreement, which amount was paid in July 1996. The Company's investment in RJR Nabisco Common Stock decreased from a $5,661 unrealized gain at June 30, 1996 to a $20,794 unrealized loss at August 13, 1996.

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

The details of the investment categories by type of security at June 30, 1996 are as follows:

	Cost	Fair Value
Available for sale:		
Marketable equity securities:		
RJR Nabisco Common Stock	$158,225	$163,886
Other marketable securities	2,080	2,822
Total marketable securities	160,305	166,708
Marketable debt securities (long-term)	517	517
Total securities available for sale	160,822	167,225
Trading securities (Ladenburg):		
Marketable equity securities	24,090	24,429
Equity and index options	7,041	6,739
Other securities	2,684	2,347
Total trading securities	33,815	33,515
Total investment securities	194,637	200,740
Less long-term portion of investment securities	(517)	(517)
Investment securities - current portion	$194,120	$200,223

The long-term portion of investment securities at cost consists of marketable debt securities which mature in three years.

Long-Term Investments. At June 30, 1996, long-term investments included investments in limited partnerships of $5,625, equity in a joint venture of $3,796, an equity investment in a foreign corporation of $2,000, and other investments of $85. During the first quarter of 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 $4,086. In July 1996, the Company sold its investment in a Brazilian airplane manufacturer (the "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 July 1996 representing a partial recovery of the impaired carrying value. The Company reclassified this investment to other current assets as of June 30, 1996. In June 1996, the Company determined that an other than temporary impairment in the value of its minority 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.

RJR Nabisco Equity Swap. On February 29, 1996, the Company entered into a total return equity swap transaction (the "Swap") with an unaffiliated company (the "Counterparty") relating to 1,000,000 shares of RJR Nabisco Common Stock (reduced to 750,000 shares of RJR Nabisco Common Stock as of August 13, 1996). The transaction is for a period of up to six months, subject to earlier termination at the election of the Company, and provided for the Company to make a payment to the Counterparty of $1,537 upon commencement of the

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

Swap. At the termination of the transaction, if the price of the RJR Nabisco Common Stock during a specified period prior to such date (the "Final Price") exceeds $34.42, the price of the RJR Nabisco Common Stock during a specified period following the commencement of the Swap (the "Initial Price"), the Counterparty will pay the Company an amount in cash equal to the amount of such appreciation with respect to the shares of RJR Nabisco Common Stock subject to the Swap plus the value of any dividends with a record date occurring during the Swap period. If the Final Price is less than the Initial Price, then the Company will pay the Counterparty at the termination of the transaction an amount in cash equal to the amount of such decline with respect to the shares of RJR Nabisco Common Stock subject to the Swap, offset by the value of any dividends, provided that, with respect to approximately 225,000 shares of RJR Nabisco Common Stock, the Company will not be required to pay any amount in excess of an approximate 25% decline in the value of the shares. The potential obligations of the Counterparty under the Swap are being guaranteed by the Counterparty's parent, a large foreign bank, and the Company has pledged certain collateral in respect of its potential obligations under the Swap and has agreed to pledge additional collateral under certain conditions. The Company marks its obligation with respect to the Swap to fair value which resulted in a charge to operations for the unrealized loss on the Swap of $3,231 for the six months ended June 30, 1996. Based on the market price of the RJR Nabisco Common Stock at August 13, 1996, the Company would take a charge to operations for the loss on the Swap of approximately $4,000 for the three months ended September 30, 1996. The Company had pledged U.S. government securities of $8,569 and $10,687 at June 30, 1996 and August 13, 1996, respectively, as collateral for this transaction. These amounts are classified as current restricted assets.

6. REDEEMABLE PREFERRED SHARES

At June 30, 1996, the Company had authorized and outstanding 2,000,000 and 1,035,462, respectively, of its Class A Senior Preferred Shares. At June 30, 1996 and December 31, 1995, respectively, the carrying value of such shares amounted to $222,288 and $226,396, including undeclared dividends of $124,339 and $121,893, or $120.08 and $110.06 per share.

In January and February, 1996, the Company repurchased 72,104 of such shares for $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.

As of June 30, 1996, the unamortized discount on the Class A Senior Preferred Shares was $5,597.

In March 1996 and July 1996, the Company declared and paid dividends on the Class A Senior Preferred Shares of $10.00 and $30.00 per share, respectively.

7. PREFERRED SHARES NOT SUBJECT TO REDEMPTION REQUIREMENTS

The undeclared dividends, as adjusted for conversions of Class B Preferred Shares into Common Shares, cumulatively amounted to $105,170 and $95,118 at June 30, 1996 and December 31, 1995, respectively. These undeclared dividends represent $37.68 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.

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

8. RESTRICTED ASSETS

Restricted assets at June 30, 1996 consisted primarily of the $8,569 pledged as collateral for the RJR Nabisco equity swap as described in Note 5, and $5,223 pledged as security for a long-term lease of commercial office space.

In May 1996, the Company reached an agreement with First Financial Management Corporation ("FFMC") whereby FFMC released all of the remaining $28,742 held in escrow pursuant to the Asset Purchase Agreement, dated as of October 20, 1994, between the Company and FFMC, relating to the sale of the Company's money transfer business. 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 $1,317.

9. PREPETITION CLAIMS UNDER CHAPTER 11 AND RESTRUCTURING ACCRUALS

Those liabilities that are expected to be resolved as part of the Company's First Amended Joint Chapter 11 Plan of Reorganization, as amended (the "Joint Plan") are classified in the Consolidated Balance Sheets as prepetition claims and restructuring accruals. On January 18, 1995, approximately $550 million of prepetition claims were paid pursuant to the Joint Plan. As of June 30, 1996 and December 31, 1995, the Company had $26,737 and $33,392, respectively, of prepetition claims and restructuring accruals. The prepetition claims remaining as of June 30, 1996 may be subject to future adjustments depending on pending discussions with the various parties and the decisions of the Bankruptcy Court.

10. CONTINGENCIES

Litigation

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 or results of operations.

Investment Company Act

The Investment Company Act of 1940, as amended (the "Investment Company Act"), and the rules and regulations thereunder require the registration of, and impose various substantive restrictions on, companies that engage primarily in the business of investing, reinvesting or trading in securities or engage in the business of investing, reinvesting, owning, holding or trading in securities and own or propose to acquire "investment securities" having a "value" in excess of 40% of a company's "total assets" (exclusive of Government securities and cash items) on an unconsolidated basis. Following dispositions of its then operating businesses pursuant to the Joint Plan, the Company was above this threshold and relied on the one-year exemption from registration under the Investment Company Act provided by Rule 3a-2 thereunder, which exemption expired on January 18, 1996. Prior to such date, through the Company's acquisition of the investment banking and brokerage business of Ladenburg and its acquisition of the Office Buildings and Shopping Centers (see

Note 2), the Company was engaged primarily in a business or businesses other than that of investing, reinvesting, owning, holding or trading in securities, and the value of its investment securities was below the 40% threshold. Under the Investment Company Act, the Company is required to determine the value of its total assets for purposes of the 40% threshold based on "market" or "fair" values, depending on the nature of the asset, at the end of the last preceding fiscal quarter and based on cost for assets acquired since that date. If the Company were required to register under the Investment Company Act, it would be subject to a number of material restrictions on its operations, capital structure and management, including without limitation its ability to enter into transactions with affiliates.