

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 MARCH 31, 1998

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

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

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

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

100 S.E. SECOND STREET
MIAMI, FLORIDA 33131
305/579-8000

(Address, including zip code and telephone number, including area code,
of the principal executive offices)

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

At May 15, 1998 Brooke Group Ltd. had 20,454,230 shares of common stock outstanding, and BGLS Inc. had 100 shares of common stock outstanding, all of which are held by Brooke Group Ltd.

BROOKE GROUP LTD.
BGLS INC.

FORM 10-Q

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Item 1. CONSOLIDATED FINANCIAL STATEMENTS

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

	March 31, 1998	December 31, 1997
	-----	-----
ASSETS:		
Current assets:		
Cash and cash equivalents.....	\$ 4,577	\$ 4,754
Accounts receivable - trade.....	8,994	10,462
Other receivables.....	1,589	1,239
Receivables from affiliates.....	3,253	1,978
Inventories.....	47,697	39,312
Other current assets.....	6,297	10,240
	-----	-----
Total current assets.....	72,407	67,985
Property, plant and equipment, at cost, less accumulated depreciation of \$31,635 and \$33,187.....	47,583	45,943
Intangible assets, at cost, less accumulated amortization of \$19,639 and \$19,302.....	2,203	2,610
Other assets.....	12,240	9,922
	-----	-----
Total assets.....	\$ 134,433	\$ 126,460
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT):		
Current liabilities:		
Notes payable and current portion of long-term debt.....	\$ 178,661	\$ 6,429
Accounts payable.....	15,925	10,461
Due to affiliates.....	4,965	1,226
Cash overdraft.....	937	945
Accrued promotional expenses.....	24,815	26,993
Accrued taxes payable.....	18,222	19,998
Accrued interest.....	9,782	39,782
Other accrued liabilities.....	32,258	34,670
	-----	-----
Total current liabilities.....	285,565	140,504
Notes payable, long-term debt and other obligations, less current portion.....	226,724	399,835
Noncurrent employee benefits.....	29,364	29,366
Other liabilities.....	56,532	45,152
Commitments and contingencies.....		
Stockholders' equity (deficit):		
Preferred Stock, par value \$1.00 per share, authorized 10,000,000 shares.....		
Series G Preferred Stock, 2,184,834 shares, convertible, participating, cumulative, each share convertible to 1,000 shares of common stock and cash or stock distribution, liquidation preference of \$1.00 per share.....		
Common stock, par value \$0.10 per share, authorized 40,000,000 shares, issued 26,498,043 and 24,998,043 shares, outstanding 20,348,498 and 18,097,096 shares.....	2,035	1,850
Additional paid-in capital.....	122,694	88,290
Deficit.....	(556,313)	(538,791)
Accumulated other comprehensive income.....	(1,022)	(5,607)
Less: 6,149,545 and 6,900,947 shares of common stock in treasury, at cost.....	(31,146)	(34,139)
	-----	-----
Total stockholders' equity (deficit).....	(463,752)	(488,397)
	-----	-----
Total liabilities and stockholders' equity (deficit).....	\$ 134,433	\$ 126,460
	=====	=====

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

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

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

	March 31, 1998	December 31, 1997
<hr style="border-top: 1px dashed black;"/>		
ASSETS:		
Current assets:		
Cash and cash equivalents.....	\$ 4,539	\$ 4,754
Accounts receivable - trade.....	8,994	10,462
Other receivables.....	1,548	1,191
Receivables from affiliates.....		1,603
Inventories.....	47,697	39,312
Other current assets.....	6,220	10,044
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Total current assets.....	68,998	67,366
Property, plant and equipment, at cost, less accumulated depreciation of \$31,172 and \$32,760.....	47,451	45,775
Intangible assets, at cost, less accumulated amortization of \$19,639 and \$19,302.....	2,203	
Investment in affiliate.....		2,610
Other assets.....	13,832	13,165
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Total assets.....	\$ 132,484	\$ 128,916
	=====	=====
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT):		
Current liabilities:		
Notes payable and current portion of long-term debt.....	\$178,622	\$ 6,212
Accounts payable.....	15,178	10,336
Cash overdraft.....	937	891
Due to parent.....	34,017	22,951
Accrued promotional expenses.....	24,815	26,993
Accrued taxes payable.....	18,222	19,998
Accrued interest.....	9,782	39,782
Other accrued liabilities.....	31,806	34,312
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Total current liabilities.....	313,379	161,475
Notes payable, long-term debt and other obligations, less current portion...	226,724	399,835
Noncurrent employee benefits.....	29,364	29,366
Other liabilities.....	62,733	51,355
Commitments and contingencies.....		
Stockholder's equity (deficit):		
Common stock, par value \$0.01 per share; authorized 100 shares, issued 100 shares, outstanding 100 shares.....	66,475	39,081
Additional paid-in capital.....	(568,521)	(550,339)
Deficit.....	2,330	(1,857)
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Total stockholder's deficit.....	(499,716)	(513,115)
	<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>
Total liabilities and stockholder's equity (deficit).....	\$ 132,484	\$ 128,916
	=====	=====

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

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

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

	Three Months Ended	
	March 31, 1998	March 31, 1997
Revenues*.....	\$ 84,803	\$ 80,005
Cost of goods sold*.....	41,656	41,845
	-----	-----
Gross profit.....	43,147	38,160
Operating, selling, administrative and general expenses.....	35,604	37,322
	-----	-----
Operating income.....	7,543	838
Other income (expenses):		
Interest income.....	65	559
Interest expense.....	(20,786)	(15,467)
Equity in loss of affiliate.....	(4,187)	(8,194)
Sale of assets.....	850	22,021
Retirement of debt.....		2,963
Proceeds from legal settlement.....		4,125
Other, net.....	81	119
	-----	-----
(Loss) income before income taxes.....	(16,434)	6,964
Provision for income taxes.....	931	744
	-----	-----
Net (loss) income.....	\$(17,365)	\$ 6,220
	=====	=====
Basic and diluted common share data:		
Net (loss) income applicable to common shares.....	\$(0.89)	\$0.34
	=====	=====
Weighted average common shares outstanding.....	19,465,056	18,385,985
	=====	=====

* Revenues and Cost of goods sold include federal excise taxes of \$17,918 and \$19,135 for the periods ended March 31, 1998 and 1997, respectively.

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

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

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

	Three Months Ended	
	March 31, 1998	March 31, 1997
Revenues*.....	\$ 84,803	\$80,005
Cost of goods sold*.....	41,656	41,845
	-----	-----
Gross profit.....	43,147	38,160
Operating, selling, administrative and general expenses.....	35,371	37,076
	-----	-----
Operating income.....	7,776	1,084
Other income (expenses):		
Interest income.....	56	559
Interest expense.....	(21,824)	(16,381)
Equity in loss of affiliate.....	(4,187)	(8,194)
Sale of assets.....	850	26,384
Retirement of debt.....		2,963
Other, net.....	78	112
	-----	-----
(Loss) income before income taxes.....	(17,251)	6,527
Provision for income taxes.....	931	742
	-----	-----
Net (loss) income.....	\$(18,182)	\$ 5,785
	=====	=====

* Revenues and Cost of goods sold include federal excise taxes of \$17,918 and \$19,135 for the periods ended March 31, 1998 and 1997, respectively.

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

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

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

	Common Stock		Paid-in Capital	Deficit	Treasury Stock	Accumulated Other Comprehensive Income		Total
	Shares	Amount						
Balance, December 31, 1997.....	18,097,096	\$1,850	\$ 88,290	\$(538,791)	\$(34,139)	\$ (5,607)	\$(488,397)	
Net income.....				(17,365)			(17,365)	
Issuance of warrants.....			22,421				22,421	
Issuance of common stock.....	1,500,000	150	11,342				11,492	
Effectiveness fee on debt.....			2,442		1,663		4,105	
Issuance of treasury stock.....	751,402	35	(341)	(157)	1,330		867	
Distributions on common stock (\$0.075 per share)....			(1,460)				(1,460)	
Amortization of deferred compensation.....						399	399	
Unrealized holding gain on investment in New Valley.						3,110	3,110	
Effect of New Valley capital transactions.....						1,076	1,076	
Balance, March 31, 1998.....	20,348,498	\$2,035	\$122,694	\$(556,313)	\$(31,146)	\$(1,022)	\$(463,752)	

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

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

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

	Common Stock		Additional Paid-In Capital	Deficit	Accumulated Other Comprehensive Income	Total
	Shares	Amount				
Balance, December 31, 1997.....	100		\$39,081	\$(550,339)	\$(1,856)	\$(513,114)
Net income.....				(18,182)		(18,182)
Effectiveness fee on debt.....			2,442			2,442
Issuance of warrants.....			22,421			22,421
Amortization of deferred compensation.....						
Payment of interest by parent.....			2,531			2,531
Unrealized holding gain on investment in New Valley.....					3,110	3,110
Effect of New Valley capital transactions.....					1,076	1,076
Balance, March 31, 1998.....	100		\$66,475	\$(568,521)	\$ 2,330	\$(499,716)

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

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

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

	Three Months Ended	
	March 31, 1998	March 31, 1997
Net cash used in operating activities.....	\$(25,984)	\$(26,619)
Cash flows from investing activities:		
Proceeds from sale of businesses and assets, net.....	1,217	21,906
Capital expenditures.....	(395)	(1,307)
Net cash provided by investing activities.....	822	20,599
Cash flows from financing activities:		
Proceeds from debt.....		3,000
Repayments of debt.....	(102)	(6,050)
Borrowings under revolver.....	63,961	81,291
Repayments on revolver.....	(58,799)	(69,224)
Decrease in cash overdraft.....	(45)	(6)
Distributions on common stock.....	(900)	(2,745)
Proceeds from participating loan.....	11,000	
Issuance of common stock.....	9,796	
Net cash provided by financing activities.....	24,911	6,266
Effect of exchange rate changes on cash and cash equivalents.....	79	
Net increase in cash and cash equivalents.....	(172)	246
Cash and cash equivalents, beginning of period.....	4,749	1,941
Cash and cash equivalents, end of period.....	\$ 4,577	\$ 2,187
	=====	=====
Supplemental non-cash financing activities:		
Issuance of stock to Liggett bondholders.....	\$ 4,105	
Issuance of warrants.....	22,422	

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

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

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

	Three Months Ended	
	March 31, 1998	March 31, 1997
Net cash used in operating activities.....	\$(17,218)	\$(30,609)
Cash flows from investing activities:		
Proceeds from sale of businesses and assets, net.....	1,217	21,906
Capital expenditures.....	(395)	(1,307)
Net cash provided by investing activities.....	822	20,599
Cash flows from financing activities:		
Proceeds from debt.....		3,000
Repayments of debt.....	(102)	(4,873)
Borrowings under revolver.....	63,961	81,291
Repayments on revolver.....	(58,799)	(69,224)
Increase (decrease) in cash overdraft.....	47	(6)
Proceeds from participating loan.....	11,000	
Net cash provided by financing activities.....	16,107	10,188
Effect of exchange rate changes on cash and cash equivalents.....	79	
Net (decrease) increase in cash and cash equivalents.....	(210)	178
Cash and cash equivalents, beginning of period.....	4,749	1,940
Cash and cash equivalents, end of period.....	\$ 4,539 =====	\$ 2,118 =====
Supplemental non-cash financing activities:		
Issuance of stock to Liggett bondholders.....	\$ 4,105	
Issuance of warrants.....	22,422	

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

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

1. PRINCIPLES OF REPORTING

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

The interim consolidated financial statements of the Company and BGLS are unaudited and, in the opinion of management, reflect all adjustments necessary (which are normal and recurring) to present fairly the Company's and BGLS' consolidated financial position, results of operations and cash flows. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's and BGLS' Annual Report on Form 10-K, as amended, for the year ended December 31, 1997, as filed with the Securities and Exchange Commission. The consolidated results of operations for interim periods should not be regarded as necessarily indicative of the results that may be expected for the entire year.

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

Certain amounts in the 1997 consolidated financial statements have been reclassified to conform to the 1998 presentation.

LIQUIDITY:

During the year ended December 31, 1997, the Company relied primarily on proceeds received on the sale of its indirect subsidiary, BrookeMil Ltd. ("BML"), to New Valley to meet its liquidity needs.

The Company's sources of liquidity for 1998 include, among other things, additional public and/or private debt and equity financing, management fees and certain funds available from New Valley subject to limitations imposed by BGLS' indenture agreements. New Valley may acquire or seek to acquire additional operating businesses through merger, purchase of assets, stock acquisition or other means, or to make other investments, which may limit its ability to make such distributions. New Valley's ability to make such distributions is subject to risk and uncertainties attendant to its business. (Refer to Note 2.)

On January 30, 1998, Liggett obtained the consents of the required majority of the holders of Liggett's 11.50% Series B and 19.75% Series C Senior Secured Notes due 1999 (the "Liggett Notes") to various amendments to the Indenture governing the Liggett Notes. The amendments provided, among other things, for a deferral of the February 1, 1998 mandatory redemption of \$37,500 principal amount of the Liggett Notes to the date of final maturity, February 1, 1999. (Refer to Note 6.) At maturity, the Liggett Notes will require a principal payment of \$144,892. Liggett does not anticipate it

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

will be able to generate sufficient cash from operations to make such payments. In addition, Liggett has a \$40,000 revolving credit facility expiring March 8, 1999 (the "Facility"), under which \$28,628 was outstanding at March 31, 1998. Accordingly, the Liggett Notes and the balance of the Facility have been reclassified to current liabilities as of March 31, 1998. As of March 31, 1998, Liggett had net capital and working capital deficiencies of \$190,383 and \$182,312, respectively. The current maturities of the Liggett Notes and the Facility of approximately \$174,000 contribute substantially to the working capital deficiency. If Liggett is unable to refinance or restructure the terms of the Liggett Notes or otherwise make all payments thereon, substantially all of the Liggett Notes and the Facility would be in default and holders of such debt could accelerate the maturity of such debt. In such event, Liggett may be forced to seek protection from creditors under applicable laws. Due to the many risks and uncertainties associated with the cigarette industry and the impact of tobacco litigation, there can be no assurance that Liggett will be able to meet its future earnings or cash flow goals. These matters raise substantial doubt about Liggett meeting its liquidity needs and its ability to continue as a going concern and may negatively impact the Company's liquidity.

The Company has also engaged in negotiations with the principal holders of the BGLS 15.75% Series B Senior Secured Notes (the "BGLS Notes") with respect to certain modifications to the terms of such debt. On March 2, 1998, BGLS entered into an agreement with AIF II, L.P. and an affiliated investment manager on behalf of a managed account (together, "the Apollo Holders"), who hold approximately 41.8% of the \$232,864 principal amount of the BGLS Notes. Pursuant to the terms of the agreement, the Apollo Holders have agreed to defer the payment of interest on the BGLS Notes held by them, commencing with the interest payment that was due July 31, 1997, which they had previously agreed to defer, through the interest payment due July 31, 2000. The deferred interest payments will be payable at final maturity of the BGLS Notes on January 31, 2001 or upon an event of default under the Indenture for the BGLS Notes. (Refer to Note 6.)

BOL is in the process of constructing a new tobacco factory in Moscow, Russia currently scheduled to be operational in early 1999. The remaining construction costs and equipment required for the new factory will be financed primarily by equipment lease financing currently in place and bank or other loans. (Refer to Notes 2 and 3.)

NEW ACCOUNTING PRONOUNCEMENTS

In June 1997, the Financial Accounting Standards Board (the "FASB") issued Statement on Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income". SFAS No. 130 establishes standards for reporting and display of comprehensive income. The purpose of reporting comprehensive income is to present a measure of all changes in equity that result from recognized transactions and other economic events of the period other than transactions with owners in their capacity as owners. SFAS No. 130 requires that an enterprise classify items of other comprehensive income by their nature in a financial statement and display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of the balance sheet. For the Company, other components of stockholders' equity include such items as minimum pension liability adjustments, unearned compensation expense related to stock options and the Company's proportionate interest in New Valley's capital transactions. SFAS No. 130 is effective for fiscal years beginning after December 15, 1997. The implementation of SFAS No. 130 for the quarter ended March 31, 1998 did not have any material effect on the consolidated financial statements.

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

In June 1997, the FASB issued SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information". SFAS No. 131 specifies revised guidelines for determining an entity's operating segments and the type and level of financial information to be disclosed. SFAS No. 131 provides for a two-tier test for determining those operating segments that would need to be disclosed for external reporting purposes. In addition to providing the required disclosures for reportable segments, SFAS No. 131 also requires disclosure of certain "second level" information by geographic area and for products/services. SFAS No. 131 also makes a number of changes to existing disclosure requirements. Management believes that the adoption of this pronouncement will not have a material effect on the Company's financial statement disclosures. SFAS No. 131 initially is effective for annual financial statements for fiscal years beginning after December 15, 1997.

In February 1998, SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits," was issued which revises required disclosures about pensions and postretirement benefit plans in order to facilitate financial analysis. Recognition or measurement issues are not addressed in the statement. SFAS No. 132 is effective for the Company for the year ended 1998. Management believes that the adoption of this pronouncement will not have a material effect on the Company's financial statement disclosures.

2. INVESTMENT IN NEW VALLEY CORPORATION

At March 31, 1998 and December 31, 1997, the Company's investment in New Valley consisted of an approximate 42% voting interest. At March 31, 1998 and December 31, 1997, the Company owned 57.7% of the outstanding \$15.00 Class A Increasing Rate Cumulative Senior Preferred Shares (\$100 Liquidation Value), \$.01 par value (the "Class A Preferred Shares"), 9.0% of the outstanding \$3.00 Class B Cumulative Convertible Preferred Shares (\$25 Liquidation Value), \$.10 par value (the "Class B Preferred Shares") and 41.7% of New Valley's common shares, \$.01 par value (the "Common Shares").

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 SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities", and are classified as available-for-sale. The Common Shares are accounted for pursuant to APB No. 18, "The Equity Method of Accounting for Investments in Common Stock".

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

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

The Company's and BGLS' investment in New Valley at March 31, 1998 is summarized below:

	NUMBER OF SHARES	FAIR VALUE	CARRYING AMOUNT	UNREALIZED HOLDING GAIN (LOSS)
	-----	-----	-----	-----
Class A Preferred Shares.....	618,326	\$58,277	\$ 58,277	\$(1,082)
Class B Preferred Shares.....	250,885	1,505	1,505	(349)
Common Shares.....	3,989,710	3,740	(59,782)	
		-----	-----	-----
		\$63,522	\$	\$(1,431)
		=====	=====	=====

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

The Class A Preferred Shares of New Valley are required to be redeemed on January 1, 2003 for \$100.00 per share plus dividends accrued to the redemption date. The shares are redeemable, at any time, at the option of New Valley, at \$100.00 per share plus accrued dividends. The holders of Class A Preferred Shares are entitled to receive a quarterly dividend, as declared by the Board of Directors, payable at the rate of \$19.00 per annum. At March 31, 1998, the accrued and unpaid dividends arrearage was \$176,161 (\$164.41 per share).

Holders of the Class B Preferred Shares are entitled to receive a quarterly dividend, as declared by the Board, at a rate of \$3.00 per annum. At March 31, 1998, the accrued and unpaid dividends arrearage was \$145,671 (\$52.20 per share). No dividends on the Class B Preferred Shares have been declared since the fourth quarter of 1988.

Summarized financial information for New Valley as of March 31, 1998 and December 31, 1997 and for the three months ended March 31, 1998 and 1997 follows:

	March 31, 1998	December 31, 1997
	-----	-----
Current assets, primarily cash and marketable securities.....	\$114,991	\$ 118,642
Non-current assets.....	288,248	322,749
Current liabilities.....	113,710	128,128
Non-current liabilities.....	163,122	185,024
Redeemable preferred stock.....	271,924	258,638
Shareholders' deficit.....	(145,517)	(130,399)

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	March 31,	
	1998	1997
Revenues	\$33,840	\$22,853
Costs and expenses.....	34,260	33,604
Net income (loss).....	157	(10,341)
Net loss applicable to common shares(A).....	(18,675)	(26,321)

(A) Considers all preferred accrued dividends, whether or not declared.

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

On February 20, 1998, New Valley and Apollo Real Estate Investment Fund III, L.P. ("Apollo") organized Western Realty Development LLC ("Western Realty") to make real estate and other investments in Russia. In connection with the formation of Western Realty, New Valley agreed, among other things, to contribute to Western Realty the real estate assets of its subsidiary BML and Apollo agreed to contribute up to \$58,000.

Under the terms of the agreement governing Western Realty (the "LLC Agreement"), the ownership and voting interests in Western Realty are held equally by Apollo and New Valley. Apollo is entitled to a preference on distributions of cash from Western Realty to the extent of its investment, together with a 15% annual rate of return, and New Valley is then entitled to a return of \$10,000 of BML-related expenses incurred by New Valley since March 1, 1997, together with a 15% annual rate of return; subsequent distributions will be made 70% to New Valley and 30% to Apollo. Western Realty is managed by a Board of Managers consisting of an equal number of representatives chosen by Apollo and New Valley. All material corporate transactions by Western Realty generally require the unanimous consent of the Board of Managers. Accordingly, New Valley accounts for its non-controlling interests in Western Realty on the equity method.

The organization of Western Realty was effected pursuant to the LLC Agreement. In 1996, New Valley acquired from an affiliate of Apollo eight shopping centers for \$72,500. New Valley and pension plans sponsored by BGLS have invested in investment partnerships managed by an affiliate of Apollo. Apollo's affiliate owns a substantial amount of debt securities of BGLS and warrants to purchase common stock of the Company.

On February 27, 1998, at an initial closing under the LLC Agreement, Apollo made an \$11,000 loan (the "Loan") to Western Realty. The Loan, which bore interest at the rate of 15% per annum and was due September 30, 1998, was collateralized by a pledge of New Valley's shares of BML. On April 28, 1998, the Loan and the accrued interest thereon were converted into a capital contribution by Apollo to Western Realty and the BML pledge released.

New Valley recorded its basis in the investment in Western Realty in the amount of \$59,669 based on the carrying value of assets less liabilities transferred. There was no difference between the carrying value of the investment and New Valley's proportionate interest in the underlying value of net assets of Western Realty.

Western Realty will seek to make additional real estate and other investments in Russia. New Valley and Apollo have agreed to invest, through Western Realty or another entity, up to \$25,000 in the aggregate for the potential development of a real estate project in Moscow. In addition, Western Realty has made a \$20,000 participating loan to, and payable out of a 30% profits interest in, a

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company organized by BOL which, among other things, acquired an interest in a new factory being constructed on the outskirts of Moscow by a subsidiary of BOL. (Refer to Note 3.)

3. INVESTMENT IN BROOKE (OVERSEAS) LTD.

At March 31, 1998, BOL owned approximately 96% of the stock of Liggett-Ducat including shares of such stock acquired from Liggett in connection with Liggett's debt restructuring (refer to Note 6) and purchases of stock from other shareholders.

Liggett-Ducat is in the process of constructing a new cigarette factory on the outskirts of Moscow which is currently scheduled to be operational in early 1999. Liggett-Ducat has entered into a construction contract for the plant. The remaining liability under that contract, as amended, at March 31, 1998 is approximately \$16,000. Equipment purchase agreements in place at March 31, 1998 total \$34,355, of which \$28,791 will be financed by the manufacturers.

In April, 1998, Western Realty completed making a \$20,000 participating loan to a company (the "Borrower") organized by BOL which holds BOL's interests in Liggett-Ducat and the industrial site and manufacturing facility being constructed by Liggett-Ducat on the outskirts of Moscow. The loan, which bears no fixed interest, is payable only out of 30% of distributions, if any, made by the Borrower to BOL. After the prior payment of debt service on loans to finance the construction of the new facility, 30% of distributions from the Borrower to BOL will be applied first to pay the principal of the loan and then as contingent participating interest on the loan. Any rights of payment on the loan are subordinate to the rights of all other creditors of the Borrower. An initial \$11,000 was funded in February 1998, and is classified in other long-term liabilities on the consolidated balance sheet at March 31, 1998. (Refer to Note 2.)

The performance of Liggett-Ducat's cigarette operations in Russia is affected by uncertainties in Russia which may include, among others, political or diplomatic developments, regional tensions, currency repatriation restrictions, foreign exchange fluctuations, inflation, and an undeveloped system of commercial laws and legislative reform relating to foreign ownership in Russia.

On January 31, 1997, BOL sold all its shares of BML to New Valley for \$21,500 in cash and a promissory note of \$33,500 payable \$21,500 on June 30, 1997 and \$12,000 on December 31, 1997 with interest at 9%. The note was paid in full as of December 31, 1997. The consideration received exceeded the carrying value of its investment in BML by \$43,700. The Company recognized a gain on the sale in 1997 in the amount of \$21,300. The remaining \$22,400 was deferred in recognition of the fact that the Company retains an interest in BML through its 42% equity ownership in New Valley and that a portion of the property sold (the site of the third phase of the Ducat Place real estate project being developed by BML, which is currently used by Liggett-Ducat for its existing cigarette factory), is subject to a put option held by New Valley. The option allows New Valley to put this site back to the Company at the greater of the appraised fair market value of the property at the date of exercise or \$13,600, during the period Liggett-Ducat operates the factory on such site.

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4. INVENTORIES

Inventories consist of:

	March 31, 1998	December 31, 1997

Finished goods.....	\$17,400	\$13,273
Work-in-process.....	2,456	1,976
Raw materials.....	27,383	24,495
Replacement parts and supplies.....	4,425	4,466
	-----	-----
Inventories at current cost.....	51,664	44,210
LIFO adjustments.....	(3,967)	(4,898)
	-----	-----
	\$47,697	\$39,312
	=====	=====

At March 31, 1998, Liggett and Liggett-Ducat had leaf tobacco purchase commitments of approximately \$8,714 and \$14,200, respectively.

5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of:

	March 31, 1998	December 31, 1997

Land and improvements.....	\$ 411	\$ 411
Buildings.....	6,521	6,521
Machinery and equipment.....	53,783	53,717
Leasehold improvements.....	302	302
Construction-in-progress.....	18,201	18,179
	-----	-----
	79,218	79,130
Less accumulated depreciation.....	(31,635)	(33,187)
	-----	-----
	\$ 47,583	\$ 45,943
	=====	=====

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

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

	March 31, 1998	December 31, 1997
	-----	-----
15.75% Series B Senior Secured Notes due 2001, net of unamortized discount of \$22,940 and \$1,511.....	\$209,924	\$231,723
Deferred interest on 15.75% Series B Senior Secured Notes due 2001.....	16,000	
14.500% Subordinated Debentures due 1998.....	800	800
Notes payable - Foreign.....	5,000	5,000
Other.....	300	629
 Liggett:		
11.500% Senior Secured Series B Notes due 1999, net of unamortized discount of \$159 and \$206.....	112,454	112,406
Variable Rate Series C Senior Secured Notes due 1999.....	32,279	32,279
Revolving credit facility.....	28,628	23,427
	-----	-----
Total notes payable, long-term debt and other obligations.....	405,385	406,264
 Less:		
Current maturities.....	178,661	6,429
	-----	-----
Amount due after one year.....	\$226,724	\$399,835
	=====	=====

The 14.500% Subordinated Debentures due 1998 in principal amount of \$800 were paid at maturity on April 1, 1998.

STANDSTILL AGREEMENT - BGLS:

During negotiations with the holders of more than 83% of the BGLS Notes concerning certain modifications to the terms of such debt, BGLS entered into a standstill agreement with such holders on August 28, 1997. Pursuant to the standstill agreement, as amended, such holders agreed that they would be entitled to receive their portion of the July 31, 1997 interest payment on the BGLS Notes (in total, \$15,340) only after giving BGLS 20 days' notice but in any event by February 6, 1998.

On February 6, 1998, BGLS entered into a further amendment to the standstill agreement with the Apollo Holders who hold approximately 41.8% of the BGLS Notes which extended the termination date of such agreement with respect to the Apollo Holders to March 2, 1998. Also on February 6, 1998, the holder of 41.9% of the BGLS Notes, who had previously been a party to the standstill agreement, was paid its pro rata share of the July 31, 1997 interest payment on the BGLS Notes. The Company also sold stock on January 16, 1998 to an affiliate of this holder in which it recorded an expense of \$2,531 for the first quarter 1998, representing the difference between the cost and fair market value of the shares sold. (Refer to Note 7.)

On March 2, 1998, the Company entered into an agreement with the Apollo Holders in which the Apollo Holders agreed to defer the payment of interest on the BGLS Notes held by them, commencing with the interest payment that was due July 31, 1997, which they had previously agreed to defer, through the interest payment due July 31, 2000. The deferred interest payments together with interest compounded semi-annually thereon, will be

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payable at final maturity of the BGLS Notes on January 31, 2001 or upon an event of default under the Indenture for the BGLS Notes. Accordingly, accrued interest as of March 2, 1998 was reclassified and included in other long-term obligations.

In connection with the March 2, 1998 agreement with the Apollo Holders, the Company issued to the Apollo Holders a five-year warrant to purchase 2,000,000 shares of the Company's common stock at a price of \$5.00 per share. The Apollo Holders were also issued a second warrant expiring October 31, 2004 to purchase an additional 2,150,000 shares of the Company's common stock at a price of \$0.10 per share. The second warrant will become exercisable on October 31, 1999, and the Company will have the right under certain conditions prior to that date to substitute for that warrant a new warrant for 9.9% of the common stock of Liggett.

Based on the fair value of the equity instruments given to the holders of the debt, and the difference between the fair value of the modified debt and the carrying value of the debt held by the Apollo Holders prior to the transaction, no gain or loss was recorded on the transaction. The fair value of the equity instruments was estimated based on the Black-Scholes option pricing model and the following assumptions; volatility of 77%, risk-free interest rate of 6%, expected life of five to seven years and a dividend rate of 0%. Imputed interest of approximately \$23,000 will be accreted over the term of the modified debt based on its recorded fair value.

In connection with the consents of the Liggett bondholders to the restructuring of the Liggett Notes, on February 2, 1998, the Company issued 483,002 shares of treasury stock to the Liggett bondholders of record as of January 15, 1998. (Refer to Note 7.) The Company recorded a deferred charge of \$4,105 at January 31, 1998 reflecting the fair value of the instruments issued. The Company has agreed to use its best efforts to file with the Securities and Exchange Commission ("SEC") a shelf registration statement on Form S-3 to be declared effective by May 31, 1998. If the registration statement has not been declared effective by such date, liquidated damages on the shares of common stock will accrue at the daily rate of \$25, provided that the number of days on which damages shall accrue shall not exceed 300 days. Liquidated damages would be payable, at the option of the Company, in cash or in shares of common stock of the Company.

15.75% SERIES B SENIOR SECURED NOTES DUE 2001

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

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LIGGETT 11.50% SENIOR SECURED SERIES B NOTES DUE 1999:

On February 14, 1992, Liggett issued \$150,000 in Senior Secured Notes (the "Liggett Series B Notes"). Interest on the Liggett Series B Notes is payable semiannually on February 1 and August 1 at an annual rate of 11.50%. The Liggett Series B Notes and Series C Notes referred to below (collectively, the "Liggett Notes") required mandatory principal redemptions of \$7,500 on February 1 in each of the years 1993 through 1997 and \$37,500 on February 1, 1998 with the balance of the Liggett Notes due on February 1, 1999. In February 1997, \$7,500 of Liggett Series B Notes were purchased using the Facility and credited against the mandatory redemption requirements. The transaction resulted in a net gain of \$2,963. The Liggett Notes are collateralized by substantially all of the assets of Liggett, excluding inventories and receivables. Eve Holdings Inc. is a guarantor for the Liggett Notes. The Liggett Notes may be redeemed, in whole or in part, at a price equal to 100% of the principal amount at the option of Liggett. The Liggett Notes contain restrictions on Liggett's ability to declare or pay cash dividends, incur additional debt, grant liens and enter into any new agreements with affiliates, among others.

On January 30, 1998, with the consent of the required majority of the holders of the Liggett Notes, Liggett entered into various amendments to the Indenture governing the Liggett Notes, which provided, among other things, for a deferral of the February 1, 1998 mandatory redemption payment of \$37,500 to the date of final maturity of the Liggett Notes on February 1, 1999. In connection with the deferral, the Company agreed to issue 483,002 shares of the Company's common stock to the holders of record on January 15, 1998 of the Liggett Notes. As a result of this transaction, Liggett recorded a deferred charge of approximately \$4,100 during the first quarter of 1998 reflecting the fair value of the instruments issued. This deferred charge is being amortized over a period of one year. The Indenture under which the Liggett Notes are outstanding was also amended to prohibit, with limited exceptions, payments of dividends and incurrence of new debt by Liggett and to tighten restrictions on the disposition of proceeds of asset sales. The Company and BGLS also agreed to guarantee the payment by Liggett of the August 1, 1998 interest payment on the Liggett Notes. In addition, Liggett Noteholders were granted additional collateral in the form of a security interest in 16% of the stock of Liggett-Ducat or a successor entity held by BOL.

On February 1, 1999, all of the Liggett Notes, approximately \$144,900, will reach maturity. There are no refinancing or restructuring arrangements in place at this time for the notes and no assurances can be given in this regard. (Refer to Note 1.)

LIGGETT SERIES C VARIABLE RATE NOTES:

The Series C Notes have the same terms (other than interest rate, which is 19.75%) and stated maturity as the Liggett Series B Notes.

REVOLVING CREDIT FACILITY - LIGGETT:

On March 8, 1994, Liggett entered into the Facility for \$40,000 with a syndicate of commercial lenders. The Facility is collateralized by all inventories and receivables of Liggett. At March 31, 1998, \$1,483 was available under the Facility based on eligible collateral. Borrowings under the Facility, whose interest is calculated at a rate equal to 1.5% above the Philadelphia National Bank's prime rate, bear a rate of 10.0% at March 31, 1998. The Facility requires Liggett's compliance with certain financial and other covenants, including restrictions on the payment of cash dividends and

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distributions by Liggett. In addition, the Facility, as amended April 8, 1998, imposes requirements with respect to Liggett's permitted maximum adjusted net worth (not to fall below \$195,000 as computed in accordance with the agreement, this computation was \$186,416 at March 31, 1998) and net working capital deficiencies (not to fall below a default of \$17,000 as computed in accordance with the agreement, this computation was \$4,984 at March 31, 1998). The Facility, as amended, also provides that a default by Liggett or its subsidiaries under the March 1996 Settlements, March 1997 Settlements and March 1998 Settlements (all as defined below in Note 8) shall constitute an event of default under the Facility. In January 1997, the Facility was extended for one year and, in November 1997, was extended for an additional year until March 8, 1999.

On August 29, 1997, the Facility was amended to permit Liggett to borrow an additional \$6,000 which was used on that date in making the interest payment of \$9,700 due on August 1, 1997 to the holders of the Liggett Notes. BGLS guaranteed the additional \$6,000 advance under the Facility and collateralized the guarantee with \$6,000 in cash, deposited with Liggett's lender. At March 31, 1998, this amount is classified in other assets on the consolidated balance sheet.

FOREIGN LOANS:

At March 31, 1998, Liggett-Ducat had two 6-month credit facilities open with a Russian bank. The first, for \$2,000, which expired and was paid on April 30, 1998, initially bore an interest rate of 21%, subsequently raised to 28% on December 2, 1997. The second, for \$3,000, which expired and was paid on May 16, 1998, initially bore an interest rate of 25%, subsequently raised to 28% on December 2, 1997. On April 24, 1998, Liggett-Ducat opened a credit facility for \$2,000 with a Russian bank. The facility, with a variable interest rate (currently 27%), expires October 25, 1998.

7. EQUITY

As of January 1, 1998, the Company granted to employees of the Company non-qualified stock options to purchase 42,500 shares of the Company's common stock at an exercise price of \$5.00 per share. The options have a ten-year term and vest in six equal annual installments. The Company will recognize compensation expense of \$154 over the vesting period.

On January 16, 1998, the Company entered into a Stock Purchase Agreement in which High River Limited Partnership purchased 1,500,000 shares of the Company's common stock for \$9,000.

In connection with the March 2, 1998 agreement with the Apollo Holders, the Company issued warrants to purchase the Company's common stock. (Refer to Note 6.)

On March 12, 1998, the Company granted an option for 1,250,000 shares of the Company's common stock to a law firm that represents the Company and Liggett. On May 1, 1998 and April 1, 1999, options for 250,000 and 1,000,000 shares, respectively, of common stock are exercisable at \$17.50 per share. The option expires on March 31, 2003.

During April and May 1998, the Company granted 10,000 shares of the Company's common stock to each of its three outside directors. Of these shares, 7,500 vested immediately and the remaining 22,500 shares will vest in three equal annual installments. The Company will recognize compensation expense of \$404 over the vesting period.

On May 8, 1998, the Company adopted its 1998 Long-Term Incentive Plan (the "Incentive Plan") subject to approval by the shareholders of the Company at the next annual meeting. The Incentive Plan authorizes the granting of up to five million shares of the Company's common stock through awards of stock options (which may include incentive stock options and/or nonqualified stock options), stock appreciation rights and shares of restricted Company common stock. All officers, employees and consultants of the Company and its subsidiaries are eligible to receive awards under the Incentive Plan.

8. CONTINGENCIES

TOBACCO-RELATED LITIGATION:

OVERVIEW. Since 1954, Liggett and other United States cigarette manufacturers have been named as defendants in a number of direct and third-party actions predicated on the theory that they should be liable for damages from cancer and other adverse health effects alleged to have been caused by cigarette smoking or by exposure to secondary smoke (environmental tobacco smoke, "ETS") from cigarettes. These cases are reported hereinafter as though having been commenced against Liggett (without regard to whether such cases were actually commenced against the Company or Liggett). There has been a noteworthy increase in the number of cases pending against both Liggett and the other tobacco companies. The cases generally fall into three categories: (i) smoking and health cases alleging personal injury brought on behalf of individual smokers ("Individual Actions"), (ii) smoking and health cases alleging personal injury and purporting to be brought on behalf of a class of plaintiffs ("Class Actions") and (iii) health care cost recovery actions brought by state and local governments, although recently numerous health care cost recovery actions have been commenced on behalf of other third-party payors including asbestos manufacturers, unions and taxpayers ("Attorneys General Actions"). As new cases are commenced, the costs associated with defending such cases and the risks attendant to the inherent unpredictability of litigation continue to increase. Liggett had been receiving 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, which, for the most part, consisted of the payment of counsel fees and costs, but this assistance terminated in 1997. For the three months ended March 31, 1998, Liggett incurred counsel fees and costs totaling approximately \$1,342, compared to \$1,037 for the comparable prior year period. The future financial impact on the Company of the termination of this assistance and the effects of the tobacco litigation settlements discussed below is not quantifiable at this time.

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

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INDIVIDUAL ACTIONS. As of March 31, 1998, there were approximately 250 cases pending against Liggett, and in most cases the other tobacco companies, where individual plaintiffs allege injury resulting from cigarette smoking, addiction to cigarette smoking or exposure to ETS and seek compensatory and, in some cases, punitive damages. Of these, 108 were pending in the State of Florida, 82 in the State of New York and 19 in the State of Texas. The balance of individual cases were pending in 16 states. There are four individual cases pending where Liggett is the only named defendant.

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

On May 12, 1998, Liggett settled an individual tobacco-related action entitled WIDDICK V. BROWN & WILLIAMSON, Duval County Circuit Court, Florida. The settlement will not have a material effect on the Company's or Liggett's financial condition, results of operations or cash flows.

CLASS ACTIONS. As of March 31, 1998, there were approximately 30 actions pending, for which either a class has been certified or plaintiffs are seeking class certification, where Liggett, among others, was a named defendant. Two of these cases, FLETCHER, ET AL. V. BROOKE GROUP LTD., ET AL. and WALKER, ET AL. V. LIGGETT GROUP INC., ET AL., have been settled, subject to court approval. These two settlements are more fully discussed below under the "Settlements" section.

In October 1991, an action entitled BROIN, ET AL. V. PHILIP MORRIS INCORPORATED, ET AL., Circuit Court of the Eleventh Judicial District in and for Dade County, Florida, was filed against Liggett and others. This case 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. In October 1997, the other major tobacco companies settled this matter which settlement provides for a release of the Company and Liggett. In February 1998, the Circuit Court approved the settlement, however, a Notice of Appeal was filed in the Third District Court of Appeal by an objector to the settlement.

In March 1994, an action entitled CASTANO, ET AL. V. THE AMERICAN TOBACCO COMPANY INC., ET AL., United States District Court, Eastern District of Louisiana, was filed against Liggett and others. The class action complaint sought relief for a nationwide class of smokers based on their alleged addiction to nicotine. In February 1995, the District Court granted plaintiffs' motion for class certification (the "Class Certification Order").

In May 1996, the Court of Appeals for the Fifth Circuit reversed the Class Certification Order and instructed the District Court to dismiss the class complaint. The Fifth Circuit ruled that the District

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Court erred in its analysis of the class certification issues by failing to consider how variations in state law affect predominance of common questions and the superiority of the class action mechanism. The appeals panel also held that the District Court's predominance inquiry did not include consideration of how a trial on the merits in CASTANO would be conducted. The Fifth Circuit further ruled that the "addiction-as-injury" tort is immature and, accordingly, the District Court could not know whether common issues would be a "significant" portion of the individual trials. According to the Fifth Circuit's decision, any savings in judicial resources that class certification may bring about is speculative and would likely be overwhelmed by the procedural problems certification brings. Finally, the Fifth Circuit held that in order to make the class action manageable, the District Court would be forced to bifurcate issues in violation of the Seventh Amendment.

The extent of the impact of the CASTANO decision on tobacco-related class action litigation is still uncertain, although the decertification of the CASTANO class by the Fifth Circuit may preclude other federal courts from certifying a nationwide class action for trial purposes with respect to tobacco-related claims. The CASTANO decision has had to date, however, only limited effect with respect to courts' decisions regarding narrower tobacco-related classes or class actions brought in state rather than federal court. For example, since the Fifth Circuit's ruling, courts in New York, Louisiana and Maryland have certified "addiction-as-injury" class actions that covered only citizens in those states. Two class actions pending in state court in Florida have also been certified and one of the actions, the BROIN case, had begun trial before settling in 1997. The CASTANO decision has had no measurable impact on litigation brought by or on behalf of single individual claimants.

ATTORNEYS GENERAL ACTIONS. As of March 31, 1998, 41 Attorneys General actions were filed against Liggett and the Company. As more fully discussed below, Liggett and the Company have settled 37 of these actions. In addition, the Company and Liggett have reached settlements with six Attorneys General representing states or territories which have not yet commenced litigation. As of March 31, 1998, there were approximately 55 additional third-party payor actions pending. In certain of the pending proceedings, state and local government entities and others seek reimbursement for Medicaid and other health care expenditures allegedly caused by use of tobacco products. The claims asserted in these health care cost recovery actions vary. In most of these cases, plaintiffs assert the equitable claim that the tobacco industry was "unjustly enriched" by plaintiffs' payment of health care costs allegedly attributable to smoking and seek reimbursement of those costs. Other claims made by some but not all plaintiffs include the equitable claim of indemnity, common law claims of negligence, strict liability, breach of express and implied warranty, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under state and federal statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under RICO.

On April 29, 1998, a group known as the "Coalition for Tobacco Responsibility", which represents Blue Cross and Blue Shield Plans in more than 35 states, filed federal lawsuits against the industry seeking payment of health-care costs allegedly incurred as a result of cigarette smoking and ETS. The lawsuits were filed in Federal District Courts in New York, Chicago and Seattle and seek billions of dollars in damages. The lawsuits allege conspiracy, fraud, misrepresentation, violation of federal racketeering and anti-trust laws as well as other claims.

SETTLEMENTS. In March 1996, the Company and Liggett entered into an agreement, subject to court approval, to settle the CASTANO class action tobacco litigation. Under the CASTANO settlement agreement, upon final court approval of the settlement, the CASTANO class would be entitled to receive

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up to five percent of Liggett's pretax income (income before income taxes) each year (up to a maximum of \$50,000 per year) for the next 25 years, subject to certain reductions provided for in the agreement and a \$5,000 payment from Liggett if the Company or Liggett fail to consummate a merger or similar transaction with another non-settling tobacco company defendant within three years of the date of settlement. The Company and Liggett have the right to terminate the CASTANO settlement under certain circumstances. On March 14, 1996, the Company, the CASTANO Plaintiffs Legal Committee and the CASTANO plaintiffs entered into a letter agreement. According to the terms of the letter agreement, for the period ending nine months from the date of Final Approval (as defined in the letter), if granted, of the CASTANO settlement or, if earlier, the completion by the Company or Liggett of a combination with any defendant in CASTANO, except Philip Morris, the CASTANO plaintiffs and their counsel agree not to enter into any more favorable settlement agreement with any CASTANO defendant which would reduce the terms of the CASTANO settlement agreement. If the Castano plaintiffs or their counsel enter into any such settlement during this period, they shall pay the Company \$250,000 within 30 days of the more favorable agreement and offer the Company and Liggett the option to enter into a settlement on terms at least as favorable as those included in such other settlement. The letter agreement further provides that during the same time period, and if the CASTANO settlement agreement has not been earlier terminated by the Company in accordance with its terms, the Company and its affiliates will not enter into any business transaction with any third party which would cause the termination of the CASTANO settlement agreement. If the Company or its affiliates enter into any such transaction, then the CASTANO plaintiffs will be entitled to receive \$250,000 within 30 days from the transacting party. In May 1996, the CASTANO Plaintiffs Legal Committee filed a motion with the United States District Court for the Eastern District of Louisiana seeking preliminary approval of the CASTANO settlement. In September 1996, shortly after the class was decertified, the CASTANO plaintiffs withdrew the motion for approval of the CASTANO settlement.

In March 1996, the Company and Liggett entered into a settlement of tobacco-related litigation with the Attorneys General of Florida, Louisiana, Massachusetts, Mississippi and West Virginia (the "March 1996 Settlements"). The March 1996 Settlements release the Company and Liggett from all tobacco-related claims including claims for health care cost reimbursement and claims concerning sales of cigarettes to minors. Certain of the terms of the March 1996 Settlements are summarized below.

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

Settlement funds received by the Attorneys General will be used to reimburse the states for smoking-related health care costs. The Company and Liggett also have agreed to phase in compliance with

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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 March 1996 Settlements with respect to any settling state if any of the remaining defendants in the litigation succeed on the merits in that state's respective Attorney General action. The Company and Liggett may also terminate the March 1996 Settlements if they conclude that too many states have filed Attorney General actions and have not settled such cases with the Company and Liggett.

In March 1997, Liggett, the Company and the five settling states executed an addendum pursuant to which Liggett and the Company agreed to provide to the five settling states, among other things, the additional cooperation and compliance with advertising restrictions that is provided for in the March 1997 Settlements (discussed below). Also, pursuant to the addendum, the initial settling states agreed to use best efforts to ensure that in the event of a global tobacco settlement enacted through federal legislation or otherwise, Liggett's and the Company's financial obligations under such a global settlement would be no more onerous than under this settlement.

At December 31, 1995, the Company had accrued approximately \$4,000 for the present value of the fixed payments under the March 1996 Settlements. At December 31, 1997, in connection with the March 1998 Settlements, the Company accrued \$16,421 for the present value of the fixed payments under the March 1998 Settlements. At March 31, 1998, in connection with the settlement with the Attorney General of Georgia (discussed below), the Company accrued \$481 for the present value of the fixed payments under the Georgia settlement. No additional amounts have been accrued with respect to the recent settlements discussed below. The Company cannot quantify the future costs of the settlements at this time as the amount Liggett must pay is based, in part, on future operating results. Possible future payments based on a percentage of pretax income, and other contingent payments based on the occurrence of a business combination, will be expensed when considered probable.

In March 1997, Liggett and the Company entered into a comprehensive settlement of tobacco litigation through parallel agreements with the Attorneys General of 17 states and with a nationwide class of individuals and entities that allege smoking-related claims. Thereafter, during 1997, settlements were reached with four more states through their respective Attorneys General (settlements with these 21 Attorneys General and with the nationwide class are hereinafter referred to as the "March 1997 Settlements"). On March 12, 1998, Liggett and the Company announced settlements with the Attorneys General of 14 states, the District of Columbia and the U.S. Virgin Islands (the "March 1998 Settlements"). On March 26, 1998, the Company and Liggett settled with the Attorney General of Georgia, which joined the March 1998 Settlements. The foregoing settlements cover all smoking-related claims, including both addiction-based and tobacco injury claims against the Company and Liggett, brought by the Attorneys General and, upon court approval, the nationwide class.

The states and territories where settlements have been reached with Attorneys General are: Alaska, Arizona, Arkansas, California, Colorado, Connecticut, District of Columbia, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, Texas, Utah, U.S. Virgin Islands, Washington, West Virginia, Wisconsin and Wyoming. Other states have either recently filed health care cost recovery actions or indicated intentions to do so. Both Liggett and the Company will endeavor to resolve those actions on substantially the same terms and

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conditions as the March 1998 Settlements, however, there can be no assurance that any such settlements will be completed.

As mentioned above, in March 1997, Liggett, the Company and plaintiffs filed a mandatory class settlement agreement in an action entitled FLETCHER, ET AL. V. BROOKE GROUP LTD., ET AL., Circuit Court of Mobile County, Alabama, where the court granted preliminary approval and preliminary certification of the class, and in May 1997, a similar mandatory class settlement agreement was filed in an action entitled WALKER, ET AL. V. LIGGETT GROUP INC., ET AL., United States District Court, Southern District of West Virginia. The Company anticipates that should the court in FLETCHER, after dissemination of notice to the class of the pending limited fund class action settlement and a full fairness hearing with respect thereto, issue a final order and judgment approving the settlement, such an order would preclude further prosecution by class members of tobacco-related claims against both Liggett and the Company. Under the Full Faith and Credit Act, a final judgment entered in a nationwide class action pending in a state court has a preclusive effect against any class member with respect to the claims settled and released. As the class definition in FLETCHER encompasses all persons in the United States who could claim injury as a result of cigarette smoking or ETS and any third-party payor claimants, it is anticipated that, upon final order and judgment, all such persons and third-party payor claimants would be barred from further prosecution of tobacco-related claims against Liggett and the Company.

In the FLETCHER action, it is anticipated that class members will be notified of the settlement and will have an opportunity to appear at a later court hearing. Effectiveness of the mandatory settlement is conditioned on final court approval of the settlement after a fairness hearing. There can be no assurance as to whether, or when, such court approval will be obtained.

The WALKER court also granted preliminary approval and preliminary certification of the nationwide class, however, in August 1997, the court vacated its preliminary certification of the settlement class, which decision is currently on appeal. The WALKER court relied on the Supreme Court's decision in AMCHEM PRODUCTS INC. V. WINDSOR in reaching its decision to vacate preliminary certification of the class. In AMCHEM, the Supreme Court affirmed a decision of the Third Circuit vacating the certification of a settlement class that involved asbestos-exposure claims. The Supreme Court held that the proposed settlement class did not meet the requirements of Rule 23 of the Federal Rules of Civil Procedure for predominance of common issues and adequacy of representation. The Third Circuit had held that, although classes could be certified for settlement purposes, Rule 23's requirements had to be satisfied as if the case were going to be litigated. The Supreme Court agreed that the fairness and adequacy of the settlement are not pertinent to the predominance inquiry under Rule 23(b)(3), and thus, the proposed class must have sufficient unity so that absent class members can fairly be bound by decisions of class representatives.

After the AMCHEM opinion was issued by the Supreme Court in June 1997, objectors to Liggett's settlement in WALKER moved for decertification. Although Liggett's settlement in the WALKER action is a "limited fund" class action settlement proceeding under Rule 23(b)(1) and AMCHEM was a Rule 23 (b)(3) case, the court in the WALKER action, nonetheless, decertified the WALKER class. Applying AMCHEM to the WALKER case, the District Court, in a decision issued in August 1997, determined that while plaintiffs in WALKER have a common interest in "maximizing the limited fund available from the defendants," there remained "substantial conflicts among class members relating to distribution of the fund and other key concerns" that made class certification inappropriate.

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The AMCHEM decision's ultimate affect on the viability of both the WALKER and FLETCHER settlements remains uncertain given the Fifth Circuit's recent ruling reaffirming a limited fund class action settlement in IN RE ASBESTOS LITIGATION ("AHEARN"). In June 1997, the Supreme Court remanded AHEARN to the Fifth Circuit for consideration in light of AMCHEM. On remand, the Fifth Circuit made two decisive distinctions between AMCHEM and AHEARN. First, the AHEARN class action proceeded under Rule 23(b)(1) while AMCHEM was a Rule 23(b)(3) case, and second, in AHEARN, there was no allocation or difference in award, according to nature or severity of injury, as there was in AMCHEM. The Fifth Circuit concluded that all members of the class and all class representatives share common interests and none of the uncommon questions, abounding in Amchem, exist.

The remaining material terms of the March 1996 Settlements, the March 1997 Settlements and the March 1998 Settlements are described below.

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

Pursuant to the March 1996 Settlements, any other tobacco company defendant, except Philip Morris, merging or combining with Liggett or the Company, prior to the third anniversary of the settlement, would receive certain settlement benefits, including limitations on potential liability. Pursuant to the agreement, any such combining tobacco company would be released from the lawsuits brought by the five initial settling states. Such combining tobacco company would be obligated to pay into the settlement fund within sixty days of becoming bound to the agreement \$135,000, and make annual payments of 2.5% of the combining company's pre-tax income (but not less than \$30,000 per year). Such combining tobacco company would also have to comply with the advertising and access restrictions provided for in the agreement, and would have to withdraw their objections to the FDA rule.

Pursuant to the March 1997 Settlements, any other tobacco company defendant, except Philip Morris, merging or combining with Liggett or the Company, prior to the fourth anniversary of the settlements, would receive certain settlement benefits, including limitations on potential liability for affiliates not engaged in domestic tobacco operations and a waiver of any obligation to post a bond to appeal any future adverse judgment. In addition, within 120 days following any such combination, Liggett would be required to pay the settlement fund \$25,000. Under all settlements, the plaintiffs

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have agreed not to seek an injunction preventing a defendant tobacco company combining with Liggett or the Company from spinning off any affiliate which is not engaged in the domestic tobacco business.

Pursuant to the March 1998 Settlements, Liggett is required to pay each of the settling states and territories their relative share (based on the Medicaid population of each state over the total Medicaid population of the United States) of between 27.5% and 30% of Liggett's pre-tax income each year for 25 years, with a minimum payment guarantee of \$1,000 per state over the first nine years of the agreement. The aggregate liability under the March 1996 Settlements, the March 1997 Settlements and the March 1998 Settlements (including the Georgia settlement) is \$39,556, the present value of which, when discounted at the rate of 18% per annum, is \$19,365 at December 31, 1997. Minimum payments to be made for these settlements over the next five years and thereafter are: 1998: \$4,144; 1999: \$4,518; 2000: \$4,518; 2001: \$4,577; 2002: \$4,630; thereafter: \$18,169. The annual percentage is subject to increase, pro rata from 27.5% up to 30%, depending on the number of additional states joining the settlement. Pursuant to the "most favored nation" provisions under the March 1996 Settlement and the March 1997 Settlements, each of the states settling under those settlements could benefit from the economic terms of the March 1998 Settlements. In the case of the March 1997 Settlements, in the event that the Fletcher class is approved, monies collected in the settlement fund will be overseen by a court-appointed committee and utilized to compensate state health care programs and settlement class members and to provide counter-market advertising. In all settlements, Liggett agreed to phase-in compliance with certain proposed FDA regulations regarding smoking by children and adolescents, including a prohibition on the use of cartoon characters in tobacco advertising and limitations on the use of promotional materials and distribution of sample packages where minors are present. The March 1998 Settlements provide for additional restrictions and regulations on Liggett's advertising, including a prohibition on outdoor advertising and product advertising on the Internet and on payments for product placement in movies and television.

Under all settlements, the Company and Liggett are also entitled to most favored nation treatment in the event any settling Attorney General reaches a settlement with any other defendant tobacco company. Under the March 1996 Settlement and March 1997 Settlements, in the event of a global settlement involving federal legislation with any other defendant tobacco company, the settling Attorneys General agreed to use their "best efforts" to ensure that the Company and Liggett's liability under such legislation should be no more onerous than under these settlements. Under the March 1998 Settlements, the settling Attorneys General agreed to write letters to Congress and the President of the United States to ensure that the Company and Liggett's liability under any such legislation should be no more onerous than under these settlements.

Copies of the various settlement agreements are filed as exhibits to the Company's Form 10-K and the discussion herein is qualified in its entirety by reference thereto.

TRIALS. On May 8, 1998, the other tobacco companies settled the litigation in Minnesota known as the STATE OF MINNESOTA BY HUBERT H. HUMPHREY, III, ITS ATTORNEY GENERAL AND BLUE CROSS AND BLUE SHIELD OF MINNESOTA V. PHILIP MORRIS INCORPORATED, ET AL. Liggett settled the claims of the State of Minnesota on March 20, 1997, but still remains a defendant in the case with respect to Blue Cross and Blue Shield of Minnesota as to one claim seeking equitable relief. There are several other trial dates scheduled during 1998 for individual cases; however, trial dates are subject to change.

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PROPOSED RESOLUTION. In June 1997, Philip Morris Incorporated ("Philip Morris"), R. J. Reynolds Tobacco Company ("RJR"), B&W, Lorillard Tobacco Company ("Lorillard") and the United States Tobacco Company, along with the Attorneys General for the States of Arizona, Connecticut, Florida, Mississippi, New York and Washington and the CASTANO Plaintiffs' Litigation Committee executed a Memorandum of Understanding to support the adoption of federal legislation and necessary ancillary undertakings, incorporating the features described in a proposed resolution (the "Resolution"). The proposed Resolution mandates a total reformation and restructuring of how tobacco products are manufactured, marketed and distributed in the United States.

The proposed Resolution includes provisions relating to advertising and marketing restrictions, product warnings and labeling, access restrictions, licensing of tobacco retailers, the adoption and enforcement of "no sales to minors" laws by states, surcharges against the industry for failure to achieve underage smoking reduction goals, regulation of tobacco products by the FDA, public disclosure of industry documents and research, smoking cessation programs, compliance programs by the industry, public smoking and smoking in the workplace, enforcement of the proposed Resolution, industry payments and litigation.

The proposed Resolution would require the FDA to impose annual surcharges on the industry if targeted reductions in underage smoking incidence are not achieved in accordance with a legislative timetable. The surcharge would be based upon an approximation of the present value of the profit the companies would earn over the lives of all underage consumers in excess of the target, and would be allocated among participating manufacturers based on their market share of the United States cigarette industry.

The proposed Resolution would require participating manufacturers to make substantial payments in the year of implementation and thereafter ("Industry Payments"). Participating manufacturers would be required to make an aggregate \$10 billion initial Industry Payment on the date that federal legislation implementing the terms of the proposed Resolution is signed. This Industry Payment would be based on relative market capitalization. Thereafter, the participating companies would be required to make specified annual Industry Payments determined and allocated among the companies based on volume of domestic sales as long as the companies continue to sell tobacco products in the United States. These Industry Payments, which would begin on December 31 of the first full year after implementing federal legislation is signed, would be in the following amounts (at 1996 volume levels) -- year 1: \$8.5 billion; year 2: \$9.5 billion; year 3: \$11.5 billion; year 4: \$14 billion; and each year thereafter: \$15 billion. These Industry Payments would be increased by the greater of 3% or the previous year's inflation rate, and would be adjusted to reflect changes from 1996 domestic sales volume levels.

The Industry Payments would be separate from any surcharges. The Industry Payments would receive priority and would not be dischargeable in any bankruptcy or reorganization proceeding and would be the obligation only of entities selling tobacco products in the United States (and not their affiliated companies). The proposed Resolution provides that all payments by the industry would be ordinary and necessary business expenses in the year of payment, and no part thereof would be either in settlement of an actual or potential liability for a fine or penalty (civil or criminal) or the cost of a tangible or intangible asset. The proposed Resolution would provide for the pass-through to consumers of the annual Industry Payments in order to promote the maximum reduction in underage use.

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If enacted, the federal legislation provided for in the proposed Resolution would settle present attorney general health care cost recovery actions (or similar actions brought by or on behalf of any governmental entity other than the federal government), PARENS PATRIAE and smoking and health class actions and all "addiction"/dependence claims, and would bar similar actions from being maintained in the future. However, the proposed Resolution provides that no stay applications will be made in pending governmental actions without the mutual consent of the parties. The proposed Resolution would not affect any smoking and health class action or any health care cost recovery action that is reduced to final judgment before implementing federal legislation is effective.

Under the proposed Resolution, the rights of individuals to sue the tobacco industry would be preserved, except as expressly changed by implementing federal legislation. Claims, however, could not be maintained on a class or other aggregated basis, and could be maintained only against tobacco manufacturing companies (and not their retailers, distributors or affiliated companies). In addition, all punitive damage claims based on past conduct would be resolved as part of the proposed Resolution, and future claimants could seek punitive damages only with respect to claims predicated upon conduct taking place after the effective date of implementing federal legislation. Finally, except with respect to actions pending as of June 9, 1997, third-party payor (and similar) claims could be maintained only if based on subrogation of individual claims. Under subrogation principles, a payor of medical costs can seek recovery from a third party only by "standing in the shoes" of the injured party and being subject to all defenses available against the injured party.

The proposed Resolution contemplates that participating tobacco manufacturers would enter into a joint sharing agreement for civil liabilities relating to past conduct. Judgments and settlements arising from tort actions would be paid as follows: The proposed Resolution would set an annual aggregate cap of up to 33% of the annual base Industry Payment (including any reductions for volume declines). Any judgments or settlements exceeding the cap in a particular year would roll over into the next year. While judgments and settlements would run against the defendant, they would give rise to an 80-cents-on-the-dollar credit against the annual Industry Payment. Finally, any individual judgments in excess of \$1 million would be paid at the rate of \$1 million per year unless every other judgment and settlement could first be satisfied within the annual aggregate cap. In all circumstances, however, the companies would remain fully responsible for costs of defense and certain costs associated with the fees of attorneys representing certain plaintiffs in the litigation settled by the proposed Resolution.

Under the proposed Resolution, the Company and Liggett would be deemed to be a "non-participating manufacturer". The proposed Resolution provides, among other things, that a non-participating manufacturer would be required to place into escrow, each year, an amount equal to 150% of its share of the payment required of participating manufacturers (other than the portion allocated to public health programs and federal and state enforcement). These funds would be earmarked for potential liability payments and could be reclaimed, with interest, after 35 years, to the extent they had not been paid out in liability.

The proposals are currently being reviewed by the White House, Congress and various public interest groups. Separately, the other tobacco companies negotiated settlements of the Attorneys General health care cost recovery actions in Mississippi, Florida, Texas and Minnesota. Management is unable to predict the ultimate effect, if any, of the enactment of legislation adopting the proposed resolution. Management is also unable to predict the ultimate content of any such

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legislation; however, adoption of any such legislation could have a material adverse effect on the business of the Company and Liggett.

OTHER RELATED MATTERS. In March 1997, RJR, Philip Morris, B&W and Lorillard obtained a temporary restraining order from a North Carolina state court preventing the Company and Liggett and their agents, employees, directors, officers and lawyers from turning over documents allegedly subject to the joint defense privilege in connection with the settlements, which restraining order was converted to a preliminary injunction by the court in April 1997. In March 1997, the United States District Court for the Eastern District of Texas and state courts in Mississippi and Illinois each issued orders enjoining the other tobacco companies from interfering with Liggett's filing with the courts, under seal, those documents.

The Company understands that a grand jury investigation is being conducted by the office of the United States Attorney for the Eastern District of New York (the "Eastern District Investigation") regarding possible violations of criminal law relating to the activities of The Council for Tobacco Research - USA, Inc. (the "CTR"). Liggett was a sponsor of the CTR at one time. In May 1996, Liggett received a subpoena from a Federal grand jury sitting in the Eastern District of New York, to which Liggett has responded.

In March 1996, and in each of March, July, October and December 1997, the Company and/or Liggett received subpoenas from a Federal grand jury in connection with an investigation by the United States Department of Justice (the "DOJ Investigation") involving the industry's knowledge of: the health consequences of smoking cigarettes; the targeting of children by the industry; and the addictive nature of nicotine and the manipulation of nicotine by the industry. Liggett has responded to the March 1996, March 1997 and July 1997 subpoenas and is in the process of responding to the October and December 1997 subpoenas. The Company understands that the Eastern District Investigation and the DOJ Investigation have, for all intents and purposes, been consolidated into one investigation being conducted by the Department of Justice (the "DOJ"). The Company and Liggett are unable, at this time, to predict the outcome of this investigation.

On April 28, 1998, the Company announced that Liggett had reached an agreement with the DOJ to cooperate in both the Eastern District Investigation and the DOJ Investigation. The agreement does not constitute an admission of any wrongful behavior by Liggett. The DOJ has not provided immunity to Liggett and has full discretion to act or refrain from acting with respect to Liggett in the investigation.

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

The Company is unable to make a meaningful estimate with respect to the amount of loss that could result from an unfavorable outcome of the cases pending against the Company, because the complaints filed in these cases rarely detail alleged damages. Typically, the claims set forth in an individual's complaint against the tobacco industry pray for money damages in an amount to be determined by a jury, plus punitive damages and costs. These damage claims are usually stated as being for at least the minimum necessary to invoke the jurisdiction of the court.

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Third-party payor claimants and others have set forth several additional variations on relief sought: funding of corrective public education campaigns relating to issues of smoking and health; funding for clinical smoking cessation programs; disgorgement of profits from sales of cigarettes; restitution; treble damages; and attorneys' fees. Nevertheless, no specific amounts are provided. It is, however, understood that requested damages against the tobacco company defendants in these cases may be in the billions of dollars.

It is possible that the Company's consolidated financial position, results of operation and cash flow could be materially adversely affected by an unfavorable outcome in any of such pending tobacco-related litigation.

Liggett has been involved in certain environmental proceedings, none of which, either individually or in the aggregate, rise to the level of materiality. Liggett's management believes that current operations are conducted in material compliance 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, has not had a material effect on the capital expenditures, earnings or competitive position of Liggett.

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

LEGISLATION AND REGULATION:

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

In August 1996, the Commonwealth of Massachusetts enacted legislation requiring tobacco companies to publish information regarding the ingredients in cigarettes and other tobacco products sold in that state. In December 1997, the United States District Court for the District of Massachusetts enjoined this legislation from going into effect, however, in December 1997, Liggett began complying with this legislation by providing ingredient information to the Massachusetts Department of Public Health.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) - (CONTINUED)

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

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

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

As part of the budget agreement recently approved by Congress, federal excise taxes on a pack of cigarettes, which are currently 24 cents, would rise 10 cents in the year 2000 and 5 cents more in the year 2002. In a speech in September 1997, President Clinton called for federal legislation that, among other things, would raise cigarette prices by up to \$1.50 per pack. Since then, several bills have been introduced in the Senate that purport to propose legislation along these lines. Management is unable to predict the ultimate content of any such legislation; however, adoption of any such legislation could have a material adverse effect on the business of the Company and Liggett.

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

OTHER MATTERS:

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

BROOKE GROUP LTD.

BGLS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) - (CONTINUED)

On or about March 13, 1997, a shareholder derivative suit was filed against New Valley, as a nominal defendant, its directors and the Company in the Delaware Chancery Court, by a shareholder of New Valley. The suit alleges that New Valley's purchase of the BML Shares constituted a self-dealing transaction which involved the payment of excessive consideration by New Valley. The plaintiff seeks (i) a declaration that New Valley's directors breached their fiduciary duties, the Company aided and abetted such breaches and such parties are therefore liable to New Valley, and (ii) unspecified damages to be awarded to New Valley. The Company's time to respond to the complaint has not yet expired. The Company believes that the allegations are without merit. Although there can be no assurances, management is of the opinion, after consultation with counsel, that the ultimate resolution of this matter will not have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

9. RELATED PARTY TRANSACTIONS

On January 31, 1997, New Valley entered into a stock purchase agreement with BOL pursuant to which New Valley acquired 10,483 shares of BML common stock (99.1%) for a purchase price of \$55,000, consisting of \$21,500 in cash and a \$33,500 promissory note with an interest rate of 9%. The note was paid in full in 1997. (Refer to Notes 3 and 8.)

In January 1998, the Company entered into an amendment to the Amended and Restated Consulting Agreement dated as of January 1, 1996 with a consultant who also serves as a director and President of New Valley. The amendment provides that the consultant is entitled on an annual basis to receive additional payments in an amount necessary to reimburse him, on an after-tax basis, for all applicable taxes incurred by him during the prior calendar year as a result of the grant to him, or vesting, of a 1994 award of 500,000 restricted shares of the Company's Common Stock and 1995 and 1996 awards of 500,000 and 1,000,000, respectively, options to acquire shares of the Company's Common Stock. The consultant received an additional consulting payment of \$425,000 in January 1998, which the consultant and the Company have agreed will constitute full satisfaction of the Company's obligations under the amendment with respect to 1997.

Effective May 1, 1998, a former officer of the Company entered into a severance agreement in which the Company will pay him a total of \$2,208 in stock or cash in quarterly installments over a period of 6 years. The Company will recognize the expense during the second quarter 1998.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

INTRODUCTION

The following discussion provides an assessment of the 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 include the accounts of BGLS, Liggett Group Inc. ("Liggett"), Brooke (Overseas) Ltd. ("BOL"), New Valley Holdings, Inc. ("NV Holdings"), Liggett-Ducat Ltd. ("Liggett-Ducat") and other less significant subsidiaries. The Company holds an equity interest in New Valley Corporation ("New Valley") through NV Holdings.

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

The Company is a holding company for a number of businesses which it holds through its wholly-owned subsidiary BGLS. Accordingly, a separate Management's Discussion and Analysis of Financial Condition and Results of Operations for BGLS is not presented herein as it would not differ materially from the discussion of the Company's consolidated results of operations, capital resources and liquidity.

For purposes of this discussion and other consolidated financial reporting, the Company's significant business segment is tobacco for the three months ended March 31, 1998 and March 31, 1997.

RECENT DEVELOPMENTS

THE COMPANY

STANDSTILL AGREEMENT. On March 5, 1998, BGLS entered into an agreement (the "Standstill Agreement") with AIF II, L.P. and an affiliated investment manager on behalf of a managed account (the "Apollo Holders"), who together hold approximately 41.8% of the \$232,864 principal amount of BGLS' 15.75% Senior Secured Notes due 2001 (the "BGLS Notes").

Pursuant to the terms of the Standstill Agreement, the Apollo Holders agreed to defer the payment of interest on the BGLS Notes held by them, commencing with the interest payment that was due July 31, 1997, which they had previously agreed to defer, through the interest payment due on July 31, 2000. The deferred interest payments will be payable at final maturity of the BGLS Notes on January 31, 2001 or upon an Event of Default under the Indenture for the BGLS Notes. In connection with the Standstill Agreement, the Company issued to the Apollo Holders a five-year warrant to purchase 2,000,000 shares of the Company's common stock at a price of \$5.00 per share. The Apollo Holders were also issued a second warrant expiring October 31, 2004 to purchase an additional 2,150,000 shares of the Company's common stock at a price of \$0.10 per share. The second warrant will become exercisable on October 31, 1999 and the Company will

have the right under certain conditions prior to that date to substitute for that warrant a new warrant for 9.9% of the common stock of Liggett.

On February 6, 1998, the holder of 41.9% of the BGLS Notes, who had previously been a party to the Standstill Agreement, was paid its pro-rata share of the July 31, 1997 interest payment on the BGLS Notes. On March 2, 1998, BGLS made the interest payment due on January 31, 1998 to all holders of the BGLS Notes other than the Apollo Holders.

SALE OF STOCK. On January 16, 1998, the Company entered into a Stock Purchase Agreement with High River Limited Partnership ("High River") in which High River purchased 1,500,000 shares of the Company's common stock for \$9,000.

LIGGETT

NOTES RESTRUCTURING. On January 30, 1998, with the consent of the required majority of the holders of the Liggett 11.50% Series B and 19.75% Series C Senior Secured Notes due 1999 (the "Liggett Notes"), Liggett entered into various amendments to the Indenture governing the Liggett Notes which provided, among other things, for a deferral of the February 1, 1998 mandatory redemption payment of \$37,500 to the date of final maturity of the Liggett Notes on February 1, 1999. In connection with the deferral, the Company agreed to issue 483,002 shares of the Company's common stock to the holders of record on January 15, 1998 of the Liggett Notes. The Indenture under which the Liggett Notes are outstanding was also amended to prohibit, with limited exceptions, payments of dividends and incurrence of new debt by Liggett and to tighten restrictions on the disposition of proceeds of asset sales. The Company and BGLS also agreed to guarantee the payment by Liggett of the August 1, 1998 interest payment on the Liggett Notes.

NEW VALLEY

WESTERN REALTY. In February 1998, New Valley and Apollo Real Estate Investment Fund III, L.P. ("Apollo") organized Western Realty to make real estate and other investments in Russia. In connection with the formation of Western Realty, New Valley agreed, among other things, to contribute the real estate assets of BrookeMil Ltd. ("BML") to Western Realty and Apollo agreed to contribute up to \$58,000. Western Realty will seek to make additional real estate and other investments in Russia. New Valley and Apollo have agreed to invest, through Western Realty or another entity, up to \$25,000 in the aggregate for the potential development of a real estate project in Moscow. In addition, Western Realty made a \$20,000 participating loan to, and payable out of a 30% profits interest in, a company organized by BOL which will, among other things, acquire an interest in an industrial site and manufacturing facility being constructed on the outskirts of Moscow by a subsidiary of BOL.

NEW ACCOUNTING PRONOUNCEMENTS

In June 1997, the Financial Accounting Standards Board ("FASB") issued Statement on Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income". SFAS No. 130 establishes standards for reporting and display of comprehensive income. The purpose of reporting comprehensive income is to present a measure of all changes in equity that result from recognized transactions and other economic events of the period other than transactions with owners in their capacity as owners. SFAS No. 130 requires that an enterprise classify items of other comprehensive income by their nature in a financial statement and display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of the balance sheet. For the Company, other components of stockholders' equity include such items as minimum pension liability adjustments, unearned compensation expense related to stock options and the Company's proportionate interest in New Valley's capital transactions. SFAS No. 130 is effective for fiscal years beginning after December 15, 1997, with earlier application

permitted. The implementation of SFAS No. 130 for the quarter ended March 31, 1998 did not have a material impact on the consolidated financial statements.

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

In February 1998, SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits," was issued which revises required disclosures about pensions and postretirement benefit plans in order to facilitate financial analysis. Recognition or measurement issues are not addressed in the statement. SFAS No. 132 is effective for the Company for the year ended 1998. Management believes that the implementation of this pronouncement will not have a material effect on the Company's financial statement disclosures.

RECENT DEVELOPMENTS IN THE CIGARETTE INDUSTRY

PRICING ACTIVITY. On March 7, 1997, R. J. Reynolds Tobacco Company ("RJR") initiated a list price increase on all brands of \$.40 per carton (approximately 4%). Brown & Williamson Tobacco Corporation ("B&W"), Lorillard Tobacco Company ("Lorillard") and Liggett matched this increase, and, on March 21, 1997, Philip Morris Incorporated ("Philip Morris") announced a price increase of \$.50 per carton. Subsequently, Liggett and the other manufacturers matched Philip Morris' price increase. On August 29, 1997, Philip Morris announced a second price increase of \$.70 per carton. During the first week of September, all other major United States cigarette makers, including Liggett, matched this increase.

On January 23, 1998, Philip Morris and RJR announced a list price increase of \$.25 per carton (approximately 2 1/2%). This action was matched by Liggett and the other manufacturers during the following week. On April 3, 1998, Philip Morris announced a second list price increase of \$.50 per carton (approximately 4.5%). This action was matched by Liggett and the other manufacturers. Again, on May 11, 1998, Philip Morris and RJR announced another list price increase of \$.50 per carton on all brands. This action was matched by Liggett and the other manufacturers during the following week.

LEGISLATION, REGULATION AND LITIGATION. The cigarette industry continues to be challenged on numerous fronts. New cases continue to be commenced against Liggett and the Company and other cigarette manufacturers. As of March 31, 1998, there were approximately 250 individual suits, 30 purported class actions and 95 state, municipality and other third-party payor health care reimbursement actions pending in the United States in which Liggett is a named defendant. As new cases are commenced, the costs associated with defending such cases and the risks attendant to the inherent unpredictability of litigation continue to increase. Recently, there have been a number of restrictive regulatory actions from various Federal administrative bodies, including the United States Environmental Protection Agency ("EPA") and the Food and Drug Administration ("FDA"), adverse political decisions and other unfavorable developments concerning cigarette smoking and the tobacco industry, including the commencement and certification of class actions and the commencement of Medicaid reimbursement suits by various states' Attorneys General. These

developments generally receive widespread media attention. The Company is not able to evaluate the effect of these developing matters on pending litigation or the possible commencement of additional litigation, but it is possible that Company's financial position, results of operations and cash flows could be materially adversely affected by an ultimate unfavorable outcome in any of such pending litigation. (See Note 8 to the Company's Consolidated Financial Statements for a description of legislation, regulation and litigation.)

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

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

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

Under the CASTANO settlement agreement, upon final court approval of the settlement, the CASTANO class would be entitled to receive up to 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, and a \$5,000 payment from Liggett if the Company or Liggett fails to consummate a merger or similar transaction with another non-settling tobacco company defendant within three years of the date of the settlement. The Company and Liggett have the right to terminate the CASTANO settlement under certain circumstances. On May 11, 1996, the CASTANO Plaintiffs Legal Committee filed a motion with the United States District Court for the Eastern District of Louisiana seeking preliminary approval of the CASTANO settlement. On May 23, 1996, the Court of Appeals for the Fifth Circuit reversed the February 17, 1995 order of the District Court certifying the CASTANO suit as a nationwide class action and instructed the District Court to dismiss the class complaint. (For additional information concerning the Fifth Circuit's decision, see Note 8 to the Company's Consolidated Financial Statements.) In September 1996, the CASTANO plaintiffs withdrew the motion for approval of the CASTANO settlement.

In March 1996, the Company, the CASTANO Plaintiffs Legal Committee and the CASTANO plaintiffs entered into a letter agreement. According to the terms of the letter agreement, for the period ending nine months from the date of Final Approval (if granted) of the CASTANO settlement or, if earlier, the completion by the Company or Liggett of a combination with any defendant in CASTANO, except Philip Morris, the CASTANO plaintiffs and their counsel agree not to enter into any more favorable settlement agreement with any CASTANO defendant which would reduce the terms of the CASTANO settlement agreement. If the CASTANO plaintiffs or their counsel enter into any such settlement during this period, they shall pay the Company \$250,000 within 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.

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

In March 1997, Liggett and the Company entered into a comprehensive settlement of tobacco litigation through parallel agreements with the Attorneys General of 17 states and with a nationwide class of individuals and entities that allege smoking-related claims. Thereafter, during 1997, settlements were reached with four more states through their respective Attorneys General (collectively, the "March 1997 Settlements"). The settlements cover all smoking-related claims, including both addiction-based and tobacco injury claims against the Company and Liggett brought by the states and, upon court approval, the nationwide class. On March 12, 1998, the Company and Liggett entered into additional settlements with the Attorneys General of 14 states, the District of Columbia and the U. S. Virgin Islands (the "March 1998 Settlements"). On March 26, 1998, the Company and Liggett settled with the Attorney General of Georgia which joined the March 1998 Settlements.

As mentioned above, in March 1997, Liggett, the Company and plaintiffs filed the mandatory class settlement agreement in an action entitled FLETCHER, ET AL. V. BROOKE GROUP LTD., ET AL., Circuit Court of Mobile County, Alabama, where the court granted preliminary approval and preliminary certification of the class, and on May 15, 1997, a similar mandatory class settlement agreement was filed in an action entitled WALKER, ET AL. V. LIGGETT GROUP INC., ET AL., United States District Court, Southern District of West Virginia. The WALKER court also granted preliminary approval and preliminary certification of the nationwide class; however, on August 5, 1997, the court vacated its preliminary certification of the settlement class, which decision is currently on appeal.

In the FLETCHER action, it is anticipated that class members will be notified of the settlement and will have an opportunity to appear at a later court hearing. Effectiveness of the

mandatory settlement is conditioned on final court approval of the settlement after a fairness hearing. There can be no assurance as to whether or when court approval will be obtained. (For additional information concerning the FLETCHER action, see Note 16 to the Company's Consolidated Financial Statements.)

Under the March 1998 Settlements, Liggett is required to pay each of the 14 settling states and territories their relative share (based on the Medicaid population of each state over the total Medicaid population of the United States) of between 27.5% and 30% of Liggett's pre-tax income each year for 25 years, with a minimum payment guarantee of \$1,000 per state over the first nine years of the agreement. The annual percentage is subject to increase, pro rata from 27.5% up to 30%, depending on the number of additional states joining the settlement. Pursuant to the "most favored nation" provisions under the March 1996 Settlements and the March 1997 Settlements, each of the states settling under those settlements could benefit from the economic terms of the March 1998 Settlements.

At December 31, 1995, the Company had accrued approximately \$4,000 for the present value of the fixed payments under the initial Attorneys General settlement. At December 31, 1997, in connection with the March 1998 Settlements, the Company accrued \$16,421 for the present value of the fixed payments under the March 1998 Settlements. At March 31, 1998, in connection with the settlement with the Attorney General of Georgia, the Company accrued \$481 for the present value of the fixed payments under the Georgia settlement. No additional amounts have been accrued with respect to the settlements discussed above. The Company cannot quantify the future costs of the settlements at this time as the amount Liggett must pay is based, in part, on future operating results. Possible future payments based on a percentage of pretax income, and other contingent payments based on the occurrence of a business combination, will be expensed when considered probable. (See the discussions of the tobacco litigation settlements appearing in Note 8 to the Company's Consolidated Financial Statements.)

OTHER MATTERS. On June 20, 1997, Philip Morris, RJR, B&W, Lorillard and the United States Tobacco Company, along with the Attorneys General for the States of Arizona, Connecticut, Florida Mississippi, New York and Washington and the CASTANO Plaintiffs' Litigation Committee executed a Memorandum of Understanding to support the adoption of federal legislation and necessary ancillary undertakings, incorporating the features described in a proposed resolution. The proposed resolution mandates a total reformation and restructuring of how tobacco products are manufactured, marketed and distributed in the United States. (For additional information concerning the proposed resolution, see Note 8 of the Company's Consolidated Financial Statements.) The proposals are currently being reviewed by the White House, Congress and various public interest groups. Separately, the other tobacco companies negotiated settlements of the Attorneys General health care cost recovery actions in Mississippi, Florida and Texas. Management is unable to predict the ultimate effect, if any, of the enactment of legislation adopting the proposed resolution. Management is also unable to predict the ultimate content of any such legislation. However, adoption of any such legislation could have a material adverse effect on the business of the Company and Liggett.

In a speech in September 1997, President Clinton called for federal legislation that, among other things, would raise cigarette prices by up to \$1.50 per pack. Since then, several bills have been introduced in the Senate that purport to propose legislation along these lines. Management is unable to predict the ultimate content of any such legislation; however, adoption of any such legislation could have a material adverse effect on the business of the Company and Liggett.

RESULTS OF OPERATIONS

	REVENUES		OPERATING INCOME	
	-----		-----	
	THREE MONTHS ENDED MARCH 31,		THREE MONTHS ENDED MARCH 31,	
	1998	1997	1998	1997
	-----	-----	-----	-----
Liggett	\$65,626	\$66,301	\$6,251	\$ 371
Liggett-Ducat	19,154	13,481	1,710	1,462
Other	23	223	(418)	(995)
	-----	-----	-----	-----
Total	\$84,803	\$80,005	\$7,543	\$ 838
	=====	=====	=====	=====

THREE MONTHS ENDED MARCH 31, 1998 COMPARED TO THREE MONTHS ENDED MARCH 31, 1997.

REVENUES. Total revenues were \$84,803 for the three months ended March 31, 1998 compared to \$80,005 for the three months ended March 31, 1997. This 6.0% increase in revenues was primarily due to a \$5,695 or 42.2% increase in revenues at BOL slightly offset by a decrease of \$675 or 1.0% in revenues at Liggett reflecting a 12.5% decrease in Liggett's unit sales volume (178.9 million units) accounting for \$8,300 in volume variance partially offset by price increases of \$7,285 (see "Recent Developments in the Cigarette Industry - Pricing Activity") and improved product mix of \$340. 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.

Premium sales over this period amounted to \$22,483 and represented 34.3% of total revenues, compared to \$22,604 and 34.1% of total sales for the same period in 1997. In the premium segment, revenues declined by 0.5% (\$121) over the three months ended March 31, 1998, compared to the same period in 1997, as a result of a 8.0% decline in unit sales volume (31.5 million units) accounting for \$1,816 in volume variance, which was partially offset by price increases of \$1,695.

Discount sales (comprising the brand categories of branded discount, private label, control label and generic) over this period amounted to \$43,143 and represented 65.7% of total revenues, compared to \$43,698 and 65.9% of total sales for the same period in 1997. In the discount segment, revenues declined by 1.3% (\$555) over the three months ended March 31, 1998, compared to the same period in 1997, as a result of a 14.2% decline in unit sales volume (147.4 million units) accounting for \$6,211 in volume variance, partially offset by price increases of \$5,590 and improved product mix among the brand categories of \$66. For the three months ended March 31, 1998, fixed manufacturing costs on a basis comparable to the same period in 1997 were \$251 lower, although costs per thousand units increased \$0.13 per thousand due to lower production volumes.

Net sales at Liggett-Ducat for the three months ended March 31, 1998 increased 42.8% (\$5,695) to \$19,177 over the same period in 1997 due primarily to an increase of 27.0% (\$3,630) in unit sales volume (292 million units), price increases (\$1,231) and the effect of excise tax increases (\$834) included in revenues and cost of goods sold.

GROSS PROFIT. Consolidated gross profit was \$43,147 for the three months ended March 31, 1998 compared to \$38,160 for the three months ended March 31, 1997, an increase of \$4,987 when compared to the same period last year, reflecting an increase in gross profit at Liggett of \$3,363 and an increase at Liggett-Ducat of \$1,418 for the three months ended March 31, 1998 compared to the same period in the prior year.

Gross profit at Liggett of \$39,405 for the three months ended March 31, 1998 increased due primarily to the price increases discussed above. (See "Recent Developments in the Cigarette Industry - Pricing Activity".) In 1998, Liggett's premium and discount brands contributed 36.1% and 63.9%, respectively, to the Company's overall gross profit. Over the same period in 1997, Liggett's premium and discount brands contributed 38.5% and 61.5%, respectively, to total gross profit. As a percent of revenues (excluding federal excise taxes), gross profit at Liggett increased to 77.5% for the three months ended March 31, 1998 compared to 72.9% for the same period in 1997, with gross profit for the premium segment at 79.2% and 76.6%, respectively, in the first quarter of 1998 and 1997, respectively, and gross profit for the discount segment at 76.6% and 69.5% in 1998 and 1997, respectively. This increase is the result of the March 1997, September 1997 and January 1998 list price increases and improved production variances. These increases were partially offset by increased tobacco costs at Liggett due to a reduction in the average discount available to the Company from leaf tobacco dealers on tobacco purchased under prior years' purchase commitments.

As a percent of revenues (excluding Russian excise taxes), gross profit at Liggett-Ducat increased to 22.0% for the three months ended March 31, 1998 compared to 19.0% in the same period in 1997.

EXPENSES. Selling, general and administrative expenses were \$35,604 for the three months ended March 31, 1998 compared to \$37,322 for the same period last year due to a decrease in expenses at Liggett of \$2,110, offset by an increase of \$480 at Liggett-Ducat. In the three months ended March 31, 1997, higher expenses included \$1,761 of restructuring charges at Liggett. Operating, selling, general and administrative expenses at Liggett were \$33,154 for the three months ended March 31, 1998 compared to \$33,910 for the same period for the prior year, a decrease of \$756. This reduction in operating expenses was due primarily to Liggett's decrease in unit sales volume which lowered distribution expense by \$552 and costs incurred in systems development which were \$2,025 lower than in the prior period. In addition, no severance costs were incurred during the quarter ended March 31, 1998 whereas costs in the prior period were \$1,172. Such reductions were partially offset by increases in spending on promotional and marketing programs of \$573 and higher legal expenses of \$642.

OTHER INCOME (EXPENSE). Interest expense was \$20,786 for the three months ended March 31, 1998 compared to \$15,467 for the same period last year, an increase of \$5,319 primarily due to the debt restructuring at BGLS and Liggett in which the Company took additional charges of approximately \$4,800 for the three months ended March 31, 1998. (See Note 6 to the Company's Consolidated Financial Statements.) In addition, Liggett-Ducat and BOL had total interest expense of \$527 for the three months ended March 31, 1998, compared with \$254 for the same period in 1997.

Equity in earnings of affiliate was a loss of \$4,187 for the three months ended March 31, 1998 compared to a loss of \$8,194 for the three months ended March 31, 1997 and relates in both periods to New Valley's net loss applicable to common shares of \$18,675 and \$26,321, respectively.

For the three months ended March 31, 1997, interest expense and loss in equity of affiliate were offset by the gain on sale of assets, which includes the sale of the BML shares and surplus realty at Liggett, and proceeds from a legal settlement.

CAPITAL RESOURCES AND LIQUIDITY

Net cash and cash equivalents decreased \$172 for the three months ended March 31, 1998 and increased \$246 for the three months ended March 31, 1997. Net cash used in operations for the three months ended March 31, 1998 was \$25,984 compared to net cash used in operations of \$26,219 for the comparable period of 1997. In the 1998 period, cash was used in operations for a reduction of accrued interest of \$30,000 (\$16,000 of which has been reclassified to long-term debt), reductions in promotional expenses, taxes payable and other accrued liabilities, in total amount of \$6,366, and an increase in inventories of \$8,385. These items were partially offset by an increase in accounts payable of \$4,842. In the 1997 period, cash used in operations was primarily due to an increase in receivables of \$33,500 resulting from the sale of the BML shares to New Valley, a decrease in accounts payable of \$8,300 and a decrease in accrued liabilities of approximately \$24,000. In 1997, these items were offset by a decrease in trade receivables at Liggett due to declining sales volume, equity in loss of affiliate of approximately \$8,500 and the impact of the deferred gain on the sale of the BML shares of approximately \$23,000.

Cash provided by investing activities of \$822 compares to cash provided of \$20,599 for the periods ended March 31, 1998 and 1997, respectively. In 1998, proceeds from sales of equipment and an investment were partially offset by capital expenditures of \$395 at Liggett and BOL. In 1997, proceeds include cash of \$21,500 received in the sale of the BML shares to New Valley and cash of \$2,049 received in the sale of certain of Liggett's surplus realty offset by capital expenditures of \$1,307 at Liggett and BOL.

Cash provided by financing activities was \$24,911 and \$6,266 for the three months ended March 31, 1998 and 1997, respectively. Proceeds in the 1998 period include cash received from the sale of common stock and exercise of stock options, in total \$9,796, proceeds from the participating loan made by Western Realty, and net repayments under Liggett's revolving credit facility (the "Facility") of \$5,162 partially offset by distributions on common stock of \$900. Proceeds from financing activities in 1997 include proceeds at BOL from credit lines and net borrowings under the Facility of \$12,067 at March 31, 1997. These proceeds were offset by repayments on debt including principally the required repurchase of \$7,500 face amount of Liggett bonds on February 1, 1997 at a net gain of \$2,963. Distributions on common stock in the 1997 period include distributions declared in the fourth quarter 1996 which were paid in January 1997 and distributions declared and paid in March for the first quarter of 1997.

LIGGETT. Liggett had a net capital deficiency of \$190,383 at March 31, 1998, is highly leveraged and has substantial near-term debt service requirements. In addition, the Liggett Notes mature on February 1, 1999 and the Facility expires on March 8, 1999. Due to the many risks and uncertainties associated with the cigarette industry, the impact of recent tobacco litigation settlements (see "Recent Developments in the Cigarette Industry - Legislation and Litigation") and increased tobacco costs, there can be no assurance that Liggett will be able to meet its future earnings goals. Consequently, Liggett could be in violation its debt covenants, including covenants limiting the maximum permitted adjusted net worth and net working capital deficiencies, and if its lenders were to exercise acceleration rights under the Facility or the Liggett Notes' Indenture or refuse to lend under the Facility, Liggett would not be able to satisfy such demands or its working capital requirements. (See below for additional information concerning these covenants.)

The Liggett Series B Notes (\$150,000) and Liggett C Notes (\$32,279) issued in 1992 and in 1994, respectively, pay interest semiannually at an annual rate of 11.5% and 19.75%, respectively. The Liggett Notes required mandatory principal redemptions of \$7,500 on February 1 in each of the years 1993 through 1997 and \$37,500 on February 1, 1998 with the balance of the Liggett Notes due on February 1, 1999 (see below). The Liggett Notes are collateralized by substantially all of the assets of Liggett, excluding accounts receivable and inventory. Eve is guarantor for the Liggett Notes. The Liggett Notes may be redeemed, in whole or in part, at a price equal to 100% of the principal amount, at the option of Liggett. The Liggett Notes contain restrictions on Liggett's ability

to declare or pay cash dividends, incur additional debt, grant liens and enter into any new agreements with affiliates, among others.

On January 30, 1998, Liggett obtained the consents of the required majority of the holders of the Liggett Notes to various amendments to the Indenture governing the Liggett Notes. The amendments provide, among other things, for a deferral of the February 1, 1998 mandatory redemption of \$37,500 principal amount of the Liggett Notes to the date of final maturity, February 1, 1999. In addition, the amendments prohibit, with limited exceptions, payments of dividends and incurrence of new debt by Liggett and tighten restrictions on the disposition of proceeds of asset sales. The Company and BGLS also agreed to guarantee the payment by Liggett of the August 1, 1998 interest payment on the Liggett Notes. (Refer to Note 6 to the Company's Consolidated Financial Statements.) At maturity, the Liggett Notes will require a principal payment of \$144,891. Based on Liggett's results of operations for 1997 and the three months ended March 31, 1998, Liggett does not anticipate it will be able to generate sufficient cash from operations to make such payments.

As discussed above, Liggett also has a \$40,000 Facility expiring March 8, 1999 under which \$28,628 was outstanding at March 31, 1998. On August 29, 1997, the Facility was amended to permit Liggett to borrow an additional \$6,000 which was used on that date in making the interest payment of \$9,700 due on August 1, 1997 to the holders of the Liggett Notes. BGLS guaranteed the additional \$6,000 advance under the Facility and collateralized the guarantee with \$6,000 in cash, deposited with Liggett's lender. At March 31, 1998, this amount is classified in other assets on the balance sheet. Availability under the Facility was approximately \$1,483 based on eligible collateral at March 31, 1998. The Facility is collateralized by all inventories and receivables of Liggett. Borrowings under the Facility, whose interest is calculated at a rate equal to 1.5% above Philadelphia National Bank's (the indirect parent of Congress Financial Corporation, the lead lender) prime rate, bear a rate of 10.0% at March 31, 1998. The Facility contains certain financial covenants similar to those contained in the Liggett Notes' Indenture including restrictions on Liggett's ability to declare or pay cash dividends, incur additional debt, grant liens and enter into any new agreements with affiliates, among others. In addition, the Facility, as amended on April 8, 1998, imposes requirements with respect to Liggett's adjusted net worth (not to fall below a deficit of \$195,000 as computed in accordance with the agreement, this computation was \$186,416 at March 31, 1998) and working capital (not to fall below a deficit of \$17,000 as computed in accordance with the agreement, this computation was \$4,984 at March 31, 1998). At March 31, 1998, Liggett was in compliance with all covenants under the Facility. The Facility, as amended, also provides that a default by Liggett under the March 1996 Settlements, March 1997 Settlements and March 1998 Settlements shall constitute an event of default under the Facility.

Liggett (and, in certain cases, the Company) and other United States cigarette manufacturers have been named as defendants in a number of direct and third-party actions (and purported class actions) predicated on the theory that they should be liable for damages from cancer and other adverse health effects alleged to have been caused by cigarette smoking or by exposure to so-called secondary smoke (environmental tobacco smoke) from cigarettes.

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

or the possible commencement of additional litigation. (See "Recent Development in the Cigarette Industry - Legislation, Regulation and Litigation" and "--Settlements" above and Note 8 to the Company's Consolidated Financial Statements.)

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

BGLS. On March 5, 1998, BGLS entered into the Standstill Agreement whereby the Apollo Holders agreed to the deferral of interest payments, commencing with the interest payment due July 31, 1997 through the interest payment due July 31, 2000. (See "Recent Developments - The Company - Standstill Agreement".) At March 31, 1998, the carrying value of BGLS' long-term debt (net of unamortized discount of \$22,940) was approximately \$226,724, based on modification of the terms of the debt with the Apollo Holders.

The 14.500% Subordinated Debentures due 1998 in principal amount of \$800 were paid at maturity on April 1, 1998.

Liggett-Ducat is building a new cigarette factory on the outskirts of Moscow. The new factory, which will utilize Western cigarette making technology and have a capacity of 30 billion units per year, will produce American and international blend cigarettes, as well as traditional Russian cigarettes. Western Realty has made a \$20,000 participating loan to, and payable out of a 30% profits interest, in a company organized by BOL which holds BOL's interests in Liggett-Ducat and the new manufacturing facility. (See "Recent Developments - New Valley" and Note 3 to the Company's Consolidated Financial Statements.) In addition, BOL has entered into equipment purchases of approximately \$35,400, of which \$28,800 will be financed over five years beginning in 1998. The Company is a guarantor of one of the purchases for which the remaining obligation is approximately \$7,000.

THE COMPANY. The Company has scheduled debt maturities of \$6,427 due in the year 1998; approximately \$5,000 of this debt relates to credit lines established by Liggett-Ducat which have been paid as of May 16, 1998. Liggett has a payment due on the Liggett Notes at maturity on February 1, 1999 of approximately \$145,000 and the Facility expires on March 8, 1999. The Company believes that it will continue to meet its liquidity requirements through 1998, although the BGLS Notes Indenture limits the amount of restricted payments BGLS is permitted to make to the Company during the calendar year. At March 31, 1998, the remaining amount available through December 31, 1998 in the Restricted Payment Basket related to BGLS' payment of dividends to the Company (as defined by the BGLS Notes Indenture) is \$11,086. Company expenditures in 1998 for current operations include debt service estimated at \$30,715, dividends on the Company's shares (currently at an annual rate of approximately \$6,100) and corporate expense. The Company anticipates funding 1998 current operations and long-term growth with the proceeds from public and/or private debt and equity financing, management fees and other payments from subsidiaries of approximately \$3,600 and distributions from New Valley. New Valley may acquire or seek to acquire additional operating businesses through merger, purchase of assets, stock acquisition or other means, or to make other investments, which may limit its ability to make such distributions.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

PART II
OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

Reference is made to Note 8, incorporated herein by reference, to the Consolidated Financial Statements of Brooke Group Ltd. and BGLS Inc. (collectively, the "Companies") included elsewhere in this report on Form 10-Q which contains a general description of certain legal proceedings to which the Company and/or BGLS or their subsidiaries are a party and certain related matters. Reference is also made to Exhibit 99.1 for additional information regarding the pending material legal proceedings to which the Company, BGLS and/or Liggett are party.

Item 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

No securities of the Company which were not registered under the Securities Act of 1933, as amended (the "Securities Act"), have been issued or sold by the Company during the three months ended March 31, 1998, except as follows:

- (i) As of January 1, 1998, the Company granted to officers of the Company stock options to purchase 42,500 shares of the Company's common stock at a price of \$5.00 per share.
- (ii) On January 16, 1998, High River Limited Partnership purchased 1,500,000 shares of the Company's common stock at a price of \$6.00 per share (an aggregate of \$9,000,000).
- (iii) On February 2, 1998, the Company issued 483,002 shares of its common stock to the holders of the Liggett Notes in connection with amendments to the Indenture governing the Liggett Notes.
- (iv) On March 12, 1998, the Company granted a law firm that represents the Company and Liggett an option for 1,250,000 shares of the Company's common stock at a purchase price of \$17.50 per share.
- (v) In March 1998, a consultant to the Company purchased 181,800 shares of the Company's common stock upon exercise of options at a price of \$2.00 per share (an aggregate of \$363,600).
- (vi) In March 1998, employees of the Company purchased 86,632 shares of the Company's common stock upon exercise of options at a price of \$5.00 per share (an aggregate of \$433,160).

The foregoing transactions were effected in reliance on the exemption from registration afforded by Section 4(2) of the Securities Act or did not involve a "sale" under the Securities Act.

Item 3. DEFAULTS UPON SENIOR SECURITIES

As of March 31, 1998, New Valley Corporation, the Companies' affiliate, had the following respective accrued and unpaid dividend arrearages on its 1,071,462 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) \$176.2 million or \$164.41 per Class A Share; and (2) \$145.7 million or \$52.20 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 Material Legal Proceedings.
- 99.2 Liggett Group Inc.'s Interim Consolidated Financial Statements for the quarterly period ended March 31, 1998.
- 99.3 New Valley Corporation's Interim Consolidated Financial Statements for the quarterly period ended March 31, 1998.
- 99.4 Brooke (Overseas) Ltd.'s Interim Consolidated Financial Statements for the quarterly period ended March 31, 1998.
- 99.5 New Valley Holdings, Inc.'s Interim Consolidated Financial Statements for the quarterly period ended March 31, 1998.

(b) REPORTS ON FORM 8-K

The Company filed the following reports on Form 8-K during the first quarter of 1998.

	DATE	ITEMS	FINANCIAL STATEMENTS
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1.	January 12, 1998	5, 7	None
2.	January 14, 1998	5	None
3.	January 16, 1998	5, 7	None
4.	January 21, 1998	5	None
5.	February 2, 1998	5, 7	None
6.	February 6, 1998	5, 7	None
7.	March 2, 1998	5, 7	None

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

BROOKE GROUP LTD.
(REGISTRANT)

By: /s/ Joselynn D. Van Siclen

 Joselynn D. Van Siclen
 Vice President and Chief
 Financial Officer

Date: May 20, 1998

BGLS INC.
(REGISTRANT)

By: /s/ Joselynn D. Van Siclen

 Joselynn D. Van Siclen
 Vice President and Chief
 Financial Officer

Date: May 20, 1998

3-MOS

	DEC-31-1998	JAN-01-1998	MAR-31-1998
			4,577
		0	
	8,994		
	0		
	47,697		
	72,407		47,583
	31,635		
	134,433		
285,565			226,724
0			
		0	
		2,035	
134,433		(465,787)	
		84,803	
	84,803		
		41,656	41,656
		41,656	
	4,187		
	0		
	(20,786)		
	(16,434)		
	931		
(17,365)			
	0		
	0		
		0	
	(17,365)		
	(0.89)		
	(0.89)		

5
0000927388
BGLS INC.
1,000

3-MOS

	DEC-31-1998	JAN-01-1998	MAR-31-1998
			4,539
		0	
		8,994	
		0	
		47,697	
		68,998	
			47,451
		31,172	
		132,484	
313,379			
			226,724
		0	
			0
			0
			(499,716)
132,484			
			84,803
		84,803	
			41,656
		41,656	
		4,187	
		0	
		(21,824)	
		(17,251)	
			931
(18,182)			
		0	
		0	
			0
		(18,182)	
		0	
		0	

MATERIAL LEGAL PROCEEDINGS

STATE MEDICAID REIMBURSEMENT CASES

State of Minnesota, et al. v. Philip Morris, et al., Case No. C1-94-8565, District Court, County of Ramsey, 2nd Judicial District (case filed on August 18, 1994). This case was settled by Liggett and Brooke as to the State of Minnesota on March 20, 1997. The case remains pending as to one equitable claim by Blue Cross/Shield of Minnesota against Liggett and Brooke.

Commonwealth of Puerto Rico, et al. v. Brown & Williamson, et al., Case No. 97-1910 (JAF), USDC, District Court of Puerto Rico (case filed on June 27, 1997). This case brought on behalf of the Commonwealth of Puerto Rico seeks compensatory and injunctive relief for damages incurred by the Commonwealth in paying for the medicaid expenses of indigent smokers. This case is presently stayed.

State of South Carolina v. Brown & Williamson, et al., Case No. 97-CP-40-1686, Court of Common Pleas, Richland County (case filed on May 12, 1997). This case brought on behalf of the State of South Carolina seeks compensatory and injunctive relief for damages incurred by the state in paying for the medicaid expenses of indigent smokers. This case is presently stayed pending the outcome of Congressional debate concerning national tobacco policy.

State of South Dakota, et al. v. Philip Morris, et al., Case No. 98-65, Circuit Court of 6th Circuit, Hughes County (case filed on February 23, 1998). This case brought on behalf of the State of South Dakota seeks compensatory and injunctive relief for damages incurred by the state in paying for the medicaid expenses of indigent smokers. This case is presently stayed pending the outcome of Congressional debate concerning national tobacco policy.

State of Vermont v. Philip Morris, et al., Case No. 744-97CnC, Chittenden County Superior Court (case filed on May 29, 1997). This case brought on behalf of the State of Vermont seeks compensatory and injunctive relief for damages incurred by the state in paying for the medicaid expenses of indigent smokers. This case has a trial date of November 13, 1999.

CLASS ACTION CASES

Fletcher, et al. v. Brooke Group, Ltd., et al., Case No. CV-97-913, Circuit Court of Mobile County, Alabama (case filed on March 20, 1997). Nationwide class certified and limited fund class action settlement preliminarily approved with respect to Liggett and Brooke Group on March 20, 1997.

Hansen, et al. v. The American Tobacco Company, et al., Case No. LR-C-96-881, USDC, Eastern District of Arkansas (case filed on April 4, 1997). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated addicted smokers resident in Arkansas. Plaintiffs filed a motion for class certification on September 15, 1997, which motion remains pending.

Brown, et al. v. The American Tobacco Company, et al., Case No. 711400, Superior Court of San Diego, California (case filed on October 1, 1997). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in California. No motion for class certification has been brought by plaintiff.

Finelli, et al. v. Philip Morris, et al., Case No. 96-04348, DC, Superior Court of District of Columbia. Liggett is named as a defendant in this putative class action, but has not been served.

Reed, et al. v. Philip Morris, et al., Case No. 96-05070, DC, Superior Court of District of Columbia (case filed on June 21, 1996). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated addicted smokers resident in the District of Columbia. On August 18, 1997, the court issued an order declining to certify the class.

Broin, et al. v. Philip Morris, et al., Case No. 91-49738 CA 22, FL, Circuit Court Dade County (case filed on October 31, 1991). This action brought on behalf of all flight attendants that have been injured by

exposure to environmental tobacco smoke was certified as a class action on December 12, 1994. This case was settled with respect to all defendants on October 10, 1997, which settlement was finally approved by the court on February 2, 1998. A notice of appeal is currently pending.

Engle, et al. v. R.J. Reynolds, et al., Case No. 94-08273 CA 20, FL, Circuit Court, Dade County (case filed on May 5, 1994). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in Florida. The case was certified as a class action on October 31, 1994 and trial is expected to commence on July 6, 1998.

Peterson, et al. v. The American Tobacco Company, et al., Case No. 97-0490-02, First Circuit Court, Honolulu, Hawaii (case filed on February 6, 1997). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated addicted smokers resident in Hawaii.

Clay, et al. v. The American Tobacco Company, et al., Case No. 97-4167-JPG, USDC, Southern District of Illinois (case filed on May 22, 1997). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated addicted smokers resident in 34 states. No motion for class certification has been brought by plaintiff.

Norton, et al. v. R.J. Reynolds, et al., Case No. 48-D01-9605-CP-0271, Superior Court, Madison County, Indiana (case filed on May 3, 1996). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in Indiana. No motion for class certification has been brought by plaintiff.

Brammer, et al. v. R.J. Reynolds, et al., Case No. 4-97-CV-10461, USDC, Southern District of Iowa, (case filed on June 30, 1997). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated addicted smokers resident in Iowa. To date, no motion for class certification has been filed by plaintiff.

Emig, et al. v. The American Tobacco Company, et al., Case No. 97-1121-MLB, USDC, District of Kansas (case filed on April 11, 1997). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated addicted smokers resident in Kansas. Plaintiff's motion for class certification currently is pending.

Castano, et al. v. The American Tobacco Company, et al., Case No. 95-30725, USDC, Eastern District of Louisiana (case filed on March 29, 1994). This case was certified as a class action by the district court on February 17, 1995. This case was settled by Liggett and Brooke on March 12, 1996. The class was decertified by the Fifth Circuit in May 1996. Plaintiffs' motion for approval of the settlement was withdrawn on September 6, 1996.

Granier, et al. v. The American Tobacco Company, et al., USDC, Eastern District of Louisiana (case filed on September 29, 1994). This case currently is stayed pursuant to a decision in Castano.

Young, et al. v. The American Tobacco Company, et al., Case No. 2:97-CV-03851, Civil District Court, Parish of Orleans, Louisiana (case filed on November 12, 1997). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in Louisiana. No motion for class certification has been brought by plaintiff.

Richardson, et al. v. Philip Morris, et al., Case No. 96145050/CL212596, Circuit Court, Baltimore City, Maryland (case filed on May 29, 1996). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated addicted smokers resident in Maryland. This class action was certified by the court on January 28, 1998. Trial is set for September 15, 1999.

Geiger, et al. v. The American Tobacco Company, et al., Index No. 10657/97, Supreme Court, Queens County, New York (case filed on January 12, 1997). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in New York. The case was certified as a class action on May 1, 1997, and currently is stayed pending appeal.

Nwanze, et al. v. Philip Morris, et al., Case No. 97-CIV-7344, USDC, Southern District of New York (case filed on October 17, 1997). This action is brought on behalf of all prisoners nationwide that have been

injured by exposure to environmental tobacco smoke. No motion for class certification has been brought by plaintiff.

Chamberlain, et al. v. The American Tobacco Company, Case No. 1:96CV2005, USDC, Northern District of Ohio (case filed on August 20, 1997). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated addicted smokers resident in Ohio. To date, no motion for class certification has been filed by plaintiff.

Barnes, et al. v. The American Tobacco Company, et al. Case No. 96-5903, USDC, Eastern District of Pennsylvania (case filed on August 8, 1996). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated addicted smokers resident in Pennsylvania. The district court decertified the class in this case on October 17, 1997. Plaintiff's appeal of decertification is pending.

Aksamit, et al. v. Brown & Williamson, et al., Case No. 6:97-3636-21, SC, USDC, Dist. of South Carolina, Greenville Division (case filed on November 24, 1997). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated addicted smokers resident in South Carolina. To date, no motion for class certification has been filed by plaintiff.

Newborn, et al. v. Brown & Williamson, et al., Case No. 97-2938 GV, USDC, Western District of Tennessee (case filed on October 1, 1997). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in Tennessee. No motion for class certification has been brought by plaintiff.

Mason, et al. v. The American Tobacco Company, et al., Case No. 7-97CV-293-X, USDC, Northern District of Texas (case filed on December 23, 1997). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated addicted smokers resident in Texas. To date, no motion for class certification has been filed by plaintiff.

Herrera, et al. v. The American Tobacco Company, et al., Case No. 2:98-CV-00126, USDC, District of Utah (case filed on January 28, 1998). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in Utah. No motion for class certification has been brought by plaintiff.

Jackson et al. v. Philip Morris Inc., Case No. 980901634PI, 3rd Judicial Court, Salt Lake City County, Utah (case filed on March 10, 1998). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in Utah. No motion for class certification has been brought by plaintiff.

Ingle, et al. v. Philip Morris, et al., Case No. 97-C-21-S, Circuit Court of McDowell County, West Virginia (case filed on February 4, 1997). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in West Virginia. No motion for class certification has been brought by plaintiff.

McCune, et al. v. The American Tobacco Company, et al., Case No. 97-C-204, Circuit Court of Kanawha County, West Virginia (case filed on January 30, 1997). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated addicted smokers resident in West Virginia. To date, no motion for class certification has been filed by plaintiff.

Walker, et al. v. Liggett Group Inc., et al., Case No. 2:97-0102, USDC, Southern District of West Virginia (case filed on February 12, 1997). Nationwide class certified and limited fund class action settlement preliminarily approved with respect to Liggett and Brooke Group on May 15, 1997. Class decertified and preliminary approval of settlement withdrawn by order of district court on August 5, 1997, which order currently is on appeal to the Fourth Circuit.

Insolia, et al. v. Philip Morris, et al., Case No. 97-CV-230-J, Rock County Circuit Court, Wisconsin (case filed on April 4, 1997). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in Wisconsin. No motion for class certification has been brought by plaintiff.

Parsons, et al. v. Liggett Group Inc., et al., Case No. 98-C-388, Circuit Court, Kanawha County, West Virginia (case filed on February 27, 1998). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in West Virginia. No motion for class certification has been brought by plaintiff.

OTHER REIMBURSEMENT ACTIONS

City of Birmingham, et al. v. The American Tobacco Co., et al., Case No. CV97-081, Greene County, Alabama, Circuit Court (case filed on 5/28/97). City of Birmingham seeks to recover money damages resulting from payment by the City to hospitals and other medical providers on behalf of their employees for tobacco-related disease and death. The City's amended complaint was dismissed by the court on March 4, 1998, holding that, under the common law of Alabama, the City lacked standing to recover damages from alleged third-party tortfeasors for amounts paid on behalf of the plaintiffs' injured employees. The court has, however, permitted the City to amend its complaint to bring a claim under an Alabama statute which, the court held, provided a limited authority to recover such damages under certain circumstances.

County of Los Angeles v. R.J.Reynolds, et al., Case No. 707651, Superior Court of San Diego (case filed on 8/5/97). County seeks to obtain declaratory and equitable relief and restitution as well as to recover money damages resulting from payment by the County for tobacco-related medical treatment for its citizens and health insurance for its employees. Trial is scheduled for February 5, 1999.

Ellis, on Behalf of the General Public v. R.J. Reynolds, et al., Case No. 00706458, Superior Court of San Diego (case filed on 12/13/96). Plaintiffs, two individuals, seek equitable and injunctive relief for damages incurred by the State of California in paying for the expenses of indigent smokers.

County of Cook v. Philip Morris, et al., Case No. 97L04550, Circuit Court, Cook County (case filed on 7/21/97). County of Cook seeks to obtain declaratory and equitable relief and restitution as well as to recover money damages resulting from payment by the County for tobacco-related medical treatment for its citizens and health insurance for its employees.

City of New York, et al. v. The Tobacco Institute, et al., Case No. 97-CIV-0904, Supreme Court of New York, New York County (case filed on 10/17/96). City of New York seeks to obtain declaratory and equitable relief and restitution as well as to recover money damages resulting from payment by the City for tobacco-related medical treatment for its citizens and health insurance for its employees.

State of Tennessee v. The American Tobacco Co., et al., Case No. 12,263, Monroe County Chancery Court (case filed on 5/7/97). Individual seeks equitable and injunctive relief for damages incurred by the State of Tennessee in paying for the expenses of indigent smokers.

The Crow Creek Sioux Tribe v. The American Tobacco Company, et al., Case No. CV 97-09-082, Tribal Court of The Crow Creek Sioux Tribe (case filed on 9/26/97). Indian tribe seeks equitable and injunctive relief for damages incurred by the tribe in paying for the expenses of indigent smokers.

The Republic of Marshall Islands v. The American Tobacco Co., et al., Case No. 1997-261, Republic of the Marshall Islands, The High Court (case filed on 10/30/97). Republic seeks equitable and injunctive relief for damages incurred by the Republic in paying for the expenses of indigent smokers.

Screen Actors Guild -- Producers Health Plan, et al. v. Philip Morris, et al., Case No. DC181603, Superior Court of Los Angeles County (case filed on 11/20/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Stationary Engineers Local 39 Health & Welfare Trust Fund v. Philip Morris, et al., Case No. C-97-1519-DLJ, USDC, Northern District of California (case filed on 4/25/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Steamfitters Local Union No. 614 Health and Welfare Fund v. Philip Morris, et al., Case No. 92260-2, Circuit Court for 30th Judicial District at Memphis (case filed on 1/7/98). Union Health and Welfare Fund

seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Texas Carpenters Health Benefit Fund, et al. v. Philip Morris, et al., Case No. 1:97C0625, USDC, Eastern District of Texas (case filed on 11/7/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Northwest Laborers-Employers Health & Security Trust Fund, et al. v. Philip Morris, et al., Case No. C97-849-WD, WA, USDC, Western District (case filed on 6/26/97). Health and Welfare Trust Fund seeks economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Iron Workers Local Union No.17 Insurance Fund, et al. v. Philip Morris, et al., Case No. 1:97CV 1422, USDC, Northern District of Ohio, Eastern Div. (case filed on 5/20/97). Union Insurance Trust Fund seeks economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Rhode Island Laborers' Health & Welfare Fund v. The American Tobacco Company, et al., Case No. 97-500L, USDC, District of Rhode Island (case filed on 10/24/97). Union Health and Welfare Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Teamsters Union No. 142, et al. v. Philip Morris, et al., Case No. 71C019709CP01281, USDC, Northern District of Indiana (case filed on 9/15/97). Union seeks injunctive relief and economic reimbursement to recover moneys expended by Union Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Kentucky Laborers District Council Health & Welfare Trust Fund v. Philip Morris, et al., Case No.3-97-394, USDC, Western District of Kentucky (case filed on 6/20/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Trust Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Ark-LA-Miss Laborers Welfare Fund, et al. v. Philip Morris, et al., Case No. 97-1944, USDC, Eastern District of Louisiana (case filed on 6/20/97). Welfare Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

New Jersey Carpenters Health Fund, et al. v. Philip Morris, et al., Case No. 97-3421, USDC, District of New Jersey (case filed on 10/7/97). Health Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Laborers' Local 17 Health Benefit Fund, et al. v. Philip Morris, et al., Case No. 97-CIV-4550, USDC, Southern District of New York (case filed on 7/17/97). Health Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Operating Engineers Local 12 Health and Welfare Trust v. The American Tobacco Company, et al., Case No. CV-97-7620 TJH, USDC, Central District of California (case filed on 11/6/97). Health and Welfare Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Connecticut Pipe Trades Health Fund, et al. v. Philip Morris, et al., Case No. 397CV01305CT, USDC, District of Connecticut (case filed on 7/17/97). Health Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Central Illinois Laborers Health & Welfare Trust Fund, et al. v. Philip Morris, et al., Case No. 97-L516, USDC, Southern District of Illinois (case filed on 5/22/97). Laborers' Union Health Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Laborers' and Operating Engineers Utility Agreement v. Philip Morris, et al., Case No. CIV97-1406 PHX, USDC, District of Arizona (case filed on 7/29/97). Union Health and Welfare Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Arkansas Carpenters Health & Welfare Fund v. Philip Morris, et al., Case No. LR-C-97-0754, USDC, Eastern District of Arkansas (case filed on 9/4/97). Union's Health and Welfare Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

West Virginia Laborers' Pension Trust Fund v. Philip Morris, et al., Case No. 397-0708, USDC, Southern District of West Virginia (case filed on 8/27/97). Laborers' Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

West Virginia-Ohio Valley Area I.B.E.W., et al. v. Liggett Group Inc., et al., Case No. 97-C-2135, USDC, Southern District of West Virginia (case filed on 9/19/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Massachusetts Laborers' Health & Welfare Fund, et al. v. Philip Morris, et al., Case No. C.A. 97-2892G, Superior Court, Suffolk County (case filed on 6/2/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

B.A.C. Local No. 32 Insurance Trust Fund, et al. v. Philip Morris, et al., Case No. 97-75675MI, USDC, Eastern District of Michigan (case filed on 11/18/97). Health Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Operating Engineers Local 324 Health Care Fund, et al. v. Philip Morris, Inc., et al., Case No. 598--CV-60020, Circuit Court, Wayne County (case filed on 3/9/98). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

New Mexico and West Texas Multi-Craft Health and Welfare Trust Fund, et al. v. Philip Morris, et al., Case No. CV97 0009118NM, Second Judicial District Court, Bernalillo County (case filed on 1/29/98). Health Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Oregon Laborers-Employers Health & Welfare Trust Fund, et al. v. Philip Morris, et al., Case No. 97-1051-HA, USDC, District of Oregon (case filed on 6/18/97). Health and Welfare Trust Fund seeks

injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Central States Joint Board Health & Welfare Fund v. Philip Morris, et al., Case No. 97L12855, USDC, Northern District of Illinois (case filed on 10/30/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

International Brotherhood of Teamsters, Local 734 Health & Welfare Trust Fund v. Philip Morris, et al., Case No. 97L12852, USDC, Northern District of Illinois (case filed on 10/30/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Seafarers Welfare Plan and United Industrial Workers Welfare Plan v. Philip Morris, et al., Case No. MJG-97-2127MD, USDC, District of Maryland (case filed on 8/8/97). Welfare Plan seeks injunctive relief and economic reimbursement to recover moneys expended by Plan to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Carpenters & Joiners Welfare Fund, et al. v. Philip Morris, et al., Case No. 60,633-001, USDC, District of Minnesota (case filed on 12/31/97). Health and Welfare Trust Plan seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

United Federation of Teachers Welfare Fund, et al. v. Philip Morris, et al., Case No. 97-CIV-4676, USDC, Southern District of New York (case filed on 7/17/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

United Food and Commercial Workers Unions, et al. v. Philip Morris, et al., Case No. CV-97-1340, Circuit Court of Tuscaloosa, Alabama (case filed on 11/13/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Day Care Council-Local 205 D.C. 1707 Welfare Fund v. Philip Morris, et al., Case No. 97-CIV-606240, USDC, Southern District of New York (case filed on 12/4/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Eastern States Health and Welfare Fund, et al. v. Philip Morris, et al., Case No. 97-CIV-7346, USDC, Southern District of New York (case filed on 7/28/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

IBEW Local 25 Health and Benefit Fund v. Philip Morris, et al., Case No. 97-CIV-9400, USDC, Southern District of New York (case filed on 11/25/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

IBEW Local 363 Welfare Fund v. Philip Morris, et al., Case No. 97-CIV-9396, USDC, Southern District of New York (case filed on 11/25/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Local 1199 Home Care Industry Benefit Fund v. Philip Morris, et al., Case No. 97-606249, USDC, Southern District of New York (case filed on 12/4/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Local 1199 National Benefit Fund for Health & Human Services Employees v. Philip Morris, et al., Case No. 97-606-241, USDC, Southern District of New York (case filed on 12/4/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Local 138, 138A & 138B International Union of Operating Engineers Welfare Fund v. Philip Morris, et al., Case No. 97-CIV-9402, USDC, Southern District of New York (case filed on 11/25/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Local 840 International Brotherhood of Teamsters Health & Insurance Fund v. Philip Morris, et al., Case No. 97-CIV-9398, USDC, Southern District of New York (case filed on 11/25/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Long Island Regional Council of Carpenters Welfareocal 840 International Brotherhood of Teamsters Health & Insurance Fund v. Philip Morris, et al., Case No. 97-CIV-9397, USDC, Southern District of New York (case filed on 11/25/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Puerto Rican ILGWU Health & Welfare Fund v. Philip Morris, et al., Case No. 97-CIV-8462, USDC, Southern District of New York (case filed on 11/25/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

Fibreboard Corporation, et al. v. The American Tobacco Company, et al., Case No. 791919-8, CA, Superior Court of Alameda (case filed on 11/10/97). Asbestos company seeks reimbursement for damages paid to asbestos victims for medical and other relief, which damages allegedly are attributable to the tobacco companies.

Keene Creditors Trust v. Brown & Williamson Tobacco Corp., et al., Case no. 606479/97, Supreme Court of New York, New York County (case filed on 12/19/97). Asbestos company seeks reimbursement for damages paid to asbestos victims for medical and other relief, which damages allegedly are attributable to the tobacco companies.

Conwed Corp., et al. v. R.J. Reynolds Tobacco Co., et al., Case No. C1-98-3620, District Court. Ramsey County, Minnesota (case filed on April 9, 1998). Employer seeks injunctive relief and economic reimbursement to recover moneys expended by employer to provide medical treatment to its employees suffering from smoking-related illnesses.

Nat'l Asbestos Workers Medical Fund, et al., v. Philip Morris Inc., et al., CV-98-1492, USDC. Eastern District of New York (case filed on March 23, 1998). Health and Welfare Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants suffering from smoking-related illnesses.

Milwaukee Carpenters' District Council Health Fund, et al, v. Philip Morris Inc., et al., 98CV002394, Circuit Court, Milwaukee County, Wisconsin (case filed on March 30, 1998). Health and Welfare Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants suffering from smoking-related illnesses.

Williams & Drake Co., et al. v. American Tobacco Co., et al., Case No. 98-553, USDC, Western District of Pennsylvania (case filed on March 23, 1998). Employer seeks injunctive relief and economic reimbursement to recover moneys expended by employer to provide medical treatment to its employees suffering from smoking-related illnesses.

Blue Cross and Blue Shield of New Jersey, et al. v. Phillip Morris Inc., et al., CV 98 3287, USDC, Eastern District of New York (case filed April 29, 1998). Health insurer seeks injunctive relief and economic reimbursement to recover moneys expended by insurer to provide medical treatment to its members suffering from smoking-related illnesses.

Arkansas Blue Cross and Blue Shield, et al. v. Phillip Morris Inc., et al., Case No.98 C 2612, USDC, Northern District of Illinois (case filed April 29, 1998). Health insurer seeks injunctive relief and economic reimbursement to recover moneys expanded by insurer to provide medical treatment to its members suffering from smoking-related illnesses.

Regence Blueshield, et al. v. Phillip Morris Inc., et al., Case No. C98-0559R, USDC, Western District of Washington (case filed April 29, 1998). Health insurer seeks injunctive relief and economic reimbursement to recover moneys expended by insurer to provide medical treatment to its members suffering from smoking-related illnesses.

INDIVIDUAL ACTIONS

(The following is a list of actions by the named individual plaintiffs pending against Liggett and, except as other wise noted, other tobacco

companies. The actions have been brought in state court, except as otherwise noted.)

Crozier, AL, USDC (case filed on August 2, 1996). Case is pending.

Cordova, CA, San Diego County. Trial begins February 5, 1999.

Pavolini, CA, San Francisco County (case filed on December 9, 1997). Case is pending.

Stern, CA, Monterey County (case filed on April 28, 1997). Case is pending.

Adams, FL, Broward County (case filed on April 10, 1997). Case is pending.

Allman, FL, Volusia County (case filed on June 2, 1997). Case is pending.

Altieri, FL, Orange County, (case filed on August 12, 1997). Case is pending.

Armand, FL, Volusia County (case filed on July 9, 1997). Case is pending.

Atcheson, FL, Volusia County (case filed on July 29, 1997). Case is pending.

Akins, FL, Orange County (case filed on September 16, 1997). Case is pending.

Bailey, FL, Dade County (case filed on August 18, 1997). Case is pending.

Bartley, FL, Broward County (case filed on June 21, 1997). Case is pending.

Blair, FL, Volusia County (case filed on July 29, 1997). Case is pending.

Blank, FL, Broward County (case filed on April 10, 1997). Case is pending.

Bouchard, FL, Bouchard County (case filed on June 2, 1997). Case is pending.

Bronstein, FL, Broward County (case filed on June 10, 1997). Case is pending.

Brown, FL, Orange County (case filed on September 16, 1997). Case is pending.

Burns, FL, Broward County (case filed on April 3, 1998). Case is pending.

Campbell, FL, Hillsborough County (case filed on April 18, 1997). Case is pending.

Chamberlain, FL, Duval County Circuit Court (case filed on March 4, 1998). Case is pending.

Childress, FL, Hillsborough County (case filed on August 28, 1995). Case is pending.

Chutz-Reymers, FL, USDC, Middle District (case filed on March 21, 1996). Case is pending.

Clark, FL, Dade County (case filed on July 18, 1995). Case is pending. Liggett is the only named defendant.

Davis, FL, Broward County (case filed on July 21, 1997). Case is pending.

Davison, FL, Broward County (case filed on June 10, 1997). Case is pending.

De La Torre, FL, Broward County (case filed on July 21, 1997). Case is pending.

Dell, FL, Seminole County (case filed on July 29, 1997). Case is pending.

Dick, FL, Orange County (case filed on August 21, 1997). Case is pending.

Dickman, FL, Pinellas County (case filed December 20, 1996). Case is pending.

Dill, FL, Broward County (case filed on April 10, 1997). Case is pending.

Doyle, Joseph, FL, Flagler County (case filed on September 16, 1997). Case is pending.

Doyle, Philip, FL, Pinellas County (case filed on December 20, 1996). Case is pending.

Driscoll, FL, Seminole County (case filed on July 29, 1997). Case is pending.

Ferguson, FL, Volusia County, (case filed on October 10, 1997). Case is pending.

Fischetti, FL, Orange County (case filed on November 17, 1997). Case is pending.

Flaks, FL, Broward County (case filed on June 10, 1997). Case is pending.

Gardner, FL, USDC, Middle Dist. (case filed on December 2, 1996). Case is pending.

Garretson, FL, Volusia County (case filed on October 22, 1996). Case is pending.

Gatto, FL, Citrus County (case filed on October 14, 1997). Case is pending.

Goldberg, FL, Broward County (case filed on June 10, 1997). Case is pending.

Gonzalez, FL, Hillsborough County (case filed on January 2, 1996). Case is pending.

Gray, FL, Dade County (case filed on October 15, 1997). Case is pending.

Habib, FL, Volusia County (case filed on July 10, 1997). Case is pending.

Halen, FL, Palm Beach County (case filed on June 19, 1996). Case is pending.

Harris, FL, Broward County (case filed on July 21, 1997). Case is pending.

Hart, FL, Broward County (case filed on June 10, 1997). Case is pending.

Hayes, FL, Volusia County (case filed on June 30, 1997). Case is pending.

Henin, FL, Dade County (case filed on December 26, 1997). Case is pending.

Henning, FL, Broward County (case filed on July 21, 1997). Case is pending.

Higginbotham, FL, Duval County (case filed on September 19, 1996). Case is pending.

Hirth, FL, Dade County (case filed in 1996). Case is pending.

Hitchens, FL, Broward County (case filed on June 10, 1997). Case is pending.

Humpal, FL, Volusia County (case filed on June 30, 1997). Case is pending.

Johnson, FL, Duval County (case filed on November 30, 1995). Case is pending.

Kaloustian, FL, Hillsborough County (case filed August 28, 1995). Case is pending.

Katz, FL, USDC, Southern Dist. (case filed on August 3, 1995). Case is pending. Plaintiffs have dismissed all defendants except Liggett Group Inc.

Kearney, FL, Hillsborough County (case filed April 18, 1997). Case is pending.

Krueger, FL, USDC, Middle Dist. (case filed August 30, 1996). Case is pending.

Lappin, FL, Volusia (case filed June 2, 1997). Case is pending.

Laschke, FL, Pinellas County (case filed December 20, 1996). Case is pending.

Lass, FL, Duval County (case filed December 23, 1996). Case is pending.

Lehman, FL, Volusia County (case filed on June 2, 1997). Case is pending.

Leombruno, FL, Orange County (case filed on September 16, 1997). Case is pending.

Levine, FL, Palm Beach County (case filed on July 24, 1996). Case is pending.

Levy, FL, USDC, Middle Dist. (case filed on August 30, 1996). Trial is scheduled for June 1, 1998.

Lobley, FL, Seminole County (case filed on July 29, 1997). Case is pending.

Lustig, FL, Broward County (case filed on July 21, 1997). Case is pending.

Magliarisi, FL, Broward County (case filed on June 11, 1997). Case is pending.

Manley, FL, Broward County (case filed on April 3, 1998). Case is pending.

McMahon, FL, Polk County (case filed on April 29, 1997). Case is pending.

Meagher, FL, Orange County (case filed on May 22, 1997). Case is pending.

Meckler, FL, Duval County (case filed July 10, 1997). Case is pending.

Merkow, FL, Pinellas County (case filed May 30, 1997). Case is pending.

Mullin, FL, Dade County (case filed November 7, 1995). Case is pending.

Mullins, FL, Orange County (case filed September 16, 1997). Case is pending.

O'Rourke, FL, Volusia County (case filed June 2, 1997). Case is pending.

Passer, FL, Pinellas County (case filed June 2, 1997). Case is pending.

Perez, FL, USDC, Middle Dist. (case filed August 20, 1996). Case is pending.

Phillips, FL, Volusia County (case filed on May 27, 1997). Case is pending.

Pipolo, FL, Broward County (case filed on April 10, 1997). Case is pending.

Poythress, FL, Volusia County (case filed on May 5, 1997). Case is pending.

Rauch, FL, Broward County (case filed July 21, 1997). Case is pending.

Rawls, FL, Duval County (case filed March 6, 1997). Case is pending.

Reilly, FL, Lake County (case filed October 22, 1997). Case is pending.

Rix, FL, Duval County (case filed April 29, 1996). Case is pending.

Ross, FL, Hillsborough County (case filed on November 3, 1995). Trial is scheduled for June 29, 1998.

Sas, FL, Pinellas County (case filed on June 2, 1997). Case is pending.

Shaw, FL, Broward County (case filed on June 10, 1997). Case is pending.

Shira, FL, Orange County (case filed on May 30, 1997). Case is pending.

Spotts, FL, Volusia County (case filed on September 16, 1997). Case is pending.

Sprague, FL, Dade County (case filed July 28, 1995). Case is pending.

Stafford, FL, Pinellas County (case filed November 14, 1997). Case is pending.

Stewart, FL, Lake County (case filed September 16, 1997). Case is pending.

Stone, FL, Volusia County (case filed July 29, 1997). Case is pending.

Strickland, FL, Dade County (case filed January 8, 1998). Case is pending.

Swank-Reich, FL, Broward County (case filed June 10, 1997). Case is pending.

Szewczyk, FL, Hillsborough County (case filed December 12, 1995). Case is pending.

Thomas, FL, Broward County (case filed June 10, 1997). Case is pending.

Thomson, Barry, FL, Flagler County (case filed September 2, 1997). Case is pending.

Thomson, Eileen, FL, Broward County (case filed July 21, 1997). Case is pending.

Uffner, FL, Broward County case filed December 31, 1996). Case is pending.

Unkel, FL, USDC, Middle Dist. Trial is scheduled for June 1, 1998.

Ventura, FL, Dade County (case filed on April 3, 1998). Case is pending.

Washington, FL, Volusia County (case filed September 16, 1997). Case is pending.

Weiffenbach, FL, USDC, Tampa Dist. Case is pending.

Westmoreland, FL, Hillsborough County. Trial is scheduled for November 25, 1999. Liggett is the only named defendant.

Wisch, FL, Broward County (case filed June 10, 1997). Case is pending.

Young, FL, Duval County (case filed November 30, 1995). Case is pending.

Albert, GA, USDC, Middle Dist. (case filed January 24, 1997). Liggett has not yet been served.

Brown-Jones, GA, Richmond County (case filed January 13, 1998). Case is pending.

Daley, IL, USDC, Northern Dist. (case filed on August 13, 1997). Case is pending.

Badon, LA, USDC, Western Dist. (case filed on December 29, 1997). Case is pending.

Bird, LA, Jefferson Parish (case filed April 10, 1997). Case is pending.

Brakel, LA, USDC, Eastern Dist. (case filed August 30, 1996). Case is pending.

Hebert, LA, Calcasieu Parish (case filed May 8, 1996). Case is pending.

Higgins, LA, Orleans Parish (case filed June 1, 1996). Case is pending.

Oser, LA, Orleans Parish (case filed May 27, 1997). Case is pending.

Picard, LA, USDC, Eastern Dist. (case filed March 24, 1995). Case is pending.

Pitre, LA, East Baton Rouge Parish (case filed August 7, 1992). Case is pending.

Thomas, MI, USDC, Eastern Dist. (case filed May 29, 1997). Trial is scheduled for September 1, 1998. Liggett is the only named defendant.

Blythe, MS, Jackson County (case filed August 23, 1996). Case is pending.

Butler, MS, Jones County (case filed on May 12, 1994). Trial is scheduled for June 8, 1998.

Evans, MS, Jasper County (case filed June 10, 1997). Case is pending.

Murphy, NV, USDC (case filed January 6, 1998). Liggett has not yet been served.

Rivenburgh, NV, USDC (case filed January 6, 1998). Liggett has not yet been served.

Ulrich, NV, USDC (case filed January 6, 1998). Liggett has not yet been served.

Haines, NJ, USDC (case filed February 2, 1994). Case is pending.

Altman, NY, Supreme Court, New York County (December 16, 1997). Case is pending.

Anderson, NY, Supreme Court, Kings County (case filed November 13, 1997). Case is pending.

Bellows, NY, Supreme Court, New York County (case filed November 26, 1997). Case is pending.

Caiazza, NY, Supreme Court, Richmond County (case filed October 27, 1997). Case is pending.

Cameron, NY, Supreme Court, Nassau County (case filed July 18, 1997). Case is pending.

Carll, NY, Supreme Court, New York County (case filed August 12, 1997). Case is pending.

Cavanagh, NY, Supreme Court, Richmond County (case filed April 23, 1997). Case is pending.

Collins, NY, Supreme Court, Westchester County (case filed July 2, 1997). Case is pending.

Condon, NY, Supreme Court, New York County (case filed February 4, 1997). Case is pending.

Crane, NY, USDC, Southern Dist. (case filed March 6, 1997). Case is pending.

Creech, NY, Supreme Court, Richmond County (case filed January 14, 1997). Case is pending.

Cresser, NY, Supreme Court, Kings County (case filed October 4, 1996). Case is pending.

Da Silva, NY, Supreme Court, New York County (case filed January 14, 1997). Case is pending.

Dougherty, NY, Supreme Court, Suffolk County (case filed April 18, 1997). Case is pending.

Dzak, NY, Supreme Court, Queens County (case filed December 2, 1996). Case is pending.

Evans, NY, Supreme Court, Kings County (case filed August 23, 1996). Case is pending.

Falise, NY, USDC, Eastern District (case filed November 31, 1997). Case is pending.

Fink, NY, Supreme Court, New York County (case filed April 25, 1997). Case is pending.

Golden, NY, Supreme Court, New York County (case filed August 11, 1997). Case is pending.

Greco, NY, Supreme Court, Queens County (case filed July 18, 1997). Case is pending.

Gruder, NY, Supreme Court, New York County (case filed December 8, 1997). Case is pending.

Guilloteau, NY, Supreme Court, Kings County (case filed November 26, 1997). Case is pending.

Hansen, NY, Supreme Court, Suffolk County (case filed in April 12, 1997). Case is pending.

Hellen, NY, Supreme Court, Kings County (case filed August 23, 1996). Case is pending.

Inzerilla, NY, Supreme Court, Queens County (case filed July 16, 1996). Case is pending.

Jaust, NY, Supreme Court, New York County (case filed October 14, 1997). Case is pending.

Juliano, NY, Supreme Court, Richmond County (case filed August 12, 1996). Case is pending.

Keenan, NY, Supreme Court, New York County (case filed October 6, 1997) Case is pending.

Kestenbaum, NY, Supreme Court, New York County (case filed June 4, 1997). Case is pending.

Knutsen, NY, Supreme Court, Kings County (case filed April 25, 1997). Case is pending.

Kotlyar, NY, Supreme Court, Queens County (case filed November 26, 1997). Case is pending.

Kristich, NY, Supreme Court, Suffolk County (case filed October 12, 1997). Case is pending.

Labroila, NY, Supreme Court, Suffolk County (case filed July 20, 1997). Case is pending.

Lehman, NY, Supreme Court, New York County (case filed August 11, 1997). Case is pending.

Leibstein, NY, Supreme Court, Nassau County (case filed July 25, 1997). Case is pending.

Leiderman, NY, Supreme Court, Kings County (case filed July 23, 1997). Case is pending.

Lennon, NY, Supreme Court, New York County (case filed November 19, 1997). Case is pending.

Levinson, NY, Supreme Court, Kings County (case filed 1997). Case is pending.

Lien, NY, Supreme Court, Suffolk County (case filed 1997). Case is pending.

Litke, NY, Supreme Court, Kings County (case filed May 1, 1997). Case is pending.

Lombardo, NY, Supreme Court, Nassau County (case filed 1997). Case is pending.

Long, NY, Supreme Court, Bronx County (case filed October 22, 1997). Case is pending.

Lopardo, NY, Supreme Court, Nassau County (case filed October 27, 1997). Case is pending.

Lucca, NY, Supreme Court, Kings County (case filed January 27, 1997). Case is pending.

Lynch, NY, Supreme Court, New York County (case filed October 22, 1997). Case is pending.

Maisonet, NY, Supreme Court, Kings County (case filed 1997). Case is pending.

Margolin, NY, Supreme Court, New York County (case filed November 22, 1996). Case is pending.

Martin, NY, Supreme Court, Queens County (case filed July 18, 1997). Case is pending.

McGuinness, NY, Supreme Court, New York County (case filed July 28, 1997). Case is pending.

McLane, NY, Supreme Court, Richmond County (case filed 1997). Case is pending.

Mednick, NY, Supreme Court, Kings County (case filed September 19, 1997). Case is pending.

Mishk, NY, Supreme Court, New York County (case filed May 1, 1997). Case is pending.

Newell, NY, Supreme Court, New York County (case filed November 19, 1997). Case is pending.

Nociforo, NY, Supreme Court, Suffolk County (case filed July 12, 1996). Case is pending.

Ornstein, NY, Supreme Court, New York County (case filed September 29, 1997). Case is pending.

Paw, NY, US Court of Appeals (case filed 1997). Case is pending.

Perez, NY, Supreme Court, Kings County (case filed August 26, 1997). Case is pending.

Perri, NY, Supreme Court, Nassau County (case filed November 24, 1997). Case is pending.

Piccione, NY, Supreme Court, Kings County (case filed October 27, 1997). Case is pending.

Portnoy, NY, Supreme Court, Suffolk County (case filed July 16, 1996). Case is pending.

Reitano, NY, Supreme Court, Kings County (case filed August 22, 1996). Case is pending.

Rinaldi, NY, Supreme Court, Kings County (case filed December 11, 1996). Case is pending.

Rose, NY, Supreme Court, New York County (case filed December 18, 1996). Case is pending.

Roseff, NY, Supreme Court, New York County (case filed December 10, 1997). Case is pending.

Rubinobitz, NY, Supreme Court, Nassau County (case filed 1997). Case is pending.

Schulhoff, NY, Supreme Court, Queens County (case filed November 21, 1997). Case is pending.

Schwartz, Irwin, NY, Supreme Court, Nassau County (case filed 1997). Case is pending.

Schwartz, Pearl, NY, Supreme Court, Kings County (case filed December 2, 1996). Case is pending.

Senzer, NY, Supreme Court, Queens County (case filed 1997). Case is pending.

Shapiro, NY, Supreme Court, New York County (case filed July 21, 1996). Case is pending.

Siegel, NY, Supreme Court, Kings County (case filed October 8, 1996). Case is pending.

Smith, NY, Supreme Court, Queens County (case filed September 19, 1997). Case is pending.

Sola, NY, Supreme Court, Bronx County (case filed on July 16, 1996). Case is pending.

Sprung, NY, Supreme Court, Kings County (case filed 1997). Case is pending.

Standish, NY, Supreme Court, Bronx County (case filed July 28, 1997). Case is pending.

Stern, NY, USDC, Southern Dist. (case filed January 29, 1997). Case is pending.

Valentin, NY, Supreme Court, Queens County (case filed September 16, 1997). Case is pending.

Walgreen, NY, Supreme Court, New York County (case filed 1997). Case is pending.

Werner, NY, Supreme Court, Queens County (case filed December 12, 1997). Case is pending.

Zarudsky, NY, Supreme Court, New York County (case filed 1997). Case is pending.

Zimmerman, NY, Supreme Court of NY, Queens County (case filed 1997). Case is pending.

Zuzalski, NY, Supreme Court of NY, Queens County (April 3, 1997). Case is pending.

Tompkin, OH, USDC, Northern Dist. (case filed July 25, 1994). Trial is scheduled for August 31, 1998.

Hall, PA, USDC, Middle District of Pennsylvania (case filed on February 9, 1998). Case is pending.

Nicolo, RI, USDC (case filed September 24, 1996). Case is pending. Perry, TN, Knox County (case filed July 20, 1995). Case is pending.

Adams, TX, Harris County (case filed April 30, 1996). Case is pending.

Blanchard, TX, Galveston County (case filed July 31, 1992). Case is dormant.

Bush, TX, USDC, Eastern Dist. (case filed September 22, 1997). Case is pending.

Cole, TX, USDC, Eastern Dist. (case filed May 12, 1997). Case is pending.

Colunga, TX, Nueces County (case filed April 17, 1997). Case is pending.

Dieste, TX, USDC, Eastern Dist. (case filed November 3, 1997) Case is pending.

Gossett, TX, Cameron County (case filed November 14, 1996). Liggett has not yet been served.

Hale, TX, Hidalgo County (case filed January 30, 1997). Case is pending.

Hamilton, TX, USDC, Southern Dist. (case filed February 26, 1997). Case is pending.

Harris, TX, Nueces County (case filed December 27, 1996). Case is pending.

Luna, TX, USDC, Southern Dist. (case filed February 18, 1997). Case is pending.

McLean, TX, USDC, Eastern Dist. (case filed August 30, 1996). Case is pending.

Mireles, TX, Nueces County (case filed February 14, 1997). Case is pending.

Misell, TX, Nueces County (case filed January 3, 1997). Case is pending.

Ramirez, TX, USDC, Southern Dist. (case filed December 23, 1996). Case is pending.

Rogers, TX, Jefferson County (case filed February 28, 1995). Case is pending.

Roland, TX, Nueces County, third party complaint filed against Liggett on January 12, 1998. Case is pending.

Sanchez, TX, USDC, Southern Dist. (case filed July 22, 1997). Trial is scheduled for January 4, 1999.

Thompson, TX, Nueces County (case filed on December 15, 1997). Case is pending.

Weingarten, VT, USDC (case filed July 19, 1997). Trial is scheduled for July 8, 1998. Liggett is the only named defendant.

Ball, WV, USDC, Southern District of West Virginia (case filed on April 28, 1998). Case is pending.

Hissom, WV, Kanawha County (case filed September 13, 1997). Trial is scheduled for January 4, 1999.

Huffman, WV, Kanawha County (case filed February 13, 1998). Liggett has not yet been served.

Morris, WV, Kanawha County (case filed March 3, 1998). Liggett has not yet been served.

Russell, WV, USDC, Southern District of West Virginia (case filed on April 28, 1998). Case is pending.

Stephens, WV, USDC, Southern Dist. Trial is scheduled for March 2, 1999.

LIGGETT GROUP INC.
CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 1998

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

LIGGETT GROUP INC.

CONSOLIDATED BALANCE SHEETS
(Unaudited)

(Dollars in thousands, except per share amounts)

	March 31, 1998	December 31, 1997
	-----	-----
ASSETS		
Current assets:		
Accounts receivable:		
Trade, less allowances of \$1,168 and \$1,062, respectively	\$ 8,250	\$ 9,572
Other	1,055	743
Inventories	36,200	35,057
Other current assets	644	738
	-----	-----
Total current assets	46,149	46,110
Property, plant and equipment, at cost, less accumulated depreciation of \$29,142 and \$29,452, respectively	17,062	17,756
Intangible assets, at cost, less accumulated amortization of \$19,420 and \$19,111, respectively	1,180	1,609
Other assets and deferred charges, at cost, less accumulated amortization of \$10,087 and \$9,000, respectively	4,850	3,000
	-----	-----
Total assets	\$69,241	\$68,475
	=====	=====

(continued)

LIGGETT GROUP INC.

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

	March 31, 1998 -----	December 31, 1997 -----
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Current liabilities:		
Current maturities of long-term debt	\$ 173,361	\$ 28
Cash overdraft	937	891
Accounts payable, principally trade	7,858	6,413
Accrued expenses:		
Promotional	24,815	26,993
Taxes, principally excise taxes	2,577	3,643
Estimated allowance for sales returns	4,750	4,750
Interest	3,237	8,070
Settlement accruals	3,683	4,030
Other	7,243	8,834
	-----	-----
Total current liabilities	228,461	63,652
Long-term debt, less current maturities	--	168,112
Non-current employee benefits and other liabilities	11,860	11,168
Other long-term liabilities	19,303	18,400
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)	53,156	47,640
and contributed capital	(243,539)	(240,497)
Accumulated deficit	-----	-----
Total stockholder's deficit	(190,383)	(192,857)
	-----	-----
Total liabilities and stockholder's equity (deficit)	\$ 69,241	\$ 68,475
	=====	=====

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 March 31,	
	----- 1998 -----	----- 1997 -----
Net sales*	\$ 65,626	\$ 66,301
Cost of sales*	26,221	30,259
Gross profit	39,405	36,042
Selling, general and administrative expenses	33,154	33,910
Restructuring	--	1,761
Operating income	6,251	371
Other income (expense):		
Interest income	--	57
Interest expense	(7,083)	(6,040)
Equity in loss of affiliate	--	(33)
Sale of assets	368	1,592
Retirement of debt	--	2,963
Miscellaneous, net	--	(14)
Net loss	\$ (464)	\$ (1,104)
	=====	=====

*Net sales and cost of sales include federal excise taxes of \$14,809 and \$16,860, respectively.

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

LIGGETT GROUP INC.

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

	Common Stock and Contributed Capital -----	Accumulated Deficit -----	Total Stockholder's Deficit -----
Balance at December 31, 1997	\$ 50,218	\$(243,075)	\$(192,857)
Net loss	--	(464)	(464)
Effectiveness fee on debt	4,105	--	4,105
Transfer of ownership interest in an affiliate..	(1,167)	--	(1,167)
	-----	-----	-----
Balance at March 31, 1998	\$ 53,156 =====	\$(243,539) =====	\$(190,383) =====

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

LIGGETT GROUP INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(Dollars in thousands)

	Three Months Ended March 31,	
	1998	1997
Cash flows from operating activities:		
Net loss	\$ (464)	\$ (1,104)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	1,585	1,764
Gain on sale of property, plant and equipment	(368)	(1,592)
Gain on retirement of notes	--	(2,963)
Effectiveness fee on debt	684	--
Deferred finance charges and debt discount written off	--	130
Equity in income of affiliate	--	33
Changes in assets and liabilities:		
Accounts receivable	1,010	10,079
Inventories	(1,143)	861
Accounts payable	495	(922)
Accrued expenses	(9,473)	(11,685)
Non-current employee benefits	692	(206)
Other, net	1,403	(433)
Net cash used in operating activities	(5,579)	(6,038)
Cash flows from investing activities:		
Proceeds from sale of property, plant and equipment	702	1,904
Capital expenditures	(353)	(649)
Purchase of an option in affiliate	--	(2,200)
Net cash provided by (used in) investing activities	349	(945)
Cash flows from financing activities:		
Repayments of long-term debt	21	(4,601)
Borrowings under revolving credit facility	62,692	81,291
Repayments under revolving credit facility	(57,492)	(69,224)
Deferred finance charges	(38)	--
Increase (decrease) in cash overdraft	47	(6)
Net cash provided by financing activities	5,230	7,460
Net increase in cash and cash equivalents	--	477
Cash and cash equivalents:		
Beginning of period	--	--
End of period	\$ 0	\$ 477
Supplemental cash flow information:		
Cash payments during the period for:		
Interest	\$ 10,393	\$ 11,022
Income taxes	\$ 63	\$ 93

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

LIGGETT GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(Dollars in thousands, except per share amounts)

1. The Company

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

The consolidated financial statements included herein are unaudited and, in the opinion of management, reflect all adjustments necessary (which are normal and recurring) to present fairly the Company's consolidated financial position, results of operations and cash flows. The December 31, 1997 balance sheet has been derived from audited financial statements. These consolidated financial statements should be read in conjunction with the consolidated financial statements included in the Company's Annual Report on Form 10-K, as amended, for the year ended December 31, 1997, as filed with the Securities and Exchange Commission. The results of operations for interim periods should not be regarded as necessarily indicative of the results that may be expected for the entire year.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. Liggett had a net capital deficiency of \$190,383 as of March 31, 1998, is highly leveraged and has substantial near-term debt service requirements. (See Note 7.) Due to the many risks and uncertainties associated with the cigarette industry and the impact of tobacco litigation (see Note 8), there can be no assurance that the Company will be able to meet its future earnings or cash flow goals. Consequently, the Company could be in violation of its debt covenants, including covenants limiting the maximum permitted net worth and working capital deficiencies, and if its lenders were to exercise acceleration rights under its revolving credit facility (the "Facility") or the indenture for its Senior Secured Notes (the "Liggett Notes") or refuse to lend under the Facility, the Company would not be able to satisfy such demands or its working capital requirements.

The Liggett Notes mature on February 1, 1999 and the Facility expires on March 9, 1999. Accordingly, as of March 31, 1998, the current maturities of the Liggett Notes of \$144,733 (net of unamortized discount) and of the Facility of \$28,628 contribute substantially to the working capital deficit of \$182,312.

On January 30, 1998, the Company obtained the consents of the required majority of the holders of the Liggett Notes to various amendments to the Indenture governing the Liggett Notes. The amendments provided, among other things, for a deferral of the February 1, 1998 mandatory redemption of \$37,500 principal amount of the Liggett Notes to the date of final maturity, February 1, 1999. (Refer to Note 7.) At maturity, the Liggett Notes will require a principal payment of \$144,892. Based on Liggett's results of operations for 1997 and the quarter ended March 31, 1998, the Company does not anticipate it will be able to generate sufficient cash from operations to make such payments. In addition, the Company has a \$40,000 Facility expiring March 8, 1999 under which \$28,628 was outstanding at March 31, 1998. While management currently intends to seek to refinance and/or restructure with the Company's note holders the maturity requirements on the Liggett Notes and to extend the Facility, there are no refinancing or restructuring arrangements for the notes or commitments to extend the Facility at this time, and no assurances can be given in this regard. If the Company is unable to refinance or restructure the terms of the Liggett Notes or otherwise make all payments thereon, the Liggett Notes and the Facility would be in default and holders of such debt could accelerate the maturity of such debt. In such event, Liggett may be forced to seek protection from creditors under applicable laws. These matters raise substantial doubt about the Company meeting its liquidity needs and its ability to continue as

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

The Company adopted Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" ("SFAS No. 130"), for its fiscal year ending December 31, 1998. SFAS No. 130 requires the Company to display an amount representing the total comprehensive income for the period in a financial statement which is displayed with the same prominence as other financial statements. The Company has no items of other comprehensive income in any period presented and therefore is not required to report comprehensive income.

The Company will adopt Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("SFAS No. 131"), for the year ending December 31, 1998. SFAS No. 131 requires the Company to report certain information about operating segments in complete sets of financial statements and in condensed financial statements of interim period issued to shareholders. It also establishes standards for related disclosures about products and services, geographic areas and major customers. The Company does not expect this new pronouncement to have a significant impact on the financial statements.

The Company will adopt Statement of Financial Accounting Standards No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits" ("SFAS No. 132"), for the year ending December 31, 1998. SFAS No. 132 standardizes the disclosure requirements for pensions and other postretirement benefits to the extent practicable, requires additional information and changes in the benefit obligations and fair values of plan assets that will facilitate financial analysis, and eliminates certain disclosures that are no longer useful. The Company has not yet determined the impact of this pronouncement.

2. Estimates and Assumptions

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

3. Per Share Data

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

4. Sale of Assets

On March 11, 1997, Liggett sold to Blue Devil Ventures, a North Carolina limited liability partnership, certain surplus realty in Durham, North Carolina, for a sale price of \$2,200. A gain of \$1,147 was recognized, net of costs required to prepare the properties for sale and selling costs. (See Note 9 for sales to affiliates.)

5. Inventories

Inventories consist of the following:

	March 31, 1998	December 31, 1997
	-----	-----
Finished goods	\$ 15,401	\$ 13,273
Work-in-process	2,145	1,926
Raw materials	19,117	21,211
Replacement parts and supplies	3,504	3,545
	-----	-----
Inventories at current cost	40,167	39,955
LIFO adjustment	(3,967)	(4,898)
	-----	-----
Inventories at LIFO cost	\$ 36,200	\$ 35,057
	=====	=====

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 \$8,714 at March 31, 1998.

6. Property, Plant and Equipment

Property, plant and equipment consists of the following:

	March 31, 1998	December 31, 1997
	-----	-----
Land and improvements	\$ 411	\$ 411
Buildings	6,228	6,228
Machinery and equipment	39,565	40,569
	-----	-----
Property, plant and equipment	46,204	47,208
Less accumulated depreciation	(29,142)	(29,452)
	-----	-----
Property, plant and equipment, net	\$ 17,062	\$ 17,756
	=====	=====

7. Long-Term Debt

Long-term debt consists of the following:

	March 31, 1998	December 31, 1997
	-----	-----
11.5% Senior Secured Notes due February 1, 1999, net of unamortized discount of \$159 and \$206, respectively	\$ 112,454	\$ 112,406
Variable Rate Series C Senior Secured Notes due February 1, 1999	32,279	32,279
Borrowings outstanding under revolving credit facility	28,628	23,427
Other	--	28
	-----	-----
	173,361	168,140
Current portion	(173,520)	(28)
Unamortized discount, current portion	159	0
	-----	-----
Amount due after one year	\$ 0	\$ 168,112
	=====	=====

Senior Secured Notes

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

The Series C Notes, issued in 1994, have the same terms (other than interest rate) and stated maturity as the Series B Notes. The Series C Notes bore a 16.5% interest rate, which was reset on February 1, 1995 to 19.75%.

On January 30, 1998, with the consent of the required majority of the holders of the Liggett Notes, Liggett entered into various amendments to the Indenture governing the Liggett Notes, which provided, among other things, for a deferral of the February 1, 1998 mandatory redemption payment of \$37,500 to the date of final maturity of the Liggett Notes on February 1, 1999. In connection with the deferral, BGL agreed to issue 483,002 shares of BGL's common stock to the holders of record on January 15, 1998 of the Liggett Notes. As a result of this transaction, the Company recorded a deferred charge of approximately \$4,100 during the first quarter of 1998 reflecting the fair value of the instruments issued. This deferred charge is being amortized over a period of one year. The Indenture under which the Liggett Notes are outstanding was also amended to prohibit, with limited exceptions, payments of dividends and incurrence of new debt by Liggett and to tighten restrictions on the disposition of proceeds of asset sales. BGL and BGLS also agreed to guarantee the payment by Liggett of the August 1, 1998 interest payment on the Liggett Notes and to subordinate, until repayment in full of all amounts outstanding in respect of the Liggett Notes, their reimbursement rights with respect to the guarantee of borrowings under the

Facility made in connection with the Company's August 1, 1997 interest installment and any future advances in connection with the guarantee of the August 1, 1998 interest payment. In consideration of the contribution of the BGL common stock, the waiver of certain management and other fees, the guarantee of the interest payments and subordination of certain reimbursement rights, the Company transferred its ownership interest in, and options to acquire additional shares of stock of, Liggett-Ducat Ltd. ("Liggett-Ducat") to Brooke (Overseas) Ltd. ("BOL"), a subsidiary of BGLS. The Company will account for the transfer of its ownership interest in, and options to acquire additional shares of stock of, Liggett-Ducat to BOL as a capital distribution to BGLS. Based on the carrying value of the investment at December 31, 1997, the capital distribution is expected to be approximately \$1,208. In addition, the Liggett Noteholders were granted additional collateral in the form of a security interest in 16% of the stock of Liggett-Ducat or a successor entity held by BOL.

On February 1, 1999, all of the Liggett Notes, approximately \$144,900, will reach maturity. There are no refinancing or restructuring arrangements in place at this time for the notes and no assurances can be given in this regard. (Refer to Note 1.)

Revolving Credit Facility

On March 8, 1994, Liggett entered into the Facility under which it can borrow up to \$40,000 (depending on the amount of eligible inventory and receivables as determined by the lenders) from a syndicate of commercial lenders. Availability under the Facility was approximately \$1,483 based upon eligible collateral at March 31, 1998. The Facility is collateralized by all inventories and receivables of the Company. Borrowings under the Facility are charged interest calculated at a rate equal to 1.5% above Philadelphia National Bank's (the indirect parent of Congress Financial Corporation, the lead lender) prime rate. Liggett's interest rate is currently 10.0%. The Facility contains certain financial covenants similar to those contained in the Liggett Notes Indenture, including restrictions on Liggett's ability to declare or pay cash dividends, incur additional debt, grant liens and enter into any new agreements with affiliates, among others. In addition, the Facility, as amended April 8, 1998, imposes requirements with respect to the Company's adjusted net worth (not to fall below a deficit of \$195,000 as computed in accordance with the agreement, this computation was \$186,416 at March 31, 1998) and working capital (not to fall below a deficit of \$17,000 as computed in accordance with the agreement, this computation was \$4,984 at March 31, 1998). The Facility, as amended, also provides that a default by Liggett or its subsidiaries under the March 1996 Settlements, March 1997 Settlements and March 1998 Settlements (all as defined below in Note 8) shall constitute an event of default under the Facility.

In November 1997, the Facility was extended until March 8, 1999. For information concerning Liggett's substantial near-term debt service requirements and other related matters, see Note 1.

8. Commitments and Contingencies

TOBACCO-RELATED LITIGATION:

OVERVIEW. Since 1954, Liggett and other United States cigarette manufacturers have been named as defendants in a number of direct and third-party actions predicated on the theory that they should be liable for damages from cancer and other adverse health effects alleged to have been caused by cigarette smoking or by exposure to secondary smoke (environmental tobacco smoke, "ETS") from cigarettes. These cases are reported hereinafter as though having been commenced against Liggett (without regard to whether such cases were actually commenced against Liggett or BGL). There has been a noteworthy increase in the number of cases pending against both Liggett and the other tobacco companies. The cases generally fall into three categories: (i) smoking and health cases alleging personal injury brought on behalf of individual smokers ("Individual Actions"), (ii) smoking and health cases alleging personal injury and purporting to be brought on behalf of a class of plaintiffs ("Class Actions") and (iii) health care cost recovery actions brought by state and local governments, although recently numerous health care cost recovery actions have been commenced on behalf of other third-party payors including asbestos manufacturers, unions and taxpayers ("Attorneys General Actions"). As new cases are

commenced, the costs associated with defending such cases and the risks attendant to the inherent unpredictability of litigation continue to increase. Liggett had been receiving 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, which, for the most part, consisted of the payment of counsel fees and costs, but this assistance terminated in 1997. For the three months ended March 31, 1998, Liggett incurred counsel fees and costs totaling approximately \$1,342, compared to \$1,037 for the comparable prior year period. The future financial impact on Liggett of the termination of this assistance and the effects of the tobacco litigation settlements discussed below is not quantifiable at this time.

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

INDIVIDUAL ACTIONS. As of March 31, 1998, there were approximately 250 cases pending against Liggett, and in most cases the other tobacco companies, where individual plaintiffs allege injury resulting from cigarette smoking, addiction to cigarette smoking or exposure to ETS and seek compensatory and, in some cases, punitive damages. Of these, 108 were pending in the State of Florida, 82 in the State of New York and 19 in the State of Texas. The balance of individual cases were pending in 16 states. There are four individual cases pending where Liggett is the only named defendant.

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

On May 12, 1998, Liggett settled an individual tobacco-related action entitled *Widdick v. Brown & Williamson*, Duval County Circuit Court, Florida. The settlement will not have a material affect on Liggett's or BGL's financial condition, results of operations or cash flows.

CLASS ACTIONS. As of March 31, 1998, there were approximately 30 actions pending, for which either a class has been certified or plaintiffs are seeking class certification, where Liggett, among others, was a named defendant. Two of these cases, *Fletcher, et al. v. Brooke Group Ltd., et al.* and *Walker, et al. v. Liggett Group Inc., et al.* have been settled, subject to court approval. These two settlements are more fully discussed below under the "Settlements" section.

In October 1991, an action entitled *Broin, et al. v. Philip Morris Incorporated, et al.*, Circuit Court of the Eleventh Judicial District in and for Dade County, Florida, was filed against Liggett and others. This case 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. In October 1997, the other major tobacco companies settled this matter which settlement provides for a release of Liggett and BGL. In February 1998, the Circuit Court approved the settlement, however, a Notice of Appeal was filed in the Third District Court of Appeal by an objector to the settlement.

In March 1994, an action entitled *Castano, et al. v. The American Tobacco Company Inc., et al.*, United States District Court, Eastern District of Louisiana, was filed against Liggett and others. The class action complaint sought relief for a nationwide class of smokers based on their alleged addiction to nicotine. In February 1995, the District Court granted plaintiffs' motion for class certification (the "Class Certification Order").

In May 1996, the Court of Appeals for the Fifth Circuit reversed the Class Certification Order and instructed the District Court to dismiss the class complaint. The Fifth Circuit ruled that the District Court erred in its analysis of the class certification issues by failing to consider how variations in state law affect predominance of common questions and the superiority of the class action mechanism. The appeals panel also held that the District Court's predominance inquiry did not include consideration of how a trial on the merits in Castano would be conducted. The Fifth Circuit further ruled that the "addiction-as-injury" tort is immature and, accordingly, the District Court could not know whether common issues would be a "significant" portion of the individual trials. According to the Fifth Circuit, any savings in judicial resources that class certification may bring about is speculative and would likely be overwhelmed by the procedural problems certification brings. Finally, the Fifth Circuit held that in order to make the class action manageable, the District Court would be forced to bifurcate issues in violation of the Seventh Amendment.

The extent of the impact of the Castano decision on tobacco-related class action litigation is still uncertain, although the decertification of the Castano class by the Fifth Circuit may preclude any federal court from certifying a nationwide class action for trial purposes with respect to tobacco-related claims. The Castano decision has had, however, only limited effect with respect to courts' decisions regarding narrower tobacco-related classes or class actions brought in state rather than federal court. For example, since the Fifth Circuit's ruling, courts in New York, Louisiana and Maryland have certified "addiction-as-injury" class actions that covered only citizens in those states. Two class actions pending in state court in Florida have also been certified and one of the actions, the Broin case, had begun trial before settling in 1997. The Castano decision has had no measurable impact on litigation brought by or on behalf of single individual claimants.

ATTORNEYS GENERAL ACTIONS. As of March 31, 1998, 41 Attorneys General actions were filed against Liggett and BGL. As more fully discussed below, Liggett and BGL have settled 37 of these actions. In addition, Liggett has reached settlements with 6 Attorneys General representing states or territories which have not yet commenced litigation. As of March 31, 1998, there were approximately 55 additional third-party payor actions pending. In certain of the pending proceedings, state and local government entities and others seek reimbursement for Medicaid and other health care expenditures allegedly caused by use of tobacco products. The claims asserted in these health care cost recovery actions vary. In most of these cases, plaintiffs assert the equitable claim that the tobacco industry was "unjustly enriched" by plaintiffs' payment of health care costs allegedly attributable to smoking and seek reimbursement of those costs. Other claims made by some but not all plaintiffs include the equitable claim of indemnity, common law claims of negligence, strict liability, breach of express and implied warranty, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under state and federal statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under RICO.

On April 29, 1998, a group known as the "Coalition for Tobacco Responsibility", which represents Blue Cross and Blue Shield Plans in more than 35 states, filed federal lawsuits against the industry seeking payment of health-care costs allegedly incurred as a result of cigarette smoking and ETS. The lawsuits were filed in Federal District Courts in New York, Chicago and Seattle and seek billions of dollars in damages. The lawsuits allege conspiracy, fraud, misrepresentation, violation of federal racketeering and anti-trust laws as well as other claims.

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

per year) for the next 25 years, subject to certain reductions provided for in the agreement and a \$5,000 payment from Liggett if Liggett or BGL fail to consummate a merger or similar transaction with another non-settling tobacco company defendant within three years of the date of settlement. Liggett and BGL have the right to terminate the Castano settlement under certain circumstances. On March 14, 1996, Liggett, the Castano Plaintiffs Legal Committee and the Castano plaintiffs entered into a letter agreement. According to the terms of the letter agreement, for the period ending nine months from the date of Final Approval (as defined in the letter), if granted, of the Castano settlement or, if earlier, the completion by Liggett or BGL of a combination with any defendant in Castano, except Philip Morris, the Castano plaintiffs and their counsel agree not to enter into any more favorable settlement agreement with any Castano defendant which would reduce the terms of the Castano settlement agreement. If the Castano plaintiffs or their counsel enter into any such settlement during this period, they shall pay Liggett \$250,000 within 30 days of the more favorable agreement and offer Liggett and BGL the option to enter into a settlement on terms at least as favorable as those included in such other settlement. The letter agreement further provides that during the same time period, and if the Castano settlement agreement has not been earlier terminated by Liggett in accordance with its terms, Liggett 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 Liggett or its affiliates enter into any such transaction, then the Castano plaintiffs will be entitled to receive \$250,000 within 30 days from the transacting party. In May 1996, the Castano Plaintiffs Legal Committee filed a motion with the United States District Court for the Eastern District of Louisiana seeking preliminary approval of the Castano settlement. In September 1996, shortly after the class was decertified, the Castano plaintiffs withdrew the motion for approval of the Castano settlement.

In March 1996, Liggett and BGL entered into a settlement of tobacco-related litigation with the Attorneys General of Florida, Louisiana, Massachusetts, Mississippi and West Virginia (the "March 1996 Settlements"). The March 1996 Settlements release Liggett and BGL from all tobacco-related claims including claims for health care cost reimbursement and claims concerning sales of cigarettes to minors. Certain of the terms of the March 1996 Settlements are summarized below.

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

Settlement funds received by the Attorneys General will be used to reimburse the states for smoking-related health care costs. Liggett and BGL also have agreed to phase in compliance with certain of the proposed interim FDA regulations on the same basis as provided in the Castano settlement. Liggett and BGL have the right to terminate the March 1996 Settlements with respect to any settling state if any of the remaining defendants in the litigation succeed on the merits in that state's respective Attorney General action. Liggett and BGL may also terminate the March 1996 Settlements if they conclude that too many states have filed Attorney General actions and have not settled such cases with Liggett and BGL.

In March 1997, Liggett, BGL and the five settling states executed an addendum pursuant to which Liggett and BGL agreed to provide to the five settling states, among other things, the additional cooperation and compliance with advertising restrictions that is provided for in the March 1997 Settlements (discussed below). Also, pursuant to the addendum, the initial settling states agreed to use

best efforts to ensure that in the event of a global tobacco settlement enacted through federal legislation or otherwise, Liggett's and BGL's financial obligations under such a global settlement would be no more onerous than under this settlement.

At December 31, 1995, Liggett had accrued approximately \$4,000 for the present value of the fixed payments under the March 1996 Settlements. At December 31, 1997, in connection with the March 1998 Settlements, the Company accrued \$16,421 for the present value of the fixed payments under the March 1998 Settlements. At March 31, 1998, in connection with the settlement with the Attorney General of Georgia (discussed below), the Company accrued \$481 for the present value of the fixed payments under the Georgia settlement. No additional amounts have been accrued with respect to the recent settlements discussed below. The Company cannot quantify the future costs of the settlements at this time as the amount Liggett must pay is based, in part, on future operating results. Possible future payments based on a percentage of pretax income, and other contingent payments based on the occurrence of a business combination, will be expensed when considered probable.

In March 1997, Liggett and BGL entered into a comprehensive settlement of tobacco litigation through parallel agreements with the Attorneys General of 17 states and with a nationwide class of individuals and entities that allege smoking-related claims. Thereafter, during 1997, settlements were reached with four more states through their respective Attorneys General (settlements with these 21 Attorneys General and with the nationwide class are hereinafter referred to as the "March 1997 Settlements"). On March 12, 1998, Liggett and BGL announced settlements with the Attorneys General of 14 states, the District of Columbia and the U.S. Virgin Islands (the "March 1998 Settlements"). On March 26, 1998, Liggett and BGL settled with the Attorney General of Georgia, which joined the March 1998 Settlements. The foregoing settlements cover all smoking-related claims, including both addiction-based and tobacco injury claims against Liggett and BGL, brought by the Attorneys General and, upon court approval, the nationwide class.

The states and territories where settlements have been reached with Attorneys General are: Alaska, Arizona, Arkansas, California, Colorado, Connecticut, District of Columbia, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, Texas, Utah, U.S. Virgin Islands, Washington, West Virginia, Wisconsin and Wyoming. Other states have either recently filed health care cost recovery actions or indicated intentions to do so. Both Liggett and BGL will endeavor to resolve those actions on substantially the same terms and conditions as the March 1998 Settlements, however, there can be no assurance that any such settlements will be completed.

As mentioned above, in March 1997, Liggett, BGL and plaintiffs filed the mandatory class settlement agreement in an action entitled Fletcher, et al. v. Brooke Group Ltd., et al., Circuit Court of Mobile County, Alabama, where the court granted preliminary approval and preliminary certification of the class, and in May 1997, a similar mandatory class settlement agreement was filed in an action entitled Walker, et al. v. Liggett Group Inc., et al., United States District Court, Southern District of West Virginia. The Company anticipates that should the court in Fletcher, after dissemination of notice to the class of the pending limited fund class action settlement and a full fairness hearing with respect thereto, issue a final order and judgment approving the settlement, such an order would preclude further prosecution by class members of tobacco-related claims against Liggett and BGL. Under the Full Faith and Credit Act, a final judgment entered in a nationwide class action pending in a state court has a preclusive effect against any class member with respect to the claims settled and released in the nationwide class action. As the class definition in Fletcher encompasses all persons in the United States who could claim injury as a result of cigarette smoking or ETS and any third-party payor claimants, it is anticipated that, upon final order and judgment, all such persons and third-party payor claimants would be barred from further prosecution of tobacco-related claims against Liggett and BGL.

In the Fletcher action, it is anticipated that class members will be notified of the settlement and will have an opportunity to appear at a later court hearing. Effectiveness of the mandatory settlement is

conditioned on final court approval of the settlement after a fairness hearing. There can be no assurance as to whether, or when, such court approval will be obtained.

The Walker court also granted preliminary approval and preliminary certification of the nationwide class; however, on August 5, 1997, the court vacated its preliminary certification of the settlement class, which decision is currently on appeal. The Walker court relied on the Supreme Court's decision in *Amchem Products Inc. v. Windsor* in reaching its decision. In *Amchem*, the Supreme Court affirmed a decision of the Third Circuit vacating the certification of a settlement class that involved asbestos-exposure claims. The Supreme Court held that the proposed settlement class did not meet the requirements for Rule 23 of the Federal Rules of Civil Procedure for predominance of common issues and adequacy of representation. The Third Circuit had held that, although classes could be certified for settlement purposes only, Rule 23's requirements had to be satisfied as if the case were going to be litigated. The Supreme Court agreed that the fairness and adequacy of the settlement are not pertinent to the predominance inquiry under Rule 23(b)(3), and thus, the proposed class must have sufficient unity so that absent class members can fairly be bound by decisions of class representatives.

After the *Amchem* opinion was issued by the Supreme Court on June 25, 1997, objectors to Liggett's settlement in Walker moved for decertification. Although Liggett's settlements, particularly in the Walker action, are "limited fund" class action settlements proceeding under Rule 23(b)(1), and *Amchem* was a Rule 23(b)(3) case, the court in the Walker action, nonetheless, decertified the Walker class. Applying *Amchem* to the Walker case, the District Court, in a decision issued on August 5, 1997, determined that while plaintiffs in Walker have a common interest in "maximizing the limited fund available from the defendants," there remained "substantial conflicts among class members relating to distribution of the fund and other key concerns" that made class certification inappropriate.

The *Amchem* decision's ultimate effect on the viability of the Walker and Fletcher settlements remains uncertain given the Fifth Circuit's recent ruling reaffirming the limited fund class action settlement in *In re Asbestos Litigation ("Ahearn")*. In June 1997, the Supreme Court remanded *Ahearn* to the Fifth Circuit for consideration in light of *Amchem*. On remand, the Fifth Circuit made two decisive distinctions between *Amchem* and *Ahearn*. First, the *Ahearn* class action proceeded under Rule 23(b)(1) while *Amchem* was a Rule 23(b)(3) case and second, in *Ahearn*, there was no allocation or difference in award, according to nature or severity of injury, as there was in *Amchem*. The Fifth Circuit concluded that all members of the class and all class representatives share common interests and none of the uncommon questions, abounding in *Amchem*, exist.

The remaining material terms of the March 1996 Settlements, the March 1997 Settlements and the March 1998 Settlements are described below.

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

Pursuant to the March 1996 Settlements, any other tobacco company defendant, except Philip Morris, merging or combining with Liggett or BGL, prior to the third anniversary of the settlement, would receive certain settlement benefits, including limitations on potential liability. Pursuant to the agreement, any such combining tobacco company would be released from the lawsuits brought by the five initial settling states. Such combining tobacco company would be obligated to pay into the settlement fund within sixty days of becoming bound to the agreement \$135,000, and make annual payments of 2.5% of the combining company's pre-tax income (but not less than \$30,000 per year). Such combining tobacco company would also have to comply with the advertising and access restrictions provided for in the agreement, and would have to withdraw their objections to the FDA rule.

Pursuant to the March 1997 Settlements, any other tobacco company defendant, except Philip Morris, merging or combining with Liggett or BGL, prior to the fourth anniversary of the settlements, would receive certain settlement benefits, including limitations on potential liability for affiliates not engaged in domestic tobacco operations and a waiver of any obligation to post a bond to appeal any future adverse judgment. In addition, within 120 days following any such combination, Liggett would be required to pay the settlement fund \$25,000. Under all settlements, the plaintiffs have agreed not to seek an injunction preventing a defendant tobacco company combining with Liggett or BGL from spinning off any affiliate which is not engaged in the domestic tobacco business.

Pursuant to the March 1998 Settlements, Liggett is required to pay each of settling states and territories their relative share (based on the Medicaid population of each state over the total Medicaid population of the United States) of between 27.5% and 30% of Liggett's pre-tax income each year for 25 years, with a minimum payment guarantee of \$1,000 per state over the first nine years of the agreement. The liability was computed using a discount rate of 18%. The aggregate liability under the March 1996 Settlements, the March 1997 Settlements and the March 1998 Settlements (including the Georgia settlement) is \$39,556, the present value of which, when discounted at the rate of 18% per annum, is \$19,365 at December 31, 1997. Minimum payments to be made for these settlements over the next five years and thereafter are: 1998: \$4,144; 1999: \$4,518; 2000: \$4,518; 2001: \$4,577; 2002: \$4,630; thereafter: \$18,169. The annual percentage is subject to increase, pro rata from 27.5% up to 30%, depending on the number of additional states joining the settlement. Pursuant to the "most favored nation" provisions under the March 1996 Settlements and the March 1997 Settlements, each of the states settling under those settlements could benefit from the economic terms of the March 1998 Settlements. In the case of the March 1997 Settlements, in the event that the Fletcher class is approved, monies collected in the settlement fund will be overseen by a court-appointed committee and utilized to compensate state health care programs and settlement class members and to provide counter-market advertising. In all settlements, Liggett agreed to phase-in compliance with certain proposed FDA regulations regarding smoking by children and adolescents, including a prohibition on the use of cartoon characters in tobacco advertising and limitations on the use of promotional materials and distribution of sample packages where minors are present. The March 1998 Settlements provide for additional restrictions and regulations on Liggett's advertising, including a prohibition on outdoor advertising and product advertising on the Internet and on payments for product placement in movies and television.

Under all settlements, Liggett and BGL are also entitled to most favored nation treatment in the event any settling Attorney General reaches a settlement with any other defendant tobacco company. Under the March 1996 Settlements and March 1997 Settlements, in the event of a global settlement involving federal legislation with any other defendant tobacco company, the settling Attorneys General agreed to use their "best efforts" to ensure that the Liggett and BGL's liability under such legislation should be no more onerous than under these settlements. Under the March 1998 Settlements, the settling Attorneys General agreed to write letters to Congress and the President of the United States to ensure that Liggett and BGL's liability under any such legislation should be more onerous than under these settlements.

Copies of the various settlement agreements are filed as exhibits to the Company's Form 10-K and the discussion herein is qualified in its entirety by reference thereto.

TRIALS. On May 8, 1998, the other tobacco companies settled the litigation in Minnesota known as the State of Minnesota by Hubert H. Humphrey, III, its Attorney General and Blue Cross and Blue Shield of Minnesota v. Philip Morris Incorporated, et al. Liggett settled the claims of the State of Minnesota on March 20, 1997, but still remains a defendant in the case with respect to Blue Cross and Blue Shield of Minnesota as to one claim seeking equitable relief. There are several other trial dates scheduled during 1998 for individual cases; however, trial dates are subject to change.

PROPOSED RESOLUTION. In June 1997, Philip Morris Incorporated ("Philip Morris"), R. J. Reynolds Tobacco Company ("RJR"), B&W, Lorillard Tobacco Company ("Lorillard") and the United States Tobacco Company, along with the Attorneys General for the States of Arizona, Connecticut, Florida, Mississippi, New York and Washington and the Castano Plaintiffs' Litigation Committee executed a Memorandum of Understanding to support the adoption of federal legislation and necessary ancillary undertakings, incorporating the features described in a proposed resolution (the "Resolution"). The proposed Resolution mandates a total reformation and restructuring of how tobacco products are manufactured, marketed and distributed in the United States.

The proposed Resolution includes provisions relating to advertising and marketing restrictions, product warnings and labeling, access restrictions, licensing of tobacco retailers, the adoption and enforcement of "no sales to minors" laws by states, surcharges against the industry for failure to achieve underage smoking reduction goals, regulation of tobacco products by the FDA, public disclosure of industry documents and research, smoking cessation programs, compliance programs by the industry, public smoking and smoking in the workplace, enforcement of the proposed Resolution, industry payments and litigation.

The proposed Resolution would require the FDA to impose annual surcharges on the industry if targeted reductions in underage smoking incidence are not achieved in accordance with a legislative timetable. The surcharge would be based upon an approximation of the present value of the profit the companies would earn over the lives of all underage consumers in excess of the target, and would be allocated among participating manufacturers based on their market share of the United States cigarette industry.

The proposed Resolution would require participating manufacturers to make substantial payments in the year of implementation and thereafter ("Industry Payments"). Participating manufacturers would be required to make an aggregate \$10 billion initial Industry Payment on the date that federal legislation implementing the terms of the proposed Resolution is signed. This Industry Payment would be based on relative market capitalization. Thereafter, the participating companies would be required to make specified annual Industry Payments determined and allocated among the companies based on volume of domestic sales as long as the companies continue to sell tobacco products in the United States. These Industry Payments, which would begin on December 31 of the first full year after implementing federal legislation is signed, would be in the following amounts (at 1996 volume levels) -- year 1: \$8.5 billion; year 2: \$9.5 billion; year 3: \$11.5 billion; year 4: \$14 billion; and each year thereafter: \$15 billion. These Industry Payments would be increased by the greater of 3% or the previous year's inflation rate, and would be adjusted to reflect changes from 1996 domestic sales volume levels.

The Industry Payments would be separate from any surcharges. The Industry Payments would receive priority and would not be dischargeable in any bankruptcy or reorganization proceeding and would be the obligation only of entities selling tobacco products in the United States (and not their affiliated companies). The proposed Resolution provides that all payments by the industry would be

ordinary and necessary business expenses in the year of payment, and no part thereof would be either in settlement of an actual or potential liability for a fine or penalty (civil or criminal) or the cost of a tangible or intangible asset. The proposed Resolution would provide for the pass-through to consumers of the annual Industry Payments in order to promote the maximum reduction in underage use.

If enacted, the federal legislation provided for in the proposed Resolution would settle present attorney general health care cost recovery actions (or similar actions brought by or on behalf of any governmental entity other than the federal government), parens patriae and smoking and health class actions and all "addiction"/dependence claims, and would bar similar actions from being maintained in the future. However, the proposed Resolution provides that no stay applications will be made in pending governmental actions without the mutual consent of the parties. The proposed Resolution would not affect any smoking and health class action or any health care cost recovery action that is reduced to final judgment before implementing federal legislation is effective.

Under the proposed Resolution, the rights of individuals to sue the tobacco industry would be preserved, except as expressly changed by implementing federal legislation. Claims, however, could not be maintained on a class or other aggregated basis, and could be maintained only against tobacco manufacturing companies (and not their retailers, distributors or affiliated companies). In addition, all punitive damage claims based on past conduct would be resolved as part of the proposed Resolution, and future claimants could seek punitive damages only with respect to claims predicated upon conduct taking place after the effective date of implementing federal legislation. Finally, except with respect to actions pending as of June 9, 1997, third-party payor (and similar) claims could be maintained only if based on subrogation of individual claims. Under subrogation principles, a payor of medical costs can seek recovery from a third party only by "standing in the shoes" of the injured party and being subject to all defenses available against the injured party.

The proposed Resolution contemplates that participating tobacco manufacturers would enter into a joint sharing agreement for civil liabilities relating to past conduct. Judgments and settlements arising from tort actions would be paid as follows: The proposed Resolution would set an annual aggregate cap of up to 33% of the annual base Industry Payment (including any reductions for volume declines). Any judgments or settlements exceeding the cap in a particular year would roll over into the next year. While judgments and settlements would run against the defendant, they would give rise to an 80-cents-on-the-dollar credit against the annual Industry Payment. Finally, any individual judgments in excess of \$1 million would be paid at the rate of \$1 million per year unless every other judgment and settlement could first be satisfied within the annual aggregate cap. In all circumstances, however, the companies would remain fully responsible for costs of defense and certain costs associated with the fees of attorneys representing certain plaintiffs in the litigation settled by the proposed Resolution.

Under the proposed Resolution, Liggett and BGL would be deemed to be a "non-participating manufacturer". The proposed Resolution provides, among other things, that a non-participating manufacturer would be required to place into escrow, each year, an amount equal to 150% of its share of the payment required of participating manufacturers (other than the portion allocated to public health programs and federal and state enforcement). These funds would be earmarked for potential liability payments and could be reclaimed, with interest, after 35 years, to the extent they had not been paid out in liability.

The proposals are currently being reviewed by the White House, Congress and various public interest groups. Separately, the other tobacco companies negotiated settlements of the Attorneys General health care cost recovery actions in Mississippi, Florida, Texas and Minnesota. Management is unable to predict the ultimate effect, if any, of the enactment of legislation adopting the proposed resolution. Management is also unable to predict the ultimate content of any such legislation; however, adoption of any such legislation could have a material adverse effect on the business of Liggett and BGL.

OTHER RELATED MATTERS. In March 1997, RJR, Philip Morris, B&W and Lorillard obtained a temporary restraining order from a North Carolina state court preventing Liggett and BGL and their agents, employees, directors, officers and lawyers from turning over documents allegedly subject to the joint defense privilege in connection with the settlements, which restraining order was converted to a preliminary injunction by the court in April 1997. In March 1997, the United States District Court for the Eastern District of Texas and state courts in Mississippi and Illinois each issued orders enjoining the other tobacco companies from interfering with Liggett's filing with the courts, under seal, those documents.

Liggett understands that a grand jury investigation is being conducted by the office of the United States Attorney for the Eastern District of New York (the "Eastern District Investigation") regarding possible violations of criminal law relating to the activities of The Council for Tobacco Research - USA, Inc. (the "CTR"). Liggett was a sponsor of the CTR at one time. In May 1996, Liggett received a subpoena from a Federal grand jury sitting in the Eastern District of New York, to which Liggett has responded.

In March 1996, and in each of March, July, October and December 1997, Liggett and/or BGL received subpoenas from a Federal grand jury in connection with an investigation by the United States Department of Justice (the "DOJ Investigation") involving the industry's knowledge of the health consequences of smoking cigarettes; the targeting of children by the industry and the addictive nature of nicotine and the manipulation of nicotine by the industry. Liggett has responded to the March 1996, March 1997 and July 1997 subpoenas and is in the process of responding to the October and December 1997 subpoenas. Liggett understands that the Eastern District Investigation and the DOJ Investigation have, for all intents and purposes, been consolidated into one investigation being conducted by the Department of Justice. Liggett and BGL are unable, at this time, to predict the outcome of this investigation.

On April 28, 1998, Liggett and BGL announced that they had reached an agreement with the United States Department of Justice to cooperate in both the Eastern District Investigation and the DOJ Investigation. The agreement does not constitute an admission of any wrongful behavior by Liggett. The Department of Justice has not provided immunity to Liggett and has full discretion to act or refrain from acting with respect to Liggett in the investigation.

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

Liggett is unable to make a meaningful estimate with respect to the amount of loss that could result from an unfavorable outcome of the cases pending against the Company, because the complaints filed in these cases rarely detail alleged damages. Typically, the claims set forth in an individual's complaint against the tobacco industry pray for money damages in an amount to be determined by a jury, plus punitive damages and costs. These damage claims are usually stated as being for at least the minimum necessary to invoke the jurisdiction of the court.

Third-party payor claimants and others have set forth several additional variations on relief sought: funding of corrective public education campaigns relating to issues of smoking and health; funding for clinical smoking cessation programs; disgorgement of profits from sales of cigarettes; restitution; treble damages; and attorneys' fees. Nevertheless, no specific amounts are provided. It is, however, understood that requested damages against the tobacco company defendants in these cases may be in the billions of dollars.

It is possible that Liggett's consolidated financial position, results of operation and cash flow could be materially adversely affected by an unfavorable outcome in any of such pending tobacco-related litigation.

Liggett has been involved in certain environmental proceedings, none of which, either individually or in the aggregate, rise to the level of materiality. Liggett's current operations are conducted

in material compliance 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, has not had a material effect on the capital expenditures, earnings or competitive position of Liggett.

There are several other proceedings, lawsuits and claims pending against Liggett unrelated to smoking or tobacco 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.

LEGISLATION AND REGULATION:

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

In August 1996, the Commonwealth of Massachusetts enacted legislation requiring tobacco companies to publish information regarding the ingredients in cigarettes and other tobacco products sold in that state. In December 1997, the United States District Court for the District of Massachusetts enjoined this legislation from going into effect, however, in December 1997, Liggett began complying with this legislation by providing ingredient information to the Massachusetts Department of Public Health.

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

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

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

capricious. Whatever the outcome of this litigation, issuance of the report may encourage efforts to limit smoking in public areas.

As part of the budget agreement recently approved by Congress, federal excise taxes on a pack of cigarettes, which are currently 24 cents, would rise 10 cents in the year 2000 and 5 cents more in the year 2002. In a speech on September 17, 1997, President Clinton called for federal legislation that, among other things, would raise cigarette prices by up to \$1.50 per pack. Since then, several bills have been introduced in the Senate that purport to propose legislation along these lines. Management is unable to predict the ultimate content of any such legislation; however, adoption of any such legislation could have a material adverse effect on the business of Liggett and BGL.

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

9. Related Party Transactions

On July 5, 1996, Liggett purchased 140,000 shares (19.97%) of Liggett-Ducat's tobacco operations from BOL, for \$2,100. Liggett-Ducat produces and markets cigarettes in Russia. Liggett also acquired on that date for \$3,400 a ten-year option to purchase from BOL at the same per share price up to 292,407 additional shares of Liggett-Ducat, thereby entitling Liggett to increase its interest in Liggett-Ducat to approximately 62%. On March 13, 1997, Liggett acquired a second ten-year option to purchase BOL's remaining shares in Liggett-Ducat (an additional 33%) for \$2,200 of which \$2,049 was paid in cash, with the balance settled through intercompany accounts. Such amounts are accounted for as an element of cash flows from investing activities in the Company's consolidated statements of cash flows. Liggett accounted for its investment in Liggett-Ducat under the equity method of accounting. Liggett's equity in the net income of Liggett-Ducat amounted to \$498 for the year ended December 31, 1997. The Company's equity in the loss of Liggett-Ducat amounted to \$1,116 for the year ended December 31, 1996. On December 31, 1997, the carrying value of Liggett-Ducat amounted to \$1,208. The excess of the cost of the option over carrying amount of net assets to be acquired under the option has been charged to stockholder's deficit. On January 30, 1998, in connection with the restructuring of the Liggett Notes, BOL acquired the Liggett-Ducat shares and options held by Liggett. (Refer to Note 7 to the Company's consolidated financial statements.)

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

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

Liggett has entered into an annually renewable Corporate Services Agreement with BGLS wherein BGLS agreed to provide corporate services to the Company at an annual fee paid in monthly

installments. Corporate services provided by BGLS under this agreement include the provision of administrative services related to Liggett's participation in its parent company's multi-employer benefit plan, external publication of financial results, preparation of consolidated financial statements and tax returns and such other administrative and managerial services as may be reasonably requested by Liggett. The charges for services rendered under the agreement amounted to \$1,020 in the first quarter of 1998 and \$830 in the first quarter of 1997. This fee is in addition to the management fee and overhead reimbursements described above. In connection with the January 30, 1998 amendment to the Liggett Notes Indenture, BGL and BGLS agreed to waive corporate services and management fees above \$3,600 per year, effective January 1, 1998.

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 the Company on behalf of its affiliates.

10. Restructuring Charges

During 1997, the Company reduced its headcount by 108 full-time positions and recorded a \$1,964 restructuring charge to operations (\$407 of which was included in cost of sales) for severance programs, primarily salary continuation and related benefits for terminated employees. Of the total restructuring recorded during 1997, \$1,671 was funded during 1997, leaving \$293 remaining to be funded in 1998.

For the three months ending March 31, 1998, restructuring charges of approximately \$241 were funded, leaving \$52 remaining to be funded in the following year.

EVE HOLDINGS INC.

BALANCE SHEETS
(Unaudited)

(Dollars in thousands, except per share amounts)

	March 31, 1998	December 31, 1997
	-----	-----
ASSETS		
Cash	\$ 5	\$ 1
Office equipment	2	2
Trademarks, at cost, less accumulated amortization of \$19,420 and \$18,995, respectively	993	1,418
	-----	-----
Total assets	<u>\$ 1,000</u>	<u>\$ 1,421</u>
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Federal income taxes currently payable to parent	\$ 526	\$ 91
Dividends payable	977	1,273
Other current liabilities	6	3
Deferred income taxes	348	496
	-----	-----
Total liabilities	1,857	1,863
	-----	-----
Stockholder's equity (deficit):		
Common stock (par value \$1.00 per share; authorized, issued and outstanding 100 shares) and contributed capital	46,742	45,442
Receivables from parent:		
Note receivable - interest at 14%, due no sooner than February 1, 1999	(44,520)	(44,520)
Other	(3,079)	(1,364)
	-----	-----
Total stockholder's equity (deficit)	(857)	(442)
	-----	-----
Total liabilities and stockholder's equity (deficit)	<u>\$ 1,000</u>	<u>\$ 1,421</u>
	=====	=====

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

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

	Three Months Ended March 31,	
	1998	1997
Revenues:		
Royalties - parent	\$1,519	\$1,546
Interest - parent	1,576	1,576
	3,095	3,122
Expenses:		
Amortization of trademarks	425	425
Miscellaneous, net	15	37
	2,655	2,660
Income before income taxes	2,655	2,660
Income tax provision	377	379
	\$2,278	\$2,281
Net income	\$2,278	\$2,281

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

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

	Three Months Ended March 31,	
	----- 1998 -----	----- 1997 -----
Cash flows from operating activities:		
Net income	\$ 2,278	\$ 2,281
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	425	425
Deferred income taxes	(149)	(149)
Changes in assets and liabilities:		
Federal income taxes currently payable to parent	435	528
Other current liabilities	3	(19)
	-----	-----
Net cash provided by operating activities	2,992	3,066
	-----	-----
Cash flows from financing activities:		
Dividends/capital distributions	(1,273)	(4,623)
Decrease (increase) in due from parent	(1,715)	1,653
Decrease in cash overdraft	--	(92)
	-----	-----
Net cash used in financing activities	(2,988)	(3,062)
Net increase in cash	4	4
Cash:		
Beginning of period	1	--
	-----	-----
End of period	\$ 5	\$ 4
	=====	=====
Supplemental cash flow information:		
Payments of income taxes through receivable from parent	\$ --	\$ --
Income taxes	91	32
Dividends/capital distributions declared but not paid	977	980

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

EVE HOLDINGS INC.

NOTES TO FINANCIAL STATEMENTS

(Unaudited)

(Dollars in thousands, except per share amounts)

1. The Company

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

2. Summary of Significant Accounting Policies

a. Going Concern

The accompanying financial statements have been prepared assuming that Eve will continue as a going concern. Eve's revenues are comprised solely of royalties and interest income from Liggett. In addition, Eve holds a note receivable from Liggett for \$44,520 due no sooner than February 1, 1999. Liggett had a working capital deficiency of \$182,312 and a net capital deficiency of \$190,383 as of March 31, 1998, is highly leveraged and has substantial near-term debt service requirements. Both the Liggett Series B and Series C Notes (as defined below) and the revolving credit facility, amounting in total to \$173,361, mature during the first quarter of 1998. These matters raise substantial doubt about Eve and Liggett meeting their liquidity needs and their ability to continue as going concerns.

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

b. Per Share Data

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

3. Guarantee of Liggett Notes

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

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

4. Income Taxes

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

NEW VALLEY CORPORATION
CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 1998

NEW VALLEY CORPORATION AND SUBSIDIARIES
FOR THE THREE MONTHS ENDED MARCH 31, 1998

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

	March 31, 1998	December 31, 1997
	-----	-----
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$ 9,899	\$ 11,606
Investment securities available for sale.....	41,960	51,993
Trading securities owned.....	56,028	49,988
Restricted assets.....	236	232
Receivable from clearing brokers.....	1,402	1,205
Other current assets.....	5,466	3,618
	-----	-----
Total current assets.....	114,991	118,642
	-----	-----
Investment in real estate, net.....	170,811	256,645
Furniture and equipment, net.....	11,768	12,194
Restricted assets.....	5,548	5,484
Long-term investments, net.....	26,292	27,224
Investment in joint venture.....	59,340	--
Other assets.....	14,489	21,202
	-----	-----
Total assets.....	\$ 403,239	\$ 441,391
	=====	=====
LIABILITIES AND SHAREHOLDERS' DEFICIENCY		
Current liabilities:		
Margin loan payable.....	\$ 10,170	\$ 13,012
Current portion of notes payable and long-term obligations ...	349	760
Accounts payable and accrued liabilities.....	42,310	57,722
Prepetition claims and restructuring accruals.....	12,452	12,611
Income taxes.....	18,746	18,413
Securities sold, not yet purchased.....	29,683	25,610
	-----	-----
Total current liabilities.....	113,710	128,128
	-----	-----
Notes payable.....	154,027	173,814
Other long-term obligations.....	9,095	11,210
Redeemable preferred shares.....	271,924	258,638
Shareholders' deficiency:		
Cumulative preferred shares; liquidation preference of \$69,769; dividends in arrears, \$145,671 and \$139,412.....	279	279
Common Shares, \$.01 par value; 850,000,000 shares authorized; 9,577,624 shares outstanding.....	96	96
Additional paid-in capital.....	592,004	604,215
Accumulated deficit.....	(742,270)	(742,427)
Unearned compensation on stock options.....	(405)	(158)
Accumulated other comprehensive income.....	4,779	7,596
	-----	-----
Total shareholders' deficiency.....	(145,517)	(130,399)
	-----	-----
Total liabilities and shareholders' deficiency.....	\$ 403,239	\$ 441,391
	=====	=====

See accompanying Notes to Condensed Consolidated Financial Statements

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

	Three Months Ended March 31,	
	1998	1997
	-----	-----
Revenues:		
Principal transactions, net.....	\$ 5,893	\$ 2,499
Commissions.....	6,676	3,393
Corporate finance fees.....	3,238	1,132
Gain on sale of investments.....	5,596	3,694
Loss from joint venture.....	(329)	--
Real estate leasing.....	7,776	6,282
Interest and dividends.....	2,849	1,541
Computer sales and service.....	413	3,283
Other income.....	1,728	1,029
	-----	-----
Total revenues.....	33,840	22,853
	-----	-----
Cost and expenses:		
Operating, general and administrative.....	30,100	25,946
Interest.....	4,160	3,862
Provision for loss on long-term investment.....	--	3,796
	-----	-----
Total costs and expenses.....	34,260	33,604
	-----	-----
Loss before income taxes and minority interests.....	(420)	(10,751)
Income tax provision.....	6	50
Minority interest in loss of consolidated subsidiaries.....	583	460
	-----	-----
Net income (loss).....	157	(10,341)
Dividend requirements on preferred shares.....	(18,832)	(15,980)
	-----	-----
Net loss applicable to Common Shares.....	\$ (18,675)	\$ (26,321)
	=====	=====
Loss per Common Share (basic and diluted):		
Net loss per Common Share.....	\$ (1.95)	\$ (2.75)
	=====	=====
Number of shares used in computation.....	9,578,000	9,578,000
	=====	=====

See accompanying Notes to Condensed Consolidated Financial Statements

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

	CLASS B PREFERRED SHARES -----	COMMON SHARES -----	PAID-IN CAPITAL -----	ACCUMULATED DEFICIT -----	UNEARNED COMPENSATION ON STOCK OPTIONS -----	ACCUMULATED OTHER COMPREHENSIVE INCOME -----
Balance, December 31, 1997.....	\$279	\$96	\$604,215	\$(742,427)	\$(158)	\$ 7,597
Net income.....				157		
Undeclared dividends and accretion on redeemable preferred shares...			(12,574)			
Unrealized loss on investment securities.....						(2,818)
Adjustment to unearned compensation on stock options.....			363		(363)	
Compensation expense on stock option grants.....					116	
	----	---	-----	-----	-----	-----
Balance, March 31, 1998.....	\$279 ====	\$96 ===	\$ 592,004 =====	\$(742,270) =====	\$(405) =====	\$ 4,779 =====

See accompanying Notes to Condensed Consolidated Financial Statements

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

	Three Months Ended March 31,	
	1998	1997
Cash flows from operating activities:		
Net income (loss).....	\$ 157	\$(10,341)
Adjustments to reconcile net income (loss) to net cash used for operating activities:		
Loss from joint venture.....	329	--
Depreciation and amortization.....	2,344	2,009
Provision for loss on long-term investment.....	--	3,796
Stock based compensation expense.....	828	847
Changes in assets and liabilities, net of effects from acquisitions:		
Decrease (increase) in receivables and other assets.....	(9,586)	14,313
Increase in income taxes.....	440	759
Increase (decrease) in accounts payable and accrued liabilities....	2,766	(12,905)
	-----	-----
Net cash used for operating activities.....	(2,722)	(1,522)
	-----	-----
Cash flows from investing activities:		
Sale or maturity of investment securities.....	8,129	23,193
Purchase of investment securities.....	(913)	(3,963)
Sale or liquidation of long-term investments.....	1,901	2,807
Purchase of long-term investments.....	(1,951)	(4,400)
Purchase of real estate.....	(1,419)	--
Purchase of furniture and fixtures.....	(197)	--
Payment of prepetition claims.....	(847)	(58)
Return of prepetition claims paid.....	--	1,396
(Increase) decrease in restricted assets.....	(68)	82
Net cash transferred to joint venture.....	(487)	--
Payment for acquisitions, net of cash acquired.....	--	(20,014)
	-----	-----
Net cash provided from (used for) investing activities.....	4,148	(957)
	-----	-----
Cash flows from financing activities:		
Decrease in margin loan payable.....	(2,842)	--
Prepayment of notes payable.....	(291)	(114)
Repayment of other obligations.....	--	(207)
	-----	-----
Net cash used for financing activities.....	(3,133)	(321)
	-----	-----
Net decrease in cash and cash equivalents.....	(1,707)	(2,800)
Cash and cash equivalents, beginning of period.....	11,606	57,282
	-----	-----
Cash and cash equivalents, end of period.....	\$ 9,899	\$ 54,482
	=====	=====

See accompanying Notes to Condensed Consolidated Financial Statements

NEW VALLEY CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED 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 its majority-owned subsidiaries (the "Company"). The consolidated financial statements as of March 31, 1998 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 March 31, 1998 and the results of operations and cash flows for all periods presented have been made. Results for the interim periods are not necessarily indicative of the results for an entire year.

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

These financial statements should be read in conjunction with the consolidated financial statements in the Company's Annual Report on Form 10-K, as amended, for the year ended December 31, 1997, as filed with the Securities and Exchange Commission.

Certain reclassifications have been made to prior interim period financial information to conform with current year presentation.

NEW ACCOUNTING PRONOUNCEMENTS.

In June 1997, the FASB issued SFAS No. 130, "Reporting Comprehensive Income." The Statement, which the Company adopted in the first quarter of 1998, establishes standards for reporting and displaying comprehensive income and its components in a full set of general-purpose financial statements. Where applicable, earlier periods have been restated to conform to the standards established by SFAS No. 130. The adoption of SFAS 130 did not have a material impact on the Company's financial statements.

For transactions entered into in fiscal years beginning after December 15, 1997, the Company adopted and is reporting in accordance with SOP 97-2, "Software Revenue Recognition". The adoption of SOP 97-2 did not have a material impact on the Company's financial statements.

In March 1998, the AICPA issued SOP 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." SOP 98-1 provides guidance that the carrying value of software developed or obtained for internal use is assessed based upon an analysis of estimated future cash flows on an undiscounted basis and before interest charges. SOP 98-1 is effective for transactions entered into in fiscal years beginning after December 15, 1998. The Company believes that adoption of SOP 98-1 will not have a material impact on the Company's financial statements.

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

In June 1997, the FASB issued SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information", which establishes standards for the way that public business enterprises report information about operating segments. SFAS No. 131 is effective for financial statements for fiscal years beginning after December 15, 1997. The Company is currently reviewing its operating segment disclosures and will adopt SFAS No. 131 in the fourth quarter of 1998.

2. INVESTMENT IN WESTERN REALTY

On January 31, 1997, the Company entered into a stock purchase agreement (the "Purchase Agreement") with Brooke (Overseas) Ltd. ("Brooke (Overseas)"), a wholly-owned subsidiary of Brooke Group Ltd. ("Brooke"), an affiliate of the Company, pursuant to which the Company acquired 10,483 shares (the "BML Shares") of the common stock of BrookeMil Ltd. ("BML") from Brooke (Overseas) for a purchase price of \$55,000, consisting of \$21,500 in cash and a \$33,500 9% promissory note of the Company (the "Note"). The BML Shares comprise 99.1% of the outstanding shares of BML, a real estate development company in Russia. The Note, which was collateralized by the BML Shares, was paid during 1997.

In February 1998, the Company and Apollo Real Estate Investment Fund III, L.P. ("Apollo") organized Western Realty Development LLC ("Western Realty") to make real estate and other investments in Russia. In connection with the formation of Western Realty, the Company agreed, among other things, to contribute the real estate assets of BML, including Ducat Place II and the site for Ducat Place III, to Western Realty and Apollo agreed to contribute up to \$58,000.

Under the terms of the agreement governing Western Realty ("the LLC Agreement"), the ownership and voting interests in Western Realty will be held equally by Apollo and the Company. Apollo will be entitled to a preference on distributions of cash from Western Realty to the extent of its investment, together with a 15% annual rate of return, and the Company will then be entitled to a return of \$10,000 of BML-related expenses incurred by the Company since March 1, 1997, together with a 15% annual rate of return; subsequent distributions will be made 70% to the Company and 30% to Apollo. Western Realty will be managed by a Board of Managers consisting of an equal number of representatives chosen by Apollo and the Company. All material corporate transactions by Western Realty will generally require the unanimous consent of the Board of Managers. Accordingly, the Company has accounted for its non-controlling interest in Western Realty using the equity method of accounting.

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

On February 27, 1998, at an initial closing under the LLC Agreement, Apollo made a \$11,000 loan (the "Loan") to Western Realty. The Loan, which bore interest at the rate of 15% per annum and was due September 30, 1998, was collateralized by a pledge of the Company's shares of BML. On April 28, 1998, the Loan and the accrued interest thereon were converted into a capital contribution by Apollo to Western Realty and the BML pledge was released.

The Company recorded its basis in the investment in the joint venture in the amount of \$59,669 based on the carrying value of assets less liabilities transferred. There was no difference between the carrying value of the investment and the Company's proportionate interest in the underlying value of net assets of the joint venture.

Western Realty will seek to make additional real estate and other investments in Russia. The Company and Apollo have agreed to invest, through Western Realty or another entity, up to \$25,000 in the aggregate for the potential development of a real estate project in Moscow. In addition, Western Realty has made a \$20,000 participating loan to, and payable out of a 30% profits interest in, a company organized by Brooke (Overseas) which will, among other things, acquire an interest in an industrial site and manufacturing facility being constructed on the outskirts of Moscow by a subsidiary of Brooke (Overseas).

3. INVESTMENT SECURITIES AVAILABLE FOR SALE

Investment securities classified as available for sale are carried at fair value, with net unrealized gains included as a separate component of shareholders' equity (deficit). The Company had realized gains on sales of investment securities available for sale of \$ 4,588 for the three months ended March 31, 1998.

The components of investment securities available for sale at March 31, 1998 are as follows:

	COST	GROSS UNREALIZED GAIN	GROSS UNREALIZED LOSS	FAIR VALUE
	-----	-----	-----	-----
Short-term investments.....	\$ 3,798	\$ --	\$ --	\$ 3,798
Marketable equity securities.....	29,698	1,147	611	30,234
Marketable warrants.....	--	7,103	--	7,103
Marketable debt securities	3,685	--	2,860	825
Investment securities.....	\$ 37,181	\$ 8,250	\$ 3,471	\$ 41,960
	=====	=====	=====	=====

4. LONG-TERM INVESTMENTS

At March 31, 1998, long-term investments consisted primarily of investments in limited partnerships of \$26,100. The Company is required under certain limited partnership agreements to make additional investments up to an aggregate of \$6,700 at March 31, 1998. The Company believes the fair value of the limited partnerships exceeds its carrying amount by approximately \$7,500 based on the indicated market values of the underlying investment portfolio provided by the partnerships. The Company's investments in limited partnerships are illiquid and the ultimate realization of these investments are subject to the performance of the underlying partnership and its management by the general partners.

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

In the first quarter of 1997, the Company determined that an other than temporary impairment in the value of its investment in a joint venture had occurred and wrote down this investment to zero with a charge to operations of \$3,796 for the three month period. The Company's estimates of the fair value of its long-term investments are subject to judgment and are not necessarily indicative of the amounts that could be realized in the current market.

5. REDEEMABLE PREFERRED SHARES

At March 31, 1998, the Company had authorized and outstanding 2,000,000 and 1,071,462, respectively, of its Class A Senior Preferred Shares. At March 31, 1998 and December 31, 1997, respectively, the carrying value of such shares amounted to \$271,924 and \$258,638, including undeclared dividends of \$176,161 and \$163,302 or \$164.41 and \$152.41 per share. As of March 31, 1998, the unamortized discount on the Class A Senior Preferred Shares was \$7,534.

For the three months ended March 31, 1998, the Company recorded \$712 in compensation expense related to certain Class A Senior Preferred Shares awarded to an officer of the Company in 1996. At March 31, 1998, the balance of the deferred compensation and the unamortized discount related to these award shares was \$3,849 and \$2,760, respectively.

6. 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 \$145,671 and \$139,412 at March 31, 1998 and December 31, 1997, respectively. These undeclared dividends represent \$52.20 and \$49.95 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 CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

7. CONTINGENCIES

LITIGATION

On or about March 13, 1997, a shareholder derivative suit was filed against the Company, as a nominal defendant, its directors and Brooke in the Delaware Chancery Court, by a shareholder of the Company. The suit alleges that the Company's purchase of the BML Shares constituted a self-dealing transaction which involved the payment of excessive consideration by the Company. The plaintiff seeks (i) a declaration that the Company's directors breached their fiduciary duties, Brooke aided and abetted such breaches and such parties are therefore liable to the Company, and (ii) unspecified damages to be awarded to the Company. The Company's time to respond to the complaint has not yet expired. The Company believes that the allegations were without merit. Although there can be no assurances, management is of the opinion, after consultation with counsel, that the ultimate resolution of this matter will not have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

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

PREPETITION CLAIMS UNDER CHAPTER 11 AND RESTRUCTURING ACCRUALS

The prepetition claims remaining as of March 31, 1998 of \$12,452 may be subject to future adjustments depending on pending discussions with the various parties and the decisions of the Bankruptcy Court.

BROOKE (OVERSEAS) LTD. AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 1998

BROOKE (OVERSEAS) LTD. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

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

	March 31, 1998	December 31, 1997
	-----	-----
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$ 457	\$ 968
Accounts receivable - trade.....	1,376	1,584
Inventories.....	11,497	4,255
Prepaid expenses.....	5,567	9,290
	-----	-----
Total current assets.....	18,897	16,097
Property, plant and equipment, at cost, less accumulated depreciation of \$1,224 and \$1,020.....	28,960	29,122
Goodwill, net.....	1,023	1,001
Other.....	1,168	2
	-----	-----
Total assets.....	\$ 50,048	\$ 46,222
	=====	=====
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Current liabilities:		
Notes payable and current portion of long-term debt.....	\$ 5,000	\$ 5,000
Accounts payable - trade.....	7,194	3,798
Due to affiliates.....	52,917	67,539
Unearned revenue.....	184	1
Accrued taxes.....	15,199	18,077
Other accrued liabilities.....	8,519	8,397
	-----	-----
Total current liabilities.....	89,013	102,812
Deferred gain.....	25,498	25,498
Other long-term liabilities.....	12,479	2,000
Commitments and contingencies.....		
Stockholder's equity (deficit):		
Common stock, par value \$1 per share, 701,000 shares authorized, authorized, issued and outstanding.....	701	701
Additional paid-in-capital.....	15,767	5,600
Deficit.....	(93,410)	(90,389)
	-----	-----
Total stockholder's equity (deficit).....	(76,942)	(84,088)
	-----	-----
Total liabilities and stockholder's equity (deficit).....	\$ 50,048	\$ 46,222
	=====	=====

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

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

	Three Months Ended	
	March 31, 1998	March 31, 1997
Net sales.....	\$ 19,177	\$13,704
Cost of sales.....	15,584	11,329
	-----	-----
Gross profit.....	3,593	2,375
Operating, selling, administrative and general expenses.....	2,141	1,978
	-----	-----
Operating income.....	1,452	397
Other income (expense):		
Interest income.....		480
Interest expense.....	(3,510)	(2,148)
Gain on sale of BML.....		25,563
Gain on foreign currency exchange.....	79	200
Other, net.....	(1)	(29)
	-----	-----
(Loss) income before income taxes.....	(1,980)	24,463
(Benefit) provision for income taxes.....	(234)	12,482
	-----	-----
Net (loss) income.....	\$ (1,746)	\$11,981
	=====	=====

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

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

=====

	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS (DEFICIT)	TOTAL
	----- AMOUNT -----	----- CAPITAL -----			
Balance, December 31, 1997.....	701,000	\$701	\$ 5,600	\$(90,389)	\$(84,088)
Net loss.....				(1,746)	(1,746)
Distributions to parent.....				(1,275)	(1,275)
Capital contribution.....			10,167		10,167
	-----	-----	-----	-----	-----
Balance, March 31, 1998.....	701,000	\$701	\$15,767	\$(93,410)	\$(76,942)
	=====	=====	=====	=====	=====

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

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

	Three Months Ended	
	March 31, 1998	March 31, 1997
Net cash used in operating activities.....	\$ (8,273)	\$ (1,218)
Cash flows from investing activities:		
Capital expenditures.....	(42)	(658)
Proceeds from sale of BML, net.....		20,002
Proceeds from sale of option to purchase stock in Liggett-Ducat.....		2,200
Net cash (used in) provided by investing activities.....	(42)	21,544
Cash flows from financing activities:		
Proceeds from debt.....		3,000
Repayments of debt.....		(155)
Proceeds from participating loan.....	11,000	
Capital contributions from parent.....	9,000	
Repayment of intercompany debt.....	(11,000)	
Distributions paid to parent.....	(1,275)	(24,028)
Net cash provided by (used in) financing activities.....	7,725	(21,183)
Effect of exchange rate changes on cash and cash equivalents.....	79	
Net decrease in cash and cash equivalents.....	(511)	(857)
Cash and cash equivalents, beginning of period.....	968	1,875
Cash and cash equivalents, end of period.....	\$ 457	\$ 1,018
Supplemental cash flow information:		
Cash payments during the period for:		
Interest.....	440	1,109
Income taxes.....	700	741

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

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

1. ORGANIZATION

Brooke (Overseas) Ltd. ("the Company"), a Delaware corporation, is a wholly-owned subsidiary of BGLS Inc. ("BGLS") and an indirect subsidiary of Brooke Group Ltd. ("Brooke"). The consolidated financial statements of the Company include Liggett-Ducat Ltd. ("Liggett-Ducat"), a Russian closed joint stock company engaged in the manufacture and sale of cigarettes in Russia, and Liggett-Ducat Tobacco ("LDT"), a wholly-owned subsidiary of Liggett-Ducat engaged in the construction of a new cigarette factory. Prior to January 31, 1997, BrookeMil Ltd. ("BML") was a wholly-owned subsidiary engaged in construction of office buildings and property management in Moscow, Russia. On January 31, 1997, the Company sold its shares (which represented 99.1% of all shares outstanding) in BML to New Valley Corporation ("New Valley"). (Refer to Note 3.)

The interim consolidated financial statements of the Company are unaudited and, in the opinion of management, reflect all adjustments necessary (which are normal and recurring) to present fairly the Company's consolidated financial position, results of operations and cash flows. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included as Exhibit 99.4 in Brooke's and BGLS' Annual Report on Form 10-K, as amended, for the year ended December 31, 1997, as filed with the Securities and Exchange Commission. The consolidated results of operations for interim periods should not be regarded as necessarily indicative of the results that may be expected for the entire year.

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

Certain amounts in the 1997 consolidated financial statements have been reclassified to conform to the 1998 presentation.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

LIQUIDITY:

The Company has historically relied on Brooke and BGLS for sources of financing. At March 31, 1998, the Company had net capital and working capital deficiencies of \$76,942 and \$70,116, respectively. On February 2, 1998, Brooke and BGLS cancelled a note and interest thereon which amounted to \$20,384 at December 31, 1997. On February 5, 1998, Brooke made a capital contribution of \$9,000 to the Company, which was used to repay intercompany indebtedness to BGLS. These contributions to capital reduced the net capital deficiency and amounts due affiliates by \$29,384. Management believes that it will continue to receive financing from BGLS as needed. In addition to a new factory under construction, the Company has upgraded the present cigarette operations' tobacco processing complex, increased production with over 14 billion units sold in 1997 and is

continuing to implement cost-saving measures. In connection with the move to the new factory, Liggett-Ducat plans to begin the manufacture and marketing of western style cigarettes in early 1999. Management believes that such activities will result in improved operations and cash flow, but there can be no assurances in this regard. (Refer to Note 10.)

3. SALE OF BROOKEMIL

On January 31, 1997, the Company sold all of its shares of BML to New Valley for \$21,500 in cash and a promissory note of \$33,500, collateralized by the BML shares, payable during 1997 with interest at 9%. The note was paid in full as of December 31, 1997. The consideration received exceeded the carrying value of the Company's investment in BML by \$52,500. The Company recognized a gain on the sale in 1997 in the amount of \$25,500. The remaining \$27,000 has been deferred, reflecting recognition that the Company's parent, BGLS, retains an interest in BML through its 42% equity ownership in New Valley, and that a portion of the property sold (the site of the third phase of the Ducat Place real estate project being developed by BML, which is currently used by Liggett-Ducat for its existing cigarette factory) is subject to a put option held by New Valley. This option allows New Valley, under certain circumstances, to put this site back to the Company at the greater of the appraised fair value of the property at the date of exercise or \$13,600, during the period Liggett-Ducat operates the factory on such site. The Company distributed the proceeds received from the sale of BML to BGLS.

Liggett-Ducat entered into a Use Agreement with BML whereby Liggett-Ducat is permitted to continue to utilize the site on the same basis as in the past. The Use Agreement is terminable by BML on 270 days' prior notice.

4. INVENTORIES

Inventories consist of:

	March 31, 1998	December 31, 1997
	-----	-----
Finished goods.....	\$ 1,999	\$
Work-in-process.....	311	50
Raw materials.....	8,266	3,284
Replacement parts and supplies.....	921	921
	-----	-----
	\$11,497	\$4,255
	=====	=====

Purchase commitments are for quantities not in excess of anticipated requirements and are at prices established at the date of the commitment. At March 31, 1998, the Company had leaf tobacco purchase commitments of \$14,200.

5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consists of:

	March 31, 1998	December 31, 1997
	-----	-----
Factory machinery and equipment.....	\$10,810	\$10,864
Computers and software.....	332	293
Office furniture and equipment.....	297	272
Vehicles.....	544	534
Construction-in-progress.....	18,201	18,179
	-----	-----
	30,184	30,142
Less accumulated depreciation.....	(1,224)	(1,020)
	-----	-----
	\$28,960	\$29,122
	=====	=====

Liggett-Ducat is in the process of constructing a new cigarette factory on the outskirts of Moscow which is currently scheduled to be operational in early 1999. Liggett-Ducat has entered into a construction contract for the plant. The remaining liability under that contract, as amended, at March 31, 1998 is approximately \$16,000. Equipment purchase agreements in place at March 31, 1998 total \$34,355, of which \$28,791 will be financed by the manufacturers.

In February 1998, New Valley and Apollo Real Estate Investment Fund III, L.P. organized Western Realty Development LLC ("Western Realty") to make real estate and other investments in Russia. In April, 1998, Western Realty completed making a \$20,000 participating loan to a company organized and wholly-owned by the Company, Western Tobacco Investments LLC ("Western Investments"), which holds the Company's interests in Liggett-Ducat and the new factory discussed above. The loan, which bears no fixed interest, is payable only out of 30% of distributions, if any, made by Western Tobacco to the Company. After the prior payment of debt service on loans to finance the construction of the new facility, 30% of distributions from Western Tobacco to the Company will be applied first to pay the principal of the loan and then as contingent participating interest on the loan. Any rights of payment on the loan are subordinate to the rights of all other creditors of Western Tobacco. An initial \$11,000 was funded in February 1998, with the proceeds used by the Company to reduce intercompany debt to BGLS, and is classified in other long-term liabilities on the consolidated balance sheet at March 31, 1998. (Refer to Note 2.)

6. NOTES PAYABLE, CREDIT FACILITIES AND LONG-TERM DEBT

Current and long-term debt consist of the following:

	March 31, 1998	December 31, 1997
	-----	-----
Revolving credit facilities.....	\$5,000	\$5,000
Deferred financing fees.....		
Notes payable.....		
	-----	-----
	5,000	5,000
Less:		
Current maturities.....	5,000	5,000
	-----	-----
Amount due after one year.....	\$ =====	\$ =====

At March 31, 1998, Liggett-Ducat had two 6-month credit facilities open with a Russian bank. The first, for \$2,000, which expired and was paid on April 30, 1998, initially bore an interest rate of 21%, subsequently raised to 28% on December 2, 1997. The second, for \$3,000, which expired and was paid on May 16, 1998, initially bore an interest rate of 25%, subsequently raised to 28% on December 2, 1997. On April 24, 1998, Liggett-Ducat opened a credit facility for \$2,000 with a Russian bank. The facility, with a variable interest rate (currently 27%), expires on October 25, 1998.

7. STOCK OF LIGGETT-DUCAT

In 1997, the Company purchased 1,666 shares of Liggett-Ducat stock from other shareholders for \$25. At December 31, 1997, the Company owned 75.3% of the stock of Liggett-Ducat and Liggett owned 19.97%. On January 30, 1998, in connection with the restructuring of Liggett's long-term debt, Liggett agreed to transfer to the Company all of its shares and to cancel its option agreements to acquire additional shares. At March 31, 1998, the Company owned approximately 96% of the shares of common stock of Liggett-Ducat. In April 1998, the Company transferred its interests in Liggett-Ducat to the Company's subsidiary Western Tobacco. (Refer to Note 5.)

8. RELATED PARTY TRANSACTIONS

The Company has obtained funding through a revolving credit facility with Brooke and BGLS at an annual interest rate of 20% to cover certain expenses including the cost of certain administrative services and personnel, tobacco and material purchases and upgrades of factory equipment. In addition, Brooke and BGLS have advanced funds to BML for its real estate developments projects. In February 1998, Brooke and BGLS contributed \$29,384 to the Company, in order to reduce intercompany debt. The amounts

due to Brooke and BGLS under this facility at March 31, 1998 were \$24,343, including interest of \$11,746, and \$28,475, including interest of \$4,700, respectively. (Refer to Note 2.)

Refer to Note 5 for information concerning the participating loan to Western Tobacco by Western Realty.

9. INCOME TAXES

For the three months ended March 31, 1998 and 1997, the tax (benefit) of \$234 and the tax provision of \$12,482, respectively, consist of income tax expense pursuant to Russian statutory requirements of \$931 and \$741, respectively, and U.S. income tax (benefit) expense of \$(1,165) and \$11,741 in accordance with the Company's tax sharing agreement with Brooke.

10. CONTINGENCIES

BGLS has pledged its ownership interest in the Company's common stock as collateral in connection with the issuance of BGLS' 15.75% Senior Secured Notes ("BGLS Notes") due 2001.

On March 2, 1998, BGLS entered into an agreement with AIF II, L.P. and an affiliated investment manager on behalf of a managed account (together, the "Apollo Holders"), who hold approximately 41.8% of the BGLS Notes in which the Apollo Holders agreed to defer the payment of interest on the BGLS Notes held by them, commencing with the interest payment that was due July 31, 1997, which they had previously agreed to defer, through the interest payment due July 31, 2000. The deferred interest payments will be payable at final maturity of the BGLS Notes on January 31, 2001 or upon an event of default under the Indenture for the BGLS Notes. In connection with the agreement, the Company pledged 50.1% of Western Tobacco to collateralize the BGLS Notes held by the Apollo Holders. (Refer to Note 5.)

On January 30, 1998, in connection with the restructuring of Liggett's long-term debt, Liggett agreed to transfer to the Company all of its shares of Liggett-Ducat and the Liggett noteholders were granted a security interest in 16% of Western Tobacco. (Refer to Note 7.)

The performance of Liggett-Ducat's cigarette operations in Russia is affected by uncertainties in Russia which may include, among others, political or diplomatic developments, regional tensions, currency repatriation restrictions, foreign exchange fluctuations, inflation, and an undeveloped system of commercial laws and legislative reform relating to foreign ownership in Russia.

NEW VALLEY HOLDINGS, INC.

FINANCIAL STATEMENTS

MARCH 31, 1998

NEW VALLEY HOLDINGS, INC.

FINANCIAL STATEMENTS

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

	March 31, 1998	December 31, 1997
	-----	-----
ASSETS		
Cash and cash equivalents.....	\$ 1,031	\$ 6
Investment in New Valley:		
Redeemable preferred stock.....	58,277	59,359
Common stock.....	(58,277)	(59,359)
	-----	-----
Total investment in New Valley.....		
	-----	-----
Total assets.....	\$ 1,031	\$ 6
	=====	=====
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Payable to parent.....	\$ 1,075	\$ 56
Current income taxes payable to parent.....	6,298	6,298
	-----	-----
Total liabilities.....	7,373	6,354
	-----	-----
Commitments and contingencies.....		
Common stock, \$0.01 par value, 100 shares authorized, issued and outstanding.....		
Additional paid-in capital.....	7,633	7,633
Deficit.....	(29,901)	(25,737)
Accumulated other comprehensive income.....	15,926	11,756
	-----	-----
Total stockholder's equity (deficit).....	(6,342)	(6,348)
	-----	-----
Total liabilities and stockholder's equity (deficit).....	\$ 1,031	\$ 6
	=====	=====

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	
	March 31, 1998	March 31, 1997
Equity in loss of New Valley.....	\$(4,166)	\$(8,153)
Interest income.....	9	6
General and administrative expenses	(7)	(23)
Loss from continuing operations before income taxes.....	(4,164)	(8,170)
Income tax benefit.....	-----	(7)
Net (loss).....	\$(4,164)	\$(8,163)

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

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

	Common Stock		Additional Paid-In Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income	Total
	Shares	Amount				
Balance, December 31, 1997.....	100		\$7,633	\$(25,737)	\$11,756	\$(6,348)
Unrealized holding gain on investment in New Valley.....					4,170	4,170
Net loss.....				(4,164)		(4,164)
Balance, March 31, 1998.....	100		\$7,633	\$(29,901)	\$15,926	\$ 6,342

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)

=====

	Three Months Ended	
	March 31, 1998	March 31, 1997
Net cash provided by operating activities.....	\$1,025	\$ 9
	-----	---
Net cash provided by investing activities.....		
Net cash used in financing activities.....		
Net increase in cash and cash equivalents.....	1,025	9
Cash and cash equivalents at beginning of period.....	6	1
	-----	---
Cash and cash equivalents at end of period.....	\$1,031	\$10
	=====	===

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

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

1. BASIS OF PRESENTATION OF FINANCIAL STATEMENTS

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

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

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

NEW ACCOUNTING PRONOUNCEMENTS. In June 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income". SFAS No. 130 establishes standards for reporting and display of comprehensive income. The purpose of reporting comprehensive income is to present a measure of all changes in equity that result from recognized transactions and other economic events of the period other than transactions with owners in their capacity as owners. SFAS No. 130 requires that an enterprise classify items of other comprehensive income by their nature in a financial statement and display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of the balance sheet. For the Company, other components of stockholders' equity include such items as the Company's proportionate interest in New Valley's capital transactions and unrealized gains and losses on investment securities. SFAS No. 130 is effective for fiscal years beginning after December 15, 1997. The implementation of SFAS No. 130 for the quarter ended March 31, 1998 does not have any material effect on the consolidated financial statements.

2. INVESTMENT IN NEW VALLEY CORPORATION

At March 31, 1998, the Company's investment in New Valley consisted of a 41.7% voting interest. At March 31, 1998, the Company owned 57.7% of the outstanding \$15.00 Class A Increasing Rate Cumulative Senior Preferred Shares (\$100 Liquidation Value), \$.01 par value ("Class A Preferred Shares") and 41.5% of New Valley's common shares, \$.01 par value (the "Common Shares").

The Class A Preferred Shares are accounted for as debt and equity securities pursuant to the requirements of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities", and are classified as available-for-sale. The Common Shares are accounted for pursuant to Accounting Principles Board Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock".

The Company determines the fair value of the Class A Preferred Shares based on the quoted market price. Through September 1996, earnings on the Class A Preferred Shares were comprised of dividends accrued during the period and the accretion of the difference between the Company's basis

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

The Company's investment in New Valley at March 31, 1998 is summarized below:

	Number of Shares	Fair Value	Carrying Amount	Unrealized Holding Gain (Loss)
	-----	-----	-----	-----
Class A Preferred Shares.....	618,326	\$58,277	\$ 58,277	\$(1,082)
Common Shares.....	3,969,962	3,722	(58,277)	
		-----	-----	
		\$61,999	\$	\$(1,082)
		=====		=====

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

The Class A Preferred Shares of New Valley are required to be redeemed on January 1, 2003 for \$100.00 per share plus dividends accrued to the redemption date. The shares are redeemable, at any time, at the option of New Valley, at \$100.00 per share plus accrued dividends. The holders of Class A Preferred Shares are entitled to receive a quarterly dividend, as declared by the Board of Directors, payable at the rate of \$19.00 per annum. At March 31, 1998, the accrued and unpaid dividends arrearage was \$176,161 (\$164.41 per share).

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3. NEW VALLEY CORPORATION

Summarized financial information for New Valley as of March 31, 1998 and December 31, 1997 and for the three months ended March 31, 1998 and 1997 follows:

	March 31, 1998	December 31, 1997
Current assets, primarily cash and marketable securities.....	\$114,991	\$ 118,642
Non-current assets.....	288,248	322,749
Current liabilities.....	113,710	128,128
Non-current liabilities.....	163,122	185,024
Redeemable preferred stock.....	271,924	258,638
Shareholders' deficit.....	(145,517)	(130,399)

	March 31,	
	1998	1997
Revenues.....	33,840	\$22,853
Costs and expenses.....	34,260	33,604
Net income (loss).....	157	(10,341)
Net loss applicable to common shares(A).....	(18,675)	(26,321)

(A) Considers all preferred accrued dividends, whether or not declared.

On January 31, 1997, New Valley entered into a stock purchase agreement with Brooke (Overseas) Ltd. ("BOL"), a wholly-owned subsidiary of BGLS, and acquired all of BOL's shares (the "BML Shares") in BrookeMil Ltd. ("BML"), representing 99.1% of the common stock of BML, which is engaged in real estate development in Russia. New Valley paid BOL a purchase price of \$55,000 for the BML Shares, consisting of \$21,500 in cash and a New Valley \$33,500 9% promissory note. The note was paid in full in 1997.

On February 20, 1998, New Valley and Apollo Real Estate Investment Fund III, L.P. ("Apollo") organized Western Realty Development LLC ("Western Realty") to make real estate and other investments in Russia. In connection with the formation of Western Realty, New Valley agreed, among other things, to contribute to Western Realty the real estate assets of its subsidiary BML and Apollo agreed to contribute up to \$58,000.

Under the terms of the agreement governing Western Realty (the "LLC Agreement"), the ownership and voting interests in Western Realty are held equally by Apollo and New Valley. Apollo is entitled to a preference on distributions of cash from Western Realty to the extent of its investment, together with a 15% annual rate of return, and New Valley is then entitled to a return of \$10,000 of BML-related expenses incurred by New Valley since March 1, 1997, together with a 15% annual rate of return; subsequent distributions will be made 70% to New Valley and 30% to Apollo. Western Realty is managed by a Board of Managers consisting of an equal number of representatives chosen by Apollo and New Valley. All material corporate transactions by Western Realty generally require the

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unanimous consent of the Board of Managers. Accordingly, New Valley accounts for its non-controlling interests in Western Realty on the equity method.

The organization of Western Realty was effected pursuant to the LLC Agreement. In 1996, New Valley acquired from an affiliate of Apollo eight shopping centers for \$72,500. New Valley and pension plans sponsored by BGLS have invested in investment partnerships managed by an affiliate of Apollo. Apollo's affiliate owns a substantial amount of debt securities of Brooke and warrants to purchase common stock of the Company.

Western Realty will seek to make additional real estate and other investments in Russia. New Valley and Apollo have agreed to invest, through Western Realty or another entity, up to \$25,000 in the aggregate for the potential development of a real estate project in Moscow. In addition, Western Realty has made a \$20,000 participating loan to, and payable out of a 30% profits interest in, a company organized by BOL which, among other things, owns an interest in a new factory being constructed on the outskirts of Moscow by a subsidiary of BOL.

4. FEDERAL INCOME TAX

At March 31, 1998, the Company had \$8,400 of unrecognized net deferred tax assets, comprised primarily of future deductible temporary differences. A valuation allowance has been provided against this deferred tax asset as it is presently deemed more likely than not that the benefit of the tax asset will not be utilized. The Company continues to evaluate the realizability of its deferred tax assets and its estimate is subject to change.

5. CONTINGENCIES

BGLS has pledged its ownership interest in the Company's common stock and the Company's investments in the New Valley securities as collateral in connection with the issuance of BGLS' 15.75% Senior Secured Notes ("BGLS Notes") due 2001.

On March 2, 1998, BGLS entered into an agreement with AIF II, L.P. and an affiliated investment manager on behalf of a managed account (together, the "Apollo Holders") who hold approximately 41.9% of the BGLS Notes in which the Apollo Holders agreed to defer the payment of interest on the BGLS Notes held by them, commencing with the interest payment that was due July 31, 1997, which they had previously agreed to defer, through the interest payment due July 31, 2000. The deferred interest payments will be payable at final maturity of the BGLS Notes on January 31, 2001 or upon an event of default under the Indenture for the BGLS Notes.