

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, 1997

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

DELAWARE
(State or other jurisdiction of
incorporation or organization)

1-5759
Commission File Number

51-0255124
(I.R.S. Employer Identification No.)

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

DELAWARE
(State or other jurisdiction of
incorporation or organization)

33-93576
Commission File Number

13-3593483
(I.R.S. Employer Identification No.)

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

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

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

At May 12, 1997, Brooke Group Ltd. had 18,097,096 shares of common stock outstanding, and BGLS Inc. had 100 shares of common stock outstanding, all of which are held by Brooke Group Ltd.

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BROOKE GROUP LTD.
BGLS INC.

FORM 10-Q

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Item 1. CONSOLIDATED FINANCIAL STATEMENTS

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

	March 31, 1997	December 31, 1996
	-----	-----
ASSETS:		
Current assets:		
Cash and cash equivalents	\$ 2,187	\$ 1,941
Accounts receivable - trade	9,802	19,475
Other receivables	737	1,217
Receivables from affiliates	33,587	47
Inventories	52,643	53,691
Other current assets	2,751	4,181
	-----	-----
Total current assets	101,707	80,552
Property, plant and equipment, at cost, less accumulated depreciation of \$31,377 and \$31,047	30,216	80,282
Intangible assets, at cost, less accumulated amortization of \$17,916 and \$17,457	3,979	4,421
Investment in affiliate		3,051
Other assets	5,352	9,371
	-----	-----
Total assets	\$ 141,254	\$ 177,677
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT):		
Current liabilities:		
Notes payable and current portion of long-term debt	\$ 77,446	\$ 55,242
Accounts payable	18,768	32,461
Due to affiliates		990
Dividends payable		1,387
Cash overdraft		6
Accrued promotional expenses	31,850	30,257
Accrued taxes payable	19,986	26,379
Accrued interest	9,401	24,354
Other accrued liabilities	25,113	33,387
	-----	-----
Total current liabilities	182,564	204,463
Notes payable, long-term debt and other obligations, less current portion	341,506	378,243
Noncurrent employee benefits	30,355	31,256
Other liabilities	31,404	18,704
Commitments and contingencies		
Stockholders' equity (deficit):		
Preferred Stock, par value \$1.00 per share, authorized 10,000,000 shares		
Series G Preferred Stock, 2,184,834 shares, convertible, participating, cumulative, each share convertible to 1,000 shares of common stock and cash or stock distribution, liquidation preference of \$1.00 per share		
Common stock, par value \$0.10 per share, authorized 40,000,000 shares, issued 24,998,043 shares, outstanding 18,097,096 shares	1,850	1,850
Additional paid-in capital	92,811	94,169
Deficit	(482,686)	(490,706)
Other	(22,411)	(27,963)
Less: 6,900,947 and 6,500,947 shares of common stock in treasury, at cost	(34,139)	(32,339)
	-----	-----
Total stockholders' equity (deficit)	(444,575)	(454,989)
	-----	-----
Total liabilities and stockholders' equity (deficit)	\$ 141,254	\$ 177,677
	=====	=====

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

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

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

	March 31, 1997	December 31, 1996
	-----	-----
ASSETS:		
Current assets:		
Cash and cash equivalents	\$ 2,118	\$ 1,940
Accounts receivable - trade	9,802	19,475
Other receivables	699	1,166
Receivables from affiliates	33,575	47
Inventories	52,643	53,691
Other current assets	2,632	3,878
	-----	-----
Total current assets	101,469	80,197
Property, plant and equipment, at cost, less accumulated depreciation of \$31,056 and \$30,762	29,942	79,972
Intangible assets, at cost, less accumulated amortization of \$17,916 and \$17,457	3,979	4,421
Investment in affiliate	8,319	3,051
Other assets	8,319	10,467
	-----	-----
Total assets	\$ 143,709	\$ 178,108
	=====	=====
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT):		
Current liabilities:		
Notes payable and current portion of long-term debt	\$ 77,326	\$ 53,945
Accounts payable	18,618	32,336
Cash overdraft		6
Due to parent	22,248	29,598
Accrued promotional expenses	31,850	30,257
Accrued taxes payable	19,986	26,379
Accrued interest	9,401	24,354
Other accrued liabilities	24,958	32,861
	-----	-----
Total current liabilities	204,387	229,736
Notes payable, long-term debt and other obligations, less current portion	341,506	378,243
Noncurrent employee benefits	30,355	31,256
Other liabilities	37,818	21,958
Commitments and contingencies		
Stockholder's equity (deficit):		
Common stock, par value \$0.01 per share; authorized 100 shares, issued 100 shares, outstanding 100 shares		39,081
Additional paid-in capital	39,081	39,081
Deficit	(491,679)	(499,264)
Other	(17,759)	(22,902)
	-----	-----
Total stockholder's deficit	(470,357)	(483,085)
	-----	-----
Total liabilities and stockholder's equity (deficit)	\$ 143,709	\$ 179,108
	=====	=====

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

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

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

	Three Months Ended	
	March 31, 1997	March 31, 1996
Revenues*	\$ 80,005	\$ 90,516
Cost of goods sold*	41,845	47,048
Gross profit	38,160	43,468
Operating, selling, administrative and general expenses	37,322	44,892
Operating income (loss)	838	(1,424)
Other income (expenses):		
Interest income	559	18
Interest expense	(15,467)	(14,777)
Equity in loss of affiliate	(8,557)	(1,577)
Sale of assets	22,021	
Retirement of debt	2,963	
Proceeds from legal settlement	4,125	
Other, net	119	115
Income (loss) from continuing operations before income taxes	6,601	(17,645)
Provision for income taxes	744	435
Income (loss) from continuing operations	5,857	(18,080)
Income from discontinued operations	363	303
Net income (loss)	6,220	(17,777)
Proportionate share of New Valley capital transaction, retirement of Class A Preferred Shares		1,782
Net income (loss) applicable to common shares	\$ 6,220	\$ (15,995)
Per common share:		
Income (loss) from continuing operations	\$ 0.32	\$ (0.88)
Income from discontinued operations	\$ 0.02	\$ 0.02
Net income (loss) applicable to common shares	\$ 0.34	\$ (0.86)
Weighted average common shares outstanding	18,385,985	18,497,096

* Revenues and Cost of goods sold include federal excise taxes of \$16,860 and \$21,197 for the periods ended March 31, 1997 and 1996, 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, 1997	March 31, 1996
Revenues*	\$ 80,005	\$ 90,516
Cost of goods sold*	41,845	47,048
Gross profit	38,160	43,468
Operating, selling, administrative and general expenses	37,076	44,587
Operating income (loss)	1,084	(1,119)
Other income (expenses):		
Interest income	559	18
Interest expense	(16,381)	(15,668)
Equity in loss of affiliate	(8,557)	(1,577)
Sale of assets	26,384	
Retirement of debt	2,963	
Other, net	112	(35)
Income (loss) from continuing operations before income taxes	6,164	(18,381)
Provision for income taxes	742	451
Net income (loss) from continuing operations	5,422	(18,832)
Income from discontinued operations	363	303
Net income (loss)	<u>\$ 5,785</u>	<u>\$(18,529)</u>

* Revenues and Cost of goods sold include federal excise taxes of \$16,860 and \$21,197 for the periods ended March 31, 1997 and 1996, respectively.

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

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

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

	Common Stock		Additional Paid-In Capital	Deficit	Treasury Stock	Other	Total
	Shares	Amount					
Balance, December 31, 1996	18,497,096	\$ 1,850	\$ 94,169	\$(490,706)	\$(32,339)	\$(27,963)	\$(454,989)
Net income				6,220			6,220
Distributions on common stock (\$0.075 per share)			(1,358)				(1,358)
Amortization of deferred compensation ...						409	409
Unrealized holding gain on investment in New Valley						5,804	5,804
Effect of New Valley capital transactions						(661)	(661)
Settlement of loan	(400,000)			1,800	(1,800)		
Balance, March 31, 1997	<u>18,097,096</u>	<u>\$ 1,850</u>	<u>\$ 92,811</u>	<u>\$(482,686)</u>	<u>\$(34,139)</u>	<u>\$(22,411)</u>	<u>\$(444,575)</u>

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	Other	Total
	Shares	Amount				
Balance, December 31, 1996	100		\$ 39,081	\$(499,264)	\$ (22,902)	\$(483,085)
Net income				5,785		5,785
Unrealized holding gain on investment in New Valley					5,804	5,804
Effect of New Valley capital transactions					(661)	(661)
Settlement of loan.....				1,800		1,800
Balance, March 31, 1997	100	\$	\$ 39,081	\$(491,679)	\$ (17,759)	\$(470,357)

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, 1997	March 31, 1996
Net cash used in operating activities	\$ (26,619)	\$(11,568)
Cash flows from investing activities:		
Proceeds from sale of businesses and assets, net	21,906	
Capital expenditures	(1,307)	(6,939)
Dividends from New Valley		6,183
Other, net		174
Net cash provided by (used in) investing activities	20,599	(582)
Cash flows from financing activities:		
Proceeds from debt	3,000	11,347
Repayments of debt	(6,050)	(6,537)
Borrowings under revolver	81,291	87,794
Repayments on revolver	(69,224)	(76,629)
Decrease in cash overdraft	(6)	(449)
Distributions on common stock	(2,745)	(1,369)
Net cash provided by financing activities	6,266	14,157
Net increase in cash and cash equivalents	246	2,007
Cash and cash equivalents, beginning of period	1,941	3,370
Cash and cash equivalents, end of period	\$ 2,187	\$ 5,377
	=====	=====
Supplemental non-cash financing activities:		
Exchange of Series 2 Senior Secured Notes for Series A Notes		\$ 99,154
Exchange of 14.50% Subordinated Debentures for Series B Notes		125,495
Issuance of Series A Notes for options		822
Exchange of Series A Notes for Series B Notes		99,976

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, 1997	March 31, 1996
Net cash used in operating activities	\$ (30,609)	\$(11,685)
Cash flows from investing activities:		
Proceeds from sale of businesses and assets, net	21,906	
Capital expenditures	(1,307)	(6,939)
Dividends from New Valley		6,183
Other, net		174
Net cash provided by (used in) investing activities	20,599	(582)
Cash flows from financing activities:		
Proceeds from debt	3,000	11,347
Repayments of debt	(4,873)	(6,410)
Borrowings under revolver	81,291	87,794
Repayments on revolver	(69,224)	(76,629)
(Decrease) increase in cash overdraft	(6)	56
Distributions paid to parent		(1,922)
Net cash provided by financing activities	10,188	14,236
Net increase in cash and cash equivalents	178	1,969
Cash and cash equivalents, beginning of period	1,940	3,370
Cash and cash equivalents, end of period	\$ 2,118	\$ 5,339
	=====	=====
Supplemental non-cash financing activities:		
Exchange of Series 2 Senior Secured Notes for Series A Notes		\$ 99,154
Exchange of 14.50% Subordinated Debentures for Series B Notes		125,495
Issuance of Series A Notes for options		822
Exchange of Series A Notes for Series B Notes		99,976
Forgiveness of debt by parent		13,705

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

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

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

1. PRINCIPLES OF REPORTING

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

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

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

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

LIQUIDITY:

The Company believes it will have sufficient liquidity for 1997. This is based on, among other things, the sale of BrookeMil Ltd. ("BML"), a subsidiary of BOL, to an affiliate, New Valley Corporation ("New Valley"), on January 31, 1997, and certain funds available from New Valley subject to limitations imposed by BGLS' indenture agreements.

Liggett had net capital and working capital deficiencies of \$179,782 and \$81,170, respectively, at March 31, 1997, is highly leveraged and has substantial near-term debt service requirements. Further, Liggett's Senior Secured Notes require a mandatory principal redemption of \$37,500 on February 1, 1998 and a payment at maturity on February 1, 1999 of \$107,400, and Liggett's revolving credit facility expires on March 8, 1998 unless extended by its lenders. While Liggett's management currently intends to seek to refinance and/or restructure the redemption and maturity requirements on the Senior Secured Notes with Liggett's note holders and to extend the revolving credit facility, there are no refinancing or restructuring arrangements for the notes or commitments to extend the facility at this time, and no assurances can be given in this regard. Based on Liggett's net loss for 1996 and anticipated 1997 operating results, Liggett does not anticipate it will be able to generate sufficient cash from operations to make such payments. If Liggett is unable to refinance or restructure such obligations, renegotiate the payment terms of the Senior Secured Notes, extend the revolving credit facility, or otherwise make such payments,

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

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

substantially all of its long-term debt and revolving credit facility would be in default and holders of such debt could accelerate the maturity of such debt. In such event, Liggett may be forced to seek protection from creditors under applicable laws. These matters raise substantial doubt about Liggett meeting its liquidity needs and its ability to continue as a going concern.

2. INVESTMENT IN NEW VALLEY CORPORATION

The Company's and BGLS' investment in New Valley at March 31, 1997 is summarized below:

	Number of Shares	Fair Value	Carrying Amount	Unrealized Holding Gain (Loss)
	-----	-----	-----	-----
Class A Preferred Shares	618,326	\$ 70,489	\$ 70,489	\$(19,924)
Class B Preferred Shares	250,885	2,573	2,572	718
Common Shares	3,989,710(A)	5,985	(73,061)	
		-----	-----	-----
		\$ 79,047	\$	\$(19,206)
		=====	=====	=====

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

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

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

At March 31, 1997, the Company's investment in New Valley consisted of an approximate 42% voting interest. The Company's investment is represented by 618,326 Class A Preferred Shares (57.7%), 3,989,710 Common Shares (41.7%) (giving effect to a one-for-twenty reverse stock split by New Valley in July 1996) and 250,885 Class B Preferred Shares (9.0%).

During the first quarter of 1996, New Valley repurchased 72,104 Class A Preferred Shares for a total amount of \$10,530. The Company has recorded its proportionate interest in the excess of

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

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

the carrying value of the shares over the cost of the shares repurchased as a credit to additional paid-in capital in the amount of \$1,782, along with other New Valley capital transactions of \$1,852, for the three months ended March 31, 1996. No such repurchases have been made during the quarter ended March 31, 1997. Other New Valley capital transactions charged to equity were \$661 for the three months ended March 31, 1997.

The Class A Preferred Shares of New Valley are required to be redeemed on January 1, 2003 for \$100.00 per share plus dividends accrued to the redemption date. The shares are redeemable, at any time, at the option of New Valley, at \$100.00 per share plus accrued dividends. The holders of Class A Preferred Shares are entitled to receive a quarterly dividend, as declared by the Board of Directors, payable at the rate of \$19.00 per annum. On March 13, 1996, New Valley declared a cash dividend of \$10.00 per share on its Class A Preferred Shares payable on March 27, 1996. NV Holdings received \$6,183 in the distribution. At March 31, 1997, the accrued and unpaid dividends arrearage on the Class A Preferred Shares was \$127,779 or \$119.26 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, 1997, the accrued and unpaid dividends arrearage on Class B Preferred Shares was \$121,502 or \$43.54 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, 1997 and December 31, 1996 and for the three months ended March 31, 1997 and 1996 follows:

	March 31, 1997	December 31, 1996
	-----	-----
Current assets, primarily cash and marketable securities	\$ 149,244	\$ 183,720
Non-current assets	309,098	222,820
Current liabilities	155,091	98,110
Non-current liabilities	176,213	170,223
Redeemable preferred stock	221,753	210,571
Shareholders' equity (deficit)	(94,715)	(72,364)

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

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

	March 31,	
	----- 1997	1996 -----
Revenues	\$ 19,753	\$ 31,985
Costs and expenses	31,925	38,178
Loss from continuing operations	(11,213)	(5,612)
Income from discontinued operations	872	728
Net loss applicable to common shares(A)	(26,321)	(16,067)

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

ACQUISITION OF COMMON SHARES OF BML:

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

RJR NABISCO HOLDINGS CORP.:

At March 31, 1997, New Valley held 1,062,650 shares of RJR Nabisco Holdings Corp. ("RJR Nabisco") common stock with a market value of \$34,270 (cost of \$32,574). The unrealized gain on New Valley's investment in RJR Nabisco common stock was \$1,696 at March 31, 1997. Based on the market price of RJR Nabisco common stock at March 31, 1997, no amounts are payable by the Company or New Valley under any of its net profit-sharing arrangements with respect to the RJR Nabisco common stock.

3. INVESTMENT IN BROOKE (OVERSEAS) LTD.

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

In connection with the sale of its BML shares to New Valley, certain specified liabilities aggregating \$40,800, including the Vneshtorgbank loan with a balance of \$20,419, remained with BML, and New Valley indemnified the Company and its subsidiaries with respect to any obligation arising from such liabilities.

Item 1. CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

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

On April 18, 1997, BML sold one of its office buildings, Ducat Place I, to a third party. Accordingly, the Company will recognize approximately \$1,240 of its deferred gain on the BML sale in the second quarter, 1997.

On April 28, 1997, New Valley paid BOL \$3,500, representing a portion of the promissory note payment due to BOL on June 30, 1997, together with accrued interest thereon.

4. INVENTORIES

Inventories consist of:

	March 31, 1997	December 31, 1996
	-----	-----
Finished goods	\$ 15,639	\$ 15,304
Work-in-process	5,126	4,435
Raw materials	32,274	34,002
Replacement parts and supplies	4,465	4,406
	-----	-----
Inventories at current cost	57,504	58,147
LIFO adjustments	(4,861)	(4,456)
	-----	-----
	\$ 52,643	\$ 53,691
	=====	=====

At March 31, 1997, Liggett and Liggett-Ducat had leaf tobacco purchase commitments of approximately \$21,217 and \$4,934, respectively.

5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of:

	March 31, 1997	December 31, 1996
	-----	-----
Land and improvements	\$ 455	\$ 455
Buildings	6,443	14,205
Machinery and equipment	49,647	49,401
Leasehold improvements	302	302
Construction-in-progress	4,746	46,966
	-----	-----
	61,593	111,329
Less accumulated depreciation	31,377	31,047
	-----	-----
	\$ 30,216	\$ 80,282
	=====	=====

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6. LONG TERM DEBT

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

	March 31, 1996	December 31, 1996
	-----	-----
15.75% Series B Senior Secured Notes due 2001, net of unamortized discount of \$1,418 and \$1,511	\$231,446	\$231,353
14.500% Subordinated Debentures due 1998	800	800
Notes payable - Foreign	4,758	22,668
Other	1,067	2,425
Liggett:		
11.500% Senior Secured Series B Notes due 1999, net of unamortized discount of \$349 and \$424	112,263	119,688
Variable Rate Series C Senior Secured Notes due 1999	32,279	32,279
Revolving credit facility	36,339	24,272
	-----	-----
Total notes payable and long-term debt	418,952	433,485
Less current maturities	77,446	55,242
	-----	-----
Amount due after one year	\$341,506	\$378,243
	=====	=====

REVOLVING CREDIT FACILITY - LIGGETT:

On March 8, 1994, Liggett entered into a revolving credit facility (the "Facility") for \$40,000 with a syndicate of commercial lenders. The Facility is collateralized by all inventories and receivables of Liggett. At March 31, 1997, \$461 was available under the Facility based on eligible collateral. Borrowings under the Facility bore interest at the rate of 9.75%, a rate which is equal to 1.5% above the Philadelphia National Bank's prime rate (8.25%) at March 31, 1997. On April 1, 1997, Philadelphia National Bank raised its prime rate to 8.5%, thereby increasing Liggett's interest rate to 10.0%. The Facility requires Liggett's compliance with certain financial and other covenants. The Facility also limits the amount of cash dividends and distributions by Liggett and imposes requirements with respect to Liggett's adjusted net and working capital. In January 1997, the Facility was extended for one year. The Facility is classified as short-term at March 31, 1997, since it is due on March 8, 1998, unless extended by the lender. No assurances can be given that the Facility will be further extended.

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

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LIGGETT 11.500% SENIOR SECURED SERIES B NOTES DUE 1999:

On February 14, 1992, Liggett issued \$150,000 in Senior Secured Notes (the "Liggett Series B Notes"). Interest on the Liggett Series B Notes is payable semiannually on February 1 and August 1 at an annual rate of 11.5%. The Liggett Series B Notes and Series C Notes referred to below (collectively, the "Liggett Notes") require mandatory principal redemptions of \$7,500 on February 1 in each of the years 1993 through 1997 and \$37,500 on February 1, 1998 with the balance of the Liggett Notes due on February 1, 1999. In February 1997, \$7,500 of Liggett Series B Notes were purchased using the Facility and credited against the mandatory redemption requirements. The transaction resulted in a net gain of \$2,963. The Liggett Notes are collateralized by substantially all of the assets of Liggett, excluding inventories and receivables. Eve Holdings Inc. is a guarantor for the Liggett Notes. The Liggett Notes may be redeemed, in whole or in part, at a price equal to 102% and 100% of the principal amount in the years 1997 and 1998, respectively, at the option of Liggett. The Liggett Notes contain restrictions on Liggett's ability to declare or pay cash dividends, incur additional debt, grant liens and enter into any new agreements with affiliates, among others. While Liggett management currently intends to seek to refinance and/or restructure with Liggett's note holders the February 1, 1998 mandatory redemption payment of \$37,500 and the \$107,400 payment due on February 1, 1999 on maturity of the Liggett Notes and to extend its revolving credit facility, there are no refinancing or restructuring arrangements for the notes or commitments to extend the facility at this time, and no assurances can be given in this regard.

ISSUANCE OF LIGGETT SERIES C VARIABLE RATE NOTES:

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

For information concerning Liggett's substantial near-term debt service requirements and other related matters, refer to Note 1.

FOREIGN LOANS:

On January 31, 1997, in connection with the sale of BML shares to New Valley, the Russian bank loan in the amount of \$20,419 remained with BML (Refer to Note 3). The Company is presently a guarantor on lines of credit opened by BOL in 1997 with two Russian banks. The aggregate amount available under these lines of credit is \$3,000. Interest on such lines of credit is currently 23%.

7. STOCK COMPENSATION

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

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8. RELATED PARTY TRANSACTIONS

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

9. RESTRUCTURING CHARGES

During the first quarter of 1997, Liggett reduced its headcount by 87 positions and recorded a \$1,761 restructuring charge to operations for severance programs, primarily salary continuation and related benefits for terminated employees. Approximately \$197 in restructuring charges will be funded in subsequent years. Liggett expects to continue its cost reduction programs.

10. CONTINGENCIES

TOBACCO-RELATED LITIGATION:

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

As of March 31, 1997, there were 107 cases pending against Liggett where individual plaintiffs allege injury resulting from cigarette smoking, addiction to cigarette smoking or exposure to ETS and seek compensatory and, in some cases, punitive damages. Of these, 53 are pending in the State of

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Florida and 20 are pending in the State of New York. The balance of individual cases are pending in 14 different states. The next individual case scheduled for trial where Liggett is a defendant is CHUTZ-REYMERS ET AL. V. LIGGETT GROUP INC., ET AL., United States District Court, Middle District of Florida, Tampa Division, which is scheduled for trial in June 1997. In light of the settlements discussed below, this case will not proceed against Liggett on that date. In addition to the foregoing, there are four individual cases scheduled for trial in 1997 where Liggett is a defendant, although trial dates are subject to change.

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

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

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

On October 31, 1991, an action entitled BROIN, ET AL. V. PHILIP MORRIS INCORPORATED, ET AL., Circuit Court of the Eleventh Judicial District in and for Dade County, Florida, was filed against Liggett and others. This case was the first class action commenced against the industry, and has been brought by plaintiffs on behalf of all flight attendants that have worked or are presently working for airlines based in the United States and who have never regularly smoked cigarettes but allege that they have been damaged by involuntary exposure to ETS. Plaintiffs' motion to certify the action as a class action was granted. The suit is scheduled to go to trial on June 2, 1997. In addition to Broin, as of March 31, 1997 there were 16 actions which have either been certified as a class or are seeking class certification. One of these actions, ENGLE, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Circuit

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Court of the Eleventh Judicial Circuit in and for Dade County, Florida, involving a certified class of smokers in the State of Florida, is scheduled to commence trial on September 8, 1997.

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

On September 10, 1993, an action entitled SACKMAN V. LIGGETT GROUP INC., United States District Court, Eastern District of New York, was filed against Liggett alleging as injury lung cancer. On May 25, 1996, the District Court granted Liggett summary judgment on plaintiff's fraud and breach of warranty claims. In addition, the District Court vacated the Magistrate's March 19, 1996 order compelling Liggett to produce certain CTR documents with respect to which Liggett had asserted various privilege claims, and allowed the other cigarette manufacturers and the CTR to intervene in order to assert their interests and privileges with respect to those same documents. The Magistrate Judge is presently reconsidering plaintiffs' motion to compel production of documents. No trial date has been set.

On March 25, 1994, an action entitled CASTANO, ET AL. V. THE AMERICAN TOBACCO COMPANY INC., ET AL., United States District Court, Eastern District of Louisiana, was filed against Liggett and others. The class action complaint sought relief for a nationwide class of smokers based on their alleged addiction to nicotine. The District Court granted plaintiffs' motion for class certification. On May 23, 1996, the Fifth Circuit Court of Appeals decertified the class and instructed the District Court to dismiss the class complaint. On March 12, 1996, the Company and Liggett entered into an agreement, subject to court approval, to settle the CASTANO class action tobacco litigation.

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

On March 14, 1996, the Company, the CASTANO Plaintiffs Legal Committee and the CASTANO plaintiffs entered into a letter agreement. According to the terms of the letter agreement, for the period ending

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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 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.

In February 1995, an action entitled GRADY CARTER, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Superior Court for the State of Florida, Duval County, was filed against Liggett and others. Plaintiff sought compensatory damages, including, but not limited to, reimbursement for medical costs. Both American Tobacco and Liggett were subsequently dismissed from this action. On August 9, 1996, a jury returned a verdict against the remaining defendant, Brown & Williamson Tobacco Corp., in the amount of \$750. Brown & Williamson has filed a Notice of Appeal.

On May 23, 1994, an action entitled MOORE, ATTORNEY GENERAL, EX REL STATE OF MISSISSIPPI V. THE AMERICAN TOBACCO COMPANY, ET AL., Chancery Court of Jackson County, Mississippi, was commenced against Liggett and others seeking restitution and indemnity for medical payments and expenses allegedly made or incurred for tobacco related illnesses. In May 1994, the State of Florida enacted legislation, effective July 1, 1994, allowing certain state authorities or entities to commence litigation seeking recovery of certain Medicaid payments made on behalf of Medicaid recipients as a result of diseases (including, but not limited to, diseases allegedly caused by cigarette smoking) allegedly caused by liable third parties (including, but not limited to, the tobacco industry). On February 21, 1995, the State of Florida commenced an action pursuant to this statutory scheme. In addition to Florida and Mississippi, similar actions have been filed by many other states and municipalities. The Mississippi, Florida and Texas Medicaid recovery actions are scheduled for trial in 1997 (see settlement discussions below). Legislation similar to that enacted in Florida has been introduced in the Massachusetts and New Jersey legislatures.

In certain of the pending proceedings, state and local government entities and others seek reimbursement for Medicaid and other health care expenditures allegedly caused by tobacco products. The claims asserted in these Medicaid recovery actions vary. All plaintiffs assert the equitable claim that the tobacco industry was "unjustly enriched" by plaintiffs' payment of health care costs allegedly attributable to smoking and seek reimbursement of those costs. Other claims made by some but not all plaintiffs include the equitable claim of indemnity, common law claims of negligence, strict liability, breach of express and implied warranty, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under state and federal statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under the Federal Racketeer Influenced and Corrupt Organization Act.

On March 15, 1996, the Company and Liggett entered into a settlement of tobacco-related litigation with the Attorneys General of Florida, Louisiana, Mississippi, West Virginia and Massachusetts. The

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

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

Settlement funds received by the Attorneys General will be used to reimburse the states' smoking-related healthcare costs. While neither consenting to FDA jurisdiction nor waiving their objections thereto, the Company and Liggett also have agreed to phase in compliance with certain of the proposed interim FDA regulations on the same basis as provided in the CASTANO settlement.

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

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

On March 20, 1997, Liggett, together with the Company, entered into a comprehensive settlement of tobacco litigation through parallel agreements with the Attorneys General of 17 additional states and with a nationwide class of individuals and entities that allege smoking-related claims. Thereafter, on April 14, 1997, the State of California entered into a settlement agreement with Liggett and BGL of the action which it contemplates commencing against the industry and on May 6, 1997 the State of Alaska entered into a settlement agreement with Liggett and the Company of the action which it recently commenced against the industry. The settlements cover all smoking-related claims, including both addiction-based and tobacco injury claims against the Company and Liggett, brought by the Attorneys General and, upon court approval, the nationwide class.

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The recent Attorneys General settlements, which do not require court approval, include the states of Alaska, Arizona, California, Connecticut, Hawaii, Illinois, Indiana, Iowa, Kansas, Maryland, Michigan, Minnesota, New Jersey, New York, Oklahoma, Texas, Utah, Washington and Wisconsin. The Company's and Liggett's previous settlements on March 15, 1996 with the Attorneys General of Florida, Louisiana, Massachusetts, Mississippi and West Virginia remain in full force and effect. (Several other states have either recently filed Medicaid recovery actions or indicated intentions to do so. Both Liggett and BGL will endeavor to resolve those matters on substantially the same terms and conditions as the prior settlements, however, there can be no assurance that any such settlements will be completed).

The settlement with the nationwide class covers all smoking-related claims. On March 20, 1997, Liggett, the Company and plaintiffs filed the mandatory class settlement agreement in an action entitled FLETCHER, ET AL. V. BROOKE GROUP LTD., ET AL., Circuit Court of Mobile County, Alabama, where the court granted preliminary approval and preliminary certification of the class. Class members will be notified of the settlement and will have an opportunity to appear at a later court hearing. Effectiveness of the mandatory settlement is conditioned on final court approval of the settlement after a fairness hearing. There can be no assurance as to whether or when such court approval will be obtained. There are no opt out provisions in this settlement, except for Medicaid claims by states that are not party to the Attorneys General settlements.

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

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

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

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

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

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

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

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

Litigation is subject to many uncertainties, and it is possible that some of the aforementioned actions could be decided unfavorably against the Company. An unfavorable outcome of a pending smoking and health case could encourage the commencement of additional similar litigation. The Company is not able to evaluate the effect of these developing matters on pending litigation or the possible commencement of additional litigation.

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(UNAUDITED)

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

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

LEGISLATION AND REGULATION:

On August 28, 1996, the FDA filed in the Federal Register a Final Rule classifying tobacco as a drug, asserting jurisdiction by the FDA over the manufacture and marketing of tobacco products and imposing restrictions on the sale, advertising and promotion of tobacco products. The FDA's stated objective and focus for its initiative is to limit access to cigarettes by minors by measures beyond the restrictions either mandated by existing federal, state and local laws or voluntarily implemented by major manufacturers in the industry. Litigation was commenced in the United States District Court for the Middle District of North Carolina challenging the legal authority of the FDA to assert such jurisdiction, as well as challenging the constitutionality of the rules. A hearing on the tobacco industry's motion for summary judgment in that case was held on February 10, 1997 and a decision by the Court was issued on April 25, 1997. The court granted plaintiffs' motion for summary judgment prohibiting the FDA from regulating or restricting the promotion and advertising of tobacco products. The court 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, while neither consenting to FDA jurisdiction nor waiving their objections thereto, agreed to withdraw their objections and opposition to the proposed rule making and to phase in compliance with certain of the proposed interim FDA regulations. See discussions of the CASTANO and Attorneys General settlements above.

In August 1996, the Commonwealth of Massachusetts enacted legislation requiring tobacco companies to publish information regarding the ingredients in cigarettes and other tobacco products sold in that state. Regulations adopted pursuant to this legislation are scheduled to become effective on July 1, 1997. On February 7, 1997, the United States District Court for the District of Massachusetts denied an attempt to block the new legislation on the ground that it is preempted by federal law.

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

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

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

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

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

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

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

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.

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

At March 31, 1997, there were several other proceedings, lawsuits and claims pending against the Company and its subsidiaries. The Company is of the opinion that the liabilities, if any, ultimately resulting from such other proceedings, lawsuits and claims should not materially affect its consolidated financial position, results of operations or cash flows.

11. SALES OF ASSETS

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

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

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

INTRODUCTION

The following discussion provides an assessment of the consolidated results of operations, capital resources and liquidity of Brooke Group Ltd. (the "Company") and its subsidiaries and should be read in conjunction with the Consolidated Financial Statements and notes thereto of the Company and BGLS Inc. ("BGLS") included elsewhere in this 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.

For purposes of this discussion and other consolidated financial reporting, the Company's significant business segments are tobacco for the three months ended March 31, 1997 and tobacco and real estate for the three months ended March 31, 1996.

RECENT DEVELOPMENTS

NEW VALLEY. As of March 31, 1997, New Valley held 1,062,650 shares of RJR Nabisco Holdings Corp. ("RJR Nabisco") common stock with a market value of \$35,997 (cost of \$32,574). New Valley's unrealized gain on its investment in RJR Nabisco common stock was \$1,697 at March 31, 1997. For information concerning the acquisition of BML by New Valley, see "BOL" below.

BOL. On January 31, 1997, New Valley acquired from BOL 10,483 shares (99.1%) of common stock of BML for a purchase price of \$55,000, consisting of \$21,500 in cash and a \$33,500 9% promissory note of New Valley (the "Note"). The Note is collateralized by the BML Shares and is payable \$21,500 on June 30, 1997 and \$12,000 on December 31, 1997. The Company recognized a gain of \$21,300 on the sale in the first quarter, 1997. A prepayment of \$3,500 on the Note together with accrued interest was made on April 28, 1997 which reduces the June payment discussed above to \$18,000. See Note 3 to the Company's Consolidated Financial Statements.

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

On March 11, 1997, Liggett sold to Blue Devil Ventures, a North Carolina limited liability partnership, certain surplus realty for \$2,200. The Company recognized a gain of \$1,521.

RECENT DEVELOPMENTS IN THE CIGARETTE INDUSTRY

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

LEGISLATION, REGULATION AND LITIGATION. The cigarette industry continues to be challenged on numerous fronts. New cases continue to be commenced against Liggett and the Company and other cigarette manufacturers. As of March 31, 1997, there were 107 individual suits, 14 purported class actions and 22 state (and several municipality) Medicaid reimbursement actions pending in the United States in which Liggett is a named defendant. As new cases are commenced, the costs associated with defending such cases and the risks attendant to the inherent unpredictability of litigation continue to increase. Recently, there have been a number of restrictive regulatory actions from various Federal administrative bodies, including the United States Environmental Protection Agency ("EPA") and the Food and Drug Administration ("FDA"), adverse political and legal decisions and other unfavorable developments concerning cigarette smoking and the tobacco industry, including the commencement and certification of class actions and the commencement of Medicaid reimbursement suits by various states' Attorneys General. These developments generally receive widespread media attention. The Company is not able to evaluate the effect of these developing matters on pending litigation or the possible commencement of additional litigation, but it is possible that 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 10 to the Company's Consolidated Financial Statements for a description of legislation, regulation and litigation.

The plaintiffs' allegations of liability in those cases in which individuals seek recovery for personal injuries allegedly caused by cigarette smoking are based on various theories of recovery, including negligence, gross negligence, strict liability, fraud, misrepresentation, design defect, failure to warn, breach of express and implied warranties, conspiracy, concert of action, unjust enrichment, common law public nuisance, indemnity, market share liability, and violations of deceptive trade practices laws and antitrust statutes. Plaintiffs also seek punitive damages in many of these cases. Defenses raised by defendants in these cases include lack of design defect, statutes of limitations or response, equitable defenses such as "unclean hands" and lack of benefit, failure to state a claim and preemption by the Federal Cigarette Labeling and Advertising Act, as amended.

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

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

Under the 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 fail to consummate a merger or similar transaction with another non-settling tobacco company defendant within three years of the date of the settlement. The Company and Liggett have the right to terminate the CASTANO settlement under certain circumstances. On May 11, 1996, the CASTANO Plaintiffs

Committee filed a motion with the United States District Court for the Eastern District of Louisiana seeking preliminary approval of the CASTANO settlement. On May 23, 1996, the Court of Appeals for the Fifth Circuit reversed the February 17, 1995 order of the District Court certifying the CASTANO suit as a nationwide class action and instructed the District Court to dismiss the class complaint. On September 6, 1996, the CASTANO plaintiffs withdrew the motion for approval of the CASTANO settlement.

On March 14, 1996, the Company, the CASTANO Plaintiffs Legal Committee and the CASTANO plaintiffs entered into a letter agreement. According to the terms of the letter agreement, for the period ending nine months from the date of Final Approval (if granted) of the CASTANO settlement or, if earlier, the completion by the Company or Liggett of a combination with any defendant in CASTANO, except Philip Morris, the CASTANO plaintiffs and their counsel agree not to enter into any more favorable settlement agreement with any CASTANO defendant which would reduce the terms of the CASTANO settlement agreement. If the CASTANO plaintiffs or their counsel enter into any such settlement during this period, they shall pay the Company \$250,000 within 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 on March 22, 1996, with the balance payable over nine years and indexed and adjusted for inflation). In addition, Liggett will be required to pay the states a percentage of Liggett's pretax income (income before income taxes) each year from the second through the twenty-fifth year. This annual percentage is 2-1/2% of Liggett's pretax income, subject to increase to 7-1/2% depending on the number of additional states joining the settlement. No additional states have joined this 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.

RECENT SETTLEMENTS. On March 20, 1997, Liggett, together with the Company, entered into a comprehensive settlement of tobacco litigation through parallel agreements with the Attorneys General of 17 states and with a nationwide class of individuals and entities that allege smoking-related claims. Thereafter, on April 14, 1997, the State of California settled, on the same terms, the action which it contemplates commencing against the industry and on May 6, 1997, the State of Alaska settled, with the Company, the action which it recently commenced against the industry. The 24 Attorneys General settlements cover all smoking-related claims, including both addiction-based and tobacco injury claims against Liggett and the Company, and upon court approval, the nationwide class.

The settlements with the Attorneys General, which do not require court approval, include the states of Alaska, Arizona, California, Connecticut, Hawaii, Illinois, Indiana, Iowa, Kansas, Maryland, Michigan, Minnesota, New Jersey, New York, Oklahoma, Texas, Utah, Washington and Wisconsin. The Company's and Liggett's previous settlements on March 15, 1996 with the Attorneys General of Florida, Louisiana, Massachusetts, Mississippi and West Virginia remain in full force and effect. Both the Company and Liggett will endeavor to resolve those matters on substantially the same terms and conditions as the prior settlements; however, there can be no assurance that any such settlements will be completed.

The settlement with the nationwide class covers all smoking-related claims. On March 20, 1997, Liggett, the Company and plaintiffs filed the mandatory class settlement agreement in an action entitled FLETCHER, ET AL. V BROOKE GROUP LTD., ET AL., Circuit Court of Mobile County, Alabama, where the court granted preliminary approval and preliminary certification of the class. Class members will be notified of the settlement and will have an opportunity to appear at a later court hearing. Effectiveness of the mandatory settlement is conditioned on final court approval of the settlement after a fairness hearing. There can be no assurance as to whether or when court approval will be obtained. There are no opt out

provisions in this settlement, except for Medicaid claims by states that are not party to the Attorneys General settlements.

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

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

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

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

On March 20, 1997, RJR, Philip Morris, B & W and Lorillard obtained a temporary restraining order from a North Carolina state court preventing, the Company and Liggett and their agents, employees, directors, officers and lawyers from turning over documents allegedly subject to the joint defense privilege in connection with the settlements. On March 24, 1997, the United States District Court for the Eastern District of Texas and state courts in Mississippi and Illinois each issued orders enjoining these four companies from interfering with Liggett's filing with the courts, under seal, those documents.

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

of the tobacco litigation settlements appearing in Note 10 to the Company's Consolidated Financial Statements.

RESULTS OF OPERATIONS

THREE MONTHS ENDED MARCH 31, 1997 COMPARED TO THREE MONTHS ENDED MARCH 31, 1996.

REVENUES. Total revenues were \$80,005 for the three months ended March 31, 1997 compared to \$90,516 for the three months ended March 31, 1996. This 11.6% decrease in revenues was primarily due to a \$12,187 or 15.5% decrease in revenues at Liggett reflecting a 21.6% decrease in Liggett's unit sales volume, partially offset by an increase of \$3,311 over the same period in 1996 in tobacco revenues at Liggett-Ducat. The decline in overall units sales volume of 21.6% at Liggett was comprised of declines within the premium segment of 13.5% and discount segment (which includes generic, control label and branded discount products) of 22.7%. The decline in premium and discount unit sales volume was due to certain competitors continuing leveraging rebate programs tied to their products and increased promotional activity by certain other manufacturers. The decline in the discount segment is consistent with industry trends.

GROSS PROFIT. Gross profit was \$38,160 for the three months ended March 31, 1997 compared to \$43,468 for the three months ended March 31, 1996, a decrease of \$5,308 when compared to the same period last year, due primarily to the decline in unit sales volume at Liggett discussed above. Overall, the Company's gross profit as a percentage of revenues decreased 0.3% when compared to the same period in the prior year. Liggett's gross profit as a percentage of revenues (excluding federal excise taxes) for the period decreased to 72.9% compared to 73.7% in the same period in the prior year. This decrease is the result of increased tobacco costs due to reduced worldwide supply of tobacco and a reduction in the average discount available to Liggett from leaf tobacco dealers on tobacco purchased under prior years' purchase commitments, partially offset by the March 1997 list price increase discussed above. See "Recent Developments in the Cigarette Industry".

EXPENSES. Selling, general and administrative expenses were \$37,322 for the three months ended March 31, 1997 compared to \$44,892 for the same period last year. The decrease of \$7,570 is due primarily to lower advertising, marketing and administrative expenses at Liggett partially offset by restructuring charges of \$1,761 and higher legal expenses at Liggett.

OTHER INCOME (EXPENSE). Interest expense was \$15,467 for the three months ended March 31, 1997 compared to \$14,777 for the same period last year, an increase of \$690 primarily due to the issuance of additional debt of \$7,397 at BGLS in March 1996 and higher average outstanding balances on Liggett's revolving credit facility in 1997.

Equity in earnings of affiliate was a loss of \$8,557 for the three months ended March 31, 1997 compared to a loss of \$1,577 for the three months ended March 31, 1996 and relates primarily to New Valley's net loss of \$10,341 in 1997 compared to its net loss of \$4,884 in 1996.

Interest expense and loss in equity of affiliate were offset by the gain on sale of assets, which includes the sale of the BML shares and surplus realty at Liggett, and proceeds from a legal settlement. See Notes 3, 10 and 11 to the Company's Consolidated Financial Statements.

CAPITAL RESOURCES AND LIQUIDITY

Net cash and cash equivalents increased \$246 and \$2,007 for the three months ended March 31, 1997 and 1996, respectively. Net cash used in operations for the three months ended March 31, 1997 was \$26,619 compared to net cash used in operations of \$11,568 for the comparable period of 1996, 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. 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 \$20,599 for the period ended March 31, 1997 includes principally 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 to Blue Devil Ventures. Cash received was offset by capital expenditures of \$1,307 at Liggett and BOL and the impact of the sale of BML to New Valley in the consolidated financial statements. Cash used in investing activities of \$582 for the period ended March 31, 1996 includes capital expenditures of \$5,500 and \$1,350 for real estate development at BOL and for equipment modernization at Liggett, respectively. Capital expenditures for the period ended March 31, 1996 were offset by dividends from New Valley to NV Holdings of \$6,183 (\$10.00 per share) on the Class A Preferred Shares.

Cash provided by financing activities was \$6,266 for the three months ended March 31, 1997 compared to cash provided of \$14,157 for the same period in 1996. Proceeds from financing activities include proceeds at BOL from credit lines and net borrowings under Liggett's revolving credit facility of \$12,067. 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 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 1997. Proceeds from debt in the same period in 1996 includes the private placement of BGLS' Series A Notes (later exchanged for Series B Notes) for net cash proceeds of \$6,065, borrowings by BOL for real estate development of \$5,282 and borrowings of \$11,015 by Liggett under its revolving credit facility. These transactions were primarily offset by the redemption for approximately \$6,300 of BGLS' 16.125% Senior Subordinated Reset Notes (the "Reset Notes"), including premium and accrued interest thereon, and distributions to the Company's shareholders of \$1,369.

LIGGETT. Liggett had a net capital deficiency of \$179,782 as of March 31, 1997, is highly leveraged and has substantial near-term service requirements. Due to the many risks and uncertainties associated with the cigarette industry and the impact of recent tobacco litigation settlements, there can be no assurance that Liggett will be able to meet its future earnings goals. Consequently, Liggett could be in violation of certain debt covenants, and if its lenders were to exercise acceleration rights under the Revolving Credit Facility (the "Facility") or the Senior Secured Notes (the "Liggett Notes") indentures or refuse to lend under the Facility, Liggett would not be able to satisfy such demands or its working capital requirements.

On March 8, 1994, Liggett entered into the Facility under which it can borrow up to \$40,000 (depending on the amount of eligible inventory and receivables as determined by the lenders) from a syndicate of commercial lenders. At March 31, 1997, \$36,339 was outstanding and \$461 was available under the Facility based on eligible collateral at December 31, 1996. The Facility is collateralized by all inventories and receivables of Liggett. Borrowings under the Facility, whose interest is calculated at a rate equal to 1.5% above Philadelphia National Bank's (the indirect parent of Congress Financial Corporation, the lead lender) prime rate, bear a rate of 9.75% at March 31, 1997. On April 1, 1997, Philadelphia National Bank raised its prime rate to 8.5%, thereby increasing Liggett's interest rate to 10.0%. The Facility contains certain financial covenants similar to those contained in the Liggett Notes' Indenture, including restrictions on Liggett's ability to declare or pay cash dividends, incur additional debt, grant liens and enter into any new agreements with affiliates, among others. In addition, the Facility currently imposes requirements with respect to Liggett's adjusted net worth (not to fall below a deficit of \$180,000 as computed in accordance with the agreement) and working capital (not to fall below a deficit of \$12,000 as computed in accordance with the agreement). The Facility is classified as short-term at March 31, 1997, since it is due on March 8, 1998, unless extended by the lender.

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

Further, the Liggett Notes require a mandatory principal redemption of \$37,500 on February 1, 1998 and a payment at maturity on February 1, 1999 of \$107,400. The Notes due on February 1998 (\$37,500) are classified as a short-term debt at March 31, 1997. In February 1997, Liggett purchased \$7,500 of Series B Notes using revolver availability and credited such Notes against the 1997 mandatory redemption requirement. Liggett recorded a net gain of \$2,963 for this transaction in the first quarter, 1997. Current maturities of both the Liggett Notes and the Facility of approximately \$74,000 contribute substantially to the working capital deficit of \$81,170 at March 31, 1997.

While Liggett management currently intends to seek to refinance and/or restructure with Liggett's note holders the redemption and 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. Based on Liggett's net loss for 1996 and projected 1997 operating results, Liggett does not anticipate it will be able to generate sufficient cash from operations to make such payments. If Liggett is unable to refinance or restructure such obligations, renegotiate the payment terms of the Liggett Notes, extend the Facility, or otherwise make such payments, substantially all of its long-term debt and the Facility would be in default and debt holders could accelerate the maturity of such debt. In such event, Liggett may be forced to seek protection from creditors under applicable laws. These matters raise substantial doubt about Liggett meeting its liquidity needs and Liggett's ability to continue as a going concern.

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

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

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

BGLS. At March 31, 1997, BGLS' long-term debt was approximately \$233,000.

BOL. On January 31, 1997, BOL sold its 99.1% interest in BML to New Valley for \$55,000. The purchase price paid was \$21,500 in cash and a 9% promissory note of \$33,500, payable \$21,500 on June 30, 1997 and \$12,000 on December 31, 1997. On April 28, 1997, New Valley paid \$3,500 of the promissory note due to BOL on June 30, 1997.

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

Liggett-Ducat plans to build a new cigarette factory on the outskirts of Moscow. The new factory, which will utilize Western cigarette making technology and have a capacity of 24 billion units per year, will produce American and international blend cigarettes, as well as traditional Russian cigarettes. Preliminary construction has begun, and management is actively pursuing various potential financing alternatives that would permit the new factory to be operational by the end of 1998, although no assurance can be given that such financing can be obtained on satisfactory terms.

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

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

The Company and its representatives may from time to time make oral or written "forward-looking statements" within the meaning of the Private Securities Reform Act of 1995 (the "Reform Act"), including any statements that may be contained in the foregoing discussion in "Management's Discussion and Analysis of Financial Condition and Results of Operations", in this report and in other filings with the Securities and Exchange Commission and in its reports to shareholders, which reflect management's current views with respect to future events and financial performance. These forward-looking statements are subject to certain risks and uncertainties and, in connection with the "safe-harbor" provisions of the Reform Act, the Company is hereby identifying important factors that could cause actual results to differ materially from those contained in any forward-looking statement made by or on behalf of the Company. Liggett continues to be subject to risk factors endemic to the domestic tobacco industry including, without limitation, health concerns relating to the use of tobacco products and exposure to ETS, legislation, including tax increases, governmental regulation, privately imposed smoking restrictions, governmental and grand jury investigations and litigation. Each of the Company's operating subsidiaries, namely Liggett and Liggett-Ducat, are subject to intense competition, changes in consumer preferences, the effects of changing prices for its raw materials and local economic conditions. Furthermore, the performance of Liggett-Ducat's cigarette operations in Russia are affected by uncertainties in Russia which include, among others, political or diplomatic developments, regional tensions, currency repatriation restrictions, foreign exchange fluctuations, inflation, and an undeveloped system of commercial laws and legislative reform relating to foreign ownership in Russia. In addition, the Company has a high degree of leverage and substantial near-term debt service requirements, as well as a net worth deficiency and recent losses from continuing operations. The Indenture

for BGLS' Series B Notes provides for, among other things, the restriction of certain affiliated transactions between the Company and its affiliates, as well as for certain restrictions on the use of future distributions received from New Valley. Due to such uncertainties and risks, readers are cautioned not to place undue reliance on such forward-looking statements, which speak only as of the date on which such statements are made. The Company does not undertake to update any forward-looking statement that may be made from time to time by or on behalf of the Company.

PART II
OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

Reference is made to information entitled "Contingencies" in Note 6 to the Consolidated Financial Statements of Brooke Group Ltd. and BGLS Inc. (collectively, the "Companies") included elsewhere in this report on Form 10-Q.

Item 2. CHANGES IN SECURITIES

During the first quarter of 1997, Brooke Group Ltd. granted stock options to purchase 422,000 shares of its common stock at \$5.00 per share to certain employees. These transactions did not involve public offerings of the company's securities and were exempt from the registration requirements of the Securities Act of 1933, as amended, pursuant to Section 4(2) thereunder. See Note 7 to the Consolidated Financial Statements of the Companies included elsewhere in this report on Form 10-Q.

Item 3. DEFAULTS UPON SENIOR SECURITIES

Reference is made to information entitled "Revolving Credit Facility" in Note 7 to the Consolidated Financial Statements of the Companies included elsewhere in this report on Form 10-Q.

As of March 31, 1997, New Valley Corporation, the Companies' affiliate, had the following respective accrued and unpaid dividend arrearages on its 1,072,462 outstanding shares of \$15.00 Class A Increasing Rate Cumulative Senior Preferred Shares (\$100 Liquidation Value), \$.01 par value per share (the "Class A Shares") and 2,790,776 outstanding shares of \$3.00 Class B Cumulative Convertible Preferred Shares (\$25 Liquidation Value), \$.10 par value per share (the "Class B Shares"): (1) \$127.8 million or \$119.26 per Class A Share; and (2) \$121.5 million or \$43.54 per Class B Share.

Item 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) EXHIBITS

- 10.43 Addendum to Initial States Settlement Agreement.
- 10.44 Settlement Agreement, dated April 14, 1997, by and among the State of California, Brooke Group Ltd. and Liggett Group Inc.
- 10.45 Settlement Agreement, dated May 6, 1997, by and among the State of Alaska, Brooke Group Ltd. and Liggett Group Inc.
- 27.1 Brooke Group Ltd.'s Financial Data Schedule (for SEC use only)
- 27.2 BGLS Inc.'s Financial Data Schedule (for SEC use only)
- 99.1 Liggett Group Inc.'s Interim Consolidated Financial Statements for the quarterly period ended March 31, 1997.

- 99.2 New Valley Corporation's Interim Consolidated Financial Statements for the quarterly period ended March 31, 1997.
- 99.3 Brooke (Overseas) Ltd.'s Interim Consolidated Financial Statements for the quarterly period ended March 31, 1997.
- 99.4 New Valley Holdings, Inc.'s Interim Consolidated Financial Statements for the quarterly period ended March 31, 1997.

(b) REPORTS ON FORM 8-K

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

Registrant(s) -----	Date of Report -----	Items -----	Financial Statements -----
1. Brooke Group Ltd. BGLS Inc.	January 31, 1997	2, 7	Unaudited pro-forma financial statements for the nine months ended September 30, 1996
2. Brooke Group Ltd.	February 14, 1997	7	None
3. Brooke Group Ltd.	February 25, 1997	7	None

SIGNATURES

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

BROOKE GROUP LTD.
(REGISTRANT)

By: /s/ Joselynn D. Van Siclen

Joselynn D. Van Siclen
Vice President and Chief
Financial Officer

Date: May 15, 1997

BGLS INC.
(REGISTRANT)

By: /s/ Joselynn D. Van Siclen

Joselynn D. Van Siclen
Vice President and Chief
Financial Officer

Date: May 15, 1997

ADDENDUM TO INITIAL STATES SETTLEMENT AGREEMENT

This ADDENDUM TO INITIAL STATES SETTLEMENT AGREEMENT is entered into this _____ day of March, 1997 by and among the State of West Virginia, State of Florida, State of Mississippi, Commonwealth of Massachusetts, and State of Louisiana (collectively, "Initial States") and Brooke Group Ltd., a Delaware corporation ("Brooke Group"), Liggett & Myers, Inc., a Delaware corporation ("Myers"), and Liggett Group, Inc., a Delaware corporation (which with Myers, is hereinafter referred to as "Liggett").

WHEREAS,

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

B. On March 20, 1997, eighteen States and Liggett and Brooke Group entered into a settlement (the "New Settlement") of the Actions brought by such eighteen states, pursuant to which Liggett agreed, among other things, to extend additional cooperation in connection with the prosecution of Attorneys General Actions against other Defendants than Liggett agreed to in the Initial Settlement and such other States agreed to exercise best efforts to ensure that the financial terms of any Global Settlement, legislative or otherwise, are no more onerous on, or less favorable to Brooke Group and Liggett than those set forth in the New Settlement, a copy of which is annexed hereto as Appendix B.

C. The Initial Settling States and Liggett and Brooke Group wish to expand upon the Initial Settlement, through this Addendum to Settlement Agreement to provide for additional cooperation by the Settling Defendants with the Initial Settling States, and to provide Settling Defendants with assurances that the Initial Settling States will seek to ensure that any Global Settlement provide for financial terms for Liggett that reflect appropriate recognition of Liggett's cooperative efforts.

NOW THEREFORE, in consideration of the foregoing and of the promises set forth in this Addendum to Settlement Agreement, the undersigned Attorneys General, on their own behalf and on behalf of their respective States, and Liggett and Brooke Group hereby stipulate and agree that the Initial Settlement shall be changed and amended as follows:

1. With respect to each of the Initial Settling States defined in the Agreement of March 15, 1996 and March 1997 Brooke Group and Liggett, upon execution of this Amendment to the March 15, 1996 Agreement, shall cooperate in and facilitate reasonable third party discovery from Brooke Group and Liggett in connection with any Attorney Generals Action, provided that such information disclosed or provided by Brooke Group and/or Liggett is not disclosed to any third parties except as required by law, including non-settling Attorneys General.

2. The March 15, 1996 Agreement shall be deemed amended to expressly include the following provisions from the March 1997 Attorneys General Agreement.

ss.4.1

ss.4.2

ss.4.3.1, ss.4.3.2, ss.4.3.3, ss.4.3.4

ss.4.5 to the extent this provision increases the required compliance with FDA Rules.

ss.4.8

ss.5

3. The following sections shall be deleted from the March 15, 1996 Agreement or Amended as set forth below:

ss.4.1 is deleted

ss.4.4 is replaced by ss.4.7 of the March 1997 agreement.

ss.4.5 is amended by supplementing it with ss.4.8 of the March 1997 Agreement to the extent the provision of

ss.4.8 of the March 1997 Agreement require greater compliance with FDA Rules.

4. Section 4 of the March 15, 1996 Agreement shall in all other respects remain in full force and effect.

5. Section 5.7 is to be deleted from the March 15, 1996 Agreement.

6. Section 8.2 of the March 15, 1996 Agreement shall be amended to substitute the words "Non-Settling Tobacco Companies" for the current word "Defendants".

7. Section 16.12 of the March 15, 1996 Agreement will be retained for the continuing jurisdiction of the court over documents produced under this Agreement as amended.

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

STATE OF MISSISSIPPI
By: /s/ Mike Moore

Attorney General

STATE OF LOUISIANA
By: /s/ Richard P. Leyoub

Attorney General

STATE OF WEST VIRGINIA
By: /s/ Darrell V. McGraw

Attorney General

BROOKE GROUP LTD.
By: /s/ Bennett S. LeBow

STATE OF FLORIDA
By: /s/ Robert Butterworth

Attorney General

LIGGETT GROUP INC.
By: /s/ Bennett S. LeBow

STATE OF CALIFORNIA SETTLEMENT AGREEMENT

This SETTLEMENT AGREEMENT is entered into this 14th day of April, 1997 by and among the State of California and Brooke Group Ltd., a Delaware corporation ("Brooke Group"), Liggett & Myers Inc., a Delaware corporation ("Myers"), and Liggett Group, Inc., a Delaware corporation (which, with Myers, is hereinafter referred to as "Liggett").

RECITALS

WHEREAS,

A. The State of California, by and through its Attorney General (the "Attorney General"), contemplates bringing a civil action (a "Contemplated Action", as defined in Section 1 hereof) against, among others, the American Tobacco Company, Inc., BAT Industries, Plc, British American Tobacco Company, R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation, Philip Morris, Inc., Liggett & Myers, Inc., Lorillard Tobacco Company, Inc., and United States Tobacco Company and their various parent and related companies ("Defendants"), asserting claims for, among other things, expenses allegedly arising from

tobacco-related matters and injunctive relief concerning sales of cigarettes to minors.

B. Because of the importance of the agreements and undertakings by Liggett and Brooke Group herein to the goals of the State of California, including the prosecution of the Contemplated Action against other Defendants, the State of California has agreed to extend financial settlement terms to Liggett and Brooke Group which will not be offered to any other Defendant, all as set forth in this Settlement Agreement.

C. On March 20, 1997, seventeen States, by and through their Attorneys General, and Liggett and Brooke Group entered into a settlement (the "Attorneys General Settlement") of the actions brought by such States, pursuant to which Liggett agreed to make certain payments, comply with certain proposed regulations restricting the marketing and sale of cigarettes to minors and to offer certain significant cooperation in connection with the prosecution of their respective actions against the other Defendants; all in accordance with the terms of the Attorneys General Settlement, a copy of which is annexed hereto as Appendix A.

D. The State of California and Liggett and Brooke Group wish to provide in this Settlement Agreement for the State of California to become a Subsequent Settling State under the

Attorneys General Settlement, all in accordance with the terms of this Settlement Agreement.

E. The State of California acknowledges and agrees that this Settlement Agreement, including the cooperation provisions thereof, are important to the prosecution of its Contemplated Action against non-settling Defendants.

F. The State of California and Liggett and Brooke Group recognize and support the public interest in preventing smoking by, and preventing the promotion of smoking to, children and adolescents.

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

H. The State of California recognizes and acknowledges that the cooperation being provided for in this Settlement Agreement would be valuable to the prosecution of claims against the tobacco industry. Further, the State of California acknowledges that the change in warning labels provided for in this Settlement Agreement is a step towards properly informing consumers more fully of the truth about

cigarettes and the consequences of smoking, as is the statement by Liggett also provided for herein.

NOW, THEREFORE, in consideration of the foregoing and of the promises and covenants set forth in this Agreement, the undersigned Attorney General, on behalf of the State of California, and Liggett and Brooke Group hereby stipulate and agree that any and all smoking-related claims, including any Contemplated Action, of the State of California shall be settled as against Liggett and Brooke Group all on the terms contained herein, as follows:

I. DEFINITIONS.

Capitalized terms used herein shall have the meanings assigned to them in Section 1 of the Attorneys General Settlement, except as set forth below or defined elsewhere in this Agreement:

"Agreement" means this Settlement Agreement.

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

"Attorney General Actions" means those actions settled pursuant to the Attorneys General Settlement or any similar action commenced by or on behalf of a State against the Defendants, including Contemplated Actions.

"Attorneys General Settlement" means the settlement agreement entered into on March 20, 1997 by seventeen Settling States and Settling Defendants, a copy of which is annexed hereto as Exhibit A.

"Contemplated Action" means an action which may be commenced by or on behalf of the State of California against Non-settling Tobacco Companies and/or other defendants seeking relief similar to that sought in those actions listed in Appendix A to

the Attorneys General Settlement, and shall be deemed to be an Attorney General Action under the Attorneys General Settlement.

"Potential Defendants" means Defendants, as defined in the Attorneys General Settlement.

"Parties" means the State of California and Brooke Group and Liggett.

"Protective Order" or "Stipulation Regarding Liggett Documents" means, with respect to privileged documents produced by a Settling Defendant in or to the State of California, an order by a California court of competent jurisdiction: (a) protecting the confidentiality of such documents; (b) providing that such documents may be used only in an action by the State of California and, to the extent permitted by law, only under seal; (c) providing that, to the extent such documents are or may be subject to the attorney/client privilege or the attorney work product doctrine, such production or use of the documents does not constitute a waiver of such privilege, doctrine or protection with respect to any party other than the State of California. The provisions of the order shall not apply to documents claimed to be privileged but which are determined by a court not to be

privileged for reasons other than waiver due to production pursuant to this Agreement.

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

"Settling States" means the States listed in Appendix A to the Attorneys General Settlement and Subsequent Settling States.

II. SETTLEMENT PURPOSES ONLY.

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

III. PARTIES.

Section 3 of the Attorneys General Settlement is incorporated herein by reference, with the addition of Section 3.3. below.

3.1. Section 3.1 of the Attorneys General Settlement is incorporated herein by reference.

3.2. Section 3.2 of the Attorneys General Settlement is incorporated herein by reference.

3.3. The Parties agree that, even though the State of California has not as of the date of this Settlement Agreement filed a Contemplated Action, the State of California is a Subsequent Settling State under the Attorneys General Settlement, the terms and conditions of which are incorporated herein, except as specifically modified by this Settlement Agreement because of unique circumstances relating to the State of California.

IV. PUBLIC STATEMENT; COOPERATION; ADVERTISING LIMITATIONS.

Section 4 of the Attorneys General Settlement is incorporated herein by reference, except as modified below.

A. Promptly after execution of this Settlement Agreement, Liggett shall, by and through its Director, Bennett S.

LeBow, issue in the State of California a public statement substantially in the following form and substance:

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

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

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

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

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

4. Liggett has instructed its advertising and marketing people to scrupulously avoid any and all advertising or marketing which would appeal to children or adolescents. Liggett acknowledges that the tobacco industry markets to "youth," which means those under 18 years of age, and not just those 18-24 years of age. Liggett condemns this practice and will not market to children. Liggett agrees that if it sees industry advertisements which in its view are aimed at children, it will bring this to the

attention of the Attorney General of the State of California.

5. In accordance with our settlement agreements, Liggett agrees to fully cooperate with the State of California in connection with contemplated lawsuits against the other tobacco companies. To that end, Liggett will make available to the State of California all relevant documents and information, including documents subject to Liggett's own attorney-client privileges and work product protections, and will assist the State of California in obtaining prompt court adjudication of the rest of the industry's joint privilege claims.

B. Section 4.2 of the Attorneys General Settlement is incorporated herein by reference.

C.1. Upon execution of this Agreement, each Settling Defendant shall:

(1) cooperate with the Attorney General of the State of California in that such Settling Defendant will take no steps to impede or frustrate civil investigations into, or civil prosecutions of, any of the Potential Defendants, so as to secure the just,

speedy and inexpensive determination of all such smoking-related claims against said non-settling persons and entities;

(2) cooperate in and facilitate reasonable non-party discovery from Settling Defendants in connection with a Contemplated Action;

(3) actively assist the Attorney General of the State of California in identifying and locating any and all persons known to such Settling Defendant to have documents or information that is discoverable in such proceedings, to actively assist said counsel in interviewing and obtaining documents and information from all such persons, and to encourage such person to cooperate with the Attorney General; and shall actively assist the Attorney General in interpreting documents relating to Attorney General Actions against Potential Defendants; and

(4) insofar as such Settling Defendant has or obtains any material information concerning any fraudulent or illegal conduct on the part of any parties, including Non-settling Tobacco Companies,

their agents, or their co-defendants designed to frustrate or defeat the claims of the State of California against such parties, companies, agents or co-defendants, or which have the effect of unlawfully suppressing evidence relevant to smoking claims, disclose such information to the appropriate judicial and regulatory agencies.

4.3.2. Subject to, and promptly after, the entry of a Protective Order or a Stipulation Regarding Liggett Documents by a California court of competent jurisdiction, each Settling Defendant shall:

(1) promptly provide all documents and information that are relevant to the subject matter of a Contemplated Action or which are likely to lead to admissible evidence in connection with claims asserted in a Contemplated Action, subject to the provisions of Section 4.3.2(2) hereof;

(2) waive any and all applicable attorney-client privileges and work product protections with respect to such documents and information. Such waiver shall not extend to (a) documents and information not relevant to

the subject matter of a Contemplated Action or not likely to lead to admissible evidence in connection with such an action or (b) documents subject to a joint defense or other privilege or protection which Settling Defendants cannot legally waive unilaterally, except that the waiver by the Settling Defendant shall apply, to the extent permitted by law, to its own joint defenses or other privileges. To the extent that a Settling Defendant has a good faith belief, or one or more Non-settling Tobacco Companies claims, that documents to be provided pursuant to Section 4.3.2(1) hereof may be subject to a joint defense or other privilege (or a claim of such privilege) of one or more of the Non-settling Tobacco Companies, such documents shall be deposited under seal for IN CAMERA inspection by a California court of competent jurisdiction, together with a statement to such court that such Settling Defendant has concerns as to whether some or all of such documents should be protected from discovery, and the Parties agree to request that such court shall retain jurisdiction to resolve that issue.

Liggett will participate in proceedings, including by way of court appearances or declarations, concerning issues of whether such documents are discoverable;

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

(4) demand from its past or current national legal counsel all documents and information obtained by them in the course of representation of any Settling Defendant which in any way relates to the cooperation required in paragraphs 4.3.1(1) - 4.3.2(3) above, which should be provided to the Settling States as provided under this paragraph.

4.3.3. Section 4.3.3 of the Attorneys General Settlement is incorporated herein by reference.

4.3.4. Section 4.3.4 of the Attorneys General Settlement is incorporated herein by reference.

4.4. Section 4.4 of the Attorneys General Settlement is incorporated herein by reference.

4.5. Section 4.5 of the Attorneys General Settlement and subparts 4.5.1, 4.5.2, 4.5.3, and 4.5.4 thereof are incorporated herein by reference.

4.6. Section 4.6 of the Attorneys General Settlement is incorporated herein by reference.

4.7. Section 4.7 of the Attorneys General Settlement is incorporated herein by reference.

4.8. Section 4.8 of the Attorneys General Settlement is incorporated herein by reference.

4.9. Section 4.9 of the Attorneys General Settlement is incorporated herein by reference.

V. GLOBAL SETTLEMENT.

5.1. Section 5.1 of the Attorneys General Settlement is incorporated herein by reference.

5.2. Section 5.2 of the Attorneys General Settlement is incorporated herein by reference.

VI. SETTLEMENT FUND.

6.1. Section 6.1 of the Attorneys General Settlement is incorporated herein by reference.

6.2. Section 6.2 of the Attorneys General Settlement is incorporated herein by reference.

6.3. Section 6.3 of the Attorneys General Settlement and subparts 6.3.1 and 6.3.2 thereof are incorporated herein by reference.

6.4. Section 6.4 of the Attorneys General Settlement is incorporated herein by reference.

6.5. Section 6.5 of the Attorneys General Settlement is incorporated herein by reference.

6.6. Section 6.6 of the Attorneys General Settlement is incorporated herein by reference.

6.7. Section 6.7 of the Attorneys General Settlement is incorporated herein by reference.

6.8. Section 6.8 of the Attorneys General Settlement is incorporated herein by reference.

6.9. Section 6.9 of the Attorneys General Settlement is incorporated herein by reference.

6.10. Section 6.10 of the Attorneys General Settlement is incorporated herein by reference.

6.11. Section 6.11 of the Attorneys General Settlement is incorporated herein by reference.

6.12. Section 6.12 of the Attorneys General Settlement is incorporated herein by reference.

6.13. Section 6.13 of the Attorneys General Settlement is incorporated herein by reference.

VII. RELEASE.

1

B. Upon the date of the execution of this Agreement, for good and sufficient consideration as described herein, the State of California shall for the duration or term of this Agreement (whichever is shorter) be deemed to and hereby does

release, dismiss and discharge each and every civil claim, right, and cause of action (including, without limitation, all claims for damages, restitution, medical monitoring, claims arising under California Business and Professions Code ss.ss. 17200 et seq., or any other claim for legal or equitable relief), known or unknown, asserted or unasserted, direct or indirect, which it had, now has or may hereafter have against each Settling Defendant (including its past and present parents, subsidiaries, present affiliates, employees, directors and shareholders, but only in such capacities, vis-a-vis, each such Settling Defendant, and downstream distribution entities of Settling Defendant, but only to the extent that such downstream distribution entities would have cross-claims against Settling Defendant), which is smoking-related or otherwise arises out of, or concerns, the acts, facts, transactions, occurrences, representations, or omissions that would be set forth, alleged, referred to or otherwise embraced in the complaint of the Contemplated Action, but does not in any fashion release any Non-settling Tobacco Companies or other Potential Defendants except as provided for in Seet seq., or any other claim for legal or equitable relief), known or unknown, asserted or unasserted, direct or indirect, which it had, now has or may hereafter have against each Settling Defendant (including its past and present parents, subsidiaries, present affiliates, employees, directors and shareholders, but only in such capacities, vis-a-vis, each such Settling Defendant, and downstream distribution entities of Settling Defendant, but only to the extent that such downstream distribution entities would have cross-claims against Settling Defendant), which is smoking-related or otherwise arises out of, or concerns, the acts, facts, transactions, occurrences, representations, or omissions that would be set forth, alleged, referred to or otherwise embraced in the complaint of the Contemplated Action, but does not in any fashion release any Non-settling Tobacco Companies or other Potential Defendants except as provided for in Section 17 of the Attorneys General Settlement.

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

Provided, however, as follows:

1) If this Agreement expires upon completion of its full term, these releases set forth in this Section 7.1 shall continue and apply in full force and effect with respect to all released claims which accrued or shall accrue prior to, through and including the date of such expiration, such that such claims shall be forever released, but only as to such claims through and

including such date; if this Agreement terminates for any reason prior to its full term, these releases shall be of no further force and effect and Settling Defendants shall be entitled to a credit to the extent otherwise provided in this Agreement against all claims covered by the release for the full amount paid by such Settling Defendants hereunder.

2) Except as specifically provided herein, these releases set forth in this Section 7.1 do not pertain or apply to any other existing or potential party in any Contemplated Action.

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

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

county, municipality or subdivision except for the exclusively State share of the Medicaid funds claimed in any such action.

7.2. Section 7.2 of the Attorneys General Settlement is incorporated herein by reference.

7.3. Section 7.3 of the Attorneys General Settlement is incorporated herein by reference.

7.4. Section 7.4 of the Attorneys General Settlement is incorporated herein by reference.

7.5. Notwithstanding section 1542 of the California Civil Code, which provides that:

[a] general release does not extend to claims which the creditor does not know or suspect to exist in his favor at the time of executing the release, which if known by him must have materially affected his settlement with the debtor,

these releases set forth in this Section 7 release all claims to releasee whether known or unknown, foreseen or unforeseen, that releasor may have against releasee, and releasor understands and acknowledges the significance and consequences of waiver of California Civil Code ss. 1542 and hereby assumes full responsibility for any injuries, damages or losses releasor may incur.

VIII. EXCLUSIVE REMEDY; DISMISSAL OF ACTION;

JURISDICTION OF COURT.

Section 8 of the Attorneys General Settlement is incorporated herein by reference, except as modified below. 8.1. Section 8.1 of the Attorneys General Settlement is incorporated herein by reference.

8.2. If the State of California brings a Contemplated Action, the State of California shall not name the Settling Defendants as defendants therein, except only as may be necessary to effectuate Section 11.2 hereof.

8.3. Section 8.3 of the Attorneys General Settlement is incorporated herein by reference.

IX. TERM.

Section 9 of the Attorneys General Settlement is incorporated herein by reference, except as modified below.

9.1. Section 9.1 of the Attorneys General Settlement is incorporated herein by reference.

9.2. Section 9.2 of the Attorneys General Settlement is incorporated herein by reference.

9.3. Section 9.3 of the Attorneys General Settlement is incorporated herein by reference.

9.4. Section 9.4 of the Attorneys General Settlement is incorporated herein by reference.

9.5. Section 9.5 of the Attorneys General Settlement is incorporated herein by reference.

9.6. Section 9.6 of the Attorneys General Settlement is incorporated herein by reference.

9.7. The duration of this Agreement shall be co-extensive with the duration of the Attorneys General Settlement. The exercise of any right under the Attorneys General Settlement to terminate the Attorneys General Settlement with respect to the State of California shall also be a termination of this Agreement.

X. CONTINUING ENFORCEABILITY.

Section 10 of the Attorneys General Settlement is incorporated herein by reference.

XI. ENTRY OF GOOD FAITH BAR ORDER ON CONTRIBUTION AND INDEMNITY

CLAIMS.

Section 11 of the Attorneys General Settlement is replaced with the following provisions.

A. It is the intent of the parties that the payments to be made by Liggett with respect to the claims and causes of action settled hereby, be limited to those payments set forth in this Settlement Agreement, and that Settling Defendants not be responsible for any payments relating to any contribution or indemnity claim asserted, or to be asserted, by any non-settling defendant that may arise from any Contemplated Action by the State of California. In order to effectuate this intent of the parties, and only in order to effectuate such intent, the parties agree as follows in this Section 11.

B. As promptly as reasonably practicable after a Contemplated Action is brought by the State of California, the Parties shall request that the court in which a Contemplated Action is brought by the State of California enter an order proclaiming this Settlement Agreement as a good faith settlement under California Civil Code ss. 877.6, and the State of California shall cooperate with the Settling Defendants in seeking such an order.

XII. TAX STATUS OF SETTLEMENT FUND.

12.1. Section 12.1 of the Attorneys General Settlement is incorporated herein by reference.

12.2. Section 12.2 of the Attorneys General Settlement is incorporated herein by reference.

12.3. Section 12.3 of the Attorneys General Settlement is incorporated herein by reference.

XIII. EFFECT OF DEFAULT OF SETTLING DEFENDANT.

Section 13 of the Attorneys General Settlement is replaced with the following.

In the event a Settling Defendant fails to make a payment due and owing under the terms of this Agreement, or is in default of this Agreement in any other respect, the Attorney General of the State of California shall so notify the defaulting Settling Defendant, which shall then be given 60 calendar days to "cure" the default. If the defaulting Settling Defendant does not "cure" the default in the time provided in this Section 13, the State of California may apply to a court of competent jurisdiction for relief, in addition to any other remedies the State may have hereunder.

XIV. REPRESENTATIONS AND WARRANTIES.

14.1. Section 14.1 of the Attorneys General Settlement is incorporated herein by reference.

14.2. Section 14.2 of the Attorneys General Settlement is incorporated herein by reference.

XV. ARBITRATION.

Section 15 of the Attorneys General Settlement is incorporated herein by reference.

XVI. MOST FAVORED NATION.

16.1. Section 16.1 of the Attorneys General Settlement is incorporated herein by reference.

16.1.1. Section 16.1.1 of the Attorneys General Settlement is incorporated herein by reference.

16.1.2. Section 16.1.2 of the Attorneys General Settlement is incorporated herein by reference.

16.1.3. Section 16.1.3 of the Attorneys General Settlement is incorporated herein by reference.

16.1.4. Section 16.1.4 of the Attorneys General Settlement is incorporated herein by reference.

16.1.5. Section 16.1.5 of the Attorneys General Settlement is incorporated herein by reference.

16.1.6. Section 16.1.6 of the Attorneys General Settlement is incorporated herein by reference.

16.2. Section 16.2 of the Attorneys General Settlement is incorporated herein by reference.

16.3. Section 16.3 of the Attorneys General Settlement is incorporated herein by reference.

XVII. FUTURE AFFILIATE.

17.1. Section 17.1 of the Attorneys General Settlement is incorporated herein by reference.

17.2. Section 17.2 of the Attorneys General Settlement and subparts (a) and (b) thereof are incorporated herein by reference.

17.3. Section 17.3 of the Attorneys General Settlement is incorporated herein by reference.

17.4. Section 17.4 of the Attorneys General Settlement is incorporated herein by reference.

17.5. Section 17.5 of the Attorneys General Settlement is incorporated herein by reference.

17.6. Section 17.6 of the Attorneys General Settlement is incorporated herein by reference.

17.7. Section 17.7 of the Attorneys General Settlement is incorporated herein by reference.

17.8. Section 17.8 of the Attorneys General Settlement is incorporated herein by reference.

17.9. Section 17.9 of the Attorneys General Settlement is incorporated herein by reference.

XVIII. MISCELLANEOUS

18.1. Section 18.1 of the Attorneys General Settlement is incorporated herein by reference.

18.2. Section 18.2 of the Attorneys General Settlement is incorporated herein by reference.

18.3. Section 18.3 of the Attorneys General Settlement is incorporated herein by reference.

18.4. Section 18.4 of the Attorneys General Settlement is incorporated herein by reference.

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18.7. Section 18.7 of the Attorneys General Settlement is incorporated herein by reference.

18.8. Section 18.8 of the Attorneys General Settlement is incorporated herein by reference.

18.9. Section 18.9 of the Attorneys General Settlement is incorporated herein by reference.

18.10. Section 18.10 of the Attorneys General Settlement is incorporated herein by reference.

18.11. Section 18.11 of the Attorneys General Settlement is incorporated herein by reference.

18.12. Section 18.12 of the Attorneys General Settlement is incorporated herein by reference.

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

BROOKE GROUP LTD.

STATE OF CALIFORNIA

By /s/ Bennett S. LeBow

By /s/ Daniel E. Lungren

Bennett S. LeBow

Daniel E. Lungren
Attorney General

Date: April 14, 1997

Date: April 14, 1997

LIGGETT GROUP, INC.

By /s/ Bennett S. LeBow

Bennett S. LeBow

Date: April 14, 1997

STATE OF ALASKA SETTLEMENT AGREEMENT

This SETTLEMENT AGREEMENT is entered into this 6th day of May, 1997 by and among the State of Alaska and Brooke Group Ltd., a Delaware corporation ("Brooke Group"), Liggett & Myers Inc., a Delaware corporation ("Myers"), and Liggett Group, Inc., a Delaware corporation (which, with Myers, is hereinafter referred to as "Liggett").

RECITALS

WHEREAS,

A. The State of Alaska, by and through its Attorney General (the "Attorney General"), has brought a civil action (the "Action") against, among others, the American Tobacco Company, Inc., BAT Industries, Plc, British American Tobacco Company, R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation, Philip Morris, Inc., Liggett & Myers, Inc., Lorillard Tobacco Company, Inc., and United States Tobacco Company and their various parent and related companies ("Defendants"), asserting claims for, among other things, expenses allegedly arising from tobacco-related matters and injunctive relief concerning sales of cigarettes to minors.

B. Because of the importance of the agreements and undertakings by Liggett and Brooke Group herein to the goals of the State of Alaska, including the prosecution of the Action against non-settling defendants, the State of Alaska has agreed to extend financial settlement terms to Liggett and Brooke Group which will not be offered to any other Defendant, all as set forth in this Settlement Agreement.

C. On March 20, 1997, seventeen States, by and through their Attorneys General, and Liggett and Brooke Group entered into a settlement (the "Attorneys General Settlement") of the actions brought by such States, pursuant to which Liggett agreed to make certain payments, comply with certain proposed regulations restricting the marketing and sale of cigarettes to minors and to offer certain significant cooperation in connection with the prosecution of their respective actions against the other Defendants; all in accordance with the terms of the Attorneys General Settlement, a copy of which is annexed hereto as Appendix A.

D. The State of Alaska and Liggett and Brooke Group wish to provide in this Settlement Agreement for the State of Alaska to become a Subsequent Settling State under the Attorneys

General Settlement, all in accordance with the terms of this Settlement Agreement.

E. The State of Alaska acknowledges and agrees that this Settlement Agreement, including the cooperation provisions thereof, are important to the prosecution of its Action against non-settling Defendants.

F. The State of Alaska and Liggett and Brooke Group recognize and support the public interest in preventing smoking by, and preventing the promotion of smoking to, children and adolescents.

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

H. The State of Alaska recognizes and acknowledges that the cooperation being provided for in this Settlement Agreement would be valuable to the prosecution of claims against the tobacco industry. Further, the State of Alaska acknowledges that the change in warning labels provided for in this Settlement Agreement is a step towards properly informing consumers more fully of the truth about cigarettes and the consequences of smoking, as is the statement by Liggett also provided for herein.

NOW, THEREFORE, in consideration of the foregoing and of the promises and covenants set forth in this Agreement, the undersigned Attorney General, on behalf of the State of Alaska, and Liggett and Brooke Group hereby stipulate and agree that any and all smoking-related claims, including the Action, of the State of Alaska shall be settled as against Liggett and Brooke Group all on the terms contained herein, as follows:

I. DEFINITIONS.

Capitalized terms used herein shall have the meanings assigned to them in Section 1 of the Attorneys General Settlement, except as set forth below or defined elsewhere in this Agreement:

"Action" means the case filed by the State of Alaska in Juneau Superior Court, Case No. 1JU-97-915 CI.

"Agreement" means this Settlement Agreement.

"Attorney General Actions" means those actions settled pursuant to the Attorneys General Settlement or any similar action commenced by or on behalf of a State against the Defendants.

"Attorneys General Settlement" means the settlement agreement entered into on March 20, 1997 by seventeen Settling States and Settling Defendants, a copy of which is annexed hereto as Exhibit A.

"Parties" means the State of Alaska and Brooke Group and Liggett.

"Settling States" means the States listed in Appendix A to the Attorneys General Settlement and Subsequent Settling States.

II. SETTLEMENT PURPOSES ONLY.

Section 2 of the Attorneys General Settlement is incorporated herein by reference.

III. PARTIES.

3.1. Section 3.1 of the Attorneys General Settlement is incorporated herein by reference.

3.2. Section 3.2 of the Attorneys General Settlement is incorporated herein by reference.

IV. PUBLIC STATEMENT; COOPERATION; ADVERTISING LIMITATIONS.

Section 4 of the Attorneys General Settlement is incorporated herein by reference, except as modified below.

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

I am, and have been for a number of years, a Director of Liggett Group Inc., a manufacturer of cigarettes. Cigarettes were identified as a cause of lung cancer and other diseases as early as 1950. I, personally, am not a scientist. But, like all of you, I am aware of the many reports concerning the ill-effects

of cigarette smoking. We at Liggett know and acknowledge that, as the Surgeon General and respected medical researchers have found, cigarette smoking causes health problems, including lung cancer, heart and vascular disease and emphysema. We at Liggett also know and acknowledge that, as the Surgeon General, the Food and Drug Administration and respected medical researchers have found, nicotine is addictive.

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

1. In accordance with a court-approved settlement, Liggett will set up a fund to compensate equitably those who claim to have been injured by our products.
2. Liggett will add a prominent warning to each of our packages of cigarettes and all of our cigarette advertising stating that "Smoking is Addictive".
3. Liggett supports and will not challenge Food and Drug Administration regulations concerning the sale and distribution of nicotine-containing cigarettes and smokeless

tobacco products to children and adolescents. Accordingly, Liggett has agreed to comply with many of these regulations even before they apply to the tobacco industry generally.

4. Liggett has instructed its advertising and marketing people to scrupulously avoid any and all advertising or marketing which would appeal to children or adolescents. Liggett acknowledges that the tobacco industry markets to "youth," which means those under 18 years of age, and not just those 18-24 years of age. Liggett condemns this practice and will not market to children. Liggett agrees that if it sees industry advertisements which in its view are aimed at children, it will bring this to the attention of the Attorney General of the State of Alaska.

5. In accordance with our settlement agreements, Liggett agrees to fully cooperate with the State of Alaska in connection with contemplated lawsuits against the other tobacco companies. To that end, Liggett will make available to the State of Alaska all relevant documents and information, including documents subject to Liggett's own attorney-client privileges and work product protections, and will assist the State of Alaska in obtaining prompt court

adjudication of the rest of the industry's joint privilege claims.

B. Section 4.2 of the Attorneys General Settlement is incorporated herein by reference.

C.1. Upon execution of this Agreement, each Settling Defendant shall:

(1) cooperate with the Attorney General of the State of Alaska in that such Settling Defendant will take no steps to impede or frustrate civil investigations into, or civil prosecutions of, any of the Non-settling Tobacco Companies, so as to secure the just, speedy and inexpensive determination of all such smoking-related claims against said non-settling persons and entities;

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

(3) actively assist the Attorney General of the State of Alaska in identifying and locating any and all persons known to such Settling Defendant to have documents or information that is discoverable in such

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

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

4.3.2. Subject to, and promptly after, the entry of a Protective Order or a Stipulation Regarding Liggett Documents

by the court in which the Action is pending, each Settling Defendant shall:

(1) promptly provide all documents and information that are relevant to the subject matter of the Action or which are likely to lead to admissible evidence in connection with claims asserted in the Action, subject to the provisions of Section 4.3.2(2) hereof;

(2) waive any and all applicable attorney-client privileges and work product protections with respect to such documents and information. Such waiver shall not extend to (a) documents and information not relevant to the subject matter of the Action or not likely to lead to admissible evidence in connection with such an action or (b) documents subject to a joint defense or other privilege or protection which Settling Defendants cannot legally waive unilaterally, except that the waiver by the Settling Defendant shall apply, to the extent permitted by law, to its own joint defenses or other privileges. To the extent that a Settling Defendant has a good faith belief, or one or more Non-

settling Tobacco Companies claims, that documents to be provided pursuant to Section 4.3.2(1) hereof may be subject to a joint defense or other privilege (or a claim of such privilege) of one or more of the Non-settling Tobacco Companies, such documents shall be deposited under seal for IN CAMERA inspection by the court in which the Action is pending, together with a statement to such court that such Settling Defendant has concerns as to whether some or all of such documents should be protected from discovery, and the Parties agree to request that such court shall retain jurisdiction to resolve that issue. Liggett will participate in proceedings, including by way of court appearances or declarations, concerning issues of whether such documents are discoverable;

(3) offer their employees, and any and all other individuals over whom they have control, and help locate former employees, to provide witness interviews of such employees and to testify, in depositions and at trial; it being understood and agreed that Liggett will waive and hereby does waive any and all applicable

confidentiality agreements to the extent such confidentiality agreements would restrict testimony under this Agreement, if any, to which such witnesses may be subject; and

(4) demand from its past or current national legal counsel all documents and information obtained by them in the course of representation of any Settling Defendant which in any way relates to the cooperation required in paragraphs 4.3.1(1) - 4.3.2(3) above, which should be provided to the Settling States as provided under this paragraph.

4.3.3. Section 4.3.3 of the Attorneys General Settlement is incorporated herein by reference.

4.3.4. Section 4.3.4 of the Attorneys General Settlement is incorporated herein by reference.

4.4. Section 4.4 of the Attorneys General Settlement is incorporated herein by reference.

4.5. Section 4.5 of the Attorneys General Settlement and subparts 4.5.1, 4.5.2, 4.5.3, and 4.5.4 thereof are incorporated herein by reference.

4.6. Section 4.6 of the Attorneys General Settlement is incorporated herein by reference.

4.7. Section 4.7 of the Attorneys General Settlement is incorporated herein by reference.

4.8. Section 4.8 of the Attorneys General Settlement is incorporated herein by reference.

4.9. Section 4.9 of the Attorneys General Settlement is incorporated herein by reference.

V. GLOBAL SETTLEMENT.

5.1. Section 5.1 of the Attorneys General Settlement is incorporated herein by reference.

5.2. Section 5.2 of the Attorneys General Settlement is incorporated herein by reference.

VI. SETTLEMENT FUND.

6.1. Section 6.1 of the Attorneys General Settlement is incorporated herein by reference.

6.2. Section 6.2 of the Attorneys General Settlement is incorporated herein by reference.

6.3. Section 6.3 of the Attorneys General Settlement and subparts 6.3.1 and 6.3.2 thereof are incorporated herein by reference.

6.4. Section 6.4 of the Attorneys General Settlement is incorporated herein by reference.

6.5. Section 6.5 of the Attorneys General Settlement is incorporated herein by reference.

6.6. Section 6.6 of the Attorneys General Settlement is incorporated herein by reference.

6.7. Section 6.7 of the Attorneys General Settlement is incorporated herein by reference.

6.8. Section 6.8 of the Attorneys General Settlement is incorporated herein by reference.

6.9. Section 6.9 of the Attorneys General Settlement is incorporated herein by reference.

6.10. Section 6.10 of the Attorneys General Settlement is incorporated herein by reference.

6.11. Section 6.11 of the Attorneys General Settlement is incorporated herein by reference.

6.12. Section 6.12 of the Attorneys General Settlement is incorporated herein by reference.

6.13. Section 6.13 of the Attorneys General Settlement is incorporated herein by reference.

VII. RELEASE.

7.1. Section 7.1 of the Attorneys General Settlement is incorporated herein by reference.

7.2. Section 7.2 of the Attorneys General Settlement is incorporated herein by reference.

7.3. Section 7.3 of the Attorneys General Settlement is incorporated herein by reference.

7.4. Section 7.4 of the Attorneys General Settlement is incorporated herein by reference.

VIII. EXCLUSIVE REMEDY; DISMISSAL OF ACTION;

JURISDICTION OF COURT.

8.1. Section 8.1 of the Attorneys General Settlement is incorporated herein by reference.

8.2. Section 8.2 of the Attorneys General Settlement is incorporated herein by reference.

8.3. Section 8.3 of the Attorneys General Settlement is incorporated herein by reference.

IX. TERM.

Section 9 of the Attorneys General Settlement is incorporated herein by reference, except as modified below.

9.1. Section 9.1 of the Attorneys General Settlement is incorporated herein by reference.

9.2. Section 9.2 of the Attorneys General Settlement is incorporated herein by reference.

9.3. Section 9.3 of the Attorneys General Settlement is incorporated herein by reference.

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9.5. Section 9.5 of the Attorneys General Settlement is incorporated herein by reference.

9.6. Section 9.6 of the Attorneys General Settlement is incorporated herein by reference.

9.7. The duration of this Agreement shall be co-extensive with the duration of the Attorneys General Settlement. The exercise of any right under the Attorneys General Settlement to terminate the Attorneys General Settlement with respect to the State of Alaska shall also be a termination of this Agreement.

X. CONTINUING ENFORCEABILITY.

Section 10 of the Attorneys General Settlement is incorporated herein by reference.

XI. ENTRY OF GOOD FAITH BAR ORDER ON CONTRIBUTION AND INDEMNITY

CLAIMS.

1. Section 11.1 of the Attorneys General Settlement is incorporated herein by reference.

2. Section 11.2 of the Attorneys General Settlement is incorporated herein by reference.

3. Section 11.3 of the Attorneys General Settlement is incorporated herein by reference.

4. Section 11.4 of the Attorneys General Settlement is incorporated herein by reference.

2. TAX STATUS OF SETTLEMENT FUND.

12.1. Section 12.1 of the Attorneys General Settlement is incorporated herein by reference.

12.2. Section 12.2 of the Attorneys General Settlement is incorporated herein by reference.

12.3. Section 12.3 of the Attorneys General Settlement is incorporated herein by reference.

XII. EFFECT OF DEFAULT OF SETTLING DEFENDANT.

Section 13 of the Attorneys General Settlement is incorporated herein by reference.

XIII. REPRESENTATIONS AND WARRANTIES.

14.1. Section 14.1 of the Attorneys General Settlement is incorporated herein by reference.

14.2. Section 14.2 of the Attorneys General Settlement is incorporated herein by reference.

XIV. ARBITRATION.

Section 15 of the Attorneys General Settlement is incorporated herein by reference.

XV. MOST FAVORED NATION.

16.1. Section 16.1 of the Attorneys General Settlement is incorporated herein by reference.

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16.1.2. Section 16.1.2 of the Attorneys General Settlement is incorporated herein by reference.

16.1.3. Section 16.1.3 of the Attorneys General Settlement is incorporated herein by reference.

16.1.4. Section 16.1.4 of the Attorneys General Settlement is incorporated herein by reference.

16.1.5. Section 16.1.5 of the Attorneys General Settlement is incorporated herein by reference.

16.1.6. Section 16.1.6 of the Attorneys General Settlement is incorporated herein by reference.

16.2. Section 16.2 of the Attorneys General Settlement is incorporated herein by reference.

16.3. Section 16.3 of the Attorneys General Settlement is incorporated herein by reference.

XVI. FUTURE AFFILIATE.

17.1. Section 17.1 of the Attorneys General Settlement is incorporated herein by reference.

17.2. Section 17.2 of the Attorneys General Settlement and subparts (a) and (b) thereof are incorporated herein by reference.

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17.9. Section 17.9 of the Attorneys General Settlement is incorporated herein by reference.

XVII. MISCELLANEOUS.

18.1. Section 18.1 of the Attorneys General Settlement is incorporated herein by reference.

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18.10. Section 18.10 of the Attorneys General Settlement is incorporated herein by reference.

18.11. Section 18.11 of the Attorneys General Settlement is incorporated herein by reference.

18.12. Section 18.12 of the Attorneys General Settlement is incorporated herein by reference.

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

BROOKE GROUP LTD.

STATE OF ALASKA

By /s/ Bennett S. LeBow

Bennett S. LeBow

By /s/ Bruce Botelho

Bruce Botelho
Attorney General

Date: May 6, 1997

Date: May 6, 1997

LIGGETT GROUP, INC.

By /s/ Bennett S. LeBow

Bennett S. LeBow

Date: May 6, 1997

3-MOS

	DEC-31-1997	
	JAN-01-1997	
	MAR-31-1997	
		2,187
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		10,732
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		52,643
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		744
	5,857	
		363
		0
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		6,220
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0000927388
BGLS INC.
1,000

3-MOS

	DEC-31-1997	
	JAN-01-1997	
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	10,732	
	930	
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101,469		60,998
	31,056	
	143,709	
204,387		341,506
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143,709		(470,357)
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	41,845	
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	0	
16,381		
	6,164	
		742
5,422		
	363	
	0	
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	5,785	
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LIGGETT GROUP INC.
CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 1997

LIGGETT GROUP, INC.
CONSOLIDATED FINANCIAL STATEMENTS

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LIGGETT GROUP INC.

CONSOLIDATED BALANCE SHEETS

(Unaudited)

(Dollars in thousands, except per share amounts)

	March 31, 1997	December 31, 1996
	-----	-----
ASSETS		
Current assets:		
Cash	\$ 477	\$ --
Accounts receivable:		
Trade, less allowances of \$930 and \$1,280, respectively	9,117	19,316
Other	864	744
Inventories	49,261	50,122
Other current assets	610	1,205
	-----	-----
Total current assets	60,329	71,387
Property, plant and equipment, at cost, less accumulated depreciation of \$29,981 and \$29,511, respectively	18,662	18,705
Intangible assets, at cost, less accumulated amortization of \$17,817 and \$17,388, respectively	2,898	3,327
Other assets and deferred charges, at cost, less accumulated amortization of \$7,860 and \$7,410, respectively	3,618	4,258
	-----	-----
Total assets	\$85,507	\$97,677
	=====	=====

(continued)

LIGGETT GROUP INC.

CONSOLIDATED BALANCE SHEETS (Continued)

(Unaudited)

(Dollars in thousands, except per share amounts)

	March 31, 1997 -----	December 31, 1996 -----
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Current liabilities:		
Current maturities of long-term debt	\$ 73,838	\$ 31,807
Cash overdraft	--	6
Accounts payable, principally trade	14,618	18,949
Accrued expenses:		
Promotional	31,850	30,257
Compensation and related items	502	682
Taxes, principally excise taxes	2,698	7,565
Estimated allowance for sales returns	5,000	5,000
Interest	3,243	8,435
Other	9,750	9,380
	-----	-----
Total current liabilities	141,499	112,081
Long-term debt, less current maturities	107,245	144,698
Non-current employee benefits and other liabilities	16,545	17,376
Commitments and contingencies (Notes 5 and 8)		
Stockholder's equity (deficit):		
Redeemable preferred stock (par value \$1.00 per share; authorized 1,000 shares; no shares issued and outstanding)		
Common stock (par value \$0.10 per share; authorized 2,000 shares; issued and outstanding 1,000 shares) and contributed capital	47,640	49,840
Accumulated deficit	(227,422)	(226,318)
	-----	-----
Total stockholder's deficit	(179,782)	(176,478)
	-----	-----
Total liabilities and stockholder's equity (deficit)	\$ 85,507	\$ 97,677
	=====	=====

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

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

	Three Months Ended March 31,	
	1997 ----	1996 ----
Net sales*.....	\$66,301	\$78,488
Cost of sales*.....	30,259 -----	36,292 -----
Gross profit	36,042	42,196
Selling, general and administrative expenses.....	33,910	42,118
Restructuring.....	1,761 -----	-- -----
Operating income	371	78
Other income (expense):		
Interest income	57	--
Interest expense	(6,040)	(5,856)
Equity in loss of affiliate	(33)	--
Sale of assets	1,592	--
Retirement of debt	2,963	--
Miscellaneous, net	(14) -----	(12) -----
Net loss.....	\$(1,104) =====	\$(5,790) =====

*Net sales and cost of sales include federal excise taxes of \$16,860 and \$21,197, respectively.

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

LIGGETT GROUP INC.

CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY (DEFICIT)

(Unaudited)
(Dollars in thousands)

	Common Stock and Contributed Capital	Accumulated Deficit	Total Stockholder's Deficit
	-----	-----	-----
Balance at December 31, 1996.	\$49,840	\$(226,318)	\$(176,478)
Net loss	--	(1,104)	(1,104)
Consideration for option to acquire affiliate stock in excess of its net assets (Note 9)	(2,200)	--	(2,200)
	-----	-----	-----
Balance at March 31, 1997.	\$47,640 =====	\$(227,422) =====	\$(179,782) =====

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,	
	1997	1996
	-----	-----
Cash flows from operating activities:		
Net loss	\$ (1,104)	\$ (5,790)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,764	1,990
Deferred income taxes	--	(57)
(Gain) loss on sale of property, plant and equipment	(1,592)	16
Gain on retirement of notes	(2,963)	--
Deferred finance charges and debt discount written off	130	--
Equity in loss of affiliate	33	--
Changes in assets and liabilities:		
Accounts receivable	10,079	10,151
Inventories	861	(2,115)
Accounts payable	(922)	(2,335)
Accrued expenses	(11,685)	(10,982)
Non-current employee benefits	(206)	(348)
Other, net	(433)	(187)
	-----	-----
Net cash used in operating activities	(6,038)	(9,657)
	-----	-----
Cash flows from investing activities:		
Proceeds from sale of property, plant and equipment	1,904	--
Capital expenditures	(649)	(1,350)
Purchase of an option in affiliate	(2,200)	--
	-----	-----
Net cash used in investing activities	(945)	(1,350)
	-----	-----
Cash flows from financing activities:		
Repayments of long-term debt	(4,601)	(64)
Borrowings under revolving credit facility	81,291	87,644
Repayments under revolving credit facility	(69,224)	(76,629)
Increase (decrease) in cash overdraft	(6)	56
	-----	-----
Net cash provided by financing activities	7,460	11,007
	-----	-----
Net change in cash and cash equivalents	477	--
Cash and cash equivalents:		
Beginning of period	--	--
	-----	-----
End of period	\$ 477	\$ --
	=====	=====
Supplemental cash flow information:		
Cash payments (refunds) during the period for:		
Interest	\$ 11,022	\$ 10,793
Income taxes	\$ 93	\$ 15

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

LIGGETT GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Dollars in thousands, except per share amounts)

1. THE COMPANY

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

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

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. Liggett had a net capital deficiency of \$179,782 as of March 31, 1997, is highly leveraged and has substantial near-term debt service requirements. Due to the many risks and uncertainties associated with the cigarette industry and the impact of tobacco litigation (see Note 8), there can be no assurance that the Company will be able to meet its future earnings and/or cash flow goals. Consequently, the Company could be in violation of certain debt covenants, and if its lenders were to exercise acceleration rights under the revolving credit facility or Senior Secured Notes indentures or refuse to lend under the revolving credit facility, the Company would not be able to satisfy such demands or its working capital requirements.

Further, the Company's Senior Secured Notes require a mandatory principal redemption of \$37,500 on February 1, 1998 and a payment at maturity on February 1, 1999 of \$107,400 and its revolving credit facility expires on March 8, 1998 unless extended by its lenders. Current maturities of both the Senior Secured Notes and revolving credit facility of approximately \$74,000 contribute substantially to the working capital deficit of approximately \$81,170 as of March 31, 1997.

While management currently intends to seek to refinance and/or restructure with the Company's note holders the redemption and maturity requirements on the Senior Secured Notes and to extend the revolving credit facility, there are no refinancing or restructuring arrangements for the notes or commitments to extend the facility at this time, and no assurances can be given in this regard. Based on the Company's net loss for 1996 and anticipated 1997 operating results, the Company does not anticipate it will be able to generate sufficient cash from operations to make such payments. If the Company is unable to refinance or restructure such obligations, renegotiate the payment terms of the Senior Secured Notes, extend the revolving credit facility, or otherwise make such payments, substantially all of its long-term debt and revolving credit facility would be in default and holders of such debt could accelerate the maturity of such debt. In such event, the Company may be forced to seek protection from creditors under applicable laws. These matters raise substantial doubt about the Company meeting its liquidity needs and its ability to continue as a going concern.

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

2. ESTIMATES AND ASSUMPTIONS

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

3. PER SHARE DATA

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

4. ASSETS UNDER AGREEMENTS FOR SALE

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

5. INVENTORIES

Inventories consist of the following:

	March 31, 1997	December 31, 1996
	-----	-----
Finished goods	\$ 15,320	\$ 15,304
Work-in-process	4,812	4,382
Raw materials	30,349	31,338
Replacement parts and supplies	3,641	3,554
	-----	-----
Inventories at current cost	54,122	54,578
LIFO adjustment	(4,861)	(4,456)
	-----	-----
Inventories at LIFO cost	\$ 49,261	\$ 50,122
	=====	=====

The Company has a leaf inventory management program whereby, among other things, it is committed to purchase certain quantities of leaf tobacco. The purchase commitments are for quantities not in excess of anticipated requirements and are at prices, including carrying costs, established at the date of the commitment. Liggett had leaf tobacco purchase commitments of approximately \$21,217 at March 31, 1997.

6. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consists of the following:

	March 31, 1997	December 31, 1996
	-----	-----
Land and improvements	\$ 455	\$ 455
Buildings	6,150	5,848
Machinery and equipment	42,038	41,913
	-----	-----
Property, plant and equipment	48,643	48,216
Less accumulated depreciation	(29,981)	(29,511)
	-----	-----
Property, plant and equipment, net	<u>\$ 18,662</u>	<u>\$ 18,705</u>

7 LONG-TERM DEBT

Long-term debt consists of the following:

	March 31, 1997	December 31, 1996
	-----	-----
11.5% Senior Secured Notes due February 1, 1999, net of unamortized discount of \$349 and \$424, respectively	\$112,263	\$119,688
Variable Rate Series C Senior Secured Notes due February 1, 1999	32,279	32,279
Borrowings outstanding under revolving credit facility	36,339	24,272
Other	202	266
	-----	-----
	181,083	176,505
Current portion	(73,838)	(31,807)
	-----	-----
Amount due after one year	<u>\$107,245</u>	<u>\$144,698</u>

Senior Secured Notes

On February 14, 1992, Liggett issued \$150,000 in Senior Secured Notes (the "Series B Notes"). Interest on the Series B Notes is payable semiannually on February 1 and August 1 at an annual rate of 11.5%. The Series B Notes and Series C Notes referred to below (collectively, the "Notes") require mandatory principal redemptions of \$7,500 on February 1 in each of the years 1993 through 1997 and \$37,500 on February 1, 1998 with the balance of the Notes due on February 1, 1999. In February 1997, \$7,500 of 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 Notes are collateralized by substantially all of the assets of the Company, excluding inventories and receivables. Eve is a guarantor for the Notes. The Notes may be redeemed, in whole or in part, at a price equal to 102% and 100% of the principal amount in the years 1997 and 1998, respectively, at the option of the

Company. The Notes contain restrictions on Liggett's ability to declare or pay cash dividends, incur additional debt, grant liens and enter into any new agreements with affiliates, among others.

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

Revolving Credit Facility

On March 8, 1994, Liggett entered into a revolving credit facility (the "Facility") under which it can borrow up to \$40,000 (depending on the amount of eligible inventory and receivables as determined by the lenders) from a syndicate of commercial lenders. Availability under the Facility was approximately \$461 based upon eligible collateral at March 31, 1997. The Facility is collateralized by all inventories and receivables of the Company. Borrowings under the Facility, whose interest is calculated at a rate equal to 1.5% above Philadelphia National Bank's (the indirect parent of Congress Financial Corporation, the lead lender) prime rate of 8.25%, bore a rate of 9.75% on March 31, 1997. On April 1, 1997, Philadelphia National Bank raised its prime rate to 8.5%, thereby increasing Liggett's interest rate to 10.0%. The Facility contains certain financial covenants similar to those contained in the Note indenture, including restrictions on Liggett's ability to declare or pay cash dividends, incur additional debt, grant liens and enter into any new agreements with affiliates, among others. In addition, the Facility currently imposes requirements with respect to the Company's adjusted net worth (not to fall below a deficit of \$180,000 as computed in accordance with the agreement) and working capital (not to fall below a deficit of \$12,000 as computed in accordance with the agreement). The Facility is classified as short-term debt as of March 31, 1997, as it becomes due on March 8, 1998, unless extended by the lenders.

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

For information concerning Liggett's substantial near-term debt service requirements and other related matters, see Note 1.

8. COMMITMENTS AND CONTINGENCIES

Litigation

Since 1954, Liggett and other United States cigarette manufacturers have been named as defendants in a number of direct and third-party actions predicated on the theory that they should be liable for damages from cancer and other adverse health effects alleged to have been caused by cigarette smoking or by exposure to secondary smoke (environmental tobacco smoke, "ETS") from cigarettes. These cases are reported hereinafter as though having been commenced against Liggett (without regard to whether such cases were actually commenced against BGL or Liggett). New cases continue to be commenced against Liggett and other

cigarette manufacturers. As new cases are commenced, the costs associated with defending such cases and the risks attendant to the inherent unpredictability of litigation continue to increase. Liggett had been receiving certain financial and other assistance from others in the industry in defraying the costs and other burdens incurred in the defense of smoking and health litigation and related proceedings, but these benefits have recently ended. Certain joint defense arrangements, and the financial benefits incident thereto, have also ended. The future financial impact on the Company of the termination of this assistance and the effects of the tobacco litigation settlements discussed below is not quantifiable at this time.

As of March 31, 1997, there were 107 cases pending against Liggett where individual plaintiffs allege injury resulting from cigarette smoking, addiction to cigarette smoking or exposure to ETS and seek compensatory and, in some cases, punitive damages. Of these, 53 are pending in the State of Florida and 20 are pending in the State of New York. The balance of individual cases are pending in 14 different states. The next individual case scheduled for trial where Liggett is a defendant is CHUTZ-REYMERS V. LIGGETT GROUP INC., ET AL. United States District Court, Middle District of Florida, Tampa Division, which is scheduled for trial in June 1997. In light of the settlements discussed below, this case will not proceed against Liggett on that date. In addition to the foregoing, there are four individual cases scheduled for trial in 1997 where Liggett is a defendant, although trial dates are subject to change.

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

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

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

On October 31, 1991, an action entitled BROIN ET AL. V. PHILIP MORRIS INCORPORATED, ET AL., Circuit Court of the Eleventh Judicial District in and for Dade County, Florida, was filed against Liggett and others. This case was the first class action commenced against the industry, and has been brought by plaintiffs on behalf of all flight attendants that have worked or are presently working for airlines based in

the United States and who have never regularly smoked cigarettes but allege that they have been damaged by involuntary exposure to ETS. Plaintiffs' motion to certify the action as a class action was granted. The suit is scheduled to go to trial on June 2, 1997. In addition to Broin, as of March 31, 1997 there were 16 other actions which have either been certified as a class or are seeking class certification. One of these actions, ENGLE, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Circuit Court of the Eleventh Judicial Circuit in and for Dade County, Florida, involving a certified class of smokers in the State of Florida, is scheduled to commence trial on September 8, 1997.

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

On September 10, 1993, an action entitled SACKMAN V. LIGGETT GROUP INC., United States District Court, Eastern District of New York, was filed against Liggett alleging as injury lung cancer. On May 25, 1996, the District Court granted Liggett summary judgment on plaintiff's fraud and breach of warranty claims. In addition, the District Court vacated the Magistrate's March 19, 1996 order compelling Liggett to produce certain CTR documents with respect to which Liggett had asserted various privilege claims, and allowed the other cigarette manufacturers and the CTR to intervene in order to assert their interests and privileges with respect to those same documents. The Magistrate Judge is presently reconsidering plaintiffs' motion to compel production of documents. No trial date has been set.

On March 25, 1994, an action entitled CASTANO, ET AL. V. THE AMERICAN TOBACCO COMPANY INC., ET AL., United States District Court, Eastern District of Louisiana, was filed against Liggett and others. The class action complaint sought relief for a nationwide class of smokers based on their alleged addiction to nicotine. The District Court granted plaintiffs' motion for class certification. On May 23, 1996, the Fifth Circuit Court of Appeals decertified the class and instructed the District Court to dismiss the class complaint. On March 12, 1996, Liggett and BGL entered into an agreement, subject to court approval, to settle the CASTANO class action tobacco litigation.

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 BGL 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. BGL 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 District Court seeking preliminary approval of the CASTANO settlement. On September 6, 1996, the CASTANO plaintiffs withdrew the motion for approval of the CASTANO settlement.

On March 14, 1996, BGL, the CASTANO Plaintiffs Legal Committee and the CASTANO plaintiffs entered into a letter agreement. According to the terms of the letter agreement, for the period ending nine months from the date of Final Approval (as defined in the letter), if granted, of the CASTANO settlement or, if earlier, the completion by BGL 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 BGL \$250,000 within thirty days of the more favorable agreement and offer BGL and

Liggett the option to enter into a settlement on terms at least as favorable as those included in such other settlement. The letter agreement further provides that during the same time period, and if the CASTANO settlement agreement has not been earlier terminated by BGL in accordance with its terms, BGL and its affiliates will not enter into any business transaction with any third party which would cause the termination of the CASTANO settlement agreement. If BGL or its affiliates enter into any such transaction, then the CASTANO plaintiffs will be entitled to receive \$250,000 within thirty days from the transacting party.

In February 1995, an action entitled GRADY CARTER, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Superior Court for the State of Florida, Duval County, was filed against Liggett and others. Plaintiff sought compensatory damages, including, but not limited to, reimbursement for medical costs. Both American Tobacco and Liggett were subsequently dismissed from this action. On August 9, 1996, a jury returned a verdict against the remaining defendant, Brown & Williamson Tobacco Corp., in the amount of \$750. Brown & Williamson has filed a Notice of Appeal.

On May 23, 1994, an action entitled MOORE, ATTORNEY GENERAL, EX REL STATE OF MISSISSIPPI V. THE AMERICAN TOBACCO COMPANY, ET AL., Chancery Court of Jackson County, Mississippi, was commenced against Liggett and others seeking restitution and indemnity for medical payments and expenses allegedly made or incurred for tobacco related illnesses. In May 1994, the State of Florida enacted legislation, effective July 1, 1994, allowing certain state authorities or entities to commence litigation seeking recovery of certain Medicaid payments made on behalf of Medicaid recipients as a result of diseases (including, but not limited to, diseases allegedly caused by cigarette smoking) allegedly caused by liable third parties (including, but not limited to, the tobacco industry). On February 21, 1995, the State of Florida commenced an action pursuant to this statutory scheme. In addition to Florida and Mississippi, similar actions have been filed by many other states and municipalities. The Mississippi, Florida and Texas Medicaid recovery actions are scheduled for trial in 1997 (see settlement discussions below). Legislation similar to that enacted in Florida has been introduced in the Massachusetts and New Jersey legislatures.

In certain of the pending proceedings, state and local government entities and others seek reimbursement for Medicaid and other health care expenditures allegedly caused by tobacco products. The claims asserted in these Medicaid recovery actions vary. All plaintiffs assert the equitable claim that the tobacco industry was "unjustly enriched" by plaintiffs' payment of health care costs allegedly attributable to smoking and seek reimbursement of those costs. Other claims made by some but not all plaintiffs include the equitable claim of indemnity, common law claims of negligence, strict liability, breach of express and implied warranty, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under state and federal statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under the Federal Racketeer Influenced and Corrupt Organization Act.

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

Under the settlement, the states would share an initial payment by Liggett of \$5,000 (\$1,000 of which was paid on March 22, 1996, with the balance payable over nine years and indexed and adjusted for inflation), provided that any unpaid amount will be due sixty days after either a default by Liggett in its payment obligations under the settlement or a merger or other similar transaction by Liggett or BGL with another defendant in the lawsuits. In addition, Liggett will be required to pay the states a percentage of Liggett's pretax income (income before income taxes) each year from the second through the twenty-fifth year. This annual percentage is 2-1/2% of Liggett's pretax income, subject to increase to 7-1/2%

depending on the number of additional states joining the settlement. No additional states have joined this settlement to date. All of Liggett's payments are subject to certain reductions provided for in the agreement. Liggett has also agreed to pay to the states \$5,000 if Liggett or BGL fails to consummate a merger or other similar transaction with another defendant in the lawsuits within three years of the date of the settlement.

Settlement funds received by the Attorneys General will be used to reimburse the states' smoking-related healthcare costs. While neither consenting to FDA jurisdiction nor waiving their objections thereto, Liggett and BGL also have agreed to phase in compliance with certain of the proposed interim FDA regulations on the same basis as provided in the CASTANO settlement.

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

At December 31, 1995, the Company had accrued approximately \$4,000 for the present value of the fixed payments under the March 1996 Attorneys General settlement, of which \$2,278 was outstanding on March 31, 1997. 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 occurrence of a business combination, will be expensed when considered probable.

On March 20, 1997, Liggett, together with BGL, entered into a comprehensive settlement of tobacco litigation through parallel agreements with the Attorneys General of 17 additional states and with a nationwide class of individuals and entities that allege smoking-related claims. Thereafter, on April 14, 1997, the State of California entered into a settlement agreement with Liggett and BGL, of the action which it contemplates commencing against the industry and on May 6, 1997, the State of Alaska entered into a settlement agreement with Liggett and BGL, of the action which it recently commenced against the industry. The settlements cover all smoking-related claims, including both addiction-based and tobacco injury claims against Liggett and BGL, brought by the Attorneys General and, upon court approval, the nationwide class.

The recent Attorneys General settlements, which do not require court approval, include the states of Alaska, Arizona, California, Connecticut, Hawaii, Illinois, Indiana, Iowa, Kansas, Maryland, Michigan, Minnesota, New Jersey, New York, Oklahoma, Texas, Utah, Washington and Wisconsin. Liggett and BGL's previous settlements on March 15, 1996, with the Attorneys General of Florida, Louisiana, Massachusetts, Mississippi and West Virginia remain in full force and effect. Several other states have either recently filed Medicaid recovery actions or indicated intentions to do so. Both Liggett and BGL will endeavor to resolve those matters on substantially the same terms and conditions as the prior settlements; however, there can be no assurance that any such settlements will be completed.

The settlement with the nationwide class covers all smoking-related claims. On March 20, 1997, Liggett, BGL and plaintiffs filed the mandatory class settlement agreement in an action entitled FLETCHER, ET AL. V. BROOKE GROUP LTD., ET AL., Circuit Court of Mobile County, Alabama, where the court granted preliminary approval and preliminary certification of the class. Class members will be notified of the settlement and will have an opportunity to appear at a later court hearing. Effectiveness of the mandatory settlement is conditioned on final court approval of the settlement after a fairness hearing. There can be no assurance as to whether or when court approval will be obtained. There are no opt out provisions in this settlement, except for Medicaid claims by states that are not party to the Attorneys General settlements.

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

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

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

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

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

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

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

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

On March 15, 1996, an action entitled SPENCER J. VOLK V. LIGGETT GROUP INC. was filed in the United States District Court for the Southern District of New York, Case No. 96-CIV-1921, wherein the plaintiff, who was formerly employed as Liggett's President and Chief Executive Officer, seeks recovery of certain monies allegedly owing by Liggett to him for long-term incentive compensation. At a September 19, 1996 hearing, the court dismissed the plaintiff's alternate claim for recovery under a fraud theory and by order dated March 10, 1997, the court dismissed the balance of plaintiff's claims. A notice of appeal has been filed by the plaintiff.

Litigation is subject to many uncertainties, and it is possible that some of the aforementioned actions could be decided unfavorably against the Company. An unfavorable outcome of a pending smoking and health case could encourage the commencement of additional similar litigation. The Company is not able to evaluate the effect of these developing matters on pending litigation or the possible commencement of additional litigation.

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

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

Legislation and Regulation

On August 28, 1996, the Food and Drug Administration ("FDA") filed in the Federal Register a Final Rule classifying tobacco as a drug, asserting jurisdiction by the FDA over the manufacture and marketing of tobacco products and imposing restrictions on the sale, advertising and promotion of tobacco products. The FDA's stated objective and focus for its initiative is to limit access to cigarettes by minors by measures beyond the restrictions either mandated by existing federal, state and local laws or voluntarily implemented by major manufacturers in the industry. Litigation 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. A hearing on the tobacco industry's motion for summary judgment in that case was held on February 10, 1997 and a decision by the Court was issued on April 25, 1997. The court granted plaintiffs' motion for summary judgment prohibiting the FDA from regulating or restricting the promotion and advertising of tobacco products. The court 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, while neither consenting to FDA jurisdiction nor waiving their objections thereto, agreed to withdraw their objections and opposition to the proposed rule making and to phase in compliance with certain of the proposed interim FDA regulations. See discussions of the CASTANO and Attorneys General settlements above.

In August 1996, the Commonwealth of Massachusetts enacted legislation requiring tobacco companies to publish information regarding the ingredients in cigarettes and other tobacco products sold in that state. Regulations adopted pursuant to this legislation are scheduled to become effective on July 1, 1997. On February 7, 1997, the United States District Court for the District of Massachusetts denied an attempt to block the new legislation on the ground that it is preempted by federal law.

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

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

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

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

regulate ETS, and that given the current body of scientific evidence and the EPA's failure to follow its own guidelines in making the determination, the EPA's classification of ETS was arbitrary and capricious. Whatever the outcome of this litigation, issuance of the report may encourage efforts to limit smoking in public areas.

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

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

9. RELATED PARTY TRANSACTIONS

On July 5, 1996, Liggett purchased 140,000 shares (19.97%) of Liggett-Ducat Ltd.'s ("Liggett-Ducat") tobacco operations from Brooke (Overseas) Ltd. ("BOL"), an indirect subsidiary of BGL, for \$2,100. Liggett-Ducat, which produces cigarettes in Russia, manufactured and marketed 11.4 billion cigarettes in 1996. Liggett also acquired on that date for \$3,400 a ten-year option, exercisable by Liggett in whole or in part, to purchase from BOL at the same per share price up to 292,407 additional shares of Liggett-Ducat, thereby entitling Liggett to increase its interest in Liggett-Ducat to approximately 62%. The option fee is to be credited against the purchase price. In addition, as part of the same transaction, Liggett had the right on or before June 30, 1997 to acquire from BOL for \$2,200 another ten-year option on the same terms to purchase the remaining shares of Liggett-Ducat (an additional 33%). On March 13, 1997, Liggett acquired this option and paid BOL \$2,000, and recorded a payable to BOL for the remaining \$0.2 million. Liggett accounts for its investment in Liggett-Ducat under the equity method of accounting. Liggett's equity in the net loss of Liggett-Ducat amounted to \$33 for the three months ended March 31, 1997. The excess of the cost of the option over carrying amount of net assets to be acquired under the option has been charged to stockholder's deficit.

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

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

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

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

10. RESTRUCTURING CHARGES

In the first three months of 1997, the Company reduced its headcount by 87 positions and recorded a \$1,761 restructuring charge to operations for severance programs, primarily salary continuation and related benefits for terminated employees. Approximately \$285 in restructuring charges will be funded in subsequent years. The Company expects to continue its cost reduction programs.

EVE HOLDINGS INC.

BALANCE SHEETS

(Unaudited)

(Dollars in thousands, except per share amounts)

	March 31, 1997	December 31, 1996
	-----	-----
ASSETS		
Cash	\$ 4	\$ --
Office equipment	1	2
Trademarks, at cost, less accumulated amortization of \$17,719 and \$17,294, respectively	2,694	3,119
	-----	-----
Total assets	\$ 2,699	\$ 3,121
	=====	=====
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Federal income taxes currently payable to parent	\$ 528	\$ --
Dividends payable	980	4,623
Cash overdraft	--	92
Other current liabilities	--	19
Deferred income taxes	943	1,092
	-----	-----
Total liabilities	2,451	5,826
	-----	-----
Stockholder's equity (deficit):		
Common stock (par value \$1.00 per share; authorized, issued and outstanding 100 shares) and contributed capital	47,848	46,548
Receivables from parent:		
Note receivable - interest at 14%, due no sooner than February 1, 1999	(44,520)	(44,520)
Other	(3,080)	(4,733)
	-----	-----
Total stockholder's equity (deficit)	248	(2,705)
	-----	-----
Total liabilities and stockholder's equity (deficit)	\$ 2,699	\$ 3,121
	=====	=====

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

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

	Three Months Ended March 31,	
	1997	1996
Revenues:		
Royalties - parent	\$1,546	\$1,713
Interest - parent	1,576	1,576
	3,122	3,289
Expenses:		
Amortization of trademarks	425	425
Miscellaneous	37	24
	2,660	2,840
Income before income taxes	2,660	2,840
Income tax provision	379	994
	\$2,281	\$1,846
Net income	\$2,281	\$1,846

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,	
	1997	1996
	-----	-----
Cash flows from operating activities:		
Net income	\$ 2,281	\$ 1,846
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	528	978
Other current liabilities	(19)	--
	-----	-----
Net cash provided by operating activities	3,066	3,100
	-----	-----
Cash flows from financing activities:		
Dividends/capital distributions	(4,623)	(2,536)
Increase in due from parent	1,653	(569)
Decrease in cash overdraft	(92)	--
	-----	-----
Net cash used in financing activities	(3,062)	(3,105)
	-----	-----
Net increase (decrease) in cash	4	(5)
Cash:		
Beginning of period	--	8
	-----	-----
End of period	\$ 4	\$ 3
	=====	=====
Supplemental cash flow information:		
Payments of income taxes through receivable from parent	\$ --	\$ 164
Income taxes	32	--
Dividends/capital distributions declared but not paid	980	2,122

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 \$81,170 and a capital deficiency of \$179,782 as of March 31, 1997, is highly leveraged and has substantial near-term debt service requirements. These matters raise substantial doubt about Eve and Liggett meeting their liquidity needs and their ability to continue as going concerns.

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

b. Per Share Data

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

3. GUARANTEE OF LIGGETT NOTES

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

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

4. INCOME TAXES

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

Exhibit 99.2

NEW VALLEY CORPORATION
CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 1997

NEW VALLEY CORPORATION
CONSOLIDATED FINANCIAL STATEMENTS

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NEW VALLEY CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share amounts)

(Unaudited)

	March 31, 1997	December 31, 1996
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$ 54,482	\$ 57,282
Investment securities available for sale.....	40,291	61,454
Trading securities owned.....	21,836	29,761
Restricted assets.....	2,109	2,080
Receivable from clearing brokers.....	19,507	23,870
Other current assets.....	11,019	9,273
	149,244	183,720
Investment in real estate.....	257,649	179,571
Investment securities available for sale.....	2,974	2,716
Restricted assets.....	6,655	6,766
Long-term investments, net.....	12,917	13,270
Other assets.....	28,903	20,497
	\$ 458,342	\$ 406,540
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable and accrued liabilities.....	\$ 41,991	\$ 44,888
Prepetition claims and restructuring accruals.....	16,864	15,526
Income taxes.....	19,002	18,243
Securities sold, not yet purchased.....	21,006	17,143
Note payable to related party.....	33,500	--
Current portion of notes payable and long-term obligations	22,728	2,310
	155,091	98,110
Notes payable.....	157,827	157,941
Other long-term obligations.....	18,386	12,282
Redeemable preferred shares.....	221,753	210,571
Shareholders' equity (deficit):		
Cumulative preferred shares; liquidation preference of \$69,769; dividends in arrears, \$121,502 and \$115,944.....	279	279
Common Shares, \$.01 par value; 850,000,000 shares authorized; 9,577,624 shares outstanding.....	96	96
Additional paid-in capital.....	634,731	644,789
Accumulated deficit.....	(732,195)	(721,854)
Unearned compensation on stock options.....	(1,008)	(731)
Unrealized gain on investment securities	3,382	5,057
	(94,715)	(72,364)
Total liabilities and shareholders' equity (deficit).....	\$ 458,342	\$ 406,540
	=====	=====

See accompanying Notes to Quarterly Consolidated Financial Statements

NEW VALLEY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in thousands, except per share amounts)
(Unaudited)

	Three Months Ended March 31,	
	1997	1996
Revenues:		
Principal transactions, net.....	\$ 2,499	\$ 8,738
Commissions.....	3,393	3,863
Real estate leasing.....	6,282	5,706
Interest and dividends.....	1,541	5,184
Other income.....	6,038	8,494
	-----	-----
Total revenues.....	19,753	31,985
	-----	-----
Cost and expenses:		
Operating, general and administrative.....	24,267	33,654
Interest.....	3,862	4,524
Provision for loss on long-term investment.....	3,796	--
	-----	-----
Total costs and expenses.....	31,925	38,178
	-----	-----
Loss from continuing operations before income taxes and minority interest.....	(12,172)	(6,193)
Income tax provision (benefit).....	50	(100)
Minority interests in loss from continuing operations of consolidated subsidiary.....	1,009	481
	-----	-----
Loss from continuing operations.....	(11,213)	(5,612)
Discontinued operations:		
Income from discontinued operations.....	872	728
	-----	-----
Net loss.....	(10,341)	(4,884)
Dividend requirements on preferred shares.....	(15,980)	(15,462)
Excess of carrying value of redeemable preferred shares over cost of shares purchased.....	--	4,279
	-----	-----
Net loss applicable to Common Shares.....	\$(26,321)	\$(16,067)
	=====	=====
Loss per common share:		
Continuing operations.....	\$ (2.84)	\$ (1.76)
Discontinued operations.....	.09	.08
	-----	-----
Net loss per Common Share.....	\$ (2.75)	\$ (1.68)
	=====	=====
Number of shares used in computation.....	9,578,000	9,578,000
	=====	=====

See accompanying Notes to Quarterly Consolidated Financial Statements

NEW VALLEY CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIT)

(Dollars in thousands, except per share amounts)

(Unaudited)

	Class B Preferred Shares	Common Shares	Paid-In Capital	Accumulated Deficit	Unearned Compensation on Stock Options	Unrealized Gain
	-----	-----	-----	-----	-----	-----
Balance, December 31, 1996.....	\$279	\$96	\$644,789	\$(721,854)	\$ (731)	\$ 5,057
Net loss.....				(10,341)		
Undeclared dividends and accretion on redeemable preferred shares...			(10,422)			
Unrealized loss on investment securities.....						(1,675)
Adjustment to unearned compensation on stock options....			364		(364)	
Compensation expense on stock option grants.....					87	
Balance, March 31, 1997.....	==== \$279	==== \$96	===== \$634,731	===== \$(732,195)	===== \$ (1,008)	===== \$ 3,382

See accompanying notes to Quarterly Consolidated Financial Statements

NEW VALLEY CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands, except per share amounts)

(Unaudited)

	Three Months Ended March 31,	
	1997	1996
Cash flows from operating activities:		
Net loss.....	\$(10,341)	\$ (4,884)
Adjustments to reconcile net loss to net cash provided from (used for) operating activities:		
Income from discontinued operations.....	(872)	(728)
Depreciation and amortization.....	2,009	1,090
Provision for loss on long-term investment.....	3,796	--
Stock based compensation expense.....	847	--
Changes in assets and liabilities, net of effects from acquisitions:		
Decrease (increase) in receivables and other assets.....	14,541	(7,420)
Decrease (increase) in income taxes.....	759	(3,473)
Increase (decrease) in accounts payable and accrued liabilities....	(12,634)	9,583
Net cash used for continuing operations.....	(1,895)	(5,832)
Net cash provided from discontinued operations.....	373	797
Net cash provided from (used for) operating activities.....	(1,522)	(5,035)
Cash flows from investing activities:		
Sale or maturity of investment securities.....	23,193	8,627
Purchase of investment securities.....	(3,963)	(15,844)
Sale or liquidation of long-term investments.....	2,807	13,887
Purchase of long-term investments.....	(4,400)	--
Purchase of real estate.....	--	(24,732)
Payment of prepetition claims.....	(58)	(508)
Return of prepetition claims paid.....	1,396	--
Decrease (increase) in restricted assets.....	82	(12,526)
Payment for acquisitions, net of cash acquired.....	(20,014)	1,915
Net cash used for investing activities.....	(957)	(29,181)
Cash flows from financing activities:		
Payment of preferred dividends.....	--	(10,354)
Purchase of Class A preferred stock.....	--	(10,530)
Increase in margin loans payable.....	--	17,255
Prepayment of notes payable.....	(114)	--
Repayment of other obligations.....	(207)	(439)
Net cash used for financing activities.....	(321)	(4,068)
Net decrease in cash and cash equivalents.....	(2,800)	(38,284)
Cash and cash equivalents, beginning of period.....	57,282	51,742
Cash and cash equivalents, end of period.....	\$ 54,482	\$ 13,458

See accompanying Notes to Quarterly Consolidated Financial Statements

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO QUARTERLY CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share amounts)

(Unaudited)

1. PRINCIPLES OF REPORTING

The consolidated financial statements include the accounts of New Valley Corporation and Subsidiaries (the "Company"). The consolidated financial statements as of March 31, 1997 presented herein have been prepared by the Company without an audit. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the financial position as of March 31, 1997 and the results of operations and cash flows for all periods presented have been made. Results for the interim periods are not necessarily indicative of the results for an entire year.

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

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

2. ACQUISITION

On January 31, 1997, the Company entered into a stock purchase agreement (the "Purchase Agreement") with Brooke (Overseas) Ltd. ("Brooke (Overseas)"), a wholly-subsiidiary of Brooke Group Ltd. ("Brooke"), a related party through the ownership of an approximate 42% voting interest in the Company. Pursuant to the Purchase Agreement, the Company acquired 10,483 shares (the "BML Shares") of the common stock of BrookeMil Ltd. ("BML") from Brooke (Overseas) for a purchase price of \$55,000, consisting of \$21,500 in cash and a \$33,500 9% promissory note of the Company (the "Note"). The BML Shares comprise 99.1% of the outstanding shares of BML, a real estate development company in Russia. The Note is collateralized by the BML Shares and is payable \$21,500 on June 30, 1997 and \$12,000 on December 31, 1997. On April 28, 1997, the Company paid Brooke (Overseas) \$3,500, representing a portion of the Note payment due on June 30, 1997, together with accrued interest thereon.

BML is developing a three-phase complex on 2.2 acres of land in downtown Moscow, for which it has a 98-year lease. In 1993, the first phase of the project, Ducat Place I, a 46,500 sq. ft. Class-A office building, was constructed and leased. On February 5, 1997, BML entered into an agreement to sell Ducat Place I to one of its tenants for approximately \$7,500, which purchase price has been reduced to reflect prepayments of rent, and consummated the sale on April 18, 1997. In 1995, BML began construction of Ducat Place II, a 150,000 sq. ft. office building. Ducat Place II has been substantially pre-leased to a number of leading international companies with occupancy expected by July 1997. The third phase, Ducat Place III, is planned as a 400,000 sq. ft. mixed-use complex, with construction anticipated to commence in 1998.

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO QUARTERLY CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(Dollars in thousands, except per share amounts)

(Unaudited)

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

The purchase price was allocated as follows: current assets of approximately \$9,000, investment in real estate of \$79,200, other assets of \$8,800, assumption of current liabilities of \$35,146 and long-term liabilities of \$6,854. Current assets consisted primarily of an asset held for sale of \$6,400 related to the estimated proceeds from the sale of Ducat Place I, net of \$1,100 in accrued closing costs. Liabilities included a \$20,400 loan to a Russian bank for the construction of Ducat Place II. The loan, which matures \$6,100 in April 1997 (paid with the proceeds from the sale of Ducat Place I), \$4,100 in July 1997 and \$10,200 in October 1997, is collateralized by a mortgage on Ducat Place II. In addition, the liabilities of BML included approximately \$13,800 of rents and related payments prepaid by tenants of Ducat Place II for periods generally ranging from 15 to 18 months. Proforma operating results for the three months ended March 31, 1997 and 1996 are not presented herein as the historical operating results of BML are not material to the historical operating results of the Company.

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

The components of the Company's investment in real estate at March 31, 1997 are as follows:

	U.S. ----	BML ---	Total -----
Land	\$ 36,162	\$ 14,200	\$ 50,362
Buildings.....	146,799	65,000	211,799
Construction-in-progress.....	234		234
	-----	-----	-----
Total.....	183,195	79,200	262,395
Less: accumulated depreciation.....	(4,746)		(4,746)
	-----	-----	-----
Net investment in real estate.....	\$ 178,449 =====	\$ 79,200 = =====	\$ 257,649 =====

3. DISCONTINUED OPERATIONS

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

Summarized operating results of the discontinued operations of Thinking Machines for the three months ended March 31, 1997 and the two months ended March 31, 1996 from the date of acquisition.

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO QUARTERLY CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(Dollars in thousands, except per share amounts)

(Unaudited)

	Three Months Ended March 31,	
	1997	1996
	-----	-----
Revenues.....	\$ 3,100	\$ 4,699
	=====	=====
Operating income.....	\$ 1,421	\$ 1,186
	=====	=====
Income before income taxes and minority interests.....	\$ 1,421	\$ 1,186
Minority interests.....	(549)	(458)
	-----	-----
Net income.....	\$ 872	\$ 728
	=====	=====

In April 1997, Thinking Machines sold the remaining part of its discontinued operations for \$2,405 in cash which resulted in the Company recording a gain on disposal of discontinued operations of approximately \$200.

4. INCOME TAXES

At March 31, 1997, the Company had approximately \$95,000 of unrecognized net deferred tax assets, comprised primarily of net operating loss carryforwards, available to offset future taxable income for federal tax purposes. A valuation allowance has been provided against the amount as it is deemed more likely than not that the benefit of the deferred tax assets will not be utilized. The Company continues to evaluate the realizability of the deferred tax assets and its estimate is subject to change. The income tax provision (benefit), which principally represented the effects of state income taxes, for the three months ended March 31, 1997 and 1996, does not bear a customary relationship with pre-tax accounting income principally as a consequence of the change in the valuation allowance relating to deferred tax assets.

5. INVESTMENT SECURITIES AVAILABLE FOR SALE

Investment securities classified as available for sale are carried at fair value, with net unrealized gains included as a separate component of shareholders' equity (deficit). The Company had realized gains on sales of investment securities available for sale of \$3,694 for the three months ended March 31, 1997.

The components of investment securities available for sale at March 31, 1997 are as follows:

	Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
	----	-----	-----	-----
Marketable equity securities:				
RJR Nabisco common stock.....	\$ 32,574	\$ 1,696		\$ 34,270
Other marketable securities.....	3,624	2,830	\$ 433	6,021
	-----	-----	-----	-----
Total marketable equity securities...	36,198	4,526	433	40,291
Marketable debt securities (long-term).....	3,685		711	2,974
	-----	-----	-----	-----
Total securities available for sale.....	39,883	4,526	1,144	43,265
Less long-term portion of investment securities.....	(3,685)		(711)	(2,974)
	-----	-----	-----	-----
Investment securities - current portion.....	\$ 36,198	\$ 4,526	\$ 433	\$ 40,291
	=====	=====	=====	=====

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO QUARTERLY CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(Dollars in thousands, except per share amounts)

(Unaudited)

As of March 31, 1997, the long-term portion of investment securities available for sale consisted of marketable debt securities which mature in two years.

As of March 31, 1997, the Company, through a wholly-owned subsidiary, held approximately 1.06 million shares of RJR Nabisco Holdings Corp. ("RJR Nabisco") common stock with a market value of \$34,270 (cost of \$32,574). Based on the market price of the RJR Nabisco common stock at May 9, 1997 (\$30.625 per share), no amounts are payable by the Company under any of its profit sharing arrangements with respect to the RJR Nabisco common stock.

6. LONG-TERM INVESTMENTS

At March 31, 1997, long-term investments consisted primarily of investments in limited partnerships of \$11,782 and an equity investment in a corporation of \$1,000. The Company has determined that an other than temporary impairment in the value of its investment in a joint venture has occurred and has written-down this investment to zero with a charge to operations of \$3,796 for the three months ended March 31, 1997. The fair value of the Company's long-term investments approximates its carrying amount. The Company's estimates of the fair value of its long-term investments are subject to judgment and are not necessarily indicative of the amounts that could be realized in the current market.

The Company is required under certain limited partnership agreements to make additional investments up to an aggregate of \$24,000. The Company's investments in limited partnerships are illiquid and the ultimate realization of these investments are subject to the performance of the underlying partnership and its management by the general partners.

7. REDEEMABLE PREFERRED SHARES

At March 31, 1997, the Company had authorized and outstanding 2,000,000 and 1,071,462, respectively, of its Class A Senior Preferred Shares. At March 31, 1997 and December 31, 1996, respectively, the carrying value of such shares amounted to \$221,753 and \$210,571, including undeclared dividends of \$127,779 and \$117,117, or \$119.26 and \$109.31 per share. As of March 31, 1997, the unamortized discount on the Class A Senior Preferred Shares was \$5,312.

For the three months ended March 31, 1997, the Company recorded \$759 in compensation expense related to certain Class A Senior Preferred Shares awarded to an officer of the Company in 1996. At March 31, 1997, the balance of the deferred compensation and the unamortized discount related to these award shares was \$4,900 and \$2,960, respectively.

8. PREFERRED SHARES NOT SUBJECT TO REDEMPTION REQUIREMENTS

The undeclared dividends, as adjusted for conversions of Class B Preferred Shares into Common Shares, cumulatively amounted to \$121,502 and \$115,944 at March 31, 1997 and December 31, 1996, respectively. These undeclared dividends represent \$43.54 and \$41.55 per share as of the end of each period. No accrual was recorded for such undeclared dividends as the Class B Preferred Shares are not mandatorily redeemable.

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO QUARTERLY CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(Dollars in thousands, except per share amounts)

(Unaudited)

9. PREPETITION CLAIMS UNDER CHAPTER 11 AND RESTRUCTURING ACCRUALS

Those liabilities that are expected to be resolved as part of the Company's First Amended Joint Chapter 11 Plan of Reorganization, as amended (the "Joint Plan") are classified in the Consolidated Balance Sheets as prepetition claims and restructuring accruals. On January 18, 1995, approximately \$550 million of prepetition claims were paid pursuant to the Joint Plan. The prepetition claims remaining as of March 31, 1997 of \$16,864 may be subject to future adjustments depending on pending discussions with the various parties and the decisions of the Bankruptcy Court.

10. CONTINGENCIES

Litigation

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

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

BROOKE (OVERSEAS) LTD. AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 1997

BROOKE (OVERSEAS) LTD. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

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

	March 31, 1997	December 31, 1996
	-----	-----
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,018	\$ 1,875
Accounts receivable - trade	685	166
Receivables from affiliates	33,651	
Inventories	3,382	3,569
Other current assets	1,930	2,640
	-----	-----
Total current assets	40,666	8,250
Property, plant and equipment, at cost, less accumulated depreciation of \$454 and \$676	9,666	59,607
Goodwill, net	1,081	1,094
Deferred finance costs		2,805
Other	5	540
	-----	-----
Total assets	\$ 51,418	\$ 72,296
	=====	=====
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Current liabilities:		
Notes payable	\$ 3,000	\$ 21,658
Accounts payable - trade	4,255	13,074
Due to affiliates	45,638	48,875
Unearned revenue	3	7,406
Accrued taxes	18,989	8,474
Accrued interest	45	597
Other accrued liabilities	2,019	2,692
	-----	-----
Total current liabilities	73,949	102,776
Notes payable	1,758	
Unearned revenue		9,458
Other liabilities	26,990	1,494
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	5,600	3,400
Deficit	(57,580)	(45,533)
	-----	-----
Total stockholder's equity (deficit)	(51,279)	(41,432)
	-----	-----
Total liabilities and stockholder's equity (deficit)	\$ 51,418	\$ 72,296
	=====	=====

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

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

	Three Months Ended	
	March 31, 1997	March 31, 1996
Net sales	\$ 13,704	\$ 10,839
Cost of sales	11,329	9,995
Gross profit	2,375	844
Operating, selling, administrative and general expenses	1,978	2,061
Operating income (loss)	397	(1,217)
Other income (expense):		
Interest income	480	
Interest expense	(2,148)	(1,824)
Gain on sale of stock	25,563	
Gain on foreign currency exchange	200	153
Other, net	(29)	(156)
Income (loss) before income taxes	24,463	(3,044)
Provision for income taxes	12,482	451
Net income (loss)	<u>\$ 11,981</u>	<u>\$ (3,495)</u>

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	Deficit	Total
	Shares	Amount			
Balance, December 31, 1996	701,000	\$ 701	\$ 3,400	\$(45,533)	\$(41,432)
Net income				11,981	11,981
Distributions to parent				(24,028)	(24,028)
Capital contribution			2,200		2,200
Balance, March 31, 1997	701,000	\$ 701	\$ 5,600	\$(57,580)	\$(51,279)

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, 1997	March 31, 1996
Net cash used in operating activities	\$ (1,218)	\$ (1,962)
Cash flows from investing activities:		
Capital expenditures	(658)	(4,584)
Proceeds from sale of BML, net	20,002	
Proceeds from sale of option to purchase stock in Liggett-Ducat	2,200	
Net cash provided by (used in) investing activities	21,544	(4,584)
Cash flows from financing activities:		
Proceeds from debt	3,000	1,648
Repayments of debt	(155)	(155)
Borrowings under revolver		4,254
Repayments on revolver		(195)
Distributions paid to parent	(24,028)	
Net cash (used in) provided by financing activities	(21,183)	5,552
Net decrease in cash and cash equivalents	(857)	(994)
Cash and cash equivalents, beginning of period	1,875	1,660
Cash and cash equivalents, end of period	\$ 1,018	\$ 666

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

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

1. ORGANIZATION

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

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

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

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

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

LIQUIDITY:

The Company has historically relied on Brooke and BGLS for sources of financing. At March 31, 1997, the Company had net capital and working capital deficiencies of \$51,279

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

and \$33,283, respectively. The Company has upgraded the cigarette operations' tobacco processing complex and is continuing to implement cost-saving measures. Liggett-Ducat plans to begin the manufacture and marketing of western style cigarettes. Management believes that such activities will result in improved operations and cash flow, but there can be no assurances in this regard.

3. SALE OF BROOKEMIL

On January 31, 1997, the Company sold its 99.1% of the outstanding shares of BML to New Valley Corporation ("New Valley") for \$21,500 in cash and a promissory note of \$33,500, collateralized by the BML shares, payable during 1997 with an annual interest rate of 9%. The consideration received exceeded the carrying value of the Company's investment in BML by \$52,500. The Company recognized 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, further, a portion of the property sold is subject to a put option held by New Valley. This option allows New Valley, under certain circumstances, to put a portion of the property sold back to the Company at the greater of the appraised fair value of the property at the date of exercise or \$13,600. The Company distributed the \$21,500 cash proceeds received from the sale of BML to BGLS and anticipates distributing to BGLS proceeds from the \$33,500 promissory note.

In connection with the sale of the BML shares, certain specified liabilities aggregating \$40,800 including the Vneshtorgbank loan with a balance of \$20,418, remained with BML. Further, the Company, Brooke and BGLS each contributed to the capital of BML, through cancellation of all indebtedness of BML to each such entity, the aggregate amount of which was \$19,275 including accrued interest thereon. Further, 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.

SUBSEQUENT EVENTS:

On April 18, 1997, BML sold one of its office buildings, Ducat Place I, to a third party. Accordingly, the Company will recognize approximately \$1,490 of the deferred gain on the BML sale in the second quarter, 1997.

On April 28, 1997, New Valley paid BOL \$3,500, representing a portion of the promissory note payment due to BOL on June 30, 1997, together with accrued interest thereon.

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

4. INVENTORIES

Inventories consist of:

	March 31, 1997	December 31, 1996
	-----	-----
Finished goods	\$ 319	\$
Work-in-process	314	53
Raw materials	1,925	2,664
Replacement parts and supplies	824	852
	-----	-----
	\$3,382	\$3,569
	=====	=====

The Company has a leaf inventory management program whereby, among other things, it is committed to purchase certain quantities of leaf tobacco. The purchase commitments are for quantities not in excess of anticipated requirements and are at prices established at the date of the commitment. At March 31, 1997, the Company had leaf tobacco purchase commitments of \$4,934.

5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consists of:

	March 31, 1997	December 31, 1996
	-----	-----
Buildings	\$	\$ 8,064
Factory machinery and equipment ...	4,526	4,419
Computers and software	295	289
Office furniture and equipment	137	129
Vehicles	416	416
Construction-in-progress	4,746	46,966
	-----	-----
	10,120	60,283
Less accumulated depreciation	454	676
	-----	-----
	\$ 9,666	\$59,607
	=====	=====

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

SUBSEQUENT EVENT:

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

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

6. LONG-TERM DEBT

Current and long-term debt consist of the following:

	March 31, 1997	December 31, 1996
	-----	-----
Bank loan	\$	\$20,418
Deferred financing fees		1,240
Notes payable	4,758	
	-----	-----
	4,758	21,658
Less current maturities	3,000	21,658
	-----	-----
Amount due after one year	\$ 1,758	\$
	=====	=====

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

REVOLVING CREDIT FACILITY:

In February and March 1997, the Company obtained lines of credit in the amounts of \$1,000 at 28% per annum and \$2,000 at 26%, respectively, in order to secure tobacco commitment purchases. The lines of credit will expire in May 1997 and June 1997. In April and May 1997, the rates of interest were renegotiated at 23%. Also in April 1997, an additional \$1,000 line of credit was obtained. Brooke is a guarantor on the lines of credit.

7. RELATED PARTY TRANSACTIONS

The Company has obtained funding through a revolving credit facility with Brooke and BGLS at an annual interest rate of 20% to cover certain expenses including the cost of certain administrative services and personnel, tobacco and material purchases and upgrades of factory equipment. In addition, Brooke and BGLS have advanced funds to BML for its real estate developments projects. The amount due to Brooke and BGLS under this facility at March 31, 1997 was \$33,410 including interest of \$12,128, of which \$19,933 including interest of \$5,897 is due from Liggett-Ducat and LDT.

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

8. INCOME TAXES

The entire 1996 and a portion (\$741) of the 1997 provision for income taxes is payable pursuant to Russian statutory requirements. Further, the Company has recorded a

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

provision for income taxes of \$11,741 related to its sale of BML in 1997 in accordance with its tax sharing agreement with Brooke.

9. CONTINGENCIES

BGLS has pledged its ownership interest in the Company's Common Stock as collateral in connection with the issuance of BGLS' 15.75% Senior Secured Notes due 2001.

NEW VALLEY HOLDINGS, INC.

FINANCIAL STATEMENTS

MARCH 31, 1997

NEW VALLEY HOLDINGS, INC.

FINANCIAL STATEMENTS

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

	March 31, 1997	December 31, 1996
	-----	-----
ASSETS		
Cash and cash equivalents	\$ 10	\$ 1
Investment in New Valley:		
Redeemable preferred stock	70,489	72,962
Common stock	(70,489)	(72,962)
	-----	-----
Total investment in New Valley	-----	-----
	-----	-----
Total assets	\$ 10	\$ 1
	=====	=====
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Payable to parent	\$ 28	\$ 4
Accrued expenses	8	7
Current income taxes payable to parent	6,305	6,312
	-----	-----
Total liabilities	6,341	6,323
	-----	-----
Commitments and contingencies		
Common stock, \$0.01 par value, 100 shares authorized, issued and outstanding		
Additional paid-in capital	7,633	7,633
Retained earnings (deficit)	(8,890)	(727)
Other	(5,074)	(13,228)
	-----	-----
Total stockholder's equity (deficit)	(6,331)	(6,322)
	-----	-----
Total liabilities and stockholder's equity (deficit)	\$ 10	\$ 1
	=====	=====

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

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

	Three Months Ended	
	March 31, 1997	March 31, 1996
Equity in loss of New Valley	\$(8,514)	\$(1,495)
Interest income	6	7
General and administrative expenses	(23)	(2)
Loss from continuing operations before income taxes	(8,531)	(1,490)
(Benefit) provision for income taxes:		
Current	(7)	435
Deferred		(2,688)
Income tax benefit	(7)	(2,253)
(Loss) income from continuing operations	(8,524)	763
Income from discontinued operations of New Valley net of taxes of \$0 and \$0 in 1997 and 1996, respectively ...	361	
Net (loss) income	<u>\$(8,163)</u>	<u>\$ 763</u>

The accompanying notes are an integral part
of the consolidated 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)	Other	Total
	Shares	Amount				
Balance, December 31, 1996	100	\$	\$ 7,633	\$ (727)	\$(13,228)	\$(6,322)
Proportionate share of New Valley's capital transactions					(658)	(658)
Unrealized holding gain on investment in New Valley					8,812	8,812
Net loss				(8,163)		(8,163)
Balance, March 31, 1997	100	\$	\$ 7,633	\$(8,890)	\$ (5,074)	\$(6,331)

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

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

	Three Months Ended	
	March 31, 1997	March 31, 1996
Net cash provided by operating activities	\$ 9	\$ 4
Cash flows from investing activities:		
Dividends received from New Valley		6,183
Net cash provided by investing activities		6,183
Cash flows from financing activities:		
Distributions paid to parent		(2,851)
Net cash used in financing activities		(2,851)
Net increase in cash and cash equivalents	9	3,336
Cash and cash equivalents at beginning of period	1	738
Cash and cash equivalents at end of period	\$ 10	\$4,074
	=====	=====

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

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

1. PRINCIPLES OF REPORTING

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

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

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

USE OF ESTIMATES AND ASSUMPTIONS:

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

2. INVESTMENT IN NEW VALLEY CORPORATION

The Company's investment in New Valley at March 31, 1997 is summarized below:

	Number of Shares -----	Fair Value -----	Carrying Amount -----	Unrealized Holding Gain (Loss) -----
Class A Preferred Shares	618,326	\$ 70,489	\$ 70,489	\$(19,924)
Common Shares	3,969,962(A)	5,955	(70,489)	
		-----	-----	-----
		\$ 76,444	\$	\$(19,924)
		=====	=====	=====

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

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

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

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

At March 31, 1997, the Company's investment in New Valley consisted of an approximate 42% voting interest. The Company's investment is represented by 618,326 Class A Preferred Shares (57.7%) and 3,969,962 Common Shares (41.5%) after giving effect to a one-for-twenty reverse stock split by New Valley in July 1996.

During the first quarter of 1996, New Valley repurchased 72,104 Class A Preferred Shares for a total amount of \$10,530. The Company has recorded its proportionate interest in the excess of the carrying value of the shares over the cost of the shares repurchased as a credit to additional paid-in capital in the amount of \$1,782 for the three months ended March 31, 1996. No such repurchases have been made during the quarter ended March 31, 1997.

The Class A Preferred Shares of New Valley are required to be redeemed on January 1, 2003 for \$100.00 per share plus dividends accrued to the redemption date. The shares are redeemable, at any time, at the option of New Valley, at \$100.00 per share plus accrued dividends. The holders of Class A Preferred Shares are entitled to receive a quarterly dividend, as declared by the Board of Directors, payable at the rate of \$19.00 per annum. On March 27, 1996, New Valley paid a cash dividend on the Class A Preferred Shares of \$10.00 per share. The Company received \$6,183 in the distribution. At March 31, 1997, the accrued and unpaid dividends arrearage was \$127,779 (\$119.26 per share).

3. NEW VALLEY CORPORATION

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

	March 31, 1997 -----	December 31, 1996 -----
Current assets, primarily cash and marketable securities	\$ 149,244	\$ 183,720
Non-current assets	309,098	222,820
Current liabilities	155,091	98,110
Non-current liabilities	176,213	170,223
Redeemable preferred stock	221,753	210,571
Shareholders' equity (deficit).....	(94,715)	(72,364)

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

	March 31,	
	----- 1997 ----	----- 1996 ----
Revenues	\$19,753	\$31,985
Costs and expenses	31,925	38,178
Loss from continuing operations	(11,213)	(5,612)
Income from discontinued operations	872	728
Net loss applicable to common shares(A)	(26,321)	(16,067)

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

ACQUISITION OF COMMON SHARES OF BML:

On January 31, 1997, New Valley acquired substantially all the common shares of BrookeMil Ltd., a real estate investment company doing business in Russia, from Brooke Overseas Ltd. ("BOL"), for \$55,000, \$21,500 payable in cash and a promissory note of \$33,500 payable \$21,500 on June 30, 1997 and \$12,000 on December 31, 1997 with interest at 9%.

RJR NABISCO HOLDINGS CORP.:

At March 31, 1997, New Valley held 1,062,650 shares of RJR Nabisco Holdings Corp. ("RJR Nabisco") common stock with a market value of \$34,270 (cost of \$32,574). The unrealized gain on New Valley's investment in RJR Nabisco common stock was \$1,696 at March 31, 1997. Based on the market price of RJR Nabisco common stock at March 31, 1997, no amounts are payable by Brooke or New Valley under any of their net profit-sharing arrangements with respect to the RJR Nabisco common stock.

SUBSEQUENT EVENT:

On April 28, 1997, New Valley paid \$3,500 representing a portion of the promissory note payment due to BOL on June 30, 1997, together with accrued interest thereon.

4. FEDERAL INCOME TAX

At March 31, 1997, the Company had \$8,400 of unrecognized net deferred tax assets, comprised primarily of future deductible temporary differences. A valuation allowance has been provided against this deferred tax asset as it is presently deemed more likely than not that the benefit of the tax asset will not be utilized. The Company continues to evaluate the realizability of its deferred tax assets and its estimate is subject to change.

The provision for taxes for the three month period ended March 31, 1996 does not bear a customary relationship to the pretax income for the Company due principally to the effects of the 80% dividends received deduction for Federal taxes. The benefit for income taxes at March 31, 1997 is based on the current taxable loss.

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

5. CONTINGENCIES

BGLS has pledged its ownership interest in the Company's Common Stock and the Company's investments in the New Valley securities as collateral in connection with the issuance of BGLS' 15.75% Senior Secured Notes due 2001.