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

FORM 10-Q

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

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

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

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

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

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

Indicate by check mark whether the Registrants (1) have filed all
reports required to be filed by Section 13 or 15(d) of the Securities Exchange
Act of 1934, as amended (the "Exchange Act"), during the preceding 12 months (or
for such shorter period that the Registrants were required to file such
reports), and (2) have been subject to such filing requirements for the past 90
days. Yes [X] 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 November 10, 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 SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	September 30, 1997	December 31, 1996
	-----	-----
ASSETS:		
Current assets:		
Cash and cash equivalents.....	\$ 2,361	\$ 1,941
Accounts receivable - trade.....	11,539	19,475
Other receivables.....	734	1,217
Receivables from affiliates.....	12,050	47
Inventories.....	41,360	53,691
Other current assets.....	3,844	4,181
	-----	-----
Total current assets.....	71,888	80,552
Property, plant and equipment, at cost, less accumulated depreciation of \$32,237 and \$31,047.....	36,720	80,282
Intangible assets, at cost, less accumulated amortization of \$18,837 and \$17,457.....	3,071	4,421
Investment in affiliate.....		3,051
Other assets.....	10,209	9,371
	-----	-----
Total assets.....	\$121,888	\$177,677
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT):		
Current liabilities:		
Notes payable and current portion of long-term debt.....	\$ 38,245	\$ 55,242
Accounts payable.....	9,117	32,461
Due to affiliates.....		990
Dividends payable.....		1,387
Cash overdraft.....	2,395	6
Accrued promotional expenses.....	31,372	30,257
Accrued taxes payable.....	19,518	26,379
Accrued interest.....	25,121	24,354
Other accrued liabilities.....	25,623	33,387
	-----	-----
Total current liabilities.....	151,391	204,463
Notes payable, long-term debt and other obligations, less current portion	370,973	378,243
Noncurrent employee benefits.....	34,630	31,256
Other liabilities.....	28,005	18,704
Commitments and contingencies.....		
Stockholders' equity (deficit):		
Preferred Stock, par value \$1.00 per share, authorized 10,000,000 shares.....		
Series G Preferred Stock, 2,184,834 shares, convertible, participating, cumulative, each share convertible to 1,000 shares of common stock and cash or stock distribution, liquidation preference of \$1.00 per share.....		
Common stock, par value \$0.10 per share, authorized 40,000,000 shares, issued 24,998,043 shares, outstanding 18,097,096 and 18,497,096 shares.....	1,850	1,850
Additional paid-in capital.....	90,020	94,169
Deficit.....	(512,229)	(490,706)
Other.....	(8,613)	(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).....	(463,111)	(454,989)
	-----	-----
Total liabilities and stockholders' equity (deficit).....	\$121,888	\$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)

	September 30, 1997	December 31, 1996
	-----	-----
ASSETS:		
Current assets:		
Cash and cash equivalents.....	\$ 2,323	\$ 1,940
Accounts receivable - trade.....	11,539	19,475
Other receivables.....	693	1,166
Receivables from affiliates.....	13,546	47
Inventories.....	41,360	53,691
Other current assets.....	3,518	3,878
	-----	-----
Total current assets.....	72,979	80,197
Property, plant and equipment, at cost, less accumulated depreciation of \$31,845 and \$30,762.....	36,517	79,972
Intangible assets, at cost, less accumulated amortization of \$18,837 and \$17,457.....	3,071	4,421
Investment in affiliate.....	13,452	3,051
Other assets.....	13,452	10,467
	-----	-----
Total assets.....	\$ 126,019	\$ 178,108
	=====	=====
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT):		
Current liabilities:		
Notes payable and current portion of long-term debt.....	\$ 37,896	\$ 53,945
Accounts payable.....	8,992	32,336
Cash overdraft.....	2,395	6
Due to parent.....	23,636	29,598
Accrued promotional expenses.....	31,372	30,257
Accrued taxes payable.....	19,518	26,379
Accrued interest.....	25,121	24,354
Other accrued liabilities.....	25,580	32,861
	-----	-----
Total current liabilities.....	174,510	229,736
Notes payable, long-term debt and other obligations, less current portion...	370,973	378,243
Noncurrent employee benefits.....	34,630	31,256
Other liabilities.....	34,205	21,958
Commitments and contingencies.....		
Stockholder's equity (deficit):		
Common stock, par value \$0.01 per share; 100 shares authorized, issued and outstanding.....	39,080	39,081
Additional paid-in capital.....	(522,761)	(499,264)
Deficit.....	(4,618)	(22,902)
Other.....	(4,618)	(22,902)
	-----	-----
Total stockholder's deficit.....	(488,299)	(483,085)
	-----	-----
Total liabilities and stockholder's equity (deficit).....	\$ 126,019	\$ 178,108
	=====	=====

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

Item 1. Consolidated Financial Statements - (Continued)

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

	Three Months Ended		Nine Months Ended	
	Sept. 30, 1997	Sept. 30, 1996	Sept. 30, 1997	Sept. 30, 1996
Revenues*	\$ 100,308	\$ 114,635	\$ 276,906	\$ 330,364
Cost of goods sold*	53,045	58,361	145,841	168,931
Gross profit	47,263	56,274	131,065	161,433
Operating, selling and general expenses	40,498	55,326	117,535	158,482
Operating income	6,765	948	13,530	2,951
Other income (expenses):				
Interest income	431	75	1,682	203
Interest expense	(15,791)	(15,254)	(46,757)	(45,488)
Equity in loss of affiliate	(7,090)	(4,618)	(21,488)	(7,152)
Sale of assets		3,047	23,086	6,745
Retirement of debt			2,963	
Proceeds from legal settlement			4,125	
Other, net	(257)	3,210	(77)	1,846
Loss from continuing operations before income taxes	(15,942)	(12,592)	(22,936)	(40,895)
(Benefit) provision for income taxes	(248)	1,145	541	1,291
Loss from continuing operations	(15,694)	(13,737)	(23,477)	(42,186)
Discontinued operations:				
Income from discontinued operations	106		153	
Net loss	(15,588)	(13,737)	(23,324)	(42,186)
Proportionate share of New Valley capital transactions, retirement of Class A Preferred Shares				1,782
Net loss applicable to common shares	\$ (15,588)	\$ (13,737)	\$ (23,324)	\$ (40,404)
Per common share:				
Loss from continuing operations	\$ (0.87)	\$ (0.74)	\$ (1.29)	\$ (2.18)
Loss from discontinued operations	\$ 0.01	\$	\$ 0.01	\$
Net loss applicable to common shares	\$ (0.86)	\$ (0.74)	\$ (1.28)	\$ (2.18)
Weighted average common shares outstanding	18,097,096	18,497,096	18,192,233	18,497,096

* Revenues and Cost of goods sold include federal excise taxes of \$19,250 and \$26,074 for the three months ended September 30, 1997 and 1996, respectively, and \$55,263 and \$76,758 for the nine months ended September 30, 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		Nine Months Ended	
	Sept. 30, 1997	Sept. 30, 1996	Sept. 30, 1997	Sept. 30, 1996
Revenues*	\$ 100,308	\$ 114,635	\$ 276,906	\$ 330,364
Cost of goods sold*	53,045	58,361	145,841	168,931
Gross profit	47,263	56,274	131,065	161,433
Operating, selling and general expenses	40,502	54,627	117,159	157,287
Operating income	6,761	1,647	13,906	4,146
Other income (expenses):				
Interest income	431	62	1,670	140
Interest expense	(16,750)	(16,245)	(49,542)	(48,308)
Equity in loss of affiliate	(7,090)	(4,618)	(21,488)	(7,152)
Sale of assets		3,047	27,663	6,745
Retirement of debt			2,963	
Other, net	(257)	502	(84)	(1,528)
Loss from continuing operations before income taxes	(16,905)	(15,605)	(24,912)	(45,957)
(Benefit) provision for income taxes	(248)	4,945	539	5,143
Loss from continuing operations	(16,657)	(20,550)	(25,451)	(51,100)
Discontinued operations:				
Income from discontinued operations	106		153	
Net loss	\$ (16,551)	\$ (20,550)	\$ (25,298)	\$ (51,100)

* Revenues and Cost of goods sold include federal excise taxes of \$19,250 and \$26,074 for the three months ended September 30, 1997 and 1996, respectively, and \$55,263 and \$76,758 for the nine months ended September 30, 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 SUBSIDIARY
 CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)
 (DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
 (UNAUDITED)

	Common Stock		Additional Paid-In Capital	Deficit	Other	Treasury Stock	Total
	Shares	Amount					
Balance, December 31, 1996.....	18,497,096	\$1,850	\$94,169	\$(490,706)	\$(27,963)	\$(32,339)	\$(454,989)
Net loss.....				(23,324)			(23,324)
Distributions on common stock (\$0.225 per share).....			(4,148)				(4,148)
Amortization of deferred compensation.....					1,066		1,066
Unrealized holding gain on investment in New Valley.....					8,801		8,801
Effect of New Valley capital transactions.....					9,483		9,483
Settlement of loan.....	(400,000)			1,800		(1,800)	
Balance, September 30, 1997.....	<u>18,097,096</u>	<u>\$1,850</u>	<u>\$90,021</u>	<u>\$(512,230)</u>	<u>\$ (8,613)</u>	<u>\$(34,139)</u>	<u>\$(463,111)</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 loss.....				(25,298)		(25,298)
Unrealized holding gain on investment in New Valley.....					8,801	8,801
Effect of New Valley capital transactions.....					9,483	9,483
Settlement of loan.....				1,800		1,800
Balance, September 30, 1997.....	100	\$	\$39,081	\$(522,762)	\$ (4,618)	\$(488,299)
	====	=====	=====	=====	=====	=====

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

Item 1. Consolidated Financial Statements - (Continued)

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

	Nine Months Ended	
	September 30, 1997	September 30, 1996
Net cash used in operating activities.....	\$ (30,511)	\$ (22,000)
Cash flows from investing activities:		
Proceeds from sale of businesses and assets, net.....	43,091	8,031
Investments.....		(482)
Capital expenditures.....	(9,857)	(24,047)
Dividends from New Valley.....		24,733
Net cash provided by investing activities.....	33,234	8,235
Cash flows from financing activities:		
Proceeds from debt.....	5,198	19,837
Repayments of debt.....	(10,323)	(8,559)
Borrowings under revolver.....	209,822	265,117
Repayments on revolver.....	(202,881)	255,763
Increase (decrease) in cash overdraft.....	1,416	(4,266)
Distributions on common stock.....	(5,535)	(4,162)
Other, net.....		(18)
Net cash (used in) provided by financing activities.....	(2,303)	12,498
Net increase (decrease) in cash and cash equivalents.....	420	(1,267)
Cash and cash equivalents, beginning of period.....	1,941	3,370
Cash and cash equivalents, end of period.....	\$ 2,361	\$ 2,103
	=====	=====
Supplemental non-cash investing and financing activities:		
Exchange of Series 2 Senior Secured Notes for Series A Notes.....		\$ 99,154
Exchange of 14.50% Subordinated Debentures for Series B Notes.....		125,495
Issuance of Series A Notes for options.....		822
Exchange of Series A Notes for Series B Notes.....		99,976
Issuance of promissory notes for shares of Liggett-Ducat.....		1,643
Distribution of MAI shares to stockholders.....		
Promissory note from New Valley.....	33,500	

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

Item 1. Consolidated Financial Statements - (Continued)

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

	Nine Months Ended	
	September 30, 1997	September 30, 1996
Net cash used in operating activities.....	\$ (36,989)	\$ (21,924)
Cash flows from investing activities:		
Proceeds from sale of businesses and assets, net.....	43,091	8,031
Investments.....		(482)
Capital expenditures.....	(9,857)	(24,047)
Dividends from New Valley.....		24,733
Net cash provided by investing activities.....	33,234	8,235
Cash flows from financing activities:		
Proceeds from debt.....	4,723	18,351
Repayments of debt.....	(8,942)	(8,134)
Borrowings under revolver.....	209,822	264,473
Repayments on revolver.....	(202,881)	(254,963)
Increase (decrease) in cash overdraft.....	1,416	(3,761)
Distributions paid to parent.....		(3,621)
Other, net.....		(18)
Net cash (used in) provided by financing activities.....	(4,138)	12,327
Net increase (decrease) in cash and cash equivalents.....	383	(1,362)
Cash and cash equivalents, beginning of period.....	1,940	3,370
Cash and cash equivalents, end of period.....	<u>\$ 2,323</u>	<u>\$ 2,008</u>
Supplemental non-cash investing and financing activities:		
Exchange of Series 2 Senior Secured Notes for Series A Notes.....		\$ 99,154
Exchange of 14.50% Subordinated Debentures for Series B Notes.....		125,495
Issuance of Series A Notes for options.....		822
Exchange of Series A Notes for Series B Notes.....		99,976
Forgiveness of debt by parent.....		13,705
Issuance of promissory notes for shares of Liggett-Ducat.....		1,643
Promissory note from New Valley.....	33,500	

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

Item 1. Consolidated Financial Statements - (Continued)

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

1. PRINCIPLES OF REPORTING

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

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

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

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

LIQUIDITY:

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

Liggett had net capital and working capital deficiencies of \$180,011 and \$47,292, respectively, at September 30, 1997, is highly leveraged and has substantial near-term debt service requirements. Further, Liggett's Senior Secured Notes (the "Liggett Notes") require a mandatory principal redemption of \$37,500 on February 1, 1998 and a payment at maturity on February 1, 1999 of \$107,400. Based on Liggett's net loss for 1996 and anticipated 1997 operating results, Liggett does not anticipate it will be able to generate sufficient cash from operations to make such payments. While Liggett has engaged in negotiations with its note holders to restructure the terms of the Liggett Notes, there are no commitments to restructure the Liggett Notes at this time, and no assurances can be given in this regard. In conjunction with these discussions, the Company has also engaged in negotiations with the principal holders of the BGLS 15.75% Series B Senior Secured Notes (the "BGLS Notes") with respect to certain related modifications to the terms of such debt.

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

During such negotiations, BGLS and Liggett postponed making the interest payments of approximately \$18,338 for the BGLS Notes due on July 31, 1997 and approximately \$9,700 for the Liggett Notes due on August 1, 1997. A Standstill Agreement and Consent (the "Standstill Agreement") was reached on August 28, 1997, as amended, among the holders of more than 83% of the BGLS Notes and BGLS whereby each of such principal holders of the BGLS Notes waived the right to receive on August 29, 1997 its pro rata share of the July 31, 1997 interest payment (in total, \$15,340). On August 29, 1997, BGLS made the interest payment on the BGLS Notes to all holders other than the principal holders. Pending completion of the negotiations with the principal holders, such holders have agreed with BGLS that they will be entitled to receive their portion of the July 31, 1997 interest payment only after giving BGLS 20 days' notice but, in any event, by December 10, 1997. On August 29, 1997, Liggett's revolving credit facility (the "Facility") was amended to permit Liggett to borrow an additional \$6,000 which was used in making the interest payment of \$9,700 due on August 1, 1997 to the holders of the Liggett Notes. BGLS guaranteed the additional \$6,000 advance under the Facility and collateralized the guarantee with \$6,000 in cash, deposited with Liggett's lender. In November 1997, Liggett's Facility was extended for an additional year until March 8, 1999.

If Liggett is unable to restructure the terms of the Liggett Notes or otherwise make such payments, substantially all of Liggett's long-term debt and the Facility would be in default and holders of such debt could accelerate the maturity of such debt. In such event, Liggett may be forced to seek protection from creditors under applicable laws. These matters raise substantial doubt about Liggett meeting its liquidity needs and its ability to continue as a going concern.

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

NEW ACCOUNTING PRONOUNCEMENTS

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

In June 1997, the FASB issued SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information". SFAS 131 specifies revised guidelines for determining an entity's operating segments and the type and level of financial information to be disclosed. Once operating segments have been determined, SFAS 131 provides for a two-tier test for determining those operating segments that would need to be disclosed for external reporting purposes. In addition to providing the required disclosures for reportable segments, SFAS 131 also requires disclosure of certain "second level" information by geographic area and for products/services. SFAS 131 also makes a number of changes to existing disclosure requirements. SFAS 131 is effective for fiscal years

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)

beginning after December 15, 1997, with earlier application encouraged. The Company has not yet determined the impact of the implementation of SFAS 131.

2. INVESTMENT IN NEW VALLEY CORPORATION

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

	Number of Shares -----	Fair Value -----	Carrying Amount -----	Unrealized Holding Loss ----
Class A Preferred Shares...	618,326	\$56,886	\$56,886	\$(15,325)
Class B Preferred Shares...	250,885	1,004	1,004	(251)
Common Shares.....	3,989,710(A)	3,491	(57,890)	
		-----	-----	-----
		\$61,381	\$	\$(15,576)
		=====	=====	=====

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

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

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

At September 30, 1997, the Company's investment in New Valley consisted of an approximate 42% voting interest. The Company's investment is represented by 57.7% of the Class A Preferred Shares, 41.7% of the Common Shares and 9.0% of the Class B Preferred Shares.

During the first quarter of 1996, New Valley repurchased 72,104 Class A Preferred Shares for a total amount of \$10,530. The Company has recorded its proportionate interest in the excess of the carrying value of the shares over the cost of the shares repurchased as a credit to additional paid-in capital in the amount of \$1,782, along with other New Valley capital transactions of \$1,563, for the nine months ended September 30, 1996. No such repurchases have been made during the nine months ended September 30, 1997. Other New Valley capital transactions charged to equity were \$9,483 for the nine months ended September 30, 1997, which represents the Company's portion of the unrealized gain on investment securities at New Valley.

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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 prior to that date, at the option of New Valley, at \$100.00 per share plus accrued dividends. The holders of Class A Preferred Shares are entitled to receive a quarterly dividend, as declared by the Board of Directors (the "Board"), payable at the rate of \$19.00 per annum. At September 30, 1997, the accrued and unpaid dividends arrearage on the Class A Preferred Shares was \$150,871 or \$140.81 per share. During the nine months ended September 30, 1996, NV Holdings received \$24,733 (\$40.00 per share) on the Class A Preferred Shares in dividend distributions. No such dividend distributions have been made in 1997.

Holdings 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 September 30, 1997, the accrued and unpaid dividends arrearage on Class B Preferred Shares was \$133,248 or \$47.75 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 September 30, 1997 and December 31, 1996 and for the three and nine months ended September 30, 1997 and 1996 follows:

	September 30, 1997	December 31, 1996		

Current assets, primarily cash and marketable securities.....	\$140,465	\$183,720		
Non-current assets.....	326,368	222,820		
Current liabilities.....	131,593	98,110		
Non-current liabilities.....	194,040	170,223		
Redeemable preferred stock.....	245,740	210,571		
Shareholders' equity (deficit).....	(104,540)	(72,364)		

			Three Months Ended	Nine Months Ended

	Sept. 30, 1997	Sept. 30, 1996	Sept. 30, 1997	Sept. 30, 1996

Revenues	\$ 26,448	\$ 21,276	\$ 70,605	\$ 83,710
Costs and expenses.....	34,378	28,998	95,897	102,314
Loss from continuing operations.....	(6,830)	(7,105)	(22,313)	(17,589)
Income (loss) from discontinued operations.....	256	(5,339)	369	(4,501)
Net loss applicable to common shares(A).....	(24,141)	(27,844)	(72,241)	(64,319)

(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.)

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RJR NABISCO HOLDINGS CORP.:

At September 30, 1997, New Valley held 762,650 shares of RJR Nabisco Holdings Corp. ("RJR Nabisco") common stock with a market value of \$26,216 (cost of \$23,378). The unrealized gain on New Valley's investment in RJR Nabisco common stock was \$2,838 at September 30, 1997.

3. INVESTMENT IN BROOKE (OVERSEAS) LTD.

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

During the second quarter 1997, New Valley paid \$21,500 to BOL, representing a portion of the promissory note together with accrued interest thereon. As of September 30, 1997, the balance remaining on the note was \$12,000, subsequently reduced to \$8,500, which is due on or before December 31, 1997.

In connection with the sale of its BML shares to New Valley, certain specified liabilities aggregating \$40,800, including the Vneshtorgbank loan, which was repaid in full during the third quarter, remained with BML, and New Valley indemnified the Company and its subsidiaries with respect to any obligation arising from such liabilities.

4. INVENTORIES

Inventories consist of:

	September 30, 1997	December 31, 1996
	-----	-----
Finished goods.....	\$13,108	\$15,304
Work-in-process.....	4,178	4,435
Raw materials.....	25,937	34,002
Replacement parts and supplies.....	4,546	4,406
	-----	-----
Inventories at current cost.....	47,769	58,147
LIFO adjustments.....	(6,409)	(4,456)
	-----	-----
	\$41,360	\$53,691
	=====	=====

At September 30, 1997, Liggett and Liggett-Ducat had leaf tobacco purchase commitments of approximately \$12,207 and approximately \$23,900, respectively.

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5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of:

	September 30, 1997	December 31, 1996
	-----	-----
Land and improvements.....	\$ 455	\$ 455
Buildings.....	6,443	14,205
Machinery and equipment.....	52,294	49,401
Leasehold improvements.....	302	302
Construction-in-progress.....	9,463	46,966
	-----	-----
	68,957	111,329
Less accumulated depreciation.....	32,237	31,047
	-----	-----
	\$36,720	\$ 80,282
	=====	=====

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

On September 9, 1997, BOL entered into a contract to purchase cigarette manufacturing and processing equipment to be used in the new factory for \$15,000. \$12,750 will be financed by a series of ten promissory notes payable every six months at 6.71% per annum interest with the first note due in 1999. The Company is a guarantor of the notes.

On September 24, 1997, BOL entered into an additional contract to purchase cigarette manufacturing and processing equipment to be used in the new factory for \$12,400, of which \$10,500 will be financed by a series of sixty promissory notes payable monthly at 7.5% per annum interest. The first note will be due six months after delivery of the equipment. Delivery is estimated to be completed by September 1998.

6. INCOME TAXES

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

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

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

	Sept. 30, 1997	December 31, 1996
15.75% Series B Senior Secured Notes due 2001, net of unamortized discount of \$1,233 and \$1,511.....	\$231,631	\$231,353
14.500% Subordinated Debentures due 1998.....	800	800
Notes payable - Foreign.....		22,668
Other.....	936	2,425
Liggett:		
11.500% Senior Secured Series B Notes due 1999, net of unamortized discount of \$254 and \$424.....	112,358	119,688
Variable Rate Series C Senior Secured Notes due 1999.....	32,279	32,279
Revolving credit facility.....	31,214	24,272
Total notes payable and long-term debt.....	409,218	433,485
Less current maturities.....	38,245	55,242
Amount due after one year.....	\$370,973 =====	\$378,243 =====

STANDSTILL AGREEMENT-BGLS:

During negotiations with the BGLS and Liggett note holders, BGLS postponed making the interest payments of approximately \$18,338 for the BGLS Notes due on July 31, 1997. (Refer to Note 1.) A Standstill Agreement and Consent (the "Standstill Agreement") was reached on August 28, 1997, as amended, among the holders of more than 83% of the BGLS Notes and BGLS whereby each of such principal holders of the BGLS Notes waived the right to receive on August 29, 1997 its pro rata share of the July 31, 1997 interest payment (in total, \$15,340).

On August 29, 1997, BGLS made the interest payment on the BGLS Notes to all holders other than the principal holders. Pending completion of the negotiations with the principal holders, such holders have agreed with BGLS that they will be entitled to receive their portion of the July 31, 1997 interest payment only after giving BGLS 20 days notice but in any event by December 10, 1997.

REVOLVING CREDIT FACILITY - LIGGETT:

On March 8, 1994, Liggett entered into the Facility for \$40,000 with a syndicate of commercial lenders. The Facility is collateralized by all inventories and receivables of Liggett. At September 30, 1997, \$2,809 was available under the Facility based on eligible collateral. Borrowings under the Facility, whose interest is calculated at a rate equal to 1.5% above the Philadelphia National Bank's prime rate (8.25%), bore a rate of 9.75% at March 31, 1997. On April 1, 1997, Philadelphia National Bank raised its prime rate to 8.5%, thereby increasing Liggett's interest rate to 10.0%. The Facility requires Liggett's compliance with certain financial and other covenants. The Facility also limits the amount of cash dividends and distributions by Liggett and imposes requirements with respect to Liggett's adjusted net and working capital. In January 1997, the Facility was extended for one year and in November 1997 was extended for an additional year until March 8, 1999.

During the first quarter of 1997, Liggett violated the working capital covenant contained in the Facility. This violation occurred during February 1997 when \$37,500 of the Liggett Notes were reclassified

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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.

On August 29, 1997, the Facility was amended to permit Liggett to borrow an additional \$6,000 which was used on that date in making the interest payment of \$9,700 due on August 1, 1997 to the holders of the Liggett Notes. BGLS guaranteed the additional \$6,000 advance under the Facility and collateralized the guarantee with \$6,000 in cash, deposited with Liggett's lender. At September 30, 1997, this amount is classified in other assets on the balance sheet.

LIGGETT 11.500% SENIOR SECURED SERIES B NOTES DUE 1999:

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

ISSUANCE OF LIGGETT SERIES C VARIABLE RATE NOTES:

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

As discussed above, the Liggett Notes require a mandatory principal redemption of \$37,500 on February 1, 1998 and a payment at maturity on February 1, 1999 of \$107,400. Liggett has engaged in negotiations with its note holders to restructure the Liggett Notes. In conjunction with these discussions, the Company is also engaged in negotiations with the principal holders of the BGLS Notes with respect to certain related modifications to the terms of such debt. (Refer to Note 1.)

FOREIGN LOANS:

The Company was a guarantor on lines of credit opened by BOL during the first quarter 1997 with two Russian banks in total amount of \$4,000 with interest at 23%. These lines of credit were

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collateralized by accounts receivable, inventory and equipment. The lines of credit expired in August and September 1997 with balances paid in full.

8. STOCK COMPENSATION

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

9. RELATED PARTY TRANSACTIONS

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

10. RESTRUCTURING CHARGES

During the first nine months of 1997, Liggett reduced its headcount by 123 full-time positions and recorded a \$1,926 restructuring charge to operations for severance programs, primarily salary continuation and related benefits for terminated employees. Approximately \$285 in restructuring charges will be funded in subsequent years. Liggett expects to continue its cost reduction programs.

11. CONTINGENCIES

TOBACCO-RELATED LITIGATION:

Overview. Since 1954, Liggett and other United States cigarette manufacturers have been named as defendants in a number of direct and third-party actions predicated on the theory that they should be liable for damages from cancer and other adverse health effects alleged to have been caused by

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cigarette smoking or by exposure to secondary smoke (environmental tobacco smoke, "ETS") from cigarettes. These cases are reported hereinafter as though having been commenced against Liggett (without regard to whether such cases were actually commenced against the Company or Liggett). There has been a noteworthy increase in the number of cases pending against both Liggett and the other tobacco companies. The cases generally fall into three categories: (i) smoking and health cases alleging personal injury brought on behalf of individual smokers ("Individual Actions"), (ii) smoking and health cases alleging personal injury and purporting to be brought on behalf of a class of plaintiffs ("Class Actions") and (iii) health care cost recovery actions brought by state and local governments, although recently several health care cost recovery actions have been commenced on behalf of other third-party payors including asbestos manufacturers, unions and taxpayers ("Attorneys General Actions"). As new cases are commenced, the costs associated with defending such cases and the risks attendant to the inherent unpredictability of litigation continue to increase. Liggett had been receiving assistance from others in the industry in defraying the costs and other burdens incurred in the defense of smoking and health litigation and related proceedings, but these benefits have 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.

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

Individual Actions. As of September 30, 1997, there were 218 cases pending against Liggett, and in most cases the other tobacco companies, where individual plaintiffs allege injury resulting from cigarette smoking, addiction to cigarette smoking or exposure to ETS and seek compensatory and, in some cases, punitive damages. Of these, 103 are pending in the State of Florida, 62 are pending in the State of New York and 19 are pending in the State of Texas. The balance of individual cases are pending in 15 states. Of the 218 individual cases, there are five cases pending where Liggett is the only named defendant.

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

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negligence, lack of design defect, statute of limitations, equitable defenses such as "unclean hands" and lack of benefit, failure to state a claim and federal preemption.

On 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 October 6, 1997, the parties settled this matter.

Class Actions. As of September 30, 1997, there were 39 actions pending, for which either a class has been certified or plaintiffs are seeking class certification, where Liggett, among others, was a named defendant. Two of these cases, Fletcher, et al. v. Brooke Group Ltd., et al. and Walker, et al. v. Liggett Group Inc., et al. have been settled, subject to court approval. These two settlements are more fully discussed below under the "Settlements" section.

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 has been brought by plaintiffs on behalf of all flight attendants that have worked or are presently working for airlines based in the United States and who have never regularly smoked cigarettes but allege that they have been damaged by involuntary exposure to ETS. On October 10, 1997, the other major tobacco companies settled this matter, subject to a fairness hearing, which settlement would provide for a full release on behalf of the Company and Liggett.

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. On February 17, 1995, the District Court granted plaintiffs' motion for class certification. 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.

Attorneys General Actions. As of September 30, 1997, 38 state Attorneys General actions were filed and served on Liggett and the Company. As more fully discussed below, Liggett has reached settlements in 26 of these actions. As of September 30, 1997, there were 18 additional third-party payor actions pending. In certain of the pending proceedings, state and local government entities and others seek reimbursement for Medicaid and other health care expenditures allegedly caused by use of tobacco products. The claims asserted in these health care cost recovery actions vary. In most of these cases, plaintiffs assert the equitable claim that the tobacco industry was "unjustly enriched" by plaintiffs' payment of health care costs allegedly attributable to smoking and seek reimbursement of those costs. Other claims made by some but not all plaintiffs include the equitable claim of indemnity, common law claims of negligence, strict liability, breach of express and implied warranty, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under state and federal statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under RICO.

Settlements. On March 12, 1996, the Company and Liggett entered into an agreement, subject to court approval, to settle the Castano class action tobacco litigation. Under the Castano settlement agreement, upon final court approval of the settlement, the Castano class would be entitled to receive up to five percent of Liggett's pretax income (income before income taxes) each year (up to a maximum of \$50,000 per year) for the next 25 years, subject to certain reductions provided for in the

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agreement. The Company and Liggett have the right to terminate the Castano settlement under certain circumstances. On March 14, 1996, the Company, the Castano Plaintiffs Legal Committee and the Castano plaintiffs entered into a letter agreement. According to the terms of the letter agreement, for the period ending nine months from the date of Final Approval (as defined in the letter), if granted, of the Castano settlement or, if earlier, the completion by the Company or Liggett of a combination with any defendant in Castano, except Philip Morris, the Castano plaintiffs and their counsel agree not to enter into any more favorable settlement agreement with any Castano defendant which would reduce the terms of the Castano settlement agreement. If the Castano plaintiffs or their counsel enter into any such settlement during this period, they shall pay the Company \$250,000 within 30 days of the more favorable agreement and offer the Company and Liggett the option to enter into a settlement on terms at least as favorable as those included in such other settlement. The letter agreement further provides that during the same time period, and if the Castano settlement agreement has not been earlier terminated by the Company in accordance with its terms, the Company and its affiliates will not enter into any business transaction with any third party which would cause the termination of the Castano settlement agreement. If the Company or its affiliates enter into any such transaction, then the Castano plaintiffs will be entitled to receive \$250,000 within 30 days from the transacting party. 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 September 6, 1996, shortly after the class was decertified, the Castano plaintiffs withdrew the motion for approval of the Castano settlement.

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 "March 1996 Settlement"). The March 1996 Settlement releases the Company and Liggett from all tobacco-related claims including claims for health care cost reimbursement and claims concerning sales of cigarettes to minors. The March 1996 Settlement provides that additional states which commence similar 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 March 1996 Settlement are summarized below.

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

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

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

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 (the "March 1997 Settlement") and with a nationwide class of individuals and entities that allege smoking-related claims. The settlements cover all smoking-related claims, including both addiction-based and tobacco injury claims against the Company and Liggett, brought by the Attorneys General and, upon court approval, the nationwide class.

As of September 30, 1997, settlements with a total of 26 Attorneys General were reached, including the Attorneys General of Alaska, Arizona, California, Connecticut, Hawaii, Illinois, Indiana, Iowa, Kansas, Maryland, Michigan, Minnesota, Nevada, New Jersey, New York, Oklahoma, Oregon, Texas, Utah, Washington and Wisconsin. The March 1996 Settlement remains in full force and effect. Other states have either recently filed health care cost recovery actions or indicated intentions to do so. Both Liggett and the Company will endeavor to resolve those actions on substantially the same terms and conditions as the March 1997 Settlement; however, there can be no assurance that any such settlements will be completed.

As mentioned above, on March 20, 1997, Liggett, the Company and plaintiffs filed the mandatory class settlement agreement in an action entitled Fletcher, et al. v. Brooke Group Ltd., et al., Circuit Court of Mobile County, Alabama, where the court granted preliminary approval and preliminary certification of the class, and on May 15, 1997, a similar mandatory class settlement agreement was filed in an action entitled Walker, et al. v. Liggett Group Inc., et al., United States District Court, Southern District of West Virginia. The Walker court also granted preliminary approval and preliminary certification of the nationwide class; however, on August 5, 1997, the court vacated its preliminary certification of the settlement class, which decision is currently on appeal.

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

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(UNAUDITED)

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

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

Under the recent 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 settlements, would receive certain settlement benefits, including limitations on potential liability for affiliates not engaged in domestic tobacco operations and a waiver of any obligation to post a bond to appeal any future adverse judgment. In addition, within 120 days following any such combination, Liggett would be required to pay the settlement fund \$25,000. The settling Attorneys General and the nationwide class have agreed not to seek an injunction preventing a defendant tobacco company combining with Liggett or the Company from spinning off any affiliate which is not engaged in the domestic tobacco business.

The Company and Liggett are also entitled to most favored nation treatment in the event any settling Attorney General reaches a settlement with any other defendant tobacco company. In addition, in the event of a "global" tobacco settlement enacted through Federal legislation or otherwise, the settling Attorneys General and tobacco plaintiffs agreed to use their "best efforts" to ensure that the Company and Liggett's liability under such a plan should be no more onerous than under these new settlements.

Imminent Trials. Although trial schedules are subject to change, the next case scheduled for trial, where Liggett is a defendant, is State of Minnesota by Hubert H. Humphrey, III, its Attorney General and Blue Cross and Blue shield of Minnesota V. Philip Morris Incorporated, et al., District Court of the Second Judicial District, Ramsey County, Minnesota, which is scheduled for trial in January 1998. Liggett settled the claims of the State of Minnesota on March 20, 1997, but still remains a defendant in the case with respect to the State's co-plaintiff, Blue Cross and Blue Shield of Minnesota. In addition, there is one class action, Engle, et al. v. R.J. Reynolds Tobacco Company, et al., Circuit Court, 11th Judicial Circuit, Dade County, Florida and one individual ETS case, Dunn and Wiley v. RJR Nabisco Holdings Corp., et al., Superior Court, Delaware County, Indiana, scheduled for trial in February 1998.

Other Matters. On June 20, 1997, Philip Morris Incorporated ("Philip Morris"), R. J. Reynolds Tobacco Company ("RJR"), B&W, Lorillard Tobacco Company ("Lorillard") and the United States Tobacco Company, along with the Attorneys General for the States of Arizona, Connecticut, Florida, Mississippi, New York and Washington and the Castano Plaintiffs' Litigation Committee executed a

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Memorandum of Understanding to support the adoption of federal legislation and necessary ancillary undertakings, incorporating the features described in a proposed resolution. The proposed resolution mandates a total reformation and restructuring of how tobacco products are manufactured, marketed and distributed in the United States. The proposals are currently being reviewed by the White House, Congress and various public interest groups. Separately, the other tobacco companies negotiated settlements of the Attorneys General health care cost recovery actions in Mississippi and Florida. Management is unable to predict the ultimate effect, if any, of the enactment of legislation adopting the proposed resolution. Management is also unable to predict the ultimate content of any such legislation; however, adoption of any such legislation could have a material adverse effect on the business of the Company and Liggett.

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

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

In March 1996, March 1997, July 1997 and October 1997, the Company and/or Liggett received subpoenas from a Federal grand jury in connection with an investigation by the United States Department of Justice, relating to issues raised in testimony provided by tobacco industry executives before Congress and other related matters. Liggett has responded to the March 1996 and March 1997 subpoenas and is in the process of responding to the July and October 1997 subpoenas. The Company and Liggett are unable, at this time, to predict the outcome of this investigation.

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

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

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

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

LEGISLATION AND REGULATION:

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

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

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 specified levels, which levels vary by country. Management believes that the TRQ levels are sufficiently high to allow Liggett to operate without material disruption to its business. On February 20, 1996, the United States Trade representative issued an "advance notice of rule making" concerning how tobaccos imported under the TRQ should be allocated. Currently, tobacco imported under the TRQ is allocated on a "first-come, first-served" basis, meaning that entry is allowed on an open basis to those first requesting entry in the quota year. Others in the cigarette industry have suggested an "end-user licensing" system under which the right to import tobacco under the quota would be initially assigned on the basis of domestic market share. Such an approach, if adopted, could have a material adverse effect on the Company and Liggett.

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

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

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

In a speech on September 17, 1997, President Clinton called for federal legislation that, among other things, would raise cigarette prices by up to \$1.50 per pack. In November 1997, several bills were introduced in the Senate that purport to propose legislation along these lines. Management is unable to predict the ultimate content of any such legislation; however, adoption of any such legislation could have a material adverse effect on the business of the Company and Liggett.

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

12. SALES OF ASSETS

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

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

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

INTRODUCTION

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

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

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

RECENT DEVELOPMENTS

BOL. On January 31, 1997, New Valley acquired from BOL 10,483 shares (99.1%) of common stock of BML (the "BML Shares") for a purchase price of \$55,000, consisting of \$21,500 in cash and a \$33,500 9% promissory note of New Valley (the "Note"). The Note is collateralized by the BML Shares. During the second quarter 1997, New Valley paid \$21,500 to BOL. The remaining balance on the Note at September 30, 1997 was \$12,000, subsequently reduced to \$8,500 and is due on or before December 31, 1997. The Company recognized a gain of \$21,300 on the sale in the first quarter, 1997. On April 18, 1997, BML sold one of its office buildings to a third party. Accordingly, the Company recognized approximately \$1,240 of the deferred gain. See Note 3 to the Company's Consolidated Financial Statements.

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

Debt Service. Liggett has engaged in negotiations with its note holders with respect to a restructuring of the terms of Liggett's Senior Secured Notes (the "Liggett Notes"). In conjunction with these discussions, the Company has also engaged in negotiations with the principal holders of the BGLS 15.75% Series B Senior Secured Notes (the "BGLS Notes") with respect to certain related modifications to the terms of such debt. A Standstill Agreement and Consent (the "Standstill Agreement") was reached on August 28, 1997, as amended, among the principal holders of the BGLS Notes and BGLS whereby each of the principal holders of the BGLS Notes waived the right to receive on August 29, 1997 its pro rata share of the July interest amount (\$15,340). Other BGLS note holders and the Liggett note holders received the interest payments which had been due on July 31, 1997 and on August 1, 1997, respectively, on August 29, 1997. Pending completion of the negotiations with the principal holders, such holders have agreed with BGLS that they will be entitled

to receive their portion of the July 31, 1997 interest payment only after giving BGLS 20 days notice but in any event by December 10, 1997. On August 29, 1997, Liggett's revolving credit facility (the "Facility") was amended to permit Liggett to borrow an additional \$6,000 which was used in making the interest payment of \$9,700 due on August 1, 1997 to the holders of the Liggett Notes. BGLS guaranteed the additional \$6,000 advance under the Facility and collateralized the guarantee with \$6,000 in cash, deposited with Liggett's lender. With respect to Liggett's liquidity and near-term debt service requirements and related matters, refer to "Capital Resources and Liquidity" below.

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

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

RECENT DEVELOPMENTS IN THE CIGARETTE INDUSTRY

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

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 September 30, 1997, there were 218 individual suits, 39 class actions or actions where class certification has been sought and 38 state (and numerous municipality and other third-party payor) health care cost reimbursement actions pending in the United States in which Liggett is a named defendant and has been served. As new cases are commenced, the costs associated with defending such cases and the risks attendant to the inherent unpredictability of litigation continue to increase. Recently, there have been a number of restrictive regulatory actions from various Federal administrative bodies, including the United States Environmental Protection Agency ("EPA") and the Food and Drug Administration ("FDA"), adverse political and legal decisions and other unfavorable developments concerning cigarette smoking and the tobacco industry, including the commencement and certification of class actions and the commencement of Medicaid reimbursement suits by various states' Attorneys General. These developments generally receive widespread media attention. The Company is not able to evaluate the effect of these developing matters on pending litigation or the possible commencement of additional litigation, but it is

possible that the Company's financial position, results of operations and cash flows could be materially adversely affected by an ultimate unfavorable outcome in any of such pending litigation. See Note 11 to the Company's Consolidated Financial Statements for a description of legislation, regulation and litigation.

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

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

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

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

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

terms, the Company and its affiliates will not enter into any business transaction with any third party which would cause the termination of the Castano settlement agreement. If the Company or its affiliates enter into any such transaction, then the Castano plaintiffs will be entitled to receive \$250,000 within 30 days from the transacting party.

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

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

As of September 30, 1997, settlements with a total of 26 Attorneys General were reached, including the Attorneys General of Alaska, Arizona, California, Connecticut, Hawaii, Illinois, Indiana, Iowa, Kansas, Maryland, Michigan, Minnesota, Nevada, New Jersey, New York, Oklahoma, Oregon, Texas, Utah, Washington and Wisconsin. The Company's and Liggett's previous settlement on March 15, 1996 with the Attorneys General of Florida, Louisiana, Massachusetts, Mississippi and West Virginia remains in full force and effect. Other states have either recently filed health care cost recovery actions or indicated intentions to do so. Both Liggett and the Company will endeavor to resolve those 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.

As mentioned above, on March 20, 1997, Liggett, the Company and plaintiffs filed the mandatory class settlement agreement in an action entitled *Fletcher, et al. v. Brooke Group Ltd., et al.*, Circuit Court of Mobile County, Alabama, where the court granted preliminary approval and preliminary certification of the class, and on May 15, 1997, a similar mandatory class settlement agreement was filed in an action entitled *Walker, et al. v. Liggett Group Inc., et al.*, United States District Court, Southern District of West Virginia. The Walker court also granted preliminary approval and preliminary certification of the nationwide class; however, on August 5, 1997, the court vacated its preliminary certification of the settlement class, which decision is currently on appeal.

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

Pursuant to the above-mentioned settlements, the Company and Liggett agreed to cooperate fully with the Attorneys General and the nationwide class in their respective lawsuits against the tobacco industry. The Company and Liggett agreed to provide to these parties all relevant tobacco documents in their possession, other than those subject to claims of joint defense privilege, and to waive, subject to court order, certain attorney-client privileges and work product protections regarding Liggett's smoking-related documents to the extent Liggett and the Company can so waive these privileges and protections. The Attorneys General and the nationwide class agreed to keep Liggett's documents under protective order and, subject to final court approval, to limit their use to those actions brought by parties to the

settlement agreements. Those documents that may be subject to a joint defense privilege with other tobacco companies will not be produced to the Attorneys General or the nationwide class, but will be, pursuant to court order, submitted to the appropriate court and placed under seal for possible in camera review. Additionally, under similar protective conditions, the Company and Liggett agreed to offer their employees for witness interviews and testimony at deposition and trial. Pursuant to both settlement agreements, Liggett also agreed to place an additional warning on its cigarette packaging stating that "smoking is addictive" and to issue a public statement, as requested by the Attorneys General. Liggett has commenced distribution of cigarette packaging which displays the new warning label.

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

Under the recent 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 settlements, would receive certain settlement benefits, including limitations on potential liability for affiliates not engaged in domestic tobacco operations and a waiver of any obligation to post a bond to appeal any future adverse judgment. In addition, within 120 days following any such combination, Liggett would be required to pay the settlement fund \$25,000. The settling Attorneys General and the nationwide class agreed not to seek an injunction preventing a defendant tobacco company combining with Liggett or the Company from spinning-off any of its affiliates which are not engaged in the domestic tobacco business.

The Company and Liggett are also entitled to certain most favored nation treatment in the event any settling Attorney General reaches a settlement with any other defendant tobacco company. In addition, in the event of a "global" tobacco settlement enacted through Federal legislation or otherwise, the settling Attorneys General and tobacco plaintiffs agreed to use their "best efforts" to ensure that the Company and Liggett's liability under such a plan should be no more onerous than under these new settlements.

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

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

In a speech on September 17, 1997, President Clinton called for federal legislation that, among other things, would raise cigarette prices by up to \$1.50 per pack. In November 1997, several bills were introduced in the Senate that purport to propose legislation along these lines. Management is unable to predict the ultimate content of any such legislation; however, adoption of any such legislation could have a material adverse effect on the business of the Company and Liggett.

RESULTS OF OPERATIONS

Three Months Ended September 30, 1997 Compared to Three Months Ended September 30, 1996.

Revenues. Total revenues were \$100,308 for the three months ended September 30, 1997 compared to \$114,635 for the three months ended September 30, 1996. This 12.5% decrease in revenues was primarily due to a \$21,757 or 21.5% decrease in revenues at Liggett reflecting a 29.6% decrease in Liggett's overall unit sales volume, partially offset by an increase in tobacco revenues at Liggett-Ducat of \$8,100 or 63.1% over the same period in 1996 and an increase of 22.8% in overall unit sales volume. (See also "Recent Developments in the Cigarette Industry-Pricing Activity" for a discussion of the March and September 1997 domestic price increases). The decline in overall unit sales volume of 29.6% at Liggett was comprised of declines within the premium segment of 18.6% and discount segment (which includes generic, control label and branded discount products) of 28.8%. The decline in premium and discount unit sales volume was due to certain competitors' continuing leveraged rebate programs tied to their products and increased promotional activity by certain other manufacturers. The increase in tobacco revenues at Liggett-Ducat is attributable to increased unit sales volume of 22.8% and price increases. The increase in tobacco revenues at Liggett-Ducat is offset by a decline in real estate revenues of \$668 due to the sale of the BML Shares.

Gross Profit. Gross profit was \$47,263 for the three months ended September 30, 1997 compared to \$56,274 for the three months ended September 30, 1996, a decrease of \$9,011 when compared to the same period last year, due primarily to the decline in unit sales volume at Liggett discussed above. Overall, the Company's gross profit as a percentage of revenues decreased 2.0% when compared to the same period in the prior year. Liggett's gross profit as a percentage of revenues (excluding federal excise taxes) for the period decreased to 72.2% compared to 74.0% in the same period in the prior year. This decrease is the result of increased tobacco costs due to a reduction in the average discount available to Liggett from leaf tobacco dealers on tobacco purchased under prior years' purchase commitments, partially offset by the March and September 1997 list price increases discussed above. See "Recent Developments in the Cigarette Industry". Gross profit at Liggett-Ducat increased \$3,712 over the prior year due to increased sales volume and cigarette price increases.

Expenses. Selling, general and administrative expenses were \$40,498 for the three months ended September 30, 1997 compared to \$55,326 for the same period last year. The decrease of \$14,828 is due primarily to a decrease in expenses at Liggett of approximately \$13,300 which include lower promotion, marketing and administrative expenses as well as lower charges for restructuring partially offset by higher legal expenses at Liggett and a decrease of approximately \$900 in operating expenses at BOL due to the sale of BML Shares in January 1997.

Other Income (Expense). Interest expense was \$15,791 for the three months ended September 30, 1997 compared to \$15,254 for the same period last year.

Equity in earnings of affiliate was a loss of \$7,090 for the three months ended September 30, 1997 compared to a loss of \$4,618 for the three months ended September 30, 1996 and relates primarily to losses at New Valley.

Nine Months Ended September 30, 1997 Compared to Nine Months Ended September 30, 1996.

Revenues. Total revenues were \$276,906 for the nine months ended September 30, 1997 compared to \$330,364 for the nine months ended September 30, 1996. This 16.2% decrease in revenues was primarily due to a \$69,008 or 23.6% decrease in revenues at Liggett reflecting a 30.8% decrease in Liggett's overall unit sales volume, partially offset by an increase of \$19,874 or 60.2% over the same period in 1996 in tobacco revenues and an increase of 24.1% in overall unit sales volume at Liggett-Ducat. The decline in overall units sales volume at Liggett was comprised of declines within the premium segment of 22.7% and discount segment (which includes generic, control label and branded discount products) of 30.0%. The decline in premium and discount unit sales volume was due to certain competitors' continuing

leveraged rebate programs tied to their products and increased promotional activity by certain other manufacturers. Liggett has had two price increases this year as compared with one price increase in 1996 and Liggett-Ducat has also experienced price increases. The increase in tobacco revenues at Liggett-Ducat is offset by a decline in real estate rental revenues of \$1,783 due to the sale of the BML Shares.

Gross Profit. Gross profit was \$131,065 for the nine months ended September 30, 1997 compared to \$161,433 for the nine months ended September 30, 1996, a decrease of \$30,368 when compared to the same period last year, due primarily to the decline in unit sales volume at Liggett discussed above. Overall, the Company's gross profit as a percentage of revenues decreased 1.5% 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 72.0% compared to 73.3% in the same period in the prior year. This decrease is the result of increased tobacco costs due to a reduction in the average discount available to Liggett from leaf tobacco dealers on tobacco purchased under prior years' purchase commitments, partially offset by the March and September 1997 list price increases. See "Recent Developments in the Cigarette Industry".

Expenses. Selling, general and administrative expenses were \$117,535 for the nine months ended September 30, 1997 compared to \$158,482 for the same period last year. The decrease of \$40,947 is due primarily to lower promotion, marketing and administrative expenses at Liggett caused by the decline in unit sales volume discussed above partially offset by restructuring charges of \$1,926, as compared with restructuring charges of \$1,180 in the same period in the prior year, and higher legal expenses at Liggett.

Other Income (Expense). Interest expense was \$46,757 for the nine months ended September 30, 1997 compared to \$45,488 for the same period last year. The increase is due to additional interest expense at corporate headquarters and higher outstanding balances under Liggett's Facility partially offset by the redemption of \$7,500 Liggett Series B Notes in February 1997.

Equity in earnings of affiliate was a loss of \$21,488 for the nine months ended September 30, 1997 compared to a loss of \$7,152 for the nine months ended September 30, 1996 and relates to losses at New Valley and the decline in market value of the Class A Preferred Shares.

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 of \$4,125. See Notes 3 and 12 to the Company's Consolidated Financial Statements.

CAPITAL RESOURCES AND LIQUIDITY

Net cash and cash equivalents increased \$420 and decreased \$1,267 for the nine months ended September 30, 1997 and 1996, respectively. Net cash used in operations for the nine months ended September 30, 1997 was \$30,511 compared to net cash used in operations of \$22,000 for the comparable period of 1996, primarily due to net losses of \$23,324 and \$40,404, respectively. Such losses included interest payments of approximately \$41,000 in 1997 as compared with \$53,000 in 1996. In addition, there was an increase in receivables from affiliates of \$28,190 resulting from the sale of the BML Shares to New Valley, a decrease in accounts payable and other accrued liabilities of \$26,058. These items were offset by a decrease in trade receivables and inventories at Liggett due to declining sales volume, and non-cash items including equity in loss of affiliate of approximately \$22,000 and the impact of the deferred gain on the sale of the BML Shares of approximately \$22,000.

Cash provided by investing activities of \$33,234 for the period ended September 30, 1997 includes principally cash of \$43,000 received in the sale of the BML Shares to New Valley and net cash received in the sale of certain of Liggett's surplus realty to Blue Devil Ventures. Cash received was offset by capital expenditures of \$9,857, principally at B0L. Capital expenditures include costs incurred in the development of the new Russian cigarette factory and equipment purchases and \$1,282 in costs for equipment modernization at Liggett. Cash used in investing activities of \$8,235 for the nine months ended September 30, 1996 includes capital expenditures of approximately \$24,047, principally for real estate development at B0L and for costs of \$2,983 for equipment modernization at Liggett. Capital expenditures in 1996 were

offset by dividends received on the New Valley Class A Preferred Shares of \$24,733 or \$40.00 per share and proceeds from the sale of certain surplus realty at Liggett and the sale of assets of COM Products Inc.

Cash used in financing activities was \$2,303 for the nine months ended September 30, 1997 compared to cash provided of \$12,498 for the same period in 1996. Proceeds from financing activities of \$5,198 primarily include proceeds at BOL from credit lines and net borrowings under Liggett's Facility of \$6,941. These proceeds were offset by repayments on credit lines and on debt including principally the required repurchase of \$7,500 face amount of the Liggett Notes on February 1, 1997 at a net gain of \$2,963. Distributions on common stock include distributions declared in the fourth quarter 1996 which were paid in January 1997 and distributions declared and paid in March, June and September 1997. Proceeds from debt in the same period in 1996 include the private placement of BGLS' Series A Notes (later exchanged for Series B Notes) for net cash proceeds of \$6,065, borrowings by BOL for real estate development of \$12,400 and borrowings of \$9,500 by Liggett and BOL under their revolving credit facilities. These transactions were primarily offset by the redemption for approximately \$6,237 of BGLS' 16.125% Senior Subordinated Reset Notes including premium and accrued interest thereon, and distributions to the Company's shareholders of \$4,162.

Liggett. Liggett had a net capital deficiency of \$180,011 as of September 30, 1997, is highly leveraged and has substantial near-term debt service requirements. Due to the many risks and uncertainties associated with the cigarette industry and the impact of recent tobacco litigation settlements, there can be no assurance that Liggett will be able to meet its future earnings or cash flow goals. Consequently, Liggett could be in violation of certain debt covenants, and if its lenders were to exercise acceleration rights under the Facility or the Liggett Notes indenture, or refuse to lend under the Facility, Liggett would not be able to satisfy such demands or its working capital requirements.

Further, the Liggett Notes require a mandatory principal redemption of \$37,500 on February 1, 1998 and a payment at maturity on February 1, 1999 of \$107,400. Based on Liggett's net loss for 1996 and anticipated 1997 operating results, Liggett does not anticipate it will be able to generate sufficient cash from operations to make such payments. While Liggett has engaged in negotiations with its note holders to restructure the terms of the Liggett Notes, there are no commitments to restructure the Liggett Notes at this time, and no assurances can be given in this regard. In conjunction with these discussions, the Company has also engaged in negotiations with the principal holders of the BGLS Notes with respect to certain related modifications to the terms of such debt. During such negotiations, both BGLS and Liggett postponed making the interest payments of approximately \$18,338 for the BGLS Notes due on July 31, 1997 and approximately \$9,700 for the Liggett Notes due on August 1, 1997. On August 29, 1997, Liggett's Facility was amended to permit Liggett to borrow an additional \$6,000 which was used on that date in making the interest payment of \$9,700 due on August 1, 1997 to the Liggett note holders. BGLS guaranteed the additional \$6,000 advance under the Facility and collateralized the guarantee with \$6,000 in cash, deposited with Liggett's lenders.

If Liggett is unable to restructure the terms of the Liggett Notes, or otherwise make all payments thereon, substantially all of Liggett's long-term debt and the Facility would be in default and holders of such debt could accelerate its maturity. In such event, Liggett may be forced to seek protection from creditors under applicable laws. These matters raise substantial doubt about Liggett meeting its liquidity needs and its ability to continue as a going concern.

On March 8, 1994, Liggett entered into the Facility under which it can borrow up to \$40,000 (depending on the amount of eligible inventory and receivables as determined by the lenders) from a syndicate of commercial lenders. At September 30, 1997, \$31,214 was outstanding and \$2,809 was available under the Facility based on eligible collateral. The Facility is collateralized by all inventories and receivables of Liggett. Borrowings under the Facility are charged interest at a rate equal to 1.5% above Philadelphia National Bank's (the indirect parent of Congress Financial Corporation, the lead lender) prime rate. Liggett's interest rate is currently 10.0%. The Facility contains certain financial covenants similar to those contained in the Liggett Notes Indenture, including restrictions on Liggett's ability to declare or pay cash dividends, incur additional debt, grant liens and enter into any new agreements with affiliates, among others. In addition, the Facility 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, this computation is currently \$173,602) and working capital (not to fall below a deficit of \$12,000 as computed in accordance with the agreement, this computation is currently \$3,492).

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

In November 1997, the Facility was extended until March 8, 1999. The balance on the Facility, \$31,214, was reclassified from current to long-term debt as of September 30, 1997.

In February 1997, Liggett purchased \$7,500 of Series B Notes using Facility 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. BGLS or its affiliates may, from time to time, based on current market conditions, purchase Liggett Notes in the open market or in privately negotiated transactions. Current maturities of the Liggett Notes of \$37,500 contribute substantially to Liggett's working capital deficit of \$47,292 at September 30, 1997.

Liggett (and, in certain cases, the Company) and other United States cigarette manufacturers have been named as defendants in a number of direct and third-party actions (and purported class actions) predicated on the theory that they should be liable for damages from cancer and other adverse health effects alleged to have been caused by cigarette smoking or by exposure to so-called secondary smoke (environmental tobacco smoke) from cigarettes. As new cases are commenced, the costs associated with defending such cases and the risk attendant to the inherent unpredictability of litigation continue. Liggett had been receiving certain assistance from others in the industry in defraying the costs and other burdens incurred in the defense of smoking and health litigation and related proceedings, but these benefits have ended. 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 September 30, 1997, BGLS' long-term debt was approximately \$233,000. In connection with the interest payment BGLS made on August 29, 1997, the Standstill Agreement was reached with the

principal holders of BGLS debt on August 28, 1997, as amended, and interest was paid to other BGLS note holders in the amount of \$3,039 on August 29, 1997. (See "Recent Developments" and Liggett discussion above).

BOL. As discussed in "Recent Developments," on January 31, 1997, BOL sold its 99.1% interest in BML to New Valley for \$55,000. The purchase price paid was \$21,500 in cash and a 9% promissory note of \$33,500, of which \$21,500 was paid during the second quarter 1997. The remaining balance of \$12,000, subsequently reduced to \$8,500, is due on or before December 31, 1997.

In October 1995, Liggett-Ducat entered into a loan agreement with Vneshtorgbank, Moscow, Russia, to borrow up to \$20,400 to fund real estate development. Interest on the note is based on the London Interbank Offered Rate plus 10%. The Company had 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. BML paid the balance of the loan in full during the third quarter, 1997.

Liggett-Ducat is building a new cigarette factory on the outskirts of Moscow. The new factory, which will utilize Western cigarette making technology and have a capacity of 30 billion units per year, will produce American and international blend cigarettes, as well as traditional Russian cigarettes. 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.

In connection with the new cigarette factory, BOL has entered into equipment purchases of approximately \$28,000, of which \$23,000 will be financed over 5 years beginning in 1998. The Company is a guarantor of one of the purchases for which the remaining obligation is \$12,750.

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, the redemption of \$7,500 of the Liggett Notes on February 1, 1997 and the extension of the Liggett Facility through March 8, 1999, the Company decreased its scheduled near-term debt maturities to \$38,245 due in the year 1998; at September 30, 1997, \$37,500 of this debt relates to Liggett. In addition, Liggett has a payment due at maturity of the Liggett Notes on February 1, 1999 of \$107,400. The BGLS Notes Indenture limits the amount of restricted payments BGLS is permitted to make to the Company during the calendar year. At September 30, 1997, the remaining amount available through December 31, 1997 in the Restricted Payment Basket related to BGLS' payment of dividends to the Company (as defined by the BGLS Notes Indenture) is \$6,443. In March and June 1997, the Company provided for its quarterly dividends 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 originally estimated at \$36,800 on which payments of \$21,377 have been made. The remaining balance of \$15,340 is the subject of the Standstill Agreement with the principal holders of the BGLS Notes discussed above and is due upon 20 days' notice by such holders but in any event by December 10, 1997. Additional expenditures include dividends on the Company's shares (currently at an annual rate of approximately \$5,500) and corporate expense. The Company anticipates funding current operations with the remaining proceeds from the sale of BML, management fees and other payments from subsidiaries of approximately \$5,000. The Company expects to finance its long-term growth, working capital requirements, capital expenditures and debt service requirements through a combination of cash provided from operations, proceeds from the sale of certain assets, additional public or private debt and/or equity financing and distributions from New Valley. New Valley may acquire or seek to acquire additional operating businesses through merger, purchase of assets, stock acquisition or other means, or to make other investments, which may limit its ability to make such distributions.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

The Company and its representatives may from time to time make oral or written "forward-looking statements" within the meaning of the Private Securities Reform Act of 1995 (the "Reform Act"), including any

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

PART II
OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 3. Defaults Upon Senior Securities

As of September 30, 1997, New Valley Corporation, the Companies' affiliate, had the following respective accrued and unpaid dividend arrearages on its 1,071,462 outstanding shares of \$15.00 Class A Increasing Rate Cumulative Senior Preferred Shares (\$100 Liquidation Value), \$.01 par value per share (the "Class A Shares") and 2,790,776 outstanding shares of \$3.00 Class B Cumulative Convertible Preferred Shares (\$25 Liquidation Value), \$.10 par value per share (the "Class B Shares"): (i) \$150.9 million or \$140.81 per Class A Share; and (ii) \$133.2 million or \$47.75 per Class B Share.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

- 10.1 Settlement Agreement dated September 15, 1997 by and among the State of Nevada and Brooke Group Ltd. and Liggett Group Inc.
- 10.2 Settlement Agreement dated June 9, 1997 by and among the State of Oregon and Brooke Group Ltd. and Liggett Group Inc.
- 10.3 Standstill Agreement and Consent ("Standstill Agreement"), dated as of August 28, 1997, among BGLS Inc., AIF II, L.P., Artemis America Partnership and Tortoise Corp. (incorporated by reference to exhibit 99.2 in the Companies' Form 8-K dated August 29, 1997.
- 10.4 Amendment to Standstill Agreement dated November 13, 1997.
- 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 September 30, 1997.
- 99.2 New Valley Corporation's Interim Consolidated Financial Statements for the quarterly period ended September 30, 1997.
- 99.3 Brooke (Overseas) Ltd.'s Interim Consolidated Financial Statements for the quarterly period ended September 30, 1997.
- 99.4 New Valley Holdings, Inc.'s Interim Consolidated Financial Statements for the quarterly period ended September 30, 1997.

(b) Reports on Form 8-K

During the third quarter of 1997, the Companies filed current reports on Form 8-K, dated July 31, 1997 and August 29, 1997, concerning Items 5 and 7 (no financial statements were included therewith).

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: November 17, 1997

BGLS INC.
(REGISTRANT)

By: /s/ Joselynn D. Van Siclen

Joselynn D. Van Siclen
Vice President and Chief
Financial Officer

Date: November 17, 1997

STATE OF NEVADA SETTLEMENT AGREEMENT

This SETTLEMENT AGREEMENT is entered into this 15th day of September, 1997 by and among the State of Nevada 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 Nevada, 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 Nevada, including the prosecution of the Action against non-settling defendants, the State of Nevada 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 Nevada and Liggett and Brooke Group wish to provide in this Settlement Agreement for the State of Nevada 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 Nevada 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 Nevada 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 Nevada 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 Nevada 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 Nevada, and Liggett and Brooke Group hereby stipulate and agree that any and all smoking-related claims, including the Action, of the State of Nevada shall be settled as against Liggett and Brooke Group all on the terms contained herein, as follows:

1. 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 action entitled State of Nevada v. Philip Morris Inc., et al., Nev. Dist., 2nd Jud. Dist. (Washoe Cty., Nevada).

"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 Nevada and Brooke Group and Liggett.

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

2. Settlement Purposes Only.

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

3. 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.

4. Public Statement; Cooperation; Advertising Limitations.

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

4.1 Promptly after execution of this Settlement Agreement, Liggett shall, by and through its Director, Bennett S. LeBow, issue in the State of Nevada 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 Nevada.

5. In accordance with our settlement agreements, Liggett agrees to fully cooperate with the State of Nevada in connection with contemplated lawsuits against the other tobacco companies. To that end, Liggett will make available to the State of Nevada 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 Nevada in obtaining prompt court adjudication of the rest of the industry's joint privilege claims.

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

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

(1) cooperate with the Attorney General of the State of Nevada 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 Nevada 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 Nevada 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.

5. 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.

5.3. Subject to and in accordance with applicable law, in the event of a Global Settlement which does not impose financial terms, financial obligations or financial conditions as to Brooke Group and Liggett which are more onerous on, or less favorable to, Brooke Group and Liggett than those of this Settlement Agreement (at least to the extent Liggett's Market Share does not exceed 3%; such Market Share limitation being included solely for purposes of this Section 5.3), and pursuant to which Brooke Group and Liggett receive a limitation of liability for smoking-related claims, and any other benefits conferred thereunder, at least to the same extent as received by the Non-settling Tobacco Companies, Liggett agrees to abide by the provisions of such Global Settlement that pertain to the pricing of Cigarettes.

6. 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.

7. 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.

8. 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.

9. 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 Nevada shall also be a termination of this Agreement.

10. Continuing Enforceability.

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

11. Entry of Good Faith Bar Order on Contribution and Indemnity Claims.

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

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

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

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

12. 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.

13. Effect of Default of Settling Defendant.

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

14. 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.

15. Arbitration.

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

16. 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.

17. 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.

18. 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.

18.5. Section 18.5 of the Attorneys General Settlement is incorporated herein by reference.

18.6. Section 18.6 of the Attorneys General Settlement is incorporated herein by reference.

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 Nevada

By /s/ Bennett S. LeBow

Bennett S. LeBow

By /s/ Frankie Sue Del Papa

Frankie Sue Del Papa
Attorney General

Date: 9/15/97

Date: 9/17/97

LIGGETT GROUP, INC.

By /s/ Bennett S. LeBow

Bennett S. LeBow

Date: 9/15/97

STATE OF OREGON SETTLEMENT AGREEMENT

This SETTLEMENT AGREEMENT is entered into this 9th day of June, 1997 by and among the State of Oregon 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 Oregon, 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 Oregon, including the prosecution of the Contemplated Action against other Defendants, the State of Oregon 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 Oregon and Liggett and Brooke Group wish to provide in this Settlement Agreement for the State of Oregon 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 Oregon 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 Oregon 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 tobacco industry has for many years acted in concert to seek to deny, refute or dilute warnings concerning smoking issued by the United States Surgeon General, the Environmental Protection Agency and other respected health authorities. Liggett and Brooke Group have determined, in entering into agreements settling smoking-related litigation, that they will not be party to this industry activity.

I. The State of Oregon 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 Oregon 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 Oregon, and Liggett and Brooke Group hereby stipulate and agree that any and all smoking-related claims, including any Contemplated Action, of the State of Oregon shall be settled as against Liggett and Brooke Group all on the terms contained herein, as follows:

1. 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 Oregon 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 Oregon 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 Oregon, an order by a Oregon 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 Oregon 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 Oregon. 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.

2. 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 Oregon 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 Oregon 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 Oregon or in any other action or proceeding of any kind, or as an admission by the State of Oregon 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.

3. 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 Oregon has not as of the date of this Settlement Agreement filed a Contemplated Action, the State of Oregon 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 Oregon.

4. Public Statement; Cooperation; Advertising Limitations.

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

4.1 Promptly after execution of this Settlement Agreement, Liggett shall, by and through its Director, Bennett S. LeBow, issue in the State of Oregon 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 Oregon.

5. In accordance with our settlement agreements, Liggett agrees to fully cooperate with the State of Oregon in connection with contemplated lawsuits against the other tobacco companies. To that end, Liggett will make available to the State of Oregon 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 Oregon in obtaining prompt court adjudication of the rest of the industry's joint privilege claims.

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

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

(1) cooperate with the Attorney General of the State of Oregon in that such Settling Defendant will take no steps to impede or frustrate any investigation or preparation leading to the filing of a Contemplated Action or any other 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 Oregon 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 a Contemplated Action; 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 Oregon 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 Oregon 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 Oregon 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.

5. 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.

6. 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.

6.14. Any sums distributed to the State of Oregon pursuant to this Settlement Agreement shall be deposited to the Consumer Protection and Education Revolving Account established pursuant to ORS 180.095. Said sum, if any, shall be used by the Oregon Department of Justice as provided by law.

7. Release.

Section 7 of the Attorneys General Settlement is incorporated herein by reference, except as modified below.

7.1. Upon the date of the execution of this Agreement, for good and sufficient consideration as described herein, the State of Oregon shall for the duration or term of this Agreement (whichever is shorter) be deemed to and hereby does release, dismiss and discharge each and every civil claim, right, and cause of action (including, without limitation, all claims for damages, restitution, medical monitoring, or any other 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 Oregon, 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 Oregon 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.

8. 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 Oregon brings a Contemplated Action, the State of Oregon 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.

9. 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 Oregon shall also be a termination of this Agreement.

10. Continuing Enforceability.

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

11. Entry of Good Faith Bar Order on Contribution and Indemnity Claims.

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

11.1. 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 Oregon. 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.

11.2. As promptly as reasonably practicable after a Contemplated Action is brought by the State of Oregon, the Parties shall request that the court in which a Contemplated Action is brought by the State of Oregon enter an order barring and prohibiting the commencement and prosecution of any claim or action by any non-settling defendant against any Settling Defendant, including but not limited to any contribution, indemnity and/or subrogation claim seeking reimbursement for payments made or to be made to any Settling State for claims settled under this Agreement. Settling Defendants shall be entitled to dismissal with prejudice of any non-settling defendants' claims against them which violate or are inconsistent with this bar, if granted.

11.3. The State of Oregon shall not seek to collect any amount on any judgment in a Contemplated Action against a non-settling defendant to the extent, and only to the extent, that such non-settling defendant has a right of contribution or indemnification against the Settling Defendants. This section will not apply to any agreement or understanding, known or

unknown, written or otherwise, with any non-settling defendant or any other party that entitles any non-settling defendant to indemnity or contribution from Brooke Group or Liggett.

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

12. 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.

13. 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 Oregon 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 Oregon may apply to a court of competent jurisdiction for relief, in addition to any other remedies the State may have hereunder.

14. 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.

15. Arbitration.

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

16. 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.

17. 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.

18. 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.

18.5. Section 18.5 of the Attorneys General Settlement is incorporated herein by reference.

18.6. Section 18.6 of the Attorneys General Settlement is incorporated herein by reference.

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 OREGON

By /s/ Bennett S. LeBow

By /s/ Hardy Myers

Bennett S. LeBow

Hardy Myers
Attorney General

Date: 6/10/97

Date: 6/9/97

LIGGETT GROUP, INC.

By /s/ Bennett S. LeBow

Bennett S. LeBow

Date: 6/10/97

AMENDMENT TO STANDSTILL AGREEMENT AND CONSENT

This Amendment to Standstill Agreement and Consent, dated as of November 13, 1997 ("Amendment"), among BGLS INC., a Delaware corporation (the "Company"), AIF II, L.P., a Delaware limited partnership ("AIF II"), ARTEMIS AMERICA PARTNERSHIP, a Delaware partnership (as successor to Artemis America LLC, a Delaware limited liability company) ("Artemis") and TORTOISE CORP., a New York corporation ("Tortoise"; together with AIF II and Artemis, the "Participating Holders") amends the Standstill Agreement and Consent among the Company and the Participating Holders dated as of August 28, 1997 (the "Standstill Agreement"). Capitalized terms not otherwise defined herein shall have the meanings specified in the Standstill Agreement.

WHEREAS, the Company has requested that the Participating Holders extend the termination date of the Standstill Agreement; and

WHEREAS, the Participating Holders have agreed to such an extension on the terms and conditions contained in this Agreement;

NOW, THEREFORE, in consideration of the premises and the mutual covenants and agreement of the parties contained in this Amendment, the parties hereto agree as follows:

1. AMENDMENT TO SECTION 7. Section 7 of the Standstill Agreement is hereby amended by deleting the date "November 30, 1997" contained in clause (iv) of such section and replacing it with the date "December 10, 1997".

2. CONDITIONS PRECEDENT TO EFFECTIVENESS OF THIS AMENDMENT. This Amendment shall become effective upon the execution and delivery of this Amendment by the Company and each of the Participating Holders.

3. ABSENCE OF WAIVER. The parties hereto agree that, except to the extent expressly set forth herein, nothing contained herein shall be deemed to:

(a) be a consent to, or waiver of, any Default or Event of Default;

(b) prejudice any right or remedy which any of the Participating Holders may now have or may in the future have under the Indenture, the Series B Securities or otherwise, including, without limitation, any right or remedy resulting from any Default or Event of Default; or

(c) constitute a waiver of the rights of any of the Participating Holders under Section 2.12 of the Indenture.

4. REPRESENTATIONS. Each party hereto hereby represents and warrants to the other parties that:

(a) such party is a corporation or partnership, as applicable, duly organized, validly existing, and in good standing under the laws of the state of its incorporation or formation, as applicable;

(b) the execution, delivery and performance of this Amendment by such party is within its corporate or partnership powers, as applicable, has been duly authorized by all necessary corporate or partnership action, as applicable, has received all necessary consents and approvals (if any shall be required), and does not and will not contravene or conflict with any provisions of law or of the charter or by-laws, or partnership agreement, as applicable, of such party or of any material agreement binding upon such party or its property; and

(c) upon its effectiveness under Section 2, this Amendment constitutes the legal, valid and binding obligation of such party, enforceable against it in accordance with its terms.

In addition, the Company represents and warrants that the best of its knowledge, except as set forth in the Standstill Agreement no Default or Event of Default under the Indenture has occurred and is continuing.

5. CONTINUING EFFECT, ETC. Except as expressly provided herein, the Company hereby agrees that the Standstill Agreement, the Indenture and the Series B Securities shall continue unchanged and in full force and effect, and all rights, powers and remedies of the Participating Holders thereunder and under applicable law are hereby expressly reserved.

6. EXPENSES.

(a) The Company hereby agrees to reimburse each of the Participating Holders for their reasonable attorneys fees and expenses incurred in connection with this Amendment.

(b) The Company agrees that an actual or threatened or potential claim, action or proceeding against or affecting an Indemnitee (as defined in the Exchange Agreement dated as of November 21, 1995 among INTER ALIA the Company and the Participating Holders) that at any time results from, relates to or arises out of the execution, delivery or performance by the Participating Holders of this Amendment is deemed to be an Indemnification Event (as defined in the Exchange Agreement).

7. MISCELLANEOUS.

(a) This Amendment may be executed in any number of counterparts and by the different parties on separate counterparts and each such counterpart shall be deemed to be an original, but all such counterparts shall together constitute but one and the same agreement.

(b) This Amendment shall be a contract made under the governed by the laws of the State of New York.

(c) This Amendment shall be binding upon the Company, the Participating Holders and their respective successors and assigns, and shall inure to the benefit of the Company, the Participating Holders and their respective successors and assigns.

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be executed by their duly authorized representatives as of the date first above written.

BGLS INC.

By: /s/ RICHARD J. LAMPEN

Name: Richard J. Lampen
Title: Executive Vice President

AIF II, L.P.

By: APOLLO ADVISORS, L.P.
Managing General Partner

By: APOLLO CAPITAL MANAGEMENT, INC.
General Partner

By: /s/ JOHN J. HANNAN

Name: John J. Hannan
Title:

ARTEMIS AMERICA PARTNERSHIP

By: LION ADVISORS, L.P.
Attorney-in-Fact

By: LION CAPITAL MANAGEMENT, INC.
General Partner

By: /s/ JOHN J. HANNAN

Name: John J. Hannan
Title:

TORTOISE CORP.

By: /s/ EDWARD E. MATTNER

Name: Edward E. Mattner
Title: President

ACKNOWLEDGED, AGREED & CONSENTED TO
WITH RESPECT TO SECTION 6(b):

BROOKE GROUP LTD.

By: /s/ RICHARD J. LAMPEN

Name: Richard J. Lampen
Title: Executive Vice President

5
0000059440
BROOKE GROUP LTD
1,000
DOLLARS

9-MOS
DEC-31-1997
JAN-01-1997
SEP-30-1997
1
2,361
0
13,317
1,044
41,360
71,888
68,957
32,237
121,888
151,391
370,393
0
0
1,850
121,888 (464,961)
276,906
276,906
145,841
145,841
21,488
0
46,757
(22,936)
541
(23,477)
157
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(23,477)
(1.28)
(1.28)

5
0000927388
BGLS INC.
1,000
DOLLARS

9-MOS
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JAN-01-1997
SEP-30-1997
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126,019
174,510
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0
488,299
126,019
276,906
276,906
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(24,912)
539
(25,451)
153
0
0
(25,298)
0
0

LIGGETT GROUP INC.
CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 1997

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

LIGGETT GROUP INC.

CONSOLIDATED BALANCE SHEETS
(Unaudited)

(Dollars in thousands, except per share amounts)

	September 30, 1997 ----	December 31, 1996 ----
ASSETS		
Current assets:		
Accounts receivable:		
Trade, less allowances of \$1,044 and \$1,280, respectively	\$11,001	\$19,316
Other	788	744
Inventories	37,793	50,122
Other current assets	996	1,205
Total current assets	----- 50,578	----- 71,387
Property, plant and equipment, at cost, less accumulated depreciation of \$28,852 and \$29,511, respectively	17,288	18,705
Intangible assets, at cost, less accumulated amortization of \$18,679 and \$17,388, respectively	2,040	3,327
Other assets and deferred charges, at cost, less accumulated amortization of \$8,620 and \$7,410, respectively	3,292	4,258
Total assets	----- \$73,198 =====	----- \$97,677 =====

(continued)

LIGGETT GROUP INC.

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

	September 30, 1997 ----	December 31, 1996 ----
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Current liabilities:		
Current maturities of long-term debt	\$37,391	\$ 31,807
Cash overdraft	1,422	6
Accounts payable:		
Trade	5,893	14,979
Affiliates	2,482	216
Accrued expenses:		
Promotional	31,372	33,666
Compensation and related items	874	682
Taxes, principally excise taxes	1,688	7,565
Estimated allowance for sales returns	5,000	5,000
Interest	3,240	8,435
Other	8,508	9,380
	-----	-----
Total current liabilities	97,870	111,736
Long-term debt, less current maturities	138,542	144,698
Non-current employee benefits and other liabilities	16,797	17,721
Commitments and contingencies (Notes 5 and 8)		
Stockholder's equity (deficit):		
Redeemable preferred stock (par value \$1.00 per share; authorized 1,000 shares; no shares issued and out- standing)		
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	(227,651)	(226,318)
	-----	-----
Total stockholder's deficit	(180,011)	(176,478)
	-----	-----
Total liabilities and stockholder's equity (deficit)	\$73,198	\$ 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 September 30,		Nine Months Ended September 30,	
	1997	1996	1997	1996
Net sales*	\$ 79,368	\$ 101,125	\$ 223,811	\$ 292,899
Cost of sales*	35,971	45,614	102,444	134,439
Gross profit	43,397	55,511	121,367	158,460
Selling, general and administrative expenses...	38,721	51,709	110,061	148,357
Restructuring	95	425	1,926	1,180
Operating income	4,581	3,377	9,380	8,923
Other income (expense):				
Interest income	--	23	60	23
Interest expense	(5,950)	(5,982)	(17,920)	(17,831)
Equity in income (loss) of affiliate	321	(740)	506	(740)
Sale of assets	(302)	--	3,692	3,698
Retirement of debt	--	--	2,963	--
Miscellaneous, net	(1)	--	(14)	--
Net loss before income taxes	(1,351)	(3,322)	(1,333)	(5,927)
Income tax provision	--	3,800	--	3,800
Net loss	<u>\$ (1,351)</u>	<u>\$ (7,122)</u>	<u>\$ (1,333)</u>	<u>\$ (9,727)</u>

*Net sales and cost of sales include federal excise taxes of \$19,250, \$26,074, \$55,263, and \$76,758, 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	--	(1,333)	(1,333)
Consideration for option to acquire affiliate stock in excess of its net assets (Note 10)	(2,200)	--	(2,200)
Balance at September 30, 1997	\$47,640 =====	\$(227,651) =====	\$(180,011) =====

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

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

	Nine Months Ended September 30,	
	1997	1996
Cash flows from operating activities:		
Net loss	\$ (1,333)	\$ (9,727)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	5,180	6,071
Deferred income taxes		3,800
Gain on sale of property, plant and equipment	(3,692)	(3,698)
Gain on retirement of notes	(2,963)	--
Deferred finance charges and debt discount written off	130	--
Equity in income of affiliate	(506)	740
Changes in assets and liabilities:		
Accounts receivable	8,271	5,537
Inventories	12,329	3,977
Accounts payable	(6,864)	(261)
Accrued expenses	(13,526)	(6,141)
Non-current employee benefits	(434)	(246)
Other, net	(1,336)	(914)
Net cash used in operating activities	(4,744)	(862)
Cash flows from investing activities:		
Proceeds from sale of property, plant and equipment	4,589	4,415
Capital expenditures	(1,282)	(2,983)
Purchase of an option in affiliate	(2,200)	(5,500)
Net cash provided by (used in) investing activities	1,107	(4,068)
Cash flows from financing activities:		
Repayments of long-term debt	(4,721)	(191)
Borrowings under revolving credit facility	209,822	264,473
Repayments under revolving credit facility	(202,880)	(254,963)
Deferred finance charges	--	(18)
Increase (decrease) in cash overdraft	1,416	(3,761)
Net cash provided by financing activities	3,637	5,540
Net increase in cash and cash equivalents	0	610
Cash and cash equivalents:		
Beginning of period	0	0
End of period	\$ 0	\$ 610
Supplemental cash flow information:		
Cash payments during the period for:		
Interest	\$ 22,616	\$ 22,400
Income taxes	\$ 118	\$ 129

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 10.)

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 \$180,011 as of September 30, 1997, is highly leveraged and has substantial near-term debt service requirements. (See Note 7). Due to the many risks and uncertainties associated with the cigarette industry and the impact of tobacco litigation (see Note 8), there can be no assurance that the Company will be able to meet its future earnings or cash flow goals. Consequently, the Company could be in violation of certain debt covenants, and if its lenders were to exercise acceleration rights under its revolving credit facility (the "Facility") or the indenture for its Senior Secured Notes (the "Liggett Notes") or refuse to lend under the Facility, the Company would not be able to satisfy such demands or its working capital requirements.

As of September 30, 1997, the current maturities of the Liggett Notes of \$37,391 (net of unamortized discount) contribute substantially to the working capital deficit of approximately \$47,292. 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. In November 1997, the Facility was extended for an additional year until March 8, 1999.

While the Company has engaged in negotiations with its note holders to restructure the terms of the Liggett Notes, there are no commitments to restructure the Liggett Notes, 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. During such negotiations, the Company postponed making the interest payment of approximately \$9,700 due on August 1, 1997 on the Liggett Notes. On August 29, 1997, the Facility was amended to permit the Company to borrow an additional \$6,000 which was used on that date in making the interest payment of \$9,700 due on August 1, 1997 to the Liggett note holders. BGLS guaranteed the additional \$6,000 advance under the Facility and collateralized the guarantee with \$6,000 in cash, deposited with Liggett's lenders.

If the Company is unable to restructure the terms of the Liggett Notes, or otherwise make all payments thereon, substantially all of its long-term debt and the Facility would be in default and holders of such debt could accelerate the maturity of such debt. In such event, the Company may be forced to seek protection from creditors under applicable laws. These matters raise substantial doubt about the Company

meeting its liquidity needs and its ability to continue as a going concern. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

2. Estimates and Assumptions

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

3. Per Share Data

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

4. Sale of Assets

On April 29, 1996, Liggett executed a definitive agreement (as amended) with Blue Devil Ventures, a North Carolina limited liability partnership, for the sale by Liggett to Blue Devil Ventures of certain surplus realty in Durham, North Carolina, for a sale price of \$2,200. The net book value of those assets (\$309) for which the agreement was signed was classified as current assets on the Company's Consolidated Balance Sheet as of December 31, 1996. The transaction closed on March 11, 1997. A gain of \$1,147 was recognized, net of costs required to prepare the properties for sale and selling costs. (See Note 10 for sales to affiliates.)

5. Inventories

Inventories consist of the following:

	September 30, 1997 -----	December 31, 1996 -----
Finished goods	\$ 13,103	\$ 15,304
Work-in-process	3,951	4,382
Raw materials	23,543	31,338
Replacement parts and supplies	3,605	3,554
	-----	-----
Inventories at current cost	44,202	54,578
LIFO adjustment	(6,409)	(4,456)
	-----	-----
Inventories at LIFO cost	\$ 37,793	\$ 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 \$12,207 at September 30, 1997.

6. Property, Plant and Equipment

Property, plant and equipment consists of the following:

	September 30, 1997 ----	December 31, 1996 ----
Land and improvements	\$ 455	\$ 455
Buildings	6,150	5,848
Machinery and equipment	39,535	41,913
	-----	-----
Property, plant and equipment	46,140	48,216
Less accumulated depreciation	(28,852)	(29,511)
	-----	-----
Property, plant and equipment, net	\$ 17,288 =====	\$ 18,705 =====

7. Long-Term Debt

Long-term debt consists of the following:

	September 30, 1997 ----	December 31, 1996 ----
11.5% Senior Secured Notes due February 1, 1999, net of unamortized discount of \$254 and \$424, respectively	\$ 112,358	\$ 119,688
Variable Rate Series C Senior Secured Notes due February 1, 1999	32,279	32,279
Borrowings outstanding under revolving credit facility	31,214	24,272
Other	82	266
	-----	-----
	175,933	176,505
Current portion	(37,500)	(31,807)
Unamortized discount, current portion	109	0
	-----	-----
Amount due after one year	\$ 138,542 =====	\$ 144,698 =====

Senior Secured Notes

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

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

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

Revolving Credit Facility

On March 8, 1994, Liggett entered into the Facility under which it can borrow up to \$40,000 (depending on the amount of eligible inventory and receivables as determined by the lenders) from a syndicate of commercial lenders. Availability under the Facility was approximately \$2,809 based upon eligible collateral at September 30, 1997. The Facility is collateralized by all inventories and receivables of the Company. Borrowings under the Facility are charged interest calculated at a rate equal to 1.5% above Philadelphia National Bank's (the indirect parent of Congress Financial Corporation, the lead lender) prime rate. Liggett's interest rate is currently 10.0%. The Facility contains certain financial covenants similar to those contained in the Liggett Notes indenture, including restrictions on Liggett's ability to declare or pay cash dividends, incur additional debt, grant liens and enter into any new agreements with affiliates, among others. In addition, the Facility 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, this computation is currently \$173,602) and working capital (not to fall below a deficit of \$12,000 as computed in accordance with the agreement, this computation is currently \$3,492). The Company is currently in compliance with these covenants.

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

The Company has engaged in negotiations with a committee composed of a majority of its note holders to restructure the terms of the Liggett Notes. During such negotiations, the Company postponed making the interest payment of approximately \$9,700 due on August 1, 1997 on the Liggett Notes. On August 29, 1997, the Facility was amended to permit the Company to borrow an additional \$6,000 which was used on that date in making the interest payment of \$9,700 due on August 1, 1997 to the Liggett note holders. BGLS guaranteed the additional \$6,000 advance under the Facility and collateralized the guarantee with \$6,000 in cash, deposited with Liggett's lenders. In November 1997, the Facility was extended until March 8, 1999. The balance on the Facility, \$31,214, was reclassified from current to long-term debt as of September 30, 1997. For information concerning Liggett's substantial near-term debt service requirements and other related matters, see Note 1.

8. Contingencies

Tobacco-Related Litigation

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

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

INDIVIDUAL ACTIONS. As of September 30, 1997, there were 218 cases pending against Liggett, and in most cases the other tobacco companies, where individual plaintiffs allege injury resulting from cigarette smoking, addiction to cigarette smoking or exposure to ETS and seek compensatory and, in some cases, punitive damages. Of these, 103 are pending in the State of Florida, 62 are pending in the State of New York and 19 are pending in the State of Texas. The balance of individual cases are pending in 15 states. Of the 218 individual cases, there are five cases pending where Liggett is the only named defendant.

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

On 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 October 6, 1997, the parties settled this matter.

CLASS ACTIONS. As of September 30, 1997, there were 39 actions pending, for which either a class has been certified or plaintiffs are seeking class certification, where Liggett, among others, was a named defendant. Two of these cases, Fletcher, et al. v. Brooke Group Ltd., et al. and Walker, et al. v. Liggett Group Inc., et al. have been settled, subject to court approval. These two settlements are more fully discussed below under the "Settlements" section.

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 has been brought by plaintiffs on behalf of all flight attendants that have worked or are presently working for airlines based in the United States and who have never regularly smoked cigarettes but allege that they have been damaged by involuntary exposure to ETS. On October 10, 1997, the other major tobacco companies settled this matter, subject to a fairness hearing, which settlement would provide for a full release on behalf of Liggett and BGL.

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. On February 17, 1995, the District Court granted plaintiffs' motion for class certification. 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.

ATTORNEYS GENERAL ACTIONS. As of September 30, 1997, 38 state Attorneys General actions were filed and served on Liggett and BGL. As more fully discussed below, Liggett has reached settlements in 26 of these actions. As of September 30, 1997, there were 18 additional third-party payor actions pending. In certain of the pending proceedings, state and local government entities and others seek reimbursement for Medicaid and other health care expenditures allegedly caused by use of tobacco products. The claims asserted in these health care cost recovery actions vary. In most of these cases, plaintiffs assert the equitable claim that the tobacco industry was "unjustly enriched" by plaintiffs' payment of health care costs allegedly attributable to smoking and seek reimbursement of those costs. Other claims made by some but not all plaintiffs include the equitable claim of indemnity, common law claims of negligence, strict liability, breach of express and implied warranty, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under state and federal statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under RICO.

SETTLEMENTS. On March 12, 1996, Liggett and BGL entered into an agreement, subject to court approval, to settle the Castano class action tobacco litigation. Under the Castano settlement agreement, upon final court approval of the settlement, the Castano class would be entitled to receive up to five percent of Liggett's pretax income (income before income taxes) each year (up to a maximum of \$50,000 per year) for the next 25 years, subject to certain reductions provided for in the agreement. Liggett and BGL have the right to terminate the Castano settlement under certain circumstances. On March 14, 1996, BGL, the Castano Plaintiffs legal Committee and the Castano plaintiffs entered into a letter agreement. According to the terms of the letter agreement, for the period ending nine months from the date of Final Approval (as defined in the letter), if granted, of the Castano settlement or, if earlier, the completion by Liggett or BGL of a combination with any defendant in Castano, except Philip Morris, the Castano plaintiffs and their counsel agree not to enter into any more favorable settlement agreement with

any Castano defendant which would reduce the terms of the Castano settlement agreement. If the Castano plaintiffs or their counsel enter into any such settlement during this period, they shall pay BGL \$250,000 within 30 days of the more favorable agreement and offer Liggett and BGL the option to enter into a settlement on terms at least as favorable as those included in such other settlement. The letter agreement further provides that during the same time period, and if the Castano settlement agreement has not been earlier terminated by BGL in accordance with its terms, BGL and its affiliates will not enter into any business transaction with any third party which would cause the termination of the Castano settlement agreement. If BGL or its affiliates enter into any such transaction, then the Castano plaintiffs will be entitled to receive \$250,000 within 30 days from the transacting party. 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 September 6, 1996, shortly after the class was decertified, the Castano plaintiffs withdrew the motion for approval of the Castano settlement.

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 "March 1996 Settlement"). The March 1996 Settlement releases Liggett and BGL from all tobacco-related claims including claims for health care cost reimbursement and claims concerning sales of cigarettes to minors. The March 1996 Settlement provides that additional states which commence similar 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 March 1996 Settlement are summarized below.

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

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

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

On March 20, 1997, Liggett, together with BGL, entered into a comprehensive settlement of tobacco litigation through parallel agreements with the Attorneys General of 17 additional states (the "March 1997 Settlement") and with a nationwide class of individuals and entities that allege smoking-related claims. The settlements cover all smoking-related claims, including both addiction-based and

tobacco injury claims against Liggett and BGL, brought by the Attorneys General and, upon court approval, the nationwide class.

As of September 30, 1997, settlements with a total of 26 Attorneys General were reached, including the Attorneys General of Alaska, Arizona, California, Connecticut, Hawaii, Illinois, Indiana, Iowa, Kansas, Maryland, Michigan, Minnesota, Nevada, New Jersey, New York, Oklahoma, Oregon, Texas, Utah, Washington and Wisconsin. The March 1996 Settlement remains in full force and effect. Other states have either recently filed health care cost recovery actions or indicated intentions to do so. Both Liggett and BGL will endeavor to resolve those actions on substantially the same terms and conditions as the March 1997 Settlement; however, there can be no assurance that any such settlements will be completed.

As mentioned above, on March 20, 1997, Liggett, BGL and plaintiffs filed the mandatory class settlement agreement in an action entitled Fletcher, et al. v. Brooke Group Ltd., et al., Circuit Court of Mobile County, Alabama, where the court granted preliminary approval and preliminary certification of the class, and on May 15, 1997 a similar mandatory class settlement agreement was filed in an action entitled Walker, et al. v. Liggett Group Inc., et al., United States District Court, Southern District of West Virginia. The Walker court also granted preliminary approval and preliminary certification of the nationwide class; however, on August 5, 1997, the court vacated its preliminary certification of the settlement class, which decision is currently on appeal.

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

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

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

Under the recent settlement agreements, any other tobacco company defendant, except Philip Morris, merging or combining with Liggett or BGL, prior to the fourth anniversary of the settlements, would receive certain settlement benefits, including limitations on potential liability for affiliates not

engaged in domestic tobacco operations and a waiver of any obligation to post a bond to appeal any future adverse judgment. In addition, within 120 days following any such combination, Liggett would be required to pay the settlement fund \$25,000. The settling Attorneys General and the nationwide class have agreed not to seek an injunction preventing a defendant tobacco company combining with Liggett or BGL from spinning off any affiliate which is not engaged in the domestic tobacco business.

Liggett and BGL are also entitled to most favored nation treatment in the event any settling Attorney General reaches a settlement with any other defendant tobacco company. In addition, in the event of a "global" tobacco settlement enacted through Federal legislation or otherwise, the settling Attorneys General and tobacco plaintiffs agreed to use their "best efforts" to ensure that Liggett's and BGL's liability under such a plan should be no more onerous than under these new settlements.

IMMINENT TRIALS. Although trial schedules are subject to change, the next case scheduled for trial, where Liggett is a defendant, is State of Minnesota by Hubert H. Humphrey, III, its Attorney General and Blue Cross and Blue Shield of Minnesota v. Philip Morris Incorporated, et al., District Court of the Second Judicial District, Ramsey County, Minnesota, which is scheduled for trial in January, 1998. Liggett settled the claims of the State of Minnesota on March 20, 1997, but still remains a defendant in the case with respect to the State's co-plaintiff, Blue Cross and Blue Shield of Minnesota. In addition, there is one class action, Engle, et al. v. R.J. Reynolds Tobacco Company, et al., Circuit Court, 11th Judicial Circuit, Dade County, Florida and one individual ETS case, Dunn and Wiley v. RJR Nabisco Holdings Corp., et al., Superior Court, Delaware County, Indiana, scheduled for trial in February 1998.

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

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

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

In March 1996, March 1997, July 1997 and October 1997 Liggett and/or BGL received subpoenas from a Federal grand jury in connection with an investigation by the United States Department of Justice, relating to issues raised in testimony provided by tobacco industry executives before Congress and other related matters. Liggett has responded to the March 1996 and March 1997 subpoenas and is in the process of responding to the July and October 1997 subpoenas. Liggett and BGL are unable, at this time, to predict the outcome of this investigation.

Liggett has been involved in certain environmental proceedings, none of which, either individually or in the aggregate, rise to the level of materiality. Liggett's current operations are conducted in material compliance with all environmental laws and regulations. Management is unaware of any material environmental conditions affecting its existing facilities. Compliance with federal, state and local provisions regulating the discharge of materials into the environment, or otherwise relating to the

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

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

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

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

Legislation and Regulation

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

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

On September 13, 1995, the President of the United States issued Presidential Proclamation 6821, which established a tariff rate quota ("TRQ") on certain imported tobacco, imposing extremely high tariffs on imports of flue-cured and burley tobacco in excess of certain specified levels, which levels vary by country. Management believes that the TRQ levels are sufficiently high to allow Liggett to operate without material disruption to its business. On February 20, 1996, the United States Trade representative issued an "advance notice of rule making" concerning how tobaccos imported under the TRQ should be allocated. Currently, tobacco imported under the TRQ is allocated on a "first-come, first-served" basis, meaning that entry is allowed on an open basis to those first requesting entry in the quota year. Others in the cigarette industry have suggested an "end-user licensing" system under which the right to import tobacco under the quota would be initially assigned on the basis of domestic market share. Such an approach, if adopted, could have a material adverse effect on Liggett.

In April 1994, the United States Occupational Safety and Health Administration ("OSHA") issued a proposed rule that could ultimately ban smoking in the workplace. Hearings were completed during

1995. OSHA has not yet issued a final rule or a proposed revised rule. While Liggett cannot predict the outcome, some form of federal regulation of smoking in workplaces may result.

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

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

In a speech on September 17, 1997, President Clinton called for federal legislation that, among other things, would raise cigarette prices by up to \$1.50 per pack. In November 1997, several bills were introduced in the Senate that purport to propose legislation along these lines. Management is unable to predict the ultimate content of any such legislation; however, adoption of any such legislation could have a material adverse effect on the business of Liggett and BGL.

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

9. Income Taxes

During the quarter ended September 30, 1996, Liggett increased its valuation allowance for its deferred tax assets by \$3,800 based on its current determination that it is more likely than not that such future tax benefits may not be realized.

10. 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 produces and markets cigarettes in Russia. 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%. On March 13, 1997, Liggett acquired a second ten-year option to purchase BOL's remaining shares in Liggett-Ducat (an additional 33%) for \$2,200 of which \$2,049 was paid in cash. Liggett accounted for its investment in Liggett-Ducat under the equity method of accounting. Liggett's equity in the net income of Liggett-Ducat amounted to \$506 for the nine months ended September 30, 1997. The excess of the cost of the option over carrying amount of net assets to be acquired under the option has been charged to stockholder's deficit.

On April 28, 1997, BOL purchased excess production equipment from Liggett for \$3,000, for a gain of \$2,578.

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 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, \$790, \$2,489 and \$2,370 for the three and nine months ended September 30, 1997 and 1996, respectively. Since April 1994, the Company has leased equipment from BGLS for \$50 per month.

11. Restructuring Charges

In the first nine months of 1997, the Company reduced its headcount by 123 full-time positions and recorded a \$1,926 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)

	September 30, 1997 ----	December 31, 1996 ----
ASSETS		
Cash	\$ 6	\$ --
Office equipment	1	2
Trademarks, at cost, less accumulated amortization of \$18,569 and \$17,294, respectively	1,844 -----	3,119 -----
Total assets	\$ 1,851 =====	\$ 3,121 =====
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Federal income taxes currently payable to parent	\$ 59	\$ --
Dividends payable	1,178	4,623
Cash overdraft	--	92
Other current liabilities	--	19
Deferred income taxes	645 -----	1,092 -----
Total liabilities	1,882 -----	5,826 -----
Stockholder's equity (deficit):		
Common stock (par value \$1.00 per share; authorized, issued and outstanding 100 shares) and contributed capital	50,448	46,548
Receivables from parent:		
Note receivable - interest at 14%, due no sooner than February 1, 1999	(44,520)	(44,520)
Other	(5,959) -----	(4,733) -----
Total stockholder's equity (deficit)	(31) -----	(2,705) -----
Total liabilities and stockholder's equity (deficit) ..	\$ 1,851 =====	\$ 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 September 30,		Nine Months Ended September 30,	
	1997	1996	1997	1996
Revenues:				
Royalties - parent	\$1,830	\$2,233	\$ 5,137	\$ 6,383
Interest - parent	1,576	1,576	4,729	4,729
	-----	-----	-----	-----
	3,406	3,809	9,866	11,112
Expenses:				
Amortization of trademarks	425	425	1,276	1,275
Miscellaneous, net	18	227	82	286
	-----	-----	-----	-----
Income before income taxes	2,963	3,157	8,508	9,551
Income tax provision	486	1,105	1,323	3,343
	-----	-----	-----	-----
Net income	\$2,477	\$2,052	\$ 7,185	\$ 6,208
	=====	=====	=====	=====

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

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

	Nine Months Ended September 30,	
	1997	1996
	-----	-----
Cash flows from operating activities:		
Net income	\$ 7,185	\$ 6,208
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,276	1,275
Deferred income taxes	(447)	(446)
Changes in assets and liabilities:		
Federal income taxes currently payable to parent	59	(160)
Other current liabilities	(19)	200
	-----	-----
Net cash provided by operating activities	8,054	7,077
	-----	-----
Cash flows from financing activities:		
Dividends/capital distributions	(6,730)	(7,521)
Decrease (increase) in due from parent	(1,226)	442
Decrease in cash overdraft	(92)	--
	-----	-----
Net cash used in financing activities	(8,048)	(7,079)
	-----	-----
Net increase in cash	6	(2)
Cash:		
Beginning of period	--	8
	-----	-----
End of period	\$ 6	\$ 6
	=====	=====
Supplemental cash flow information:		
Payments of income taxes through receivable from parent	\$ 1,710	\$ 3,949
Income taxes	32	--
Dividends/capital distributions declared but not paid	1,178	2,052

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 \$47,292 and a net capital deficiency of \$180,011 as of September 30, 1997, is highly leveraged and has substantial near-term debt service requirements. These matters raise substantial doubt about Eve and Liggett meeting their liquidity needs and their ability to continue as going concerns.

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

b. Per Share Data

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

3. Guarantee of Liggett Notes

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

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

4. Income Taxes

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

NEW VALLEY CORPORATION
CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 1997

NEW VALLEY CORPORATION AND SUBSIDIARIES
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 1997

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

	September 30, 1997	December 31, 1996
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$ 16,707	\$ 57,282
Investment securities available for sale.....	65,407	61,454
Trading securities owned.....	51,920	29,761
Restricted assets.....	1,029	2,080
Receivable from clearing brokers.....	1,628	23,870
Other current assets.....	3,774	9,273
Total current assets.....	140,465	183,720
Investment in real estate.....	261,597	179,571
Investment securities available for sale.....	2,074	2,716
Restricted assets.....	5,566	6,766
Long-term investments, net.....	19,921	13,270
Furniture and equipment, net.....	9,508	9,225
Other assets.....	27,702	11,272
Total assets.....	\$ 466,833	\$406,540
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable and accrued liabilities.....	\$ 59,018	\$ 44,888
Prepetition claims and restructuring accruals.....	15,723	15,526
Income taxes.....	18,329	18,243
Securities sold, not yet purchased.....	24,212	17,143
Note payable to related party.....	12,000	-
Current portion of notes payable and long-term obligations ...	2,311	2,310
Total current liabilities.....	131,593	98,110
Notes payable.....	177,631	157,941
Other long-term obligations.....	16,409	12,282
Redeemable preferred shares.....	245,740	210,571
Shareholders' equity (deficit):		
Cumulative preferred shares; liquidation preference of \$69,769; dividends in arrears, \$133,248 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.....	614,123	644,789
Accumulated deficit.....	(743,798)	(721,854)
Unearned compensation on stock options.....	(306)	(731)
Unrealized gain on investment securities.....	25,066	5,057
Total shareholders' equity (deficit).....	(104,540)	(72,364)
Total liabilities and shareholders' equity (deficit).....	\$ 466,833	\$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 September 30,		Nine Months Ended September 30,	
	1997	1996	1997	1996
Revenues:				
Principal transactions, net.....	\$ 6,131	\$ 3,926	\$ 11,857	\$ 18,836
Commissions.....	4,235	4,700	11,059	13,383
Real estate leasing.....	7,079	5,941	19,664	17,605
Interest and dividends.....	2,554	4,230	6,677	14,056
Other income.....	6,449	2,479	21,348	19,830
	-----	-----	-----	-----
Total revenues.....	26,448	21,276	70,605	83,710
	-----	-----	-----	-----
Cost and expenses:				
Operating, general and administrative.....	30,149	24,371	79,967	88,424
Interest.....	4,229	4,627	12,134	13,890
Provision for loss on long-term investment.....	--	--	3,796	--
	-----	-----	-----	-----
Total costs and expenses.....	34,378	28,998	95,897	102,314
	-----	-----	-----	-----
Loss from continuing operations before income taxes and minority interest.....	(7,930)	(7,722)	(25,292)	(18,604)
Income tax provision (benefit).....	24	(233)	119	67
Minority interests in loss from continuing operations of consolidated subsidiary.....	1,124	384	3,098	1,082
	-----	-----	-----	-----
Loss from continuing operations.....	(6,830)	(7,105)	(22,313)	(17,589)
Discontinued operations:				
Income (loss) from discontinued operations.....	--	(5,339)	583	(4,501)
Income (loss) on sale of discontinued operations.....	256	--	(214)	--
	-----	-----	-----	-----
Total discontinued operations.....	256	(5,339)	369	(4,501)
	-----	-----	-----	-----
Net loss.....	(6,574)	(12,444)	(21,944)	(22,090)
Dividend requirements on preferred shares.....	(17,567)	(15,400)	(50,297)	(46,508)
Excess of carrying value of redeemable preferred shares over cost of shares purchased.....	--	--	--	4,279
	-----	-----	-----	-----
Net loss applicable to Common Shares.....	\$ (24,141)	\$ (27,844)	\$ (72,241)	\$ (64,319)
	=====	=====	=====	=====
Loss per common share:				
Continuing operations.....	\$ (2.55)	\$ (2.35)	\$ (7.58)	\$ (6.25)
Discontinued operations.....	.03	(.56)	.04	(.47)
	-----	-----	-----	-----
Net loss per Common Share.....	\$ (2.52)	\$ (2.91)	\$ (7.54)	\$ (6.72)
	=====	=====	=====	=====
Number of shares used in computation.....	9,578	9,578	9,578	9,578
	=====	=====	=====	=====

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.....				(21,944)		
Undeclared dividends and accretion on redeemable preferred shares...			(32,996)			
Unrealized gain on investment securities.....						20,009
Public sale of subsidiary's common stock.....			2,715			
Adjustment to unearned compensation on stock options....			(385)		385	
Compensation expense on stock option grants.....					40	
	----	---	-----	-----	-----	-----
Balance, September 30, 1997.....	\$279	\$96	\$614,123	\$(743,798)	\$ (306)	\$ 25,066
	====	===	=====	=====	=====	=====

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)

	Nine Months Ended September 30,	
	1997	1996
Cash flows from operating activities:		
Net loss.....	\$ (21,944)	\$ (22,090)
Adjustments to reconcile net loss to net cash provided from (used for) operating activities:		
Loss (income) from discontinued operations.....	(369)	4,501
Depreciation and amortization.....	6,635	3,507
Provision for loss on long-term investment.....	3,796	--
Stock based compensation expense.....	2,213	--
Changes in assets and liabilities, net of effects from acquisitions:		
Increase in receivables and other assets.....	(8,291)	(5,963)
Decrease (increase) in income taxes.....	86	(3,029)
Increase in accounts payable and accrued liabilities.....	5,951	8,786
Net cash used for continuing operations.....	(11,923)	(14,288)
Net cash provided from (used for) discontinued operations.....	1,779	(2,659)
Net cash used for operating activities.....	(10,144)	(16,947)
Cash flows from investing activities:		
Sale or maturity of investment securities.....	37,697	70,319
Purchase of investment securities.....	(20,999)	(17,644)
Sale or liquidation of long-term investments.....	2,807	14,500
Purchase of long-term investments.....	(11,404)	(2,639)
Purchase or improvements of real estate.....	(6,208)	(24,882)
Sale of other assets.....	5,561	--
Payment of prepetition claims.....	(1,199)	(6,723)
Return of prepetition claims paid.....	1,396	--
Decrease in restricted assets.....	2,251	29,011
Payment for acquisitions, net of cash acquired.....	(20,014)	1,915
Net cash provided from (used for) investing activities.....	(10,112)	63,857
Cash flows from financing activities:		
Payment of preferred dividends.....	--	(41,419)
Purchase of Class A preferred stock.....	--	(10,530)
Increase in margin loans payable.....	--	744
Sale of subsidiary's common stock.....	5,417	--
Proceeds from notes payable.....	19,993	--
Repayment of notes payable to related party.....	(21,500)	--
Repayment of notes payable.....	(20,703)	--
Repayment of other obligations.....	(3,526)	(8,888)
Net cash used for financing activities.....	(20,319)	(60,093)
Net decrease in cash and cash equivalents.....	(40,575)	(13,183)
Cash and cash equivalents, beginning of period.....	57,282	51,742
Cash and cash equivalents, end of period.....	\$ 16,707	\$ 38,559

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 September 30, 1997 presented herein have been prepared by the Company without an audit. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the financial position as of September 30, 1997 and the results of operations and cash flows for all periods presented have been made. Results for the interim periods are not necessarily indicative of the results for an entire year.

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

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

NEW ACCOUNTING PRONOUNCEMENTS

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

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

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

2. ACQUISITION

On January 31, 1997, the Company entered into a stock purchase agreement (the "Purchase Agreement") with Brooke (Overseas) Ltd. ("Brooke (Overseas)"), a wholly-owned subsidiary of Brooke Group Ltd. ("Brooke"), a related party through the ownership of an approximate 42% voting interest in the Company. Pursuant to the Purchase Agreement, the Company acquired 10,483 shares (the "BML Shares") of the common stock of BrookeMil Ltd. ("BML") from Brooke (Overseas) for a purchase price of \$55,000, consisting of \$21,500 in cash and a \$33,500 9% promissory note of the Company (the "Note"). The BML Shares comprise 99.1% of the outstanding shares of BML, a real estate development company in Russia. The Note is collateralized by the BML Shares and, as of September 30, 1997, had a balance of \$12,000 which is payable on December 31, 1997. The note was subsequently reduced to a balance of \$8,500 as of November 13, 1997.

BML is developing a three-phase complex on 2.2 acres of land in downtown Moscow, for which it has a 49-year lease. In 1993, the first phase of the project, Ducat Place I, a 46,500 sq. ft. Class-A office building, was constructed and leased. On April 18, 1997, BML sold Ducat Place I to one of its tenants for approximately \$7,500, which purchase price has been reduced to reflect prepayments of rent. In 1997, BML completed construction of Ducat Place II, a 150,000 sq. ft. office building, which has been substantially pre-leased to a number of leading international companies. The third phase, Ducat Place III, is planned as a 400,000 sq. ft. mixed-use complex, with construction anticipated to commence in 1999. The Company is currently evaluating plans for financing the construction of Ducat Place III.

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

The purchase price was allocated as follows: current assets of approximately \$9,000, investment in real estate of \$79,200, other assets of \$8,800, assumption of current liabilities of \$35,146 and long-term liabilities of \$6,854. Current assets consisted primarily of an asset held for sale of \$6,400 related to the estimated proceeds from the sale of Ducat Place I, net of \$1,100 in accrued closing costs. Liabilities included a \$20,400 loan to a Russian bank for the construction of Ducat Place II ("Construction Loan"). 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 nine months ended September 30, 1997 and 1996 are not presented herein as the historical operating results of BML are not material to the historical operating results of the Company.

In August 1997, BML refinanced all amounts due under the Construction Loan with borrowings under a new credit facility with a Russian bank. The new credit facility bears interest at 16% per year, matures no later than August 2002, with principal payments commencing after the first year, and is collateralized by a mortgage on Ducat Place II and guaranteed by the Company. At September 30, 1997, borrowings under the new credit agreement totaled \$19,993.

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO QUARTERLY CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

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

	U.S. ----	BML ----	TOTAL -----
Land	\$ 36,162	\$ 20,773	\$ 56,935
Buildings.....	147,033	65,000	212,033
Construction-in-progress.....	29	--	29
	-----	-----	-----
Total.....	183,224	85,773	268,997
Less: accumulated depreciation.....	(6,994)	(406)	(7,400)
	-----	-----	-----
Net investment in real estate.....	\$176,230	\$ 85,367	\$261,597
	=====	=====	=====

On November 10, 1997, the Company sold one of its shopping centers located in Marathon, Florida for \$5,400 which resulted in a gain on sale of approximately \$1,200.

3. DISCONTINUED OPERATIONS

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

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

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	1997 ----	1996 ----	1997 ----	1996 ----
Revenues.....	\$ --	\$ 3,318	\$3,386	\$12,115
	=====	=====	=====	=====
Operating income (loss).....	\$ --	\$ (9,409)	\$ 950	\$ (8,044)
	=====	=====	=====	=====
Income (loss) before income taxes and minority interests..	\$ --	\$ (9,409)	\$ 950	\$ (8,044)
Minority interests.....	\$ --	4,070	(367)	3,543
	-----	-----	-----	-----
Net income (loss).....	\$ --	\$ (5,339)	\$ 583	\$ (4,501)
	=====	=====	=====	=====

In April 1997, Thinking Machines sold the remaining part of its discontinued operations for \$2,405 in cash and a percentage of certain future operating profits. The sale resulted in the Company recording a loss on disposal of discontinued operations of \$470, after the recognition of minority interests of \$592 and the write-off of goodwill of \$1,410. In July 1997, Thinking Machines received its first installment on the operating profits from the discontinued operations which the Company recorded as a gain on discontinued operations of \$256.

4. INCOME TAXES

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

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO QUARTERLY CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

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 \$1,466 and \$8,518 for the three and nine months ended September 30, 1997, respectively.

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

	COST ----	GROSS UNREALIZED GAIN ----	GROSS UNREALIZED LOSS ----	FAIR VALUE -----
Marketable equity securities:				
RJR Nabisco common stock.....	\$23,378	\$ 2,838		\$26,216
Other marketable equity securities.....	10,604	24,395	\$ 557	34,442
	-----	-----	-----	-----
Total marketable equity securities...	33,982	27,233	557	60,658
Marketable debt securities (short-term).....	4,749	--	--	4,749
Marketable debt securities (long-term).....	3,684	--	1,610	2,074
	-----	-----	-----	-----
Total securities available for sale.....	42,415	27,233	2,167	67,481
Less long-term portion of investment securities.....	3,684	--	1,610	2,074
	-----	-----	-----	-----
Investment securities - current portion.....	\$38,731	\$27,233	\$ 577	\$65,407
	=====	=====	=====	=====

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

In October 1997, the Company sold certain appreciated securities and recognized a gain of approximately \$11,000.

6. LONG-TERM INVESTMENTS

At September 30, 1997, long-term investments consisted primarily of investments in limited partnerships of \$18,719 and an equity investment in a company of \$1,000. The Company determined that an other than temporary impairment in the value of its investment in a joint venture had occurred and wrote-down this investment to zero in March 1997 with a charge to operations of \$3,796. The fair value of the Company's long-term investments approximates its carrying amount. The Company's estimates of the fair value of its long-term investments are subject to judgment and are not necessarily indicative of the amounts that could be realized in the current market.

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

NOTES TO QUARTERLY CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

The Company is required under certain limited partnership agreements to make additional investments up to an aggregate of \$13,000 as of September 30, 1997. The Company's investments in limited partnerships are illiquid and the ultimate realization of these investments are subject to the performance of the underlying partnership and its management by the general partners.

7. REDEEMABLE PREFERRED SHARES

At September 30, 1997, the Company had authorized and outstanding 2,000,000 and 1,071,462, respectively, of its Class A Senior Preferred Shares. At September 30, 1997 and December 31, 1996, respectively, the carrying value of such shares amounted to \$245,740 and \$210,571, including undeclared dividends of \$150,871 and \$117,117, or \$140.81 and \$109.31 per share. As of September 30, 1997, the unamortized discount on the Class A Senior Preferred Shares was \$5,057.

For the nine months ended September 30, 1997, the Company recorded \$2,173 in compensation expense related to certain Class A Senior Preferred Shares awarded to an officer of the Company in 1996. At September 30, 1997, the balance of the deferred compensation and the unamortized discount related to these award shares was \$4,302 and \$2,870, 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 \$133,248 and \$115,944 at September 30, 1997 and December 31, 1996, respectively. These undeclared dividends represent \$47.75 and \$41.55 per share as of the end of each period. No accrual was recorded for such undeclared dividends as the Class B Preferred Shares are not mandatorily redeemable.

9. PREPETITION CLAIMS UNDER CHAPTER 11 AND RESTRUCTURING ACCRUALS

Those liabilities that are expected to be resolved as part of the Company's First Amended Joint Chapter 11 Plan of Reorganization, as amended (the "Joint Plan"), are classified in the Consolidated Balance Sheets as prepetition claims and restructuring accruals. On January 18, 1995, approximately \$550 million of prepetition claims were paid pursuant to the Joint Plan. The prepetition claims remaining as of September 30, 1997 of \$15,723 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.

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO QUARTERLY CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

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.

Risks and Uncertainties

BML's real estate development and management operations in Russia could be affected by uncertainties in Russia which may include, among others, political or diplomatic developments, regional tensions, currency repatriation restrictions, foreign exchange fluctuations, inflation, and an undeveloped system of commercial laws and legislative reform relating to foreign ownership in Russia.

BROOKE (OVERSEAS) LTD. AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 1997

BROOKE (OVERSEAS) LTD. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

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

	September 30, 1997	December 31, 1996
	-----	-----
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 2,191	\$ 1,875
Accounts receivable - trade	538	166
Receivables from affiliates	12,178	
Inventories	3,567	3,569
Prepaid expenses and other	2,496	2,640
	-----	-----
Total current assets	20,970	8,250
Property, plant and equipment, at cost, less accumulated depreciation of \$751 and \$676	20,286	59,607
Goodwill, net	1,031	1,094
Deferred finance costs		2,805
Other	5	540
	-----	-----
Total assets	\$ 42,292	\$ 72,296
	=====	=====
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Current liabilities:		
Notes payable and current portion of long-term debt	\$ 1,000	\$ 21,658
Cash overdrafts	973	
Accounts payable - trade	2,948	13,074
Due to affiliates	56,851	48,875
Unearned revenue	158	7,406
Accrued taxes	7,812	8,474
Taxes due to affiliate	11,741	
Accrued interest		597
Other accrued liabilities	3,190	2,692
	-----	-----
Total current liabilities	83,673	102,776
Deferred gain	2,253	1,494
Unearned revenue		9,458
Other liabilities	25,498	
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	(76,433)	(45,533)
	-----	-----
Total stockholder's equity (deficit)	(70,132)	(41,432)
	-----	-----
Total liabilities and stockholder's equity (deficit)	\$ 42,292	\$ 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		Nine Months Ended	
	Sept. 30, 1997	Sept. 30, 1996	Sept. 30, 1997	Sept. 30, 1996
Net sales.....	\$ 20,940	\$ 13,509	\$ 53,095	\$ 35,006
Cost of sales.....	17,224	12,897	43,847	33,070
Gross profit.....	3,716	612	9,248	1,936
Operating, selling, administrative and general expenses.....	2,318	3,211	6,236	8,213
Operating income (loss).....	1,398	(2,599)	3,012	(6,277)
Other income (expense):				
Interest income.....	273	2	1,424	
Interest expense.....	(2,366)	(1,859)	(6,890)	(5,806)
Gain on sale of stock.....			27,055	
Gain on foreign currency exchange.....	60	357	370	917
Other, net.....	(21)	(74)	(121)	(764)
(Loss) income before income taxes.....	(656)	(4,173)	24,850	(11,930)
(Benefit) provision for income taxes.....	(248)	1,145	12,279	1,343
Net income (loss).....	\$ (408)	\$ (5,318)	\$12,571	\$(13,273)
	=====	=====	=====	=====

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				12,571	12,571
Distributions to parent				(43,471)	(43,471)
Capital contribution	-----	-----	2,200	-----	2,200
Balance, September 30, 1997	701,000	\$ 701	\$5,600	\$(76,433)	\$(70,132)
	=====	=====	=====	=====	=====

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)

	----- Nine Months Ended -----	
	September 30, 1997	September 30, 1996
	-----	-----
Net cash provided by operating activities.....	\$ 10,841	\$ 4,506
	-----	-----
Cash flows from investing activities:		
Capital expenditures.....	(11,574)	(21,002)
Proceeds from sale of BML, net.....	41,502	
Proceeds from sale of stock in Liggett-Ducat, net.....		1,600
Proceeds from sale of option to purchase stock in Liggett-Ducat.....	2,200	3,400
	-----	-----
Net cash provided by (used in) investing activities.....	32,128	(16,002)
	-----	-----
Cash flows from financing activities:		
Proceeds from debt.....	4,723	12,442
Repayments of debt.....	(3,905)	(1,375)
Borrowings under credit facility.....		644
Repayments on credit facility.....		(800)
Distributions paid to parent.....	(43,471)	
	-----	-----
Net cash (used in) provided by financing activities.....	(42,653)	10,911
	-----	-----
Net increase (decrease) in cash and cash equivalents.....	316	(585)
Cash and cash equivalents, beginning of period.....	1,875	1,660
	-----	-----
Cash and cash equivalents, end of period.....	\$ 2,191	\$ 1,075
	=====	=====

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

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

1. ORGANIZATION

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

On July 5, 1996, Liggett Group Inc. ("Liggett"), a wholly-owned subsidiary of BGLS, purchased from the Company 140,000 shares (19.97%) of the tobacco operations of Liggett-Ducat for \$2,100. In addition, Liggett acquired a ten-year option entitling Liggett to increase its ownership in Liggett-Ducat to 95%. 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.

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 ("New Valley"). (Refer to Note 3.)

The interim consolidated financial statements of the Company are unaudited and, in the opinion of management, reflect all adjustments necessary (which are normal and recurring) to present fairly the Company's consolidated financial position, results of operations and cash flows. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included as Exhibit 99.4 in Brooke's and BGLS' Annual Report on Form 10-K, as amended, for the year ended December 31, 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.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

LIQUIDITY:

The Company has historically relied on Brooke and BGLS for sources of financing. At September 30, 1997, the Company had net capital and working capital deficiencies of \$70,132 and \$63,703, respectively. The Company has upgraded the cigarette operations' tobacco processing complex and significantly increased production while continuing to implement cost-saving measures. Liggett-Ducat plans to begin the manufacture and marketing of western style cigarettes in 1998. Management believes that such activities will result in improved operations and cash flow, but there can be no assurances in this regard. In addition, the Company is in the process of constructing a new tobacco factory as discussed in Note 5 and is actively pursuing various potential financing alternatives related thereto.

3. SALE OF BROOKEMIL

On January 31, 1997, the Company sold its 99.1% of the outstanding shares of BML to New Valley for \$21,500 in cash and a promissory note of \$33,500, collateralized by the BML shares, payable during 1997 with an annual interest rate of 9%. The consideration received exceeded the carrying value of the Company's investment in BML by \$52,500. The Company recognized an immediate gain on the sale in the amount of \$25,500. The remaining \$27,000 was deferred, reflecting recognition that the Company's parent, BGLS, retains an interest in BML through its 42% equity ownership in New Valley, and that further, a portion of the property sold is subject to a put option held by New Valley. This option allows New Valley, under certain circumstances, to put a portion of the property sold back to the Company at the greater of the appraised fair value of the property at the date of exercise or \$13,600. The Company distributed the \$21,500 cash proceeds received from the sale of BML to BGLS on January 31, 1997. During the second quarter 1997, New Valley paid \$21,500 to BOL, representing a portion of the promissory note together with accrued interest thereon. As of September 30, 1997, the balance remaining on the note was \$12,000, subsequently reduced to \$8,500. The balance is due on or before December 31, 1997. As of September 30, 1997, BOL had distributed to BGLS \$21,500 in proceeds received from the New Valley note together which accrued interest thereon.

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

In connection with the sale of the BML shares, certain specified liabilities aggregating \$40,800 remained with BML, including the Vneshtorgbank loan with a balance of \$20,418 which was paid in full during the third quarter, 1997. Further, the Company, Brooke and BGLS each contributed to the capital of BML, through cancellation of all indebtedness of BML to each such entity, the aggregate amount of which was \$19,275 including accrued interest thereon. In addition, Liggett-Ducat entered into a Use Agreement with BML whereby Liggett-Ducat is permitted to continue to utilize the existing factory site on the

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

same basis as in the past which includes obligations for costs involved in carrying the site. The Use Agreement is terminable by BML on 270 days' prior notice.

4. INVENTORIES

Inventories consist of:

	September 30, 1997 -----	December 31, 1996 -----
Finished goods.....	\$ 5	\$
Work-in-process.....	227	53
Raw materials.....	2,394	2,664
Replacement parts and supplies.....	941	852
	-----	-----
	\$3,567	\$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 September 30, 1997, the Company had leaf tobacco purchase commitments of approximately \$23,900.

5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consists of:

	September 30, 1997 -----	December 31, 1996 -----
Buildings.....	\$	\$ 8,064
Factory machinery and equipment.....	10,564	4,419
Computers and software.....	308	289
Office furniture and equipment.....	245	129
Vehicles.....	457	416
Construction-in-progress.....	9,463	46,966
	-----	-----
	21,037	60,283
Less accumulated depreciation.....	751	676
	-----	-----
	\$20,286	\$59,607
	=====	=====

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

On September 9, 1997, the Company entered into a contract to purchase cigarette manufacturing and processing equipment to be used in the new factory for \$15,000. Of

BROOKE (OVERSEAS) LTD. AND SUBSIDIARIES
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 (DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) - (CONTINUED)
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this amount, \$12,750 will be financed by a series of ten promissory notes payable every six months at 6.71% per annum interest with the first note due in 1999. Brooke is a guarantor of the notes.

On September 24, 1997, the Company entered into an additional contract to purchase cigarette manufacturing and processing equipment to be used in the new factory for \$12,400, of which \$10,500 will be financed by a series of sixty promissory notes payable monthly at 7.5% per annum interest. The first note will be due six months after delivery of the equipment. Delivery is estimated to be completed by September 1998.

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

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

	September 30, 1997	December 31, 1996
	-----	-----
Bank loan.....	\$	\$ 20,418
Deferred financing fees.....		1,240
Other obligations.....	3,253	
	-----	-----
Total.....	3,253	21,658
Less current maturities.....	1,000	21,658
	-----	-----
Amount due after one year.....	\$ 2,253	\$
	=====	=====

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. The loan was repaid in full by BML in August 1997. (Refer to Note 3.)

REVOLVING CREDIT FACILITIES:

In February and March 1997, the Company obtained lines of credit in the amounts of \$1,000 at 28% per annum and \$2,000 at 26%, respectively, in order to secure tobacco commitment purchases. The lines of credit were extended in May 1997 and interest rates reduced to 23%. Also in April 1997, an additional \$1,000 line of credit was obtained. Lines of credit expired in August and September 1997 and any balance outstanding was paid in full.

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. The amount due to Brooke and BGLS under this facility

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

at September 30, 1997 was \$40,208 together with interest of \$16,543. As of such date, \$19,513 together with interest of \$8,067 is due to the Company from Liggett-Ducat and LDT, which amounts are collateralized by a pledge of the LDT stock.

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

8. INCOME TAXES

The entire 1996 and a portion (\$538) of the 1997 provision for income taxes is payable pursuant to Russian statutory requirements. Further, the Company has recorded a provision for income taxes of \$11,741 related to its sale of BML in 1997 in accordance with its tax sharing agreement with Brooke.

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

9. CONTINGENCIES

BGLS has pledged its ownership interest in the Company's Common Stock as collateral in connection with the issuance of BGLS' 15.75% Senior Secured Notes ("BGLS Notes") due 2001. Liggett has engaged in negotiations with its note holders to restructure the terms of its Senior Secured Notes. During such negotiations, BGLS postponed making its interest payment due on July 31, 1997 of approximately \$18,338 on the BGLS Notes. A Standstill Agreement and Consent (the "Standstill Agreement") was reached on August 28, 1997, as amended, among the holders of more than 83% of the BGLS Notes and BGLS whereby each of such principal holders of the BGLS Notes waived the right to receive on August 29, 1997 its pro rata share of the July 31, 1997 interest payment (in total, \$15,340). On August 29, 1997, BGLS made the interest payment on the BGLS Notes to all holders other than the principal holders discussed above. Pending completion of the negotiations with the principal holders, such holders have agreed with BGLS that they will be entitled to receive their portion of the July 31, 1997 interest payment only after giving BGLS 20 days' notice but in any event by December 10, 1997.

NEW VALLEY HOLDINGS, INC.

FINANCIAL STATEMENTS

SEPTEMBER 30, 1997

NEW VALLEY HOLDINGS, INC.

FINANCIAL STATEMENTS

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

	September 30, 1997	December 31, 1996
	-----	-----
ASSETS		
Cash and cash equivalents	\$ 7	\$ 1
Investment in New Valley:	-----	-----
Redeemable preferred stock	56,886	72,962
Common stock	(56,886)	(72,962)
	-----	-----
Total investment in New Valley	-----	-----
Total assets	\$ 7	\$ 1
	=====	=====
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Payable to parent	\$ 45	\$ 4
Accrued expenses	7	7
Current income taxes payable to parent	6,302	6,312
	-----	-----
Total liabilities	6,347	6,323
	-----	-----
Commitments and contingencies		
Common stock, \$0.01 par value, 100 shares authorized, issued and outstanding	7,633	7,633
Additional paid-in capital	(21,973)	(727)
Deficit	8,000	(13,228)
Other	-----	-----
Total stockholder's equity (deficit)	(6,340)	(6,322)
	-----	-----
Total liabilities and stockholder's equity (deficit)	\$ 7	\$ 1
	=====	=====

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

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

	Three Months Ended		Nine Months Ended	
	Sept. 30, 1997	Sept. 30, 1996	Sept. 30, 1997	Sept. 30, 1996
Equity in loss of New Valley.....	\$(7,018)	\$ (4,836)	\$(21,343)	\$(7,818)
Interest income.....		7	6	55
General and administrative expenses	(4)	(13)	(34)	(17)
Loss from continuing operations before income taxes.....	(7,022)	(4,842)	(21,371)	(7,780)
(Benefit) provision for income taxes:				
Current.....	(2)	1,297	(10)	1,745
Deferred.....	(24)	7,212	(40)	4,004
Income tax (benefit) provision.....	(26)	8,509	(50)	5,749
Loss from continuing operations.....	(6,996)	(13,351)	(21,321)	(13,529)
Income from discontinued operations of New Valley, net of income taxes.....	45		75	
Net loss.....	\$(6,951)	\$(13,351)	\$(21,246)	\$(13,529)

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

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

	Common Stock Shares Amount	Additional Paid-In Capital	Deficit	Other	Total	
	-----	-----	-----	-----	-----	
Balance, December 31, 1996.....	100		\$ 7,633	\$ (727)	\$(13,228)	\$ (6,322)
Proportionate share of New Valley's capital transactions.....				9,435		9,435
Unrealized holding gain on investment in New Valley.....				11,793		11,793
Net loss.....	---	-----		(21,246)		(21,246)
	---	-----	-----	-----	-----	-----
Balance, September 30, 1997.....	100 ===	\$ =====	\$7,633 =====	\$(21,973) =====	\$ 8,000 =====	\$ 6,340 =====

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

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

	Nine Months Ended	
	September 30, 1997	September 30, 1996
Net cash provided by operating activities.....	\$ 6	\$ 49
Cash flows from investing activities:		
Dividends received from New Valley.....		24,733
Net cash provided by investing activities.....		24,733
Cash flows from financing activities:		
Distributions paid to parent.....		(25,507)
Net cash used in financing activities.....		(25,507)
Net increase (decrease) in cash and cash equivalents.....	6	(725)
Cash and cash equivalents at beginning of period.....	1	726
Cash and cash equivalents at end of period.....	\$ 7	\$ 1

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

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

1. PRINCIPLES OF REPORTING

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

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

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

USE OF ESTIMATES AND ASSUMPTIONS:

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

2. INVESTMENT IN NEW VALLEY CORPORATION

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

	Number of Shares -----	Fair Value -----	Carrying Amount -----	Unrealized Holding Loss -----
Class A Preferred Shares.....	618,326	\$56,886	\$ 56,886	\$(13,089)
Common Shares.....	3,969,962(A)	3,474	(56,886)	
		----- \$60,360	----- \$	----- \$(13,089)
		=====	=====	=====

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

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

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

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

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

During the nine months ended September 30, 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 \$1,773, along with other New Valley capital transactions of \$10,055 for this period. No such repurchases have been made during the nine months ended September 30, 1997. The Company's share of other New Valley capital transactions were \$9,435 for the nine months ended September 30, 1997, which represents the Company's portion of the unrealized gain on investment securities at New Valley.

The Class A Preferred Shares of New Valley are required to be redeemed on January 1, 2003 for \$100.00 per share plus dividends accrued to the redemption date. The shares are redeemable, at any time, at the option of New Valley, at \$100.00 per share plus accrued dividends. The holders of Class A Preferred Shares are entitled to receive a quarterly dividend, as declared by the Board of Directors, payable at the rate of \$19.00 per annum. At September 30, 1997, the accrued and unpaid dividends arrearage was \$150,871 (\$140.81 per share). As of September 30, 1996, the Company had received \$24,733 (\$40.00 per share) in dividend distributions.

3. NEW VALLEY CORPORATION

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

	September 30, 1997	December 31, 1996

Current assets, primarily cash and marketable securities.....	\$ 140,465	\$ 183,720
Non-current assets.....	326,368	222,820
Current liabilities.....	131,593	98,110
Non-current liabilities.....	194,040	170,223
Redeemable preferred stock.....	245,740	210,571
Shareholders' equity (deficit).....	(104,540)	(72,364)

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	Three Months Ended		Nine Months Ended	
	Sept. 30, 1997	Sept. 30, 1996	Sept. 30, 1997	Sept. 30, 1996
Revenues.....	\$26,448	\$21,276	\$70,605	\$ 83,710
Costs and expenses.....	34,378	28,998	95,897	102,314
Loss from continuing operations.....	(6,830)	(7,105)	(22,313)	(17,589)
Income (loss) from discontinued operations....	256	(5,339)	369	(4,501)
Net loss applicable to common shares(A).....	(24,141)	(27,844)	(72,241)	(64,319)

(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. During the second quarter 1997, New Valley paid BOL \$21,500, representing a portion of the promissory note together with accrued interest thereon. As of September 30, 1997, the balance remaining on the note was \$12,000, subsequently reduced to \$8,500 which is due on or before December 31, 1997.

RJR NABISCO HOLDINGS CORP.:

At September 30, 1997, New Valley held 762,650 shares of RJR Nabisco Holdings Corp. ("RJR Nabisco") common stock with a market value of \$26,216 (cost of \$23,378). The unrealized gain on New Valley's investment in RJR Nabisco common stock was \$2,838 at September 30, 1997.

4. FEDERAL INCOME TAX

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

The provision for taxes for the nine-month period ended September 30, 1997 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 September 30, 1997 is based on the current taxable loss.

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'

NEW VALLEY HOLDINGS, INC.
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15.75% Senior Secured Notes ("BGLS Notes") due 2001. Liggett Group Inc., a subsidiary of BGLS, has engaged in negotiations with its note holders to restructure the terms of its Senior Secured Notes. During such negotiations, BGLS postponed its interest payment of approximately \$18,338 due July 31, 1997, on the BGLS Notes. A Standstill Agreement and Consent (the "Standstill Agreement") was reached on August 28, 1997, as amended, among the holders of more than 83% of the BGLS Notes and BGLS whereby each of such principal holders of the BGLS Notes waived the right to receive on August 29, 1997 its pro rata share of the July 31, 1997 interest payment (in total, \$15,340). On August 29, 1997, BGLS made the interest payment on the BGLS Notes to all holders other than the principal holders discussed above. Pending completion of the negotiations with the principal holders, such holders have agreed with BGLS that they will be entitled to receive their portion of the July 31, 1997 interest payment only after giving BGLS 20 days' notice but in any event by December 10, 1997.