SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K/A No. 2

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

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

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

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

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

100 S.E. Second Street
Miami, Florida 33131
305/579-8000

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

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

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

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

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

Explanatory Note: BGLS Inc. is required to file all reports required by Section 13 or 15(d) of the Exchange Act in connection with its 15.75% Series B Senior Secured Notes due 2001. BGLS Inc. meets the conditions set forth in General Instruction I(l)(a) and (b) of Form 10-K and is therefore filing this form with the reduced disclosure format.

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

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

At March 21, 1997, Brooke Group Ltd. had 18,097,096 shares of common stock outstanding, and BGLS Inc. had 100 shares of common stock outstanding, all of which are held by Brooke Group Ltd.

Documents Incorporated by Reference:

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

BROOKE GROUP LTD.
BGLS INC.
FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 1996

The annual report on Form 10-K for 1996 is amended by replacing the financial statements and financial statement schedules included therein with the following:

INDEX TO FINANCIAL STATEMENTS
AND FINANCIAL STATEMENT SCHEDULE

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

FINANCIAL STATEMENT SCHEDULE:

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

New Valley Corporation

MAI Systems Corporation

REPORT OF INDEPENDENT ACCOUNTANTS

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

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

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

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

As discussed in Note 20, the Company has engaged in negotiations with the principal holders of BGLS Inc.'s 15.75% Senior Secured Notes ("the BGLS Notes") to restructure certain of its debt service requirements. The Company has also entered into a standstill and consent agreement with the principal holders of the BGLS Notes whereby each of the principal holders waived the right to receive on August 29, 1997 its pro rata share of the interest payment originally due on July 31, 1997, in the total amount of $15,340,000. The standstill and consent agreement expires on February 6, 1998. In addition, the Company has completed a third party equity financing. While all liquidity requirements have not been met, management currently believes that new debt and equity financing and a successful restructuring of certain of its debt service requirements along with cash provided from operations and distributions from New Valley, will provide the Company with sufficient liquidity for 1998.

COOPERS & LYBRAND L.L.P.

Miami, Florida
March 27, 1997, except for Note 20, for which the date is January 30, 1998.

REPORT OF INDEPENDENT ACCOUNTANTS

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

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

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

COOPERS & LYBRAND L.L.P.

Miami, Florida
March 27, 1997

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

	December 31, 1996	December 31, 1995
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 1,941	$ 3,370
Accounts receivable - trade	19,475	23,844
Other receivables	1,217	1,448
Receivables from affiliates	47	1,502
Inventories	53,691	60,522
Deferred tax assets		1,061
Other current assets	4,181	4,868
Total current assets	80,552	96,615
Property, plant and equipment, at cost, less accumulated depreciation of $31,047 and $27,323	80,282	48,352
Intangible assets, at cost, less accumulated amortization of $17,457 and $15,679	4,421	5,453
Investment in affiliate	3,051	63,901
Other assets	9,371	11,299
Total assets	$177,677	$225,620
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT):		
Current liabilities:		
Notes payable and current portion of long-term debt	$ 55,242	$ 2,387
Accounts payable	32,461	22,762
Due to affiliates	990	
Dividends payable	1,387	
Cash overdraft	6	4,266
Accrued promotional expenses	30,257	25,519
Accrued taxes payable	26,379	22,846
Accrued interest	24,354	16,863
Other accrued liabilities	33,387	24,534
Total current liabilities	204,463	119,177
Notes payable, long-term debt and other obligations, less current portion	378,243	406,744
Noncurrent employee benefits	31,256	31,672
Other liabilities	18,704	24,131
Commitments and contingencies		
Stockholders' equity (deficit):		
Preferred Stock, par value $1.00 per share, authorized 10,000,000 shares		
Series G Preferred Stock, 2,184.834 shares, convertible, participating, cumulative, each share convertible to 1,000 shares of common stock and cash or stock distribution, liquidation preference of $1.00 per share		
Common stock, par value $0.10 per share, authorized 40,000,000 shares, issued 24,998,043 shares, outstanding 18,497,096 shares	1,850	1,850
Additional paid-in capital	94,169	93,186
Deficit	(490,706)	(428,173)
Other	(27,963)	9,372
Less: 6,500,947 shares of common stock in treasury, at cost	(32,339)	(32,339)
Total stockholders' equity (deficit)	(454,989)	(356,104)
Total liabilities and stockholders' equity (deficit)	$177,677	$225,620

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation:

The consolidated financial statements of Brooke Group Ltd. (the "Company") include the consolidated statements of its wholly-owned subsidiary, BGLS Inc. ("BGLS"). The consolidated statements of BGLS include the accounts of Liggett Group Inc. ("Liggett"), Brooke (Overseas) Ltd. ("BOL"), New Valley Holdings, Inc. ("NV Holdings") and other less significant subsidiaries. Based on the Company's ability to assert sufficient control, the Company consolidated the accounts of Liggett-Ducat Ltd. ("Liggett-Ducat") at December 31, 1995. (Refer to Note 4.) Liggett is engaged primarily in the manufacture and sale of cigarettes, principally in the United States. Liggett-Ducat is engaged in the manufacture and sale of cigarettes in Russia. All significant intercompany balances and transactions have been eliminated.

(b) Liquidity:

The Company believes it will have sufficient liquidity for 1997. This is based on, among other things, forecasts of cash flow for the principal operating companies which indicate that they will be self-sufficient, the sale of BrookeMil Ltd. ("BML"), a subsidiary of BOL, to an affiliate, New Valley Corporation ("New Valley"), on January 31, 1997, and certain funds available from New Valley subject to limitations imposed by BGLS' indenture agreements. Liggett had net capital and working capital deficiencies of $176,478 and $40,694, respectively, at December 31, 1996, is highly leveraged and has substantial near-term debt service requirements. These matters raise substantial doubt about Liggett meeting its liquidity needs and its ability to continue as a going concern. (Refer to Notes 2, 4 and 9.)

(c) Estimates and Assumptions:

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

(d) Cash and Cash Equivalents:

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

(e) Financial Instruments:

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

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

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

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

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

(f) Significant Concentrations of Credit Risk:

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

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

(g) Accounts Receivable:

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

(h) Inventories:

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

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

(i) Property, Plant and Equipment:

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

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

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

(j) Intangible Assets:

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

(k) Other Assets:

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

(l) Impairment of Long-Lived Assets:

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

(m) Employee Benefits:

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

(n) Postretirement Benefits other than Pensions:

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

(o) Postemployment Benefits:

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

(p) Stock Options:

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

(q) Income Taxes:

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

(r) Revenue Recognition:

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

(s) Earnings Per Share:

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

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

(t) Foreign Currency Translation:

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

(u) Reclassifications:

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

2. INVESTMENT IN NEW VALLEY CORPORATION

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

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

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

The $15.00 Class A Increasing Rate Cumulative Senior Preferred Shares ($100 Liquidation Value), $.01 par value (the "Class A Preferred Shares") and the $3.00 Class B Cumulative Convertible Preferred Shares ($25 Liquidation Value), $.10 par value (the "Class B Preferred Shares") are accounted for as debt and equity securities, respectively, pursuant to the requirements of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," and are classified as available-for-sale. Prior to January 1, 1996, the Class A Preferred Shares' fair value had been estimated with reference to the securities' preference features, including dividend and liquidation preferences, and the composition and nature of the underlying net assets of New Valley. During 1996, however, New Valley became engaged in the ownership and management of commercial real estate and acquired a controlling interest in Thinking Machines Corporation ("Thinking Machines"). Because these businesses affected the composition and nature of the underlying net assets of New Valley, the Company determined the fair value of the Class A and Class B Preferred Shares based on the quoted market price commencing with the quarter ended March 31, 1996. Through September 1996 earnings on the Class A Preferred Shares were comprised of dividends accrued during the period and the accretion of the difference between the Company's basis and their mandatory redemption price. New Valley's Common Shares, $.01 par value (the "Common Shares") were accounted for pursuant to APB No. 18, "The Equity Method of Accounting for Investments in Common Stock."

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

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

At December 31, 1996 and 1995, the Company's investment in New Valley consisted of an approximate 42% voting interest. The Company's investment in 1996 and 1995 was represented by 618,326 Class A Preferred Shares, 3,989,710 Common Shares (41.7%) (giving effect to a one-for-twenty reverse stock split by New Valley in July 1996) and 250,885 Class B Preferred Shares (9.0%). At December 31, 1996, the Company owns 57.7% of the outstanding Class A Preferred Shares.

In February 1995, New Valley repurchased 54,445 Class A Preferred Shares pursuant to a tender offer made as part of the Joint Plan. During 1995, New Valley repurchased 339,400 additional Class A Preferred Shares on the open market at an aggregate cost of $43,405. During 1996, New Valley repurchased 72,104 Class A Preferred Shares for a total amount of $10,530. The Company has recorded its proportionate interest in the excess of the carrying value of the shares over the cost of the shares repurchased as a credit to additional paid-in capital in the amount of $1,782 and $16,802, along with other New Valley capital transactions of $0 and $241, for the years ended December 31, 1996 and December 31, 1995, respectively.

The Class A Preferred Shares of New Valley are required to be redeemed on January 1, 2003 for $100.00 per share plus dividends accrued to the redemption date. The shares are redeemable, at any time, at the option of New Valley, at $100.00 per share plus accrued dividends. The holders of Class A Preferred Shares are entitled to receive a quarterly dividend, as declared by the Board of Directors, payable at the rate of $19.00 per annum. At December 31, 1996 and 1995, respectively, the accrued and unpaid dividends arrearage was $117,117 ($109.31 per share) and $121,893 ($110.06 per share). The Company received $24,733 ($40.00 per share) and $61,832 ($100.00 per share) in dividend distributions in 1996 and 1995, respectively.

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Holders of the Class B Preferred Shares are entitled to receive a quarterly dividend, as declared by the Board, at a rate of $3.00 per annum. At December 31, 1996 and 1995, respectively, the accrued and unpaid dividends arrearage was $115,944 ($41.55 per share) and $95,118 ($34.08 per share). No dividends on the Class B Preferred Shares have been declared since the fourth quarter of 1988.

Summarized financial information for New Valley follows:

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

(A) Includes gain on sale of New Valley's money transfer business of $1,056,081, net of income taxes of $52,000.

(B) The Company's share of the extraordinary item ($46,487) was related to extinguishment of debt in 1994. The Company's share of income from discontinued operations in 1994 was determined after accounting for losses not recognized in prior years as follows:

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

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

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

3. RJR NABISCO HOLDINGS CORP.

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

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

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

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

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

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

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

On February 29, 1996, New Valley entered into a total return equity swap transaction (the "Swap") with an unaffiliated company relating to 1,000,000 shares of RJR Nabisco common stock. During the

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third quarter of 1996, the Swap was terminated. New Valley recognized a loss on the Swap of $7,305 for the year ended December 31, 1996.

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

As of December 31, 1996, New Valley held approximately 1,700,000 shares of RJR Nabisco common stock with a market value of $59,200 (cost of approximately $53,400). As of March 14, 1997, New Valley held approximately 1,063,000 shares of RJR Nabisco common stock with a market value of $35,997 (cost of $32,574). During 1996 and 1995, New Valley expensed $11,724 and $3,879, respectively, for costs relating to its RJR Nabisco investment. Based on the market price of RJR Nabisco common stock at March 14, 1997, no amounts are payable by the Company or New Valley under any of its net profit-sharing arrangements with respect to the RJR Nabisco common stock discussed above.

4. INVESTMENT IN BROOKE (OVERSEAS) LTD.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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SUBSEQUENT EVENT:

Sale of BrookeMil:

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

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

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

5. DISCONTINUED OPERATIONS

A summary of discontinued operations follows:

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

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

New Valley:

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

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

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

MAI:

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

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

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

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SkyBox:

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

6. INVENTORIES

Inventories consist of:

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

The Company has a leaf inventory management program whereby, among other things, it is committed to purchase certain quantities of leaf tobacco. The purchase commitments are for quantities not in excess of anticipated requirements and are at prices, including carrying costs, established at the date of the commitment. At December 31, 1996, Liggett had leaf tobacco purchase commitments of approximately $20,116.

7. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of:

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

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

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

8. SALE OF ASSETS

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

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

Subsequent Event:

On January 31, 1997, BOL sold BML to New Valley for $21,500 in cash and a promissory note of $33,500 payable $21,500 on June 30, 1997 and $12,000 on December 31, 1997. (Refer to Note 4.)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

LIGGETT 11.500% SENIOR SECURED SERIES B NOTES DUE 1999:

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

ISSUANCE OF LIGGETT SERIES C VARIABLE RATE NOTES:

On January 31, 1994, Liggett issued $22,500 of Variable Rate Series C Senior Secured Notes Due 1999 (the "Liggett Series C Notes"). The Liggett Series C Notes bore a 16.5% interest rate, which was reset on February 1, 1995 to 19.75%, the maximum reset rate. Liggett had received the necessary consents from the required percentage of holders of Liggett Series B Notes allowing for an aggregate principal amount up to but not exceeding $32,850 of Liggett Series C Notes to be issued under the Liggett Series C Notes indenture. The Series C Notes have the same terms (other than interest rate) and stated maturity as the Liggett Series B Notes. In connection with the consents, holders of Liggett Series B Notes received Liggett Series C Notes totaling $2,842 or 2% of their then current Liggett Series B Notes holdings. Liggett issued the remaining $7,508 of Series C Notes in November 1994.

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

REVOLVING CREDIT FACILITY - LIGGETT:

On March 8, 1994, Liggett entered into a revolving credit facility (the "Facility") for $40,000 with a syndicate of commercial banks. The Facility is collateralized by all inventories and receivables of Liggett. At December 31, 1996, $24,272 was outstanding and $13,098 was available under the Facility. Borrowings under the Facility bore interest at the rate of 9.75%, a rate which is equal to 1.5% above the Philadelphia National Bank's prime rate (8.25%) at December 31, 1996. The Facility requires Liggett's compliance with certain financial and other covenants. The Facility also limits the amount of cash dividends and distributions by Liggett. In addition, the Facility imposes requirements with respect to Liggett's adjusted net worth (not to fall below a deficit of $175,000 as computed in accordance with the agreement) and working capital (not to fall below a deficit of $35,000 as computed in accordance with the agreement). The Facility is classified as short-term at December 31, 1996, as it was due on March 8, 1997. In January 1997, the Facility was extended for a one-year period ending March 8, 1998. No assurances can be given that the Facility will be further extended.

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

FOREIGN LOANS:

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

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

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Scheduled Maturities:

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

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

10. RESTRUCTURING CHARGES

Liggett:

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

11. EMPLOYEE BENEFIT PLANS

Defined Benefit Retirement Plans:

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

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

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

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

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

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

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

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

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

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

Postretirement Medical and Life Insurance Plans:

BGLS and Liggett

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

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

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

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

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

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

Profit Sharing Plan:

Liggett

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

12. INCOME TAXES

The Company files a consolidated federal income tax return that includes its more than 80%-owned United States subsidiaries. At December 31, 1996, the Company had $90,646 of unrecognized net deferred tax assets, comprised primarily of net operating loss carryforwards, available to offset future taxable income for federal tax purposes. A valuation allowance has been provided against this deferred tax asset as it is presently deemed more likely than not that the benefit of the tax asset will not be utilized. The Company continues to evaluate the realizability of its deferred tax assets and its estimate is subject to change.

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The amounts provided for income taxes are as follows:

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

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

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

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

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

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

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

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13. COMMITMENTS

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

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

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

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

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

14. EQUITY

Series G Preferred Stock:

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

Treasury Stock:

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

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

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15. STOCK PLANS

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

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

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

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

Subsequent Event:

As of January 1, 1997, the Company granted to employees of the Company non-qualified stock options to purchase 422,000 shares of the Company's common stock at an exercise price of $5.00 per share. The options, which will become exercisable over a ten-year term, vest in six equal annual installments.

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16. CONTINGENCIES

Tobacco-Related Litigation:

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

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

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

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

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occasion to eliminate the federal preemption defense. Enactment of any federal legislation with such an effect could result in a significant increase in claims, liabilities and litigation costs.

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

On October 31, 1991, an action entitled BROIN, ET AL. V. PHILIP MORRIS INCORPORATED, ET AL., Circuit Court of the Eleventh Judicial District in and for Dade County, Florida, was filed against Liggett and others. This case was the first class action commenced against the industry, and has been brought by plaintiffs on behalf of all flight attendants that have worked or are presently working for airlines based in the United States and who have never regularly smoked cigarettes but allege that they have been damaged by involuntary exposure to ETS. Plaintiff's motion to certify the action as a class action was granted. The suit is scheduled to go to trial on June 2, 1997. In addition to Broin, as of March 25, 1997 there were 12 actions which have either been certified as a class or are seeking class certification. One of these actions, ENGLE, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Circuit Court of the Eleventh Judicial Circuit in and for Dade County, Florida, involving a certified class of smokers in the State of Florida, is scheduled to commence trial on September 8, 1997.

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

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

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

Under the CASTANO settlement agreement, upon final court approval of the settlement, the CASTANO class would be entitled to receive up to 5% of Liggett's pretax income (income before income taxes) each year (up to a maximum of $50,000 per year) for the next twenty-five years, subject to certain reductions provided for in the agreement, and a $5,000 payment from Liggett if the Company or Liggett fails to consummate a merger or similar transaction with another non-settling tobacco company defendant within three years of the date of the settlement. The Company and Liggett have the right to terminate the CASTANO settlement under certain circumstances. On May 11, 1996, the CASTANO Plaintiffs Legal Committee filed a motion with the District Court seeking preliminary approval of the CASTANO settlement. On September 6, 1996, the CASTANO plaintiffs withdrew the motion for approval of the CASTANO settlement.

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

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

On May 23, 1994, an action entitled MOORE, ATTORNEY GENERAL, EX REL STATE OF MISSISSIPPI V. THE AMERICAN TOBACCO COMPANY, ET AL., Chancery Court of Jackson County, Mississippi, was commenced against Liggett and others seeking restitution and indemnity for medical payments and expenses allegedly made or incurred for tobacco related illnesses. In May 1994, the State of Florida enacted legislation, effective July 1, 1994, allowing certain state authorities or entities to commence litigation seeking recovery of certain Medicaid payments made on behalf of Medicaid recipients as a result of diseases (including, but not limited to, diseases allegedly caused by cigarette smoking) allegedly caused by liable third parties (including, but not limited to, the tobacco industry). On February 21, 1995, the State of Florida commenced an action pursuant to this statutory scheme. In addition to the foregoing, similar actions have been filed on behalf of 20 states and several municipalities. The Mississippi, Florida and Texas Medicaid recovery actions are scheduled for trial in 1997. Legislation similar to that enacted in Florida has been introduced in the Massachusetts and New Jersey legislatures.

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

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

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

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

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

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

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

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

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

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

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

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

Subsequent Events:

On March 20, 1997, Liggett, together with the Company, entered into a comprehensive settlement of tobacco litigation through parallel agreements with the Attorneys General of 17 states and with a nationwide class of individuals and entities that allege smoking-related claims. The Company and Liggett have now obtained settlements with each of the 22 states that have commenced suit against them. The settlements cover all smoking-related claims, including both addiction-based and tobacco injury claims against the Company and Liggett, brought by the 22 states and, upon court approval, the nationwide class.

The settlement with the Attorneys General, which does not require court approval, includes the states of Arizona, Connecticut, Hawaii, Illinois, Indiana, Iowa, Kansas, Maryland, Michigan, Minnesota, New Jersey, New York, Oklahoma, Texas, Utah, Washington and Wisconsin. The Company's and Liggett's previous settlements on March 15, 1996 with the Attorneys General of Florida, Louisiana, Massachusetts, Mississippi and West Virginia remain in full force and effect.

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

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

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

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

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

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

Legislation and Regulation:

On August 28, 1996, the FDA filed in the Federal Register a Final Rule classifying tobacco as a drug, asserting jurisdiction by the FDA over the manufacture and marketing of tobacco products and imposing restrictions on the sale, advertising and promotion of tobacco products. The FDA's stated objective and focus for its initiative is to limit access to cigarettes by minors by measures beyond the restrictions either mandated by existing federal, state and local laws or voluntarily implemented by major manufacturers in the industry. Litigation has been commenced in the United States District Court for the Middle District of North Carolina challenging the legal authority of the FDA to assert such jurisdiction, as well as challenging the constitutionality of the rules. A hearing on the tobacco industry's motion for summary judgment in that case was held on February 10, 1997, and a decision by the Court is expected soon. The FDA's proposed restrictions, some of which became effective as early as February 28, 1997, purport to (i) limit access to tobacco products and (ii) limit advertising and marketing. Management is unable to predict whether the Final Rule will be upheld as enforceable against the industry. Management is also unable to predict the effects of the proposed restrictions, if implemented, on Liggett's operations, but such actions could have an unfavorable impact thereon.

The Company and Liggett, while neither consenting to FDA jurisdiction nor waiving their objections thereto, agreed to withdraw their objections and opposition to the proposed rule making and to phase in compliance with certain of the proposed interim FDA regulations. See discussions of the Castano and Attorneys General settlements above.

In August 1996, the Commonwealth of Massachusetts enacted legislation requiring tobacco companies to publish information regarding the ingredients in cigarettes and other tobacco products sold in that state. Regulations adopted pursuant to this legislation are scheduled to become effective on July 1, 1997. On February 7, 1997, the United States District Court for the District of

Massachusetts denied an attempt to block the new legislation on the ground that it is preempted by federal law.

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

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

On September 13, 1995, the President of the United States issued Presidential Proclamation 6821, which established a tariff rate quota ("TRQ") on certain imported tobacco, imposing extremely high tariffs on imports of flue-cured and burley tobacco in excess of certain levels which vary from country to country. Oriental tobacco is exempt from the quota as well as all tobacco originating from Canada, Mexico or Israel. Management believes that the TRQ levels are sufficiently high to allow Liggett to operate without material disruption to its business. In addition the Presidential Proclamation served to limit the application of the DMA to only those activities occurring in calendar year 1994.

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

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

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

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

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conducted in accordance with all environmental laws and regulations. Management is unaware of any material environmental conditions affecting its existing facilities. Compliance with federal, state and local provisions regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, have not had a material effect on the capital expenditures, earnings or competitive position of Liggett.

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

Other Matters:

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

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

Subsequent Events:

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

17. RELATED PARTY TRANSACTIONS

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

Effective July 1, 1990, a former executive transferred all of his equity in the Company to the Chairman and resigned from substantially all of his positions with the Company and its affiliates. In consideration for this transfer, a partnership (the "Partnership") controlled by the Chairman agreed, among other things, to make certain payments to the Company on account of the former executive's outstanding indebtedness of $8,677 (deducted from equity). In connection with this transaction, the Partnership had pledged 1,681,715 of the shares it held of the Company's common stock to secure this non-recourse obligation, except as to the pledged shares. In May 1994, the Partnership paid

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$3,200 in partial satisfaction of the obligation. In consideration thereof, the Company released 1,281,715 of the pledged shares. On March 7, 1997, the Partnership transferred to the Company the remaining 400,000 pledged shares in final satisfaction of the obligation.

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

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

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

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

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

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

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

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

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

Subsequent Events:

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

18. SEGMENT INFORMATION

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

Industry Segment:

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

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

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

Geographic Area:

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

19. SUPPLEMENTAL CASH FLOW INFORMATION

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

	Year Ended December 31,		
	1996	1995	1994
I. Cash paid during the period for:			
Interest	$57,362	$60,158	$39,429
Income taxes, net of refunds	582	1,735	605
II. Non-cash investing and financing activities:			
Dividends payable	$ 1,387		$ 131
Issuance and exchange of long-term debt			114,888
Distribution of MAI to stockholders		$27,085	
Series G dividend			3,200
Shareholder settlement			6,250
Transfer of pension liability to SkyBox			4,305
Exchange of Series 2 Senior Secured Notes for Series A Notes	99,154		
Exchange of 14.50% Subordinated Debentures for Series B Notes	125,495		
Issuance of Series A Notes for options	822		
Exchange of Series A Notes for Series B Notes	99,976		
Issuance of promissory notes for shares of Liggett-Ducat	1,643		

20. STANDSTILL AND CONSENT AGREEMENT; CURRENT REQUIREMENTS

The Company has engaged in negotiations with the principal holders of more than 83% of the BGLS Notes to restructure certain of its debt service requirements. A standstill and consent agreement was reached among the Company, BGLS and the principal holders on August 28, 1997, as subsequently amended, 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 31, 1997 interest payment (in total, $15,340). Pending completion of the negotiations with the principal holders, such holders have agreed 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 February 6, 1998. The Company has recently completed a third party equity financing. While all liquidity requirements have not been met, management currently believes that new debt and equity financing and a successful restructuring of certain of its debt service requirements along with cash provided from operations and distributions from New Valley, will provide the Company with sufficient liquidity for 1998.

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

21. QUARTERLY FINANCIAL RESULTS (UNAUDITED)

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

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

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

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

(Dollars in Thousands)

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

(a) Charged to net sales.

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

REPORT OF INDEPENDENT ACCOUNTANTS

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

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

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

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

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

COOPERS & LYBRAND L.L.P.

Miami, Florida
March 24, 1997

REPORT OF INDEPENDENT ACCOUNTANTS

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

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

/s/ Price Waterhouse LLP

PRICE WATERHOUSE LLP

Morristown, New Jersey
March 24, 1995

NEW VALLEY CORPORATION AND SUBSIDIARIES

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

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

See accompanying Notes to Consolidated Financial Statements

NEW VALLEY CORPORATION AND SUBSIDIARIES

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

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

See accompanying Notes to Consolidated Financial Statements.

NEW VALLEY CORPORATION AND SUBSIDIARIES

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

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

See accompanying Notes to Consolidated Financial Statements

NEW VALLEY CORPORATION AND SUBSIDIARIES

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

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

See accompanying Notes to Consolidated Financial Statements.

NEW VALLEY CORPORATION AND SUBSIDIARIES

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

1. BASIS OF PRESENTATION

PRINCIPLES OF CONSOLIDATION

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

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

NATURE OF OPERATIONS

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

REORGANIZATION

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

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

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

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

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

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

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

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

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

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

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

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

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

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

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

3. ACQUISITIONS

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

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

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

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

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

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

4. DISCONTINUED OPERATIONS

As noted above, the Company sold FSI during the fourth quarter of 1994 and sold the Messaging Services Business effective October 1, 1995. During the fourth quarter of 1996, Thinking Machines adopted a plan to terminate its parallel processing computer sales and service business. Consequently, the operating results of this segment have been classified as discontinued operations. Thinking Machines wrote-down certain assets, principally inventory, related to these operations to their net realizable value and recorded a charge of $6,100 for these reserves, which is included in the loss on discontinued operations. Accordingly, the financial statements reflect the financial position and the results of operations of the discontinued operations of FSI, the Messaging Services Business, and Thinking Machines separately from continuing operations.

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

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

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

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

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

5. INVESTMENT SECURITIES AVAILABLE FOR SALE

Investment securities classified as available for sale are carried at fair value, with net unrealized gains included as a separate component of shareholders' equity (deficit). The Company had net realized gains on sales of investment securities available for sale of $1,347 ($6,114 of realized gains and $4,767 of realized losses) for the year ended December 31, 1996, and $6,736 ($9,223 of realized gains and $2,487 of realized losses) for the year ended December 31, 1995.

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

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

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

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

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

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

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

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

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

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

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

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

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

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

7. INVESTMENT IN REAL ESTATE AND NOTES PAYABLE

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

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

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

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

8. LONG-TERM INVESTMENTS

Long-term investments consisted of investments in the following:

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

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

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

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

The fair value of the Company's long-term investments approximates its carrying amount. The Company's estimate of the fair value of its long-term investments are subject to judgment and are not necessarily indicative of the amounts that could be realized in the current market.

9. PENSIONS AND RETIREE BENEFITS

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

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

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

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

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

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

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

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

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

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

10. COMMITMENT AND CONTINGENCIES

Leases

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

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

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

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

Lawsuits

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

11. FEDERAL INCOME TAX

At December 31, 1996, the Company had $91,272 of unrecognized net deferred tax assets, comprised primarily of net operating loss carryforwards, available to offset future taxable income for federal tax purposes. A valuation allowance has been provided against this deferred tax asset as it is presently deemed more likely than not that the benefit of the tax asset will not be utilized. The Company continues to evaluate the realizability of its deferred tax assets and its estimate is subject to change. The provision for income taxes, which represented the effect of the Alternative Minimum Tax and state income taxes, for the three years ended December 31, 1996, 1995 and 1994, does not bear a customary relationship with pre-tax accounting income from continuing operations principally as a consequence of the change in the valuation allowance relating to deferred tax assets. The provision for income taxes on continuing operations differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate (35%) to pretax income from continuing operations as a result of the following differences:

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

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

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

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

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

As of December 31, 1996, the Company had consolidated net operating loss carryforwards of approximately $208,000 for tax purposes, which expire at various dates through 2007. Approximately $46,000 of net

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

operating loss carryforwards constitute pre-change losses and $162,000 of net operating losses were unrestricted.

12. OTHER LONG-TERM LIABILITIES

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

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

13. REDEEMABLE PREFERRED SHARES

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

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

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

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

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

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

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

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

14. PREFERRED SHARES NOT SUBJECT TO REDEMPTION REQUIREMENTS

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

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

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

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

No dividends on the Class B Preferred Shares have been declared since the fourth quarter of 1988. The undeclared dividends, as adjusted for conversions of Class B Preferred Shares into Common Shares, cumulatively amounted to $115,944 and $95,100 at December 31, 1996 and 1995, respectively. These undeclared dividends represent $41.55 and $34.08 per share as of the end of each period. No accrual was recorded for such undeclared dividends as the Class B Preferred Shares are not mandatorily redeemable.

15. COMMON SHARES

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

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

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

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

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

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

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

16. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

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

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

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

17. PREPETITION CLAIMS UNDER CHAPTER 11 AND RESTRUCTURING ACCRUALS

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

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

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

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

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

18. RELATED PARTY TRANSACTIONS

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

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

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

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

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

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

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

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

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

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

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

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

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

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

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

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

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

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

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

20. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

21. BUSINESS SEGMENT INFORMATION

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

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

22. SUBSEQUENT EVENTS

Acquisition -- On January 31, 1997, the Company entered into a stock purchase agreement (the "Purchase Agreement") with Brooke (Overseas) Ltd. ("Brooke (Overseas)"), a wholly-subsidiary of Brooke, pursuant to which the Company acquired 10,483 shares (the "BML Shares") of the common stock of BrookeMil Ltd. ("BML") from Brooke (Overseas) for a purchase price of $55,000, consisting of $21,500 in

NEW VALLEY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

cash and a $33,500 9% promissory note of the Company (the "Note"). The BML Shares comprise 99.1% of the outstanding shares of BML, a real estate development company in Russia. The Note is collateralized by the BML Shares and is payable $21,500 on June 30, 1997 and $12,000 on December 31, 1997.

BML is developing a three-phase complex on 2.2 acres of land in downtown Moscow, for which it has a 98-year lease. In 1993, the first phase of the project, Ducat Place I, a 46,500 sq. ft. Class-A office building, was constructed and leased. On February 5, 1997, BML entered into an agreement to sell Ducat Place I to one of its tenants for approximately $7,500, which purchase price has been reduced to reflect prepayments of rent. The closing of the sale is subject to a number of contingencies. If the transaction does not occur by April 5, 1997, the tenant has the right to terminate the agreement and apply its $1,000 down payment to its future rental obligations. In 1995, BML began construction of Ducat Place II, a 150,000 sq. ft. office building. Ducat Place II has been pre-leased to a number of leading international companies. The third phase, Ducat Place III, is planned as a 400,000 sq. ft. mixed-use complex, with construction anticipated to commence in 1998.

In connection with the Purchase Agreement, certain specified liabilities of BML aggregating approximately $40,000 remained as liabilities of BML after the purchase of the BML Shares of the Company. These liabilities include a $20,400 loan to a Russian bank for the construction of Ducat Place II. The loan, which matures $6,100 in April 1997, $4,100 in July 1997 and $10,200 in October 1997, is collateralized by a mortgage On Ducat Place II. In addition, the liabilities of BML include approximately $13,800 of rents and related payments prepaid by tenants of Ducat Place II for periods generally ranging from 15 to 18 months.

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

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

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

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

SCHEDULE II

NEW VALLEY CORPORATION

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

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

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

SCHEDULE III

NEW VALLEY CORPORATION

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

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

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

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

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors of
Thinking Machines Corporation:

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

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

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

/s/ Arthur Andersen LLP
ARTHUR ANDERSEN LLP

Boston, Massachusetts
February 11, 1997

Independent Auditors' Report

The Board of Directors
MAI Systems Corporation:

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

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

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

KPMG PEAT MARWICK LLP
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KPMG Peat Marwick LLP

Orange County, California
March 9, 1995