

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

-----  
FORM 10-K/A  
(Amendment No. 1)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES AND EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 1995

Commission File Number: 1-5759

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

Delaware  
(State or other jurisdiction of  
incorporation or organization)

51-0255124  
(I.R.S. Employer  
Identification Number)

100 S.E. Second Street, Miami, Florida  
(Address of principal executive offices)

33131  
(Zip Code)

Registrant's telephone number, including area code: (305)579-8000

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

| Title of each class                     | Name of each exchange on<br>which registered |
|---|--|
| -----                                   | -----  |
| Common Stock, par value \$.10 per share | New York Stock Exchange                      |

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K [ ].

The aggregate market value of the voting stock held by non-affiliates of the registrant as of April 1, 1996 was approximately \$52,726,529. Directors and officers and ten percent or greater stockholders are considered affiliates for purposes of this calculation but should not necessarily be deemed affiliates for any other purpose.

As of April 1, 1996, there were 18,497,096 shares of common stock outstanding.

Documents Incorporated by Reference: None

Part II of the Annual Report on Form 10-K of Brooke Group Ltd. (the "Company") for the fiscal year ended December 31, 1995 (the "Form 10-K") is amended with respect to Item 8 as follows:

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The Company's Consolidated Financial Statements and Notes thereto, together with the report thereon of Coopers & Lybrand L.L.P. ("Coopers & Lybrand") dated April 15, 1996, are set forth on pages C-1 through C-49 and quarterly financial results on page C-48 of this report.

Part III of the Form 10-K is amended in its entirety to add the following information:

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The following table sets forth certain information, as of April 24, 1996, with respect to each person who is a director of the Company. Each director is a citizen of the United States. For information concerning Bennett S. LeBow and the other executive officers of the Company, see Item 4, "Submission of Matters to a Vote of Security-Holders; Executive Officers of the Registrant."

| NAME AND ADDRESS<br>-----   | AGE<br>--- | PRINCIPAL<br>OCCUPATION<br>-----                                   |
|---|------------|--|
| Bennett S. LeBow<br>Brooke Group Ltd.<br>100 S.E. Second Street<br>Miami, FL 33131        | 58         | Chairman of the Board,<br>President and Chief Executive<br>Officer |
| Robert J. Eide<br>Aegis Capital Corp.<br>70 E. Sunrise Highway<br>Valley Stream, NY 11581 | 43         | Secretary and Treasurer, Aegis<br>Capital Corp                     |
| Jeffrey S. Podell<br>Newsote, Inc.<br>26 Jefferson Street<br>Passaic, NJ 07055            | 55         | Chairman of the Board and<br>President, Newsote, Inc.              |

Each director is elected annually and serves until the next annual meeting of stockholders or until his successor is duly elected and qualified.

BUSINESS EXPERIENCE OF DIRECTORS (OTHER THAN EXECUTIVE OFFICERS)

ROBERT J. EIDE has been a director of the Company since November 1993. Mr. Eide has been a director of BGLS since November 1993, a director of NV Holdings since September 1994,

Secretary and Treasurer of Aegis Capital Corp., a registered broker-dealer, since before 1988 and President of Aegis Planning Inc., a real estate investment company, since before 1988. Mr. Eide also serves as a director of Nathan's Famous, Inc., a restaurant chain. Mr. Eide served as a director of VTX Electronics Corp., a wire and cable distributor, from September 1991 until November 1995 and served as Chairman of the Board thereof from April 1994 until November 1995. Mr. Eide has also been a stockholder of a corporate general partner of a limited partnership organized to acquire and operate real estate property. The limited partnership filed for protection under the Federal bankruptcy laws in 1991.

JEFFREY S. PODELL has been a director of the Company since November 1993. Mr. Podell has been a director of BGLS since November 1993, a director of NV Holdings since September 1994 and the Chairman of the Board and President of Newsote, Inc., the parent of Pantasote, Inc., a former manufacturer of plastic products, since 1989. Mr. Podell was a director of VTX Electronics Corp. from 1991 until 1995, and was a registered representative at Aegis Capital Corp. from before 1988 to 1992.

#### COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT

Section 16(a) of the Exchange Act requires directors and executive officers of the Company, as well as persons who own more than 10% of a registered class of the Company's equity securities (the "Reporting Persons"), to file reports of initial beneficial ownership and changes in beneficial ownership on Forms 3, 4 and 5 with the SEC and the New York Stock Exchange. Such Reporting Persons are also required by SEC regulations to furnish the Company with copies of all Section 16(a) forms they file.

To the Company's knowledge, based solely on review of the copies of such reports furnished to the Company and representations that no other reports were required, during and with respect to the fiscal year ended December 31, 1995, all Reporting Persons have timely complied with all filing requirements applicable to them, except Mr. Chakalian will file late his initial statement of beneficial ownership of securities on Form 3 after being designated an executive officer by the Company.

#### ITEM 11. EXECUTIVE COMPENSATION

The following table sets forth information concerning compensation awarded to, earned by or paid during the past three years to those persons who were, at December 31, 1995, the Company's (i) Chief Executive Officer and (ii) the other four most highly compensated executive officers of the Company whose cash compensation exceeded \$100,000 (of which there are only two whose compensation exceeds the threshold amount) (collectively, the "named executive officers").

## SUMMARY COMPENSATION TABLE (1)(2)

| NAME AND<br>PRINCIPAL POSITION                         | YEAR | ANNUAL COMPENSATION |         |                              |                           |
|--|------|---------------------|---------|------------------------------|---------------------------|
|  |      | SALARY              | BONUS   | OTHER ANNUAL<br>COMPENSATION | ALL OTHER<br>COMPENSATION |
|  |      | (\$)                | (\$)    | (\$)                         | (\$)                      |
| Bennett S. LeBow                                       | 1995 | 1,187,500           | 593,750 | 118,750(3)                   | --                        |
| Chairman of the Board,                                 | 1994 | 950,000             | 475,000 | 95,000(3)                    | --                        |
| President and Chief<br>Executive Officer               | 1993 | 950,000             | 475,000 | 95,000(3)                    | 4,497(4)                  |
| Gerald E. Sauter                                       | 1995 | 278,534(5)          | --      | --                           | --                        |
| Vice President, Chief                                  | 1994 | 229,167             | 80,000  | --                           | 12,040(7)                 |
| Financial Officer<br>and Treasurer                     | 1993 | 264,063(6)          | 50,000  | --                           | 4,497(4)                  |
| Rouben V. Chakalian(8)                                 | 1995 | 432,000             | 285,120 | --                           | --                        |
| Chairman of the Board,                                 | 1994 | 252,000             | 302,400 | 250,000(9)                   | --                        |
| President and Chief<br>Executive Officer of<br>Liggett | 1993 | --                  | --      | --                           | --                        |

- (1) The aggregate value of perquisites and other personal benefits received by the named executive officers are not reflected because the amounts were below the reporting requirements established by the rules of the SEC.
- (2) No restricted stock or stock options were granted in 1993, 1994 or 1995 to the named executive officers.
- (3) Includes an annual payment in lieu of certain other executive benefits.
- (4) Represents employer contributions under profit sharing (i.e., 401(k)) and similar plans maintained by the Company.
- (5) In 1995, all of Mr. Sauter's salary was paid by New Valley, 25% (or \$69,633) of which was subsequently reimbursed to New Valley by the Company. The table reflects 100% of Mr. Sauter's 1995 salary.
- (6) Includes \$26,562 relating to a salary increase that was declared in May 1994, and retroactively effective as of April 1993.
- (7) Includes life insurance premiums paid by the Company.
- (8) Effective April 1, 1996, Mr. Chakalian assumed the title of Chairman of the Board of Liggett.

- (9) Represents payments made pursuant to a consulting agreement between Mr. Chakalian and Liggett. See "Employment Agreements".

#### COMPENSATION OF DIRECTORS

Outside directors of the Company each receive \$7,000 per annum as compensation for serving as a director, \$1,000 per annum for each Board committee membership, \$1,000 per meeting for each Board meeting attended, and \$500 per meeting for each committee meeting attended. In addition, each outside director of BGLS receives \$28,000 per annum as compensation for serving as a director, \$500 per annum for each Board committee membership, \$500 per meeting for each Board meeting attended, and \$500 for each committee meeting attended. Each outside director also is reimbursed for reasonable out-of-pocket expenses incurred in serving on the Board of the Company and/or BGLS. In January 1995, each outside director of the Company also received an award of 10,000 shares of the Company's Common Stock for services as a director during 1994.

#### EMPLOYMENT AGREEMENTS

The Chairman is a party to an employment agreement with the Company dated February 21, 1992. The agreement has a one-year term with automatic renewals for additional one-year terms unless notice of non-renewal is given by either party six months prior to the termination date. As of January 1, 1996, his annual base salary was \$1,484,375. He is entitled to a minimum annual bonus of \$742,188, payable quarterly, in lieu of participation in Company stock incentive plans. He is also entitled to an annual payment equal to 10% of his base salary in lieu of certain other executive benefits such as club memberships, company paid automobiles and other similar perquisites. Following termination of his employment without cause (as defined), he would continue to receive his then current base salary and minimum bonus for 24 months. Following termination of his employment within two years of a change of control (as defined) or in connection with similar events, he is entitled to receive a lump sum payment equal to 2.99 times his then current base salary and minimum bonus. In connection with the settlement of a stockholder lawsuit against the Company and the Chairman, the Chairman has agreed that for a period of four years beginning January 1, 1994, his employment contract shall be adjusted on an annual basis on such terms as are established by a compensation committee consisting entirely of independent directors. In addition, the Chairman's salary and bonus may not be increased from one year to the next during the same four-year period by more than 10% per annum, except that his salary and bonus may be increased in the same percentage amount as any increase in the price of the Company's Common Stock during a calendar year, subject to a maximum increase of 25% per annum. His salary and bonus is subject to decrease if the price of the Common Stock decreases by more than 10% during a calendar year, up to a maximum decrease of 25% per annum, but in no event lower than compensation earned in 1993.

Rouben V. Chakalian, Chairman of the Board of Directors and, prior to April 1, 1996, President and Chief Executive Officer of Liggett, is a party to an employment agreement with Liggett, dated and effective as of June 1, 1994. The agreement, which terminates on May 31, 1996, has been supplemented by a letter agreement dated January 9, 1996. Mr. Chakalian's annual base salary through May 31, 1996 is \$432,000 and thereafter is at a rate of \$240,000 per annum (plus \$2,000 per day if his presence is required at certain locations over six days per month). He is also entitled to receive a 1996 target annual bonus of 60% of his base salary, prorated for the first five months of 1996, based upon the achievement of specified EBIT (earnings before interest and taxes) targets, and, effective January 1997, his bonus target will be 25% of annual salary. In case of termination, Mr. Chakalian is covered by Liggett's executive termination policy which provides for 24 months of termination pay at the current salary of an executive, if the executive officer's employment is terminated without cause (as defined). The definition of "cause" in such executive termination pay policy is willful and continued failure to perform employment duties or obligations, willful misconduct, material breach of any provision in the agreement, fraud or conviction of a felony.

Prior to June 1994, Mr. Chakalian served as a consultant to the Company advising on both the Company's international and domestic operations. While acting as a consultant, and pursuant to a letter agreement dated June 15, 1993, Mr. Chakalian received payments of \$250,000 and \$196,000 for consulting services rendered during 1994 and 1993, respectively.

#### COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

During 1995, the Chairman and Messrs. Eide and Podell were members of the Company's compensation committee. Messrs. Eide and Podell serve as directors of BGLS and NV Holdings. Mr. Eide is a stockholder of and serves as the Secretary and Treasurer of Aegis Capital Corp. ("ACC"), a registered broker-dealer that has performed services for the Company and its affiliates since before January 1, 1995. During 1995, ACC received commissions and other income in the aggregate amount of \$584,616 from the Company and/or its affiliates. In connection with the acquisition of certain office buildings by New Valley on January 10, 1996, Mr. Eide received a commission of \$220,000 from the seller.

The Chairman is a director of Liggett. He is Chairman of the Board and Chief Executive Officer of New Valley. The Chairman is a director of BGLS and NV Holdings.

#### DEFINED BENEFIT OR ACTUARIAL PLAN DISCLOSURE

BGLS sponsors the Retirement Plan For Salaried Non-Bargaining Unit Employees (the "Retirement Plan") of Liggett, which is a noncontributory, defined benefit plan. Each salaried employee of the participating companies becomes a participant on the first day of the month following one year of employment with 1,000 hours of service and the attainment of age 21. A participant becomes vested as to benefits on the earlier of his attainment of age 65, or upon completion of five years of service. Benefits become payable on a participant's normal retirement date, age 65, or, at the participant's election, at his early retirement after he has attained age 55 and completed ten years of service. A participant's annual benefit at normal retirement date is equal to the sum of: (A) the product of: (1) the sum of: (a) 1.4% of the participant's average annual earnings during the five-year period from January 1, 1986 through December 31, 1990 not in excess of \$19,500 and (b) 1.7% of his average annual earnings during such five-year period in excess of \$ 19,500 and (2) the number of his years of credited service prior to January 1, 1991; (B) 1.55% of his annual earnings during each such year after December 31, 1990, not in excess of \$16,500; and (C) 1.85% of his annual earnings during such year in excess of \$16,500. The maximum years of credited service is 35. If hired prior to January 1, 1983, there is no reduction for early retirement. If hired on or after January 1, 1983, there is a reduction for early retirement equal to 3% per year for the number of years prior to age 65 (age 62 if the participant has at least 20 years of service) that the participant retires. The Retirement Plan also provides benefits to disabled participants and to surviving spouses of participants who die prior to retirement. Benefits are paid in the form of a single life annuity, with optional actuarially equivalent forms of annuity available. Payment of

benefits is made beginning on the first day of the month immediately following retirement. As of December 31, 1993, the accrual of benefits under the plan for Liggett employees was frozen.

As of December 31, 1995, none of the named executive officers were eligible to receive any benefits under the Retirement Plan.

Under certain circumstances, the amount of retirement benefit payable under the Retirement Plan to certain employees may be limited by the federal tax laws. Any Retirement Plan benefit lost due to such a limitation will be made up by BGLS through a non-qualified supplemental retirement benefit plan. BGLS has accrued, but not funded, amounts to pay benefits under this supplemental plan.

#### STOCK OPTION GRANTS AND STOCK OPTION EXERCISES

There were no stock options granted to or exercised by any of the named executive officers during 1995.

#### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth, as of April 24, 1996, the number and percentage of shares of the Company's Common Stock, the only class of the Company's voting securities, beneficially owned by (i) each person known to the Company to own beneficially more than five percent of the Common Stock, (ii) each director of the Company, (iii) each named executive officer and (iv) all directors and executive officers as a group. Unless otherwise indicated, each person possesses sole voting and investment power with respect to the shares indicated as beneficially owned, and the business address of each person is 100 S.E. Second Street, Miami, Florida 33131.

| NAME AND ADDRESS OF<br>BENEFICIAL OWNER<br>-----   | NUMBER OF<br>SHARES<br>----- | PERCENT OF<br>CLASS<br>----- |
|--|------------------------------|------------------------------|
| Bennett S. LeBow (1)   | 10,451,208                   | 56.5%                        |
| BSL Partners (2)   | 4,844,156                    | 26.2%                        |
| LeBow Limited Partnership (3)  | 1,681,715                    | 9.1%                         |
| LeBow Family Partnership 1993, Ltd. (4)  | 999,999                      | 5.4%                         |
| Richard S. Ressler (5)<br>Orchard Capital Corporation<br>11100 Santa Monica Boulevard<br>Suite 2050<br>Los Angeles, CA 90025 | 1,999,999                    | 10.8%                        |

|   |            |       |
|---|------------|-------|
| Robert J. Eide (6)<br>Aegis Capital Corp.<br>70 East Sunrise Highway<br>Valley Stream, NY 11581 | 10,000     | (*)   |
| Jeffrey S. Podell (6)<br>Newsote, Inc.<br>26 Jefferson Street<br>Passaic, NJ 07055              | 10,000     | (*)   |
| Gerald E. Sauter (7)  | 0          | -     |
| Rouben V. Chakalian (7)<br>Liggett Group Inc.<br>700 West Main Street<br>Durham, NC 27702       | 0          | -     |
| All directors and executive officers<br>as a group (5 persons)                                  | 10,471,208 | 56.6% |

- - - - -

- (\*) The percentage of shares beneficially owned does not exceed 1% of the Common Stock.
- (1) Includes Common Stock held by BSL Partners, a New York general partnership ("BSL Partners"), LeBow Limited Partnership, a Delaware limited partnership ("LLP"), and LeBow Family Partnership 1993, Ltd., a Florida limited partnership ("LFP"). In January 1996, 2,874,129 of the shares of Common Stock beneficially owned by Mr. LeBow (together with shares of certain other affiliated holders specified below) were pledged, among other securities, in favor of a financial institution (the "1996 Pledge").
- (2) Bennett S. LeBow (the "Chairman") owns an 80% interest in BSL Partners and the remaining interest is owned by LLP. Pursuant to the 1996 Pledge, 4,844,156 shares of Common Stock owned by BSL Partners were pledged.
- (3) The Chairman is the general partner of LLP with a 99.99% interest. In 1990, 1,681,715 shares of Common Stock owned by LLP were pledged to secure its obligation to make certain payments to the Company on account of a former executive's outstanding indebtedness of \$8,677,000, due in 1997. In May 1994, LLP paid \$3,200,000 in partial satisfaction of the obligation. In consideration thereof, the Company released 1,281,715 of the pledged shares. Pursuant to the 1996 Pledge, these 1,281,715 shares of Common Stock owned by LLP were pledged.
- (4) The Chairman is the general partner and a limited partner of LFP, and trusts, for the benefit of the Chairman and certain family members, hold the remaining partnership interests.



- (5) Based upon Amendment No. 4, dated November 16, 1994, to a Schedule 13D filed by the named individual.
- (6) The named individual is a director of the Company.
- (7) The named individual is an executive officer of the Company.

In addition, by virtue of his controlling interest in the Company, the Chairman might be deemed to own beneficially the securities of the Company's subsidiaries, including BGLS and Liggett, and securities of New Valley, in which the Company holds an indirect voting interest of approximately 42%. The disclosure of this information shall not be construed as an admission that the Chairman is the beneficial owner of any securities of the Company's subsidiaries or New Valley under Rule 13d-3 of the Exchange Act, or for any other purpose, and such beneficial ownership is expressly disclaimed. None of the Company's other directors or executive officers beneficially owns any equity securities of any of the Company's subsidiaries or New Valley.

#### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

On January 25, 1995, the Company entered into a Non-qualified Stock Option Agreement (the "Agreement") with a consultant who serves as President and a director of New Valley pursuant to which it granted such consultant non-qualified stock options to purchase 500,000 shares of the Company's restricted Common Stock at an exercise price of \$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. Pursuant to the Agreement, Common Stock dividend equivalents are paid on each unexercised option. During 1995, the consultant received \$320,000 of consulting fees from the Company. Since January 1, 1996, the consultant has received consulting fees of \$40,000 per month from the Company and a subsidiary.

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, LLP, a 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 \$8,677,000. In connection with this transaction, LLP pledged 1,681,715 of the shares it held of Common Stock to secure its obligation. In May 1994, the Partnership paid \$3,200,000 in partial satisfaction of the obligation. In consideration thereof, the Company released 1,281,715 of the pledged shares.

During 1995, Richard Ressler, the beneficial owner of 10.8% of the Company's common stock and a director of New Valley, served as a consultant to the Company and its subsidiaries and received consulting fees of \$270,000.

During 1995, the Company and New Valley entered into an expense sharing agreement whereby New Valley agreed to reimburse the Company for its portion of certain operating expenses, rent and utilization of personnel. Expense reimbursements amounted to \$571,000 for the year ended December 31, 1995.

For information concerning certain agreements and transactions between the Company, BGLS and New Valley relating to RJR Nabisco Holdings Corp., see Note 3 (RJR Nabisco

Holdings Corp.) and Note 17 (Related Party Transactions) to the Company's Consolidated Financial Statements.

See, also, Item 11, "Executive Compensation - Compensation Committee Interlocks and Insider Participation."

## REPORT OF INDEPENDENT ACCOUNTANTS

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

We have audited the accompanying consolidated balance sheets of Brooke Group Ltd. and Subsidiaries (the "Company") as of December 31, 1995 and 1994 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, 1995. 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 audits. We did not audit the financial statements of MAI Systems Corporation ("MAI"), a discontinued subsidiary (Note 5), which statements reflect total liabilities comprising 5% of consolidated total liabilities at December 31, 1994, and net income comprising 4% and 114% of consolidated net income for the years ended December 31, 1994 and 1993, respectively. Further, we did not audit the financial statements of New Valley Corporation ("New Valley") for the years ended December 31, 1994 and 1993, the investment in which is being accounted for by the Company using the equity method of accounting (Note 2). The Company's investment in New Valley represents 43% of consolidated total assets at December 31, 1994. The equity in the net income of New Valley represents 85% and 0% of consolidated net income for the years ended December 31, 1994 and 1993, 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 at December 31, 1995 and 1994 and the consolidated results of their operations and their cash flows for each of three years in the period ended December 31, 1995 in conformity with generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, in 1993 the Company changed its method of accounting for postretirement benefits other than pensions to conform with Statement of Financial Accounting Standards No. 106.

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

COOPERS & LYBRAND L.L.P.

Miami, Florida  
April 15, 1996

## REPORT OF INDEPENDENT ACCOUNTANTS

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

Our report on the consolidated financial statements of Brooke Group Ltd. and Subsidiaries is included on Page C-1 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 C-49 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, 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  
April 15, 1996

## BROOKE GROUP LTD. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS  
(Dollars in Thousands, Except Per Share Amounts)

|   | December 31, |           |
|---|--------------|-----------|
|   | 1995         | 1994      |
| ASSETS:   |              |           |
| Current assets:   |              |           |
| Cash and cash equivalents . . . . .   | \$ 3,370     | \$ 4,276  |
| Accounts receivable - trade . . . . .   | 23,844       | 31,325    |
| Other receivables . . . . .   | 1,448        | 1,558     |
| Receivables from affiliates . . . . .   | 1,502        |           |
| Inventories . . . . .   | 60,522       | 47,098    |
| Deferred tax assets . . . . .   | 1,061        |           |
| Other current assets . . . . .  | 4,155        | 3,247     |
|   | 95,902       | 87,504    |
| Property, plant and equipment, at cost, less accumulated<br>depreciation of \$27,868 and \$24,460 . . . . . | 49,065       | 25,806    |
| Intangible assets, at cost, less accumulated amortization<br>of \$15,679 and \$13,936 . . . . .             | 5,453        | 6,728     |
| Investment in affiliate . . . . .   | 63,901       | 97,520    |
| Other assets . . . . .  | 11,299       | 11,867    |
|   | \$225,620    | \$229,425 |

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

## BROOKE GROUP LTD. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS, Continued  
(Dollars in Thousands, Except Per Share Amounts)

|   | December 31, |            |
|---|--------------|------------|
|   | 1995         | 1994       |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT):</b>  |              |            |
| Current liabilities:  |              |            |
| Notes payable and current portion of long-term debt . . . . .   | \$ 2,387     | \$ 26,491  |
| Accounts payable . . . . .  | 22,762       | 12,415     |
| Cash overdraft . . . . .  | 4,266        | 4,860      |
| Accrued promotional expenses . . . . .  | 25,519       | 29,853     |
| Accrued taxes payable . . . . .   | 25,928       | 21,849     |
| Accrued interest . . . . .  | 16,863       | 17,201     |
| Dividends payable . . . . .   |              | 131        |
| Net current liabilities of business held for disposition . . .  |              | 4,974      |
| Other accrued liabilities . . . . .   | 21,452       | 26,577     |
|   | -----        | -----      |
| Total current liabilities . . . . .   | 119,177      | 144,351    |
| Notes payable, long-term debt and other obligations, less current portion . . . . .   | 406,744      | 405,798    |
| Noncurrent employee benefits . . . . .  | 31,672       | 31,119     |
| Net-long term liabilities of business held for disposition . . .  |              | 23,009     |
| Other liabilities . . . . .   | 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 and 18,260,844 shares, respectively . . . . .  | 1,850        | 1,826      |
| Additional paid-in capital . . . . .  | 93,186       | 66,245     |
| Deficit . . . . .   | (428,173)    | (420,746)  |
| Other . . . . .   | 9,372        | 11,365     |
| Less: 6,500,947 and 6,737,199 shares of common stock in treasury, at cost . . . . .   | (32,339)     | (33,542)   |
|   | -----        | -----      |
| Total stockholders' equity (deficit) . . . . .  | (356,104)    | (374,852)  |
|   | -----        | -----      |
| Total liabilities and stockholders' equity (deficit) . . .  | \$ 225,620   | \$ 229,425 |
|   | =====        | =====      |

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, |            |            |
|---|-------------------------|------------|------------|
|   | 1995                    | 1994       | 1993       |
| Revenues(*) . . . . .   | \$461,459               | \$479,343  | \$493,041  |
| Cost of goods sold(*) . . . . .   | 216,187                 | 229,807    | 233,386    |
| Gross profit . . . . .  | 245,272                 | 249,536    | 259,655    |
| Operating, selling, administrative and general expenses . . . . .                                       | 237,212                 | 235,374    | 256,902    |
| Restructuring charges . . . . .   |                         |            | 11,913     |
| Operating income (loss) . . . . .   | 8,060                   | 14,162     | (9,160)    |
| Other income (expenses):  |                         |            |            |
| Interest income . . . . .   | 989                     | 533        | 2,292      |
| Interest expense . . . . .  | (57,505)                | (55,952)   | (54,915)   |
| Equity in earnings of affiliate . . . . .   | 678                     |            |            |
| Other, net . . . . .  | 2,776                   | (1,221)    | (2,252)    |
| (Loss) from continuing operations before income taxes . . . . .   | (45,002)                | (42,478)   | (64,035)   |
| Provision (benefit) for income taxes . . . . .  | 342                     | (24,487)   | 5,193      |
| (Loss) from continuing operations . . . . .   | (45,344)                | (17,991)   | (69,228)   |
| Discontinued operations:  |                         |            |            |
| Income from discontinued operations . . . . .   | 2,860                   | 23,693     | 62,001     |
| Gain on disposal . . . . .  | 18,369                  | 150,990    |            |
| Income from discontinued operations . . . . .   | 21,229                  | 174,683    | 62,001     |
| (Loss) income before extraordinary items and accounting changes . . . . .                               | (24,115)                | 156,692    | (7,227)    |
| Extraordinary items:  |                         |            |            |
| (Loss) gain resulting from the early extinguishment of debt . . . . .                                   | (9,810)                 | (47,513)   | 42,849     |
| Gain on foreclosure of MAI . . . . .  |                         |            | 64,452     |
| Gain on reorganization of MAI . . . . .   |                         | 916        | 46,440     |
| (Loss) income from extraordinary items . . . . .  | (9,810)                 | (46,597)   | 153,741    |
| (Loss) income before cumulative effect of accounting changes . . . . .                                  | (33,925)                | 110,095    | 146,514    |
| Cumulative effect of accounting changes:  |                         |            |            |
| Retiree health and life insurance benefits . . . . .  |                         |            | (16,167)   |
| Cumulative effect of change in fiscal year end of MAI . . . . .   |                         |            | (23,567)   |
| Net (loss) income . . . . .   | (33,925)                | 110,095    | 106,780    |
| Proportionate share of New Valley capital transaction, retirement of Class A Preferred Shares . . . . . | 16,802                  |            |            |
| Net (loss) income applicable to common shares . . . . .   | \$(17,123)              | \$110,095  | \$106,780  |
| Per common share:   |                         |            |            |
| (Loss) from continuing operations . . . . .   | \$(1.56)                | \$(1.02)   | \$(4.19)   |
| Income from discontinued operations . . . . .   | \$ 1.16                 | \$ 9.92    | \$ 3.45    |
| Extraordinary items . . . . .   | \$(0.54)                | \$(2.65)   | \$ 8.55    |
| Cumulative effect of accounting changes . . . . .   | \$                      | \$         | \$(2.21)   |
| Net (loss) income applicable to common shares . . . . .   | \$(0.94)                | \$ 6.25    | \$ 5.60    |
| Weighted average common shares and common stock equivalents outstanding . . . . .                       | 18,301,186              | 17,610,898 | 17,977,487 |

(\*) Revenues and Cost of goods sold include federal excise taxes of \$123,420, \$131,877 and \$127,341 for the years ended December 31, 1995, 1994 and 1993, 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<br>Series E, F and G |        | Common Stock |         | Additional<br>Paid-In<br>Capital |
|--|--------------------------------------|--------|--------------|---------|----------------------------------|
|  | Shares                               | Amount | Shares       | Amount  |                                  |
| Balance, December 31, 1992   |                                      |        | 18,646,738   | \$1,865 | \$ 60,561                        |
| Common stock exchanged for Preferred stock                               |                                      |        |              |         |                                  |
| Series E   | 8,929,338                            | \$ 9   | (8,929,338)  | (893)   | 884                              |
| Series F and G   | 2,194,834                            | 2      | (2,194,834)  | (220)   | 218                              |
| Dividends on Series G preferred  |                                      |        |              |         |                                  |
| Stock issued to officer and employee                                     |                                      |        | 375,000      | 38      | (358)                            |
| Stock surrendered by former officers and employees                       |                                      |        | (225,000)    | (23)    | 23                               |
| Reduction of Contingent Value Rights liability                           |                                      |        |              |         |                                  |
| SERP minimum liability adjustment  |                                      |        |              |         |                                  |
| Preferred stock exchanged for common stock                               | (8,939,338)                          | (9)    | 8,939,338    | 894     | (885)                            |
| Repayment of Chairman's loans  |                                      |        |              |         |                                  |
| Net income   |                                      |        |              |         |                                  |
| Treasury stock, at cost  |                                      |        | (1,352,142)  | (135)   | 135                              |
| Balance, December 31, 1993   | 2,184,834                            | 2      | 15,259,762   | 1,526   | 60,578                           |
| Foreign Currency Adjustment  |                                      |        |              |         |                                  |
| Preferred stock exchanged for common                                     | (2,184,834)                          | (2)    | 2,184,834    | 218     | (216)                            |
| Reclassification of former Vice Chairman's<br>loan to other receivables  |                                      |        |              |         |                                  |
| Contingent Value Rights Settlement                                       |                                      |        |              |         |                                  |
| Repayment by Chairman of interest  |                                      |        |              |         |                                  |
| Waiver of dividends, shareholder settlement                              |                                      |        |              |         | 6,250                            |
| Transfer of pension liability to SkyBox                                  |                                      |        |              |         |                                  |
| Stock grant pursuant to consulting agreement                             |                                      |        | 250,000      | 25      |                                  |
| Contract settlement  |                                      |        |              |         | (371)                            |
| Exercise of warrant  |                                      |        | 607,889      | 61      |                                  |
| Net income   |                                      |        |              |         |                                  |
| Unrealized gain on investment in New Valley                              |                                      |        |              |         |                                  |
| Treasury stock, at cost  |                                      |        | (41,641)     | (4)     | 4                                |
| Balance, December 31, 1994   |                                      |        | 18,260,844   | 1,826   | 66,245                           |
| Net loss   |                                      |        |              |         |                                  |
| Consolidation of foreign subsidiary                                      |                                      |        |              |         | 14,435                           |
| Distributions on common stock of BGL (\$0.075 per share,<br>per quarter) |                                      |        |              |         | (5,474)                          |
| Stock grant to directors   |                                      |        | 20,000       | 2       | (2)                              |
| Stock grant to consultant  |                                      |        | 250,000      | 25      |                                  |
| Stock options granted to consultant                                      |                                      |        |              |         | 938                              |
| MAI spin-off   |                                      |        |              |         |                                  |
| Net unrealized holding gain on investment in New Valley                  |                                      |        |              |         |                                  |
| Effect of New Valley capital transactions                                |                                      |        |              |         | 17,043                           |
| Other, net   |                                      |        |              |         | (2)                              |
| Treasury stock, at cost  |                                      |        | (33,748)     | (3)     | 3                                |
| Balance, December 31, 1995   |                                      | \$     | 18,497,096   | \$1,850 | \$93,186                         |

|   | Deficit     | Treasury<br>Stock | Other  | Total       |
|---|-------------|-------------------|--------|-------------|
| Balance, December 31, 1992  | \$(672,823) | \$(34,548)        |        | \$(644,945) |
| Common stock exchanged for Preferred stock                              |             |                   |        |             |
| Series E  |             |                   |        |             |
| Series F and G  |             |                   |        |             |
| Dividends on Series G preferred   | (30,831)    |                   |        | (30,831)    |
| Stock issued to officer and employee                                    | (1,345)     | 2,040             |        | 375         |
| Stock surrendered by former officers and employees                      | (863)       | 459               |        | (404)       |
| Reduction of Contingent Value Rights liability                          | 44,140      |                   |        | 44,140      |
| SERP minimum liability adjustment                                       | (1,695)     |                   |        | (1,695)     |
| Preferred stock exchanged for common stock                              |             |                   |        |             |
| Repayment of Chairman's loans   | 15,695      |                   |        | 15,695      |
| Net income  | 106,780     |                   |        | 106,780     |
| Treasury stock, at cost   |             | (3,797)           |        | (3,797)     |
| Balance, December 31, 1993  | (540,942)   | (35,846)          |        | (514,682)   |
| Foreign Currency Adjustment   |             |                   | \$ 201 | 201         |
| Preferred stock exchanged for common                                    |             |                   |        |             |
| Reclassification of former Vice Chairman's<br>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                             | 3,200       |                   |        | 9,450       |
| Transfer of pension liability to SkyBox                                 | 4,305       |                   |        | 4,305       |
| Stock grant pursuant to consulting agreement                            | (739)       | 1,182             |        | 468         |
| Contract settlement   |             |                   |        | (371)       |



|   |             |            |          |             |
|---|-------------|------------|----------|-------------|
| Exercise of warrant   | (2,875)     | 2,875      |          | 61          |
| Net income  | 110,095     |            |          | 110,095     |
| Unrealized gain on investment in New Valley                           |             |            | 11,164   | 11,164      |
| Treasury stock, at cost   | 1,672       | (1,753)    |          | (81)        |
|   | -----       | -----      | -----    | -----       |
| Balance, December 31, 1994  | (420,746)   | (33,542)   | 11,365   | (374,852)   |
| Net loss  | (33,925)    |            |          | (33,925)    |
| Consolidation of foreign subsidiary                                   |             |            |          | 14,435      |
| Distributions on common stock of BGL (\$0.075 per share, per quarter) |             |            |          | (5,474)     |
| Stock grant to directors  |             | 94         |          | 94          |
| Stock grant to consultant   | (800)       | 1,244      |          | 469         |
| Stock options granted to consultant                                   |             |            | (563)    | 375         |
| MAI spin-off  | 27,286      |            | (201)    | 27,085      |
| Net unrealized holding gain on investment in New Valley               |             |            | (2,332)  | (2,332)     |
| Effect of New Valley capital transactions                             |             |            | 1,103    | 18,146      |
| Other, net  | 12          |            |          | 10          |
| Treasury stock, at cost   |             | (135)      |          | (135)       |
|   | -----       | -----      | -----    | -----       |
| Balance, December 31, 1995  | \$(428,173) | \$(32,339) | \$ 9,372 | \$(356,104) |
|   | =====       | =====      | =====    | =====       |

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, |           |           |
|--|-------------------------|-----------|-----------|
|  | 1995                    | 1994      | 1993      |
| Cash flows from operating activities:  |                         |           |           |
| Net (loss) income . . . . .  | \$(33,925)              | \$110,095 | \$106,780 |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: |                         |           |           |
| Depreciation and amortization . . . . .  | 9,076                   | 6,821     | 11,041    |
| Noncash compensation expense . . . . .   | 559                     | 8,463     |           |
| Income taxes . . . . .   |                         | (24,487)  | 9,287     |
| Gain on sale of assets . . . . .   | (1,042)                 | (11,925)  |           |
| Loss (gain) on early extinguishment of debt . . .  | 9,810                   |           | (42,849)  |
| Impact of discontinued operations . . . . .  | (21,229)                | (117,275) | (106,574) |
| Other, net . . . . .   | 4,167                   | 6,265     | 89        |
| Changes in assets and liabilities, net:  |                         |           |           |
| Receivables . . . . .  | 6,561                   | (4,002)   | 42,585    |
| Inventories . . . . .  | (7,490)                 | (9,574)   | 14,686    |
| Accounts payable and accrued liabilities . . .   | (5,445)                 | (8,576)   | (25,282)  |
| Other assets and liabilities, net . . . . .  | 15,972                  | 135       | 12,187    |
| Net cash (used in) provided by operating activities . . .  | (22,986)                | (44,060)  | 21,950    |
| Cash flows from investing activities:  |                         |           |           |
| Proceeds from sale of business and assets . . . . .  | 14,152                  | 29,542    | 21,372    |
| Impact of discontinued operations . . . . .  |                         | (4,555)   | (16,078)  |
| Investments . . . . .  | (1,965)                 |           |           |
| Capital expenditures . . . . .   | (8,805)                 | (3,023)   | (443)     |
| Dividends from New Valley . . . . .  | 61,832                  |           |           |
| Other, net . . . . .   | 1,660                   | 1,897     | 371       |
| Net cash provided by investing activities . . . . .  | 66,874                  | 23,861    | 5,222     |

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, |          |           |
|---|-------------------------|----------|-----------|
|   | 1995                    | 1994     | 1993      |
| Cash flows from financing activities:                                     |                         |          |           |
| Proceeds from debt . . . . .  | 2,343                   | 12,523   | 6,498     |
| Deferred financing costs . . . . .  |                         | (2,705)  | (520)     |
| Purchase of bonds . . . . .   |                         |          | (10,772)  |
| Repayments of debt . . . . .  | (40,801)                | (2,027)  | (26,059)  |
| (Decrease) increase in cash overdraft . . . . .                           | (594)                   | (12,669) | 19,217    |
| Series G preferred dividend . . . . .                                     | (75)                    | (5,923)  | (15,695)  |
| Distributions on common stock . . . . .                                   | (5,475)                 |          |           |
| CVR Settlement (Redemption) . . . . .                                     |                         | 1,875    | (1,122)   |
| Treasury stock purchases . . . . .  | (135)                   | (21)     | (3,797)   |
| Return (deposit) of CVR collateral . . . . .                              |                         |          | 12,000    |
| Stockholder loan and interest repayments . . . . .                        |                         | 17,774   |           |
| Impact of discontinued operations . . . . .                               |                         | (437)    | (8,297)   |
| Other, net . . . . .  | (57)                    | 375      | (1,475)   |
|   | -----                   | -----    | -----     |
| Net cash (used in) provided by financing activities . .                   | (44,794)                | 8,765    | (30,022)  |
|   | -----                   | -----    | -----     |
| Effect of exchange rate changes on cash and cash<br>equivalents . . . . . |                         | (63)     | 795       |
|   | -----                   | -----    | -----     |
| Net (decrease) in cash and cash equivalents . . . . .                     | (906)                   | (11,497) | (2,055)   |
| Cash and cash equivalents, beginning of period . . . .                    | 4,276                   | 15,773   | 17,828    |
|   | -----                   | -----    | -----     |
| Cash and cash equivalents, end of period . . . . .                        | \$ 3,370                | \$ 4,276 | \$ 15,773 |
|   | =====                   | =====    | =====     |

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

BROOKE GROUP LTD. AND SUBSIDIARIES  
 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 accounts of BGLS Inc. ("BGLS"), Liggett Group Inc. ("Liggett"), Brooke (Overseas) Ltd. ("BOL"), New Valley Holdings, Inc. ("NV Holdings"), other less significant subsidiaries and, as of December 29, 1995, Liggett-Ducat Ltd. ("LDL"). (Refer to Note 4). Liggett is engaged primarily in the manufacture and sale of cigarettes, principally in the United States. LDL is engaged both in real estate development and the sale and manufacturing of cigarettes in Russia.

(b) Liquidity:

The Company believes it will have sufficient liquidity for 1996. This is based on, among other things, forecasts of cash flow for the principal operating companies which indicate that they will be self-sufficient, satisfactory resolution of the Contingent Value Rights ("CVR") suit (refer to Notes 13 and 16), the restructuring of the Company's debt which includes the exchange of the 13.75% Series 2 Senior Secured Notes due 1997 ("Series 2 Notes") for the 15.75% Series A Senior Secured Notes due 2001 ("Series A Notes"), the sale of \$7,397 face value of additional Series A Notes, the proceeds of which were used for the redemption of the 16.125% Senior Subordinated Reset Notes due 1997 (the "Reset Notes") on March 29, 1996 and certain funds available from New Valley Corporation ("New Valley") subject to limitations imposed by the Company's indenture agreements. (Refer to Notes 2 and 8).

(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 and disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses. 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, | 1995               |               | 1994               |               |
|-----------------|--------------------|---------------|--------------------|---------------|
|                 | Carrying<br>Amount | Fair<br>Value | Carrying<br>Amount | Fair<br>Value |
| Long-term debt  | \$409,131          | \$343,517     | \$432,289          | \$347,912     |

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

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 No. 107, "Disclosures About Fair Value of Financial Instruments" ("SFAS 107"), 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 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 11.6% of net sales for the year ended December 31, 1995. No single customer accounted for more than 10% of the Company's net sales in 1994 and 1993. 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 not exceeded management's expectations.

(g) Accounts Receivable:

The allowance for doubtful accounts and cash discounts was \$1,536 and \$969 at December 31, 1995 and 1994, respectively.

(h) Inventories:

Liggett tobacco inventories, which comprise 83.3% of total inventory, 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.

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

(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.

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.

For fiscal years beginning after December 15, 1995, the Company will be required to review long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable, in accordance with the provisions of Statement of Financial Accounting Standards No. 121 ("SFAS 121"), "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of". The Company does not anticipate a significant effect on its results of operations or its financial position from the adoption of SFAS 121.

(j) Intangible Assets:

Intangible assets, consisting of goodwill, trademarks and covenants not-to-compete, are amortized using the straight-line method over 10-12 years. Amortization expense for the years ended December 31, 1995, 1994 and 1993 was \$1,725, \$1,722 and \$1,971, 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 and are being amortized over the life of the debt.

(l) 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, 1995 and 1994 which are subject to significant fluctuations in the near term.

(m) Postretirement Benefits other than Pensions:

Effective January 1, 1993, the Company adopted the provisions of SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions". Under SFAS 106, 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.

As permitted by SFAS 106, the Company has elected to fully recognize the transition obligation (the excess of the accumulated postretirement benefit obligation as of January 1, 1993 over the accrued cost). This resulted in a one-time charge for the Company of \$16,167 recorded in the first quarter of 1993.

(n) Postemployment Benefits:

SFAS No. 112, "Employers' Accounting for Postemployment Benefits", is effective for fiscal years beginning after December 15, 1993. SFAS 112 establishes standards of financial accounting and reporting for the estimated cost of benefits provided by an employer to former or

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

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.

(o) Income Taxes:

Effective January 1, 1993, the Company adopted the provisions of SFAS No. 109, "Accounting for Income Taxes". Under the provisions of SFAS 109, the Company adjusted previously recorded deferred taxes to reflect currently enacted income tax rates. The Company has not retroactively adjusted for business combinations as it is impracticable. Under SFAS 109, a valuation allowance is provided against deferred tax assets when it is deemed more likely than not that future taxable income will be insufficient to realize the deferred tax assets.

(p) 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 could be materially adversely affected by significant unit sales volume declines, increased tobacco costs or reductions in the selling price of cigarettes in the near term.

(q) Earnings Per Share:

Per share calculations are based on the equivalent shares of common stock outstanding and include the impact of the CVR liability decrement for the year ended December 31, 1993 (Note 13). The decrement increased earnings by \$1.37 for the year ended December 31, 1993. The Series G Preferred Stock are common stock equivalents; however, in making per-share calculations for 1993, they have been treated as preferred stock since treating them as common stock would be anti-dilutive (Note 14). The net income per share calculation for December 31, 1993 assumed conversion of the outstanding warrant (Note 15). For the year ended December 31, 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 \$16,802.

(r) Foreign Currency Translation:

The Company accounts for translation of foreign currency in accordance with SFAS 52, "Foreign Currency Translation." The Company's Russian subsidiary operates in a "highly inflationary" economy and use 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. Because the Company only consolidated the operations of the Russian subsidiary from December 29, 1995, the translation adjustments were not material. (Refer to Note 4).

(s) Reclassifications:

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

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

2. INVESTMENT IN NEW VALLEY CORPORATION

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, all of New Valley's \$15.00 Class A Increasing Rate Cumulative Senior Preferred Shares (\$100 Liquidation Value), \$.01 par value (the "Class A Preferred Shares"), all of New Valley's \$3.00 Class B Cumulative Convertible Preferred Shares (\$25 Liquidation Value), \$.10 par value (the "Class B Preferred Shares"), and all of New Valley's Common Shares, \$.01 par value (the "Common Shares") and other equity interests, were reinstated and retained all of their legal, equitable and contractual rights.

Prior to December 31, 1994, under the equity method of accounting, the Company's investment was carried at \$0 since the Company had no intention or commitment to fund New Valley's losses. As of December 31, 1994, the Company's investment in New Valley was \$97,520, principally as a result of recording its share of New Valley's fourth quarter 1994 income. (Refer to Note 5).

At December 31, 1994, the Company's investment in New Valley consisted of a 41.6% voting interest. The Company's investment was represented by 618,326 Class A Preferred Shares with an aggregate fair value of \$145,963 and 79,399,254 common shares (42.1%) with a quoted market value of \$13,498 at December 31, 1994. In addition, the Company held an irrevocable proxy to vote an additional 32,543 Class A Preferred Shares. These shares had been transferred to a third party in December 1994 resulting in compensation expense of \$7,682. This proxy expired on December 31, 1995. Options to purchase up to an aggregate of 9,000,000 New Valley common shares owned by the Company were terminated on December 13, 1995 in exchange for \$822 of Series A Notes issued by the Company pursuant to the 1995 Exchange Offer. (Refer to Note 8). During 1995, the Company acquired an additional 394,975 shares of New Valley common stock at an average price of \$0.28 per share and 250,885 shares of Class B Preferred Shares at an average price of \$7.39 per share. At December 31, 1995, the Company's voting interest is 41.9%.

The Company's investment in the common shares (79,794,229 shares or 41.7%) has a quoted market value of \$21,544 at December 31, 1995. The common shares are accounted for pursuant to APB 18, "The Equity Method of Accounting for Investments in Common Stock", and have a negative carrying value of approximately \$48,747 and \$48,443 at December 31, 1995 and 1994, respectively. The Company's investment represents its proportionate share of New Valley's common shareholders' deficit in addition to the accrued and unpaid dividends on the Class B Preferred Shares. Further, as a result of the Company's purchase of certain Class B Preferred Shares during 1995, the Company has recorded negative goodwill which is being amortized over 10 years. Negative goodwill at December 31, 1995 is approximately \$3,000.



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

The Company's investment in New Valley's stock at December 31, 1995 is summarized as follows:

|                          | Number of<br>Shares<br>----- | Fair<br>Value<br>----- | Amortized<br>Cost<br>----- | Unrealized<br>Holding Gain<br>----- | Earnings<br>----- |
|--------------------------|------------------------------|------------------------|----------------------------|-------------------------------------|-------------------|
| Class A Preferred Shares | 618,326                      | \$109,386              | \$101,962                  | \$7,424                             | \$28,996          |
| Class B Preferred Shares | 250,885                      | 3,262                  | 1,854                      | 1,408                               |                   |
| Common Shares.....       | 79,794,229                   | 21,544                 |                            |                                     | (21,287)(A)       |
|                          |                              | -----<br>\$134,192     | -----<br>\$103,816         | -----<br>\$8,832                    | -----<br>\$ 7,709 |
|                          |                              | =====                  | =====                      | =====                               | =====             |

(A) Amount does not include \$18,146 of New Valley capital transactions credited directly to equity.

The Class A Preferred Shares and the Class B Preferred Shares are accounted for as debt and equity securities, respectively, pursuant to the requirements of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities", and are classified as available-for-sale. The Class A Preferred Shares' fair value has 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. Earnings on the Class A Preferred Shares are comprised of dividends accrued during the period and the accretion of the difference between the Company's basis and their mandatory redemption price. Subsequent to December 31, 1995, however, New Valley became engaged in the ownership and management of commercial real estate and acquired a controlling interest in an operating company. Because these businesses affect the composition and nature of the underlying net assets of New Valley, the Company will determine the fair value of the Class A Preferred Shares based on the quoted market price commencing with the quarter ended March 31, 1996. Had the Company valued its investment in the Class A Preferred Shares using the quoted market price at December 31, 1995, the carrying value would have been decreased by approximately \$19,100.

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 the twelve months ended December 31, 1995, at various times, New Valley's Board of Directors authorized the repurchase of up to 500,000 additional Class A Preferred Shares. At December 31, 1995, 339,400 of such shares had been repurchased on the open market at an aggregate cost of \$43,405 or an average cost of \$127.89 per share. 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 \$16,802, along with other New Valley capital transactions of \$241 for the year ended December 31, 1995.

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, 1995, the accrued and unpaid dividends arrearage was \$121,893 or \$110.06 per share. The Company received \$61,832 (\$100.00 per share) in dividend distributions in 1995.

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

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, 1995, the accrued and unpaid dividends arrearage was \$95,118 or \$34.08 per share. No dividends on the Class B Preferred Shares have been declared since the fourth quarter of 1988.

Each Class B Preferred Share is convertible at the option of the holder into 8.3333 Common Shares based on a \$25 liquidation value and a conversion price of \$3.00 per Common Share. 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.

Summarized financial information for New Valley as of and for the years ended December 31, 1995 and 1994 follows:

|   | 1995      | 1994          |
|---|-----------|---------------|
|   | -----     | -----         |
| Current assets, primarily cash and marketable securities in 1995 and cash and cash equivalents in 1994..... | \$333,485 | \$1,039,209   |
| Noncurrent assets.....  | 52,337    | 30,682        |
| Current liabilities.....  | 177,920   | 754,360       |
| Noncurrent liabilities.....   | 11,967    | 36,177        |
| Redeemable preferred stock.....   | 226,396   | 317,798       |
| Common shareholders' deficit.....   | (30,461)  | (38,444)      |
| Revenues.....   | 67,730    | 10,381        |
| Cost and expenses.....  | 66,064    | 26,146        |
| Income (loss) from continuing operations.....   | 1,374     | (15,265)      |
| Income from discontinued operations.....  | 16,873    | 1,135,706 (A) |
| Extraordinary item.....   |           | (110,500)     |
| Net (loss) income applicable to common shares(C)  | (13,714)  | 929,904       |
| Company's share of discontinued operations.....   | 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, the excess of carrying value of redeemable preferred shares over cost of shares purchased.

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

Subsequent Events: On January 11, 1996, a subsidiary of New Valley made a \$10,600 bridge loan to finance Thinking Machines Corporation, a developer and marketer of parallel software for high-end and networked computer systems. The loan was converted in February 1996 into a controlling interest in a partnership which holds approximately 61% of the outstanding common stock of Thinking Machines Corporation.

On January 10 and January 11, 1996, New Valley acquired four commercial office buildings (the "Office Buildings") and eight shopping centers (the "Shopping Centers"), respectively, for an aggregate purchase price of \$183,900, consisting of \$23,900 in cash and \$160,000 in mortgage financing.

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

In the first quarter of 1996, New Valley repurchased 72,104 Class A Preferred Shares for a total amount of \$10,530. The Company now owns 59.72% of the Class A Preferred Shares.

On March 13, 1996, New Valley declared a cash dividend of \$10.00 per share on its Class A Preferred Shares payable on March 27, 1996. The Company received \$6,183 in the distribution.

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

3. RJR NABISCO HOLDINGS CORP.

In August 1995, New Valley received approval from the Federal Trade Commission to purchase up to 15% of the voting securities of RJR Nabisco Holdings Corp. ("RJR Nabisco") in the open market. As of December 31, 1995, New Valley held approximately 4,900,000 shares of RJR Nabisco common stock, par value \$.01 per share (the "RJR Nabisco Common Stock"), with a market value of \$150,446 (cost of \$149,005). New Valley's investment in RJR Nabisco collateralizes margin loan financing of \$75,119 at December 31, 1995.

On October 17, 1995, New Valley 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, New Valley sold approximately 1,600,000 shares of RJR Nabisco Common Stock to High River for an aggregate purchase price of \$51,000 and the parties agreed that New Valley and High River would each invest up to approximately \$250,000 in shares of RJR Nabisco Common Stock, subject to certain conditions and limitations. Any party to the Agreement may terminate it at any time, although under certain circumstances, the terminating party will be required to pay a fee of \$50,000 to the nonterminating party. The Agreement also provides for the parties to pay certain other fees to each other under certain circumstances, including a net profit override to High River equal to 20% of New Valley's profit on its RJR Nabisco Common Stock, after certain expenses as defined in the Agreement.

On October 17, 1995, the Company and BGLS entered into a separate agreement, as amended (the "High River Agreement"). 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 is 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. Among other things, High River agreed in the High River Agreement to grant a written consent to the Spinoff Resolution with respect to all shares of RJR Nabisco Common Stock held by it and to grant a proxy with respect to all such shares in the event that the Company seeks to replace the incumbent Board of Directors of RJR Nabisco at the 1996 annual meeting of stockholders with a slate of directors committed to effect the spinoff. The Company and BGLS agreed not to engage in certain transactions with RJR Nabisco (including a sale of Liggett or a sale of its RJR Nabisco Common Stock to RJR Nabisco) and not to take certain other actions to the detriment of RJR Nabisco stockholders. High River also agreed that it would not engage in such transactions or take such other actions while the agreement was in effect. In the event that any signatory engages in such transactions or takes such other actions, the High River Agreement provides that the party so doing must pay a fee of \$50,000 to the other. Any party to the High River Agreement may terminate it at any time, although under certain circumstances, the terminating party will be required to pay a fee of \$50,000 to the nonterminating party. The High River Agreement also provides that BGLS pay certain other fees to High River under certain circumstances.

On November 20, 1995, the Company, acting to preserve its right to nominate a slate of directors at RJR Nabisco's 1996 annual stockholders' meeting, submitted to RJR Nabisco information with respect to nominees committed to an immediate spinoff of 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 pursuing the completed consent solicitation and the proxy solicitation. 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

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

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 solicitation, the proxy solicitation 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 completed consent solicitation and the proxy solicitation.

On December 28, 1995, as amended on February 20, 1996 and April 9, 1996, New Valley, the Company and Liggett engaged Jefferies & Company, Inc. ("Jefferies") as financial advisor in connection with New Valley's investment in RJR Nabisco and the Company's solicitation of consents and proxies from the shareholders of RJR Nabisco. New Valley has (i) paid to Jefferies an initial fee of \$1,500 and (ii) has agreed to pay to Jefferies for the period commencing January 1, 1996 and ending March 31, 1996, monthly fees of \$250 (which increased to \$500 on February 20, 1996) and, in addition, until March 31, 1996, an additional monthly fee of \$100 and for the month of April 1996, a fee of \$160. 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, the proxy solicitation and the costs of acquiring the shares of the common stock. In addition, New Valley and the Company agreed to indemnify Jefferies against certain liabilities arising out of the solicitations.

On December 29, 1995, the Company filed a definitive Consent Statement with the SEC and commenced solicitation of consents from stockholders of RJR Nabisco seeking, among other things, the approval of the Spinoff Resolution.

Subsequent Events: On February 29, 1996, New Valley entered into a total return equity swap transaction ("The Equity Swap Agreement") with an unaffiliated company (the "Counterparty") relating to 1,000,000 shares of RJR Nabisco Common Stock. The transaction is for a period of up to six months, subject to earlier termination at the election of New Valley and provides for New Valley to make payment to the Counterparty of approximately \$1,537 upon commencement of the swap. At the termination of the transaction, if the price of the common stock during a specified period prior to such date (the "Final Price") exceeds \$34.42, the price of the RJR Nabisco Common Stock during a specified period following the commencement of the swap (the "Initial Price"), the Counterparty will pay New Valley an amount in cash equal to the amount of such appreciation with respect to 1,000,000 shares of RJR Nabisco Common Stock plus the value of any dividends with a record date occurring during the swap period. If the Final Price is less than the Initial Price, then New Valley will pay the Counterparty at the termination of the transaction an amount in cash equal to the amount of such decline with respect to 1,000,000 shares of RJR Nabisco Common Stock, offset by the value of any dividends, provided that, with respect to approximately 225,000 shares of RJR Nabisco Common Stock, New Valley will not be required to pay any amount in excess of an approximate 25% decline in the value of the shares. The potential obligations of the Counterparty under the swap are being guaranteed by the Counterparty's parent, a large foreign bank, and New Valley has pledged certain collateral in respect of its potential obligations under the swap and has agreed to pledge additional collateral under certain conditions. As of March 29, 1996, New Valley had an unrealized loss on this swap transaction of approximately \$4,200 and had pledged collateral of approximately \$11,800.

On March 4, 1996, the Company filed a definitive Proxy Statement with the SEC and commenced solicitation of proxies in favor of its previously nominated slate of directors to replace RJR Nabisco's incumbent Board of Directors at its 1996 annual meeting of stockholders. As of March 29, 1996, New Valley had expensed approximately \$10,000 for costs relating to its RJR Nabisco investment, of which approximately \$4,000 was expensed in 1995.

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

On March 13, 1996, the Company was informed by the independent inspectors of election that consents representing 142,237,880 votes (50.58%) were delivered in favor of the Spinoff Resolution and 150,926,535 votes (53.67%) were delivered in favor of the Bylaw Amendment. RJR Nabisco announced that it currently had no plans to contest the outcome of the vote.

At March 29, 1996, New Valley held approximately 5,200,000 shares of RJR Nabisco Common Stock with a market value \$156,143 (cost of approximately \$158,000) collateralizing margin loan financing of approximately \$83,500.

#### 4. INVESTMENT IN BROOKE (OVERSEAS) LTD.

On October 1, 1993, the Company transferred the stock of its wholly-owned real estate development subsidiary, BrookeMil Ltd. ("BrookeMil"), to LDL in exchange for 58% of the stock of LDL and a promissory note from BrookeMil as part of the settlement of a dispute with employees of LDL's tobacco company. Also on October 1, 1993, BrookeMil entered into a long-term lease, as lessor, of a western style office building in Moscow and received prepaid rent from the lessee. Cash received from the lessee was used by BrookeMil to repay the promissory note together with accrued interest of \$5,313 and \$4,017 in 1993 and 1995, respectively. These payments have been deferred by the Company and are being recognized over the lease term. In prior years, the Company did not consolidate LDL due to certain events continuing through 1995 which impaired the Company's ability to control the operations of LDL. The amounts invested in Russian ventures of \$5,723 and \$2,878 in 1994 and 1993, respectively, were expensed, based on the determination that there was significant uncertainty as to the recoverability of these amounts. The Company has reexamined the issue of consolidating LDL and at December 29, 1995 determined that a series of events in the latter part of 1995 (see below) has enabled the Company to exert sufficient control so that the recoverability of its investment appears reasonable.

In the third quarter of 1995, BOL increased its investment in LDL from approximately 58% to 68% through a direct purchase of stock from other shareholders. BOL recorded goodwill in the amount of \$435 which is being amortized over a ten year period.

In October 1995, LDL entered into a loan agreement with Rosvneshtorg Bank, Moscow, Russia, to borrow up to \$20,000 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. The loan agreement was arranged through a third party for a net fee of \$4,044 payable ratably over the term of the loan. The Company has guaranteed the payment of the note and the broker's fee. All of the stock of BrookeMil has been pledged as collateral for the loan. At December 31, 1995, BrookeMil has drawn approximately \$8,000 of the loan and accrued approximately \$3,000 of the broker's fee, which has been deferred and is being amortized over the life of the loan.

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

Finally, on December 29, 1995, LDL relinquished its 59.4% ownership in a joint real estate venture in exchange for 100% ownership of a tobacco factory owned by the venture with the intention of constructing a new manufacturing facility on the outskirts of Moscow. LDL's cost basis in the joint real estate venture of \$2,675 was transferred to its basis in the tobacco factory.

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

The additional amounts included in the financial statements as a result of consolidating the Russian subsidiaries 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.

Amounts invested in the Russian subsidiary during the year ended December 31, 1995 were approximately \$18,000. Of this amount, approximately \$7,300 was capitalized.

Subsequent Event: On April 3, 1996, the Company entered into a stock purchase agreement (the "purchase agreement") with the chairman of LDL (the "Seller"). Under the purchase agreement, the Company acquired the 84,540 shares held by the Seller for \$15 per share (\$1,268). The purchase price is payable in installments during 1996 and the 84,540 shares of LDL collateralize the Company's obligations under both the purchase agreement and consulting agreement (described below). This transaction is expected to increase the Company's ownership percentage in LDL from 68% to 80%.

Concurrently, the Company entered into a consulting agreement with the Seller for services through December 31, 1997. Under the terms of the consulting agreement, the Company will pay the Seller approximately \$5,232 over five years. Also, LDL extended the Seller's employment agreement with LDL for one year at \$384. Additionally, certain obligations of the Seller totaling approximately \$2,300 were assigned to an affiliate of the Seller and a note receivable from a third party for approximately \$3,300 relating to the sale of a previously owned subsidiary in Russia, which receivables had been charged to operations in prior years, were assigned to the affiliate in exchange for a waiver of an additional \$1,000 in payments under the consulting agreement.

#### 5. DISCONTINUED OPERATIONS

A summary of discontinued operations follows:

|                                      | Year Ended December 31, |           |          |
|--------------------------------------|-------------------------|-----------|----------|
|                                      | 1995                    | 1994      | 1993     |
|                                      | -----                   |           |          |
| Income from discontinued operations: |                         |           |          |
| New Valley.....                      | \$ 1,800                |           |          |
| MAI.....                             | 698                     | \$ 3,628  | \$28,177 |
| SkyBox.....                          | 362                     | 20,065    | 33,824   |
|                                      | -----                   | -----     | -----    |
|                                      | 2,860                   | 23,693    | 62,001   |
|                                      | -----                   | -----     | -----    |
| Gain from disposal of operations:    |                         |           |          |
| New Valley(A).....                   | 5,231                   | 139,935   |          |
| SkyBox.....                          | 13,138                  | 11,055    |          |
|                                      | -----                   | -----     | -----    |
|                                      | 18,369                  | 150,990   |          |
|                                      | -----                   | -----     | -----    |
| Income from discontinued operations. | \$21,229                | \$174,683 | \$62,001 |
|                                      | =====                   | =====     | =====    |

(A) See Note 2 for discussion of discontinued operations related to New Valley.

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

Net revenues of MAI Systems Corporation ("MAI") for the period January 1, 1995 to February 6, 1995 were \$6,652 and for the years ended December 31, 1994 and 1993 were \$66,095 and \$115,291, respectively. Net revenues of SkyBox were \$65,119 for the nine months ended September 30, 1993.

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"). (Refer to Note 2). 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.

MAI:

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 assets and liabilities of MAI at December 31, 1994 are included in other accrued liabilities and net long-term liabilities of businesses held for disposition. The MAI Distribution reduced the stockholder's deficit by \$27,085 in the first quarter of 1995.

On April 12, 1993, MAI filed a voluntary petition under Chapter 11 of the Bankruptcy Code. MAI emerged from bankruptcy on November 18, 1993. Under the plan of reorganization, the Company did not receive any distribution for its original equity ownership but did receive a 44.9% common ownership interest for the MAI debt it held as MAI's largest single creditor. Further, 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. When combined with the interest originally received in the reorganization, total common ownership held by the Company at December 31, 1994 was approximately 65.2%.

The terms of the plan of reorganization provided for the issuance of new MAI common stock having an estimated fair market value of \$50,000 in exchange for the cancellation of unsecured debt. In connection with the issuance of the new common stock, the Company recorded an extraordinary gain of \$46,440 for the difference between the debt being forgiven and the fair market value of the new MAI common stock issued.

On March 22, 1993, a syndicate of banks (the "Banks") foreclosed on all of the outstanding capital stock of certain of MAI's European subsidiaries, on certain intellectual property of MAI and on



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

amounts due to MAI from certain of its European subsidiaries (the "Foreclosure"), in satisfaction of all amounts due under MAI's term loan facilities and revolving facilities with the Banks. Because management's estimated fair market value of assets surrendered was less than the amount of the debt satisfied, the Foreclosure was accounted for as a troubled debt restructuring. As a result, the difference between the book value and management's estimated fair market value of the assets surrendered of \$22,187 is included in the gain from discontinued operations and the difference between the carrying amount of the debt satisfied and the fair market value of the assets surrendered of \$64,452 is classified as an extraordinary gain on foreclosure. 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.

In 1993 MAI changed its year end to December 31 from September 30 and, therefore, in 1993 MAI was no longer consolidated on a three month lag. This change, amounting to \$23,567, is reported as a change in accounting in the first quarter of 1993. The condensed statement of operations for this three month period which ended December 31, 1992 follows:

|  |            |
|--|------------|
| Total revenue.....                           | \$ 59,183  |
| Direct costs.....                            | 37,442     |
|  | -----      |
| Gross profit.....                            | 21,741     |
| Selling, general and administrative expenses | 22,792     |
| Non-recurring charges.....                   | 15,340     |
|  | -----      |
| Operating loss.....                          | (16,391)   |
| Interest, net.....                           | (4,675)    |
|  | -----      |
| Loss before taxes.....                       | (21,066)   |
| Income taxes.....                            | 2,501      |
|  | -----      |
| Net loss.....                                | \$(23,567) |
|  | =====      |

SkyBox:

On October 6, 1993 the Company distributed (hereinafter referred to as the "Distribution") to holders of record of its common stock at September 20, 1993 one share of common stock of its subsidiary, SkyBox International Inc. ("SkyBox"), for each of its 6,522,929 shares of common stock then outstanding, representing 81.5% of the SkyBox common stock and 46.6% of its direct voting power. After October 1, 1993, SkyBox was no longer consolidated and was accounted for on the equity method. During the fourth quarter of 1993 and continuing throughout 1994 and the first quarter of 1995, the Company sold all of its remaining SkyBox common stock for approximately \$20,000. In addition, during the same period SkyBox redeemed the 300 shares of SkyBox Series A Preferred Stock which the Company held at the stated redemption price of \$100,000 per share for a total of \$30,000.

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

## 6. INVENTORIES

Inventories consist of:

|                                | December 31, |          |
|--------------------------------|--------------|----------|
|                                | 1995         | 1994     |
| Finished goods.....            | \$19,129     | \$18,374 |
| Work-in-process.....           | 3,570        | 2,952    |
| Raw materials.....             | 29,021       | 20,609   |
| Replacement parts and supplies | 4,903        | 3,754    |
|                                | -----        | -----    |
| Inventories at current cost... | 56,623       | 45,689   |
| LIFO adjustments.....          | 3,899        | 1,409    |
|                                | -----        | -----    |
|                                | \$60,522     | \$47,098 |
|                                | =====        | =====    |

The Company has a leaf inventory management program whereby, among other things, it is committed to purchase certain quantities of leaf tobacco. The purchase commitments are for quantities not in excess of anticipated requirements and are at prices, including carrying costs, established at the date of the commitment. Liggett normally purchases all of its tobacco requirements from domestic and foreign leaf tobacco dealers, much of it under long-term purchase commitments which expire principally in December 1996. At December 31, 1995, Liggett had leaf tobacco purchase commitments of approximately \$25,500.

## 7. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of:

|                               | December 31, |           |
|-------------------------------|--------------|-----------|
|                               | 1995         | 1994      |
| Land and improvements.....    | \$ 541       | \$ 716    |
| Buildings.....                | 31,947       | 8,703     |
| Machinery and equipment.....  | 42,877       | 35,069    |
| Leasehold improvements.....   | 309          | 82        |
| Assets held for sale.....     | 1,259        |           |
| Asset under capital lease.... |              | 5,696     |
|                               | -----        | -----     |
|                               | 76,933       | 50,266    |
| Less accumulated depreciation | (27,868)     | (24,460)  |
|                               | -----        | -----     |
|                               | \$ 49,065    | \$ 25,806 |
|                               | =====        | =====     |

The amounts provided for depreciation for the years ended December 31, 1995, 1994 and 1993 were \$4,699, \$4,609 and \$4,675, respectively.

The amount provided for amortization of assets under capital lease for the year ended December 31, 1994 was \$551.

Subsequent event: On April 9, 1996 Liggett executed a definitive agreement with the County of Durham for the sale by Liggett to the County of Durham of certain surplus realty for a sale price of \$4,300. It is anticipated that closing will occur on or before May 31, 1996.

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

## 8. NOTES PAYABLE, LONG-TERM DEBT AND OTHER OBLIGATIONS

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

|   | December 31,<br>1995 | 1994      |
|---|----------------------|-----------|
| -----   |                      |           |
| 13.75% Series 1 Senior Secured Notes due 1995.....    |                      | \$ 23,594 |
| 13.75% Series 2 Senior Secured Notes due 1997.....    | \$ 91,179            | 91,294    |
| 16.125% Senior Subordinated Reset Notes due 1997..... | 5,670                | 5,670     |
| 14.500% Subordinated Debentures due 1998.....         | 126,295              | 126,295   |
| Notes Payable - Foreign.....                          | 11,122               |           |
| Other.....  | 2,084                | 4,940     |
|   |                      |           |
| Liggett:  |                      |           |
| 11.500% Senior Secured Series B Notes due 1993 - 1999 | 119,485              | 126,234   |
| Variable rate Series C Senior Secured Notes due 1999. | 32,279               | 29,415    |
| Revolving credit facility.....                        | 21,017               | 24,847    |
| -----   |                      |           |
| Total notes payable and long-term debt.....           | 409,131              | 432,289   |
| Less:   |                      |           |
| Current maturities.....                               | 2,387                | 26,491    |
| -----   |                      |           |
| Amount due after one year.....                        | \$406,744            | \$405,798 |
|   | =====                | =====     |

## Offer to Exchange:

15.75% Series A Senior Secured Notes Due 2001 for 13.75% Series 2 Senior Secured Notes Due 1997, and  
 15.75% Series B Senior Secured Notes Due 2001 for 16.125% Senior Subordinated Reset Notes Due 1997 and 14.500% Subordinated Debentures:

As a result of the Exchange Agreement, dated November 21, 1995 (the "1995 Exchange Agreement"), on November 27, 1995, BGLS commenced an offer to exchange a total of \$232,868 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 15.75% Series B Senior Secured Notes ("Series B Notes") for each \$1,000 principal amount of Reset Notes exchanged and \$1,000 principal amount of new Series B Senior Secured Notes for each \$1,000 principal amount of Subordinated Debentures exchanged. The new Series A Notes and the new Series B Notes were identical except that the Series B Notes were not subject to restrictions on transfer.

The holders of in excess of 99% of the Series 2 Notes and 88% of the Subordinated Debentures agreed, subject to certain conditions, to tender their securities in the exchange offer. The Exchange offer closed on January 30, 1996. All \$91,179 of the Series 2 Notes and \$125,495 of the Subordinated Debentures were exchanged. In addition, BGLS cancelled all of the Subordinated Debentures (\$13,705) held by the Company. Subordinated Debentures in the amount of \$800 remain outstanding (see "14.500% Subordinated Debentures due 1998" below). Holders of Reset Notes did not exchange and, in accordance with the 1995 Exchange Agreement, BGLS issued an irrevocable notice of redemption for all of the outstanding Reset Notes which were redeemed on March, 29 1996 for a total amount of \$5,785, including premium, together with accrued interest of \$452.

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

The new Series A and 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. Interest is payable at the rate of 15.75% per annum on January 31 and July 31 of each year, except for the period ended July 31, 1996 when interest is payable at 13.75% from October 1, 1995 to January 30, 1996 and 15.75% from January 31, 1996 through July 31, 1996.

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, based upon the binding agreement as of November 21, 1995.

The Series B Notes Indenture contains certain covenants, which among other things, limit the ability of BGLS to make distributions to the Company, limit additional indebtedness to \$10,000 and restrict certain transactions with affiliates.

Subsequent event: On March 7, 1996, an additional \$7,397 face amount of Series A Notes were sold for \$6,300 including accrued interest with proceeds being used for the redemption of the Reset Notes (see above).

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.

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.

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. 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.

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.

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.

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

16.125% Senior Subordinated Reset Notes due 1997  
14.500% Subordinated Debentures due 1998:

Pursuant to the 1995 Exchange Offer, discussed above, the Reset Notes were redeemed on March 29, 1996. The Subordinated Debentures in face amount of \$800 remain outstanding and, as part of the 1995 Exchange Agreement, the Sixth Supplemental Indenture dated January 26, 1996 was executed by the Company in which substantially all of the covenants and events of default were eliminated pertaining to the Subordinated Debentures.

15.501% Junior Subordinated Secured Notes due 2008:

Pursuant to an agreement (the "Purchase Agreement") dated February 23, 1989 among the Company, Liberty Service Corporation ("Liberty") and its parent, Columbia Savings & Loan Association ("Columbia"), Liberty purchased from the Company \$48,560 of the Company's 15.501% Junior Subordinated Secured Notes due 2008 (the "Junior Secured Notes") which was utilized to purchase New Valley securities. In the year ended December 31, 1993, the Company repurchased \$48,560 of the Junior Secured Notes for \$10,198. As a result of this transaction, the Company recorded extraordinary gains on extinguishment of indebtedness of \$38,362 in the year ended December 31, 1993.

Liggett 11.500% Senior Secured Series B Notes due 1993 - 1999:

During the first quarter 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 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 Series B Notes due on February 1, 1999. The Liggett Series B Notes are collateralized by substantially all of the assets of Liggett, excluding accounts receivable and inventory. The Liggett Series B Notes may be redeemed, in whole or in part, at a price equal to 104%, 102% and 100% of the principal amount in the years 1996, 1997 and 1998, respectively, at the option of Liggett at any time on or after February 1, 1996. The Liggett Series B Notes contain restrictions on Liggett's ability to pay dividends, incur additional debt, grant liens and enter into any new agreements with affiliates.

Issuance of Series C Variable Rate Notes:

On January 31, 1994, Liggett issued \$22,500 of Variable Rate Series C Senior Secured Notes Due 1999 (the "Series C Notes"). Liggett received \$15,000 from the issuance in cash and received \$7,500 in Liggett Series B Notes which were credited against the mandatory redemption requirements of Liggett Series B Notes required under the indenture for February 1, 1994. 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 Series C Notes to be issued under the Liggett Series B 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 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. The Series C Notes bore a 16.5% interest rate, which was reset on February 1, 1995 to 19.75%, the maximum reset rate.

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

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, 1995, \$21,017 was outstanding and \$13,340 was available under the facility. Borrowings under the facility bear interest at a rate equal to 1.5% above the Philadelphia National Bank's prime rate which was 8.75% at December 31, 1995. The facility requires Liggett's compliance with certain financial and other covenants. The facility also limits the amount of dividends and distributions by Liggett. At December 31, 1995, Liggett was in compliance with all covenants under the facility.

Foreign Loans:

In October, 1995, LDL, a subsidiary of BOL, entered into a construction loan agreement with Rosvneshtorg Bank, Moscow, Russia for a period of two years on behalf of BrookeMil for \$20,000. The interest rate is LIBOR plus 10%. (Refer to Note 4). The outstanding balance at December 31 was \$7,967. Broker's fees of approximately \$3,000 were recorded and are payable ratably over the term of the loan.

In January 1995, LDL entered into a revolving credit facility for \$1,667 with the same bank. The facility is denominated in rubles and is due within 180 days with an automatic renewal. Because the credit facility exists in a hyperinflationary economy, it bears interest at a rate of 85% per annum. At December 31, 1995, the balance was \$155.

Scheduled Maturities:

Subsequent to the closing of the 1995 Exchange Agreement on January 30, 1996 and the redemption of the Reset Notes, scheduled maturities of long-term debt for each of the next five years are as follows:

|            |           |
|------------|-----------|
| 1996.....  | \$ 2,387  |
| 1997.....  | 38,519    |
| 1998.....  | 38,506    |
| 1999.....  | 107,375   |
| 2000.....  |           |
| Thereafter | 232,868   |
|            | -----     |
|            | \$419,655 |
|            | =====     |

9. RESTRUCTURING CHARGES

Liggett:

In early 1993, Liggett restructured its headquarters operations to reduce operating costs. In connection with the restructuring, Liggett has recorded a non-recurring net charge to operating income of \$5,565 (\$2,531 is included in cost of sales).

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

In January 1994, Liggett reduced its field sales force and recorded a charge of \$3,000 against operating income in the fourth quarter of 1993.

During the year ended December 31, 1995, Liggett offered a severance and benefit program to reduce personnel costs on an ongoing basis. This program resulted in a charge to operations of \$2,548.

Headquarters:

In 1993, the Company restructured its domestic and foreign operations including reduction in personnel and subleasing of certain office spaces to reduce operating costs. In connection with the restructuring, the Company recorded non-recurring charges of approximately \$5,879 for the year ended December 31, 1993.

10. 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. As a result of this, the Company recorded a curtailment charge of \$1,550, \$691 and \$4,766 in 1995, 1994 and 1993, respectively.

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

|  | Year Ended December 31, |          |          |
|--|-------------------------|----------|----------|
|  | 1995                    | 1994     | 1993     |
| Service cost - benefits earned during the period | \$ 454                  | \$ 1,140 | \$ 2,065 |
| Interest cost on projected benefit obligation... | 12,850                  | 12,363   | 13,746   |
| Actual return on assets.....                     | (23,501)                | (5,144)  | (23,925) |
| Curtailment related to plan restructuring.....   | 1,550                   | 691      | 4,766    |
| Net amortization and deferral.....               | 9,547                   | (8,337)  | 8,727    |
|  | \$ 900                  | \$ 713   | \$ 5,379 |
|  | =====                   | =====    | =====    |

In accordance with SFAS 87, "Employers' Accounting for Pensions", the overfunded and underfunded plans with respect to the accumulated benefit obligation at December 31, 1994 have been segregated for financial statement presentation. All plans were underfunded with respect to the 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, 1995 and 1994 for the pension plans are as follows:

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

|  | December 31,<br>1995                     | December 31,<br>1994                     |  |
|--|--|--|--|
|  | Accumulated<br>Benefits Exceed<br>Assets | Assets Exceed<br>Accumulated<br>Benefits | Accumulated<br>Benefits Exceed<br>Assets |
| Actuarial present value of benefit obligations:                            |  |  |  |
| Vested benefit obligation.....   | \$166,448                                | \$77,521                                 | \$81,472                                 |
|  | =====                                    | =====                                    | =====                                    |
| Accumulated benefit obligation.....  | \$172,317                                | \$77,521                                 | \$83,471                                 |
|  | =====                                    | =====                                    | =====                                    |
| Projected benefit obligation.....  | \$172,317                                | \$77,521                                 | \$83,622                                 |
| Plan assets at fair value.....   | 163,913                                  | 78,239                                   | 78,475                                   |
|  | -----                                    | -----                                    | -----                                    |
| Projected benefit obligation in excess of (less<br>than) plan assets.....  | 8,404                                    | (718)                                    | 5,147                                    |
| Unrecognized net gain.....   | 14,449                                   | 7,232                                    | 11,143                                   |
| Unrecognized prior service cost.....                                       |  |  | (229)                                    |
| Adjustment required to recognize minimum liability..                       | 976                                      |  | 803                                      |
|  | -----                                    | -----                                    | -----                                    |
| Pension liability before purchase accounting<br>valuation adjustments..... | 23,829                                   | 6,514                                    | 16,864                                   |
| Purchase accounting valuation adjustments related<br>to income taxes.....  | (3,773)                                  | (2,061)                                  | (2,060)                                  |
|  | -----                                    | -----                                    | -----                                    |
| Net pension liability included in the balance sheets                       | \$ 20,056                                | \$ 4,453                                 | \$14,804                                 |
|  | =====                                    | =====                                    | =====                                    |

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

|  | 1995         | 1994         |
|--|--------------|--------------|
| Discount rates.....                        | 6.25 - 8.50% | 5.75 - 8.50% |
| Accrued rates of return on invested assets | 9.0%         | 9.0%         |
| Salary increase assumptions.....           | N/A          | 3.0%         |
|  | 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 the Company's United States employees were eligible for certain postretirement benefits if they reach retirement age while working for the Company; however, there were several modifications made to the Company's Plans in 1993. Prior to 1994, the Plans had reimbursed 80 percent of retirees' medical claims. However, the Company announced on November 11, 1993 that retirees would be required to fund 60 percent of participant medical premiums in 1994 and 100 percent of premiums on a going-forward basis, effective January 1, 1995. As a result of the above modifications, the Plan's Accumulated Postretirement Benefit Obligation was decreased from \$39,029 at January 1, 1993 to \$15,137 at December 31, 1993.

The components of net periodic postretirement (benefit) cost for the years ended December 31, 1995, 1994 and 1993 are as follows:



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

|  | 1995    | 1994    | 1993      |
|--|---------|---------|-----------|
|  | -----   | -----   | -----     |
| Service cost, benefits attributed to employee service during the year..... | \$ 68   | \$ 63   | \$ 587    |
| Interest cost on accumulated postretirement benefit obligation.....        | 970     | 1,037   | 3,133     |
| Curtailment credits related to restructuring expense.....                  |         |         | (623)     |
| Immediate recognition of transition obligation                             |         |         | 16,853    |
| Curtailment credits related to modification of Medical Plans.....          |         |         | (26,172)  |
| Charge for special termination benefits.....                               | 489     |         |           |
| Amortization of net (gain) loss.....                                       | (26)    | 33      |           |
|  | -----   | -----   | -----     |
| Net periodic postretirement cost (benefit)....                             | \$1,501 | \$1,133 | \$(6,222) |
|  | =====   | =====   | =====     |

The following sets forth the actuarial present value of the Accumulated Postretirement Benefit Obligation ("APBO") at December 31, 1995 and 1994 applicable to each employee group:

|  | 1995      | 1994     |
|--|-----------|----------|
|  | -----     | -----    |
| Retired employees.....   | \$ 8,673  | \$ 9,292 |
| Active employees - fully eligible.....                                 | 1,707     | 1,170    |
| Active employees - not fully eligible.....                             | 1,078     | 1,143    |
|  | -----     | -----    |
| APBO.....  | \$ 11,458 | \$11,605 |
| Unrecognized net gain.....   | 1,339     | 1,277    |
| Purchase accounting valuation adjustments related to income taxes..... | (1,181)   | (1,291)  |
|  | -----     | -----    |
| Postretirement liability.....  | \$ 11,616 | \$11,591 |
|  | =====     | =====    |

The APBO at December 31, 1995 was determined using a discount rate of 7.5% and a health-care cost trend rate ranging from 10% in the near term, declining to 4% in the third and subsequent years. A 1% increase in the trend rate for health care costs would have increased the APBO and postretirement benefit costs by \$420 and \$50 for the year ended December 31, 1995. 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. Liggett contributed \$900, \$420 and \$1,787 to the 401(k) plans for the years ended December 31, 1995, 1994 and 1993, respectively.

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

## 11. INCOME TAXES

The Company files a consolidated Federal Income Tax Return that includes its more than 80% owned United States subsidiaries.

The amounts provided for income taxes are as follows:

|   | Year Ended December 31, |            |         |
|---|-------------------------|------------|---------|
|   | 1995                    | 1994       | 1993    |
| Current:  |                         |            |         |
| U.S. Federal.....                                   |                         | \$(24,714) | \$1,000 |
| State.....  | \$342                   | 227        |         |
| Deferred:   |                         |            |         |
| U.S. Federal.....                                   |                         |            | 2,141   |
| State.....  |                         |            | 2,052   |
| Total provision (benefit) for continuing operations | \$342                   | \$(24,487) | \$5,193 |
|   | ===                     | =====      | =====   |

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

|  | December 31, 1995      |                             | December 31, 1994      |                             |
|--|------------------------|-----------------------------|------------------------|-----------------------------|
|  | Deferred Tax<br>Assets | Deferred Tax<br>Liabilities | Deferred Tax<br>Assets | Deferred Tax<br>Liabilities |
| Sales and product allowances.....                                      | \$ 2,337               |                             | \$ 2,721               |                             |
| Inventory.....   | 831                    | \$ 1,280                    | 550                    | \$ 2,397                    |
| Coupon accruals.....   | 3,198                  |                             | 4,645                  |                             |
| Property, plant and equipment.....                                     |                        | 6,200                       |                        | 6,554                       |
| Employee benefit accruals.....   | 13,249                 |                             | 12,502                 |                             |
| Debt restructuring charges.....  | 5,702                  |                             | 3,403                  |                             |
| Excess of tax basis over book basis-<br>non-consolidated entities..... | 4,327                  |                             | 17,508                 |                             |
| Excess of book basis over tax basis-<br>non-consolidated entities..... |                        | 5,564                       |                        | 21,306                      |
| Other.....   |                        |                             | 1,289                  |                             |
| Legal settlements.....   | 3,556                  |                             |                        |                             |
| Net operating loss carryforwards....                                   | 54,860                 |                             | 48,501                 |                             |
| Valuation allowance.....   | (73,955)               |                             | (60,862)               |                             |
| Reclassifications.....   | (13,044)               | (13,044)                    | (30,257)               | (30,257)                    |
|  | \$ 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, |            |            |
|--|-------------------------|------------|------------|
|  | 1995                    | 1994       | 1993       |
| (Loss) from continuing operations<br>before income taxes.....  | \$(45,002)              | \$(42,478) | \$(64,035) |
| Federal income tax (benefit) at statutory rate                 | (15,751)                | (14,867)   | (22,412)   |
| Increases (decreases) resulting from:                          |                         |            |            |
| State income taxes, net of federal income tax<br>benefits..... | 342                     | 148        | 1,333      |
| Changes in valuation allowance.....                            | 11,810                  | 14,432     | 26,272     |
| Other.....   | 3,941                   |            |            |
| Reduction of reserves.....                                     |                         | (24,200)   |            |
| Provision (benefit) for income tax.....                        | \$ 342                  | \$(24,487) | \$ 5,193   |
|  | =====                   | =====      | =====      |



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

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, 1995, the Company and its consolidated group had net operating loss carryforwards for tax purposes of approximately \$135,000 which may be subject to certain restrictions and limitations and which will expire in the years 2006 to 2009.

12. 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: |          |
|--------------------------|----------|
| 1996.....                | \$ 4,014 |
| 1997.....                | 2,989    |
| 1998.....                | 2,344    |
| 1999.....                | 1,252    |
| 2000.....                | 900      |
| 2001 and thereafter..... | 24,950   |
|                          | -----    |
|                          | \$36,449 |
|                          | =====    |

Lease commitments for 2001 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 as follows:

| Year ending December 31: |       |
|--------------------------|-------|
| 1996.....                | \$642 |
| 1997.....                | 126   |
|                          | ---   |
|                          | \$768 |
|                          | ===   |

The Company's rental expense for the years ended December 31, 1995, 1994 and 1993 was \$4,449, \$4,808 and \$7,286 respectively.

13. CONTINGENT VALUE RIGHTS

The CVR entitled the holder (3,117,400 CVRs outstanding at December 31, 1992) to receive on November 15, 1993 a cash payment equal to the amount, if any, by which the then current market value of the Company's common stock for a period of 20 trading days ending five days before such date was less than \$19.45 per share, reduced as provided in the CVR agreement for dividends and distributions, if any, paid on shares of common stock up to the time of maturity. The Company was

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

permitted to redeem the CVRs in whole or in part, at any time after May 15, 1991, for a price equal to \$13.75 per share increased from November 1990 at a 15% compound annual rate as adjusted for dividends paid (the "Target Price") minus the then market price of the common stock as of a date 60 days before the redemption date. The CVR obligation, initially recorded at fair market value which was de minimis, was adjusted to the calculated redemption value through October 15, 1993, with the change reflected directly in stockholder's equity.

The CVR's were senior collateralized obligations of the Company and were freely transferable separately from the common stock. They were collateralized by assets (\$12,000 in cash and certain securities of the Company) deposited with a trustee.

The Company satisfied the major portion of its liability with respect to the CVR obligation on October 6, 1993 through the distribution of SkyBox common stock which removed \$44,813 of the obligation. The remaining portion of the obligation was satisfied pursuant to a Notice of Redemption given on October 15, 1993 whereby the Company redeemed each CVR for \$0.36 (a total of \$1,122) on December 9, 1993 or thereafter when such CVR was surrendered to the Trustee. Accordingly, all collateral (except for the \$1,122, above) which included cash and certain securities of the Company and BGLS was released. (See also Note 16, "Contingencies", regarding a complaint filed by a group of CVR holders).

#### 14. EQUITY

##### Preferred Stock Series E, F and G:

On September 14, 1993, certain officers and an employee of the Company exchanged 11,124,172 common shares for 8,929,338 shares of Series E and 2,194,834 of Series F redeemable preferred stock. Each share of Series E Preferred Stock is convertible beginning 30 days after initial issuance into 1,000 shares of the Company's common stock. At October 31, 1993, all Series E Preferred Stock had been converted into the Company's common stock.

The terms of the Series F Preferred Stock are identical to those of the Series E Preferred Stock, except that the Series F Preferred Stock are entitled to receive, in addition to dividends payable on the Series E Preferred Stock, a special dividend per share in an amount equal to the appraised value per share of the SkyBox common stock (\$14.375) divided in the Distribution times the number of shares into which it is convertible, payable one year from the date of the Distribution, in cash, or at the option of the Company, in the Company's common stock valued at its average closing price over the 20 trading days prior to payment. Following payment of this dividend, each share of Series F Preferred Stock will convert automatically into Company common stock.

On December 30, 1993, certain present and a former officer of the Company were offered an exchange for all shares remaining (a total of 2,184,834) of Series F redeemable preferred stock for 2,184,834 shares of Series G redeemable preferred stock.

The terms of the Series G Preferred Stock are identical to those of the Series F Stock, except that the special dividend on Series G stock was accelerated and paid in two parts. To the extent that 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

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

installment payment date and October 6, 1994, the date the Special dividend on the Series F preferred stock was to have been paid out. (Refer to Note 16 "Contingencies" and Note 17 "Related Party Transactions"). At December 31, 1994, all Series G Preferred Stock had been converted into Company common stock.

Treasury Stock:

For information concerning the exercise of a warrant for 607,889 shares of the Company's common stock, for the year ended December 31, 1994, refer to Note 17.

For the year ended December 31, 1993, the Company purchased at market prices 1,224,200 shares of common stock in the open market for a total amount of \$3,323. 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. Through December 31, 1993, 225,000 unvested shares were surrendered by a former officer and two employees. In addition, 127,939 vested shares were transferred to the Company by two former officers and an employee in satisfaction of certain liabilities.

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, 1995, 1994 and 1993, no options were outstanding; however, there were 212,400 shares available to be granted under this Plan.

On August 7, 1991, the Company's Board of Directors adopted the 1991 Stock Incentive Plan (the "1991 Incentive Plan") for officers and other key employees of the Company and its subsidiaries and authorized the grant of up to 1,213,343 shares of common stock under the 1991 Incentive Plan. The 1991 Incentive Plan was approved by stockholders on September 12, 1991, and all shares were granted during 1991.

Of the awards made under the 1991 Incentive Plan, 110,000 shares were unrestricted shares and the remainder were shares whose transferability were restricted for a specified period of time and vest over a four-year period (the "Restricted Shares"). Restricted Shares had full voting rights and, subject to certain escrow arrangements, were entitled to all dividends. Holders of unrestricted shares had all rights of a stockholder. In connection with the Company's 1991 Incentive Plan described above, the Company issued an additional 998,043 shares of common stock.

During the first quarter of 1993, the Company granted an additional 375,000 shares of common stock to an officer and an employee, under terms substantially similar to the Restricted Shares described above. During the fourth quarter of 1993, the officer surrendered the equivalent of 150,000 unvested shares received earlier in the year.

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

Pursuant to an agreement dated as of January 1, 1994, the Company granted 500,000 shares of restricted common stock to a consultant who also serves as the Chairman of SkyBox and a member of the Board of Directors and President of New Valley. 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. Unexercised options do not provide any rights of a stockholder; however, the grant does provide for dividend equivalent rights on the unexercised shares.

During 1995, 1994 and 1993, the Company recorded charges to income of \$557, \$781 and \$790 for compensation equal to the excess of the fair market value for the shares granted over the price paid for them and, in 1995, recorded charges to income of \$150 for the dividend equivalent rights. In 1993, 75,000 restricted shares were cancelled and all other shares were deemed unrestricted as a result of certain officers' termination of employment.

#### 16. CONTINGENCIES

##### Liggett:

Since 1954, Liggett and other United States cigarette manufacturers have been named as defendants in a number of direct and third-party actions predicated on the theory that they should be liable for damages from cancer and other adverse health effects alleged to have been caused by cigarette smoking or by exposure to secondary smoke (environmental tobacco smoke, "ETS") from cigarettes. These cases are reported hereinafter as though having been commenced against Liggett (without regard to whether such actually were commenced against Brooke Group Ltd. in its former name or in its present name or against Liggett), since all involve the tobacco manufacturing and marketing activities currently performed by Liggett. New cases continue to be commenced against Liggett and other cigarette manufacturers. As new cases are commenced, the costs associated with defending such cases and the risks attendant to the inherent unpredictability of litigation continue to increase. Liggett has been receiving certain financial assistance from others in the industry in defraying the costs incurred in the defense of smoking and health litigation and related proceedings. The future financial benefit to the Company is not quantifiable at this time since the arrangements for assistance can be terminated on limited notice, or under certain circumstances, without notice, and the amount of assistance received is a function of the level of costs incurred. Certain joint defense arrangements, and the financial benefits incident thereto, have ended. No assurances can be made that other arrangements will continue. To date a number of such actions, including several against Liggett, have been disposed of favorably to the defendants and no plaintiff has ultimately prevailed in trial for recovery of damages in any such action.

In the action entitled *Cipollone v. Liggett Group Inc., et al.*, the United States Supreme Court on June 24, 1992, issued an opinion regarding federal preemption of state law damage actions. The Supreme Court in *Cipollone* concluded that The Federal Cigarette Labeling and Advertising Act (the "1965 Act") did not preempt any state common law damage claims. Relying on The Public Health Cigarette Smoking Act of 1969 (the "1969 Act"), however, the Supreme Court concluded that the 1969 Act preempted certain, but not all, common law damage claims. Accordingly, the decision bars plaintiff from asserting claims that, after the effective date of the 1969 Act, the tobacco companies either failed to warn adequately of the claimed health risks of cigarette smoking or sought to neutralize those claimed risks in their advertising or promotion of cigarettes. It does permit, however, claims for

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

fraudulent misrepresentation (other than a claim of fraudulently neutralizing the warning), concealment (other than in advertising and promotion of cigarettes), conspiracy and breach of express warranty after 1969. The Court expressed no opinion on whether any of these claims are viable under state law, but assumed arguendo that they are viable.

In addition, bills have been introduced in Congress on occasion to eliminate the federal preemption defense. Enactment of any federal legislation with such an effect could result in a significant increase in claims, liabilities and litigation costs.

On September 10, 1993, an action entitled *Sackman v. Liggett Group Inc.*, United States District Court, Eastern District of New York, was filed against Liggett alone alleging as injury lung cancer. Fact discovery closed on August 31, 1995 and expert discovery is scheduled to close on July 3, 1996. It is possible that the case will be scheduled for trial during 1996. On March 19, 1996, the Magistrate Judge assigned to the case ordered Liggett to produce certain of its documents with respect to which Liggett has asserted various claims of privilege. Liggett intends to appeal the decision and order. Upon Liggett's motion, the Court has enlarged the time to and including May 1, 1996 for Liggett to file its appeal. The other major cigarette manufacturers and The Council for Tobacco Research U.S.A., Inc. have moved to intervene.

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

On May 12, 1992, an action entitled *Cordova v. Liggett Group Inc., et al.*, Superior Court of the State of California, City of San Diego, was filed against Liggett and others. In her complaint, plaintiff, purportedly on behalf of the general public, alleges that defendants have been engaged in unlawful, unfair and fraudulent business practices by allegedly misrepresenting and concealing from the public scientific studies pertaining to smoking and health funded by, and misrepresenting the independence of, the Council for Tobacco Research and its predecessor. The complaint seeks equitable relief against the defendants, including the imposition of a corrective advertising campaign, restitution of funds, disgorgement of revenues and profits and the imposition of a constructive trust. The case is presently in the discovery phase.

On October 31, 1991, an action entitled *Broin et al v. Philip Morris Companies, Inc., et al.*, Circuit Court of the 11th Judicial District in and for Dade County, Florida, was filed against Liggett and others. This case was the first class action commenced against the industry, and has been brought by plaintiffs on behalf of all flight attendants that have worked or are presently working for airlines based in the United States and who have never regularly smoked cigarettes but allege that they have been damaged by involuntary exposure to ETS. On December 12, 1994, plaintiffs' motion to certify the action as a class action was granted. Defendants have appealed this ruling and on January 3, 1996, the Third District of the Florida Court of Appeals affirmed the ruling of the trial court. On January 18, 1996, defendants filed a petition for rehearing, for rehearing en banc and for certification to the Florida Supreme Court. Defendants' petition has not been ruled upon as yet.



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

On March 25, 1994, an action entitled *Castano, et al v. The American Tobacco Company, et al.*, United States District Court, Eastern District of Louisiana, was filed against Liggett and others. The class action complaint was brought on behalf of plaintiffs and residents of the United States who claim to be addicted to tobacco products and survivors who claim their decedents were also so addicted. The complaint is based upon the claim that defendants manipulated the nicotine levels in their tobacco products with the intent to addict plaintiffs and the class members and, inter alia, fraud, deceit, negligent misrepresentation, breach of express and implied warranty, strict liability and violation of consumer protection statutes. Plaintiffs seek compensatory and punitive damages, equitable relief including disgorgement of profits from the sale of cigarettes and creation of a fund to monitor the health of class members and to pay for medical expenses allegedly caused by defendants, attorneys' fees and costs. On February 17, 1995, the court issued an Order that granted in part Plaintiffs' motion for class certification for certain claims, together with punitive damages to the end of establishing a multiplier to compute punitive damage awards. Defendants' application for discretionary appeal to the Court of Appeals for the Fifth Circuit was granted. Oral argument was held on April 2, 1996.

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

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

Under the settlement, the *Castano* class would receive up to 5% of Liggett's pretax income (income before income taxes) each year (up to a maximum of \$50,000 per year) for the next twenty-five years, subject to certain reductions provided for in the agreement, together with reasonable fees and expenses of the *Castano* Plaintiffs Legal Committee. Settlement funds received by the class would be used to pay half the cost of smoking-cessation programs for eligible class members. While neither consenting to FDA jurisdiction nor waiving their objections thereto, the Company and Liggett also have agreed to phase in compliance with certain of the proposed interim FDA regulations regarding smoking by children and adolescents, including a prohibition on the use of cartoon characters in tobacco advertising and limitations on the use of promotional materials and distribution of sample packages where minors are present.

The Company and Liggett have the right to terminate the *Castano* settlement if the remaining defendants succeed on the merits or in the event of a full and final denial of class action certification.

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

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

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

An action entitled Yvonne Rogers v. Liggett Group Inc. et al., Superior Court, Marion County, Indiana, was filed by the plaintiff on March 27, 1987 against Liggett and others. The plaintiff seeks compensatory and punitive damages for cancer alleged to have been caused by cigarette smoking. Trial commenced on January 31, 1995. The trial ended on February 22, 1995 when the trial court declared a mistrial due to the jury's inability to reach a verdict. The Court directed a verdict in favor of the defendants as to the issue of punitive damages during the trial of this action. A second trial has been scheduled to commence August 5, 1996.

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

On November 28, 1995, each of the major manufacturers in the industry, including Liggett, filed suit in both the Commonwealth of Massachusetts and in the State of Texas seeking declaratory relief to the

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

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

The State of Florida enacted legislation, effective July 1, 1994, allowing certain state authorities or entities to commence litigation seeking recovery of 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). This statute purportedly abrogates certain defenses typically available to defendants. This legislation would impose on the tobacco industry, if ultimate liability of the industry is established in litigation, liability based upon market share for such payments made as a result of such smoking related diseases. Although a suit has been commenced to challenge the constitutionality of the Florida legislation, no assurance can be given that it will be successful. On May 6, 1995, the Florida legislature voted in favor of a bill to repeal this legislation, but the Governor of Florida vetoed this repealer bill. On March 13, 1996, the Florida legislature considered taking certain action to override the veto of the repealer bill if the requisite vote could be attained, but decided not to take formal action when it was determined that it could not attain the requisite vote. On February 22, 1995, suit was commenced pursuant to the above-referenced enabling statute by the State of Florida, acting through the Agency For Health Care Administration against Liggett and others, seeking restitution of monies expended in the past and which may be expended in the future by the State of Florida to provide health care to Medicaid recipients for injuries and ailments allegedly caused by the use of cigarettes and other tobacco products. Plaintiffs also seek a variety of other forms of relief including a disgorgement of all profits from the sales of cigarettes in Florida.

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

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

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

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

number of additional states joining the settlement. All of Liggett's payments are subject to certain reductions provided for in the agreement. Liggett has also agreed to pay to the states \$5,000 if the Company or Liggett fails to consummate a merger or other 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 bases 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. In the event of any such termination by the Company and Liggett, the named plaintiffs would be at liberty to renew the prosecution of such civil action against the Company and Liggett.

Currently, in addition to Cordova, approximately 90 product liability lawsuits, which have been filed in various jurisdictions, are pending and active in which Liggett is a defendant. Of these, 68 are pending in the State of Florida. In most of these lawsuits, plaintiffs seek punitive as well as compensatory damages. In the product liability lawsuits presently pending in Florida against Liggett and others, three are scheduled for trial during 1996.

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

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

In March and April 1994, the Health and the Environmental Subcommittee of the Energy and Commerce Committee of the House of Representatives held hearings regarding nicotine in cigarettes. On March 25, 1994, Commissioner David A. Kessler of the Food and Drug Administration ("FDA") gave testimony as to the potential regulation of nicotine under the Food, Drug and Cosmetic Act, and the potential for jurisdiction over the regulation of cigarettes to be accorded to the FDA. In response to commissioner Kessler's allegations about manipulation of nicotine by cigarette manufacturers, the chief executive of each of the major cigarette manufacturers, including Liggett, testified before the subcommittee on April 14, 1994, denying Commissioner Kessler's claims. An FDA advisory panel has stated that it believes nicotine is addictive. On August 10, 1995, the FDA filed in the Federal Register a Notice of Proposed Rule-Making (the "Proposed Rule-Making") which would classify tobacco as a drug, assert jurisdiction by the FDA over the manufacture and marketing of tobacco products and impose restrictions on the sale, advertising and promotion of tobacco products. The FDA's stated objective and focus for its initiative is to limit access to cigarettes by minors by measures beyond the restrictions either mandated by existing federal, state and local laws

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

or voluntarily implemented by major manufacturers in the industry. Liggett and other major manufacturers in the industry responded by filing a civil action in the United States District court for the Middle District of North Carolina on that day challenging the legal authority of the FDA to assert such jurisdiction. In addition thereto, Liggett and the other four major cigarette manufacturers, as well as others, have filed comments in opposition to the Proposed Rule-Making. Management is unable to predict whether such a classification will be made. Management is also unable to predict the effects of such a classification, were it to occur, or of such regulations, if implemented, on Liggett's operations, but such actions could have an unfavorable impact thereon.

On March 12, 1996, Liggett, together with the Company, entered into an agreement to settle the Castano class action tobacco litigation, and on March 15, 1996, Liggett, together with the Company, entered into an agreement with the Attorneys General of the State of West Virginia, State of Florida, State of Mississippi, Commonwealth of Massachusetts and the State of Louisiana to settle certain actions brought against Liggett by such states. In these two settlements, Liggett and the Company, while neither consenting to FDA jurisdiction nor waiving their objections thereto, agreed to withdraw their objections and opposition to the Proposed Rule-Making and to phase in compliance with certain of the proposed interim FDA regulations. See discussions of the Castano Settlement Agreement and the Attorneys General Settlement Agreement appearing hereinabove and hereinafter.

The Omnibus Budget Reconciliation Act of 1993 ("OBRA") required United States cigarette manufacturers to use at least 75% domestic tobacco in the aggregate of the cigarettes manufactured in the United States, effective January 1, 1994, on an annualized basis or pay a "marketing assessment" based upon price differentials between foreign and domestic tobacco and under certain circumstances make purchases of domestic tobacco from the stabilization cooperatives organized by the United States government. OBRA was repealed retroactively (as of December 31, 1994) coincident in time with the recent issuance of a Presidential proclamation, effective September 13, 1995, imposing tariffs on imported tobacco in excess of certain quotas.

On February 14, 1995, Liggett filed with the United States Department of Agriculture (the "USDA") its certification as to usage of domestic and imported tobaccos during 1994 and an audit was commenced by the USDA during August 1995 to verify this certification. Liggett received the results of the audit from the USDA, which states that Liggett did not satisfy the 75% domestic tobacco usage requirement for 1994. The marketing assessment presently is estimated to approximate \$5,500, which amount is disputed by the Company. It is the understanding of the Company that the levels of domestic tobacco inventories currently on hand at the tobacco stabilization organizations are below reserve stock levels, and for such reason, the Company is of the opinion that it will not be obligated to make such purchases of domestic tobacco from the tobacco stabilization cooperatives.

The Company is currently engaged in negotiations with the USDA in an effort to resolve this matter on satisfactory terms. At December 31, 1995, the Company has accrued \$4,900, representing its best estimate for the USDA marketing assessment. The charge is included as a component of cost of sales in 1995.

On September 13, 1995, the President of the United States, after negotiations with the affected countries, declared a tariff rate quota ("TRQ") on certain imported tobacco, imposing prohibitive tariffs on imports of flue-cured and burley tobaccos in excess of certain levels which vary from country to country. Oriental (Turkish) 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.

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

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 materially adverse effect on the Company. The Company believes it is unlikely that an end-user licensing system will be adopted because it would likely lead to another GATT proceeding. The end-user licensing system has not been authorized by legislation and it could create significant problems for U.S. exports in other product markets. However, no assurances can be made that an end-user licensing system will not be adopted.

On March 15, 1996, an action entitled Spencer J. Volk v. Liggett Inc. was filed in the United States District Court for the Southern District of New York, Case No. 96-CIV-1921, wherein plaintiff, who was formerly employed as Liggett's President and Chief Executive officer, seeks recovery of certain monies allegedly owing to him by Liggett to plaintiff for long-term incentive compensation. The action presently is in the pleading stage and discovery has not as yet commenced.

As a consequence of certain tobacco litigation settlements and marketing assessment contingencies discussed above, Liggett charged approximately \$8,846 to operations in the fourth quarter of 1995. Possible future payments under the litigation settlements which are based on a percentage of Liggett's pretax income, if any, will be charged to operations in the period that Liggett's operating results are known.

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

As to each of the cases referred to above which is pending against Liggett, Liggett believes, and has been so advised by counsel handling the respective cases, that Liggett has a number of valid defenses to the claim or claims asserted against Liggett. Litigation is subject to many uncertainties, and it is possible that some of these actions could be decided unfavorably. An unfavorable outcome of a pending smoking and health case could encourage the commencement of additional similar litigation. Recently, there have been a number of restrictive regulatory actions, adverse political decisions and other unfavorable developments concerning cigarette smoking and the tobacco industry, including the commencement of the purported class actions referred to above. These developments generally receive widespread media attention. Liggett is not able to evaluate the effect of these developing matters on pending litigation or the possible commencement of additional litigation.

The Company:

On September 20, 1993, a group of CVR holders and the CVR trustee filed an action in the Delaware Court of Chancery, New Castle County, against the Company and certain of its present and former directors, challenging and seeking to enjoin or rescind the Distribution. Pursuant to notice given on October 15, 1993, the Company redeemed its CVRs on December 9, 1993 for a payment of \$.36 per CVR. On June 2, 1994, the Company and the director defendants entered into a Stipulation and Agreement of Compromise and Settlement (the "Stipulation") pursuant to which a class of CVR holders, which includes the plaintiff CVR holders and all other persons who held CVRs at any time between September 20, 1993 and June 2, 1994, were to receive a total of \$4,000 plus an award of

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

attorneys' and experts' fees and expenses, as approved by the Court of Chancery, not to exceed \$900. The \$4,000 settlement fund has been deposited into an escrow account for eventual disbursement to all eligible CVR holders.

By order dated June 10, 1994, the Court of Chancery scheduled a settlement hearing to be held on August 16, 1994 to determine, inter alia, whether the Stipulation is fair, reasonable and adequate. That settlement hearing was adjourned at the named plaintiff CVR holders' request because of issues arising from the Company's filing of a motion for leave to amend the Company's complaint in a separate lawsuit pending against the CVR trustee. The named plaintiff CVR holders subsequently asked the court to rescind the Stipulation, stating, in substance, that they had mistakenly entered into it in the erroneous belief that the Company would be unable to assert claims against the trustee which those CVR holders might have to indemnify. On December 28, 1994, the court rescinded the Stipulation, finding that such a mistake had been made; however, the named plaintiff CVR holders and the defendants continued settlement discussions, seeking to address the named plaintiff CVR holders' concerns over their obligation to indemnify the trustee. On March 3, 1995, these parties advised the court that they had reached an agreement in principle to settle the case on a class basis, subject to the final resolution of certain remaining issues.

The issues have recently been resolved and on March 21, 1996 a revised settlement agreement was filed with the court. A hearing on approval of the settlement is scheduled for June 4, 1996. The CVR trustee withdrew from the action coincident with the initial presentation of the settlement to the court in June 1994. Notwithstanding this, all claims, the assertions of which the CVR trustee initially joined, would be compromised and dismissed under the proposed settlement. The proposed settlement would leave both the Company and the plaintiff CVR holders free to pursue claims, in certain circumstances, against the CVR trustee.

On November 20, 1995, RJR Nabisco filed an action against the Company and Messrs. LeBow and Icahn in the United States District Court for the Middle District of North Carolina alleging violations of the federal securities laws. Specifically, RJR Nabisco alleges that the Company and Messrs. LeBow and Icahn violated sections 14(a) and 10(b) of the Securities Exchange Act of 1934, as amended, and Rules 14a-9 and 10b-5 promulgated thereunder, by purportedly making materially false or incomplete statements concerning the purpose and background of the consent solicitation. RJR Nabisco seeks temporary and permanent injunctions barring the Company and Messrs. LeBow and Icahn from proceeding with the consent solicitation until such time as they remedy the alleged disclosure obligation violations. RJR Nabisco also alleges that the Company and Messrs. LeBow and Icahn secretly formed a group of investors to purchase a controlling interest in RJR Nabisco and the Company. According to the complaint, the purpose for such a combination is to eliminate certain alleged issues under the Investment Company Act allegedly applicable to the Company, BGLS and/or New Valley.

The Company and Messrs. LeBow and Icahn believe the allegations are without merit and are defending the action vigorously. In addition, the Company and LeBow asserted counterclaims against RJR Nabisco, alleging that RJR Nabisco had made false statements and material omissions in its opposition to the Company's consent solicitation. On March 5, 1996, RJR Nabisco voluntarily dismissed, without prejudice, its claims asserted against Icahn.

At December 31, 1995, there were several other proceedings, lawsuits and claims pending against subsidiaries of the Company. The Company is of the opinion that the liabilities, if any, ultimately resulting from the CVR action, the RJR Nabisco action and such other proceedings, lawsuits and claims should not materially affect its consolidated financial position, results of operations or cash flows.

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

17. RELATED PARTY TRANSACTIONS

Effective June 1993, \$14,692 of principal indebtedness (the "Consolidated Indebtedness") of the Chairman and certain of his affiliates to the Company were consolidated and the terms of such indebtedness were amended. On January 5, 1994, 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 stock. (Refer to Footnote 13 "Equity"). 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.

Certain of the various debts under the Consolidated Indebtedness that were satisfied are discussed below:

In September 1992, the Chairman became indebted to the Company for a shortfall of \$1,640 under a note assigned to the Company in prior years. In March 1993, a shortfall in the amount of \$3,573 arose with respect to a second note and as a result he became obligated to pay such shortfall amount (plus interest at prime plus 1%) to the Company. These shortfalls were a portion of the Consolidated Indebtedness which was repaid in January 1994.

A corporation owned by the Chairman, and subsequently a subsidiary of BGLS, had an outstanding payable for approximately \$994 at December 5, 1993. This payable had been assigned to BGLS, in September 1992, in exchange for the cancellation by BGLS of a like amount of debt owed to it by the subsidiary. Prior to the assignment to BGLS, no interest had been charged in respect of this receivable. The Chairman had agreed to guarantee payment of this receivable to BGLS, plus interest at prime rate plus one percent. This loan was repaid as part of the Consolidated Indebtedness and was repaid in January 1994.

In December 1991, the Company acquired an option to purchase rights in an aircraft from a company controlled by the Chairman. The appraised value of the plane exceeded the purchase price at that time. The option expired unexercised on January 15, 1993, after which time the aircraft was sold to a third party. The Chairman's company was obligated to repay the option price (\$2,895) as well as an amount of approximately \$300 related to unreimbursed medical payments from another company owned by the Chairman. Both of the above repayments were a portion of the Consolidated Indebtedness which was repaid in January 1994.

As of January 1, 1993, the Chairman had approximately \$1,650 of other personal unsecured indebtedness to the Company. In addition, the Chairman was indebted to the Company in 1993 for approximately \$2,049 collateralized by 6,234,837 shares of common stock and 1,754,657 shares of Series G Preferred to the Company owned directly or indirectly by the Chairman. On January 11, 1993, the Company approved a \$1,475 line of credit for the Chairman on the same terms as the unsecured loans described above, of which \$1,475 was outstanding. These loans bore interest at the prime rate plus 1% and were due on June 30, 1993. All of these amounts were repaid in January 1994 as part of the Consolidated Indebtedness.

Other related party transactions follow:

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



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

Partnership had pledged 1,681,715 of the shares it held of the Company's common stock to secure its obligation. In May 1994, the Partnership paid \$3,200 in partial satisfaction of the obligation. In consideration thereof, the Company released 1,281,715 of the pledged shares.

The Company and companies in which it has an interest also paid aircraft-related charges of approximately \$376 to affiliated companies during the years ended December 31, 1993.

Prior to 1990, The Company advanced funds to the former Vice Chairman (\$5,126 outstanding as of December 31, 1991, plus accrued interest, and deducted from equity at December 31, 1991). The loans bore interest at either the prime rate or federal short-term interest rate and were payable semiannually or annually. The loans were scheduled to mature in 1995 and 1997, were collateralized by 607,889 shares of the former Vice Chairman's common stock in the Company and, with the exception of loans in the principal amount of \$1,500, were nonrecourse to him. Effective December 30, 1992, the former Vice Chairman transferred the 607,889 shares of common stock in the Company which were the collateral for the nonrecourse loan (approximately \$4,600 including accrued interest) in connection with the termination of such loans. The Company recorded a \$2,654 charge to income as a result of this transfer. In conjunction with the transfer of shares, the former Vice Chairman was granted a warrant (the "Warrant") to purchase 607,889 shares of the Company's common stock for an exercise price of \$7.60 per share. This price was subsequently reduced to \$0.10 per share as a result of the SkyBox Distribution. The Warrant was exercised in November 1994. The remaining loans in principal amount of \$1,500 were to mature in 1995, bore interest at the federal short-term rate, are payable semiannually and are recourse to the former Vice Chairman. On December 31, 1993, the former Vice Chairman repaid \$900 of the loan out of certain dividend proceeds. Effective January 1, 1994, the former Vice Chairman resigned waiving all rights in respect of a lump sum severance payment of \$1,500 which was part of an employment agreement in effect since January 1, 1991. The Company waived all rights to the remaining \$600 balance on the loan. The agreement provides that the former Vice Chairman remains as a consultant to the Company. The former Vice Chairman has served on the Board of Directors of New Valley since 1990. During the fourth quarter of 1994, he was elected President and Chief Executive Officer of MAI.

In February 1991, the Company made a loan to a former executive vice president of the Company in the amount of \$250, bearing interest at the prime rate plus one percent and due March 1, 1994. On July 26, 1993, the former officer transferred 50,000 shares of the Company's common stock with a fair market value of \$275 to the Company in satisfaction of the loan and interest thereon.

Pursuant to an agreement dated as of January 1, 1994, as amended, the Company granted 500,000 shares of restricted common stock (with dividend equivalent rights) to a consultant who also served as the Chairman of SkyBox and is currently President and a Board member of New Valley. Of the total number of shares granted, 250,000 were immediately vested and issued during the third quarter of 1994. The remaining 250,000 shares have been issued and will vest in 1997. In addition, on January 25, 1995, the Company entered into a nonqualified stock option agreement. 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. Unexercised options do not provide any rights of a stockholder; however, the grant does provide for dividend equivalent rights on the unexercised shares. During 1995 and 1994, the Company recorded charges to income of \$479 and \$586, respectively, for compensation equal to the excess of the fair market value for the shares granted over the price paid for them.

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

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

December 31, 1993. The broker-dealer received commissions of approximately \$121, and commissions and other income of approximately \$584 from the Company and/or its affiliates during 1994 and 1995, respectively. 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 New Valley agreed to reimburse the Company for its portion of certain operating expenses, rent and utilization of personnel. Expense reimbursements amounted to \$571 for the year ended December 31, 1995.

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 from and against any losses incurred by such nominees resulting from, relating to, or arising out of any claim in connection with the solicitation of proxies in support of the nominees' election at the Annual Meeting, including the right to be advanced by the Company for any expenses incurred in connection with any such claim.

18. SEGMENT INFORMATION

The Company's major operations are in tobacco products, principally cigarettes, and real estate development. The tobacco segment operates primarily in the United States with a much smaller manufacturing facility 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, 1995 were approximately \$45,400. (Refer to Note 4.)

| 1995<br>----                          | Tobacco<br>----- | Real<br>Estate<br>----- | Corporate<br>and Others<br>----- | Consolidated<br>----- |
|---------------------------------------|------------------|-------------------------|----------------------------------|-----------------------|
| 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<br>amortization..... | 7,972            |                         | 1,104                            | 9,076                 |

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

## 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, |           |          |
|--|-------------------------|-----------|----------|
|  | 1995                    | 1994      | 1993     |
| <b>I. Cash paid during the period for:</b>                   |                         |           |          |
| Interest.....  | \$60,158                | \$ 39,429 | \$56,217 |
| Income taxes, net of refunds.....                            | 1,735                   | 605       | 2,110    |
|  | -----                   | -----     | -----    |
|  | \$61,893                | \$ 40,034 | \$58,327 |
|  | =====                   | =====     | =====    |
| <b>II. Noncash investing and financing activities:</b>       |                         |           |          |
| Contingent Value Rights liability.....                       |                         |           | \$43,821 |
| Dividends payable.....                                       |                         | \$ 131    | 15,136   |
| Issuance and exchange of long-term debt..                    |                         | 114,888   |          |
| Distribution of MAI to stockholders.....                     | \$27,085                |           |          |
| Common stock received in connection with debt repayment..... |                         |           | 275      |
| Financing of equipment purchases.....                        |                         |           | 3,500    |
| Series G dividend.....                                       |                         | 3,200     |          |
| Shareholder settlement.....                                  |                         | 6,250     |          |
| Transfer of pension liability to SkyBox..                    |                         | 4,305     |          |

## 20. SUPPLEMENTAL INFORMATION

Supplemental balance sheet information at December 31 is as follows:

|  | 1995     | 1994     |
|--|----------|----------|
|  | -----    | -----    |
| <b>Other assets:</b>                               |          |          |
| Deferred financing costs, net of amortization..... | \$10,502 | \$ 9,933 |
| Other.....   | 797      | 1,934    |
|  | -----    | -----    |
| Total other assets.....                            | \$11,299 | \$11,867 |
|  | =====    | =====    |
| <b>Other accrued liabilities:</b>                  |          |          |
| Compensation and related items.....                | \$ 1,201 | \$ 3,913 |
| Debt guarantee.....                                | 7,500    | 7,500    |
| Restructuring.....                                 | 515      | 1,306    |
| Estimated allowance for future sales returns.....  | 5,000    | 5,800    |
| Legal and professional fees.....                   | 1,469    | 1,510    |
| Unearned revenue.....                              | 2,955    | 2,056    |
| Other.....   | 2,812    | 4,492    |
|  | -----    | -----    |
| Total other accrued liabilities.....               | \$21,452 | \$26,577 |
|  | =====    | =====    |

BROOKE GROUP LTD. AND SUBSIDIARIES  
 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, 1995 and 1994 (reclassified) are as follows(A):

|   | December 31,<br>1995 | September 30,<br>1995 | June 30,<br>1995 | March 31,<br>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 of 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 of 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           |

|  | December 31,<br>1994 | September 30,<br>1994 | June 30,<br>1994 | March 31,<br>1994 |
|--|----------------------|-----------------------|------------------|-------------------|
| Revenues                                 | \$121,715            | \$124,446             | \$119,077        | \$114,105         |
| Gross profit                             | 64,999               | 66,599                | 61,129           | 56,809            |
| (Loss) income from continuing operations | (14,007)             | 9,113                 | (6,377)          | (6,720)           |
| Income of discontinued operations        | 154,604              | 9,805                 | 4,960            | 5,314             |
| Extraordinary items                      | (45,479)             |                       |                  | (1,118)           |
| Net income                               | 95,118               | 18,918                | (1,417)          | (2,524)           |
| Per share data:                          |                      |                       |                  |                   |
| (Loss) income from continuing operations | \$(0.79)             | \$0.52                | \$(0.37)         | \$(0.38)          |
| Income of discontinued operations        | \$ 8.75              | \$0.55                | \$ 0.29          | \$ 0.30           |
| Extraordinary items                      | \$(2.60)             | \$                    | \$               | \$(0.06)          |
| Net income                               | \$ 5.27              | \$1.07                | \$(0.08)         | \$(0.14)          |
| Share prices:                            |                      |                       |                  |                   |
| High                                     | 4 1/2                | 5 3/8                 | 2                | 2 1/4             |
| Low                                      | 2 5/8                | 1 3/8                 | 1 1/4            | 1 1/2             |

(A) Results of operations have been reclassified for discontinued operations in 1994 (Note 5).

## BROOKE GROUP LTD.

## SCHEDULE II -- VALUATION AND QUALIFYING ACCOUNTS

(IN THOUSANDS)

| Description                          | Balance at<br>Beginning<br>of Period | Additions                           |                                 | Deductions | Balance<br>at End<br>of Period |
|--------------------------------------|--------------------------------------|-------------------------------------|---------------------------------|------------|--------------------------------|
|                                      |                                      | Charged to<br>Costs and<br>Expenses | Charged to<br>Other<br>Accounts |            |                                |
| 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                       |
| YEAR ENDED DECEMBER 31, 1993         |                                      |                                     |                                 |            |                                |
| Allowances for:                      |                                      |                                     |                                 |            |                                |
| Doubtful accounts.....               | \$ 300                               | \$ 240                              |                                 | \$ 305     | \$ 235                         |
| Cash discounts.....                  | 1,191                                | 13,018                              |                                 | 13,464     | 745                            |
| Sales returns.....                   | 10,700                               |                                     | \$ 3,800 (a)                    | 8,200      | 6,300                          |
| Price increase credits.....          | 919                                  |                                     |                                 | 919        |                                |
| Total.....                           | \$ 13,110                            | \$13,258                            | \$ 3,800                        | \$22,888   | \$ 7,280                       |
| Provision for inventory obsolescence | \$ 1,090                             | \$ 350                              | \$                              | \$ 22      | \$ 1,418                       |

(a) Charged to net sales.

(b) Amounts include impact of consolidating LDL.

## SIGNATURES

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

BROOKE GROUP LTD.  
(REGISTRANT)

By: /s/ Gerald E. Sauter

-----  
Gerald E. Sauter  
Vice President and  
Chief Financial Officer

Date: April 29, 1996