SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

JOINT ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE
SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 1997

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

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

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

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

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

SECURITIES REGISTERED PURSUANT TO SECTION 12(B) OF THE ACT:

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

SECURITIES REGISTERED PURSUANT TO SECTION 12(G) OF THE ACT: None

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

Explanatory Note: BGLS Inc. is required to file all reports required by Section 13 or 15(d) of the Exchange Act in connection with its 15.75% Series B Senior Secured Notes due 2001. BGLS Inc. meets the conditions set forth in General Instruction I(1)(a) and (b) of Form 10-K and is therefore filing this form with the reduced disclosure format.

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

The aggregate market value of the voting stock held by non-affiliates of Brooke Group Ltd. as of April 6, 1998 was approximately $171,000,000. Directors and officers and ten percent or greater stockholders of Brooke Group Ltd. are considered affiliates for purposes of this calculation but should not necessarily be deemed affiliates for any other purpose.

At April 6, 1998, Brooke Group Ltd. had 20,348,498 shares of common stock outstanding, and BGLS Inc. had 100 shares of common stock outstanding, all of which are held by Brooke Group Ltd.

DOCUMENTS INCORPORATED BY REFERENCE:

Part III (items 10, 11, 12 and 13) from the definitive Proxy Statement of Brooke Group Ltd. for the 1998 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission no later than 120 days after the end of the Registrant's fiscal year covered by this report.

BROOKE GROUP LTD.
BGLS INC.

FORM 10-K

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PART I

ITEM 1. BUSINESS

GENERAL

Brooke Group Ltd. (the "Company"), a Delaware corporation founded in 1980, is a holding company for a number of businesses. The Company is principally engaged, through its subsidiary Liggett Group Inc. ("Liggett"), in the manufacture and sale of cigarettes in the United States; through its subsidiary Brooke (Overseas) Ltd. ("BOL"), in the manufacture and sale of cigarettes in Russia; and through its investment in New Valley Corporation ("New Valley"), in the investment banking and brokerage business, in real estate development in Russia and the Ukraine, in the ownership and management of commercial real estate in the United States and in the acquisition of operating companies. The Company holds such businesses through its wholly-owned subsidiary, BGLS Inc. ("BGLS"), a Delaware corporation organized in 1990.

The Company is controlled by Bennett S. LeBow, the Chairman and Chief Executive Officer of the Company, BGLS and New Valley, who beneficially owns approximately 46% of the Company's common stock. The principal executive offices of the Company and BGLS are located at 100 S.E. Second Street, Miami, Florida 33131, and the telephone number is (305) 579-8000.

LIGGETT GROUP INC.

General. The Company's tobacco business in the United States is conducted through its indirect wholly-owned subsidiary Liggett, which is the operating successor to the Liggett & Myers Tobacco Company. Substantially all of Liggett's manufacturing facilities are located in or near Durham, North Carolina. Liggett is registered under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and files periodic reports and other information with the Securities and Exchange Commission (the "SEC").

Liggett is engaged in the manufacture and sale of cigarettes, primarily in the United States. Liggett's management believes, based on published industry sources, that Liggett's domestic shipments of approximately 6.45 billion cigarettes during 1997 accounted for 1.3% of the total cigarettes shipped in the United States during such year. This represents a market share decline of 0.5% from 1996 and 0.9% from 1995. Liggett produces both premium cigarettes as well as discount cigarettes (which include among others, control label, branded discount and generic cigarettes). Premium cigarettes are generally marketed under well-recognized brand names at full retail prices to adult smokers with strong preference for branded products, whereas discount cigarettes are marketed at lower retail prices to adult smokers who are more cost conscious. Liggett's cigarettes are produced in approximately 300 combinations of length, style and packaging.

Liggett produces four premium cigarette brands: L&M, Chesterfield, Lark and Eve. Liggett's premium cigarettes represented approximately 33%, 31% and 30% of net sales (excluding federal excise taxes) in 1997, 1996 and 1995, respectively. Liggett's management believes, based on published industry sources, that Liggett's share of the premium market segment was approximately 0.5% for 1997, compared to 0.7% and 0.8% for 1996 and 1995, respectively.

In 1980, Liggett was the first major domestic cigarette manufacturer to successfully introduce discount cigarettes as an alternative to premium cigarettes. In 1989, Liggett established a new price point within the discount market segment by introducing Pyramid, a branded discount product which, at that time, sold for less than most other discount cigarettes. Liggett's management believes, based on published industry sources, that Liggett held a share of approximately 3.5% of the discount market segment for 1997, compared to 4.9% and 5.5% for 1996 and 1995, respectively. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations - Results of Operations" for additional information concerning Liggett's premium and discount product sales.

At the present time, Liggett has no foreign operations. Liggett does not own the international rights to its premium cigarette brands, which are actively marketed by other companies in foreign markets, thereby adversely affecting Liggett's ability to penetrate such markets. Liggett does, however, export other cigarette brands primarily to Eastern Europe and the Middle East. Export sales of approximately 85 million units accounted for approximately 1% of Liggett's 1997 total unit sales volume. Revenues from export sales were $0.8 million for 1997, compared to $3.3 million and $5.4 million for 1996 and 1995, respectively. Operating loss attributable to export sales in 1997 amounted to approximately $0.1 million compared to operating losses of $1.8 million and $2.1 million in 1996 and 1995, respectively.

Business Strategy. Liggett's near-term business strategy is to reduce further certain operating and selling costs in order to increase the profitability of both its premium and discount products, and to reduce its investment in working capital. As part of this strategy, Liggett reorganized its sales force in early 1994, reducing its field sales force by 150 permanent positions and adding approximately 300 part-time positions. Liggett has also reduced costs in both administrative and manufacturing functions by making additional modifications to its manufacturing operations and significantly curtailing employee benefit programs. In 1995, Liggett continued its efforts towards reducing costs by, among other things, offering voluntary retirement programs to eligible employees and reducing headcount by an additional 120 positions.

In January 1997, Liggett underwent a major restructuring from a centralized organization to a decentralized enterprise with four Strategic Business Units, each a profit center, and a corporate headquarters. This restructuring is intended to more closely align sales and marketing strategies with the unique requirements of regional markets as well as reduce working capital by improved production planning and inventory control. As a result of this reorganization, Liggett further reduced its salaried, hourly and part-time headcount by a total of 108 positions (18%) over the succeeding twelve months.

Liggett's long-term business strategy in the premium segment of the market is to maintain or improve its profit margins in the face of declining unit sales and market share by improving operating efficiencies and implementing further cost reduction programs. Liggett's long-term business strategy in the discount segment of the market is to maintain its market share or improve its profit margins by consistently providing high-quality products and services at prices and on terms comparable to those available elsewhere in the market.

Sales, Marketing and Distribution. Liggett's products are distributed from a central distribution center in Durham, North Carolina to 26 public warehouses located throughout the United States. These warehouses serve as local distribution centers for Liggett's customers. Liggett's products are transported from the central distribution center to the warehouses via third-party trucking companies to meet pre-existing contractual obligations to its customers.

Liggett's customers are primarily candy and tobacco distributors, the military and large grocery, drug and convenience store chains. Liggett offers its customers discount payment terms, traditional rebates and promotional incentives. Customers typically pay for purchased goods

within two weeks following delivery from Liggett. Liggett's largest single customer, Speedway SuperAmerica LLC, accounted for approximately 19.4% of net sales in 1997, approximately 13.9% of net sales in 1996, and approximately 11.6% of net sales in 1995. Sales to this customer were primarily in the private label discount segment and constituted approximately 29.1%, 20.3% and 16.8% of Liggett's discount segment sales in 1997, 1996 and 1995, respectively. Liggett is currently negotiating the renewal of its contract with this customer, which contract is due to expire on June 30, 1998.

Following the January 1997 restructuring, Liggett's marketing and sales functions were performed by approximately 110 direct sales representatives calling on national and regional customer accounts, together with approximately 90 part-time retail sales consultants who service retail outlets. In addition, Liggett employs food broker groups in certain geographic locations to perform these marketing and sales functions.

Trademarks. All of the major trademarks used by Liggett are federally registered or are in the process of being registered in the United States and other markets where Liggett's products are sold. Trademarks registrations typically have a duration of ten years and can be renewed at Liggett's option prior to their expiration date. In view of the significance of cigarette brand awareness among consumers, management believes that the protection afforded by these trademarks is material to the conduct of its business. All of Liggett's trademarks are owned by its wholly-owned subsidiaries, Eve Holdings Inc. ("Eve") and Cigarette Exporting Company of America, Ltd. ("CECOA"). Liggett does not own the international rights to its premium cigarette brands.

Manufacturing. Liggett purchases and maintains leaf tobacco inventory to support its cigarette manufacturing requirements. Liggett believes that there is a sufficient supply of tobacco within the worldwide tobacco market to satisfy its current production requirements. Liggett stores its leaf tobacco inventory in warehouses in North Carolina and Virginia. There are several different types of tobacco, including flue-cured leaf, burley leaf, Maryland leaf, oriental leaf, cut stems and reconstituted sheet. Leaf components of cigarettes are generally the flue-cured and burley tobaccos. While premium and discount brands use many of the same tobacco products, input ratios of tobacco products account for the differences between premium and discount products. Domestically grown tobacco is an agricultural commodity subject to United States government production controls and price supports which can substantially affect its market price. Foreign flue-cured and burley tobaccos, some of which are used in the manufacture of Liggett's cigarettes, are generally 10% to 15% less expensive than comparable domestic tobaccos. Liggett normally purchases all of its tobacco requirements from domestic and foreign leaf tobacco dealers, much of it under long-term purchase commitments. As of December 31, 1997, approximately 64% of Liggett's commitments were for the purchase of foreign tobacco. Increasing tobacco costs due to reduced worldwide supply of tobacco and a reduction in the average discount available to Liggett from leaf tobacco dealers on tobacco purchased under prior years' purchase commitments will have an unfavorable impact on Liggett's operations during 1998.

Liggett's cigarette manufacturing facilities are designed for the execution of short production runs in a cost-effective manner, which enables Liggett to manufacture and market a wide variety of cigarette brand styles. Liggett's cigarettes are produced in approximately 300 different brand styles under Eve's and CECOA's trademarks and brand names as well as private labels for other companies, typically retail or wholesale distributors who supply supermarkets and convenience stores. Liggett believes that its existing facilities are sufficient to accommodate a substantial increase in production.

While Liggett pursues product development, its total expenditures for research and development on new products have not been financially material over the past three years.

Competition. Liggett is the smallest of the five major manufacturers of cigarettes in the United States. The four largest manufacturers of cigarettes are Philip Morris, Inc. ("Philip Morris"), R.J. Reynolds Tobacco Company ("RJR"), Brown & Williamson Tobacco Corporation, and Lorillard Tobacco Company, Inc.

There are substantial barriers to entry into the cigarette business, including extensive distribution organizations, large capital outlays for sophisticated production equipment, substantial inventory investment, costly promotional spending, regulated advertising and strong brand loyalty. In this industry, the major cigarette manufacturers compete among themselves for market share on the basis of brand loyalty, advertising and promotional activities and trade rebates and incentives. Liggett's four major competitors all have substantially greater financial resources than Liggett, and most of these competitors' brands have greater sales and consumer recognition than Liggett's brands.

Liggett's management believes, based on published industry sources, that Philip Morris' and RJR's sales together accounted for approximately 72.9% of the domestic cigarette market in 1997. Liggett's domestic shipments of approximately 6.45 billion cigarettes during 1997 accounted for 1.3% of the approximately 485 billion cigarettes shipped in the United States during such year, compared to 8.95 billion cigarettes (1.9%) and 10.52 billion cigarettes (2.2%) during 1996 and 1995, respectively.

Industry-wide shipments of cigarettes in the United States have been declining for a number of years although this trend reversed itself in 1996. Consistent with published industry sources that domestic industry-wide shipments declined by approximately 0.5% in 1997, Liggett's management believes that industry-wide shipments of cigarettes in the United States will continue to decline as a result of numerous factors, including health considerations, diminishing social acceptance of smoking, legislative limitations on smoking in public places and federal and state excise tax increases which have augmented cigarette price increases.

Historically, because of their dominant market share, Philip Morris and RJR have been able to determine cigarette prices for the various pricing tiers within the industry, and the other cigarette manufacturers have brought their prices into line with the levels established by the two industry leaders. Off-list price discounting by manufacturers, however, has substantially affected the average price differential at retail, which can be significantly greater than the manufacturers' list price gap.

Legislation, Regulation and Litigation. Reports with respect to the alleged harmful physical effects of cigarette smoking have been publicized for many years and, in the opinion of Liggett's management, have had and may continue to have an adverse effect on cigarette sales. Since 1964, the Surgeon General of the United States and the Secretary of Health and Human Services have released a number of reports which claim that cigarette smoking is a causative factor with respect to a variety of health hazards, including cancer, heart disease and lung disease, and have recommended various government actions to reduce the incidence of smoking. In 1997, Liggett publicly acknowledged that, as the Surgeon General and respected medical researchers have found, smoking causes health problems, including lung cancer, heart vascular disease and emphysema.

Since 1966, federal law has required that cigarettes manufactured, packaged or imported for sale or distribution in the United States include specific health warnings on their packaging. Since 1972, Liggett and the other cigarette manufacturers have included the federally required warning statements in print advertising, on billboards and on certain categories of point-of-sale display materials relating to cigarettes.

The Comprehensive Smoking Education Act ("CSEA"), which became effective in October 1985, requires that packages of cigarettes distributed in the United States and cigarette advertisements (other than billboard advertisements) in the United States bear one of the following four warning statements on a quarterly rotating basis: "SURGEON GENERAL'S WARNING: Smoking Causes Lung Cancer, Heart Disease, Emphysema, and May Complicate Pregnancy"; "SURGEON GENERAL'S WARNING: Quitting Smoking Now Greatly Reduces Serious Risks to Your Health"; "SURGEON GENERAL'S WARNING: Smoking by Pregnant Women May Result in Fetal Injury, Premature Birth, and Low Birth Weight"; and "SURGEON GENERAL'S WARNING: Cigarette Smoke Contains Carbon Monoxide". Shortened versions of these statements are also required, on a rotating basis, on billboard advertisements. By a limited eligibility amendment to the CSEA, for which Liggett qualifies, Liggett is allowed to display all four required package warnings for the majority of its brand packages on a simultaneous basis (such that the packages at any time may carry any one of the four required warnings), although it rotates the required warnings for advertising on a quarterly basis in the same manner as do the other major cigarette manufacturers. The law also requires that each person who manufactures, packages or imports cigarettes annually provide to the Secretary of Health and Human Services a list of ingredients added to tobacco in the manufacture of cigarettes. Annual reports to the United States Congress are also required from the Secretary of Health and Human Services as to current information on the health consequences of smoking and from the Federal Trade Commission on the effectiveness of cigarette labeling and current practices and methods of cigarette advertising and promotion. Both federal agencies are also required annually to make such recommendations as they deem appropriate with regard to further legislation. In addition, since 1997, Liggett has included the warning: "SMOKING IS ADDICTIVE" on its packages.

In August 1996, the Food and Drug Administration ("FDA") filed in the Federal Register a Final Rule classifying tobacco as a "drug" or "medical device", asserting jurisdiction over the manufacture and marketing of tobacco products and imposing restrictions on the sale, advertising and promotion of tobacco products. Litigation has been commenced in the United States District Court for the Middle District of North Carolina challenging the legal authority of the FDA to assert such jurisdiction, as well as challenging the constitutionality of the rules. The court, after argument, granted plaintiffs' motion for summary judgment prohibiting the FDA from regulating or restricting the promotion and advertising of tobacco products and denied plaintiffs' motion for summary judgment on the issue of whether the FDA has the authority to regulate access to, and labeling of, tobacco products. The other four major cigarette manufacturers and the FDA have filed notices of appeal. The Company and Liggett support the FDA Rule and have begun to phase in compliance with certain of the proposed interim FDA regulations. See discussions of the tobacco litigation settlements in Note 16 to the Consolidated Financial Statements of the Company and BGLS (the "Company's Consolidated Financial Statements") included elsewhere in this report.

In August 1996, the Commonwealth of Massachusetts enacted legislation requiring tobacco companies to publish information regarding the ingredients in cigarettes and other tobacco products sold in that state. In December 1997, the United States District Court for the District of Massachusetts enjoined this legislation from going into effect on the grounds that it is preempted by federal law, however, on December 15, 1997, Liggett began complying with this legislation by providing ingredient information to the Massachusetts Department of Public Health. The enactment of this legislation has encouraged efforts to enact similar legislation in other states.

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

government. After an audit, the United States Department of Agriculture ("USDA") informed Liggett that it did not satisfy the 75% domestic tobacco usage requirement in 1994 and was subject to a DMA of approximately $5.5 million. Liggett agreed to pay this assessment in quarterly installments, with interest, over a five-year period. Since the levels of domestic tobacco inventories on hand at the tobacco stabilization organizations are below reserve stock levels, Liggett was not obligated to make purchases of domestic tobacco from the tobacco stabilization cooperatives.

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

In April 1994, the United States Occupational Safety and Health Administration ("OSHA") issued a proposed rule that could ultimately ban smoking in the workplace. Hearings were completed during 1995 and the period for post-hearing submissions ended in February 1996. OSHA has not yet issued a final rule or a proposed revised rule. While the Company cannot predict the outcome, some form of federal regulation of smoking in workplaces may result.

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

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

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

There are various other legislative efforts pending on the federal and state level which seek, among other things, to restrict or prohibit smoking in public buildings and other areas, increase excise taxes, require additional warnings on cigarette packaging and advertising, ban vending machine sales, curtail affirmative defenses of tobacco companies in product liability litigation, place cigarettes under the regulatory jurisdiction of the FDA and require that cigarettes meet certain fire safety standards. If adopted, at least certain of the foregoing legislative proposals could have a material adverse impact on Liggett's operations. In addition, the industry is facing increased pressure from anti-smoking groups and an extraordinary increase in smoking and health litigation, including private class action litigation, and health care cost recovery actions brought by states, local governments and other third parties.

While attitudes toward cigarette smoking vary around the world, a number of foreign countries have also taken steps to discourage cigarette smoking, to restrict or prohibit cigarette advertising and promotion and to increase taxes on cigarettes. Such restrictions are, in some cases, more onerous than restrictions imposed in the United States. Due to Liggett's lack of foreign operations, and minimal export sales to foreign countries, the risks of foreign limitations or restrictions on the sale of cigarettes are limited to entry barriers into additional foreign markets and the inability to grow the existing markets.

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

The cigarette industry continues to be challenged on numerous fronts. New cases continue to be commenced against Liggett and other cigarette manufacturers. As of December 31, 1997, there were approximately 250 individual suits, 40 purported class actions or actions where class certification has been sought and 75 state, municipality and other third-party payor health care reimbursement actions pending in the United States in which Liggett is a named defendant. The plaintiffs' allegations of liability in those cases in which individuals seek recovery for personal injuries allegedly caused by cigarette smoking are based on various theories of recovery, including negligence, gross negligence, special duty, voluntary undertaking, strict liability, fraud, misrepresentation, design defect, failure to warn, breach of express and implied warranties, conspiracy, aiding and abetting, concert of action, unjust enrichment, common law public nuisance, indemnity, market share liability, and violations of deceptive trade practice laws, the Federal Racketeer Influenced and Corrupt Organization Act ("RICO") and antitrust statutes. In many of these cases, in addition to compensatory damages, plaintiffs also seek other forms of relief including disgorgement of profits and punitive damages. Defenses raised by defendants in these cases include lack of proximate cause, assumption of the risk, comparative fault and/or contributory negligence, lack of design defect, statutes of limitations, equitable defenses such as "unclean hands" and lack of benefit, failure to state a claim and federal preemption.

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

In March 1996, Liggett and the Company entered into an agreement to settle the Castano class action tobacco litigation and an agreement with the Attorneys General of West Virginia, Florida, Mississippi, Massachusetts and Louisiana to settle certain actions brought against Liggett and the Company by such states. In March 1997, Liggett and the Company entered into a comprehensive settlement of tobacco litigation through parallel agreements with the Attorneys General of 17 states and with a nationwide class of individuals and entities that allege smoking-related claims. Thereafter, during 1997, settlements were reached with four more states through their respective Attorneys General. On March 12, 1998, the Company and Liggett reached a settlement agreement resolving the tobacco-related Medicaid reimbursement claims of 14 additional states, the District of Columbia and U.S. Virgin Islands. On March 27, 1998, a settlement with Georgia's Attorney General was reached. The Company and Liggett now have settlement agreements with the Attorneys General of 43 states and territories accounting for more than 85% of the nation's potential Medicaid claims. The settlements cover all smoking-related claims, including both addiction-based and tobacco injury claims against Liggett and the Company brought by the states and, upon court approval, the nationwide class.

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

Management believes that Liggett is in compliance in all material respects with the laws regulating cigarette manufacturers.

See Item 3. "Legal Proceedings", Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations - Recent Developments in the Cigarette Industry - Legislation and Litigation" and Note 16 to the Company's Consolidated Financial Statements for a description of legislation, regulation and litigation and of the Company's and Liggett's settlements.

BROOKE (OVERSEAS) LTD.

Liggett-Ducat Ltd. BOL, a wholly-owned subsidiary of BGLS, is engaged in the manufacture and sale of cigarettes in Russia through Liggett-Ducat, a Russian joint stock company. BOL owns a 95.9% equity interest in Liggett-Ducat. On February 2, 1998, BOL acquired the 19.97% interest in, and options to acquire additional shares of, Liggett-Ducat previously owned by Liggett. See Note 4 to the Company's Consolidated Financial Statements.

Liggett-Ducat, one of Russia's leading cigarette producers since 1892, manufactured and marketed 14.5 billion cigarettes in 1997. Liggett-Ducat produces or has rights to produce 19 different brands of cigarettes, including Russian brands such as Pegas, Prima, Novosti and Balomorkanal.

Liggett-Ducat manufactures three types of cigarettes: filter, non-filter and papirossi. Papirossi is a traditional type of Russian cigarette featuring a long paper filter comprising two-thirds of the cigarette with tobacco filling up the balance. In 1997, Liggett-Ducat sold 4.4 billion filter cigarettes (30%), 7.6 billion non-filter cigarettes (52%) and 2.6 billion papirossi (18%).

The long-term strategy of Liggett-Ducat is to upgrade the quality of its traditional Russian cigarette brands to international standards and to expand the range of cigarettes it offers to

include the higher-margin American blend and international blend cigarettes. The new types of cigarettes should appeal to the growing segment of the market that prefers American blend cigarettes over traditional Russian blended cigarettes. Russian blend cigarettes have a very strong flavored oriental tobacco blend with a heavy pungent odor, while the American blend is a lighter flavored Virginia tobacco blend. The international blend will be a mix between Russian and American blends. As markets have developed in Eastern Europe, consumer preferences have typically shifted toward international and American blend cigarettes.

Liggett-Ducat produces its cigarettes in a 150,000 square foot factory complex located on Gasheka Street in downtown Moscow and operates a 150,000 square foot warehouse outside of the city. Liggett-Ducat is currently building a new cigarette factory on the outskirts of Moscow on land it has leased for a term of 49 years. The new factory, which will utilize Western cigarette making technology and have a capacity of approximately 30 billion units per year, will produce American and international blend cigarettes, as well as traditional Russian cigarettes. Construction of the new factory is currently scheduled for completion by the end of 1998, although no assurances thereof can be given.

Liggett-Ducat currently manufactures its cigarettes on four production lines, comprised of both Russian-made and imported machinery. Liggett-Ducat has recently upgraded the equipment at the existing factory to improve its operations, and all upgraded equipment will be utilized at the new factory. During 1996 and 1997, Liggett-Ducat installed an upgraded primary processing complex manufactured by GBE Tobacco which will enable the factory to produce international standard cigarettes. In addition, Liggett-Ducat acquired a new filter-making complex from Hoechst Celanese which allows Liggett-Ducat to produce Western quality filters, previously purchased from outside vendors, and installed a new rejected cigarette tobacco reclamation machine to reduce waste.

The Russian cigarette market is one of the largest and fastest growing cigarette markets in the world. Annual consumption of cigarettes is estimated at 300 billion units in Russia (1997 estimate), making the market the third largest in the world after the United States and China. The potential size of the market is estimated by management at up to 450 billion units per year. Approximately 61% of Russian men and 17% of Russian women are estimated to smoke cigarettes. The market has been growing rapidly over the past several years (particularly the female market) as imported cigarettes have become available to satisfy increasing demand.

While growth in consumption had been restrained historically by static domestic cigarette making capacity, recent increases in domestic production capacity resulted in an estimated 20% increase in domestic production to approximately 170 billion cigarettes (57% of the market) in 1997. Excess demand and demand for Western style cigarettes were satisfied by approximately 130 billion units of imported cigarettes (43% of the market).

Russian customs legislation continues to support local producers. During 1996 and 1997, the Russian Government raised the duties on imported cigarettes several times to a current effective rate of 115% of cost. In the past, many imported cigarettes were sold illegally without payment of required duties. Recent efforts to improve enforcement of import duties has maintained the differential between the price of imported and domestic cigarettes. Imported cigarettes currently range in price at retail from approximately 2 to 18 rubles ($.50 to $3.00) per pack, as compared to domestically produced cigarettes which sell for approximately 1 to 3 rubles ($.16 to $.50) per pack.

Liggett-Ducat's brands currently compete primarily against those of other Russian cigarette makers. Liggett-Ducat as well as other Russian producers sell their cigarettes at the lowest price points in the market. Competition in this sector of the market is generally based on price and name recognition of the producing factory. There is very limited advertising of these

products, typically only in trade publications and wholesale catalogs. Liggett-Ducat's brands also compete to a lesser extent against lower priced imported cigarettes from Eastern Europe and Asia.

In order to increase their presence in the Russian market and avoid import duties, several of the major international cigarette manufacturers have begun to produce American and international blend cigarettes domestically. Such activities by companies with well established, international brands will provide significant additional competition to Liggett-Ducat as its seeks to increase its sales of such higher margin products upon completion of the new factory.

Sale of BrookeMil Ltd. Until January 31, 1997, BOL was also engaged in the real estate development business in Moscow through its subsidiary BrookeMil Ltd. ("BML"). On January 31, 1997, BOL entered into a stock purchase agreement (the "Purchase Agreement") with New Valley, pursuant to which BOL sold 10,483 shares of the common stock of BML to New Valley, comprising 99.1% of the outstanding shares of BML (the "BML Shares"). New Valley paid to BOL, for the BML Shares, a purchase price of $55 million, consisting of $21.5 million in cash and a $33.5 million 9% promissory note of New Valley (the "Note"). The Note, which was collateralized by the BML Shares, was paid during 1997. The transaction was approved by the independent members of the Board of Directors of the Company. The Company retained independent legal counsel in connection with the evaluation and negotiation of the transaction. See Notes 4 and 16 to the Company's Consolidated Financial Statements for a discussion of the transaction and information regarding a pending lawsuit relating to New Valley's purchase of the BML Shares.

The site of the proposed third phase of the Ducat Place project being developed by BML is currently used by Liggett-Ducat as the site for its existing cigarette factory. In connection with the sale of the BML Shares, Liggett-Ducat entered into a Use Agreement with BML whereby Liggett-Ducat is permitted to continue to utilize the site on the same basis as in the past. The Use Agreement is terminable by BML on 270 days' prior notice. In addition, New Valley has the right under the Purchase Agreement to require BOL and BGLS to repurchase this site for the then appraised fair market value, but in no event less than $13.6 million, during the period Liggett-Ducat operates the factory on such site.

NEW VALLEY CORPORATION

General. New Valley is engaged, through its ownership of Ladenburg Thalmann & Co. Inc. ("Ladenburg"), in the investment banking and brokerage business, through its ownership of BML, in the real estate development business in Russia and the Ukraine, through its New Valley Realty division, in the ownership and management of commercial real estate in the United States, and in the acquisition of operating companies. New Valley is registered under the Exchange Act and files periodic reports and other information with the SEC.

The Company indirectly holds, through BGLS and BGLS' wholly-owned subsidiary, New Valley Holdings, Inc. ("NV Holdings"), approximately 42% of the voting interest in New Valley. This approximate 42% interest consists, as of March 31, 1998, of (i) 19,748 shares of common stock (the "New Valley Common Shares") (approximately 0.2% of the class) and 250,885 shares of $3.00 Class B Cumulative Convertible Shares (the "Class B Preferred Shares") (approximately 9.0% of the class) held directly by BGLS and (ii) 3,969,962 New Valley Common Shares (approximately 41.4% of the class) and 618,326 $15.00 Class A Increasing Rate Cumulative Senior Preferred Shares (the "Class A Preferred Shares") (approximately 57.7% of the class) held by NV Holdings. See Note 2 to the Company's Consolidated Financial Statements.

Bennett S. LeBow, Chairman of the Board, President and Chief Executive Officer of the Company and of BGLS and the controlling stockholder of the Company, serves as Chairman of

the Board and Chief Executive Officer of New Valley. Howard M. Lorber, a consultant to the Company and its subsidiaries and a stockholder of the Company, serves as President and Chief Operating Officer, and is a director, of New Valley. Richard J. Lampen, Executive Vice President of the Company and of BGLS, serves as Executive Vice President, and is a director, of New Valley. Marc N. Bell, Vice President, General Counsel and Secretary of the Company and of BGLS, serves as Vice President, Associate General Counsel and Secretary of New Valley.

On January 18, 1995, New Valley emerged from bankruptcy reorganization proceedings and completed substantially all distributions to creditors under its First Amended Joint Chapter 11 Plan of Reorganization, as amended (the "Joint Plan"). The Joint Plan was confirmed by the United States Bankruptcy Court for the District of New Jersey, Newark Division on November 1, 1994, and pursuant thereto, New Valley effected certain related asset dispositions.

Joint Plan Provisions; Dispositions Pursuant to the Joint Plan. The Joint Plan of New Valley places restrictions on and requires approvals for certain transactions with the Company and its affiliates to which New Valley or a subsidiary of, or entity controlled by, New Valley may be party, including the requirements, subject to certain exceptions for transactions involving less than $1 million in a year or pro rata distributions on New Valley's capital stock, of approval by not less than two-thirds of the entire Board, including at least one of the directors elected by the holders of New Valley's preferred shares, and receipt of a fairness opinion from an investment banking firm. In addition, the Joint Plan requires that, whenever New Valley's Certificate of Incorporation provides for the vote of the holders of the Class A Senior Preferred Shares acting as a single class, such vote must, in addition to satisfying all other applicable requirements, reflect the affirmative vote of either (x) 80% of the outstanding shares of that class or (y) a simple majority of all shares of that class voting on the issue exclusive of shares beneficially owned by the Company.

Pursuant to the Joint Plan, on November 15, 1994, New Valley sold the assets and operations with which it provided domestic and international money transfer services, bill payment services, telephone cards, money orders and bank card services (collectively, the "Money Transfer Business") which included the capital stock of its subsidiary, Western Union Financial Services, Inc. ("FSI") and certain related assets, to First Financial Management Corporation ("FFMC"), and, on January 13, 1995, it sold to FFMC all of the trademarks and trade names used in the Money Transfer Business and constituting the Western Union name and trademark. The aggregate purchase price was approximately $1.193 billion, including $893 million in cash and $300 million representing the assumption by FFMC of substantially all of New Valley's obligations under its pension plan. Pursuant to the Joint Plan, all of New Valley's debt and allowed claims were satisfied in full and all classes of equity and other equity interests were reinstated and retained all of their legal, equitable and contractual rights.

Through October 1, 1995, New Valley was engaged in the messaging services business through its wholly-owned subsidiary, Western Union Data Services Company, Inc. ("DSI"). On October 31, 1995, New Valley completed the sale of substantially all of the assets (exclusive of certain contracts) and conveyance of substantially all of the liabilities of DSI to FFMC for $20 million, subject to certain adjustments. This transaction was effective as of October 1, 1995.

Ladenburg Thalmann & Co. Inc. On May 31, 1995, New Valley acquired all of the outstanding shares of common stock and other equity interests of Ladenburg for $25.8 million, net of cash acquired, subject to adjustment. Ladenburg is a full service broker-dealer which has been a member of the New York Stock Exchange since 1876. Its specialties include investment banking, trading, research, market making, private client services, institutional sales and asset management.

Ladenburg's investment banking area maintains relationships with businesses and provides them with research, advisory and investor relations support. Services include merger and acquisition consulting, management of and participation in underwriting of equity and debt financing, private debt and equity financing, and rendering appraisals, financial evaluations and fairness opinions. Ladenburg's listed securities, fixed income and over-the-counter trading areas include trading a variety of financial instruments. Ladenburg's client services and institutional sales departments serve over 20,000 accounts worldwide and its asset management area provides investment management and financial planning services to numerous individuals and institutions.

Ladenburg is a wholly-owned subsidiary of Ladenburg Thalmann Group Inc. ("Ladenburg Group"), which has other subsidiaries specializing in merchant banking, venture capital and investment banking activities on an international level. Ladenburg Thalmann International ("LTI"), a wholly-owned subsidiary of Ladenburg Group, is engaged in corporate finance and capital markets activities in Russia and Ukraine, seeking, among other things, mandates to raise capital for local corporate issuers in the international capital markets. LTI, headquartered in New York City, has an office in Kiev, Ukraine.

In July 1997, LTI, together with Societe Generale, formed a fund with an initial capitalization of U.S.$90.5 million for investment in public and private equity securities in Ukraine. LTI's Kiev office serves as investment advisor to the fund.

BrookeMil Ltd. On January 31, 1997, New Valley acquired the BML Shares, representing 99.1% of the outstanding shares of BML, from BOL. New Valley paid to BOL a purchase price of $55 million, consisting of $21.5 million in cash and the $33.5 million 9% Note of New Valley. The Note, which was collateralized by the BML Shares, was paid during 1997. The source of funds used by New Valley for the acquisition, including the payment of the Note, was general working capital including cash and cash equivalents and proceeds from the sale of investment securities available for sale. The amount of consideration paid by New Valley was determined based on a number of factors including current valuations of the assets, future development plans, local real estate market conditions and prevailing economic and political conditions in Russia.

New Valley retained independent legal counsel and financial advisors in connection with the evaluation and negotiation of the transaction, which was approved by a special committee of the independent directors of New Valley. In accordance with the terms of the Joint Plan, the transaction was approved by not less than two-thirds of the entire Board of Directors, including the approval of at least one of the directors elected by the holders of New Valley's preferred shares, and a fairness opinion from an investment banking firm was obtained. The shareholders of New Valley did not vote on the BML transaction (nor the acquisition of Ladenburg or the Office Buildings and Shopping Centers described below) as their approval was not required by applicable corporate law or New Valley's constituent documents.

BML is developing the three-phase Ducat Place complex on 2.2 acres of land in downtown Moscow, for which it has a 49-year lease. The first phase of the project, Ducat Place I, a 46,500 square foot Class-A office building, was successfully built and leased in 1993, and sold by BML to a tenant in April 1997. In 1997, BML completed construction of Ducat Place II, a premier 150,000 square foot office building. Ducat Place II has been leased to a number of leading international companies including Motorola, Conoco, Lukoil-Arco and Morgan Stanley. The third phase, Ducat Place III, is planned as a 350,000 square foot mixed-use complex, with construction anticipated to commence in 1999. For further information with respect to this transaction, see "Brooke (Overseas) Ltd. - Sale of BrookeMil Ltd.".

Western Realty. In February 1998, New Valley and Apollo Real Estate Investment Fund III, L.P. ("Apollo") organized Western Realty Development LLC ("Western Realty") to make real estate and other investments in Russia. In connection with the formation of Western Realty, New

Valley agreed, among other things, to contribute to Western Realty the real estate assets of BML, including Ducat Place II and the site for Ducat Place III, and Apollo agreed to contribute up to $58 million.

Under the terms of the agreement governing Western Realty (the "LLC Agreement"), the ownership and voting interests in Western Realty will be held equally by Apollo and New Valley. Apollo will be entitled to a preference on distributions of cash from Western Realty to the extent of its investment, together with a 15% annual rate of return, and New Valley will then be entitled to a return of $10 million of BML-related expenses incurred by New Valley since March 1, 1997, together with a 15% annual rate of return; subsequent distributions will be made 70% to New Valley and 30% to Apollo. Western Realty will be managed by a Board of Managers consisting of an equal number of representatives chosen by Apollo and New Valley. All material corporate transactions by Western Realty will generally require the unanimous consent of the Board of Managers. Accordingly, New Valley will account for its non-controlling interest in Western Realty on the equity method. See Note 3 to the New Valley's Consolidated Financial Statements accompaying this report.

The Company, New Valley and their affiliates have other business relationships with affiliates of Apollo. On January 11, 1996, the Company acquired from an affiliate of Apollo the Shopping Centers for $72.5 million. New Valley and pension plans sponsored by BGLS have invested in investment partnerships managed by an affiliate of Apollo. Affiliates of Apollo own a substantial amount of debt securities of BGLS and warrants to purchase common stock of the Company. See Note 9 to the Company's Consolidated Financial Statements.

On February 27, 1998, at an initial closing under the LLC Agreement, Apollo made a $11 million loan (the "Loan") to Western Realty. The Loan, which bears interest at the rate of 15% per annum and is due September 30, 1998, is secured by a pledge of New Valley's shares of BML. Upon completion of the transfer of Ducat Place II and the satisfaction of other conditions under the LLC Agreement, the Loan and the accrued interest thereon will be converted into a capital contribution by Apollo to Western Realty and the BML pledge released.

Western Realty will seek to make additional real estate and other investments in Russia. New Valley and Apollo have agreed to invest, through Western Realty or another entity, up to $25 million in the aggregate for the potential development of a real estate project in Moscow. In addition, Western Realty has agreed to invest $20 million for a 30% profits interest in a company organized by BOL which will, among other things, acquire an interest in an industrial site and manufacturing facility being constructed on the outskirts of Moscow by a subsidiary of BOL.

The foregoing summary reflects all material terms of, and is qualified in its entirety by, reference to the text of the LLC Agreement, a copy of which is incorporated by reference as an exhibit to New Valley's Annual Report on Form 10-K for the year ended December 31, 1997 and is incorporated by reference herein.

New Valley Realty Division. 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 $183.9 million, consisting of $23.9 million in cash and $160 million in non-recourse mortgage financing provided by the sellers. The Office Buildings and Shopping Centers are being operated through New Valley's New Valley Realty division.

The Office Buildings consist of two adjacent commercial office buildings in Troy, Michigan and two adjacent commercial office buildings in Bernards Township, New Jersey. New Valley acquired the Office Buildings in Michigan from Bellemead of Michigan, Inc. ("Bellemead Michigan") and the Office Buildings in New Jersey from Jared Associates, L.P. (each, a "Seller"), for an aggregate purchase price of $111.4 million. Each Seller was an affiliate of Bellemead

Development Corporation, which was indirectly wholly-owned by The Chubb Corporation. The purchase price was paid for the Office Buildings as follows: (i) $23.5 million for the 700 Tower Drive property, located in Troy, Michigan; (ii) $28.1 million for the 800 Tower Drive property, located in Troy, Michigan; (iii) $48.3 million for the Westgate I property, located in Bernards Township, New Jersey; and (iv) $11.4 million for the Westgate II property, located in Bernards Township, New Jersey. The two Michigan buildings were constructed in 1987 and the two New Jersey buildings were constructed in 1991. The gross square footage of the Office Buildings ranges from approximately 50,300 square feet to approximately 244,000 square feet.

New Valley acquired a fee simple interest in each Office Building (subject to certain rights of existing tenants), together with a fee simple interest in the land underlying three of the Office Buildings and a 98-year ground lease (the "Ground Lease") underlying one of the Office Buildings. Under the Ground Lease, Bellemead Michigan, as lessor, is entitled to receive rental payments of a fixed monthly amount and a specified portion of the income received from the 700 Tower Drive property. Space in the Office Buildings is leased to commercial tenants and, as of March 20, 1998, the Office Buildings were fully occupied.

Concurrently with the acquisition of the Office Buildings, New Valley engaged a property-management affiliate of Sellers that had previously managed the Office Buildings to act as the managing agent and leasing agent for the Office Buildings. The agreement for the New Jersey Office Buildings has a fifteen-year term and the agreement for the Michigan Office Buildings expires June 30, 1998, but the agreements may be terminated by either party on 60 days' notice without cause or economic penalty. Effective November 1997, the agreements were assigned to Gale & Wentworth, a national real estate company.

On January 11, 1996, New Valley acquired the Shopping Centers from various limited partnerships (AP Century I., L.P., AP Century II, L.P., AP Century III, L.P., AP Century IV, L.P., AP Century V, L.P., AP Century VI, L.P., AP Century VIII, L.P., and AP Century IX, L.P.) (each, a "Partnership") for an aggregate purchase price of $72.5 million. Each Partnership is an affiliate of Apollo. The Shopping Centers are located in Marathon and Royal Palm Beach, Florida; Lincoln, Nebraska; Santa Fe, New Mexico; Milwaukee, Oregon; Richland and Marysville, Washington; and Charleston, West Virginia. New Valley acquired a fee simple interest in each Shopping Center and the underlying land for each property. Space in the Shopping Center is leased to a variety of commercial tenants and, as of March 20, 1998, the aggregate occupancy of the Shopping Centers was approximately 92%. The Shopping Centers were constructed at various times during the period 1963-1988. The gross square footage of the Shopping Centers ranges from approximately 108,500 square feet to approximately 222,500 square feet.

The purchase price paid for the Shopping Centers was as follows: (i) $3.9 million for the Marathon Shopping Center property, located in Marathon, Florida; (ii) $9.8 million for the Village Royale Plaza Shopping Center property, located in Royal Palm Beach, Florida; (iii) $6.0 million for the University Place property, located in Lincoln, Nebraska; (iv) $9.6 million for the Coronado Shopping Center property, located in Santa Fe, New Mexico; (v) $7.3 million for the Holly Farm Shopping Center property, located in Milwaukee, Oregon; (vi) $10.6 million for the Washington Plaza property, located in Richland, Washington; (vii) $12.4 million for the Marysville Towne Center property, located in Marysville, Washington; and (viii) $12.9 million for the Kanawha Mall property, located in Charleston, West Virginia (the properties described in clauses (i), (ii), (v), (vii) and (viii) are subject to an underlying mortgage in favor of a single lender and are referred to collectively as the "Properties"). See Notes 3 and 7 to New Valley's Consolidated Financial Statements accompanying this report.

Concurrently with the acquisition of the Shopping Centers, New Valley engaged a property-management firm, whose principals were the former minority partners in the Partnerships, that had previously operated the Shopping Centers to act as the managing agent

and leasing agent for the Shopping Centers. Effective December 31, 1996, such firm's engagement was terminated, and Kravco Company was engaged as managing agent and leasing agent for the Kanawha Mall and Insignia Commercial Group, Inc. as managing agent and leasing agent for the remaining Shopping Centers.

The acquisition of the Office Buildings was effected pursuant to a purchase agreement dated January 10, 1996. The acquisition of the Shopping Centers was effected pursuant to a purchase agreement dated January 11, 1996. For information concerning other business relationships with affiliates of Apollo, see "Western Realty". The foregoing summary reflects all material terms of and is qualified in its entirety by reference to the purchase agreements, copies of which are incorporated by reference as exhibits to New Valley's Annual Report on Form 10-K for the year ended December 31, 1996, and are incorporated by reference herein.

On November 10, 1997, New Valley sold its Marathon, Florida Shopping Center for $5.4 million and recognized a gain of $1.3 million on the sale.

Thinking Machines Corporation. On January 11, 1996, Ladenburg Thalmann Capital Corp., the merchant banking subsidiary of Ladenburg Group, in connection with the First Amended Joint Plan of Reorganization (the "TMC Plan") of Thinking Machines Corporation ("Thinking Machines") made a $10.6 million convertible bridge loan (the "Loan") to TMCA Acquisition Corp. ("TMCA"). TMCA is an entity formed to invest the Loan proceeds (net of certain expenses) in Thinking Machines, currently a developer and marketer of data mining and knowledge discovery software and, through 1996, of parallel software for high-end and networked computer systems (discontinued in 1996).

On February 8, 1996, the date of confirmation of the TMC Plan, Thinking Machines emerged from bankruptcy and merged with TMCA pursuant to the TMC Plan. As a result of the merger, the Loan was converted into a controlling interest in a partnership which held approximately 61% of the outstanding common stock of Thinking Machines. Thinking Machines used the Loan proceeds to help fund its advanced product development and marketing. In December 1997, New Valley acquired for $3.15 million additional shares in Thinking Machines pursuant to a rights offering by Thinking Machines to its existing shareholders which increased its ownership to approximately 73% of the outstanding Thinking Machines shares.

Thinking Machines designs, develops, markets and supports software offering prediction-based management solutions under the name LoyaltyStream(TM) for businesses such as financial services and telecommunications providers to help reduce customer attrition, control costs, more effectively cross-sell or bundle products or services and manage risks. Incorporated in LoyaltyStream is Darwin(R), a data mining software tool set with which a customer can analyze vast amounts of its pre-existing data as well as external demographics data to predict behavior or outcomes, and then send this information through systems integration to those divisions of the customer which can use it to more effectively anticipate and solve business problems. To date, no material revenues have been recognized by Thinking Machines with respect to the sale or licensing of such software and services.

During the fourth quarter of 1996, Thinking Machines adopted a plan to terminate its parallel processing computer sales and service business. As a result, Thinking Machines wrote-down certain assets, principally inventory, related to these operations to their net realizable value by $6.1 million. Thinking Machines sold its parallel processing software business on November 19, 1996 for $4.3 million and sold its remaining parallel processing service business in April 1997 for $2.4 million in cash and a percentage of certain future operating profits.

Miscellaneous Investments. At December 31, 1997, New Valley owned 50.1% of the outstanding shares of PC411, Inc. ("PC411"), a development stage company which completed an

initial public offering in May 1997 with net proceeds of $5.9 million. PC411, which provides on-line electronic directory assistance to personal computer users, is currently offering a limited version of the PC411 service over the Internet. PC411's long-term strategy is to position itself as an Internet/intranet (private server based networks) information publishing and distribution company.

In addition, as of December 31, 1997, New Valley's long-term investments consisted primarily of investments in limited partnerships of $27.2 million. See Note 8 to New Valley's Consolidated Financial Statements accompanying this report.

New Valley may acquire additional operating businesses through merger, purchase of assets, stock acquisition or other means, or seek to acquire control of operating companies through one of such means. There can be no assurance that New Valley will be successful in targeting or consummating any such acquisitions.

EMPLOYEES

At December 31, 1997, the Company and its subsidiaries had approximately 1,556 full-time employees, of whom approximately 476 were employed by Liggett and approximately 1,063 were employed by Liggett-Ducat. Approximately 16% of the Company's (including its subsidiaries) employees are hourly employees and are represented by unions. The Company and its subsidiaries have not experienced any significant work stoppages since 1977, and the Company believes that relations with its employees and their unions are satisfactory.

ITEM 2. PROPERTIES

The Company's and BGLS' principal executive offices are located in Miami, Florida. The Company subleases 12,356 square feet of office space from an unaffiliated company in an office building in Miami, which it shares with BGLS and New Valley and various of their subsidiaries. New Valley has entered into an expense-sharing arrangement for use of such office space. The sublease expires on February 28, 1999.

Substantially all of Liggett's tobacco manufacturing facilities, consisting principally of factories, distribution and storage facilities, are located in or near Durham, North Carolina. Such facilities are both owned and leased. As of December 31, 1997, the principal properties owned or leased by Liggett are as follows:

TYPE	LOCATION	OWNED OR LEASED	APPROXIMATE TOTAL SQUARE FOOTAGE
Office and Manufacturing Complex	Durham, NC	Owned	932,000
Warehouse	Durham, NC	Owned	203,000
Storage Facilities	Danville, VA	Owned	578,000
Distribution Center	Durham, NC	Leased	260,000

Liggett's Durham, North Carolina complex consists of 10 major structures over approximately 17 acres. Included are Liggett's manufacturing plant, research facility and corporate offices. Liggett's management believes its property, plant and equipment are well maintained and in good condition and that its existing facilities are sufficient to accommodate a substantial increase in production.

Liggett leases the Durham, North Carolina distribution center pursuant to a lease which expires in May 1999. Liggett has an option to purchase the leased property at any time during the term of the lease. Liggett utilizes approximately 40% of the distribution center. Liggett also leases excess space in its research facility to third parties.

On March 11, 1997, Liggett sold to Blue Devil Ventures, a North Carolina limited liability partnership, certain surplus realty in Durham, North Carolina, for a sale price of $2.2 million. The Company recognized a gain of approximately $1.1 million on the sale.

Liggett-Ducat has a 49-year land lease on a site on the outskirts of Moscow, Russia where Liggett-Ducat plans to build a new cigarette factory. Liggett-Ducat utilizes the site for its existing cigarette factory in Moscow pursuant to a Use Agreement with BML. See Item 1. "Business - Brooke (Overseas) Ltd. - Sale of BrookeMil Ltd."

ITEM 3. LEGAL PROCEEDINGS

Reference is made to Note 16, incorporated herein by reference, to the Company's Consolidated Financial Statements, which contain a general description of certain legal proceedings to which the Company and/or BGLS or their subsidiaries are a party and certain related matters. Reference is also made to Exhibit 99.1, incorporated herein by reference, for additional information regarding the pending material legal proceedings to which the Company, BGLS and/or Liggett are party.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

During the last quarter of 1997 no matter was submitted to the Company's stockholders for their vote or approval, through the solicitation of proxies or otherwise. Such information with respect to BGLS is omitted due to the fact that BGLS meets the conditions set forth in General Instruction (I)(1)(a) and (b) of Form 10-K and is therefore filing this report with the reduced disclosure format.

EXECUTIVE OFFICERS OF THE REGISTRANTS

The table below, together with the accompanying text, present certain information regarding all current executive officers of the Company and of BGLS as of March 27, 1998. Each of the executive officers of the Company and of BGLS serves until the election and qualification of such individual's successor or until such individual's death, resignation or removal by the Board of Directors of the respective company.

NAME	AGE	POSITION	YEAR INDIVIDUAL BECAME AN EXECUTIVE OFFICER
Bennett S. LeBow	60	Chairman of the Board, President and Chief Executive Officer of the Company and of BGLS	1990
Richard J. Lampen	44	Executive Vice President of the Company and of BGLS	1996

NAME	AGE	POSITION	YEAR INDIVIDUAL BECAME AN EXECUTIVE OFFICER
Joselynn D. Van Siclen	57	Vice President, Chief Financial Officer and Treasurer of the Company and of BGLS	1996
Marc N. Bell	37	Vice President, General Counsel and Secretary of the Company and of BGLS	1998
Ronald S. Fulford	64	Chairman of the Board, President and Chief Executive Officer of Liggett	1996

BENNETT S. LEBOW has been the Chairman of the Board, President and Chief Executive Officer of the Company, a New York Stock Exchange-listed holding company, since June 1990, and has been a director of the Company since October 1986. Since November 1990, he has been Chairman of the Board, President and Chief Executive Officer of BGLS, which directly or indirectly holds the Company's equity interests in several private and public companies.

Mr. LeBow has been a director of Liggett since June 1990 and Chairman of the Board of Liggett from July 1990 to May 1993. He served as one of three interim Co-Chief Executive Officers from March 1993 to May 1993.

He has been Chairman of the Board of New Valley, in which the Company holds an indirect voting interest of approximately 42%, since January 1988, and Chief Executive Officer since November 1994. In November 1991, an involuntary petition seeking an order for relief under Chapter 11 of Title 11 of the United States Code was commenced against New Valley by certain of its bondholders. New Valley emerged from bankruptcy reorganization proceedings in January 1995. He has been Chairman of the Board, President and Chief Executive Officer of NV Holdings since September 1994.

He was a director of MAI Systems Corporation ("MAI"), the Company's former indirect majority-owned subsidiary, from September 1984 to October 1995, Chairman of the Board from November 1990 to May 1995 and the Chief Executive Officer from November 1990 to April 1993. In April 1993, MAI filed for protection under Chapter 11 of Title 11 of the United States Code. In November 1993, MAI emerged from bankruptcy reorganization proceedings. MAI is engaged in the development, sale and service of a variety of computer and software products.

RICHARD J. LAMPEN has served as the Executive Vice President of the Company and of BGLS since July 1996. Since October 1995, Mr. Lampen has been the Executive Vice President of New Valley. From May 1992 to September 1995, Mr. Lampen was a partner at Steel Hector & Davis, a law firm located in Miami, Florida. From January 1991 to April 1992, Mr. Lampen was a Managing Director at Salomon Brothers Inc, an investment bank, and was an employee at Salomon Brothers Inc from 1986 to April 1992. Mr. Lampen is a director of New Valley, Thinking Machines, PC411 and Spec's Music, Inc. Mr. Lampen has served as a director of a number of other companies, including U.S. Can Corporation and The International Bank of Miami, N.A., as well as a court-appointed independent director of Trump Plaza Funding, Inc.

JOSELYNN D. VAN SICLEN has been Vice President, Chief Financial Officer and Treasurer of the Company and of BGLS since May 1996, and currently holds various positions with certain

of BGLS' subsidiaries, including Vice President and Treasurer of Eve Holdings, Inc., a wholly-owned subsidiary of Liggett, since April 1994 and May 1996, respectively. Prior to May 1996, Ms. Van Siclen served as Director of Finance of the Company and was employed in various accounting capacities for various subsidiaries of the Company since 1992. Since before 1990 to November 1992, Ms. Van Siclen was an audit manager for the accounting firm of Coopers & Lybrand L.L.P.

MARC N. BELL has been the Vice President of the Company and of BGLS since January 1998 and has served as General Counsel and Secretary of the Company and of BGLS since May 1994. Since November 1994, Mr. Bell has served as Associate General Counsel and Secretary of New Valley and since February 1998, as Vice President. Prior to May 1994, Mr. Bell was with the law firm of Zuckerman, Spaeder, Taylor & Evans, in Miami, Florida and from June 1991 to May 1993, with the law firm of Fischbein - Badillo - Wagner - Harding in New York, New York.

RONALD S. FULFORD has served as Chairman of the Board, President and Chief Executive Officer of Liggett since September 1996. Mr. Fulford has also served as a consultant to the Company from March 1996 to March 1997. From June, 1986 until February 1996, Mr. Fulford served as Executive Chairman of Imperial Tobacco ("Imperial"), the British tobacco unit of the British conglomerate Hanson PLC ("Hanson"). Before Imperial, Mr. Fulford was chief executive of three other Hanson companies: London Brick, British EverReady UK & South Africa and United Gas Industries UK & Europe.

PART II

ITEM 5. MARKET FOR REGISTRANTS' COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's common stock, $.10 par value per share, is listed and traded on the New York Stock Exchange ("NYSE") under the symbol "BGL". The high and low sale prices for a share of the Company's common stock on the NYSE, as reported by the NYSE, for each fiscal quarter of 1997 and 1996 were as follows (in dollars):

Year	High	Low
1997:		
Fourth Quarter	$ 11 1/8	$ 5 5/8
Third Quarter	6 3/4	3 1/16
Second Quarter	5 1/4	3 1/2
First Quarter	5 3/8	4
1996:		
Fourth Quarter	5 3/4	4 1/4
Third Quarter	6 1/4	4 5/8
Second Quarter	8 7/8	5 5/8
First Quarter	10 1/8	7 3/4

There is no public market for BGLS' common stock, $.01 par value per share, as all of such common stock is held by the Company.

HOLDERS

At April 6, 1998, there were 280 holders of record of the Company's common stock.

DIVIDENDS

During 1997 and 1996, the Company declared and paid regular quarterly cash dividends of $.075 per share on its common stock. The declaration of future cash dividends is within the discretion of the Board of Directors of the Company and is subject to a variety of contingencies such as market conditions, earnings and the financial condition of the Company as well as the availability of cash. The payment of dividends and other distributions to the Company by BGLS are subject to the Indenture for BGLS' Senior Secured Notes. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations - Capital Resources and Liquidity".

ITEM 6. SELECTED FINANCIAL DATA

	Year Ended December 31,				
	1997	1996	1995	1994	1993
	(dollars in thousands, except per share amounts)				
STATEMENT OF OPERATIONS DATA:					
Revenues(1)	$ 389,615	$ 460,356	$ 461,459	$ 479,343	$ 493,041
Loss from continuing operations	(51,810)	(64,918)	(45,344)	(17,991)	(69,228)
Income from discontinued operations(2)	1,925	2,385	21,229	174,683	--
(Loss) income from extraordinary items(4)	--	--	(9,810)	(46,597)	153,741
Net (loss) income	(49,885)	(62,533)	(33,925)	110,095	106,780
Basic/diluted loss from continuing operations per share(3)	(2.85)	(3.41)	(1.56)	(1.02)	(4.19)
Basic/diluted income from discontinued operations per share	0.11	0.13	1.16	9.92	3.45
Basic/diluted (loss) income from extraordinary items per share	--	--	(0.54)	(2.65)	8.55
Basic/diluted net (loss) income per share(3)	(2.74)	(3.28)	(0.94)	6.25	5.60
Cash distributions declared per common share	0.30	0.30	0.30	--	--
BALANCE SHEET DATA:					
Current assets	$ 67,985	$ 80,552	$ 96,615	$ 87,504	$ 114,411
Total assets	126,460	177,677	225,620	229,425	164,819
Current liabilities	140,504	204,463	119,177	144,351	220,207
Notes payable, long-term debt and other obligations, less current portion	399,835	378,243	406,744	405,798	389,671
Noncurrent employee benefits, deferred credits and other long-term liabilities	74,518	49,960	55,803	54,128	69,623
Stockholders' equity (deficit)	(488,397)	(454,989)	(356,104)	(374,852)	(514,682)

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(1) Revenues include federal excise taxes of $87,683, $112,218, $123,420, $131,877 and $127,341, respectively.
(2) See Note 5 to the Company's Consolidated Financial Statements.
(3) Per share computations include the impact of New Valley's repurchase of Class A Preferred Shares in 1996 and 1995.
(4) In 1995 and 1994, extraordinary items represent loss resulting from the early extinguishment of debt. In 1993, such items represent gain resulting from the early extinguishment of debt as well as gain on foreclosure and gain on reorganization of MAI Systems, Inc.

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

(Dollars in Thousands, Except Per Share Amounts)

INTRODUCTION

The following discussion provides an assessment of the results of operations, capital resources and liquidity of the Company and should be read in conjunction with the Company's Consolidated Financial Statements and notes thereto included elsewhere in this report. The operating results of the periods presented were not significantly affected by inflation. The consolidated financial statements include the accounts of BGLS, Liggett, BOL, NV Holdings, other less significant subsidiaries and, as of December 29, 1995, Liggett-Ducat.

The Company holds an equity interest in New Valley. At December 31, 1997, the Company accounts for its share of earnings based on its ownership of New Valley Common Shares (42%), Class B Preferred Shares (9%) and Class A Preferred Shares (58%). The Common Shares are accounted for pursuant to the equity method; the Class A Preferred Shares and the Class B Preferred Shares are accounted for under Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities".

On January 31, 1997, BOL sold its interest in BML, a real estate development company doing business in Russia, to New Valley. See Item 1. "Business - Brooke (Overseas) Ltd. - Sale of BrookeMil Ltd." and Note 4 to the Company's Consolidated Financial Statements.

For purposes of this discussion and other consolidated financial reporting, the Company's significant business segment is tobacco for the year ended December 31, 1997 and tobacco and real estate for the years ended December 31, 1996 and 1995.

RECENT DEVELOPMENTS

THE COMPANY

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

Pursuant to the terms of the Standstill Agreement, the Apollo Holders agreed to defer the payment of interest on the BGLS Notes held by them, commencing with the interest payment that was due July 31, 1997, which they had previously agreed to defer, through the interest payment due on July 31, 2000. The deferred interest payments will be payable at final maturity of the BGLS Notes on January 31, 2001 or upon an Event of Default under the Indenture for the BGLS Notes. In connection with the Standstill Agreement, the Company issued to the Apollo Holders a five-year warrant to purchase 2,000,000 shares of the Company's common stock at a price of $5.00 per share. The Apollo Holders were also issued a second warrant expiring October 31, 2004 to purchase an additional 2,150,000 shares of the Company's common stock at a price of $0.10 per share. The second warrant will become exercisable on October 31, 1999 and the Company will have the right under certain conditions prior to that date to substitute for that warrant a new warrant for 9.9% of the common stock of Liggett.

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

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

LIGGETT

Notes Restructuring. On January 30, 1998, with the consent of the required majority of the holders of the Liggett 11.50% Series B and 19.75% Series C Senior Secured Notes due 1999 (the "Liggett Notes"), Liggett entered into various amendments to the Indenture governing the Liggett Notes which provided, among other things, for a deferral of the February 1, 1998 mandatory redemption payment of $37,500 to the date of final maturity of the Liggett Notes on February 1, 1999. In connection with the deferral, the Company agreed to issue 482,970 shares of the Company's common stock to the holders of record on January 15, 1998 of the Liggett Notes. The Indenture under which the Liggett Notes are outstanding was also amended to prohibit, with limited exceptions, payments of dividends and incurrence of new debt by Liggett and to tighten restrictions on the disposition of proceeds of asset sales. The Company and BGLS also agreed to guarantee the payment by Liggett of the August 1, 1998 interest payment on the Liggett Notes.

NEW VALLEY

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

Investment in RJR Nabisco. At December 31, 1997, New Valley held 612,650 shares of common stock of RJR Nabisco Holdings corp. ("RJR Nabisco") with a market value of $22,898 (cost of $18,780). New Valley expensed $100 in 1997, $11,724 in 1996 and $3,879 in 1995 relating to the RJR Nabisco investment.

In June 1996, various agreements between High River, the Company and New Valley were terminated by mutual consent. Pursuant to these agreements the parties had agreed to take certain actions during late 1995 and throughout 1996 designed to cause RJR Nabisco to effectuate a spinoff of its food business, Nabisco Holdings Corp. The terminations of the High River agreements left in effect for one year certain provisions concerning payments to be made to High River in the event New Valley achieved a profit (after deducting certain expenses) on the sale of the shares of RJR Nabisco common stock which were held by it or they were valued at the end of such year at higher than their purchase price or in the event the Company or its affiliates engaged in certain transactions with RJR Nabisco. Based on the market price of RJR Nabisco common stock, no amounts were payable by New Valley under these agreements.

Pursuant to a December 27, 1995 agreement between the Company and New Valley whereby New Valley agreed to reimburse the Company and its subsidiaries for certain reasonable out-of-pocket expenses in connection with RJR Nabisco, New Valley paid the Company and its subsidiaries a total of $17 and $2,370 in 1997 and 1996.

On February 29, 1996, New Valley entered into a total return equity swap transaction (the "Swap") with an unaffiliated company (the "Counterparty") relating to 1,000,000 shares of RJR Nabisco common stock (reduced to 750,000 shares of RJR Nabisco common stock as of August 13, 1996). New Valley entered into the Swap in order to be able to participate in any increase or decrease in the value of the RJR Nabisco common stock during the term of the Swap. The transaction was for a period of up to six months, unless extended by the parties, subject to earlier termination at the election of New Valley, and provided for New Valley to make a payment to the Counterparty of $1,537 upon commencement of the Swap. At the termination of the transaction, if the price of the RJR Nabisco common stock during a specified period prior to such date (the "Final Price") exceeded $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 was required to pay New Valley an amount in cash equal to the amount of such appreciation with respect to the shares of RJR Nabisco common stock subject to the Swap plus the value of any dividends with a record date occurring during the Swap period. If the Final Price was less than the Initial Price, then New Valley was required to pay the Counterparty at the termination of the transaction an amount in cash equal to the amount of such decline with respect to the shares of RJR Nabisco common stock subject to the Swap, offset by the value of any dividends, provided that, with respect to approximately 225,000 shares of RJR Nabisco common stock, New Valley was not 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 were guaranteed by the Counterparty's parent, a large foreign bank, and New Valley pledged certain collateral in respect of its potential obligations under the Swap and agreed to pledge additional collateral under certain conditions. New Valley marked its obligation with respect to the Swap to fair value with unrealized gains or losses included in income. During the third quarter of 1997, the Swap was terminated in connection with New Valley's reduction of its holdings of RJR Nabisco common stock, and New Valley recognized a loss on the Swap of $7,305 for the year ended December 31, 1996.

BOL

Sale of BML. On January 31, 1997, New Valley acquired from BOL 10,483 shares (99.1%) of common stock of BML for a purchase price of $55,000, consisting of $21,500 in cash and a $33,500 9% promissory note of New Valley (the "Note"). The Note was paid during 1997. The Company recognized a gain of approximately $21,300 on the sale in 1997. See Note 4 to the Company's Consolidated Financial Statements.

YEAR 2000 COSTS

The Company has evaluated the costs to implement century date change compliant systems conversions and is in the process of executing a planned conversion of its systems prior to the year 2000. Although such costs may be a factor in describing changes in operating profit for one or more of the Company's business segments in any given reporting period, the Company currently does not believe that the anticipated costs of year 2000 systems conversions will have a material impact on its future consolidated results of operations or cash flows. However, due to the interdependent nature of computer systems, the Company may be adversely impacted in the year 2000 depending on whether it or entities not affiliated with the Company have addressed this issue successfully.

New Accounting Pronouncements. In June 1997, the Financial Accounting Standards Board ("FASB") issued SFAS No. 130, "Reporting Comprehensive Income". SFAS No. 130

establishes standards for reporting and display of comprehensive income. The purpose of reporting comprehensive income is to present a measure of all changes in equity that result from recognized transactions and other economic events of the period other than transactions with owners in their capacity as owners. SFAS No. 130 requires that an enterprise classify items of other comprehensive income by their nature in a financial statement and display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of the balance sheet. For the Company, other components of stockholders' equity include such items as minimum pension liability adjustments, unearned compensation expense related to stock options and the Company's proportionate interest in New Valley's capital transactions. SFAS No. 130 is effective for fiscal years beginning after December 15, 1997, with earlier application permitted. The Company does not anticipate that implementation of SFAS No. 130 will have a material impact on the consolidated financial statements.

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

In February 1998, SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits," was issued which revises required disclosures about pensions and postretirement benefit plans. SFAS No. 132 is effective for the Company for the year ended 1998. The Company has not yet determined the impact of its implementation.

RECENT DEVELOPMENTS IN THE CIGARETTE INDUSTRY

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

On January 23, 1998, Philip Morris and RJR announced a list price increase of $.25 per carton (approximately 2 1/2%). This action was matched by Liggett and the other manufacturers during the following week. On April 3, 1998, Philip Morris announced a second list price increase of $.50 per carton (approximately 4.5%). This action, the fourth in 13 months, was matched by Liggett and the other manufacturers.

Legislation, Regulation and Litigation. The cigarette industry continues to be challenged on numerous fronts. New cases continue to be commenced against Liggett and the Company and other cigarette manufacturers. As of December 31, 1997, there were approximately 250 individual suits, 40 purported class actions and 75 state, municipality and other third-party payor health care reimbursement actions pending in the United States in which Liggett is a named defendant. As new cases are commenced, the costs associated with defending such cases and the risks attendant to the inherent unpredictability of litigation continue to increase. Recently, there have been a number of

restrictive regulatory actions from various Federal administrative bodies, including the United States Environmental Protection Agency ("EPA") and the Food and Drug Administration ("FDA"), adverse political decisions and other unfavorable developments concerning cigarette smoking and the tobacco industry, including the commencement and certification of class actions and the commencement of Medicaid reimbursement suits by various states' Attorneys General. These developments generally receive widespread media attention. The Company is not able to evaluate the effect of these developing matters on pending litigation or the possible commencement of additional litigation, but it is possible that Company's financial position, results of operations and cash flows could be materially adversely affected by an ultimate unfavorable outcome in any of such pending litigation. (See Item 3. "Legal Proceedings" and Note 16 to the Company's Consolidated Financial Statements for a description of legislation, regulation and litigation.)

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

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

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

Under the Castano settlement agreement, upon final court approval of the settlement, the Castano class would be entitled to receive up to 5% of Liggett's pretax income (income before income taxes) each year (up to a maximum of $50,000 per year) for the next twenty-five years, subject to certain reductions provided for in the agreement, and a $5,000 payment from Liggett if the Company or Liggett fails to consummate a merger or similar transaction with another non-settling tobacco company defendant within three years of the date of the settlement. The Company and Liggett have the right to terminate the Castano settlement under certain circumstances. On May 11, 1996, the Castano Plaintiffs Legal Committee filed a motion with the United States District Court for the Eastern District of Louisiana seeking preliminary approval of the Castano settlement. On May 23, 1996, the Court of Appeals for the Fifth Circuit reversed the February 17, 1995 order of the District Court certifying the Castano suit as a nationwide class action and instructed the District Court to dismiss the class complaint. (For additional information

concerning the Fifth Circuit's decision, see Note 16 to the Company's Consolidated Financial Statements.) On September 6, 1996, the Castano plaintiffs withdrew the motion for approval of the Castano settlement.

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

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

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

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

court vacated its preliminary certification of the settlement class, which decision is currently on appeal.

In the Fletcher action, it is anticipated that class members will be notified of the settlement and will have an opportunity to appear at a later court hearing. Effectiveness of the mandatory settlement is conditioned on final court approval of the settlement after a fairness hearing. There can be no assurance as to whether or when court approval will be obtained. (For additional information concerning the Fletcher action, see Note 16 to the Company's Consolidated Financial Statements.)

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

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

Other Matters. On June 20, 1997, Philip Morris, RJR, B&W, Lorillard and the United States Tobacco Company, along with the Attorneys General for the States of Arizona, Connecticut, Florida Mississippi, New York and Washington and the Castano Plaintiffs' Litigation Committee executed a Memorandum of Understanding to support the adoption of federal legislation and necessary ancillary undertakings, incorporating the features described in a proposed resolution. The proposed resolution mandates a total reformation and restructuring of how tobacco products are manufactured, marketed and distributed in the United States. (For additional information concerning the proposed resolution, see Note 16 of the Company's Consolidated Financial Statements.) The proposals are currently being reviewed by the White House, Congress and various public interest groups. Separately, the other tobacco companies negotiated settlements of the Attorneys General health care cost recovery actions in Mississippi, Florida and Texas. Management is unable to predict the ultimate effect, if any, of the enactment of legislation adopting the proposed resolution. Management is also unable to predict the ultimate content of any such legislation. However, adoption of any such legislation could have a material adverse effect on the business of the Company and Liggett.

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

RESULTS OF OPERATIONS

	Revenues			Operating Income		
	Year Ended December 31,			Year Ended December 31,		
	1997	1996	1995	1997	1996	1995
Liggett	$312,268	$401,062	$455,666	$ 3,688	$ 6,753	$ 24,619
Liggett-Ducat	77,115	54,160		8,642	(6,825)	
Other	232	5,134	5,793	(4,301)	(3,855)	(16,559)
Total	$389,615	$460,356	$461,459	$ 8,029	$(3,927)	$ 8,060

1997 compared to 1996

Revenues. Consolidated revenues were $389,615 for the year ended December 31, 1997 compared to $460,356 for the year ended December 31, 1996, a decrease of $70,741 primarily due to a decline in sales of $88,794 at Liggett offset by an increase in tobacco revenues at Liggett-Ducat of $22,955. Revenues in 1996 also included real estate rental income of $2,675 and sales of microfiche products of $2,459.

Net sales at Liggett decreased in total by 22.1% ($88,794) due primarily to a decline in unit sales volume of 30.9% ($124,029) partially offset by price increases of $23,237 and improved product mix of $11,998 (see "Recent Developments in the Cigarette Industry - Pricing Activity"). The decline in Liggett's sales volume was due to certain competitors' continuing leveraged rebate programs tied to their products and increased promotional activity by certain other manufacturers. In the premium segment, revenues declined in 1997 by 16.4% ($20,158) to $102,440 as a result of a 21.4% decline in unit sales volume of $26,184 which was partially offset by price increases of $6,026. In the discount segment, revenues declined in 1997 by 24.6% ($68,636) to $209,828 due to a 33.8% decline in unit sales volume of $85,846 which was partially offset by price increases of $17,210. In 1997, fixed manufacturing costs on a basis comparable to 1996 were $1,428 lower although costs per thousand units increased $0.56 per thousand due to higher fixed costs per unit.

Net sales at Liggett-Ducat increased 42.8% ($22,955) to $77,115 over 1996 due primarily to higher unit sales volume ($13,211), price increases ($5,087) and the effect of excise tax increases ($4,667).

Gross Profit. Consolidated gross profit of $187,494 for the year ended December 31, 1997 decreased $29,529 from gross profit of $217,023 for the same period in 1996, reflecting a decrease in gross profit at Liggett of $40,305 offset by an increase at Liggett-Ducat of $11,720 for the year ended December 31, 1997 compared to the same period in the prior year. The 1997 decline in consolidated gross profit was due primarily to the decline in unit sales volume discussed above. In 1997, Liggett's premium and discount brands contributed 33.8% and 58.5%, respectively, to the Company's gross profit while Liggett-Ducat contributed 7.22%. The improved performance at Liggett-Ducat during 1997 is due to lower tobacco and material prices resulting from purchases in higher volume ($6,600) and the effect of price increases ($5,500). In 1996, Liggett's premium and discount brands contributed 34.4% and 63.9%, respectively, to the Company's gross margin and Liggett-Ducat and BML contributed .7%. As a percent of revenues (excluding federal excise taxes), gross profit at Liggett increased to 73.0% for 1997 compared to 72.0% for 1996 with gross profit for the premium segment at 77.1% both in 1997 and 1996 and gross profit for the discount segment at 70.8% and 69.4% in 1997 and 1996, respectively. This

increase is the result of the March and September 1997 list price increases and improved production variances. These increases were partially offset by increased tobacco costs at Liggett due to a reduction in the average discount available to Liggett from leaf tobacco dealers on tobacco purchased under prior years' purchase commitments. Gross profit margin was further reduced by restructuring charges of $407 in cost of sales in 1997. As a percent of revenues (excluding Russian excise taxes), gross profit at Liggett-Ducat increased to 17.0% for 1997 compared to 3.0% in 1996.

Expenses. Consolidated operating, selling, general and administrative expenses were $179,465 for the year ended December 31, 1997 compared to $220,950 for the same period for the prior year, a decrease of $41,485. The decrease was due primarily to Liggett's decrease in unit sales volume with corresponding reductions in spending on promotional programs and marketing programs of $43,657 as well as reductions in administrative costs of approximately $7,000 over the prior year. Such reductions were somewhat offset by increases in legal expenses of $19,368, which includes the legal settlement discussed above of $16,421 and also reflects, in part, the end of joint defense arrangements. (Refer to Note 16 of Company's Consolidated Financial Statements.) Expenses at BOL also declined approximately $4,700 primarily due to workforce reductions at Liggett-Ducat in late 1996 and the sale of BML in January of 1997.

Other Income (Expense). Consolidated interest expense was $61,778 for the year ended December 31, 1997 compared to $60,556 for the same period for the prior year. The increase of $1,222 relates to additional interest expense incurred as a result of deferred payments during negotiations with BGLS Noteholders (see "Capital Resources and Liquidity"). Equity in loss of affiliate in 1997 and 1996 of $27,035 and $7,211, respectively, represents the Company's proportionate share of losses from continuing operations at New Valley and the decline in value of the New Valley Class A Preferred Shares. This is partially offset by discontinued operations in which the Company reflected its portion of New Valley's income from discontinued operations which was $1,925 in 1997 and $2,385 in 1996 reflecting the Company's proportionate interest in the discontinued operations of Thinking Machines, a subsidiary of New Valley. Other income also includes the sale of assets, primarily the sale of the BML shares by BOL to New Valley in 1997 and the sale of surplus realty at Liggett and the assets of COM Products Inc. ("COM") in 1996.

Loss from Continuing Operations. The loss from continuing operations for the year ended December 31, 1997 was $51,810 compared with a loss of $64,918 for the same period in the prior year. A tax provision of $1,123 in 1997 and $1,402 in 1996 relates to foreign income taxes at the subsidiary level.

Other. At December 31, 1997, the Company and its consolidated group had net operating loss carryforwards for tax purposes of approximately $125,000 which may be subject to certain restrictions and limitations and which will generally expire in the years 2006 to 2017.

1996 compared to 1995

Revenues. Consolidated revenues were $460,356 for the year ended December 31, 1996 compared to $461,459 for the year ended December 31, 1995, a decrease of $1,103 primarily due to a decline in sales of $54,604 at Liggett offset by an increase in tobacco revenues at Liggett-Ducat of $53,377. Results of operations for Liggett-Ducat were not included in 1995 since consolidation occurred as of December 29, 1995.

Net sales at Liggett decreased in 1996 12.0% ($54,604) from the prior year, due primarily to a 17.9% decline in unit sales volume of $81,644, partially offset by the effects of the April 1996 list price increase of $16,975 and improved product mix of $10,065. The decline in premium and discount unit sales volume was due to certain competitors continuing leveraging rebate programs tied to their products and increased promotional activity by certain other manufacturers. Liggett

experienced a significant increase in volume at the end of the fourth quarter of 1996, in part due to ongoing trade programs based on quarterly volume targets for its customers and to consumer promotional programs consisting of coupons and variable price reductions. In the premium segment, revenues declined in 1996 by 10.8% ($14,925) to $122,598 as a result of a 13.7% decline in unit sales volume ($18,893) which was partially offset by price increases of $3,968. In the discount segment, revenues declined in 1996 by 12.5% ($39,679) to $278,464 as a result of a 19.1% decline in unit sales volume ($52,640) which was partially offset by price increases of $13,007. In 1996, fixed manufacturing costs on a basis comparable to 1995 were $203 lower although costs per thousand units increased $0.29 due to higher fixed costs per unit.

Liggett-Ducat (not included in the prior year's results) increased unit sales volume over the prior year by 8.7% to approximately 11.4 billion units and increased revenues by $9,832 driven by the expanding market in Russia.

Gross Profit. Consolidated gross profit of $217,023 for the year ended December 31, 1996 decreased $28,249 from gross profit of $245,272 for the same period in 1995, reflecting a decrease in gross profit at Liggett of $30,089 for the year ended December 31, 1996 compared to the same period in the prior year. The 1996 decline in consolidated gross profit was due primarily to the decline in unit sales volume discussed above. In 1996, Liggett's premium and discount brands contributed 34.4% and 63.9%, respectively, to the Company's gross profit while Liggett-Ducat contributed 0.7% and BML 1.0%. This was somewhat offset by gross margin at Liggett-Ducat of $4,036 which margins were not included in the prior year's results. As a percent of revenues (excluding federal excise taxes), Liggett's gross profit decreased to 72.0% for 1996 compared to 73.2% for 1995 with gross profit for the premium segment at 77.1% and 79.7% in 1996 and 1995, respectively, and gross profit for the discount segment at 69.4% and 72.4% in 1996 and 1995, respectively. This decrease in gross profit in 1996 is the result of increased tobacco costs due to reduced worldwide supply of tobacco, and a reduction in the average discount available to Liggett from leaf tobacco dealers on tobacco purchased under prior years' purchase commitments, partially offset by the April 1996 list price increase. Gross profit for 1995 was also reduced by an accrual of approximately $4,900 for the United States Department of Agriculture ("USDA") domestic marketing assessment. See Note 16 to the Company's Consolidated Financial Statements.

Expenses. Consolidated operating, selling, general and administrative expenses were $220,950 for the year ended December 31, 1996 compared to $237,212 for the same period for the prior year, a decrease of $16,262. The decrease was due primarily to Liggett's decrease in sales volume with corresponding reductions in spending on promotional programs ($4,682) offset by charges for restructuring of $3,428 for severance programs ($132 of which is included in cost of sales). The anticipated savings of the restructuring related primarily to reduced payroll and benefits expenses in future periods. Of the total restructuring expense recorded during 1996, $1,416 was funded during 1996 and $2,012 remained to be funded in subsequent years. In addition, corporate expenses, primarily legal fees, decreased by approximately $4,000. In 1995, expenses increased due to increased spending on trade and promotional programs and the accrual of approximately $4,000 for the settlement of certain tobacco litigations with the Attorneys General of certain states. See Note 16 to the Company's Consolidated Financial Statements.

Other Income (Expense). Consolidated interest expense was $60,556 for the year ended December 31, 1996 compared to $57,505 for the same period for the prior year. The increase of $3,051 relates to interest expense at Liggett-Ducat not reflected in the prior year's consolidation, increased interest accrued for the USDA domestic marketing assessment expense at Liggett partially offset by redemption of $7,000 of the Liggett Senior Secured Notes (the "Liggett Series B Notes") and an increase in interest expense at corporate due to an increase in outstanding indebtedness of approximately $9,000. Equity in loss of affiliate of $7,211 in 1996 represents the Company's proportionate share of losses from continuing operations at New Valley. This is partially offset by discontinued operations in which the Company reflected its portion of New Valley's loss

from discontinued operations ($1,591) and the gain on disposal ($3,976). In 1995, equity in earnings of affiliate was $678 with income from discontinued operations of $2,860 and gains in discontinued operations of $18,369 attributable to New Valley. Other income in 1996 includes the sale of assets of COM and the sale of surplus realty at Liggett as a result of which the Company realized gains of $3,047 and $3,669, respectively.

Loss from Continuing Operations. The loss from continuing operations for the year ended December 31, 1996 was $64,918 compared with a loss of $45,344 for the same period in the prior year. A tax provision of $1,402 in 1996 and $342 in 1995 relates to foreign income taxes at the subsidiary level in 1996 and state income taxes at the subsidiary level in 1995.

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

Discontinued Operations. Income from discontinued operations of $2,385 for the year ended December 31, 1996 and $21,229 for the prior year reflects the Company's proportionate interest in the discontinued operations of Thinking Machines, a subsidiary of New Valley, in 1996 and the redemption/sale of SkyBox preferred and common stock and the sale of New Valley's message servicing business in 1995.

CAPITAL RESOURCES AND LIQUIDITY

Net cash and cash equivalents increased $2,813 and decreased $1,429 and $906 for the twelve months ended December 31, 1997, 1996 and 1995, respectively.

Net cash used in operations in 1997 was $25,063 compared to cash used in 1996 of $3,705 primarily due to decreases in trade payables, promotional spending and taxes payable offset by decreasing trade receivables, decreased inventories and increasing in corporate accruals for interest charges.

Net cash used in operations in 1996 of $3,705 was lower than cash used in 1995 of $22,986, primarily due to the declining sales volume at Liggett resulting in lower working capital requirements, decreasing trade receivables and increases in accrual of promotional expense. This is compared to net cash used in 1995 of $22,986, primarily the impact of non-cash adjustments relating to discontinued operations and an increase in inventory levels. Such effects on the uses of cash were offset by an increase in liabilities for various legal settlements, debt issuance costs and unearned revenue.

Net cash provided by investing activities in 1997 of $36,327 was principally due to the sale of BML by BOL for $55,000 on January 30, 1997 and the sale of used equipment by Liggett offset by capital expenditures of $20,142 principally costs for construction and equipment by Liggett-Ducat for the new cigarette factory in Russia. This is compared to net cash used in investing activities in 1996 of $4,279 which was principally due to continuing capital expenditures for real estate development in Russia of $29,800 by BML and expenditures at Liggett of $4,300 for equipment modernization partially offset by dividends received from New Valley on the Class A Preferred Shares held by the Company and the proceeds from the sale of assets at both Liggett and the Company.

Net cash provided by investing activities was $66,874 for the year ended December 31, 1995. In the year ended December 31, 1995, cash was provided through dividends from New Valley on the Class A Preferred Shares of $61,832, the redemption of SkyBox preferred stock for $4,000 and the sale of the SkyBox common stock for $9,282. These amounts were offset by

capital expenditures, particularly for building improvements related to real estate development by BML in Russia.

Net cash used in financing activities of $8,532 in 1997 was comprised of repurchase of $7,500 principal amount of Liggett Notes, repayment of credit facilities in Russia, repayments of Liggett's revolving credit facility (the "Facility") and distributions on the Company's common stock partially offset by proceeds from credit facilities in Russia and proceeds from the Facility at Liggett.

Net cash provided by financing activities in 1996 was $6,680, primarily due to bank loans for Russian real estate development, the sale by BGLS of additional 15.75% Series A Senior Secured Notes Due 2001 (the "Series A Notes") later exchanged for the 15.75% Series B Senior Secured Notes Due 2001 (the "Series B Notes") and an increase in borrowings under Liggett's Facility. Cash provided was offset by redemption of BGLS' 16.125% Senior Subordinated Reset Notes Due 1997 (the "Reset Notes"), a decrease in the cash overdraft and distributions to the Company's stockholders of $4,162.

Cash used in financing activities in 1995 was $44,794 reflecting the redemption of BGLS' Series 1 Senior Secured Notes on June 12, 1995 in the amount of $23,594, repayments and redemptions of Liggett's long-term debt of $7,983, repayments under Liggett's revolver of $3,830, distributions by the Company of $5,475 to stockholders and a decrease in cash overdraft of $594 partially offset by proceeds from debt of $2,568.

Liggett. Liggett had a net capital deficiency of $192,857 as of December 31, 1997, is highly leveraged and has substantial near-term service requirements. Due to the many risks and uncertainties associated with the cigarette industry, the impact of recent tobacco litigation settlements (see "Recent Developments in the Cigarette Industry - Legislation and Litigation") and increased tobacco costs, there can be no assurance that Liggett will be able to meet its future earnings goals. Consequently, Liggett could be in violation its debt covenants, including covenants limiting the maximum permitted adjusted net worth and net working capital deficiencies, and if its lenders were to exercise acceleration rights under the Facility or the Liggett Notes' Indenture or refuse to lend under the Facility, Liggett would not be able to satisfy such demands or its working capital requirements.

The Liggett Series B Notes ($150,000) and Liggett C Notes ($32,279) issued in 1992 and in 1994, respectively, pay interest semiannually at an annual rate of 11.5% and 19.75%, respectively. The Liggett Notes required mandatory principal redemptions of $7,500 on February 1 in each of the years 1993 through 1997 and $37,500 on February 1, 1998 with the balance of the Liggett Notes due on February 1, 1999. The Liggett Notes are collateralized by substantially all of the assets of Liggett, excluding accounts receivable and inventory. Eve is guarantor for the Liggett Notes. The Liggett Notes may be redeemed, in whole or in part, at a price equal to 100% of the principal amount, at the option of Liggett. The Liggett Notes contain restrictions on Liggett's ability to declare or pay cash dividends, incur additional debt, grant liens and enter into any new agreements with affiliates, among others. At December 31, 1997, Liggett was in compliance with all debt covenants under the Liggett Notes' Indenture.

On January 30, 1998, Liggett obtained the consents of the required majority of the holders of the Liggett Notes to various amendments to the Indenture governing the Liggett Notes. The amendments provide, among other things, for a deferral of the February 1, 1998 mandatory redemption of $37,500 principal amount of the Liggett Notes to the date of final maturity, February 1, 1999. In addition, the amendments prohibit, with limited exceptions, payments of dividends and incurrence of new debt by Liggett and tighten restrictions on the disposition of proceeds of asset sales. The Company and BGLS also agreed to guarantee the payment by Liggett of the August 1, 1998 interest payment on the Liggett Notes. (Refer to Note 9 to the Company's Consolidated

Financial Statements.) At maturity, the Liggett Notes will require a principal payment of $144,891. Based on Liggett's results of operations for 1997, Liggett does not anticipate it will be able to generate sufficient cash from operations to make such payments.

Liggett also has a $40,000 revolving credit facility expiring March 8, 1999 (the "Facility"), under which $23,428 was outstanding at December 31, 1997. On August 29, 1997, the Facility was amended to permit Liggett to borrow an additional $6,000 which was used on that date in making the interest payment of $9,700 due on August 1, 1997 to the holders of the Liggett Notes. BGLS guaranteed the additional $6,000 advance under the Facility and collateralized the guarantee with $6,000 in cash, deposited with Liggett's lender. At December 31, 1997, this amount is classified in other assets on the balance sheet. Availability under the Facility was approximately $7,728 based on eligible collateral at December 31, 1997. The Facility is collateralized by all inventories and receivables of Liggett. Borrowings under the Facility, whose interest is calculated at a rate equal to 1.5% above Philadelphia National Bank's (the indirect parent of Congress Financial Corporation, the lead lender) prime rate, bear a rate of 10% at December 31, 1997. The Facility contains certain financial covenants similar to those contained in the Liggett Notes' Indenture including restrictions on Liggett's ability to declare or pay cash dividends, incur additional debt, grant liens and enter into any new agreements with affiliates, among others. In addition, the Facility, as amended on April 8, 1998, imposes requirements with respect to Liggett's adjusted net worth (not to fall below a deficit of $195,000 as computed in accordance with the agreement) and working capital (not to fall below a deficit of $17,000 as computed in accordance with the agreement). At December 31, 1997, Liggett was in compliance with all covenants under the Facility.

On May 14, 1996, Liggett sold certain surplus realty in Durham, North Carolina to the County of Durham for a sale price of $4,300. A gain of approximately $3,600 was recognized on this sale.

On March 11, 1997, Liggett sold certain surplus realty in Durham, North Carolina to Blue Devil Ventures, a North Carolina limited liability partnership, for a sale price of $2,200. A gain of approximately $1,600 was recognized on this sale.

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

The Company believes, and has been so advised by counsel handling the respective cases, that the Company and Liggett have a number of valid defenses to the claim or claims asserted against them. Litigation is subject to many uncertainties, and it is possible that some of these actions could be decided unfavorably. An unfavorable outcome of a pending smoking and health case could encourage the commencement of additional similar litigation. Recently, there have been a number of adverse regulatory, political and other developments concerning cigarette smoking and the tobacco industry, including the commencement of the purported class actions referred to above. These developments generally receive widespread media attention. Neither the Company nor Liggett is able to evaluate the effect of these developing matters on pending litigation or the possible commencement of additional litigation. (See "Recent Development in the Cigarette Industry - Legislation, Regulation and Litigation" and "--Settlements" above and Note 16 to the Company's Consolidated Financial Statements.)

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

BGLS. At December 31, 1997, BGLS' long-term debt was approximately $233,664.

On November 27, 1995, BGLS commenced an offer to exchange a total of $232,864 principal amount of 15.75% Senior Secured Notes due January 31, 2001, for all its outstanding 13.75% Series 2 Senior Secured Notes Due 1997 ("Series 2 Notes"), Reset Notes and 14.50% Subordinated Debentures Due 1998 ("Subordinated Debentures"). The exchange ratio was $1,087.47 principal amount of new Series A Notes for each $1,000 principal amount of Series 2 Notes exchanged, $1,132.28 principal amount of Series B Notes for each $1,000 principal amount of Reset Notes exchanged and $1,000 principal amount of new Series B Notes for each $1,000 principal amount of Subordinated Debentures exchanged. The new Series A Notes and the new Series B Notes were identical except that the Series B Notes were not subject to restrictions on transfer.

The exchange offer closed on January 30, 1996. All $91,179 of the Series 2 Notes and $125,495 of the Subordinated Debentures were exchanged. In addition, BGLS cancelled all of the Subordinated Debentures ($13,705) held by the Company. Subordinated Debentures in the amount of $800 remained outstanding and were paid at maturity on April 1, 1998. As part of the exchange offer, substantially all of the covenants and events of default were eliminated pertaining to the Subordinated Debentures.

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

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

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

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

On March 5, 1998, BGLS entered into the Standstill Agreement whereby the Apollo Holders agreed to the deferral of interest payments, commencing with the interest payment due July 31, 1997 through the interest payment due July 31, 2000. (See "Recent Developments - Standstill Agreement".)

BOL. On January 31, 1997, BOL sold its 99.1% interest in BML to New Valley for $55,000. The purchase price paid was $21,500 in cash and a 9% promissory note of $33,500, which was paid during 1997. (See Item 1. "Business - Brooke (Overseas) Ltd. - Sale of BrookeMil Ltd.".)

In October 1995, Liggett-Ducat entered into a loan agreement with a Russian bank to borrow up to $20,400 to fund real estate development. The Company guaranteed the payment of the note. In December 1996, the loan was assigned by Liggett-Ducat to BML which has pledged Ducat Place II, the second phase of BML's Ducat Place real estate development, as collateral for the loan. On January 31, 1997, New Valley purchased BOL's 99.1% interest in BML and indemnified the Company and its subsidiaries with respect to the loan. BML paid the balance of the loan in full during the third quarter 1997.

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

The Company. Prior to the 1995 exchange offer, the Company had substantial near-term consolidated debt service requirements, with aggregate required principal payments of $318,106 due in the years 1995 through 1998. As a result of the 1995 exchange offer, the redemption of the Reset Notes in 1996 and the sale of the BML shares to New Valley in January 1997 and the 1998 Liggett restructuring, the Company has decreased its scheduled debt maturities to $6,427 due in the year 1998; approximately $5,000 of this debt relates to credit lines established by Liggett-Ducat. Liggett has a payment at maturity on February 1, 1999 of approximately $145,000. The Company believes that it will continue to meet its liquidity requirements through 1998, although the BGLS Notes Indenture limits the amount of restricted payments BGLS is permitted to make to the Company during the calendar year. At December 31, 1997, the remaining amount available through December 31, 1998 in the Restricted Payment Basket related to BGLS' payment of dividends to the Company (as defined by BGLS' Series B Notes Indenture) is $11,086. Company expenditures (exclusive of Liggett and Liggett-Ducat) in 1998 for current operations include debt service estimated at $30,715, dividends on the Company's shares (currently at an annual rate of approximately $6,100) and corporate expense. The Company anticipates funding 1998 current operations and long-term growth with the proceeds from public and/or private debt and equity financing, management fees and other payments from subsidiaries of approximately $3,600 and distributions from New Valley. New Valley may acquire or seek to acquire additional operating businesses through merger, purchase of assets, stock acquisition or other means, or to make other investments, which may limit its ability to make such distributions.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

The Company and its representatives may from time to time make oral or written "forward-looking statements" within the meaning of the Private Securities Reform Act of 1995 (the "Reform Act"), including any statements that may be contained in the foregoing discussion in "Management's Discussion and Analysis of Financial Condition and Results of Operations", in this report and in other filings with the Securities and Exchange Commission and in its reports to shareholders, which reflect management's current views with respect to future events and financial performance. These forward-looking statements are subject to certain risks and uncertainties and, in connection with the "safe-harbor" provisions of the Reform Act, the Company is hereby identifying important factors that

could cause actual results to differ materially from those contained in any forward-looking statement made by or on behalf of the Company. Liggett continues to be subject to risk factors endemic to the domestic tobacco industry including, without limitation, health concerns relating to the use of tobacco products and exposure to ETS, legislation, including tax increases, governmental regulation, privately imposed smoking restrictions, governmental and grand jury investigations and litigation. Each of the Company's operating subsidiaries, namely Liggett and Liggett-Ducat, are subject to intense competition, changes in consumer preferences, the effects of changing prices for its raw materials and local economic conditions. Furthermore, the performance of Liggett-Ducat's operations in Russia are affected by uncertainties in Russia which include, among others, political or diplomatic developments, regional tensions, currency repatriation restrictions, foreign exchange fluctuations, inflation, and an undeveloped system of commercial laws and legislative reform relating to foreign ownership in Russia. In addition, the Company has a high degree of leverage and substantial near-term debt service requirements, as well as a net worth deficiency and recent losses from continuing operations. The Indenture for BGLS' Series B Notes provides for, among other things, the restriction of certain affiliated transactions between the Company and its affiliates, as well as for certain restrictions on the use of future distributions received from New Valley. Due to such uncertainties and risks, readers are cautioned not to place undue reliance on such forward-looking statements, which speak only as of the date on which such statements are made. The Company does not undertake to update any forward-looking statement that may be made from time to time by or on behalf of the Company.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not Applicable.

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. dated April 3, 1998, and quarterly financial results are set forth beginning on page F-1 of this report.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEMS 10, 11, 12 AND 13.

The information called for by Items 10, 11, 12 and 13 with respect to the Company will be contained in the Company's definitive Proxy Statement for its 1998 annual meeting of stockholders, to be filed with the SEC not later than 120 days after the end of the Company's fiscal year covered by this report pursuant to Regulation 14A under the Exchange Act, and incorporated herein by reference.

Such information with respect to BGLS is omitted due to the fact that BGLS meets the conditions set forth in General Instruction (I)(1)(a) and (b) of Form 10-K and is therefore filing this report with the reduced disclosure format.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(A)(1) INDEX TO 1997 CONSOLIDATED FINANCIAL STATEMENTS:

The Company's Consolidated Financial Statements and the Notes thereto, together with the report thereon of Coopers & Lybrand L.L.P. dated April 3, 1998, appears beginning on page F-1 of this report. Financial statement schedules not included in this report have been omitted because they are not applicable or the required information is shown in the Consolidated Financial Statements or the Notes thereto.

(A)(2) FINANCIAL STATEMENT SCHEDULES:

Schedule II - Valuation and Qualifying Accounts .... Page F-53

(A)(3) EXHIBITS

(a) The following is a list of exhibits filed herewith as part of the report on Form 10-K:

INDEX OF EXHIBITS

EXHIBIT NO.	DESCRIPTION
* 2.1	Stock Purchase Agreement dated as of January 31, 1997 among BrookeMil Ltd. ("BML"), Brooke (Overseas) Ltd. ("BOL"), BGLS Inc. ("BGLS") and New Valley Corporation ("New Valley") (incorporated by reference to exhibit 2.1 in New Valley's Current Report on Form 8-K dated January 31, 1997, Commission File No. 1-2493 (the "New Valley Form 8-K")).
* 3.1	Restated Certificate of Incorporation of Liggett Group Inc. (the predecessor to Brooke Group Ltd. (the "Company")) (incorporated by reference to the Company's Registration Statement on Form S-1, Commission File No. 33-16868).
* 3.2	Certificate of Amendment of the Restated Certificate of Incorporation of the Company (incorporated by reference to the Company's Form 10-Q for the quarter ended June 30, 1990, Commission File No. 1-5759).
* 3.3	Amended and Restated By-Laws of the Company, effective December 5, 1995 (incorporated by reference to the Company's current Report on Form 8-K dated December 5, 1995, Commission File No. 1-5759).
* 3.4	Certificate of Designations of Series A Junior Convertible Participating PIK Preferred Stock, Series B Junior Convertible Participating Reset Preferred Stock, Series C Junior Convertible Participating Reset Preferred Stock and Series D Junior Convertible Participating Reset Preferred Stock (incorporated by reference to the Company's Form 10-Q for the quarter ended September 30, 1990, Commission File No. 1-5759).
* 3.5	Certificate of Designation of Series E Junior Convertible Participating Preferred Stock of the Company (incorporated by reference to the Company's Report on Form 8-K dated October 29, 1993).
* 3.6	Certificate of Designation of Series F Junior Convertible Participating Preferred Stock of the Company (incorporated by reference to the Company's Report on Form 8-K dated October 29, 1993, Commission File No. 1-5759).
* 3.7	Certificate of Designation of Series G Junior Convertible Participating Preferred Stock of the Company (incorporated by reference to the Company's Form 10-K for the fiscal year ended 1993, Commission File No. 1-5759).

EXHIBIT NO.	DESCRIPTION
* 3.8	Certificate of Incorporation of BGLS (incorporated by reference to exhibit 3.1 in BGLS' Registration Statement on Form S-4 dated December 19, 1995, Commission File Number 33-80593).
* 3.9	By-Laws of BGLS (incorporated by reference to exhibit 3.2 in BGLS' Registration Statement on Form S-4 dated December 19, l995, Commission File Number 33-80593).
* 4.1	Indenture, dated as of January 1, 1996, between BGLS Inc. ("BGLS") and Fleet National Bank of Massachusetts ("Fleet"), as Trustee, relating to the "Series A Notes" and the 15.75% Series B Senior Secured Notes due 2001 (the "Series B Notes"), including the form of Series A Note and the form of Series B Note (the "Series A and Series B Indenture") (incorporated by reference to exhibit 4.1 in BGLS' Registration Statement on Form S-4 dated December 19, 1995, Commission File No. 33-80593).
* 4.2	Pledge and Security Agreement, dated as of January 1, 1996, between BGLS and Fleet, as Trustee, under the Series A and Series B Indenture (incorporated by reference to exhibit 4.2 in BGLS' Registration Statement on Form S-4 dated December 19, 1995, Commission File No. 33-80593).
* 4.3	A/B Exchange and Registration Rights Agreement, dated as of November 21, 1995, among the Company, BGLS, AIF II L.P., Artemis America Partnership, Tortoise Corp., and Mainstay High Yield Corporate Bond Fund (incorporated by reference to exhibit 4.3 in BGLS' Registration Statement on Form S-4 dated December 19, 1995, Commission File No. 33-80593).
* 4.4	Pledge and Security Agreement, dated as of January 1, 1996, between New Valley Holdings, Inc. and Fleet, as Trustee, under the Series A and Series B Indenture (incorporated by reference to exhibit 4.4 in BGLS' Registration Statement on Form S-4 dated December 19, 1995, Commission File No. 33-80593).
* 4.5	Standstill Agreement and Consent, dated as of August 28, 1997, among BGLS, AIF II, L.P., Artemis America Partnership and Tortoise Corp. (incorporated by reference to exhibit 99.2 in the Company's Form 8-K dated August 29, 1997, Commission No. 1-5759).
* 4.6	Standstill Agreement, dated as of March 3, 1998, among BGLS and AIF II, L.P. ("AIF II") and Artemis America Partnership ("AAP" and collectively, with AIF, the "Apollo Holders") (incorporated by reference to exhibit 10.1 in the Company's Form 8-K dated March 2, 1998, Commission File No. 1-5759).
* 4.7	Limited Recourse Guarantee Agreement, dated as of March 2, 1998, made by Brooke (Overseas) Ltd. ("BOL") for the benefit of the Apollo Holders (incorporated by reference to exhibit 10.8 in the Company's Form 8-K dated March 2, 1998, Commission File No. 1-5759).

EXHIBIT NO.	DESCRIPTION
* 4.8	Pledge Agreement, dated as of March 2, 1998, between BOL and AIF (incorporated by reference to exhibit 10.9 in the Company's Form 8-K dated March 2, 1998, Commission File No. 1-5759).
* 4.9	Pledge Agreement, dated as of March 2, 1998, between BOL and AAP (incorporated by reference to exhibit 10.10 in the Company's Form 8-K dated March 2, 1998, Commission File No. 1-5759).
* 4.10	Indenture, dated April 1, 1988, between BGLS and First Trust National Association ("First Trust"), as Trustee, relating to the Subordinated Debentures (the "14.5% Debenture Indenture") (incorporated by reference to exhibit 4(ff) in the Company's Form 10-Q for the quarter ended September 30, 1990, Commission File No. 1-5759).
* 4.11	First Supplemental Indenture, dated September 4, 1990, to the 14.5% Debenture Indenture, between BGLS and First Trust, as Trustee (incorporated by reference to exhibit 4(f) in the Company's Form 10-K for the year ended December 31, 1990, Commission File No. 1-5759).
* 4.12	Second Supplemental Indenture, dated November 19, 1990, to the 14.5% Debenture Indenture, between BGLS and First Trust, as Trustee (incorporated by reference to exhibit 4(g) in the Company's Form 10-K for the year ended December 31, 1990, Commission File No. 1-5759).
* 4.13	Third Supplemental Indenture, dated November 19, 1990, to the 14.5% Debenture Indenture, between BGLS and First Trust, as Trustee (incorporated by reference to exhibit 4(i) in the Company's Form 10-K for the year ended December 31, 1990, Commission File No. 1-5759).
* 4.14	Fourth Supplemental Indenture, dated October 22, 1993, to the 14.5% Debenture Indenture, between BGLS and First Trust, as Trustee (incorporated by reference to exhibit 4(y) in the Company's Form 10-Q for the quarter ended September 30, 1993, Commission File No. 1-5759).
* 4.15	Fifth Supplemental Indenture, dated January 18, 1995, to the 14.5% Debenture Indenture, between BGLS and First Trust, as Trustee (incorporated by reference to exhibit 4(e) in the Company's Form 10-K for the year ended December 31, 1994, Commission File No. 1-5759).
* 4.16	Sixth Supplemental Indenture, dated as of January 26, 1996, to the 14.5% Debenture Indenture, between BGLS and First Trust, as Trustee (incorporated by reference to exhibit 4.13 in BGLS' Registration Statement on Form S-4 dated December 19, 1995, Commission File No. 33-80593).

EXHIBIT NO.	DESCRIPTION
* 4.17	Indenture, dated February 14, 1992, among Liggett Group Inc. ("Liggett"), Eve Holdings Inc. ("Eve") and Bankers Trust Company, as Trustee ("Bankers Trust"), including the Forms of Series A Notes and Series B Notes and the Guaranty thereon (the "Liggett Indenture") (incorporated by reference to exhibit 4(m) in the Company's Form 10-K for the year ended December 31, 1991, Commission File No. 1-5759).
* 4.18	First Supplemental Indenture, dated January 26, 1994, including the Form of Series C Variable Rate Senior Secured Note and the Guaranty thereon (incorporated by reference to exhibit 4.2 in Liggett's Registration Statement on Form S-1, Commission File No. 33-75224).
* 4.19	Second Supplemental Indenture and Amendment to Series B and Series C Senior Secured Notes, dated as of January 30, 1998, between Liggett, Eve and Bankers Trust (incorporated by reference to exhibit 99.2 in the Company's Form 8-K dated February 2, 1998, Commission File No. 1-5759).
* 4.20	Security Agreement, dated February 14, 1992, among Liggett, Eve and Bankers Trust (the "Security Agreement") (incorporated by reference to exhibit 4(n) in the Company's Form 10-K for the year ended December 31, 1991, Commission File No. 1-5759).
* 4.21	Amendment No. 1 to the Security Agreement, dated January 26, 1994 (incorporated by reference to exhibit 4.4 in Liggett's Registration Statement on Form S-1, Commission File No. 33-75224).
* 4.22	Amendment No. 2 to Security Agreement, dated as of January 30, 1998, among Liggett, Eve and Bankers Trust (incorporated by reference to exhibit 99.3 in the Company's Form 8-K dated February 2, 1998, Commission File No. 1-5759).
* 4.23	Deed of Trust and Assignment of Rents, Leases and Leasehold Interests, dated February 14, 1992, by Liggett to Bankers Trust relating to each of the Virginia and North Carolina properties (the "Deed of Trust") (incorporated by reference to exhibit 4(o) in the Company's Form 10-K for the year ended December 31, 1991, Commission File No. 1-5759).
* 4.24	Amendment No. 1 to the Deed of Trust (North Carolina), dated January 26, 1994 (incorporated by reference to exhibit 4.6 in Liggett's Registration Statement on Form S-1, Commission File No. 33-75224).
* 4.25	Amendment No. 1 to the Deed of Trust (Virginia), dated January 26, 1994 (incorporated by reference to exhibit 4.7 in Liggett's Registration Statement on Form S-1, Commission File No. 33-75224).

EXHIBIT NO.	DESCRIPTION
* 4.26	Pledge Agreement, dated as of January 30, 1998, among BOL and Bankers Trust (incorporated by reference to exhibit 99.6 in the Company's Form 8-K dated February 2, 1998, Commission File No. 1-5759).
* 4.27	Loan and Security Agreement, dated as of March 8, 1994, in the amount of $40,000,000 between Liggett and Congress Financial Corporation (incorporated by reference to exhibit 10(xx) in the Company's Form 10-K for the year ended December 31, 1993, Commission File No. 1-5759).
* 4.28	First Amended Joint Chapter 11 Plan or Reorganization for New Valley Corporation ("New Valley") dated September 27, 1994, Notice of Modification of the First Amended Joint Chapter 11 Plan of Reorganization dated October 20, 1994 and Plan Amendment dated October 28, 1994, as confirmed by the United States Bankruptcy Court for the District of New Jersey, Newark Division, on November 1, 1994 (incorporated by reference to exhibit 2 in New Valley's Form 10-Q for the quarter ended September 30, 1994, Commission File No. 1-2493).
* 4.29	Order Confirming First Amended Joint Chapter 11 Plan of Reorganization for New Valley entered by the Bankruptcy Court on November 1, 1994 (incorporated by reference to exhibit 99(b) in New Valley's Form 10-Q for the quarter ended September 30, 1994, Commission File No. 1-2493).
* 10.1	Corporate Services Agreement, dated as of June 29, 1990, between the Company and Liggett (incorporated by reference to exhibit 10.10 in Liggett's Registration Statement on Form S-1, Commission File No. 33-47482).
* 10.2	Corporate Services Agreement, dated June 29, 1990, between the Company and Liggett (incorporated by reference to exhibit 10.11 in Liggett's Registration Statement on Form S-1, Commission File No. 33-47482).
* 10.3	Services Agreement, dated as of February 26, 1991, between Brooke Management Inc. ("BMI") and Liggett (the "Liggett Services Agreement") (incorporated by reference to exhibit 10.5 in BGLS' Registration Statement on Form S-1, Commission File No. 33-93576).
* 10.4	First Amendment to Liggett Services Agreement, dated as of November 30, 1993, between Liggett and BMI (incorporated by reference to exhibit 10.6 of BGLS' Registration Statement on Form S-1, Commission File No. 33-93576).
* 10.5	Second Amendment to Liggett Services Agreement, dated as of October 1, 1995, between BMI, the Company and Liggett (incorporated by reference to exhibit 10(c) in the Company's Form 10-Q for the quarter ended September 30, 1995, Commission File No. 1-5759).

EXHIBIT NO.	DESCRIPTION
* 10.6	Corporate Services Agreement, dated January 1, 1992, between BGLS and Liggett (the "Liggett Services Agreement") (incorporated by reference to exhibit 10.13 of Liggett's Registration Statement on Form S-1, Commission File No. 33-47482).
* 10.7	Employment Agreement, dated February 21, 1992, between the Company and Bennett S. LeBow (incorporated by reference to exhibit 10(xx) in the Company's Form 10-K for the year ended December 31, 1991, Commission File No. 1-5759).
* 10.8	Tax-Sharing Agreement, dated June 29, 1990, among the Company, Liggett and certain other entities (incorporated by reference to exhibit 10.12 in Liggett's Registration Statement on Form S-1, Commission File No. 33-47482).
* 10.9	Lease with respect to Liggett's distribution center in Durham, North Carolina, including letter agreement extending term of Lease (incorporated by reference to exhibit 10.15 in Liggett's Registration Statement on Form S-1, Commission File No. 33- 47482).
* 10.10	Tax Indemnity Agreement, dated as of October 6, 1993, among the Company, Liggett and certain other entities (incorporated by reference to exhibit 10.2 in SkyBox International Inc.'s Form 10-Q for the quarter ended September 30, 1993, Commission File No. 0-22126).
* 10.11	Exchange Agreement, dated as of November 21, 1995, among the Company, BGLS, AIF, Artemis Partnership, Tortoise, Starfire Holding Corporation and Mainstay (incorporated by reference to exhibit 10.13 in BGLS' Registration Statement on Form S-4 dated December 19, 1995, Commission File No. 33-80593).
* 10.12	Registration Rights Agreement, dated as of January 1, 1996, among the Company, New Valley, BGLS and Fleet, as Trustee (incorporated by reference to exhibit 10.14 in BGLS' Registration Statement on Form S-4 dated December 19, 1995, Commission File No. 33-80593).
* 10.13	Agreement among BGLS, the Company and High River Limited Partnership ("High River"), dated October 17, 1995 (incorporated by reference to exhibit 10(b) in the Company's Form 10-Q for the quarter ended September 30, 1995, Commission File No. 1-5759).

EXHIBIT NO.	DESCRIPTION
* 10.14	Letter Agreement among BGLS, the Company and High River dated November 5, 1995 (incorporated by reference to exhibit 10(a) in the Company's Form 10-Q for the quarter ended September 30, 1995, Commission File No. 1-5759).
* 10.15	Agreement between New Valley and the Company, dated as of December 27, 1995 (incorporated by reference to exhibit 10.19 in BGLS' Registration Statement on Form S-4 dated December 19, 1995, Commission File No. 33-80593).
* 10.16	Expense Sharing Agreement, dated as of January 18, 1995, between the Company and New Valley (incorporated by reference to exhibit 10(d) in the Company's Form 10-Q for the quarter ended September 30, 1995, Commission File No. 1-5759).
* 10.17	Stock Option Agreement, dated January 25, 1995, between the Company and Howard M. Lorber (incorporated by reference to exhibit 10(g) in the Company's Form 10-K for the year ended December 31, 1994, Commission File No. 1-5759).
* 10.18	Agreement among New Valley, ALKI and High River, dated October 17, 1995 (the "High River Agreement") (incorporated by reference to exhibit 10(d) in New Valley's Form 10-Q for the quarter ended September 30, 1995, Commission File No. 1-2493).
* 10.19	Letter Amendment, dated October 17, 1995, to the High River Agreement (incorporated by reference to exhibit 10(e) in the New Valley's Form 10-Q for the quarter ended September 30, 1995, Commission No. 1-2493).
* 10.20	Letter Amendment, dated November 5, 1995, to the High River Agreement (incorporated by reference to exhibit 10(f) in New Valley's Form 10-Q for the quarter ended September 30, 1995, Commission File No. 1-2493).
* 10.21	Agreement of Termination, dated June 5, 1996, between New Valley, ALKI, High River, the Company and BGLS (incorporated by reference to exhibit 16 in the Schedule 13D filed by, among others, the Company with the Commission on March 11,1966, as amended, with respect to the common stock of RJR Nabisco Holdings Corp. (the "Schedule 13D")).
* 10.22	Amended and Restated Consulting Agreement, dated as of March 1, 1996, between the Company and Howard M. Lorber (the "Lorber Consulting Agreement") (incorporated by reference to exhibit 10.25 in the Company's Form 10-K for the year ended December 31, 1995, Commission File No. 1-5759).

EXHIBIT NO.	DESCRIPTION
10.23	Amendment dated January 1, 1998 to the Lorber Consulting Agreement.
* 10.24	Settlement Agreement, dated March 12, 1996, by and between Dianne Castano and Ernest Perry, the putative representative plaintiffs in Dianne Castano, et al. v. The American Tobacco Company, Inc. et al., Civil No. 94-1044, United States District Court for the Eastern District of Louisiana, for themselves and on behalf of the plaintiff settlement class, and the Company and Liggett, as supplemented by the letter agreement dated March 14, 1996 (the "Settlement Agreement") (incorporated by reference to exhibit 13 in the Schedule 13D).
* 10.25	Addendum to Settlement Agreement (incorporated by reference to exhibit 10.30 in the Company's Form 10-K/A No. 1 for the year ended December 31, 1996, Commission File No. 1-5759).
* 10.26	Settlement Agreement, dated March 15, 1996, by and among the State of West Virginia, State of Florida, State of Mississippi, Commonwealth of Massachusetts, and State of Louisiana, the Company and Liggett (incorporated by reference to exhibit 15 in the Schedule 13D).
* 10.27	Addendum to Initial States Settlement Agreement (incorporated by reference to exhibit 10.43 in the Company's Form 10-Q for the quarterly period ended March 31, 1997, Commission File No. 1-5759).
* 10.28	Settlement Agreement, dated March 20, 1997, by and among the States listed in Appendix A thereto, the Company and Liggett (incorporated by reference to exhibit 10.40 in the Company's Form 10-K for the year ended December 31, 1996).
* 10.29	Settlement Agreement, dated March 20, 1997, by and between the named and representative plaintiffs in Fletcher, et al. v. Brooke Group Ltd., et al., for themselves and on behalf of the plaintiff settlement class, and the Company and Liggett (incorporated by reference to exhibit 10.41 in the Company's Form 10-K for the year ended December 31, 1996).
* 10.30	Settlement Agreement, dated April 14, 1997, by and among the State of California, the Company and Liggett (incorporated by reference to exhibit 10.44 in the Company's Form 10-Q for the quarter ended March 31, 1997, Commission File No. 1-5759).
* 10.31	Settlement Agreement, dated May 6, 1997, by and between the State of Alaska, the Company and Liggett (incorporated by reference to exhibit 10.44 in the Company's Form 10-Q for the quarter ended March 31, 1997, Commission File No. 1-5759).

EXHIBIT NO.	DESCRIPTION
* 10.32	Class Settlement Agreement, dated May 15, 1997, by and between the named and representative plaintiff in Earl William Walker, et. al., v. Liggett Group Inc., et. al., for himself and on behalf of the plaintiff settlement class, and the Company and Liggett (incorporated by reference to exhibit 10.1 in the Company's Form 10-Q for the quarter ended June 30, 1997, Commission File No. 1-5759).
* 10.33	Settlement Agreement, dated June 9, 1997, by and between the State of Oregon and the Company and Liggett (incorporated by reference to exhibit 10.2 in the Company's Form 10-Q for the quarter ended September 30, 1997, Commission File No. 1-5759).
* 10.34	Settlement Agreement, dated September 15, 1997, by and among the State of Nevada and the Company and Liggett (incorporated by reference to exhibit 10.1 in the Company's Form 10-Q for the quarter ended September 30, 1997, Commission File No.1-5759).
10.35	Settlement Agreement, dated March 12, 1998, by and among the States listed in Appendix A thereto, the Company and Liggett.
* 10.36	Stock Purchase Agreement, dated April 3, 1996, among Liggett-Ducat Ltd. ("Liggett-Ducat"), Belgrave Limited ("Belgrave"), Eduard Z. Nakhamkin ("Nakhamkin") and BOL (incorporated by reference to exhibit 10.28 in the Company's Form 10-K for the year ended December 31, 1995, Commission File No. 1-5759).
* 10.37	Consulting Agreement, dated April 3, 1996, among BOL, Belgrave and Nakhamkin (incorporated by reference to exhibit 10.29 in the Company's Form 10-K for the year ended December 31, 1995, Commission File No. 1-5759).
* 10.38	Pledge Agreement, dated April 3, 1996, between BOL and Belgrave (incorporated by reference to exhibit 10.30 in the Company's Form 10-K for the year ended December 31, 1995, Commission File No. 1-5759).
* 10.39	Stock Option Agreement, dated December 16, 1996, between the Company and Howard M. Lorber (incorporated by reference to exhibit 10.34 in the Company's Form 10-K for the year ended December 31, 1996, Commission File No. 1-5759.
* 10.40	Letter Agreement dated September 5, 1996 between Ronald S. Fulford and Liggett (incorporated by reference to exhibit 10.23 in Liggett's Form 10-K for the year ended December 31, 1996, Commission File No. 33-75224).
* 10.41	Stock Option Agreement, dated January 1, 1997, between the Company and Richard J. Lampen (incorporated by reference to exhibit 10.35 in the Company's Form 10-K for the year ended December 31, 1996).

EXHIBIT NO.	DESCRIPTION
* 10.42	Stock Option Agreement, dated January 1, 1997, between the Company and Marc N. Bell (incorporated by reference to exhibit 4.3 in the Company's Registration Statement on Form S-8 (No. 333-24217).
10.43	Stock Option Agreement, dated January 1, 1998, between the Company and Joselynn D. Van Siclen.
* 10.44	Promissory Note of New Valley dated January 31, 1997 in favor of BOL (incorporated by reference to exhibit 10.1 in the New Valley Form 8-K).
* 10.45	Pledge Agreement dated as of January 31, 1997 entered into by and between BOL and New Valley (incorporated by reference to exhibit 10.2 in the New Valley Form 8-K).
* 10.46	Use Agreement dated as of January 31, 1997, entered into by and between BML and Liggett-Ducat Joint Stock Company (incorporated by reference to exhibit 10.3 in the New Valley Form 8-K).
* 10.47	Stock Purchase Agreement, dated as of January 16, 1998, by and between the Company and High River Limited Partnership (incorporated by reference to the Company's Form 8-K dated January 16, 1998, Commission File No. 5759).
* 10.48	Commitment, Contribution and Subordination Agreement, dated as of January 30, 1998, by Liggett, the Company, BGLS, BOL and Bankers Trust (incorporated by reference to exhibit 99.4 in the Company's Form 8-K dated February 2, 1998, Commission File No. 1-5759).
* 10.49	Registration Rights Agreement, dated as of January 30, 1998, among the Company and the holders of record of the shares of the Company's common stock referred to therein (incorporated by reference to exhibit 99.5 in the Company's Form 8-K dated February 2, 1998, Commission File No. 1-5759).
* 10.50	Warrant to purchase common stock of the Company, dated March 2, 1998, issued to AIF (incorporated by reference to exhibit 10.2 in the Company's Form 8-K dated March 2, 1998, Commission File No. 1-5759).
* 10.51	Warrant to purchase common stock of the Company, dated March 2, 1998, issued to AAP (incorporated by reference to exhibit 10.3 in the Company's Form 8-K dated March 2, 1998, Commission File No. 1-5759).
* 10.52	Warrant to purchase common stock of the Company, dated March 2, 1998, issued to AIF (incorporated by reference to exhibit 10.4 in the Company's Form 8-K dated March 2, 1998, Commission File No. 1-5759).

EXHIBIT NO.	DESCRIPTION
* 10.53	Warrant to purchase common stock of the Company, dated March 2, 1998, issued to AAP (incorporated by reference to exhibit 10.5 in the Company's Form 8-K dated March 2, 1998, Commission File No. 1-5759).
* 10.54	Registration Rights Agreement, dated as of March 2, 1998, among the Company and the Apollo Holders (incorporated by reference to exhibit 10.6 in the Company's Form 8-K dated March 2, 1998, Commission File No. 1-5759).
* 10.55	Registration Rights Agreement, dated as of March 2, 1998, among the Company and the Apollo Holders (incorporated by reference to exhibit 10.7 in the Company's Form 8-K dated March 2, 1998, Commission File No. 1-5759).
10.56	Stock Option Agreement, dated as of March 12, 1998, by and between the Company and Kasowitz, Benson, Torres & Friedman LLP, Marc E. Kasowitz and Daniel R. Benson.
21	Subsidiaries of the Company.
23.1	Consent of Coopers & Lybrand L.L.P. relating to the Company's Registration Statements on Form S-3 (No. 33-38869 and No. 33-63119) and Form S-8 (No. 333-24217).
23.2	Consent of Arthur Anderson LLP relating to the Company's Registration Statements on Form S-3 (No. 33-38869 and No. 33-63119) and Form S-8 (No. 333-24217).
27.1	Financial Data Schedule of the Company.
27.2	Financial Data Schedule of BGLS.
99.1	Material Legal Proceedings
99.2	Liggett Group Inc.'s Consolidated Financial Statements for the fiscal year ended December 31, 1997.
99.3	New Valley Holdings, Inc.'s Financial Statements for the fiscal year ended December 31, 1997.
99.4	Brooke (Overseas) Ltd.'s Consolidated Financial Statements for the fiscal year ended December 31, 1997.

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* Incorporated by reference

Each management contract or compensatory plan or arrangement required to be filed as an exhibit to this report pursuant to Item 14(c) is listed in exhibit nos. 10.7, 10.40, 10.41, 10.42 and 10.43.

(B) REPORTS ON FORM 8-K:

The Company filed the following reports on Form 8-K during the fourth quarter of 1997:

	DATE	ITEMS	FINANCIAL STATEMENTS
1.	November 26, 1997	5, 7	None
2.	December 17, 1997	5, 7	None

SIGNATURES

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

BROOKE GROUP LTD.
(REGISTRANT)

By: /s/ Joselynn D. Van Siclen

Joselynn D. Van Siclen
Vice President and
Chief Financial Officer

Date: April 8, 1998

BGLS INC.
(REGISTRANT)

By: /s/ Joselynn D. Van Siclen

Joselynn D. Van Siclen
Vice President and
Chief Financial Officer

Date: April 8, 1998

POWER OF ATTORNEY

The undersigned directors and officers of Brooke Group Ltd. and BGLS Inc. hereby constitute and appoint Richard J. Lampen, Joselynn D. Van Siclen and Marc N. Bell, and each of them, with full power to act without the other and with full power of substitution and resubstitutions, our true and lawful attorneys-in-fact with full power to execute in our name and behalf in the capacities indicated below, this Annual Report on Form 10-K and any and all amendments thereto and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, and hereby ratify and confirm all that such attorneys-in-fact, or any of them, or their substitutes shall lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on April 8, 1998.

SIGNATURE	TITLE
/s/ Bennett S. LeBow Bennett S. LeBow	Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer)
/s/ Joselynn D. Van Siclen Joselynn D. Van Siclen	Vice President and Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)
/s/ Robert J. Eide Robert J. Eide	Director
/s/ Jeffrey S. Podell Jeffrey S. Podell	Director

BROOKE GROUP LTD.
BGLS INC.
FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 1997
ITEMS 8, 14(a) (1) AND (2), AND 14(d)

INDEX TO FINANCIAL STATEMENTS
AND FINANCIAL STATEMENT SCHEDULE

Financial Statements and Schedule of the Registrant and its subsidiaries required to be included in Items 8, 14(a) (1) and (2), and 14(d) are listed below:

FINANCIAL STATEMENTS:	Page
Brooke Group Ltd./BGLS Inc. Consolidated Financial Statements	
Reports of Independent Accountants	F-3
Brooke Group Ltd. Consolidated Balance Sheets as of December 31, 1997 and 1996	F-5
BGLS Inc. Consolidated Balance Sheets as of December 31, 1997 and 1996	F-6
Brooke Group Ltd. Consolidated Statements of Operations for the years ended December 31, 1997, 1996 and 1995	F-7
BGLS Inc. Consolidated Statements of Operations for the years ended December 31, 1997, 1996 and 1995	F-8
Brooke Group Ltd. Consolidated Statements of Stockholders' Equity (Deficit) for the years ended December 31, 1997, 1996 and 1995	F-9
BGLS Inc. Consolidated Statements of Stockholder's Equity (Deficit) for the years ended December 31, 1997, 1996 and 1995	F-10
Brooke Group Ltd. Consolidated Statements of Cash Flows for the years ended December 31, 1997, 1996 and 1995	F-11
BGLS Inc. Consolidated Statements of Cash Flows for the years ended December 31, 1997, 1996 and 1995	F-13
Notes to Consolidated Financial Statements	F-15
FINANCIAL STATEMENT SCHEDULE:	
Schedule II -- Valuation and Qualifying Accounts	F-53

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

New Valley Corporation	
Reports of Independent Accountants	F-54
Consolidated Balance Sheets as of December 31, 1997 and 1996	F-55
Consolidated Statements of Operations for the years ended December 31, 1997, 1996 and 1995	F-56
Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 1997, 1996 and 1995	F-58
Consolidated Statements of Cash Flows for the years ended December 31, 1997, 1996 and 1995	F-59
Notes to Consolidated Financial Statements	F-61

Liggett Group Inc.

The consolidated financial statements of Liggett Group Inc. are incorporated herein by reference from Liggett Group Inc.'s Form 10-K for the year ended December 31, 1997, and are filed as exhibit 99.2 to this report.

New Valley Holdings, Inc.

The financial statements of New Valley Holdings, Inc. are filed as exhibit 99.3 to this report and are incorporated herein by reference.

Brooke (Overseas) Ltd.

The consolidated financial statements of Brooke (Overseas) Ltd. are filed as exhibit 99.4 to this report and are incorporated herein by reference.

REPORT OF INDEPENDENT ACCOUNTANTS

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

We have audited the accompanying consolidated balance sheets of Brooke Group Ltd. and Subsidiaries (the "Company") and BGLS Inc. and Subsidiaries ("BGLS") as of December 31, 1997 and 1996 and the related consolidated statements of operations, stockholder's equity (deficit) and cash flows for each of the three years in the period ended December 31, 1997. These financial statements are the responsibility of the Company's and BGLS's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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 provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Brooke Group Ltd. and Subsidiaries and BGLS Inc. and Subsidiaries at December 31, 1997 and 1996 and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 1997 in conformity with generally accepted accounting principles.

COOPERS & LYBRAND L.L.P.

Miami, Florida
April 8, 1998

REPORT OF INDEPENDENT ACCOUNTANTS

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

Our report on the consolidated financial statements of Brooke Group Inc. and Subsidiaries and BGLS Inc. and Subsidiaries is included on Page F-3 of this Form 10-K. In connection with our audits of such financial statements, we have also audited the related financial statement schedule on Page F-53 on 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.

COOPERS & LYBRAND L.L.P.

Miami, Florida
April 8, 1998

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

	December 31, 1997	December 31, 1996
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 4,754	$ 1,941
Accounts receivable - trade	10,462	19,475
Other receivables	1,239	1,217
Receivables from affiliates	1,978	47
Inventories	39,312	53,691
Other current assets	10,240	4,181
Total current assets	67,985	80,552
Property, plant and equipment, at cost, less accumulated depreciation of $33,187 and $31,047	45,943	80,282
Intangible assets, at cost, less accumulated amortization of $19,302 and $17,457	2,610	4,421
Investment in affiliate		3,051
Other assets	9,922	9,371
Total assets	$ 126,460	$ 177,677
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT):		
Current liabilities:		
Notes payable and current portion of long-term debt	$ 6,429	$ 55,242
Accounts payable	10,461	32,017
Due to affiliates	1,226	990
Dividends payable		1,387
Cash overdraft	945	6
Accrued promotional expenses	26,993	30,257
Accrued taxes payable	19,998	26,379
Accrued interest	39,782	24,354
Other accrued liabilities	34,670	33,831
Total current liabilities	140,504	204,463
Notes payable, long-term debt and other obligations, less current portion	399,835	378,243
Noncurrent employee benefits	29,366	25,220
Other liabilities	45,152	24,740
Commitments and contingencies		
Stockholders' equity (deficit):		
Preferred Stock, par value $1.00 per share, authorized 10,000,000 shares		
Series G Preferred Stock, 2,184,834 shares, convertible, participating, cumulative, each share convertible to 1,000 shares of common stock and cash or stock distribution, liquidation preference of $1.00 per share		
Common stock, par value $0.10 per share, authorized 40,000,000 shares, issued 24,998,043 shares, outstanding 18,097,096	1,850	1,850
Additional paid-in capital	88,290	94,169
Deficit	(538,791)	(490,706)
Other	(5,607)	(27,963)
Less: 6,900,947 shares of common stock in treasury, at cost	(34,139)	(32,339)
Total stockholders' equity (deficit)	(488,397)	(454,989)
Total liabilities and stockholders' equity (deficit)	$ 126,460	$ 177,677

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

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

	December 31, 1997	December 31, 1996
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 4,754	$ 1,940
Accounts receivable - trade	10,462	19,475
Other receivables	1,191	1,166
Receivables from affiliates	1,603	47
Inventories	39,312	53,691
Other current assets	10,044	3,878
Total current assets	67,366	80,197
Property, plant and equipment, at cost, less accumulated depreciation of $32,760 and $30,762	45,775	79,972
Intangible assets, at cost, less accumulated amortization of $19,302 and $17,457		4,421
Investment in affiliate	2,610	3,051
Other assets	13,165	10,467
Total assets	$ 128,916	$ 178,108
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT):		
Current liabilities:		
Notes payable and current portion of long-term debt	$ 6,212	$ 53,945
Accounts payable	10,336	31,892
Cash overdraft	891	6
Due to parent	22,951	29,598
Accrued promotional expenses	26,993	30,257
Accrued taxes payable	19,998	26,379
Accrued interest	39,782	24,354
Other accrued liabilities	34,312	33,305
Total current liabilities	161,475	229,736
Notes payable, long-term debt and other obligations, less current portion	399,835	378,243
Noncurrent employee benefits	29,366	25,220
Other liabilities	51,355	27,994
Commitments and contingencies		
Stockholder's equity (deficit):		
Common stock, par value $0.01 per share; 100 shares authorized, issued and outstanding		
Additional paid-in capital	39,081	39,081
Deficit	(550,339)	(499,264)
Other	(1,857)	(22,902)
Total stockholder's equity (deficit)	(513,115)	(483,085)
Total liabilities and stockholder's equity (deficit)	$ 128,916	$ 178,108

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,		
	1997	1996	1995
Revenues*	$ 389,615	$ 460,356	$ 461,459
Cost of goods sold*	202,121	243,333	216,187
Gross profit	187,494	217,023	245,272
Operating, selling, administrative and general expenses	162,938	220,950	233,236
Settlement charges	16,527		3,976
Operating income (loss)	8,029	(3,927)	8,060
Other income (expenses):			
Interest income	553	220	989
Interest expense	(61,778)	(60,556)	(57,505)
Equity in (loss) earnings of affiliate	(27,035)	(7,211)	678
Sale of assets	23,086	6,716	
Other, net	6,458	1,242	2,776
Loss from continuing operations before income taxes	(50,687)	(63,516)	(45,002)
Provision for income taxes	1,123	1,402	342
Loss from continuing operations	(51,810)	(64,918)	(45,344)
Discontinued operations:			
Income (loss) from discontinued operations	276	(1,591)	2,860
Gain on disposal	1,649	3,976	18,369
Income from discontinued operations	1,925	2,385	21,229
(Loss) before extraordinary items	(49,885)	(62,533)	(24,115)
Extraordinary items:			
Loss from extraordinary items-early extinguishment of debt			(9,810)
Net loss	(49,885)	(62,533)	(33,925)
Proportionate share of New Valley capital transactions, retirement of Class A Preferred Shares		1,782	16,802
Net loss applicable to common shares	$ (49,885)	$ (60,751)	$ (17,123)
Per basic and diluted common share:			
Loss from continuing operations	$ (2.85)	$ (3.41)	$ (1.56)
Income from discontinued operations	$ 0.11	$ 0.13	$ 1.16
Extraordinary items	$	$	$ (0.54)
Net loss applicable to common shares	$ (2.74)	$ (3.28)	$ (0.94)
Weighted average common shares outstanding	18,168,329	18,497,096	18,301,186

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*Revenues and Cost of goods sold include excise taxes of $87,683, $112,218 and $123,420 for ended the years ended December 31, 1997, 1996 and 1995, respectively.

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

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

	Year Ended December 31,		
	1997	1996	1995
Revenues*	$389,615	$460,356	$461,459
Cost of goods sold*	202,121	243,333	216,187
Gross profit	187,494	217,023	245,272
Operating, selling and general expenses	162,548	219,039	232,985
Settlement charges	16,527		3,976
Operating income (loss)	8,419	(2,016)	8,311
Other income (expenses):			
Interest income	543	157	989
Interest expense	(65,581)	(64,417)	(61,036)
Equity in (loss) earnings of affiliate	(27,035)	(7,211)	678
Sale of assets	27,663	6,716	
Other, net	2,326	(2,579)	2,292
Loss from continuing operations before income taxes	(53,665)	(69,350)	(48,766)
Provision for income taxes	1,135	5,254	1,736
Loss from continuing operations	(54,800)	(74,604)	(50,502)
Discontinued operations:			
Income (loss) from discontinued operations	276	(1,591)	2,860
Gain on disposal	1,649	3,976	18,369
Income from discontinued operations	1,925	2,385	21,229
(Loss) before extraordinary items	(52,875)	(72,219)	(29,273)
Extraordinary items:			
Loss resulting from the early extinguishment of debt			(9,810)
Loss from extraordinary items			(9,810)
Net (loss) income	$(52,875)	$(72,219)	$(39,083)

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*Revenues and Cost of goods sold include excise taxes of $87,683, $112,218 and $123,420 for the years ended December 31, 1997, 1996 and 1995, 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)

	Common Stock		Additional Paid-In		Treasury		
	Shares	Amount	Capital	Deficit	Stock	Other	Total
Balance, December 31, 1994	18,260,844	$ 1,826	$ 66,245	$(420,746)	$(33,542)	$ 11,365	$(374,852)
Net loss				(33,925)			(33,925)
Consolidation of foreign subsidiary			14,435				14,435
Distributions on common stock ($0.30 per share)			(5,474)				(5,474)
Stock grant to directors	20,000	2	(2)		94		94
Stock grant to consultant	250,000	25		(800)	1,244	(563)	469
Stock options granted to consultant			938			(201)	375
MAI spin-off				27,286		(2,332)	27,085
Unrealized holding loss on investment in New Valley						1,103	(2,332)
Effect of New Valley capital transactions			17,043				18,146
Treasury stock, at cost	(33,748)	(3)	3		(135)		(135)
Other, net			(2)	12			10
Balance, December 31, 1995	18,497,096	1,850	93,186	(428,173)	(32,339)	9,372	(356,104)
Net loss				(62,533)			(62,533)
Distributions on common stock ($0.30 per share)			(5,549)				(5,549)
Amortization of deferred compensation						252	252
Stock options granted to consultant			4,750			(4,750)	
Unrealized holding loss on investment in New Valley						(33,936)	(33,936)
Effect of New Valley capital transactions			1,782			1,099	2,881
Balance, December 31, 1996	18,497,096	1,850	94,169	(490,706)	(32,339)	(27,963)	(454,989)
Net loss				(49,885)			(49,885)
Distributions on common stock ($0.30 per share)			(5,504)				(5,504)
Amortization of deferred compensation						1,311	1,311
Stock options granted to consultant			(375)				(375)
Unrealized holding loss on investment in New Valley						16,842	16,842
Effect of New Valley capital transactions						3,190	3,190
Pension-related minimum liability adjustment						1,013	1,013
Settlement of loan	(400,000)			1,800	(1,800)		
Balance, December 31, 1997	18,097,096	$ 1,850	$ 88,290	$(538,791)	$(34,139)	$ (5,607)	$(488,397)

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

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

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Deficit	Other	Total
Balance, December 31, 1994	100			$(402,643)	$ 11,365	$(391,278)
Distributions paid to parent				(5,872)		(5,872)
Distribution of MAI to parent				24,942	(201)	24,741
Net loss				(39,083)		(39,083)
Unrealized loss on investment in New Valley					(2,332)	(2,332)
Effect of New Valley capital transactions............			$ 17,043		1,103	18,146
Forgiveness of debt by parent			4,565			4,565
Capital contribution			1,986			1,986
Other, net				(768)		(768)
Balance, December 31, 1995	100		23,594	(423,424)	9,935	(389,895)
Distributions paid to parent.........................				(3,621)		(3,621)
Net loss				(72,219)		(72,219)
Unrealized holding loss on investment in New Valley .					(33,936)	(33,936)
Effect of New Valley capital transactions			1,782		1,099	2,881
Forgiveness of debt by parent........................			13,705			13,705
Balance, December 31, 1996	100		39,081	(499,264)	(22,902)	(483,085)
Net loss				(52,875)		(52,875)
Unrealized holding loss on investment in New Valley .					16,842	16,842
Effect of New Valley capital transactions					3,190	3,190
Pension-related minimum liability adjustment					1,013	1,013
Settlement of loan				1,800		1,800
Balance, December 31, 1997	100	$	$ 39,081	$(550,339)	$ (1,857)	$(513,115)

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,		
	1997	1996	1995
Cash flows from operating activities:			
Net (loss) income	$(49,885)	$(62,533)	$(33,925)
Adjustments to reconcile net income (loss) to net cash used in operating activities:			
Depreciation and amortization	8,135	8,819	9,076
Noncash compensation expense	1,311	252	559
Deferred income taxes		1,061	
Gain on sale of assets	(26,247)	(6,716)	(1,042)
Extraordinary item			9,810
Impact of discontinued operations	(1,925)	(2,385)	(21,229)
Equity in loss (earnings) of affiliates	27,034	7,211	(678)
Other, net			4,845
Changes in assets and liabilities (net of effect of dispositions):			
Receivables	8,839	6,222	6,561
Inventories	14,379	6,830	(7,490)
Accounts payable and accrued liabilities	7,585	27,716	(5,445)
Deferred Gain	(6,459)		
Other assets and liabilities, net	(7,830)	9,818	15,972
Net cash used in operating activities	(25,063)	(3,705)	(22,986)
Cash flows from investing activities:			
Proceeds from sale of business and assets	56,494	8,040	14,152
Investments	(25)	(2,811)	(1,965)
Capital expenditures	(20,142)	(34,241)	(8,805)
Dividends from New Valley		24,733	61,832
Other, net			1,660
Net cash provided by (used in) investing activities	36,327	(4,279)	66,874

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,		
	1997	1996	1995
Cash flows from financing activities:			
Proceeds from debt	10,305	20,702	2,568
Repayments of debt	(11,516)	(8,864)	(37,196)
Borrowings under revolver	278,442	353,365	397,873
Repayments on revolver	(279,435)	(350,105)	(401,703)
Increase (decrease) in cash overdraft	938	(4,256)	(594)
Series G preferred dividend			(75)
Distributions on common stock	(7,266)	(4,162)	(5,475)
Treasury stock purchases			(135)
Other, net			(57)
Net cash (used in) provided by financing activities	(8,532)	6,680	(44,794)
Effect of exchange rate changes on cash and cash equivalents	81	(125)	
Net increase (decrease) in cash and cash equivalents	2,813	(1,429)	(906)
Cash and cash equivalents, beginning of period	1,941	3,370	4,276
Cash and cash equivalents, end of period	$ 4,754	$ 1,941	$ 3,370

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

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

	Year Ended December 31,		
	1997	1996	1995
Cash flows from operating activities:			
Net (loss) income	$(52,875)	$(72,219)	$(39,083)
Adjustments to reconcile net income (loss) to net cash used in operating activities:			
Depreciation and amortization	7,993	8,677	8,946
Gain on sale of assets	(26,247)	(6,716)	
Deferred income taxes		4,861	
Extraordinary item			9,810
Impact of discontinued operations	(1,925)	(2,385)	(21,229)
Equity in loss (earnings) of affiliates	27,034	7,211	(678)
Other, net			120
Changes in assets and liabilities (net of effect of dispositions):			
Receivables	8,838	5,863	7,261
Inventories	14,379	6,830	(7,489)
Accounts payable and accrued liabilities	1,245	34,461	1,001
Deferred Gain	(3,511)		
Other assets and liabilities, net	(8,287)	9,712	16,970
Net cash used in operating activities	(33,356)	(3,705)	(24,371)
Cash flows from investing activities:			
Proceeds from sale of business and assets		8,040	13,852
Impact of discontinued operations	56,494		
Investments	(25)	(2,811)	(2,765)
Capital expenditures	(20,142)	(34,241)	(8,569)
Dividends from New Valley		24,733	61,832
Other, net			1,660
Net cash provided by (used in) investing activities	36,327	(4,279)	66,010

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

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

	Year Ended December 31,		
	1997	1996	1995
Cash flows from financing activities:			
Proceeds from debt	10,305	19,060	2,568
Repayments of debt	(10,436)	(8,265)	(37,166)
Borrowings under revolver	278,442	353,365	397,873
Repayments on revolver	(279,435)	(350,105)	(401,703)
Increase (decrease) in cash overdraft	885	(3,755)	(215)
Distributions paid to parent		(3,621)	(5,871)
Other, net			1,986
Net cash (used in) provided by financing activities	(239)	6,679	(42,528)
Effect of exchange rate changes on cash and cash equivalents	81	(125)	
Net increase (decrease) in cash and cash equivalents	2,813	(1,430)	(889)
Cash and cash equivalents, beginning of period	1,941	3,370	4,259
Cash and cash equivalents, end of period	$ 4,754	$ 1,940	$ 3,370

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

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation:

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

(b) Liquidity:

During the years ended December 31, 1996 and 1995, the Company relied primarily on dividends received from New Valley Corporation ("New Valley") and in 1997, proceeds received on the sale of its indirect subsidiary, BrookeMil Ltd. ("BML"), to New Valley to meet its liquidity needs.

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

Liggett had net capital and working capital deficiencies of $192,857 and $17,542, respectively, at December 31, 1997, is highly leveraged and has substantial near-term debt service requirements. On January 30, 1998, Liggett obtained the consents of the required majority of the holders of Liggett's 11.50% Series B and 19.75% Series C Senior Secured Notes due 1999 (the "Liggett Notes") to various amendments to the Indenture governing the Liggett Notes. The amendments provide, among other things, for a deferral of the February 1, 1998 mandatory redemption of $37,500 principal amount of the Liggett Notes to the date of final maturity, February 1, 1999. (Refer to Note 9.) At maturity, the Liggett Notes will require a principal payment of $144,891. Liggett does not anticipate it will be able to generate sufficient cash from operations to make such payments. In addition, Liggett has a $40,000 revolving credit facility expiring March 8, 1999 (the "Facility"), under which $23,427 was outstanding at December 31, 1997. If Liggett is unable to refinance or restructure the terms of the Liggett Notes or otherwise make all payments thereon, substantially all of Liggett's long-term debt and the Facility would be in default and holders of such debt could accelerate the maturity of such debt. In such event, Liggett may be forced to seek protection from creditors under applicable laws. Due to the many risks and uncertainties associated with the cigarette industry and the impact of tobacco litigation, there can be no assurance that Liggett will be able to meet its future earnings or cash flow goals. These matters raise substantial doubt about Liggett meeting its liquidity needs and its ability to continue as a going concern and may negatively impact the Company's liquidity.

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

The Company has also engaged in negotiations with the principal holders of the BGLS 15.75% Series B Senior Secured Notes (the "BGLS Notes") with respect to certain modifications to the terms of such debt. On March 2, 1998, BGLS entered into an agreement with AIF II, L.P. and an affiliated investment manager on behalf of a managed account (together, "the Apollo Holders"), who hold approximately 41.8% of the $232,864 principal amount of the BGLS Notes. Pursuant to the terms of the agreement, the Apollo Holders have agreed to defer the payment of interest on the BGLS Notes held by them, commencing with the interest payment that was due July 31, 1997, which they had previously agreed to defer, through the interest payment due July 31, 2000. The deferred interest payments will be payable at final maturity of the BGLS Notes on January 31, 2001 or upon an event of default under the Indenture for the BGLS Notes. (Refer to Notes 9 and 14.)

BOL is in the process of constructing a new tobacco factory in Moscow, Russia currently scheduled to be operational in early 1999. The remaining construction costs are expected to be financed primarily by equipment lease financing currently in place and bank or other loans. (Refer to Note 4.)

(c) Estimates and Assumptions:

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

(d) Cash and Cash Equivalents:

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

(e) Financial Instruments:

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

At December 31,	1997		1996	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term debt	$406,264	$314,108	$433,485	$294,451

Short-term debt - The carrying amounts reported in the Consolidated Balance Sheets are a reasonable estimate of fair value.

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.

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

The methods and assumptions used by the Company's management in estimating fair values for financial instruments presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair values.

(f) Significant Concentrations of Credit Risk:

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

Liggett's customers are primarily candy and tobacco distributors, the military and large grocery, drug and convenience store chains. One customer accounted for approximately 19.4% of net sales in 1997, 13.7% of net sales in 1996 and 11.6% of net sales in 1995. Sales to this customer were primarily in the private label discount segment. Concentrations of credit risk with respect to trade receivables are limited due to the large number of customers, located primarily throughout the United States, comprising Liggett's customer base. Ongoing credit evaluations of customers' financial condition are performed and, generally, no collateral is required. Liggett maintains reserves for potential credit losses and such losses, in the aggregate, have generally not exceeded management's expectations.

Liggett-Ducat sells its products primarily to companies in the wholesale distribution and retail industries in the Russian Federation. Two distributors accounted for 24.9% and 22.0% of sales in 1997. Prepayment for goods and services is a customary business practice in Russia and Liggett-Ducat receives payment in advance for the majority of its sales. Although Liggett-Ducat does not require collateral and, as a consequence, is exposed to credit risk, Liggett-Ducat does perform ongoing credit evaluations of its customers and believes that its trade accounts receivable risk exposure is limited.

(g) Accounts Receivable:

The allowance for doubtful accounts and cash discounts was $1,383 and $1,280 at December 31, 1997 and 1996, respectively.

(h) Inventories:

Liggett tobacco inventories, which comprise 92.6% and 95.0% of total inventory in 1997 and 1996, respectively, are stated at the lower of cost or market and are determined primarily by the last-in, first-out (LIFO) method. Although portions of leaf tobacco inventories may not be used or sold within one year because of the time required for aging, they are included in current assets, which is common practice in the industry. It is not practicable to determine the amount that will not be used or sold within one year.

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

BROOKE GROUP LTD.
BGLS INC.
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.

Interest costs are capitalized in connection with the construction of major facilities. Capitalized interest is recorded as part of the asset to which it relates and is amortized over the asset's estimated useful life. In 1997, 1996 and 1995, interest costs of $693, $6,387 and $1,004, respectively, were capitalized.

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

(j) Intangible Assets:

Intangible assets, consisting principally of trademarks and goodwill, are amortized using the straight-line method over 10-12 years. Amortization expense for the years ended December 31, 1997, 1996 and 1995 was $1,845, $1,778 and $1,725, respectively. Management periodically reviews the carrying value of such assets to determine whether asset values are impaired.

(k) Impairment of Long-Lived Assets:

Impairment losses on long-lived assets are recognized when expected future cash flows are less than the assets' carrying value. Accordingly, when indicators of impairment are present, the Company evaluates the carrying value of property, plant and equipment and intangibles in relation to the operating performance and estimates of future cash flows of the underlying business.

(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, 1997 and 1996 which are subject to significant fluctuations in the near term.

(m) Postretirement Benefits other than Pensions:

The cost of providing retiree health care and life insurance benefits is actuarially determined and accrued over the service period of the active employee group.

(n) Stock Options:

The Company measures compensation expense for stock-based employee compensation plans using the intrinsic value method and provides pro forma disclosures of net income as if the fair value-based method had been applied in measuring compensation expense.

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

(o) Income Taxes:

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

(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 and cash flows have been and could continue to be materially adversely affected by significant unit sales volume declines, litigation and defense costs, increased tobacco costs or reductions in the selling price of cigarettes in the near term.

(q) Advertising and Promotional Costs:

Advertising and promotional costs are expensed as incurred. Advertising expenses were $40,534, $74,238 and $75,713 for the years ended December 31, 1997, 1996 and 1995, respectively.

(r) Legal Costs:

The Company's policy is to accrue legal and other costs related to contingencies as services are performed.

(s) Earnings Per Share:

In February 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share". SFAS No. 128 specifies new standards designed to improve the earnings per share ("EPS") information provided in financial statements by simplifying the existing computational guidelines, revising the disclosure requirements and increasing the comparability of EPS data on an international basis. Some of the changes made to simplify the EPS computations include: (a) eliminating the presentation of primary EPS and replacing it with basic EPS, with the principal difference being that common stock equivalents are not considered in computing basic EPS, (b) eliminating the modified treasury stock method and the three percent materiality provision and (c) revising the contingent share provisions and the supplemental EPS data requirements. SFAS No. 128 also makes a number of changes to existing disclosure requirements. SFAS No. 128 is effective for financial statements issued for periods ending after December 15, 1997, including interim periods. Prior period EPS information is restated to conform to the provisions of SFAS No. 128. For the years ended December 31, 1996 and 1995 per share calculations include the Company's proportionate share of excess carrying value of New Valley redeemable preferred shares over the cost of shares repurchased of $1,782 and $16,802, respectively.

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(t) Foreign Currency Translation:

The Company's Russian subsidiary operates in a "highly inflationary" economy and uses the U.S. dollar as the functional currency. Therefore, certain assets of this entity (principally inventories and property and equipment) are translated at historical exchange rates with all other assets and liabilities translated at year end exchange rates and all translation adjustments are reflected in the consolidated statements of operations.

(u) Reclassifications:

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

NEW ACCOUNTING PRONOUNCEMENTS

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

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

In February 1998, SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits," was issued which revises required disclosures about pensions and postretirement benefit plans. SFAS No. 132 is effective for the Company for the year ended 1998. The Company has not yet determined the impact of its implementation.

2. INVESTMENT IN NEW VALLEY CORPORATION

At December 31, 1997 and 1996, the Company's investment in New Valley consisted of an approximate 42% voting interest. At December 31, 1997 and 1996, the Company owned 57.7% of

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the outstanding $15.00 Class A Increasing Rate Cumulative Senior Preferred Shares ($100 Liquidation Value), $.01 par value (the "Class A Preferred Shares"), 9.0% of the outstanding $3.00 Class B Cumulative Convertible Preferred Shares ($25 Liquidation Value), $.10 par value (the "Class B Preferred Shares") and 41.7% of New Valley's common shares, $.01 par value (the "Common Shares").

The Class A Preferred Shares and the Class B Preferred Shares are accounted for as debt and equity securities, respectively, pursuant to the requirements of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities", and are classified as available-for-sale. The Common Shares are accounted for pursuant to APB No. 18, "The Equity Method of Accounting for Investments in Common Stock".

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

The Company's and BGLS' investment in New Valley at December 31, 1997 and 1996, respectively, is summarized below:

	Number of Shares	Fair Value	Carrying Amount	Unrealized Holding Gain (Loss)
1997				
Class A Preferred Shares.......	618,326	$59,359	$59,359	$ (5,494)
Class B Preferred Shares.......	250,885	941	941	(913)
Common Shares..................	3,989,710(A)	1,995	(60,300)	
		$62,295	$	$ (6,407)
1996				
Class A Preferred Shares.......	618,326	$72,962	$72,962	$(24,881)
Class B Preferred Shares.......	250,885	1,631	1,631	(223)
Common Shares..................	3,989,710(A)	5,985	(71,542)	
		$80,578	$ 3,051	$(25,104)

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

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

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the Common Shares and other equity interests were reinstated and retained all of their legal, equitable and contractual rights.

In February 1995, New Valley repurchased 54,445 Class A Preferred Shares pursuant to a tender offer made as part of the Joint Plan. During 1995, New Valley repurchased 339,400 additional Class A Preferred Shares on the open market at an aggregate cost of $43,405. During 1996, New Valley repurchased 72,104 Class A Preferred Shares for a total amount of $10,530. The Company has recorded its proportionate interest in the excess of the carrying value of the shares over the cost of the shares repurchased as a credit to additional paid-in capital in the amount of $1,782 and $16,802 for the years ended December 31, 1996 and 1995, respectively, 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, 1997 and 1996, respectively, the accrued and unpaid dividends arrearage was $163,302 ($152.41 per share) and $117,117 ($109.31 per share). The Company received $24,733 ($40.00 per share) and $61,832 ($100.00 per share) in dividend distributions in 1996 and 1995, respectively.

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, 1997 and 1996, respectively, the accrued and unpaid dividends arrearage was $139,412 ($49.95 per share) and $115,944 ($41.55 per share). No dividends on the Class B Preferred Shares have been declared since the fourth quarter of 1988.

Summarized financial information for New Valley follows:

	1997	1996	1995
Current assets, primarily cash and marketable securities..	$118,642	$183,720	
Noncurrent assets..	322,749	222,820	
Current liabilities......................................	128,128	98,110	
Noncurrent liabilities...................................	185,024	170,223	
Redeemable preferred stock................................	258,638	210,571	
Shareholders' equity (deficit)...........................	(130,399)	(72,364)	
Revenues...	108,441	111,954	$ 67,730
Costs and expenses.......................................	136,685	128,209	66,064
(Loss) income from continuing operations.................	(25,193)	(13,216)	1,374
Income from discontinued operations......................	4,620	5,726	16,873
Net loss applicable to Common Shares(A)..................	(89,048)	(65,160)	(13,714)
Company's share of discontinued operations...............	1,925	2,385	7,031

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

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

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

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

The organization of Western Realty was effected pursuant to the LLC Agreement. On January 11, 1996, the Company acquired from an affiliate of Apollo eight shopping centers for $72,500. New Valley and pension plans sponsored by BGLS have invested in investment partnerships managed by an affiliate of Apollo. Apollo's affiliate owns a substantial amount of debt securities of BGLS and warrants to purchase common stock of the Company.

On February 27, 1998, at an initial closing under the LLC Agreement, Apollo made an $11,000 loan (the "Loan") to Western Realty. The Loan, which bears interest at the rate of 15% per annum and is due September 30, 1998, is collateralized by a pledge of New Valley's shares of BML. Upon completion of the transfer of Ducat Place II and the satisfaction of other conditions under the LLC Agreement, the Loan and the accrued interest thereon will be converted into a capital contribution by Apollo to Western Realty and the BML pledge released.

Western Realty will seek to make additional real estate and other investments in Russia. New Valley and Apollo have agreed to invest, through Western Realty or another entity, up to $25,000 in the aggregate for the potential development of a real estate project in Moscow. In addition, Western Realty has agreed to acquire for $20,000, a 30% profits interest in a company organized by BOL which will, among other things, acquire an interest in a new factory being constructed on the outskirts of Moscow by a subsidiary of BOL. (Refer to Note 4.)

3. RJR NABISCO HOLDINGS CORP.

As of December 31, 1997 and 1996, New Valley held approximately 612,650 and 1,700,000 shares of RJR Nabisco Holdings Corp. ("RJR Nabisco") common stock, respectively, with a market value of $22,898 and $59,200 (cost of approximately $18,780 and $53,400). During 1997, 1996 and 1995, New Valley expensed $100, $11,724 and $3,879, respectively, for costs relating to its RJR Nabisco investment.

In June 1996, various agreements between High River Limited Partnership ("High River"), the Company, BGLS and New Valley were terminated by mutual consent. Pursuant to these agreements, the parties had agreed to take certain actions during late 1995 and in 1996 designed to cause RJR Nabisco to effectuate a spinoff of its food business, Nabisco Holdings Corp. ("Nabisco").

The terminations of the High River agreements left in effect for one year certain provisions concerning payments to be made to High River in the event New Valley achieved a profit (after deducting certain expenses) on the sale of the shares of RJR Nabisco common stock which were held by it or they were valued at the end of such year at higher than their purchase price or in the event the Company or its affiliates engaged in certain transactions with RJR Nabisco. Based on the market price of RJR Nabisco common stock, no amounts were payable by New Valley under these agreements.

Pursuant to an agreement between the Company and New Valley whereby New Valley agreed to reimburse the Company and its subsidiaries for reasonable out-of-pocket expenses in connection with RJR Nabisco, New Valley paid the Company and its subsidiaries a total of $17 and $2,370 in 1997 and 1996.

On February 29, 1996, New Valley entered into a total return equity swap transaction (the "Swap") with an unaffiliated company (the "Counterparty") relating to 1,000,000 shares of RJR Nabisco common stock (reduced to 750,000 shares of RJR Nabisco common stock as of August 13, 1996). New Valley entered into the Swap in order to be able to participate in any increase or decrease in the value of the RJR Nabisco common stock during the term of the Swap. The transaction was for a period of up to six months, unless extended by the parties, subject to earlier termination at the election of New Valley, and provided for New Valley to make a payment to the Counterparty of $1,537 upon commencement of the Swap. At the termination of the transaction, if the price of the RJR Nabisco common stock during a specified period prior to such date (the "Final Price") exceeded $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 was required to pay New Valley an amount in cash equal to the amount of such appreciation with respect to the shares of RJR Nabisco common stock subject to the Swap plus the value of any dividends with a record date occurring during the Swap period. If the Final Price was less than the Initial Price, then New Valley was required to pay the Counterparty at the termination of the transaction an amount in cash equal to the amount of such decline with respect to the shares of RJR Nabisco common stock subject to the Swap, offset by the value of any dividends, provided that, with respect to approximately 225,000 shares of RJR Nabisco common stock, New Valley was not 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 were guaranteed by the Counterparty's parent, a large foreign bank, and New Valley pledged certain collateral in respect of its potential obligations under the Swap and agreed to pledge additional collateral under certain conditions. New Valley marked its obligation with respect to the Swap to fair value with unrealized gains or losses included in income. During the third quarter of 1997, the Swap was terminated in connection with New Valley's reduction of its holdings of RJR Nabisco common stock, and New Valley recognized a loss on the Swap of $7,305 for the year ended December 31, 1996.

4. INVESTMENT IN BROOKE (OVERSEAS) LTD.

On January 31, 1997, BOL sold all its shares of BML to New Valley for $21,500 in cash and a promissory note of $33,500 payable $21,500 on June 30, 1997 and $12,000 on December 31, 1997 with interest at 9%. The note was paid in full as of December 31, 1997. The consideration received exceeded the carrying value of its investment in BML by $43,700. The Company recognized a gain on the sale in 1997 in the amount of $21,300. The remaining $22,400 was deferred in recognition of the fact that the Company retains an interest in BML through its 42% equity ownership in New Valley and that a portion of the property sold (the site of the third phase of the Ducat Place real estate

project being developed by BML, which is currently used by Liggett-Ducat for its existing cigarette factory), is subject to a put option held by New Valley. The option allows New Valley to put this site back to the Company at the greater of the appraised fair value of the property at the date of exercise or $13,600, during the period Liggett-Ducat operates the factory on such site. During the second quarter 1997, BML sold one of its office buildings, Ducat Place I, to a third party. Accordingly, the Company recognized $1,240 of its deferred gain.

In connection with the sale of its BML shares to New Valley, certain specified liabilities aggregating $40,800 remained with BML, including a Russian bank loan with a balance of $20,418, which was paid in full during the third quarter, 1997.

At December 31, 1997 and 1996, the Company's subsidiaries owned approximately 96% of the stock of Liggett-Ducat through purchases of stock in 1997 and 1996 from other shareholders.

Prior to December 29, 1995, the Company did not consolidate Liggett-Ducat due to certain events continuing through 1995 which impaired the Company's ability to control the operations of Liggett-Ducat. Such events included political restrictions on the Company's ability to influence and control the management and operating policies of Liggett-Ducat and the risks of loss of ownership.

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

Concurrently, the Company entered into consulting and non-compete agreements with the Sellers. Under the terms of these agreements, the Company will pay the Sellers a total of approximately $8,357 over five years. At December 31, 1997, the liability remaining under these agreements was $4,875.

In 1996, Russian tax authorities assessed Liggett-Ducat $7,600 for outstanding tax liabilities relating to 1995. The liability is payable in two parts, 50% within 2-1/2 years, the remaining 50% over the succeeding five years. The remaining liability at December 31, 1997 was $4,405.

Liggett-Ducat is in the process of constructing a new cigarette factory on the outskirts of Moscow which is currently scheduled to be operational in early 1999. A 49-year land lease was renegotiated in 1996 for the site on which Liggett-Ducat plans to build the new factory. In addition, Liggett-Ducat has entered into a construction contract for the plant. The remaining liability under that contract at December 31, 1997 is approximately $11,500. Equipment purchase agreements in place at December 31, 1997 total $26,955 of which $22,950 will be financed by the manufacturers. In February 1998, the Company agreed to guarantee payment for additional equipment purchased by Liggett-Ducat in the amount of $7,400 of which $5,841 will be financed by the manufacturers.

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

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Subsequent Event:

In February 1998, Western Realty agreed to acquire for $20,000, a 30% profits interest in a company organized by BOL, which will, among other things, acquire an interest in the new factory discussed above.

5. DISCONTINUED OPERATIONS

A summary of discontinued operations follows:

	Year Ended December 31,		
	1997	1996	1995
Income (loss) from discontinued operations:			
New Valley	$ 276	$(1,591)	$ 1,800
MAI			698
SkyBox			362
	276	(1,591)	2,860
Gain from disposal of operations:			
New Valley	1,649	3,976	5,231
SkyBox			13,138
	1,649	3,976	18,369
Income from discontinued operations	$1,925	$ 2,385	$21,229

New Valley:

In October 1996, Thinking Machines adopted a plan to terminate its parallel processing computer sales and service business. Consequently, the operating results of this segment, including the write-down of certain assets, principally inventory, to their net realizable value by $6,100, were classified as discontinued operations. The 1997 financial statements of the Company reflect its portion of the income from operations and the gain on disposal in discontinued operations.

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 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:

In February 1995, the Company distributed to its stockholders a special dividend (the "MAI Distribution") of the 65.2% equity interest it held in MAI Systems Corporation ("MAI"). The MAI Distribution reduced the Company's stockholders' equity (deficit) by $27,085 in the first quarter of 1995.

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.

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SkyBox:

During the first quarter of 1995, the Company sold all of its remaining common stock of its former subsidiary, SkyBox International Inc. ("SkyBox"), for $9,138. In addition, during the same period, SkyBox redeemed the 40 shares of SkyBox Series A Preferred Stock which the Company held for $4,000.

6. INVENTORIES

Inventories consist of:

	December 31, 1997	December 31, 1996
Finished goods	$13,273	$15,304
Work-in-process	1,976	4,435
Raw materials	24,495	34,002
Replacement parts and supplies	4,466	4,406
Inventories at current cost	44,210	58,147
LIFO adjustments	(4,898)	(4,456)
	$39,312	$53,691

The Company has a leaf inventory management program whereby, among other things, it is committed to purchase certain quantities of leaf tobacco. The purchase commitments are for quantities not in excess of anticipated requirements and are at prices, including carrying costs, established at the date of the commitment. At December 31, 1997, Liggett and Liggett-Ducat had leaf tobacco purchase commitments of approximately $10,200 and $27,800, respectively. In addition, Liggett-Ducat had leaf tobacco prepayments of $9,290.

7. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of:

	December 31, 1997	December 31, 1996
Land and improvements	$ 411	$ 455
Buildings	6,521	14,205
Machinery and equipment	53,717	49,401
Leasehold improvements	302	302
Construction-in-progress	18,179	46,966
	79,130	111,329
Less accumulated depreciation	(33,187)	(31,047)
	$45,943	$ 80,282

The amounts provided for depreciation for the years ended December 31, 1997, 1996 and 1995 were $4,513, $4,412 and $4,699, respectively.

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The amount of capitalized interest included in property, plant and equipment was $693 and $6,387 in 1997 and 1996, respectively.

8. SALE OF ASSETS

On January 31, 1997, BOL sold BML to New Valley for $21,500 in cash and a promissory note of $33,500 which was paid in 1997. (Refer to Note 4.)

On March 11, 1997, Liggett sold to Blue Devil Ventures, a North Carolina limited liability partnership, surplus realty for $2,200. The Company recognized a gain of approximately $1,100.

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

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

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

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

	December 31, 1997	December 31, 1996
15.75% Series B Senior Secured Notes due 2001, net of unamortized discount of $1,141 and $1,511	$231,723	$231,353
14.500% Subordinated Debentures due 1998	800	800
Notes payable - Foreign	5,000	22,668
Other	629	2,425
Liggett:		
11.500% Senior Secured Series B Notes due 1999, net of unamortized discount of $206 and $424	112,406	119,688
Variable Rate Series C Senior Secured Notes due 1999	32,279	32,279
Revolving credit facility	23,427	24,272
Total notes payable and long-term debt	406,264	433,485
Less:		
Current maturities	6,429	55,242
Amount due after one year	$399,835	$378,243

Standstill Agreement - BGLS:

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

On February 6, 1998, BGLS entered into a further amendment to the standstill agreement with the Apollo Holders who hold approximately 41.8% of the BGLS Notes which extended the termination date of such agreement with respect to the Apollo Holders to March 2, 1998. Also on February 6, 1998, the holder of 41.9% of the BGLS Notes, who had previously been a party to the standstill agreement, was paid its pro rata share of the July 31, 1997 interest payment on the BGLS Notes. The Company also sold stock on January 16, 1998 to an affiliate of this holder. (Refer to Note 13.)

On March 2, 1998, the Company entered into an agreement with the Apollo Holders in which the Apollo Holders agreed to defer the payment of interest on the BGLS Notes held by them, commencing with the interest payment that was due July 31, 1997, which they had previously agreed to defer, through the interest payment due July 31, 2000. The deferred interest payments will be payable at final maturity of the BGLS Notes on January 31, 2001 or upon an event of default under the Indenture for the BGLS Notes.

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

In connection with the consents of the Liggett bondholders to the restructuring of the Liggett Notes, on February 2, 1998, the Company issued 482,970 shares of treasury stock to the Liggett bondholders of record as of January 15, 1998. The Company has agreed to use its best efforts to file with the Securities and Exchange Commission (the "SEC") a shelf registration statement on Form S-3 to be declared effective by May 31, 1998. If the registration statement has not been declared effective by such date, liquidated damages on the shares of common stock will accrue at the daily rate of $25, provided that the number of days on which damages shall accrue shall not exceed 300 days. Liquidated damages would be payable, at the option of the Company, in cash or in shares of common stock of the Company.

As a result of the foregoing transactions involving the Company's debt, the Company expects to record a non cash charge of approximately $29,000 during the first quarter of 1998 reflecting the fair value of the instruments issued.

15.75% Series B Senior Secured Notes Due 2001

An exchange offer wherein BGLS offered to exchange all its outstanding Series 2 Notes, Reset Notes and Subordinated Debentures for 15.75% Series A Senior Secured Notes ("Series A Notes") and Series B Notes 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 remained outstanding and were paid at maturity on April 1, 1998. As part of the exchange offer, substantially all of the covenants and events of default were eliminated pertaining to the Subordinated Debentures.

Holders of Reset Notes did not exchange, and the Reset Notes were redeemed on March 29, 1996 for a total amount of $5,785, including premium, together with accrued interest of $452. On March 7,

1996, an additional $7,397 face amount of Series A Notes were sold for $6,300 including accrued interest with the proceeds being used for the redemption of the Reset Notes.

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

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

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.

Liggett 11.500% Senior Secured Series B Notes due 1999:

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

On January 30, 1998, with the consent of the required majority of the holders of the Liggett Notes, Liggett entered into various amendments to the Indenture governing the Liggett Notes, which provided, among other things, for a deferral of the February 1, 1998 mandatory redemption payment of $37,500 to the date of final maturity of the Liggett Notes on February 1, 1999. In connection with the deferral, the Company agreed to issue 482,970 shares of the Company's common stock to the holders of record on January 15, 1998 of the Liggett Notes. The Indenture under which the Liggett Notes are outstanding was also amended to prohibit, with limited exceptions, payments of dividends and incurrence of new debt by Liggett and to tighten restrictions on the disposition of proceeds of

asset sales. The Company and BGLS also agreed to guarantee the payment by Liggett of the August 1, 1998 interest payment on the Liggett Notes. In addition, Liggett Noteholders were granted a security interest in 16% of the stock of Liggett-Ducat or a successor entity held by BOL.

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

Issuance of Liggett Series C Variable Rate Notes:

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

Revolving Credit Facility - Liggett:

On March 8, 1994, Liggett entered into the Facility for $40,000 with a syndicate of commercial lenders. The Facility is collateralized by all inventories and receivables of Liggett. At December 31, 1997, $7,728 was available under the Facility based on eligible collateral. Borrowings under the Facility, whose interest is calculated at a rate equal to 1.5% above the Philadelphia National Bank's prime rate, bear a rate of 10.0% at December 31, 1997. The Facility requires Liggett's compliance with certain financial and other covenants. The Facility also limits the amount of cash dividends and distributions by Liggett and imposes requirements with respect to Liggett's permitted maximum adjusted net worth and net working capital deficiencies. In January 1997, the Facility was extended for one year and, in November 1997, was extended for an additional year until March 8, 1999.

During the first quarter of 1997, Liggett violated the working capital covenant contained in the Facility. This violation occurred during February 1997 when $37,500 of the Liggett Notes were reclassified from long-term to current as a result of the February 1, 1998 mandatory redemption requirement of such Notes, which redemption has now been extended to the maturity date, February 1, 1999. On March 19, 1997, the lead lender agreed to waive this covenant default, and the Facility was amended as follows: (i) the working capital definition was changed to exclude the current portion of the Liggett Notes; (ii) the maximum permitted working capital deficit was reduced to $12,000 (as computed in accordance with the agreement); (iii) the maximum permitted adjusted net worth deficit was increased to $180,000 (as computed in accordance with the agreement); and (iv) the permitted advance rates under the Facility for eligible inventory were reduced by five percent. On April 8, 1998, the Facility was further amended to increase the maximum permitted adjusted net worth and net working capital deficiencies to $195,000 and $17,000, respectively. The Facility, as amended, also provides that a default by Liggett or its subsidiaries under the March 96 Settlements, March 97 Settlements and March 98 Settlements (all as defined below in Note 16) shall constitute an event of default under the Facility.

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

Foreign Loans:

In October, 1995, Liggett-Ducat, a subsidiary of BOL, entered into a construction loan agreement with a Russian Bank for a period of two years on behalf of BML for $20,400. The loan was paid in full by BML in the third quarter of 1997. Deferred financing fees of approximately $4,044 were recorded and were amortized over the term of the loan. (Refer to Note 4.)

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At December 31, 1997, Liggett-Ducat had two 6-month credit facilities open with a Russian bank. The first, for $2,000, expires on April 30, 1998, initially bore an interest rate of 21%, subsequently raised to 28% on December 2, 1997. The second, for $3,000, expires on May 16, 1998, initially bore an interest rate of 25%, subsequently raised to 28% on December 2, 1997.

Scheduled Maturities:

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

1998	$ 6,429
1999	168,112
2000	
2001	231,723
2002	
Thereafter	
	$ 406,264

10. 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:	
1998	$2,144
1999	735
2000	280
2001	267
2002	143
Thereafter	2,155
	$5,724

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

The Company's rental expense for the years ended December 31, 1997, 1996 and 1995 was $3,625, $5,471 and $4,449, respectively.

11. EMPLOYEE BENEFIT PLANS

Defined Benefit Retirement Plans:

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

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

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

	Year Ended December 31, 1997	1996	1995
Service cost - benefits earned during the period..........	$ 350	$ 350	$ 454
Interest cost on projected benefit obligation............	12,255	12,241	12,850
Actual return on assets..................................	(42,511)	(21,143)	(23,501)
Curtailment related to plan restructuring................	484	1,463	1,550
Net amortization and deferral............................	27,430	7,384	9,547
	$ (1,992)	$ 295	$ 900

In accordance with SFAS No. 87, "Employers' Accounting for Pensions", the overfunded and underfunded plans with respect to the accumulated benefit obligation at December 31, 1996 have been segregated for financial statement presentation. All plans were underfunded with respect to the 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, 1997 and 1996 for the pension plans are as follows:

	December 31, 1997		December 31, 1996	
	Assets Exceed Accumulated Benefits	Accumulated Benefits Exceed Assets	Assets Exceed Accumulated Benefits	Accumulated Benefits Exceed Assets
Actuarial present value of benefit obligations:				
Vested benefit obligation	$ 157,193	$ 3,843	$ 155,612	$ 2,900
Accumulated benefit obligation	$ 161,614	$ 3,860	$ 160,587	$ 2,915
Projected benefit obligation	$ 161,614	$ 3,860	$ 160,587	$ 2,915
Plan assets at fair value	194,732		169,845	
Projected benefit obligation (less than) in excess of plan assets	(33,118)	3,860	(9,258)	2,915
Unrecognized net gain (loss)	51,017	(2,058)	28,221	(976)
Curtailment liability			1,463	
Adjustment required to recognize minimum liability ...		2,058		976
Pension liability before purchase accounting valuation adjustments	17,899	3,860	20,426	2,915
Purchase accounting valuation adjustments related to income taxes	(3,077)		(3,425)	
Net pension liability included in the balance sheets .	$ 14,822	$ 3,860	$ 17,001	$ 2,915

Assumptions used in the determination of net pension expense and the actuarial present value of benefit obligations for the years ended December 31, 1997 and 1996 follow:

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

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

Postretirement Medical and Life Insurance Plans:

BGLS and Liggett

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

The components of net periodic postretirement benefit cost for the years ended December 31, 1997, 1996 and 1995 are as follows:

	1997	1996	1995
Service cost, benefits attributed to employee service during the year	$ 24	$ 68	$ 68
Interest cost on accumulated postretirement benefit obligation	703	829	970
Charge for special termination benefits	47	137	489
Amortization of net (gain) loss	(193)	(92)	(26)
Net periodic postretirement benefit expense	$581	$942	$1,501

The following sets forth the actuarial present value of the Accumulated Postretirement Benefit Obligation ("APBO") at December 31, 1997 and 1996 applicable to each employee group for benefits:

	1997	1996
Retired employees	$ 6,870	$ 7,899
Active employees - fully eligible	498	674
Active employees - not fully eligible	810	515
APBO	8,178	9,088
Unrecognized net gain	3,992	3,324
Purchase accounting valuation adjustment related to income taxes	(963)	(1,072)
Postretirement liability	$11,207	$11,340

The APBO at December 31, 1997 and 1996 was determined using discount rates of 7.5% and 8%, respectively, and a health care cost trend rate of 4% in 1997 and 1996. A 1% increase in the trend rate for health care costs would have increased the APBO and net periodic postretirement benefit cost by $360 and $26, respectively, for the year ended December 31, 1997. The Company does not hold any assets reserved for use in the plan.

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Profit Sharing Plan:

Liggett

The 401(k) plans originally called for Liggett contributions matching up to a 3% employee contribution, plus additional Liggett contributions of up to 6% of salary based on the achievement of Liggett's profit objectives. Effective January 1, 1994, Liggett suspended the 3% match for the salaried employees' 401(k) Plan, but reinstated it on April 1, 1996. Liggett contributed and expensed $497, $591 and $900 to the 401(k) plans for the years ended December 31, 1997, 1996 and 1995, respectively.

12. INCOME TAXES

The Company files a consolidated federal income tax return that includes its more than 80%-owned United States subsidiaries. At December 31, 1997, the Company had $99,861 of unrecognized net deferred tax assets, comprised primarily of net operating loss carryforwards, available to offset future taxable income for federal tax purposes. The Company established a valuation allowance against this deferred tax asset as it is presently deemed more likely than not that the benefit of the tax asset will not be utilized. The Company continues to evaluate the realizability of its deferred tax assets and its estimate is subject to change.

The amounts provided for income taxes are as follows:

	Year Ended December 31,		
	1997	1996	1995
Current:			
U.S. Federal			
Foreign	$1,134	$ 1,454	
State	(11)	(52)	$ 342
Total provision (benefit) for continuing operations.	$1,123	$ 1,402	$ 342

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

	December 31, 1997		December 31, 1996	
	Deferred Tax Assets	Deferred Tax Liabilities	Deferred Tax Assets	Deferred Tax Liabilities
Sales and product allowances	$ 3,102		$ 2,504	
Inventory	457	$1,568	1,270	$ 683
Coupon accruals	2,369		4,492	
Property, plant and equipment		5,760		5,218
Employee benefit plan accruals	12,698		13,193	
Debt restructuring charges	19,105		22,334	
Excess of tax basis over book basis- non-consolidated entities	9,467		9,467	
Excess of book basis over tax basis- non-consolidated entities				5,166
Legal settlements	9,840		2,910	
Net operating loss carryforwards	50,151		45,543	
Valuation allowance	(99,861)		(90,646)	
Reclassifications	(7,328)	(7,328)	(11,067)	(11,067)
	$	$	$	$

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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,		
	1997	1996	1995
Loss from continuing operations before income taxes	$(50,687)	$(63,516)	$(45,002)
Federal income tax (benefit) at statutory rate	(17,740)	(22,231)	(15,751)
Increases (decreases) resulting from:			
State income taxes, net of federal income tax benefits	(8)	(34)	342
Foreign taxes	1,134	1,454	
Changes in valuation allowance	9,215	21,471	11,810
Other	8,522	742	3,941
Provision for income tax	$ 1,123	$ 1,402	$ 342

The Company's tax years from 1993 to 1995 are presently under audit with the Internal Revenue Service. The Company believes it has adequately reserved for any potential adjustments which may occur.

At December 31, 1997, the Company and its consolidated group had net operating loss carryforwards for tax purposes of approximately $125,000 which may be subject to certain restrictions and limitations and which will expire in the years 2006 to 2017.

13. EQUITY

Treasury Stock:

On March 7, 1997, a partnership controlled by the Company's Chairman, President and Chief Executive Office and controlling stockholder (the "Chairman") transferred 400,000 shares of common stock to the Company in satisfaction of an obligation. (Refer to Note 17.)

In 1995, pursuant to a Stock Grant Agreement, the Company purchased 33,748 shares of common stock from a former employee at market price. During 1995, the Company issued, in the aggregate, 270,000 shares from treasury.

On January 16, 1998, the Company entered into a Stock Purchase Agreement in which High River purchased 1,500,000 shares of BGL common stock for $9,000. The Company has agreed to use its best efforts to file with the SEC,a shelf registration statement on Form S-3 to be declared effective by May 15, 1998. If the registration statement has not been declared effective by such date, liquidated damages on the shares of common stock will accrue at the rate of $25 per day for the first 60-day period, and thereafter at the rate of $50 per day, provided that the aggregate liquidated damages shall not exceed $9,000.

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

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14. STOCK PLANS

On December 16, 1996, the Company entered into a Stock Option Agreement (the "Agreement") with a consultant who serves as a director and President of New Valley. The Agreement granted such consultant non-qualified stock options to purchase 1,000,000 shares of the Company's common stock at an exercise price of $1.00 per share. The options, which have a ten-year term, vest and become exercisable in six equal annual installments beginning on July 1, 1997. Pursuant to the Agreement, common stock dividend equivalents are paid on each vested and unexercised option. The Company estimated the fair value of such grant on the date of grant using the Black-Scholes option-pricing model with the following assumptions: a risk-free interest rate of 6.4%, expected option life of 10 years, volatility of 81.4% and no expected dividends or forfeiture. Under this model, the fair value of stock options granted in 1996 was $4,750. The Company recognized expense of $1,127 and $64 for the years ended 1997 and 1996, respectively.

As of January 1, 1994, the Company had granted 500,000 shares of restricted common stock to the same consultant. Of the total number of shares granted, 250,000 were immediately vested and issued during the third quarter. The remaining 250,000 shares were issued in 1995 and vested in 1997. In addition, on January 25, 1995, the Company entered into a non-qualified stock option agreement with the same consultant. Under the agreement, options to purchase 500,000 shares were granted at $2.00 per share. The options are exercisable over a ten-year period, beginning with 20% on the grant date and 20% on each of the four anniversaries of the grant date. The grant provides for dividend equivalent rights on all the shares underlying the options. During 1997, 1996 and 1995, the Company recorded charges to income of $205, $222, and $557, respectively, for compensation based on estimates of the fair market value for the shares and options granted. In 1997, 1996 and 1995, the Company also recorded charges to income of $188, $150 and $150, respectively, for the dividend equivalent rights.

As of January 1, 1998 and 1997, the Company granted to employees of the Company non-qualified stock options to purchase 42,500 and 422,000, respectively, shares of the Company's common stock at an exercise price of $5.00 per share. The options have a ten-year term and vest in six equal annual installments. The Company will recognize compensation expense of $154 over the vesting period.

The fair value of option grants to employees is estimated on the date of grant using the Black-Scholes option-pricing model for pro forma footnote disclosure purposes with the following assumptions used for grants in 1997: a risk-free interest rate of 6.44%, expected option life of 10 years, volatility of 81.46% and no expected dividends or forfeitures.

A summary of stock options granted to employees follows:

	Number of Shares	Exercise Price	Weighted Average Fair Value
Outstanding on December 31, 1996	0		
Granted	422,000	$5.00	$4.30
Exercised	0		
Cancelled	0		
Outstanding on December 31, 1997	422,000	$5.00	4.30
Exercisable	89,165		

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The Company has chosen to continue accounting for stock options at their intrinsic value. Had the fair value method of accounting been applied to the Company's stock options granted to employees, the pro forma effect would be as follows:

	1997
Net loss as reported	$(49,885)
Estimated fair value of the year's option grants	383
Net loss adjusted	(50,268)
Adjusted net loss per share - Basic and Diluted	(2.81)

15. 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,		
	1997	1996	1995
I. Cash paid during the period for:			
Interest	$ 43,028	$ 57,362	$ 60,158
Income taxes, net of refunds	462	582	1,735
II. Non-cash investing and financing activities:			
Dividends payable		$ 1,387	
Distribution of MAI to stockholders			$ 27,085
Exchange of Series 2 Senior Secured Notes for Series A Notes		99,154	
Exchange of 14.50% Subordinated Debentures for Series B Notes		125,495	
Issuance of Series A Notes for options		822	
Exchange of Series A Notes for Series B Notes		99,976	
Issuance of promissory notes for shares of Liggett-Ducat		1,643	
Promissory Note from New Valley	33,500		

16. CONTINGENCIES

Tobacco-Related Litigation:

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

governments, although recently numerous health care cost recovery actions have been commenced on behalf of other third-party payors including asbestos manufacturers, unions and taxpayers ("Attorneys General Actions"). As new cases are commenced, the costs associated with defending such cases and the risks attendant to the inherent unpredictability of litigation continue to increase. Liggett had been receiving assistance from others in the industry in defraying the costs and other burdens incurred in the defense of smoking and health litigation and related proceedings, which, for the most part, consisted of the payment of counsel fees and costs, but this assistance terminated in 1997. In 1995 and 1996, approximately $1,500 and $6,500, respectively, in counsel fees and costs were paid by others. In 1995 and 1996, Liggett incurred additional fees and costs in connection with tobacco-related litigation in the amount of approximately $4,500 and $3,500, respectively. In 1997, Liggett incurred fees and costs in the amount of approximately $5,750. The future financial impact on the Company of the termination of this assistance and the effects of the tobacco litigation settlements discussed below is not quantifiable at this time.

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

Individual Actions. As of December 31, 1997, there were approximately 250 cases pending against Liggett, and in most cases the other tobacco companies, where individual plaintiffs allege injury resulting from cigarette smoking, addiction to cigarette smoking or exposure to ETS and seek compensatory and, in some cases, punitive damages. Of these, 108 are pending in the State of Florida, 82 are pending in the State of New York and 19 are pending in the State of Texas. The balance of individual cases are pending in 16 states. There are four individual cases pending where Liggett is the only named defendant.

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

On September 10, 1993, an action entitled Sackman v. Liggett Group Inc., United States District Court, Eastern District of New York, was filed against Liggett alleging as injury lung cancer. On October 6, 1997, the parties settled this matter.

Class Actions. As of December 31, 1997, there were approximately 40 actions pending, for which either a class has been certified or plaintiffs are seeking class certification, where Liggett, among others, was a named defendant. Two of these cases, Fletcher, et al. v. Brooke Group Ltd., et al. and Walker, et al. v. Liggett Group Inc., et al., have been settled, subject to court approval. These two settlements are more fully discussed below under the "Settlements" section.

On October 31, 1991, an action entitled Broin, et al. v. Philip Morris Incorporated, et al., Circuit Court of the Eleventh Judicial District in and for Dade County, Florida, was filed against Liggett and others. This case has been brought by plaintiffs on behalf of all flight attendants that have worked or are presently working for airlines based in the United States and who have never regularly smoked cigarettes but allege that they have been damaged by involuntary exposure to ETS. On October 10, 1997, the other major tobacco companies settled this matter which settlement provides for a release of the Company and Liggett. In February 1998, the Circuit Court approved the settlement, however, a Notice of Appeal was filed in the Third District Court of Appeal by an objector to the settlement.

On March 25, 1994, an action entitled Castano, et al. v. The American Tobacco Company Inc., et al., United States District Court, Eastern District of Louisiana, was filed against Liggett and others. The class action complaint sought relief for a nationwide class of smokers based on their alleged addiction to nicotine. On February 17, 1995, the District Court granted plaintiffs' motion for class certification (the "Class Certification Order").

On May 23, 1996, the Court of Appeals for the Fifth Circuit reversed the Class Certification Order and instructed the District Court to dismiss the class complaint. The Fifth Circuit ruled that the District Court erred in its analysis of the class certification issues by failing to consider how variations in state law affect predominance of common questions and the superiority of the class action mechanism. The appeals panel also held that the District Court's predominance inquiry did not include consideration of how a trial on the merits in Castano would be conducted. The Fifth Circuit further ruled that the "addiction-as-injury" tort is immature and, accordingly, the District Court could not know whether common issues would be a "significant" portion of the individual trials. According to the Fifth Circuit's decision, any savings in judicial resources that class certification may bring about is speculative and would likely be overwhelmed by the procedural problems certification brings. Finally, the Fifth Circuit held that in order to make the class action manageable, the District Court would be forced to bifurcate issues in violation of the Seventh Amendment.

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

Attorneys General Actions. As of December 31, 1997, 39 Attorneys General actions were filed against Liggett and the Company. In February 1998, one additional action was commenced. As more fully discussed below, through March 1998, Liggett and the Company have settled 37 of these actions. In addition, the Company and Liggett have reached settlements with six Attorneys General representing states or territories which have not yet commenced litigation. As of December 31, 1997, there were

approximately 35 additional third-party payor actions pending. In certain of the pending proceedings, state and local government entities and others seek reimbursement for Medicaid and other health care expenditures allegedly caused by use of tobacco products. The claims asserted in these health care cost recovery actions vary. In most of these cases, plaintiffs assert the equitable claim that the tobacco industry was "unjustly enriched" by plaintiffs' payment of health care costs allegedly attributable to smoking and seek reimbursement of those costs. Other claims made by some but not all plaintiffs include the equitable claim of indemnity, common law claims of negligence, strict liability, breach of express and implied warranty, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under state and federal statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under RICO.

Settlements. In March 1996, the Company and Liggett entered into an agreement, subject to court approval, to settle the Castano class action tobacco litigation. Under the Castano settlement agreement, upon final court approval of the settlement, the Castano class would be entitled to receive up to five percent of Liggett's pretax income (income before income taxes) each year (up to a maximum of $50,000 per year) for the next 25 years, subject to certain reductions provided for in the agreement and a $5,000 payment from Liggett if the Company or Liggett fail to consummate a merger or similar transaction with another non-settling tobacco company defendant within three years of the date of settlement. The Company and Liggett have the right to terminate the Castano settlement under certain circumstances. On March 14, 1996, the Company, the Castano Plaintiffs Legal Committee and the Castano plaintiffs entered into a letter agreement. According to the terms of the letter agreement, for the period ending nine months from the date of Final Approval (as defined in the letter), if granted, of the Castano settlement or, if earlier, the completion by the Company or Liggett of a combination with any defendant in Castano, except Philip Morris, the Castano plaintiffs and their counsel agree not to enter into any more favorable settlement agreement with any Castano defendant which would reduce the terms of the Castano settlement agreement. If the Castano plaintiffs or their counsel enter into any such settlement during this period, they shall pay the Company $250,000 within 30 days of the more favorable agreement and offer the Company and Liggett the option to enter into a settlement on terms at least as favorable as those included in such other settlement. The letter agreement further provides that during the same time period, and if the Castano settlement agreement has not been earlier terminated by the Company in accordance with its terms, the Company and its affiliates will not enter into any business transaction with any third party which would cause the termination of the Castano settlement agreement. If the Company or its affiliates enter into any such transaction, then the Castano plaintiffs will be entitled to receive $250,000 within 30 days from the transacting party. On May 11, 1996, the Castano Plaintiffs Legal Committee filed a motion with the United States District Court for the Eastern District of Louisiana seeking preliminary approval of the Castano settlement. On September 6, 1996, shortly after the class was decertified, the Castano plaintiffs withdrew the motion for approval of the Castano settlement.

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

Under the March 1996 Settlements, the five settling states would share an initial payment by Liggett of $5,000 ($1,000 of which was paid on March 22, 1996, with the balance payable over nine years

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

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

On March 20, 1997, Liggett, the Company and the five settling states executed an addendum pursuant to which Liggett and the Company agreed to provide to the five settling states, among other things, the additional cooperation and compliance with advertising restrictions that is provided for in the March 1997 Settlements (discussed below). Also, pursuant to the addendum, the initial settling states agreed to use best efforts to ensure that in the event of a global tobacco settlement enacted through federal legislation or otherwise, Liggett's and the Company's financial obligations under such a global settlement would be no more onerous than under this settlement.

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

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

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

As mentioned above, in March 1997, Liggett, the Company and plaintiffs filed a mandatory class settlement agreement in an action entitled Fletcher, et al. v. Brooke Group Ltd., et al., Circuit Court of Mobile County, Alabama, where the court granted preliminary approval and preliminary certification of the class, and on May 15, 1997, a similar mandatory class settlement agreement was filed in an action entitled Walker, et al. v. Liggett Group Inc., et al., United States District Court, Southern District of West Virginia. The Company anticipates that should the court in Fletcher, after dissemination of notice to the class of the pending limited fund class action settlement and a full fairness hearing with respect thereto, issue a final order and judgment approving the settlement, such an order would preclude further prosecution by class members of tobacco-related claims against both Liggett and the Company. Under the Full Faith and Credit Act, a final judgment entered in a nationwide class action pending in a state court has a preclusive effect against any class member with respect to the claims settled and released. As the class definition in Fletcher encompasses all individual and third-party payor claimants, it is anticipated that, upon final order and judgment, all such class members would be barred from further prosecution of tobacco-related claims against Liggett and the Company.

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

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

After the Amchem opinion was issued by the Supreme Court in June 1997, objectors to Liggett's settlement in Walker moved for decertification. Although Liggett's settlement in the Walker action is a "limited fund" class action settlement proceeding under Rule 23(b)(1) and Amchem was a Rule 23 (b)(3) case, the court in the Walker action, nonetheless, decertified the Walker class. Applying Amchem to the Walker case, the District Court, in a decision issued in August 1997, determined that

while plaintiffs in Walker have a common interest in "maximizing the limited fund available from the defendants," there remained "substantial conflicts among class members relating to distribution of the fund and other key concerns" that made class certification inappropriate.

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

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

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

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

Pursuant to the March 1997 Settlements, any other tobacco company defendant, except Philip Morris, merging or combining with Liggett or the Company, prior to the fourth anniversary of the settlements, would receive certain settlement benefits, including limitations on potential liability for affiliates not engaged in domestic tobacco operations and a waiver of any obligation to post a bond to

appeal any future adverse judgment. In addition, within 120 days following any such combination, Liggett would be required to pay the settlement fund $25,000. Under all settlements, the plaintiffs have agreed not to seek an injunction preventing a defendant tobacco company combining with Liggett or the Company from spinning off any affiliate which is not engaged in the domestic tobacco business.

Pursuant to the March 1998 Settlements, Liggett is required to pay each of the settling states and territories their relative share (based on the Medicaid population of each state over the total Medicaid population of the United States) of between 27.5% and 30% of Liggett's pre-tax income each year for 25 years, with a minimum payment guarantee of $1,000 per state over the first nine years of the agreement. The aggregate liability under the March 1996 Settlements, the March 1997 Settlements and the March 1998 Settlements is $39,556, the present value of which, when discounted at the rate of 18% per annum, is $19,365 at December 31, 1997. Minimum payments to be made for these settlements over the next five years and thereafter are: 1998: $4,044; 1999: $4,406; 2000: $4,406; 2001: $4,465; 2002: $4,518; thereafter: $17,717. The annual percentage is subject to increase, pro rata from 27.5% up to 30%, depending on the number of additional states joining the settlement. Pursuant to the "most favored nation" provisions under the March 1996 Settlement and the March 1997 Settlements, each of the states settling under those settlements could benefit from the economic terms of the March 1998 Settlements. In the case of the March 1997 Settlements, in the event that the Fletcher class is approved, monies collected in the settlement fund will be overseen by a court-appointed committee and utilized to compensate state health care programs and settlement class members and to provide counter-market advertising. In all settlements, Liggett agreed to phase-in compliance with certain proposed FDA regulations regarding smoking by children and adolescents, including a prohibition on the use of cartoon characters in tobacco advertising and limitations on the use of promotional materials and distribution of sample packages where minors are present. The March 1998 Settlements provide for additional restrictions and regulations on Liggett's advertising, including a prohibition on outdoor advertising and product advertising on the Internet and on payments for product placement in movies and television.

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

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

Trials. Liggett is a defendant in trials currently proceeding in the State of Minnesota by Hubert H. Humphrey, III, its Attorney General and Blue Cross and Blue Shield of Minnesota v. Philip Morris Incorporated, et al., District Court of the Second Judicial District, Ramsey County, Minnesota, which commenced on January 20, 1998. Liggett settled the claims of the State of Minnesota on March 20, 1997, but still remains a defendant in the case with respect to the State's co-plaintiff, Blue Cross and Blue Shield of Minnesota. Liggett is also a defendant in Dunn and Wiley v. RJR Nabisco Holdings Corp., et al., Superior Court, Delaware County, Indiana, which trial commenced on February 9, 1998.

There are several other trial dates scheduled during 1998 for individual cases; however, trial dates are subject to change.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Legislation and Regulation:

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

In August 1996, the Commonwealth of Massachusetts enacted legislation requiring tobacco companies to publish information regarding the ingredients in cigarettes and other tobacco products sold in that state. In December 1997, the United States District Court for the District of Massachusetts enjoined this legislation from going into effect, however, on December 15, 1997, Liggett began complying with this legislation by providing ingredient information to the Massachusetts Department of Public Health.

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

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

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

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

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

Other Matters:

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

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

17. RELATED PARTY TRANSACTIONS

On March 7, 1997, a partnership controlled by the Chairman transferred to the Company the remaining 400,000 pledged shares of the Company's common stock with a market value of $1,800 in final satisfaction of an obligation to make certain payments to the Company on account of a former executive's outstanding indebtedness of $5,477 (deducted from equity).

On December 16, 1996, the Company entered into a Stock Option Agreement relating to 1,000,000 shares of the Company's common stock with a consultant who serves as a director and President of New Valley. In addition, the Company granted the same consultant options to purchase 500,000 shares in 1995. (Refer to Note 15.) During 1997 and 1996, the consultant received consulting fees of $480 per year from the Company and a subsidiary.

An outside director of the Company is a stockholder of and serves as the secretary and treasurer of a registered broker-dealer that has performed services for the Company and its affiliates since before December 31, 1994. The broker-dealer received brokerage commissions and other income of approximately $522, $317 and $584 from the Company and/or its affiliates during 1997, 1996 and 1995, respectively. The broker-dealer, in the ordinary course of its business, engages in brokerage activities with New Valley's broker-dealer subsidiary on customary terms. In connection with the acquisition of certain office buildings by New Valley on January 10, 1996, this director received a commission of $220 from the seller.

During 1995, the Company and New Valley entered into an expense sharing agreement whereby certain lease, legal and administrative expenses are allocated to the entity incurring the expense. Expense reimbursements amounted to $375, $462 and $571 for the years ended December 31, 1997, 1996 and 1995, respectively.

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

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

In connection with their agreement to serve as the Company's nominees at RJR Nabisco's 1996 annual meeting of stockholders, two directors of New Valley were each paid $30 by the Company during the fourth quarter of 1995. As discussed in Note 3, the Company has entered into certain other agreements with New Valley in connection with RJR Nabisco.

On January 31, 1997, New Valley entered into a stock purchase agreement with BOL pursuant to which New Valley acquired 10,483 shares of BML common stock (99.1%) for a purchase price of

$55,000, consisting of $21,500 in cash and a $33,500 promissory note with an interest rate of 9%. The note was paid in full in 1997. (Refer to Note 4.)

18. SEGMENT INFORMATION

On January 31, 1997, BOL sold all of its shares in BML to New Valley. (Refer to Note 4). In 1997, there is only one industry segment, tobacco and, accordingly, there is no industry segment disclosure. Information about the Company's operations by industry in the tobacco and real estate segments in 1996 follows:

Industry Segment:

1996	Tobacco	Real Estate	Corporate and Others	Consolidated
Net sales	$455,222	$ 2,675	$ 2,459	$460,356
Operating income (loss)	4,805	99	(8,831)	(3,927)
Identifiable assets	114,648	55,012	8,017	177,677
Capital expenditures	8,861	25,318	62	34,241
Depreciation and amortization	8,185	253	381	8,819

Geographic Area:

1997	United States	Russia	Consolidated
Net sales	$312,268	$77,347	$389,615
Operating income	3,794	4,235	8,029
Identifiable assets	80,235	46,222	126,457

1996	United States	Russia	Consolidated
Net sales	$403,521	$56,835	$460,356
Operating income (loss)	6,045	(9,972)	(3,927)
Identifiable assets	105,381	72,296	177,677

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

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

(Dollars in Thousands)

Description	Balance at Beginning of Period	Additions: Charged to Costs and Expenses	Additions: Charged to Other Accounts	Deductions	Balance at End of Period
Year ended December 31, 1997 Allowances for:					
Doubtful accounts	$ 750	$ 226		$ 156	$ 820
Cash discounts	530	11,319		11,286	563
Sales returns	5,000			250	4,750
Total	$6,280	$11,545	$	$11,692	$6,133
Provision for inventory obsolescence	$3,218	$ 221	$	$ 2,282	$1,157
Year ended December 31, 1996 Allowances for:					
Doubtful accounts	$ 921	$ 903		$ 1,074	$ 750
Cash discounts	615	13,929		14,014	530
Sales returns	5,000				5,000
Total	$6,536	$14,832	$	$15,088	$6,280
Provision for inventory obsolescence	$2,641	$ 1,341	$	$ 764	$3,218
Year ended December 31, 1995 Allowances for:					
Doubtful accounts	$ 249	$ 260	$ 692(b)	$ 280	$ 921
Cash discounts	720	14,579		14,684	615
Sales returns	5,800	1,030	(800)(a)	1,030	5,000
Total	$6,769	$15,869	$ (108)	$15,994	$6,536
Provision for inventory obsolescence	$1,369	$ 1,072	$ 630(b)	$ 430	$2,641

(a) Charged to net sales.

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

NEW VALLEY CORPORATION

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 1997

REPORT OF INDEPENDENT ACCOUNTANTS

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

We have audited the accompanying consolidated balance sheets of New Valley Corporation and subsidiaries as of December 31, 1997 and 1996, and the related consolidated statements of operations, changes in shareholders' equity (deficit), and cash flows for each of the three years for the period ended December 31, 1997. We have also audited the financial statement schedule of New Valley Corporation (Schedule III - Real Estate and Accumulated Depreciation as of December 31, 1997 and 1996) listed in the index on page 29 of this Form 10-K. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We did not audit the financial statements of Thinking Machines Corporation, a consolidated subsidiary, which statements reflect total assets constituting 1% and 3% of consolidated total assets at December 31, 1997 and 1996, respectively and a net loss (net of minority interest therein) constituting 25% and 90% of the consolidated net loss for the years ended December 31, 1997 and 1996, respectively. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Thinking Machines Corporation, are based solely upon the report of the other auditors.

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

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of New Valley Corporation and subsidiaries at December 31, 1997 and 1996, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 1997 in conformity with generally accepted accounting principles. In addition, in our opinion, the financial statement schedule referred to above, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information required to be included therein.

COOPERS & LYBRAND L.L.P.

Miami, Florida
March 31, 1998

NEW VALLEY CORPORATION AND SUBSIDIARIES

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

	DECEMBER 31, 1997	DECEMBER 31, 1996
ASSETS		
Current assets:		
Cash and cash equivalents	$ 11,606	$ 57,282
Investment securities available for sale	51,993	61,454
Trading securities owned	49,988	29,761
Restricted assets	232	2,080
Receivable from clearing brokers	1,205	23,870
Other current assets	3,618	9,273
Total current assets	118,642	183,720
Investment in real estate	256,645	179,571
Furniture and equipment, net	12,194	--
Investment securities available for sale	--	2,716
Restricted assets	5,484	6,766
Long-term investments, net	27,224	13,270
Other assets	21,202	20,497
Total assets	$ 441,391	$ 406,540
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)		
Current liabilities:		
Margin loan payable	$ 13,012	$ --
Current portion of notes payable and long-term obligations	760	2,310
Accounts payable and accrued liabilities	57,722	44,888
Prepetition claims and restructuring accruals	12,611	15,526
Income taxes	18,413	18,243
Securities sold, not yet purchased	25,610	17,143
Total current liabilities	128,128	98,110
Notes payable	173,814	157,941
Other long-term liabilities	11,210	12,282
Redeemable preferred shares	258,638	210,571
Commitments and contingencies	--	--
Shareholders' equity (deficiency):		
Cumulative preferred shares; liquidation preference of $69,769, dividends in arrears: 1997 - $139,412; 1996 - $115,944	279	279
Common Shares, $.01 par value; 850,000,000 shares authorized; 9,577,624 and 191,551,586 shares outstanding	96	96
Additional paid-in capital	604,215	644,789
Accumulated deficiency	(742,427)	(721,854)
Unearned compensation on stock options	(158)	(731)
Unrealized gain on investment securities	7,596	5,057
Total shareholders' equity (deficiency)	(130,399)	(72,364)
Total liabilities and shareholders' equity (deficiency)	$ 441,391	$ 406,540

See accompanying Notes to Consolidated Financial Statements

NEW VALLEY CORPORATION AND SUBSIDIARIES

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

	YEAR ENDED DECEMBER 31,		
	1997	1996	1995
Revenues:			
Principal transactions, net	$ 16,754	$ 28,344	$ 18,237
Commissions	16,727	17,755	9,888
Corporate finance fees	12,514	10,230	5,942
Gain on sale of investments	20,492	10,014	7,078
Real estate leasing	27,067	23,559	--
Interest and dividends	9,417	16,951	21,047
Other income	5,470	5,101	5,538
Total revenues	108,441	111,954	67,730
Costs and expenses:			
Selling, general and administrative expenses	115,901	119,154	54,216
Interest	16,988	17,760	2,102
Recovery of restructuring charges	--	(9,706)	(2,044)
Write-down of long-term investments	3,796	1,001	11,790
Total costs and expenses	136,685	128,209	66,064
Income (loss) from continuing operations before income taxes, minority interests and extraordinary item	(28,244)	(16,255)	1,666
Income tax provision (benefit)	186	300	292
Minority interests in loss from continuing operations of consolidated subsidiary	3,237	3,339	--
Income (loss) from continuing operations	(25,193)	(13,216)	1,374
Discontinued operations (Note 4):			
Income (loss) from discontinued operations, net of minority interests of $416 in 1997 and $2,404 in 1996, and income taxes of and $480 in 1995	661	(3,818)	4,315
Gain on disposal of discontinued operations, net of minority interests of $2,884 and $1,502 in 1997 and 1996, and income taxes of and $1,400 in 1995	3,959	9,544	12,558
Income from discontinued operations	4,620	5,726	16,873
Net income (loss)	(20,573)	(7,490)	18,247
Dividend requirements on preferred shares	(68,475)	(61,949)	(72,303)
Excess of carrying value of redeemable preferred shares over cost of shares purchased	--	4,279	40,342
Net income (loss) applicable to Common Shares	$ (89,048)	$ (65,160)	$(13,714)

See accompanying Notes to Consolidated Financial Statements

NEW VALLEY CORPORATION AND SUBSIDIARIES

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

	YEAR ENDED DECEMBER 31,		
	1997	1996	1995
Income (loss) per common share (Basic):			
Continuing operations	$ (9.78)	$ (7.40)	$ (3.20)
Discontinued operations	.48	.60	1.77
Net income (loss)	$ (9.30)	$ (6.80)	$ (1.43)
Number of shares used in computation	9,578,000	9,578,000	9,554,000
Income (loss) per common share (Diluted):			
Continuing operations	$ (9.78)	$ (7.40)	$ (3.20)
Discontinued operations	.48	.60	1.77
Net income (loss)	$ (9.30)	$ (6.80)	$ (1.43)
Number of shares used in computation	9,578,000	9,578,000	9,554,000
Supplemental information:			
Additional interest expense, absent the Chapter 11 filing			$ 2,314

See accompanying Notes to Consolidated Financial Statements

NEW VALLEY CORPORATION AND SUBSIDIARIES

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

	CLASS B PREFERRED SHARES	COMMON SHARES	ADDITIONAL PAID-IN CAPITAL	ACCUMULATED DEFICIT	UNEARNED COMPENSATION ON STOCK OPTIONS	UNREALIZED GAINS
Balance, December 31, 1994	$ 279	$ 1,887	$692,001	$(732,611)		
Net income				18,247		
Undeclared dividends and accretion on redeemable preferred shares			(53,821)			
Purchase of redeemable preferred shares			40,342			
Exercise of stock options		29	536			
Unrealized gain on investment securities, net of taxes						$2,650
Balance, December 31, 1995	279	1,916	679,058	(714,364)		2,650
Net loss				(7,490)		
Undeclared dividends and accretion on redeemable preferred shares			(41,123)			
Purchase of redeemable preferred shares			4,279			
Effect of 1-for-20 reverse stock split		(1,820)	1,820			
Issuance of stock options			755		$ (755)	
Compensation expense on stock option grants					24	
Unrealized gain on investment securities						2,407
Balance, December 31, 1996	279	96	644,789	(721,854)	(731)	5,057
Net loss				(20,573)		
Undeclared dividends and accretion on redeemable preferred shares			(45,148)			
Unrealized gain on investment securities						2,539
Compensation expense on stock option grants					15	
Adjustment to unearned compensation on stock options			(558)		558	
Public sale of subsidiaries' common stock, net			5,132			
Balance, December 31, 1997	$ 279	$ 96	$604,215	$(742,427)	$ (158)	$7,596

NEW VALLEY CORPORATION AND SUBSIDIARIES

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

	YEAR ENDED DECEMBER 31,		
	1997	1996	1995
Cash flows from operating activities:			
Net income (loss)	$ (20,573)	$ (7,490)	$ 18,247
Adjustments to reconcile net income (loss) to net cash used for operating activities:			
Gain on disposal of business	--	(9,544)	(12,558)
Loss (income) from discontinued operations	(661)	3,818	(4,315)
Depreciation and amortization	9,414	4,757	608
Provision for loss on long-term investments	3,796	1,001	11,790
Reversal of restructuring accruals		(9,706)	(2,044)
Stock Compensation Expense	2,934	--	--
Changes in assets and liabilities, net of effects from acquisition:			
Decrease (increase) in receivables and other assets	1,774	(16,069)	11,684
Decrease in income taxes payable and deferred taxes	170	(2,040)	(32,517)
Increase (decrease) in securities sold not yet purchased	8,467	4,096	(9,359)
Increase (decrease) in accounts payable and accrued Liabilities	(3,954)	6,437	5,223
Net cash used for continuing operations	1,367	(24,740)	(13,241)
Net cash provided from discontinued operations	(1,616)	2,041	6,105
Net cash used for operating activities	(249)	(22,699)	(7,136)
Cash flows from investing activities:			
Sale or maturity of investment securities	45,472	160,088	250,129
Purchase of investment securities	(30,756)	(12,825)	(458,017)
Sale or liquidation of long-term investments	2,807	18,292	36,109
Purchase of long-term investments	(18,707)	(3,051)	(77,411)
Decrease (increase) in restricted assets	3,130	29,159	341,634
Purchase of furniture and equipment	(3,478)	(5,240)	--
Purchase of and additions to real estate	(7,454)	(24,496)	--
Sale of real estate	8,718		
Payment of prepetition claims and restructuring accruals	(828)	(8,160)	(584,397)
Payment for acquisitions, net of cash acquired	(20,014)	1,915	(25,750)
Collection of contract receivable	--	--	300,000
Net proceeds from disposal of business	--	10,174	17,540
Net cash (used for) provided from investing activities	(21,110)	165,856	(200,163)
Cash flows from financing activities:			
Payment of preferred dividends	--	(41,419)	(132,162)
Purchase of redeemable preferred shares	--	(10,530)	(47,761)
Increase (decrease) in margin loan payable	13,012	(75,119)	75,119
Payment of long-term notes and other liabilities	(62,739)	(10,549)	(12,890)
Increase in long term borrowings	19,993	--	--
Issuance of subsidiary stock	5,417	--	--
Exercise of stock options	--	--	565
Net cash used for financing activities	(24,317)	(137,617)	(117,129)
Net (decrease) increase in cash and cash equivalents	(45,676)	5,540	(324,428)
Cash and cash equivalents, beginning of year	57,282	51,742	376,170
Cash and cash equivalents, end of year	$ 11,606	$ 57,282	$ 51,742

See accompanying Notes to Consolidated Financial Statements

NEW VALLEY CORPORATION AND SUBSIDIARIES

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

	YEAR ENDED DECEMBER 31,		
	1997	1996	1995
Supplemental cash flow information:			
Cash paid during the year for:			
Interest	$ 16,667	$17,482	$ 2,105
Income taxes	116	2,341	33,662
Detail of acquisitions:			
Fair value of assets acquired	$ 94,114	$27,301	$59,066
Liabilities assumed	74,100	16,701	32,316
Cash paid	20,014	10,600	26,750
Less cash acquired	--	(12,515)	(1,000)
Net cash (paid) received for acquisition	$(20,014)	$ 1,915	$(25,750)

See accompanying Notes to Consolidated Financial Statements

1. BASIS OF PRESENTATION

PRINCIPLES OF CONSOLIDATION

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

Certain amounts in the 1995 and 1996 financial statements have been reclassified to conform to the 1997 presentation.

NATURE OF OPERATIONS

The Company and its subsidiaries are engaged in the investment banking and brokerage business, in the ownership and management of commercial real estate, and in the acquisition of operating companies. As discussed in Note 21, the investment banking and brokerage segment accounted for 52% and 64% of the Company's revenues and 35% and 2% of the Company's operating loss from continuing operations for the years ended December 31, 1997 and 1996, respectively. The Company's investment banking and brokerage segment provides its services principally for middle market and emerging growth companies through a coordinated effort among corporate finance, research, capital markets, investment management, brokerage and trading professionals.

REORGANIZATION

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

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

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

On January 18, 1995, the effective date of the Joint Plan, the Company paid approximately $550,000 on account of allowed prepetition claims and emerged from bankruptcy. At December 31, 1997, the Company's remaining accruals totaled $12,611 for unsettled prepetition claims and restructuring accruals (see Note 17). The Company's accounting policy is to evaluate the remaining restructuring accruals on a quarterly basis and adjust liabilities as claims are settled or dismissed by the Bankruptcy Court.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

CASH AND CASH EQUIVALENTS. The Company considers all highly liquid financial instruments with an original maturity of less than three months to be cash equivalents.

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

INVESTMENT SECURITIES. The Company classifies investments in debt and marketable equity securities as either trading, available for sale, or held to maturity. Trading securities are carried at fair value, with unrealized gains and losses included in income. Investments classified as available for sale are carried at fair value, with net unrealized gains and losses included as a separate component of shareholders' equity (deficit). Debt securities classified as held to maturity are carried at amortized cost. Realized gains and losses are included in other income, except for those relating to the Company's broker-dealer subsidiary which are included in principal transactions revenues. The cost of securities sold is determined based on average cost.

RESTRICTED ASSETS. Restricted assets at December 31, 1997 consisted primarily of $5,484 pledged as collateral for a $5,000 letter of credit which is used as collateral for a long-term lease of commercial office space. Restricted assets at December 31, 1996 consisted primarily of $5,266 pledged as collateral for a $5,000 letter of credit which is used as collateral for a long-term lease of commercial office space, and $3,275 pledged as collateral for a letter of credit which is used as collateral for an insurance policy.

PROPERTY AND EQUIPMENT. Office buildings are depreciated over periods approximating 40 years, the estimated useful life, using the straight-line method (see Note 7). Shopping centers are depreciated over periods approximating 25 years, the estimated useful life, using the straight-line

method. Furniture and equipment (including equipment subject to capital leases) is depreciated over the estimated useful lives, using the straight-line method. Leasehold improvements are amortized on a straight-line basis over their estimated useful lives or the lease term, if shorter. The cost and the related accumulated depreciation are eliminated upon retirement or other disposition and any resulting gain or loss is reflected in operations. Depreciation and amortization expense was $9,414, $4,757, and $608 in 1997, 1996, and 1995, respectively.

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

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

REAL ESTATE LEASING REVENUES. The real estate properties are being leased to tenants under operating leases. Base rental revenue is generally recognized on a straight-line basis over the term of the lease. The lease agreements for certain properties contain provisions which provide for reimbursement of real estate taxes and operating expenses over base year amounts, and in certain cases as fixed increases in rent. In addition, the lease agreements for certain tenants provide additional rentals based upon revenues in excess of base amounts, and such amounts are accrued as earned. The future minimum rents scheduled to be received on non-cancelable operating leases at December 31, 1997 are $29,130, $25,796, $21,138, $14,156, $12,341 for the years 1998, 1999, 2000, 2001 and 2002, respectively, and $30,259 for subsequent years.

BASIC INCOME (LOSS) PER COMMON SHARE. Basic net income (loss) per common share is based on the weighted average number of Common Shares outstanding. Net income (loss) per common share represents net income (loss) after dividend requirements on redeemable and non-redeemable preferred shares (undeclared) and any adjustment for the difference between excess of carrying value of redeemable preferred shares over the cost of the shares purchased. Diluted net income (loss) per common share assuming full dilution is based on the weighted average number of Common Shares outstanding plus the additional common shares resulting from the conversion of convertible preferred shares and the exercise of stock options and warrants if such conversion was dilutive.

Options to purchase 330,000 common shares at $.58 per and 40,417 common shares issuable upon the conversion of Class B Preferred Shares were not included in the computation of diluted loss per share as the effect would have been anti-dilutive.

In February 1997, the Financial Accounting Standards Board ("FASB") issued SFAS No. 128, "Earnings Per Share". SFAS No. 128 specifies new standards designed to improve the earnings per share ("EPS") information provided in financial statements by simplifying the existing computational guidelines, revising the disclosure requirements, and increasing the comparability of EPS data on an international basis. Prior years' EPS have been restated to conform with standards established by SFAS No. 128.

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

NEW ACCOUNTING PRONOUNCEMENTS.

In June 1997, the FASB released SFAS No. 130, "Reporting Comprehensive Income). SFAS No. 130 establishes standards for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements and is effective for fiscal years beginning after December 15, 1997. The Company believes that adoption of SFAS No. 130 will not have a material impact on the Company's financial statements.

In October 1997, the AICPA issued SOP 97-2, "Software Revenue Recognition". SOP 97-2 provides guidance in recognizing revenue on software transactions when persuasive evidence of an arrangement exists, delivery has occurred, the vendor's fee is fixed or determinable and collectibility is probably. SOP 97-2 is effective for transactions entered into in fiscal years beginning after December 15, 1997. The Company believes that adoption of SOP 97-2 will not have a material impact on the Company's financial statements.

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

3. ACQUISITIONS

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

On January 10 and January 11, 1996, the Company acquired four commercial office buildings (the "Office Buildings") and eight shopping centers (the "Shopping Centers") for an aggregate purchase price of $183,900, consisting of $23,900 in cash and $160,000 in non-recourse mortgage financing provided by the sellers. In addition, the Company has capitalized approximately $800 in costs related to the acquisitions. The Company paid $11,400 in cash and executed four promissory notes aggregating $100,000 for the Office Buildings. The Shopping Centers were acquired for an aggregate purchase price of $72,500, consisting of $12,500 in cash and $60,000 in eight promissory notes. In November 1997, the Company sold one of the Shopping Centers for $5,400 and realized a gain of $1,200.

On January 11, 1996, the Company provided a $10,600 convertible bridge loan to finance Thinking Machines Corporation ("Thinking Machines"), a developer and marketer of data mining and knowledge discovery software and services. In February 1996, the bridge loan was converted into a controlling interest in a partnership which held approximately 61.4% of Thinking Machines' outstanding common shares. In December 1997, the Company acquired for $3,150 additional shares in Thinking Machines pursuant to a rights offering by Thinking Machines to its existing shareholders which increased the Company's ownership to approximately 72.7% of the outstanding Thinking Machines shares. As a result of the rights offering, the Company recorded $2,417 as additional paid-in-capital which represented its interest in the increase in Thinking Machines' shareholders' equity. The acquisition of Thinking Machines through the conversion of the bridge loan was accounted for as a purchase for financial reporting purposes, and accordingly, the operations of Thinking Machines subsequent to January 31, 1996 are included in the operations of the Company. The fair value of assets acquired, including goodwill of $1,726, was $27,301 and liabilities assumed totaled $7,613. In addition, minority interests in the amount of $9,088 were recognized at the time of acquisition. To date, no material revenues have been recognized by Thinking Machines with respect to the sale or licensing of such software and services. Thinking Machines is also subject to uncertainties relating to, without limitation, the development and marketing of computer products, including customer acceptance and required funding, technological changes, capitalization, and the ability to utilize and exploit its intellectual property and propriety software technology.

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

BML is developing a three-phase complex on 2.2 acres of land in downtown Moscow. In 1993, the first phase of the project, Ducat Place I, a 46,500 sq. ft. Class-A office building, was constructed and leased. On April 18, 1997, BML sold Ducat Place I to one of its tenants for approximately $7,500, which purchase price had been reduced to reflect prepayments of rent. In 1997, BML completed construction of Ducat Place II, a 150,000 sq. ft. office building. Ducat Place II has been leased to a number of leading international companies. The third phase, Ducat Place III, is planned as a 350,000 sq. ft. mixed-use complex, with construction anticipated to commence in 1999.

In connection with the Purchase Agreement, certain specified liabilities of BML aggregating approximately $40,000 remained as liabilities of BML after the purchase of the BML Shares by the Company. These liabilities included a $20,400 loan to a Russian bank for the construction of Ducat Place II (the "Construction Loan"). In addition, the liabilities of BML at the time of purchase included approximately $13,800 of rents and related payments prepaid by tenants of Ducat Place II for periods generally ranging from 15 to 18 months.

In August 1997, BML refinanced all amounts due under the Construction Loan with borrowings under a new credit facility with another Russian bank. The new credit facility bears interest at 16% per year, matures no later than August 2002, with principal payments commencing after the first year, and is collateralized by a mortgage on Ducat Place II and guaranteed by the Company. At December 31, 1997, borrowings under the new credit facility totaled $20,078.

In February 1998, the Company entered into a joint venture to make real estate and other investments in Russia to which the real estate assets of BML, including Ducat Place II and the site for Ducat Place III, will be contributed (see Note 22).

4. DISCONTINUED OPERATIONS

As noted above, the Company sold the Messaging Services Business effective October 1, 1995. During the fourth quarter of 1996, Thinking Machines adopted a plan to terminate its parallel processing computer sales and service business. Consequently, the operating results of this segment have been classified as discontinued operations. Thinking Machines wrote-down certain assets, principally inventory, related to these operations to their net realizable value and recorded a charge of $6,200 for these reserves, which is included in the loss on discontinued operations. Accordingly, the financial statements reflect the financial position and the results of operations of the discontinued operations of FSI, the Messaging Services Business, and Thinking Machines separately from continuing operations.

Summarized operating results of the discontinued operations, as shown below, include the discontinued operations of Thinking Machines for the year ended December 31, 1997 and the eleven months ended December 31, 1996 and the Messaging Services Business for the nine months ended September 30, 1995.

NEW VALLEY CORPORATION AND SUBSIDIARIES

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

	YEAR ENDED DECEMBER 31,		
	1997	1996	1995
Revenues	$ 3,386	$15,017	$37,771
Operating (loss) income	$ 1,077	$ (6,222)	$ 4,795
Income before income taxes and minority Interests	$ 1,077	$ (6,222)	$ 4,795
Provision for income taxes	--	--	480
Minority interests	416	2,404	--
Net (loss) income	$ 661	$ (3,818)	$ 4,315

In December 1996, Thinking Machines sold part of its discontinued operations for $4,300 in cash which resulted in the Company recording a gain on disposal of discontinued operations of $2,386, net of minority interests of $1,502. In April 1997, Thinking Machines sold the remaining part of its discontinued operations for $2,405 in cash and a percentage of certain future operating profits. The sale resulted in the Company recording a loss on disposal of discontinued operations of $470, after the recognition of minority interests of $592 and the write-off of goodwill of $1,410. During 1997, Thinking Machines received profit participation payments totaling $1,176, which the Company recorded as a gain on discontinued operations of $742, representing its average ownership percentage of Thinking Machines in 1997.

During the fourth quarter of 1996, the Company received $5,774 in cash and $600 in a promissory note (paid in 1997) in settlement of a receivable claim originally began by Western Union Telegraph Company. In addition, the Company reduced its liability related to certain Western Union retirees by $784. The Company recorded the gain on settlement of $6,374 and liability reduction of $784 as gain on disposal of discontinued operations. During 1997, the Company recorded a gain on disposal of discontinued operations of $3,687 related to reversals in estimates of certain pre-petition claims under Chapter 11 and restructuring which resulted from the Company's Money Transfer business.

5. INVESTMENT SECURITIES AVAILABLE FOR SALE

Investment securities classified as available for sale are carried at fair value, with net unrealized gains included as a separate component of shareholders' equity (deficit). The Company had net unrealized gains on sales of investment securities available for sale of $7,596 ($12,431 of unrealized gains and $4,835 of unrealized losses) for the year ended December 31, 1997 and $1,347 ($6,114 of unrealized gains and $4,767 of unrealized losses) for the year ended December 31, 1996.

NEW VALLEY CORPORATION AND SUBSIDIARIES

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

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

	COST	GROSS UNREALIZED GAIN	GROSS UNREALIZED LOSS	FAIR VALUE
1997				
Short-term investments	$ 6,218	--	--	$ 6,218
Marketable equity securities	34,494	$ 7,492	$ 2,101	39,885
Marketable warrants	--	4,939	--	4,939
Marketable debt securities	3,685	--	2,734	951
Investment securities	$ 44,397	$ 12,431	$ 4,835	$ 51,993
1996				
Marketable equity securities	$ 55,429	$ 6,501	$ 476	$ 61,454
Marketable debt securities (long-term)	3,685	--	969	2,716
Total securities available for sale	59,114	6,501	1,445	64,170
Less long-term portion of investment securities	(3,685)	--	(969)	(2,716)
Investment securities - current portion	$ 55,429	$ 6,501	$ 476	$ 61,454

Included in marketable debt securities are acquired securities with a face amount of $14,900 (cost of $3,185) of a company that was in default at the time of purchase and is currently in default under its various debt obligations.

INVESTMENT IN RJR NABISCO

As of December 31, 1997 and 1996, the Company held 612,650 and 1,741,150, respectively, shares of common stock of RJR Nabisco Holdings Corp. ("RJR Nabisco") with a market value of $22,898 (cost of $18,780) and $59,199 (cost of $53,372), respectively. The Company expensed $100 in 1997, $11,724 in 1996 and $3,879 in 1995 relating to the RJR Nabisco investment.

In June 1996, various agreements between High River Limited Partnership ("High River"), the Company and Brooke were terminated by mutual consent. Pursuant to these agreements the parties had agreed to take certain actions during late 1995 and throughout 1996 designed to cause RJR Nabisco to effectuate a spinoff of its food business, Nabisco Holdings Corp. The termination of the High River agreements left in effect for one year certain provisions concerning payments to be made to High River in the event the Company achieved a profit (after deducting certain expenses) on the sale of the shares of RJR Nabisco common stock which were held by it or they were valued at the end of such year at higher than their purchase price or in the event Brooke or its affiliates engaged in certain transactions with RJR Nabisco. Based on the market price of RJR Nabisco common stock, no amounts were payable by the Company under these agreements.

Pursuant to a December 31, 1995 agreement between the Company and Brooke whereby the Company agreed to reimburse Brooke and its subsidiaries for certain reasonable out-of-pocket expenses relating to RJR Nabisco, the Company paid Brooke and its subsidiaries a total of $17 and $2,370 in 1997 and 1996.

On February 29, 1996, the Company entered into a total return equity swap transaction (the "Swap") with an unaffiliated company (the "Counterparty") relating to 1,000,000 shares of RJR Nabisco common stock (reduced to 750,000 shares of RJR Nabisco common stock as of August 13, 1996). The Company entered into the Swap in order to be able to participate in any increase or decrease in the value of the RJR Nabisco common stock during the term of the Swap. The transaction was for a period of up to six months, unless extended by the parties, subject to earlier termination at the election of the Company, and provided for the Company to make a payment to the Counterparty of $1,537 upon commencement of the Swap. At the termination of the transaction, if the price of the RJR Nabisco common stock during a specified period prior to such date (the "Final Price") exceeded $34.42,

NEW VALLEY CORPORATION AND SUBSIDIARIES

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

the price of the RJR Nabisco common stock during a specified period following the commencement of the Swap (the "Initial Price"), the Counterparty was required to pay the Company an amount in cash equal to the amount of such appreciation with respect to the shares of RJR Nabisco common stock subject to the Swap plus the value of any dividends with a record date occurring during the Swap period. If the Final Price was less than the Initial Price, then the Company was required to pay the Counterparty at the termination of the transaction an amount in cash equal to the amount of such decline with respect to the shares of RJR Nabisco common stock subject to the Swap, offset by the value of any dividends, provided that, with respect to approximately 225,000 shares of RJR Nabisco common stock, the Company was not 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 were guaranteed by the Counterparty's parent, a large foreign bank, and the Company pledged certain collateral in respect of its potential obligations under the Swap and agreed to pledge additional collateral under certain conditions. The Company marked its obligation with respect to the Swap to fair value with unrealized gains or losses included in income. During the third quarter of 1997, the Swap was terminated in connection with the Company's reduction of its holdings of RJR Nabisco common stock, and the Company recognized a loss on the Swap of $7,305 for the year ended December 31, 1996.

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

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

	DECEMBER 31, 1997		DECEMBER 31, 1996	
	TRADING SECURITIES OWNED	SECURITIES SOLD, NOT YET PURCHASED	TRADING SECURITIES OWNED	SECURITIES SOLD, NOT YET PURCHASED
Common stock	$ 16,208	$ 4,513	$21,248	$ 5,900
Equity and index options	5,290	17,494	6,241	11,243
Other	28,490	3,603	2,272	--
	$ 49,988	$ 25,610	$29,761	$17,143

7. INVESTMENT IN REAL ESTATE AND NOTES PAYABLE

The components of the Company's investment in real estate and the related non-recourse notes payable collateralized by such real estate at December 31, 1997 are as follows:

	U.S. OFFICE BUILDINGS	RUSSIAN OFFICE BUILDINGS	SHOPPING CENTERS	TOTAL
Land	$ 19,450	$ 19,300	$ 16,087	$ 54,837
Buildings	92,332	66,688	51,430	210,450
Total	111,782	85,988	67,517	265,287
Less accumulated depreciated	(4,616)	(879)	(3,147)	(8,642)
Net investment in real estate	$107,166	$ 85,109	$ 64,370	$256,645
Notes payable	$ 99,302	$ 20,078	$ 54,801	$174,181
Current portion of notes payable	336	424		760
Notes payable - long-term portion	$ 98,966	$ 19,654	$ 54,801	$173,421

NEW VALLEY CORPORATION AND SUBSIDIARIES

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

At December 31, 1997, the Company's investment in real estate collateralized four promissory notes aggregating $99,302 related to the Office Buildings and eight promissory notes aggregating $54,801 related to the Shopping Centers. The Office Building notes bear interest at 7.5%, require principal amortization over approximately 40 years, with maturity dates ranging from 2006 to 2011. The Office Building notes have fixed monthly principal and interest payments aggregating $648. Each Shopping Center note has a term of five years, requires no principal amortization, and bears interest payable monthly at the rate of 8% for the first two and one-half years and at the rate of 9% for the remainder of the term. In November 1997, the Company sold one of the Shopping Centers for $5,400 and realized a gain of $1,200.

Required principal payments on the notes payable over the next five years are $760 in 1998, $5,675 in 1999, $7,243 in 2000, $62,741 in 2001 and $462 in 2002 and $97,300 thereafter.

8. LONG-TERM INVESTMENTS

Long-term investments consisted of investments in the following:

	DECEMBER 31, 1997		DECEMBER 31, 1996	
	CARRYING VALUE	FAIR VALUE	CARRYING VALUE	FAIR VALUE
Limited partnerships.......	$ 27,224	$ 33,329	$ 7,054	$ 7,914
Foreign corporations.......	--	--	2,000	2,000
Joint venture..............	--	--	3,796	3,796
Other......................	--	--	420	420
Total	$ 27,224	$ 33,329	$13,270	$14,130

The principal business of the limited partnerships is investing in investment securities. The estimated fair value of the limited partnerships was provided by the partnerships based on the indicated market values of the underlying investment portfolio. The Company is required under certain limited partnership agreements to make additional investments up to an aggregate of $5,740 as of December 31, 1997. The Company's investments in limited partnerships are illiquid, and the ultimate realization of these investments is subject to the performance of the underlying partnership and its management by the general partners. During 1997, the Company sold for an amount which approximated its $2,000 cost an investment in a foreign corporation which owned an interest in a Russian bank. During 1997, the Company determined that an other than temporary impairment in the value of its investment in a joint venture had occurred and wrote-down this investment to zero with a charge to operations of $3,796.

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

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

9. PENSIONS AND RETIREE BENEFITS

Ladenburg has a Profit Sharing Plan (the "Plan") for substantially all its employees. The Plan includes two features: profit sharing and a deferred compensation vehicle. Contributions to the profit sharing portion of the Plan are made by Ladenburg on a discretionary basis. The deferred compensation feature of the Plan enables non-salaried employees to invest up to 15% of their pre-tax annual compensation. For the years ended December 31, 1996 and 1995, employer contributions to the Plan were approximately $200 in each year, excluding those made under the deferred compensation feature described above. The Plan was inactive in 1997.

The Company maintains 401(k) plans for substantially all employees, except those employees of Thinking Machines. These 401(k) plans allow eligible employees to invest a percentage of their pre-tax compensation. The Company committed to contribute $500 of matching contributions in 1997. The Company did not make discretionary contributions to these 401(k) plans in 1996.

10. COMMITMENT AND CONTINGENCIES

LEASES

The Company, Thinking Machines and Ladenburg are currently obligated under three noncancelable lease agreements for office space, expiring in September 2000, October 1998 and December 2015, respectively. The following is a schedule by fiscal year of future minimum rental payments required under the agreements that have noncancelable terms of one year or more at December 31, 1997:

1998	$ 4,615
1999	4,279
2000	4,042
2001	3,552
2002	3,795
2003 and thereafter	50,246
Total	$ 70,529

Rental expense for operating leases during 1997, 1996 and 1995 was $4,076, $3,914 and $1,677, respectively.

LAWSUITS

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

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

NEW VALLEY CORPORATION AND SUBSIDIARIES

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

11. FEDERAL INCOME TAX

At December 31, 1997, the Company had $97,444 of unrecognized net deferred tax assets, comprised primarily of net operating loss carryforwards, available to offset future taxable income for federal tax purposes. A valuation allowance has been provided against this deferred tax asset as it is presently deemed more likely than not that the benefit of the tax asset will not be utilized. The Company continues to evaluate the realizability of its deferred tax assets and its estimate is subject to change. The provision for income taxes, which represented the effect of the Alternative Minimum Tax and state income taxes, for the three years ended December 31, 1997, 1996 and 1995, does not bear a customary relationship with pre-tax accounting income from continuing operations principally as a consequence of the change in the valuation allowance relating to deferred tax assets. The provision for income taxes on continuing operations differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate (35%) to pretax income from continuing operations as a result of the following differences:

	1997	1996	1995
(Loss) income from continuing operations	$ (25,007)	$(12,916)	$1,666
(Credit) provision under statutory U.S. tax rates	(8,752)	(4,521)	583
(Decrease) increase in taxes resulting from:			
Nontaxable items	2,603	(224)	543
State taxes, net of Federal benefit	55	195	180
Foreign Taxes	108		
Increase (decrease) in valuation reserve	6,172	4,850	(1,014)
Income tax provision (benefit)	$ 186	$ 300	$ 292

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

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

	1997	1996
Deferred tax assets:		
Net operating loss carryforward:		
Restricted net operating loss	$15,561	$18,675
Unrestricted net operating loss	70,216	65,237
Other	17,209	10,399
Total deferred tax assets	102,986	94,311
Deferred tax liabilities:		
Other	(5,542)	(3,039)
Total deferred tax liabilities	(5,542)	(3,039)
Net deferred tax assets	97,444	91,272
Valuation allowance	(97,444)	(91,272)
Net deferred taxes	$ --	$ --

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

As of December 31, 1997, the Company had consolidated net operating loss carryforwards of approximately $213,000 for tax purposes, which expire at various dates through 2008. Approximately $38,700 net operating loss carryforwards constitute pre-change losses and $174,300 of net operating losses were unrestricted.

12. OTHER LONG-TERM LIABILITIES

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

	DECEMBER 31,			
	1997		1996	
	LONG-TERM PORTION	CURRENT PORTION	LONG-TERM PORTION	CURRENT PORTION
Retiree and disability obligations..............	$ 3,638	$ 2,000	$ 6,774	$1,700
Minority interests..............................	6,112	--	4,775	--
Other long-term liabilities.....................	1,460	--	733	300
Total other long-term liabilities...............	$ 11,210	$ 2,000	$12,282	$2,000

13. REDEEMABLE PREFERRED SHARES

At December 31, 1997 and 1996, the Company had authorized and outstanding 2,000,000 and 1,071,462, respectively, of its Class A Senior Preferred Shares. At December 31, 1997 and 1996, respectively, the carrying value of such shares amounted to $258,638 and $210,571, including undeclared dividends of $163,302 and $117,117, or $152.41 and $109.31 per share.

The holders of Class A Senior Preferred Shares are currently entitled to receive a quarterly dividend, as declared by the Board, payable at the rate of $19.00 per annum. The Class A Senior Preferred Shares are mandatorily redeemable on January 1, 2003 at $100 per share plus accrued dividends. The Class A Senior Preferred Shares were recorded at their market value ($80 per share) at December 30, 1987, the date of issuance. The discount from the liquidation value is accreted, utilizing the interest method, as a charge to additional paid-in capital and an increase to the recorded value of the Class A Senior Preferred Shares, through the redemption date. As of December 31, 1997, the unamortized discount on the Class A Senior Preferred Shares was $4,918.

In the event a required dividend or redemption is not made on the Class A Senior Preferred Shares, no dividends shall be paid or declared and no distribution made on any junior stock other than a dividend payable in junior stock. If at any time six quarterly dividends payable on the Class A Senior Preferred Shares shall be in arrears or such shares are not redeemed when required, the number of directors will be increased by two and the

holders of the Class A Senior Preferred Shares, voting as a class, will have the right to elect two directors until full cumulative dividends shall have been paid or declared and set aside for payment. Such directors were designated pursuant to the Joint Plan in November 1994.

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

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

On November 18, 1996, the Company granted to an executive officer and director of the Company 36,000 Class A Senior Preferred Shares (the "Award Shares"). The Award Shares are identical with all other Class A Senior Preferred Shares issued and outstanding as of July 1, 1996, including undeclared dividends of $3,776 and declared dividends of $1,080. The Award Shares vested one-sixth on July 1, 1997 and one-sixth on each of the five succeeding one-year anniversaries thereof through and including July 1, 2002. The Company recorded deferred compensation of $5,436 representing the fair market value of the Award Shares on November 18, 1996 and $3,020 of original issue discount representing the difference between the book value of the Award Shares on November 18, 1996 and their fair market value. The deferred compensation will be amortized over the vesting period and the original issue discount will be accreted, utilizing the interest method, through the redemption date, both through a charge to compensation expense. During 1997 and 1996, the Company recorded $2,934 and $359, respectively, in compensation expense related to the Award Shares and, at December 31, 1997 and 1996, the balance of the deferred compensation and the unamortized discount related to the Award Shares was $6,890 and $8,097, respectively.

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

14. PREFERRED SHARES NOT SUBJECT TO REDEMPTION REQUIREMENTS

The holders of the $3.00 Class B Cumulative Convertible Preferred Shares ($25 Liquidation Value), $.10 par value per share (the "Class B Preferred Shares"), 12,000,000 shares authorized and 2,790,776 shares outstanding as of December 31, 1997 and 1996, are entitled to receive a quarterly dividend, as declared by the Board, at a rate of $3.00 per annum. Undeclared dividends are accrued quarterly at a rate of 12% per annum, and such accrued and unpaid dividends shall accrue additional dividends in respect thereof, compounded monthly at the rate of 12% per annum.

Each Class B Preferred Share is convertible at the option of the holder into .41667 Common Shares based on a $25 liquidation value and a conversion price of $60 per Common Share.

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

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

No dividends on the Class B Preferred Shares have been declared since the fourth quarter of 1988. The undeclared dividends, as adjusted for conversions of Class B Preferred Shares into Common Shares, cumulatively amounted to $139,412 and $115,944 at December 31, 1997 and 1996, respectively. These undeclared dividends represent $49.95 and $41.55 per share as of the end of each period. No accrual was recorded for such undeclared dividends as the Class B Preferred Shares are not mandatorily redeemable.

15. COMMON SHARES

On November 18, 1996, the Company granted an executive officer and director of the Company nonqualified options to purchase 330,000 Common Shares at a price of $.58 per share and 97,000 Class B Preferred Shares at a price of $1.85 per share. These options may be exercised on or prior to July 1, 2006 and vest one-sixth on July 1, 1997 and one-sixth on each of the five succeeding anniversaries thereof through and including July 1, 2002. The Company recognized compensation expense of $15 in 1997 and $24 in 1996 from these option grants and recorded deferred compensation of $158 and $755 representing the intrinsic value of these options at December 31, 1997 and December 31, 1996, respectively.

The Company applies APB Opinion No. 25 and related Interpretations in accounting for its stock options. In 1995, the FASB issued SFAS No. 123, "Accounting for Stock-Based Compensation", which, if fully adopted, changes the methods of recognition of cost on certain stock options. Had compensation cost for the nonqualified stock options been determined based upon the fair value at the grant date consistent with SFAS No. 123, the Company's net loss in 1997 and 1996 would have been increased by $316 and $33, respectively. The fair value of the nonqualified stock options was estimated at $1,774 using the Black-Scholes option-pricing model with the following assumptions: volatility of 171% for the Class B Preferred Shares and 101% for the Common Shares, a risk free interest rate of 6.2%, an expected life of 10 years, and no expected dividends or forfeiture.

16. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	DECEMBER 31,	
	1997	1996
Accounts payable and accrued liabilities:		
Accrued compensation	$11,202	$10,378
Excise tax payable (a)	4,400	6,000
Subordinated loan payable (b)	2,500	4,000
Deferred rent	4,560	4,388
Unearned Revenues	10,163	
Taxes (property and miscellaneous)	5,029	2,637

NEW VALLEY CORPORATION AND SUBSIDIARIES

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

Accrued expenses and other liabilities	19,868	17,485
Total	$57,722	$44,888

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

(b) Represents a subordinated note payable held by Ladenburg's clearing broker.

17. PREPETITION CLAIMS UNDER CHAPTER 11 AND RESTRUCTURING ACCRUALS

On January 18, 1995, approximately $550,000 of the approximately $620,000 of prepetition claims were paid pursuant to the Joint Plan. Another $57,000 of prepetition claims and restructuring accruals have been settled and paid or adjusted since January 18, 1995. The remaining prepetition claims may be subject to future adjustments depending on pending discussions with the various parties and the decisions of the Bankruptcy Court.

	DECEMBER 31,	
	1997	1996
Restructuring accruals(a)	$ 8,196	$ 9,024
Money transfer payable(b)	4,415	6,502
Total	$12,611	$15,526

(a) Restructuring accruals at December 31, 1997 consisted of $6,907 of disputed claims, primarily related to leases and former employee benefits, and $1,289 of other restructuring accruals. In 1997, 1996 and 1995, the Company reversed $0, $9,706 and $2,044, respectively, of prior year restructuring accruals as a result of settlements on certain of its prepetition claims and vacated real estate lease obligations.

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

18. RELATED PARTY TRANSACTIONS

At December 31, 1997, Brooke, a company under the control of Bennett S. LeBow, Chairman of the Company's Board of Directors, held 3,989,710 Common Shares (approximately 41.7% of such class), 618,326 Class A Senior Preferred Shares (approximately 57.7% of such class), and 250,885 Class B Preferred Shares (approximately 8.9% of such class) which represented in the aggregate 42.1% of all voting power. Several of the other officers and directors of the Company are also affiliated with Brooke. In 1995, the Company signed an expense sharing agreement with Brooke pursuant to which certain lease, legal and administrative expenses are allocated to the entity incurring the expense. The Company expensed approximately $312, $462 and $571 under this agreement in 1997, 1996 and 1995, respectively.

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

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

Two directors of the Company are or have been affiliated with law firms that rendered legal services to the Company. The Company paid these firms $568 and $4,141 during 1997 and 1996, respectively, for legal services. An executive officer and director of the Company is a shareholder and registered representative in a broker-dealer to which the Company paid $522 and $317 in 1997 and 1996, respectively, in brokerage commissions and other income, and is also a shareholder in an insurance company that received ordinary and customary insurance commissions from the Company and its affiliates of $133 and $136 in 1997 and 1996, respectively. The broker-dealer, in the ordinary course of its business, engages in brokerage activities with Ladenburg on customary terms.

As discussed in Note 5, the Company has entered into certain other agreements with Brooke in connection with its investment in RJR Nabisco. Further, two directors of the Company were each paid $30 by Brooke during the fourth quarter of 1995 in connection with their agreement to serve as Brooke nominees of RJR Nabisco's 1996 annual meeting.

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

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

See Note 3 for information concerning the purchase by the Company on January 31, 1997 of BML from a subsidiary of Brooke.

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

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

The clearing operations for Ladenburg's securities transactions are provided by several brokers. At December 31, 1997, substantially all of the securities owned and the amounts due from brokers reflected in the consolidated balance sheet are positions held at and amounts due from one clearing broker. Ladenburg is subject to credit risk should this broker be unable to fulfill its obligations.

NEW VALLEY CORPORATION AND SUBSIDIARIES

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

In the normal course of its business, Ladenburg enters into transactions in financial instruments with off-balance-sheet risk. These financial instruments consist of financial futures contracts and written index option contracts. Financial futures contracts provide for the delayed delivery of a financial instrument with the seller agreeing to make delivery at a specified future date, at a specified price. These futures contracts involve elements of market risk in excess of the amounts recognized in the consolidated statement of financial condition. Risk arises from changes in the values of the underlying financial instruments or indices. At December 31, 1997, Ladenburg had commitments to purchase and sell financial instruments under futures contracts of $37,552 and $1,494, respectively.

Equity index options give the holder the right to buy or sell a specified number of units of a stock market index, at a specified price, within a specified time from the seller ("writer") of the option and are settled in cash. Ladenburg generally enters into these option contracts in order to reduce its exposure to market risk on securities owned. Risk arises from the potential inability of the counterparties to perform under the terms of the contracts and from changes in the value of a stock market index. As a writer of options, Ladenburg receives a premium in exchange for bearing the risk of unfavorable changes in the price of the securities underlying the option. Financial instruments have the following notional amounts as December 31, 1997:

	LONG	SHORT
Equity and index options.................	$60,448	$70,500
Financial futures contracts..............	37,317	1,475

The table below discloses the fair value at December 31, 1997 of these commitments, as well as the average fair value during the year ended December 31, 1997, based on monthly observations.

	DECEMBER 31, 1997		AVERAGE	
	LONG	SHORT	LONG	SHORT
Equity and index options..................	$ 5,290	$17,495	$8,850	$18,988
Financial futures contracts...............	37,552	1,494	6,206	1,454

For the years ended December 31, 1997, 1996 and 1995, the net loss arising from options and futures contracts included in net gain on principal transactions was $2,399, $6,012 and $4,504, respectively. The Company's accounting policy related to derivatives is to value these instruments, including financial futures contracts and written index option contracts, at the last reported sales price. The measurement of market risk is meaningful only when related and offsetting transactions are taken into consideration.

20. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

	DECEMBER 31, 1997		DECEMBER 31, 1996	
	CARRYING AMOUNT	FAIR VALUE	CARRYING AMOUNT	FAIR VALUE
Financial assets:				
Cash and cash equivalents	$ 11,606	$ 11,606	$ 57,282	$ 57,282
Investments available for sale	51,993	51,993	64,170	64,170
Trading securities owned	49,988	49,988	29,761	29,761
Restricted assets	5,716	5,716	8,846	8,846
Receivable from clearing brokers	1,205	1,205	23,870	23,870
Long-term investments (Note 8)	27,224	33,329	13,270	14,130
Financial liabilities:				
Notes payable	174,574	174,574	158,251	158,251
Redeemable preferred shares	258,638	102,860	210,571	132,908

21. BUSINESS SEGMENT INFORMATION

The following table presents certain financial information of the Company's continuing operations before taxes and minority interests as of and for the years ended December 31, 1997 and 1996:

	BROKER-DEALER	REAL ESTATE	COMPUTER SOFTWARE	CORPORATE AND OTHER	TOTAL
1997					
Revenues	$ 56,197	$27,067	$561	$24,616	$108,441
Operating income (loss)	(9,958)	(7,827)	(9,233)	(1,226)	(28,244)
Identifiable assets	77,511	276,770	5,604	81,506	441,391
Depreciation and amortization	1,035	7,469	815	95	9,414
Capital expenditures	1,627	7,454	466	1,385	10,932
1996					
Revenues	$71,960	$ 23,559	$ --	$ 16,435	$111,954
Operating income (loss)	(345)	(745)	(8,860)	(6,305)	(16,255)
Identifiable assets	76,302	182,645	11,686	135,787	406,540
Depreciation and Amortization	600	3,622	532	3	4,757
Capital expenditures	3,644	183,193	1,596	18	188,451

22. SUBSEQUENT EVENTS

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

Under the terms of the agreement governing Western Realty, the ownership and voting interests in Western Realty will be held equally by Apollo and the Company. Apollo will be entitled to a preference on

distributions of cash from Western Realty to the extent of its investment, together with a 15% annual rate of return, and the Company will then be entitled to a return of $10,000 of BML-related expenses incurred by the Company since March 1, 1997, together with a 15% annual rate of return; subsequent distributions will be made 70% to the Company and 30% to Apollo. Western Realty will be managed by a Board of Managers consisting of an equal number of representatives chosen by Apollo and the Company. All material corporate transactions by Western Realty will generally required the unanimous consent of the Board of Managers. Accordingly, the Company will account for its non-controlling interest in Western Realty on the equity method.

On February 27, 1998, at an initial closing under the LLC Agreement, Apollo made a $11,000 loan (the "Loan) to Western Realty. The Loan, which bears interest at the rate of 15% per annum and is due September 30, 1998, is collateralized by a pledge of the Company's shares of BML. Upon completion of the transfer of Ducat Place II and the satisfaction of other conditions under the LLC Agreement, the Loan and the accrued interest thereon will be converted into a capital contribution by Apollo to Western Realty and the BML pledge released.

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

EXHIBIT 10.23

BROOKE GROUP LTD.
100 S.E. SECOND STREET, 32ND FLOOR
MIAMI, FLORIDA 33131

January 1, 1998

Mr. Howard M. Lorber
100 S.E. Second Street, 32nd Floor
Miami, Florida 33131

Dear Mr. Lorber:

This letter sets forth the first amendment to the Amended and Restated Consulting Agreement (the "Agreement") dated as of January 1, 1996, between Brooke Group Ltd. and you.

1. The Agreement is amended by deleting the date "December 31, 1996" in Section 1 thereof and replacing it with the date "December 31, 1999".

2. The Agreement is amended by inserting the following at the end of Section 4 thereof:

> In addition to the foregoing, commencing January 1, 1998, BGL shall pay Consultant an additional bonus on or prior to April 1st in each year during the term of this Agreement. The additional bonus shall be in an amount equal to the amount, if any, necessary to reimburse Consultant, on an after-tax basis, for all applicable federal, state and self employment taxes actually incurred by Consultant as a result of the grant or vesting of any award of Common Stock or options to acquire Common Stock during the prior calendar year.

3. This letter agreement constitutes an amendment to and a modification of the Agreement and shall for all purposes be considered a part of the Agreement. Except as amended hereby, the Agreement is confirmed and ratified in all respects and shall remain in full force and effect.

Please indicate your agreement with the foregoing by countersigning two copies of this letter agreement in the space provided below and returning one of such copies to us.

Very truly yours,

BROOKE GROUP LTD.

By: /s/ Bennett S. LeBow

Bennett S. LeBow
Chairman, President and
Chief Executive Officer

AGREED TO AND ACCEPTED:

By: /s/ Howard M. Lorber

Howard M. Lorber

Exhibit 10.35

SETTLEMENT AGREEMENT

This Settlement Agreement is entered into this 12th day of March, 1998 by and among the States listed in Appendix A hereto (collectively, "Plaintiffs" or "Settling States") and Brooke Group Ltd., a Delaware corporation ("Brooke Group"), Liggett & Myers Inc., a Delaware corporation ("Myers"), and Liggett Group, Inc., a Delaware corporation (which, with Myers, is hereinafter referred to as "Liggett").

RECITALS

WHEREAS,

A. The Plaintiffs, by and through their respective Attorneys General, (the "Attorneys General") have brought or are contemplating bringing civil actions in various jurisdictions across the nation ("Actions") against, among others, The American Tobacco Company, Inc., B.A.T. Industries, P.L.C., British-American Tobacco Company Ltd., R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation, Philip Morris, Inc., Liggett & Myers, Inc., Lorillard Tobacco Company, and United States Tobacco Company and their various parent and related companies ("Defendants"), asserting claims for, among other things, expenses allegedly arising from tobacco-related matters and injunctive relief concerning sales of cigarettes to minors.

B. Because of the importance of this Settlement Agreement and the undertakings by Liggett and Brooke Group herein to the goals of the Attorneys General, including the prosecution of the Actions against Non-Settling Defendants, the Settling States have agreed to extend financial settlement terms to Liggett and Brooke Group, which will not be offered to any other Defendants, all as set forth in this Settlement Agreement.

C. The Attorneys General acknowledge and agree that this Settlement Agreement, including the cooperation provisions

thereof, are important to the prosecution of their Actions against the Non-Settling Defendants.

D. The Attorneys General and Liggett and Brooke Group recognize and support the public interest in preventing smoking by, or promotion of smoking to, children and adolescents.

E. Liggett and Brooke Group have denied, and continue to deny any wrongdoing or any legal liability of any kind in all of the above-mentioned actions. F. The Settling States and the Attorneys General recognize and acknowledge that the cooperation being provided by Liggett and Brooke Group is valuable to the continued prosecution of the claims against the tobacco industry and Non-Settling Defendants. Further, the Settling States and the Attorneys General acknowledge that the change in warning labels provided for in this Settlement Agreement is a step toward properly informing consumers more fully of the truth about cigarettes and the consequences of smoking, as is the statement by Liggett also provided for herein.

G. Members of the tobacco industry have for many years acted in concert to seek to deny, refute or dilute warnings concerning smoking issued by the United States Surgeon General, the Environmental Protection Agency and other respected health authorities. Liggett and Brooke Group have determined, in entering into agreements settling smoking-related litigation, that they will not be party to this industry activity.

Now, therefore, in consideration of the foregoing and of the promises and covenants set forth in this Agreement, the undersigned Attorneys General, on their own behalf and on behalf of their respective States, and Liggett and Brooke Group hereby stipulate and agree that the Settling States' Attorney General Actions shall be settled as against Liggett and Brooke Group, on the terms contained herein, as follows:

SECTION 1: DEFINITIONS.

As used in and solely for the purposes of this Agreement, in addition to terms defined elsewhere in the Agreement, the following terms shall have the following respective meanings:

1.1. "AFFILIATE" means a Present Affiliate or a Future Affiliate, as described below.

1.2. "AGREEMENT" means this Settlement Agreement.

1.3. "ATTORNEYS GENERAL" means those State Attorneys General who have brought (or are contemplating bringing) civil actions against the Defendants.

1.4. "ATTORNEY GENERAL ACTIONS" OR "ACTIONS" means those tobacco related civil actions filed by the States/Territories listed in Appendix A hereto.

1.5. "ATTORNEY GENERAL SETTLEMENT FUND BOARD" or "ATTORNEY GENERAL BOARD" means the entity established pursuant to Section 6 of this Settlement Agreement.

1.6. "BROOKE GROUP" means Brooke Group Ltd. and its Present Affiliates, other than Liggett.

1.7. "CIGARETTE" means any product, including components, accessories, or parts, which is intended to be burned under ordinary conditions of use and consists of: (1) any roll of tobacco wrapped in paper or in any substance not containing tobacco; or (2) any roll of tobacco wrapped in any substances containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as described in subparagraph (1).

1.8. "CIGARETTE PACK" means a unit of twenty Cigarettes or one ounce of Tobacco Snuff or any other similar method of delivery to consumers.

1.9. "COST PER CIGARETTE PACK" means, with respect to a Tobacco Company, the aggregate costs incurred by such Tobacco Company under a Global Settlement during a specified year, divided by the number of Cigarette Packs manufactured by such Tobacco Company during such year, as determined by The Maxwell Consumer Report published by Wheat First Butcher Singer or a similar or successor report.

1.10. "DEFENDANTS" means The American Tobacco Company, Inc., B.A.T. Industries, P.L.C., British-American Tobacco Company, LTD., R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation, Philip Morris, Inc., Liggett & Myers, Inc., Lorillard Tobacco Company, and United States Tobacco Company and their various parent and related companies.

1.11. "DOMESTIC TOBACCO OPERATIONS" means the manufacture or sale of cigarettes and any other tobacco products in the United States, its territories, its possessions and the Commonwealth of Puerto Rico.

1.12. "DOWNSTREAM DISTRIBUTION ENTITY" means any person or entity that furthers the distribution of tobacco products at any point from the original place of manufacture to individuals for personal consumption, including, without limitation, wholesalers, retailers, private label purchasers and control label purchasers. Such term shall not include common carriers.

1.13. "FDA" means the Food and Drug Administration.

1.14. "FDA RULE" means the regulations promulgated by the FDA on August 28, 1996 concerning the sale and distribution of cigarettes and other products at 60 Fed. Reg. 44396, to be codified at 21 C.F.R. Parts 801, 803, 804 807, 820 and 897.

1.15. "FUTURE AFFILIATE" means any one entity, other than an entity with a Market Share greater than 30% as of the date of this Agreement, which is a Non-Settling Tobacco Company (including any successor to or assignee of its assets) if such entity or an Affiliate of such entity with the prior written approval of Brooke Group, subsequent to the date, and during the term of this Agreement but prior to March 20, 2001: (i) directly or indirectly acquires or is acquired by Liggett or Brooke Group; (ii) directly or indirectly acquires all or substantially all of the stock or assets of Liggett or Brooke Group; (iii) all or substantially all of whose stock or assets are directly or indirectly acquired by Liggett or Brooke Group; or (iv) directly or indirectly merges with Liggett or Brooke Group or otherwise combines on any basis with Liggett or Brooke Group.

1.16. "FUTURE AFFILIATE TRANSACTION" means a transaction, or series of transactions, by which an entity becomes a Future Affiliate.

1.17. "GLOBAL SETTLEMENT" means any national disposition, settlement, agreement or other arrangement, by way of legislation, executive order, regulation, taxation, levy, fine, Class Action settlement, court order or otherwise of smoking-related litigation, in direct or indirect connection with which one or more Tobacco Companies receives the benefit of a limitation of, or total or partial immunity from, liability to plaintiffs for the types of claims released under the terms of this Agreement.

1.18. "INITIAL SETTLEMENT" means the settlement agreement entered into by the Initial Settling States and the Settling Defendants on March 15, 1996.

1.19. "INITIAL SETTLING STATES" means the States of Mississippi, West Virginia, Florida, and Louisiana, the Commonwealth of Massachusetts and the respective Attorneys General thereof.

1.20. "LIGGETT" means Liggett Group, Inc. and Liggett & Myers, Inc., and their affiliates and subsidiaries.

1.21. "MARCH 1997 AGREEMENT" means the settlement agreement entered into by the Settling Defendants and seventeen States on March 20, 1997, and several subsequent States thereafter.

1.22. "MARKET SHARE" means, with respect to a Defendant and a specified year, the Domestic Tobacco Operations market share in that year of all of such Defendant's cigarettes and other tobacco products, as determined by The Maxwell Consumer Report published by Wheat First Butcher Singer or a similar or successor report.

1.24. "NATIONAL" means actually covering or potentially covering (whether by block grants to states, localities or other governmental entities or otherwise) the United States or the United States and one or more of its territories, possessions and the Commonwealth of Puerto Rico.

1.25. "NON-RELEASING GOVERNMENTAL ENTITY" means any department, agency, and other political subdivision or unit of any Settling State which, under the applicable law of such Settling State, is not considered to be part of such State and/or which is not legally represented by the Attorney General for such State in this matter. Depending upon the laws of each such Settling State, this may include cities, counties, municipalities, parishes, townships, boroughs, taxing districts, special districts or other local units of government.

1.26. "NON-SETTLING TOBACCO COMPANIES" AND "NON-SETTLING DEFENDANTS" means each of The American Tobacco Co., Lorillard Tobacco Co., Philip Morris Inc., R.J. Reynolds Tobacco Co., Brown & Williamson Tobacco Corp., and United States Tobacco Co.

1.27. "OTHER SETTLEMENT" means settlement of an action which is not a Global Settlement.

1.28. "PARENT" with respect to Liggett means Brooke Group, and with respect to any other specified corporation or entity, means another corporation, partnership or other entity which directly or indirectly controls such specified corporation or entity.

1.29. "PARTIES" means the Attorneys General and Brooke Group and Liggett.

1.30. "POPULATION" means, with respect to a geographic area, the population of that area as reported in the most recent census conducted by the United States Bureau of the Census.

1.31. "PRESENT AFFILIATE" means, with respect to a specified corporation or entity, another corporation, partnership or other entity which as of the date of this Agreement, directly or indirectly controls, is controlled by, or is under common control with, such specified corporation or entity including any and all Parents, subsidiaries, and/or sister corporations or entities of such specified corporation or entity.

1.32. "PRESENT VALUE" means, with respect to a specified amount or amounts, the present value of such amount or amounts as calculated using a discount rate equal to the yield on 10-year Treasury Notes as reported in the WALL STREET JOURNAL at the time of such calculation; provided that where such amount or amounts are not otherwise determinable, the amount or amounts to be present-valued shall be deemed to be the average for the most recent three years.

1.33. "PRETAX INCOME" means with respect to Liggett, for a specified year, the "Income before Income Taxes" as determined in accordance with generally accepted accounting principles ("GAAP") of Liggett for its most recent fiscal year, as reported in filings

to the United States Securities and Exchange Commission or, if there is no such filing, as reported by Liggett's independent outside auditors. If GAAP changes in any material respect during the term of this Agreement so that the benefits anticipated by the parties (in light of GAAP applicable on the date of this Agreement), an appropriate adjustment shall be made to the formulas and calculations hereunder to achieve the parties' expectations as of the date hereof.

1.34. "PROTECTIVE ORDER" or "STIPULATION REGARDING LIGGETT DOCUMENTS" means, with respect to privileged documents produced by a Settling Defendant in an Attorney General Action, an order in that Action: (a) protecting the confidentiality of such documents; (b) providing that such documents may be used only in that Attorney General Action and, to the extent permitted by law, only under seal; and, (c) providing that, to the extent such documents are or may be subject to the attorney/client privilege or the attorney work product doctrine, such production or use of the documents does not constitute a waiver of such privilege, doctrine or protection with respect to any party other than the Attorney General to whom the documents are produced subject to the order. The provisions of the order shall not apply to documents claimed to be privileged but which are determined by the court in any Action not to be privileged for reasons other than waiver due to production pursuant to this Agreement.

1.35. "SETTLEMENT FUND" means the fund established in accordance with the terms of Section 6 of this Agreement, which shall be established in a reputable bank or other financial institution, to provide a secure and interest-bearing fund, and which shall be solely controlled by the Attorney General Settlement Fund Board.

1.36. "SETTLING DEFENDANTS" means Brooke Group and/or Liggett.

1.37. "SETTLING DEFENDANTS' COUNSEL" means the law firm of Kasowitz, Benson, Torres & Friedman L.L.P.

1.38. "SETTLING STATES" OR "STATES" means the States and Territories listed in Appendix A hereto and Subsequent Settling States and Territories, if any.

1.39. "STATE'S ALLOCATION" means the allocation percentage noted for each entity as identified and listed on Appendix B attached to this Settlement Agreement and incorporated by reference.

1.40. "SUBSEQUENT SETTLING STATES" means States and Territories, other than those listed in Appendix A hereto, which separately execute this Agreement with the Settling Defendants.

1.41. "TOBACCO COMPANIES" means the Defendants.

1.42. "TOBACCO OPERATIONS" means the manufacture and/or sale of cigarettes or any other tobacco products.

1.43. "TOBACCO PRODUCTS" includes, without limitation, cigarettes, cigars, and smokeless tobacco, including snuff, and spit, loose and chewing tobaccos.

1.44. "TOBACCO SNUFF" means any cut, ground, powdered, or leaf tobacco that is intended to be placed in the oral cavity.

SECTION 2: SETTLEMENT PURPOSES ONLY.

This Agreement is for settlement purposes only, and neither the fact of, or any provision contained in, this Agreement nor any action taken hereunder shall constitute, be construed as, or be admissible in evidence against the Settling Defendants as any admission of the validity of any claim, any argument or any fact

alleged or which could have been alleged by Plaintiffs as to their standing or as to any jurisdictional, constitutional or any other legal or factual issue in any Attorney General Action, or alleged or which could have been alleged in any other action or proceeding of any kind, or of any wrongdoing, fault, violation of law, or liability of any kind on the part of the Settling Defendants or any admission by them of any claim or allegation made or which could have been made in any Attorney General Action or in any other action or proceeding of any kind, or as an admission by any of the Plaintiffs of the validity of any fact or defense asserted against them in any Attorney General Action or in any other action or proceeding of any kind.

SECTION 3: PARTIES.

3.1. This Agreement shall be binding, in accordance with the terms hereof, upon Brooke Group, Liggett and the Settling States; provided that, notwithstanding anything else contained in this Agreement, the payment obligations of this Agreement shall be binding only upon Liggett.

3.2. No Settling Defendant shall sell, use, dispose or transfer substantially all of its cigarette brands or businesses without first causing the acquirer, on behalf of itself and its successors, to be bound by all of the obligations of a Settling Defendant pursuant to Sections 4.2 and 4.4 through 4.9 hereunder as to such transferred brands or businesses; provided that this Section 3.2 shall not apply to the extent such sale, disposition or transfer is required by the Federal Trade Commission, Department of Justice, State Attorney General or court order.

SECTION 4: PUBLIC STATEMENT; COOPERATION; ADVERTISING LIMITATION.

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

> I am, and have been for a number of years, a Director of Liggett Group Inc., a manufacturer of cigarettes. Cigarettes were identified as a cause of lung cancer and many other diseases as early as 1950. I, personally, am not a scientist. But, like all of you, I am aware of the many reports concerning the ill-effects of cigarette smoking. We at Liggett know and acknowledge that, as the Surgeon General and respected medical researchers have found, cigarette smoking causes health problems, including lung cancer, heart and vascular disease and emphysema. We at Liggett also know and acknowledge that, as the Surgeon General, the Food and Drug Administration and respected medical researchers have found, nicotine is addictive.
>
> Liggett will continue to engage in the activity of selling cigarettes to adults, but will endeavor to ensure that these adult smokers are aware of the health risks and addictive nature of smoking. As part of our efforts, we will do the following:
>
> 1. Liggett will add a prominent warning to each of our packages of cigarettes and all of our cigarette advertising stating that "Smoking is Addictive".
>
> 2. Liggett supports and will not challenge Food and Drug Administration regulations concerning the sale and distribution of nicotine-containing cigarettes and smokeless tobacco products to children and adolescents.

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

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

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

4.2. As promptly as reasonably practicable, but no later than six months after execution of this Settlement Agreement, Settling Defendants shall cause to be printed boldly, on all of their Cigarette packages and in all of their Cigarette advertising, in addition to the warnings mandated under the Federal Cigarette Labeling and Advertising Act, as amended 15 U.S.C. section 1331 ET SEQ., the statement that cigarette smoking is addictive. To the extent any Settling Defendant manufactures and

sells other Tobacco Products, a similar warning shall be placed on such products.

4.3. With respect to each Settling State, upon execution of this Agreement, each Settling Defendant shall:

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

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

(3) actively assist the attorneys representing the Attorneys General in identifying and locating any and all persons known to such Settling Defendant to have documents or information that is discoverable in such proceedings, to actively assist said counsel in interviewing and obtaining documents and information from all such persons, and to encourage such person to cooperate with the Attorneys General; and shall actively assist counsel in interpreting documents relating to litigation against Non-Settling Tobacco Companies; and

(4) insofar as such Settling Defendant has or obtains any material information concerning any fraudulent or illegal conduct on the part of any parties, including Non-Settling Tobacco Companies, their agents, or their co-defendants designed to frustrate or defeat the

claims of the plaintiffs against such parties, companies, agents or co-defendants, or which have the effect of suppressing evidence relevant to smoking claims, disclose such information to the appropriate judicial and regulatory agencies.

4.3.1. With respect to each Settling State, subject to, and promptly after, the entry of a "Protective Order" or a "Stipulation Regarding Liggett Documents" by the court in which the respective Attorney General Action is pending, each Settling Defendant shall:

(1) promptly provide all documents and information that are relevant to the subject matter of the Actions or which are likely to lead to admissible evidence in connection with the claims asserted in any of the Actions, subject to the provisions of Section 4.3.1(2) hereof;

(2) waive any and all applicable attorney-client privileges and work product doctrine protections with respect to such documents and information. Such waiver shall not extend to (a) documents and information not relevant to the subject matter of the Actions or not likely to lead to admissible evidence in connection with claims asserted in any of the Actions or (b) documents subject to a joint defense or other privilege or protection which Settling Defendants cannot legally waive unilaterally, except that the waiver by the Settling Defendant shall apply, to the extent permitted by law, to its own joint defenses or other privileges. To the extent that a Settling Defendant has a good faith belief, or one or more Non-Settling Tobacco Companies claims, that documents to be provided pursuant to Section 4.3.1(1) and 4.3.1(5) hereof may be

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

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

(4) demand from its past or current national legal counsel all documents and information obtained by them in the course of representation of any Settling Defendant which in any way relates to the cooperation required in paragraphs 4.3(1) through 4.3.1(5) above, which should be provided to the Settling States as provided under this paragraph. 4.3.2. Nothing in this Agreement shall waive or alter the rights of the Attorneys General to obtain discovery of Liggett as required by a court order or case management order in any Attorneys General Action, provided that no order is sought that is inconsistent with this Agreement.

4.4. Each Settling Defendant, promptly after becoming bound by this Agreement, shall consent to jurisdiction by the FDA for the sole purpose of promulgating the FDA Rule with respect to all Tobacco Companies. Further, each Settling Defendant, promptly after execution of this Agreement, shall endorse, support and assist in attempts by the FDA to have the FDA Rule become enforceable. Such efforts shall include, if and as reasonably requested by the Attorneys General, filing appropriate amicus briefs and other court papers in litigation relating to the FDA Rule.

4.5. Each Settling Defendant shall follow and abide by the provisions of the FDA Rule, insofar as they pertain solely to such Settling Defendant's Domestic Tobacco Operations, as set forth in, and modified by, paragraphs 4.5.1 through 4.5.6 herein.

4.5.1. FDA Rule section 897.16(b), as stated.

4.5.2. FDA Rule section 897.16(d), as stated.

4.5.3. FDA Rule section 897.30, as stated, and further extended such that no Settling Defendant shall locate, disseminate or cause to be disseminated advertising of any Tobacco Products in the out-of-doors, including, but not limited to, advertising on billboards.

4.5.4. FDA Rule section 897.34(A), as stated.

4.5.5. FDA Rule section 897.34(B), as stated.

4.5.6. FDA Rule section 897.34(C), as stated.

4.6 Each Settling Defendant shall follow and abide by the provisions set forth in paragraphs 4.6.1 through 4.6.7 herein.

4.6.1. No Settling Defendant shall encourage placement of point of sale advertisements within two feet of any fixture on which gum, candy or confection food is displayed for sale.

4.6.2. No Settling Defendant shall make, or cause to be made, direct or indirect payments for Tobacco Product placement in movies (screen, video, or made for television), television programs or video games.

4.6.3. No Settling Defendant shall make, or cause to be made, direct or indirect payments to glamorize or otherwise encourage or promote tobacco use in any media outlets appealing to minors, including, but not limited to, recorded and live performances of music.

4.6.4. No Settling Defendant shall locate, post, disseminate or cause to be disseminated, any form of Tobacco Product advertising on the Internet or any other electronic information distribution system, unless such advertising is designed to be inaccessible in or from the United States of America.

4.6.5. Audio and video format advertising otherwise permitted under the FDA Rule may be distributed to adult consumers at point of sale (i.e., no "static video displays").

4.6.6. Subject to the provisions of Section 4.7, the Settling Defendants agree that in the event of any future Settlement Agreements and/or Consent Decrees between any Settling State and the Non-Settling Defendants related to restrictions on advertising and marketing, or requirements for labeling and packaging of Tobacco Products, in connection with a national or legislative settlement, the terms of this Settlement Agreement will be revised such that Liggett and Brooke Group will be required to abide by any additional restrictions or more restrictive requirements which may be adopted by such Settlement Agreement or Consent Decree.

4.7. Notwithstanding anything to the contrary in the FDA Rule or in this Agreement, Liggett will commence compliance with Sections 4.5 and 4.6 of this Agreement as soon as reasonably practicable, provided that if, in any year during the term hereof, Liggett's Market Share is less than 3%, Liggett may limit its compliance to the extent, if any, necessary to ensure that the net annual out-of-pocket cost to Liggett of such compliance, during such year, not exceed $1 million; and provided further that Liggett shall not be obligated pursuant hereto to breach pre-existing legal obligations, if any, it may have with respect to the matters covered by Sections 4.5 and 4.6 (and shall use its reasonable best efforts to minimize the degree to which any such obligations would impede its full compliance therewith). For purposes of this paragraph, the phrase "net annual out-of-pocket costs" means the excess of (a) the additional out-of-pocket expenditures incurred during a particular year by Liggett in complying with the matters specified in Sections 4.5 and 4.6, over (b) savings, if any, in out-of-pocket expenditures realized during such year by Liggett directly from the implementation of the matters covered by Sections 4.5 and 4.6.

4.8. If, when and to the extent that the FDA Rule, in whole or in part, becomes an enforceable legal obligation binding upon all of the Defendants, each Settling Defendant will comply therewith, without consideration of any limits or exceptions herein. If the FDA Rule does not become such a legal obligation, Liggett shall, during the duration of this Agreement, continue to comply with Sections 4.5 and 4.6.

4.9. Each Settling Defendant shall not use any cartoon characters, such as "Joe Camel," in any of its advertising and promotional materials and activities with respect to any Tobacco Products. No Settling Defendant shall enter into any new contract for advertising and promotion with respect to Tobacco Products

using any such cartoon characters after the date the Settling Defendants become bound by this Agreement.

4.10. Each Settling Defendant may, after becoming bound by this Settlement Agreement, continue in the manufacture, advertising and/or sale of Tobacco Products. This Settlement Agreement does not in any way abrogate or restrict the authority or ability of the Attorneys General to enforce future compliance with the laws of their respective States.

SECTION 5: GLOBAL SETTLEMENT.

5.1. It is the intent of the parties that the financial terms, financial obligations or financial conditions of any Global Settlement are no more onerous on, or less favorable to, Brooke Group and Liggett than the financial terms, financial obligations or financial conditions of this Settlement Agreement. In furtherance of this intent, the Attorneys General will upon the execution hereof send letters, substantially in the form and substance of Appendix C hereto, to the President of the United States, the Congressional leadership, and the Chairpersons of Congressional committees or subcommittees that have jurisdiction over a Global Settlement, requesting that any Global Settlement contain financial terms, financial obligations or financial conditions that are no more onerous on, or less favorable to, Brooke Group and Liggett than the financial terms, financial obligations or financial conditions of this Settlement Agreement.

5.2. In the event there is a Global Settlement at any time which contains financial terms, financial obligations or financial conditions as to Brooke Group and Liggett which are more onerous on, or less favorable to, Brooke Group and Liggett than those of this Settlement Agreement, then, in addition to, and not in derogation of any other rights or remedies Brooke Group and

Liggett may have, Brooke Group and Liggett shall have the right, at their option, to withdraw from further performance of the payment obligations of Section 6 of this Agreement.

SECTION 6. ATTORNEY GENERAL SETTLEMENT FUND BOARD.

6.1. Except as may otherwise be provided herein, all amounts due and owing by each Settling Defendant under this Agreement shall be paid when due into the Attorney General Settlement Fund to be allocated and distributed to the Settling States by the Attorney General Settlement Fund Board in its sole discretion. The Attorneys General of the Settling States shall establish operational procedures and appoint representatives to the Settlement Fund Board for the sole purpose of distributing monies received from the Settling Defendants pursuant to this Agreement. The Settlement Fund Board may modify the percentages listed in Appendix B regarding States' Allocations as long as such modification does not increase the total amount to be paid by the Settling Defendants pursuant to this Settlement Agreement.

6.2. Settling Defendants shall have no interest in or responsibility for allocations or distributions from the Settlement Fund and do not guarantee any earnings or insure against any losses from any portion of the Settlement Fund assets that may be maintained or administered as provided in Section 6.1 above.

6.3. Subject to the terms of this Agreement, Liggett shall make the following payments:

6.3.1 Liggett shall pay into the Attorneys' General Settlement Fund an initial payment of $25 million due 120 days from the date of a Future Affiliate Transaction. The amount payable under this Section 6.3.1 represents the same amount, and not in addition to the amount, payable under Section 6.3.1 of the March 1997 Agreement; and

6.3.2. Liggett shall directly pay each Settling State and each Subsequent Settling State:

(a) One Hundred Thousand Dollars ($100,000), of which $50,000 is payable sixty (60) days from the date of this Agreement, and $50,000 is payable on November 30, 1998; and

(b) Nine Hundred Thousand Dollars ($900,000) in equal annual installments, indexed and adjusted for inflation, payable on December 31, 1999 and the following seven anniversaries of such date (except that any then remaining unpaid amount under this Section shall be due and payable within sixty (60) days of the date Liggett defaults on any of its payment obligations under this Agreement). These payments shall constitute reimbursement for the Settling States' cost of investigation, litigation, and attorney fees and, along with the payment under subparagraph (a) above, shall be made to each Settling States' designated payee. Each Settling State's share of the amounts identified in Section 6.3.2 and 6.3.3. shall be used by such state as determined by the Attorney General of each such state at his or her exclusive option, and as otherwise consistent with such state's law.

6.3.3. For the duration of this Agreement pursuant to Section 9.1, and subject to the provisions of Sections 6.6 through 6.9, Liggett shall pay into the Settlement Fund, on a per Settling

State basis, annual payments each equivalent to the product of such Settling State's Allocation and 27.5% of Liggett's Pretax Income; provided that for each State above ten (10) that becomes a signatory to this Agreement, such percentage of Liggett's Pretax Income will increase on a pro rata basis from 27.5% to 30% by one-fourteenth of the difference per state over the initial ten (10) states that enter into this Agreement. Payments under this section 6.3.3 shall be due one hundred and twenty (120) days after the end of each fiscal year of Liggett. The first payment under this section 6.3.3 shall be due one hundred and twenty (120) days after the end of fiscal year 1998.

6.3.4. The annual payments of $112,500 to each Settling State pursuant to Section 6.3.2(b) shall act as a reduction of that Settling State's allocated percentage payment under Section 6.3.3. such that for each of the eight years referred to in Section 6.3.2(b) each Settling State will receive additional monies under Section 6.3.3. only to the extent that said Settling States' percentage allocation payment in that given year, is greater than $112,500.

6.4. Liggett shall pay the reasonable and necessary expenses of the administration, allocation, and distribution of the Settlement Fund provided that Liggett shall not be obligated to pay more than One Million Dollars ($1,000,000.00) in any year for such expenses.

6.5. Since the Settling Defendants are providing historic and valuable cooperation and other considerations under this Agreement, the amounts payable hereunder to the Settlement Fund shall represent the maximum amounts payable to the Settlement Fund under this Agreement.

6.6. With respect to each Settling State, in the event of the entry of any final non-appealable monetary judgment in such Settling State's Attorney General Action (other than by way of

settlement) against any one or more of the Non-Settling Tobacco Companies, then the Settling Defendants shall have the right to reduce the payments they are obligated to make pursuant to this Agreement to the extent necessary to make (i) the then Present Value of all amounts theretofore paid and thereafter payable to that Settling State pursuant to this Agreement by the Settling Defendants (such amounts being calculated for purpose of this Section 6.6 by multiplying (a) the total amount of the Settlement Fund allocated to all of the Settling States in that year by (b) such Settling State's Allocation per percentage point of the then Market Share of such Settling Defendant no more than seventy-five percent (75%) of (ii) the then Present Value of the dollar amount of such judgment per percentage point of the then Market Share of each such Non-Settling Tobacco Company; [Example: For purposes of this example of Section 6.6, assume: Liggett has a 2% Market Share (I.E., 2 points). A Non-Settling Tobacco Company has an 8% Market Share (i.e., 8 points), and in 1998 has a final judgment entered against it in an Attorney General Action that requires payments by such Non-Settling Tobacco Company with a then Present Value of $20 million. The Present Value of the amount allocable by Liggett to the Settling State in 1998 is $5 million. Result: In 1998, Liggett would be permitted to reduce its future payments to the extent necessary to make the Present Value of its past and future payments $3.75 million -- I.E., no more than 75% of the Present Value of the judgment, all as adjusted for relative Market Share.

The calculation would be as follows: Present Value of Liggett payment/2 points = .75 x judgment/8 points Present Value of Liggett payments = .75 x $20 million/4 = $3,750,000. Thus, the larger the judgment, the less the reduction. Under this example, if the judgment is $26,670,000 or more, there would be no reduction.] provided that such Settling Defendant give written notice of such reduction and the method of calculating such

reduction to the Settling State's Attorney General as soon as practicable after the entry of judgment.

6.7. In each year beginning with the second year after execution of this Agreement, the annual payment amount due under Section 6.3.3. of this Agreement from a Settling Defendant shall be decreased in proportion to any decrease and (only if there shall have been a prior such decrease) increased in proportion to any increase, in such Settling Defendant's Market Share from the prior year; provided, however, that (a) such annual payment amount shall not be so decreased to the extent, if any, that such annual payment amount in such year is decreased as a result of a decrease in such Settling Defendant's Pretax Income and (b) such annual payment amount shall never be increased such that the aggregate amount of any such increases exceeds the aggregate amount of any such decreases. [Example: For purposes of this example of Section 6.7, assume: There are 10 states as signatories to this Agreement, Liggett is obligated to pay 27.5% of Pretax Income, and Liggett's Pretax Income is $11 million each year, thus making Liggett's obligation under Section 6.3.3 of the settlement $3,025,000 per year during the term of this Agreement (27.5% of 11,000,000). Liggett's Market Share drops from 2% in 1997 and 1998 to 1.75% in 1999, but recovers to 1.9% in 2000, and then back to 2.0% in 2001.

Reduction: In 1999, Liggett's amount due will be reduced by $378,125 to $2,646,875. Since Liggett's Market Share fell by .25 points or 12.5%, its payments would be reduced by 12.5% or 378,125 ($3,025,000 x .125). Recapture of Market Share: In 2000, Liggett's payments to climb commensurate to its increase of .15 in Market Share (1.75 to 1.9% to $2,873,750 (($2,646,875 + ($2,646,875 + .15/1.75)). In 2001, Liggett's payment would again increase commensurate to its increase of .1 in Market Share to $3,025,000 (($2,873,750 + $2,873,750 x .1/1.90)). Liggett would not be entitled to a "double reduction" for a decrease in both

Pretax Income and Market Share. Thus, if Liggett's .25 point drop in Market Share in 1998 were accompanied by a drop in Pretax Income between 1997 and 1998 from $11 million to $8 million, there would be no Market Share reduction, as Liggett's payment obligations (27.5% of Pretax Income) would have already fallen from $3,025,000 to $2,200,000.]

6.8. In the event of a Global Settlement, the Settling Defendants shall have the right to reduce the aggregate payments due from Liggett in each year pursuant to Section 6.3.3 of this Agreement so that the aggregate payments due under that provision and all prior agreements with other States shall be no more that the lesser of (A) on a Cost Per Cigarette Pack basis, one-third of the lowest Cost Per Cigarette pack due in such year from the Non-Settling Tobacco Companies under such Global Settlement and (B) on a percentage of Pretax Income basis, one third of the lowest percentage of Pretax Income due in such year from the Non-Settling Tobacco Companies under such Global Settlement (such percentage to be computed as if the payments due from such companies were included in revenues and earnings).

6.9. Liggett shall receive as a credit against the amounts due under Section 6.3.3., any and all amounts it is required to pay under a Global Settlement.

6.10. Settling Defendants agree not to take any action the primary purpose of which is to reduce Liggett's payment obligations under this Agreement.

SECTION 7. RELEASE.

7.1. Upon the date each Settling State becomes bound by this Settlement Agreement, for good and sufficient consideration as described herein, each Settling State and each Attorney General thereof shall, for the duration or term of this Agreement

(whichever is shorter), be deemed to and hereby does release, dismiss and discharge each and every civil claim, right and cause of action (including, without limitation, all claims for damages, restitution, medical monitoring, or any other legal or equitable relief), known or unknown, asserted or unasserted, direct or indirect, which they had, now have or may hereafter have in their sovereign capacity against each Settling Defendant (including its past and present parents, subsidiaries, present affiliates, employees, directors and shareholders, but only in such capacities, vis-a-vis each such Settling Defendant and Downstream Distribution Entities of Settling Defendants, but only to the extent that such Downstream Distribution Entities would have cross-claims against Settling Defendants) which was based solely on the Settling Defendants' past conduct and which:

(i) was asserted in that State's Attorney General Action, and/or

(ii) was not asserted in said Action but which could have been asserted in said action and which arises out of, or is in furtherance of, or is related to the conduct, concerns, acts, facts, transactions, occurrences, representations, or omissions alleged therein.

This Section 7.1 is not intended, in any fashion, to release or discharge any of the Non-Settling Tobacco Companies or any other Defendants in any Attorney General Action. Moreover nothing contained herein is intended in any fashion to release any claim other than claims that have been asserted by the settling states in their Attorney General Actions against the Settling Defendants by individuals, private entities, or Non-Releasing Governmental Entities.

7.2. Upon the date each Settling State becomes bound by this Settlement Agreement, for good and sufficient consideration as described herein, each Settling Defendant shall for the duration or term of this Agreement (whichever is shorter) be deemed to and

hereby does release, dismiss and discharge each and every claim, right, and cause of action (including, without limitation, all claims for damages, restitution, fees, expenses, or any other legal or equitable relief), whether known or unknown, asserted or unasserted, direct or indirect, which they had, now have or may hereafter have against each Settling State, and its public officials, employees, and agents which:

1) was asserted in that State's Attorney General Action, and/or

2) was not asserted in said action, but which could have been asserted in such action and which otherwise arises out of, or is in furtherance of, or is related to the conduct, concerns, acts, facts, transactions, occurrences, representations, or omissions alleged therein.

7.3. Provided, however, as follows:

1) If this Agreement expires upon completion of its full term, the releases set forth in Sections 7.1 and 7.2 herein shall continue and apply in full force and effect with respect to all released claims such that such claims shall be forever released, but only as to such claims through and including such date; if this Agreement terminates for any reason prior to its full term, these releases shall be of no further force and effect and Settling Defendants shall be entitled to a credit to the extent otherwise provided in the Agreement against all claims covered by the release for the full amount paid by such Settling Defendants hereunder.

2) Except as specifically provided herein, the releases set forth in Sections 7.1 and 7.2 herein do

not pertain or apply to any other existing or potential party in any present or future Attorney General Action.

3) The releases set forth in Sections 7.1 and 7.2 herein do not in any way release claims which may be asserted by a releaser involving conduct unrelated to the manufacture and/or sale of Tobacco Products.

4) The releases set forth in Section 7.1 and 7.2 herein do not in any way abrogate or restrict the authority or ability of the Attorneys General to enforce future compliance with the laws of their respective States, including the full range of remedies available to them for future violation of state law and/or this Agreement.

5) Nothing in this Agreement is intended to prohibit the manufacture or sale of Tobacco Products in compliance with the provisions of this Agreement and all applicable Federal, State and local laws.

6) With respect to the claims of any county, municipality or political subdivision within a Settling State that, as of the date of this Agreement, has brought an action against Settling Defendants separate and apart from the action brought against Settling Defendants by the Settling States encompassing such county, municipality or political subdivision, the releases set forth in Sections 7.1 and 7.2 herein do not release the claims of such county, municipality or political subdivision, except for the exclusively State share of the Medicaid funds claimed in any such action.

7.4. Except as specifically provided herein, nothing in this Agreement shall prejudice or in any way interfere with the rights of Settling States or Settling Defendants to pursue any or all of their rights and remedies against Non-Settling Tobacco Companies or other parties not released hereunder.

SECTION 8: CONSENT DECREE; REMEDIES; JURISDICTION OF COURT.

8.1. The parties agree that this Settlement Agreement may be filed as a Consent Decree in those Settling States where Attorney General Actions are pending. Settling Defendants agree to fully cooperate with the Settling States to effectuate this provision by jointly requesting the court in any Attorney General Action, via motion or other appropriate pleading, that the court approve this Settlement Agreement in its entirety for filing as a Consent Decree.

8.2. Nothing set forth in this Agreement shall be construed as waiving or limiting the rights and remedies (including any action for contempt of Court) of any of the Settling States to seek enforcement of this Agreement and the Consent Decree (in each such Settling State's Attorney General Action) in the event that one or more of the Settling Defendants defaults or otherwise violates any term of this Agreement or the Consent Decree. Each Settling State which has not filed an Attorney General Action against the Settling Defendants shall prosecute any violations of this Agreement through the filing of a separate Action to enforce the terms of this Agreement.

8.3. This Agreement and the corresponding Consent Decree are intended to resolve all claims of the Settling States and the Settling Defendants: (1) in the Attorney General Actions and (2) in any other litigation in which claims released herein are asserted.

8.4. The court in each Attorney General Action shall retain jurisdiction over this matter for the limited purpose of enforcing compliance with the Consent Decree and this Agreement.

SECTION 9: TERM.

9.1. Unless earlier terminated in accordance with the provisions of this Agreement, the duration of this Agreement shall be twenty-five (25) years from March 20, 1997, provided that in the event of a Global Settlement, the duration of this Agreement shall be equal to the duration of the Global Settlement.

9.2. In the event of a termination of this Agreement with respect to any Settling State, such Settling Defendant shall be entitled to offset any payments made to such Settling State prior thereto against any judgments thereafter obtained by such Settling State against such Settling Defendant in an Attorney General Action.

9.3. If any Settling Defendant subsequently withdraws from this Agreement, or this Agreement, for whatever reason, is terminated other than by reason of expiration of its term, then the applicable statute of limitations or any similar time requirement for a Settling State or a terminating Settling Defendant to file a claim that would otherwise be released hereunder against, or by any Settling Defendant shall be tolled from the date such Settling State became bound by this Agreement until the later of the time permitted by applicable law or for one year from the date of such termination with the effect that the parties shall be in the same position as they were at the time the Settling State filed its original Attorney General Action with respect to the statute of limitations.

9.4. Except as may be otherwise specifically provided in this Agreement, a termination by a Settling Defendant hereunder shall have the effect of rendering this Agreement as having no force or effect whatsoever, null and void AB INITIO, and not admissible as evidence for any purpose in any pending or future litigation in any jurisdiction. However, a termination shall not

affect any prior cooperation or require the return of any documents produced to a Settling State pursuant to this Agreement.

SECTION 10: CONTINUING ENFORCEABILITY.

Unless earlier terminated, as to the Settling States, this Agreement, and each provision of or obligation arising from this Agreement, shall continue and remain fully executory and enforceable if a Settling Defendant institutes or is subject to the institution against it of any proceeding or voluntary case under Title 11, United States Code, or other proceeding seeking to adjudicate it insolvent or seeking liquidation, winding up, reorganization, arrangement adjustment, protection, relief or composition of it or its debts under any law relating to bankruptcy, insolvency or reorganization or relief or protection of debtors or other proceeding seeking the entry of an order for relief or the appointment of a receiver, trustee, custodian or other similar official for it or for any part of its property (each, a "Bankruptcy Proceeding"). The Settling States agree that Brooke Group has the right, but not the obligation, to perform any and all monetary obligations of Liggett under this Agreement, including the cure of any default under Section 13.1 of this Agreement, notwithstanding the occurrence and continuation of any Bankruptcy Proceeding with respect to Liggett. The Settling States agree that they shall have no right to terminate or to call a default under Section 13.1 of this Agreement during any period of time in which Brooke Group is performing Liggett's monetary obligations herein.

SECTION 11: CONTRIBUTION
AND INDEMNITY CLAIMS.

It is the intent of the parties that the payments to be made by Liggett with respect to the Attorneys General Actions settled hereby be limited to those payments set forth in this Agreement, and that Settling Defendants not be responsible for any payments relating to any contribution or indemnity claim asserted, or to be asserted, by any Non-Settling Defendant that may arise from any of such Attorneys General Actions. It is the further intent of the Parties that any protection that the Settling Defendants may enjoy from claims of contribution or indemnity shall be governed by the laws of the various States where such Attorneys General Actions are pending.

SECTION 12: TAX STATUS OF SETTLEMENT FUND.

12.1. The Settlement Fund created under this Agreement will be established and maintained as a Qualified Settlement Fund ("QSF") in accordance with Section 468B of the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder. Any Settling Defendant shall be permitted, in its discretion, and at its own cost, to seek a private letter ruling from the Internal Revenue Service ("IRS") regarding the tax status of the Settlement Fund. The parties agree to negotiate in good faith any changes to the Agreement which may be necessary to obtain IRS approval of the Settlement Fund as a QSF.

12.2. Representatives of the Settling States will be appointed to act as administrator of the Settlement Fund. As administrator, such representatives will undertake the following actions in accordance with the regulations under IRC section 468B: (a) apply for the tax identification number required for the Settlement Fund; (b) file, or cause to be filed, all tax returns the Settlement Fund is required to file under federal or state

laws; (c) pay from the Settlement Fund all taxes that are imposed upon the Settlement Fund by federal or state laws; and (d) file, or cause to be filed, tax elections available to the Settlement Fund, including a request for a prompt assessment under IRC sec. 6501(d), if and when the administrator deems it appropriate to do so.

12.3. The Settling Defendants, as transferors of the Settlement Fund shall prepare and file the information statements concerning their settlement payments to the Settlement Fund as required to be provided to the IRS pursuant to the regulations under IRC section 468B.

SECTION 13: EFFECT OF A DEFAULT OF SETTLING DEFENDANT.

13.1. In the event a Settling Defendant fails to make a payment due and owing under the terms of this Agreement, the Settling Defendant shall have sixty (60) calendar days to cure the default subject to the additional payment of interest on the unpaid overdue amount at an interest rate of prime plus three (3) percent. If the defaulting Settling Defendant does not cure the default in the time period provided in this Section 13.1, a Settling State shall have the right to terminate this Agreement as to their State or may apply to the court in which its respective Attorney General Action is pending for relief, in addition to any other remedies it may have hereunder.

13.2. If after a reasonable notification period a Settling Defendant is in default of a non-remunerative provision of this Agreement, except for Sections 4.5 through 4.9, the Settling Defendant shall have thirty (30) calendar days to cure the default, unless the time period is shortened pursuant to court order as is reasonably necessary under the circumstances. If the defaulting Settling Defendant does not cure the default in the

time period provided in this Section 13.2, a Settling State may apply for relief, including termination of this Agreement, to the court in which its respective Attorney General Action is pending, in addition to any other remedies it may have hereunder.

13.3. In the event that a Settling Defendant is in default of any provision contained in Sections 4.5 through 4.9 of this Agreement, a Settling State shall have the right to immediately apply for relief, including termination of this agreement, to the court in which the Attorney General Action is pending.

SECTION 14: REPRESENTATIONS AND WARRANTIES.

14.1. Each Settling Defendant represents and warrants that it (i) has all requisite corporate power and authority to execute, deliver and perform this Agreement and to consummate the transactions contemplated hereby; (ii) the execution, delivery and performance by such Settling Defendant of this Agreement and the consummation by it of the actions contemplated herein have been duly authorized by all necessary corporate action on the part of such Settling Defendant; (iii) the Agreement has been duly and validly executed and delivered by such Settling Defendant and constitutes its legal, valid and binding obligation; and (iv) this Agreement does not violate the charter of bylaws of such Settling Defendants or any Agreement to which the Settling Defendant is a party.

14.2. Each Settling State represents and warrants that pursuant to its statutory and/or common law authority (i) it has all requisite power and authority to execute, deliver and perform this Agreement and to consummate the transactions contemplated hereby; (ii) the execution, delivery and performance by such Settling State of this Agreement and the consummation by it of the actions contemplated herein have been duly authorized by all necessary action on the part of such Settling State; and (iii) the Agreement has been duly executed and authorized by such Settling State and constitutes its legal, valid and binding obligation.

SECTION 15: ARBITRATION.

In the event that the Parties are unable to agree, after good faith efforts, to the determination or calculation for any applicable year of Market Share or Pretax Income hereunder, such determination or calculation shall be submitted to binding arbitration in accordance with the rules of the American Arbitration Association.

SECTION 16. MOST FAVORED NATION.

16.1. It is the intent of the Parties hereto that the Settling Defendants enjoy a preferred position with respect to Non-Settling Tobacco Companies, in recognition of the Settling Defendants' willingness to enter into this Agreement. Accordingly, it is generally contemplated that settlements which involve all Settling States and a Non-Settling Tobacco Company (a "Group Other Settlement") or involving one Settling State and a Non-Settling Tobacco Company (a "Single State Other Settlement") shall meet certain minimum requirements in terms of the initial, periodic or lump sum payments to be made by the Non-Settling Tobacco Company (each a "Benchmark Figure"). The recital of these Benchmark Figures herein is solely for the purposes of insuring that the Settling Defendants enjoy a preferred position with respect to Non-Settling Tobacco Companies and is not intended in any way to reflect the value of the Settling States' claims against Non-Settling Tobacco Companies. For purposes of this

Section 16, a settlement involving a Non-Settling Tobacco Company and some, but not all, Settling States shall be deemed a Single Other Settlement, and the preferred position of the Settling Defendant shall be governed by Subsections 16.1.3 and 16.1.4 hereof, and determined on a state-by-state basis.

16.1.1. In the case of a Group Other Settlement which includes an initial payment such as that provided for in Section 6.3.1 hereof, the Benchmark Figure shall be that figure which represents three times the Present Value of the initial payment made hereunder, adjusted for Market Share at the time of such payment. Thus, if at the time of the initial payment hereunder, the Settling Defendant had a market share of 2 percent and made a payment the Present Value of which is $15 million, and the Settling States subsequently enter into a Group other Settlement with a Non-Settling Tobacco Company which has a market share of ten percent (10%) the Benchmark Figure for the initial payment shall be $225 million. To the extent that the initial payment actually provided for in such Group Other Settlement is less than the Benchmark Figure, the Settling Defendant shall receive a credit in like amount, up to the amount of the present value of the initial payment made hereunder, against all future payment obligations hereunder.

16.1.2. In the case of a (i) Group Other Settlement which included only a lump sum or periodic payments, and (ii) with respect to the periodic payments included in a Group Other Settlement which also includes an initial payment, the Benchmark Figure shall be that amount which constitutes three times the Present Value of all amounts paid or payable by the Settling Defendant hereunder (excluding, if the Group Other Settlement contains an initial payment, the initial payment hereunder), assuming, in the case of future payments, no increase or decrease in Market Share but assuming inflation in revenues, all adjusted

for Market Share. Thus, if the Present Value of a Settling Defendant's payments made or to be made hereunder is $60 million and such Settling Defendant enjoys a Market Share of 2%, the Benchmark Figure for a Non-Settling Defendant which at the time of a Group Other Settlement enjoys a Market Share of 15% would be $1,350 million. Similarly, the Benchmark Figure for a Non-Settling Defendant which at the time of a Group Other Settlement enjoys a Market Share of 5% would be $450 million. To the extent that the Present Value of the lump sum or periodic payments to be made under a Group Other Settlement is less than the Benchmark Figure, the Settling Defendant shall receive a credit in like amount, up to the amount of any remaining payment obligations hereunder.

16.1.3. In the case of a Single State Other Settlement which includes an initial payment such as that provided for in Section 6.3.2 hereof, the Benchmark Figure shall be that figure which represents three times the Present Value of the initial payment made hereunder to such Settling State, adjusted for Market Share at the time of such payment, computed in accordance with Section 16.1.1. To the extent that the initial payment actually provided for in such Single State Other Settlement is less than the Benchmark Figure, the Settling Defendant shall receive a credit in like amount, up to the amount of the present value of the initial payment made to the Settling State hereunder, against all future payment obligations to the Settling State hereunder.

16.1.4. In the case of a Single Other Settlement which includes only a lump sum or periodic payments, and with respect to the periodic payments included in a Single State Other Settlement which also includes an initial payment, the Benchmark Figure shall be that amount which constitutes three times the Present Value of all amounts paid or payable by the Settling Defendant to the Settling State hereunder (excluding, if the Single State Other

Settlement contains an initial payment, the Initial Payment hereunder), assuming, in the case of future payments, no increase or decrease in Market Share but assuming inflation in revenues, all adjusted for Market Share, computed as set forth in Section 16.1.2. To the extent that the Present Value of the lump sum or periodic payments to be made under a Single State Other Settlement is less than the Benchmark Figure receive a credit in like amount, up to the amount of any remaining payment obligations to the Settling State hereunder.

16.1.5. Solely for the purposes of Section 16.1, the payments due to each of the Settling States in a year shall be deemed to be equivalent to the product of (a) 10% of the Settling Defendant's Pretax Income and (b) that State's Allocation.

16.1.6. The Benchmark Figure set for in Sections 16.1.1 through 16.1.4 does not reflect in any fashion the Settling States' view as to an appropriate settlement or resolution with any Non-Settling Tobacco Company.

16.2. Except as provided in Section 16.1 hereof, in the event that, subsequent to the date of this Agreement, any settlement of any Settling State's Attorney General Action is reached with any Non-Settling Defendant, which is not a Party hereto and such settlement is on any terms more favorable to such Non-Settling Defendant than are the terms of this Agreement to a Settling Defendant, such Settling Defendant shall each have the right to replace or modify any or all of the terms of this Agreement with, or add to this Agreement, any or all such more favorable terms.

16.3. In the event that, subsequent to the date of this Agreement, any of the Settling Defendants enters into a settlement agreement with any State other than a Settling State on terms (relating to the then Present Value of amounts payable under such settlement agreement, compliance with the FDA Rule or cooperation)

that are more favorable to the State than those contained herein (as adjusted for relative State's Allocation), the Settling States shall have the right with respect to such Settling Defendant to replace or modify any or all of the terms of this Agreement with, or add to this Agreement, any or all such more favorable terms (adjusted for relative State's Allocation).

SECTION 17: FUTURE AFFILIATE.

17.1. The terms of this Agreement shall not be binding upon or applicable to a Future Affiliate of the Settling Defendants, except as provided for in this Section 17.

17.2. In the event of a Future Affiliate Transaction, the Settling States shall not (a) seek to enjoin or otherwise challenge a spinoff or like disposition of the stock or assets of any Affiliate of the Future Affiliate which is not as of the date of the execution of this Agreement a Parent of a company engaged in Domestic Tobacco Operations or itself engaged in Domestic Tobacco Operations ("Spinoff Affiliate"), (b) bring suit or otherwise take action against the Parent of the Future Affiliate with respect to such spinoff or like disposition of stock or assets, or (c) bring suit or otherwise take action against a Spinoff Affiliate for claims asserted in or related to an Attorneys General Action (and thereby release such Spinoff Affiliate pursuant to, MUTATIS MUTANDIS, Section 7.1 hereof). The Settling States reserve the right to take the actions described in this Section 17.2 in the event that such spinoff or like disposition is sought by someone other than Brooke Group or a Future Affiliate or an Affiliate of a Future Affiliate.

17.3. With respect to subsection 17.2, nothing in this provision, or elsewhere in this Agreement, limits the authority of the Attorneys General to challenge any transaction which they

reasonably believe is in violation of federal or state antitrust law.

17.4. In the event of a Future Affiliate Transaction after which Liggett remains as a separate entity such that Liggett's Pretax Income is readily calculable, Section 6.3.3 hereof shall remain in effect with respect to Pretax Income solely attributable to such separate entity. In the event of a Future Affiliate Transaction by which Liggett's Pretax Income is not readily calculable, Settling Defendants and the Attorneys General and their respective counsel, each agree to exercise best efforts to negotiate in good faith a payment schedule to replace that set forth in Section 6.3.3. Nothing in this Section 17.4 affects in any way Liggett's payment obligations under Sections 6.3.1 or 6.3.2 hereof.

17.5. Promptly after a Future Affiliate Transaction, a Future Affiliate shall abide by Sections 4.4 through 4.8 of the March 1997 Agreement.

17.6. Promptly after a Future Affiliate Transaction, Settling Defendants and the Attorneys General and their respective counsel, each agree to exercise best efforts to negotiate in good faith a settlement of all Attorneys General Actions against a Future Affiliate's Domestic Tobacco Operations.

17.7. Prior to a Future Affiliate Transaction, Settling Defendants shall not enter into any agreement with any prospective Future Affiliate which diminishes or impairs the prospective Future Affiliate's assets, other than in the established and/or ordinary course of business of such prospective Future Affiliate and shall use best efforts to prevent such prospective Future Affiliate from diminishing or impairing such assets. In the event of a Future Affiliate Transaction, Settling States reserve all of their rights to prevent the Future Affiliate from diminishing or impairing the Future Affiliate's Tobacco assets, other than in the

established and/or ordinary course of business of such Future Affiliate.

SECTION 18: MISCELLANEOUS.

18.1. All terms of this Agreement and/or obligations created thereby shall be deemed to include a covenant of good faith and fair dealing on behalf of all parties.

18.2. Brooke Group shall provide to all Settling States at the time of execution of this Agreement, an opinion in form satisfactory to the Settling States from legal counsel for Brooke Group as to the due execution of the Settlement Agreement by Brooke Group and Liggett and its enforceability against Brooke Group and Liggett and such other matters contemplated by Section 14.1 (other than the "agreements" referenced in clause (iv)).

18.3. In the event that a termination occurs pursuant to any section of this Agreement, neither the Attorney General Settlement Fund Board, nor any Settling State shall be required to return any payment received pursuant to this Agreement.

18.4. Subject to the provisions of Section 18 herein, this Agreement, including all Appendices attached hereto, if any, shall constitute the entire Agreement among the parties with regard to the subject of this Agreement and shall supersede any previous agreement and understandings between the Parties with respect to the subject matter of this Agreement. This Agreement may be changed, modified, or amended only in writing signed by all Parties or by Court Order.

18.5. With respect to each Settling State, this Agreement shall be construed under and governed by the laws of such State applied without regard to its law applicable to choice of law.

18.6. This Agreement may be executed by the Parties in one or more counterparts, each of which shall be deemed an original

but all of which together shall constitute one and the same instrument.

18.7. Any judgment by a court that any provision of this Agreement, as applied to any party or to any circumstance, is invalid or unenforceable shall in no way affect any other provision of this Agreement or the application thereof in any other circumstances, and such provision so adjudged invalid or unenforceable shall be enforced to the maximum extent permitted by law.

18.8. This Agreement shall be binding upon and inure to the benefit of the Settling States, the Settling Defendants, and their representatives, heirs, successors, and assigns.

18.9. Nothing in this Agreement shall be construed to subject any Settling Defendant's parent or affiliated company to the financial obligations or liabilities of that Settling Defendant.

18.10. The headings of the Sections of this Agreement are included for convenience only and shall not be deemed to constitute part of this Agreement or to affect its construction.

18.11. Any notice, request, instruction, or application for court orders sought in connection with this Agreement or other document to be given by any Party to any other Party shall be in writing and delivered personally or sent by registered or certified mail, postage prepaid, if to the Settling Defendants to the attention of Settling Defendants' Counsel, if to a Settling State to the attention of that State's Attorney General.

18.12. References to or use of a singular noun or pronoun in this Agreement shall include the plural, unless the context implies otherwise.

18.13. The Settling Defendants shall not represent directly or indirectly that the court or the Settling States or any Attorney General's

18.12. References to or use of a singular noun or pronoun in this Agreement shall include the plural, unless the context implies otherwise.

18.13. The Settling Defendants shall not represent directly or indirectly that the court or the Settling States or any Attorney General's

Office has sanctioned, condoned, or approved any part or aspect of their business operation or practices.

18.14. In the event that any Settling State's Attorney General must initiate legal action or incur any costs to compel the Settling Defendants to abide with the terms of this Agreement, the Settling Defendants shall be liable for any such costs, including but not limited to a reasonable sum for attorneys' fees.

18.15. The Settling Defendants shall pay their own attorney's fees and costs related in any way to this Settlement Agreement including any fees or costs incurred in connection with any investigation, compliance action, or Attorney General Action by the Settling States or any Subsequent Settling States.

SECTION 19: CONTINUING JURISDICTION

For those Settling States which have Attorney General Actions pending, this Agreement is intended to be filed in the courts in which such Actions are pending along with an appropriate motion or other pleading seeking to have this Agreement entered as a Final Judgment and Consent Decree or other comparable Order of the court. In each such Action, such Motion or other pleading shall be filed jointly by the Settling State and the Settling Defendants. Such Motion or other pleading shall include language requesting that jurisdiction be retained by the Court for the purpose of enabling any party to that Consent Decree to apply to the Court for further orders, to ensure compliance, seek relief, and/or request sanctions.

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

BROOKE GROUP LTD.

/s/ BENNETT S. LEBOW
- ------------------------
By Bennett S. LeBow

DATE:

LIGGETT GROUP, INC.

/s/ BENNETT S. LEBOW
- ------------------------
By Bennett S. LeBow

DATE:

LIGGETT & MYERS INC.

/s/ BENNETT S. LEBOW
- ------------------------
By Bennett S. LeBow

DATE:

KASOWITZ, BENSON, TORRES & FRIEDMAN

/s/ MARC E. KASOWITZ
- ------------------------
By Marc E. Kasowitz

DATE:

Attorneys for BROOKE GROUP LTD.,
LIGGETT GROUP, INC. AND
LIGGETT & MYERS INC.

APPENDIX A

OHIO

PENNSYLVANIA

COLORADO

NEW MEXICO

WYOMING

IDAHO

NEW HAMPSHIRE

MONTANA

NEBRASKA

RHODE ISLAND

ARKANSAS

MISSOURI

NORTH DAKOTA

MAINE

WASHINGTON, D.C.

U.S. VIRGIN ISLANDS

NORTH MARIANA ISLANDS

TERRITORY OF GUAM

APPENDIX B

ALABAMA	1.4686090%
ALASKA	0.2109795%
ARIZONA	1.3393470%
ARKANSAS	0.7524795%
CALIFORNIA	10.1783580%
COLORADO	1.2457280%
CONNECTICUT	1.6870710%
DELAWARE	0.2600965%
D.C.	0.5517000%
FLORIDA	4.9931995%
GEORGIA	2.2304125%
HAWAII	0.4476520%
IDAHO	0.2308300%
ILLINOIS	4.2294035%
INDIANA	1.7995035%
IOWA	0.7902830%
KANSAS	0.7575730%
KENTUCKY	1.6003985%
LOUISIANA	2.0167520%
MAINE	0.6991235%
MARYLAND	2.0541205%

MASSACHUSETTS	3.6702975%
MICHIGAN	3.9546980%
MINNESOTA	2.0636765%
MISSISSIPPI	0.7856500%
MISSOURI	2.0669735%
MONTANA	0.2867125%
NEBRASKA	0.4413985%
NEVADA	0.4549855%
NEW HAMPSHIRE	0.6051470%
NEW JERSEY	3.3842275%
NEW MEXICO	0.4426765%
NEW YORK	11.3673610%
NORTH CAROLINA	2.1193920%
NORTH DAKOTA	0.2333295%
OHIO	4.5660970%
OKLAHOMA	0.9415575%
OREGON	1.0428990%
PENNSYLVANIA	5.2222805%
RHODE ISLAND	0.6532830%
SOUTH CAROLINA	1.0689735%
SOUTH DAKOTA	0.2178195%
TENNESSEE	2.2180875%
TEXAS	5.0998475%
UTAH	0.3050030%
VERMONT	0.2743775%

VIRGINIA	1.8580990%
WASHINGTON	1.8658350%
WEST VIRGINIA	0.8055435%
WISCONSIN	1.8829015%
WYOMING	0.1264015%
AMERICAN SAMOA	0.0078600%
N. MARIANA ISLAND	0.0012700%
GUAM	0.0057040%
U.S. VIRGIN ISLANDS	0.0044130%
PUERTO RICO	0.4116015%
TOTAL	100.0000000%

APPENDIX C

Date

Re: Comprehensive Tobacco Control Legislation

Dear____________________:

The undersigned Attorneys General have reached a settlement with Brooke Group, Ltd., Liggett & Myers, Inc. and the Liggett Group, Inc. (collectively referred to as "Liggett"). Because of the Liggett's willingness to turn state's evidence in our litigation against the tobacco industry, we believe that Liggett deserves special consideration with respect to the FINANCIAL terms of any comprehensive tobacco control legislation enacted by Congress.

Specifically, in the event that such legislation mirrors the resolution reached between the Attorneys General and the tobacco industry in June 1997, we suggest that Liggett's financial obligations be as follows:

> Liggett shall have no obligation with respect to the $10 billion up front payment.
>
> Liggett shall be excused from any of the required per year payments to the extent that its market share is not more than 3%.
>
> To the extent that Liggett's share ever exceeds 3%, it shall be required to pay its share of the annual payments required by any legislation on the amount over 3%.

Sincerely,

[Insert AG Name]
[Insert Position]

STATE OF OHIO

/s/ BETTY D. MONTGOMERY

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Respectfully submitted,
STATE OF RHODE ISLAND
By Its Attorney,

/s/ JEFFREY B. PINE

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TERRITORY OF THE UNITED STATES
VIRGIN ISLANDS

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EXHIBIT 10.43

BROOKE GROUP LTD.
100 S.E. SECOND STREET, 32ND FLOOR
MIAMI, FLORIDA 33131

January 1, 1998

Ms. Joselynn D. Van Siclen
3610 Yacht Club Drive, #612
Aventura, Florida 33180

Dear Ms. Van Siclen:

We are pleased to inform you that Brooke Group Ltd. (the "Company") has granted you a nonqualified option (the "Option") to purchase 30,000 shares of the Company's common stock, par value $.10 per share (the "Common Stock"), at a price of $5.00 per share (any of the underlying shares of Common Stock to be issued upon exercise of the Option are referred to hereinafter as the "Shares"), subject to the following terms and conditions:

1. The Option may be exercised on or prior to December 31, 2006 (at which date the Option will, to the extent not previously exercised, expire), as follows: (a) as to 5,000 of the Shares, on and after the date hereof; (b) as to 5,000 of the Shares, on and after January 1, 1999; (c) as to 5,000 of the Shares, on and after January 1, 2000; (d) as to 5,000 of the Shares, on and after January 1, 2001; (e) as to 5,000 of the Shares, on and after January 1, 2002; and (f) as to the final 5,000 of the Shares, on and after January 1, 2003. Each such installment shall be cumulative and your right of purchase thereunder shall continue, unless exercised or terminated as herein provided, through the expiration date of the Option.

2. Any installment of the Option, from and after the date it becomes exercisable pursuant to Section 1 hereof, may be exercised in whole or in part by delivering to the Company a written notice of exercise in the form attached hereto as Exhibit A, specifying the number of the Shares to be purchased, together with payment of the purchase price of the Shares to be purchased. The purchase price is to be paid in cash or by delivering shares of Common Stock already owned by you and having a fair market value on the date of exercise equal to the exercise price of the Option, or a combination of such shares and cash.

3. Except to the extent provided in Section 4 hereof, in the event your employment with the Company is terminated for any reason, the Option shall forthwith terminate, provided that you may exercise any then unexercised installments of the Option then exercisable at any time prior to the earlier of three months after the termination of your employment or the expiration of the Option.

4. In the event of the occurrence of any Change of Control of the Company or of New Valley Corporation (as the term "Change of Control" is defined in Section 6(f) of the Employment Agreement, dated as of January 1, 1995, as amended as of January 1, 1996, between Howard M. Lorber and New Valley Corporation), other than any Change of Control arising by reason of a testamentary bequest by Bennett S. LeBow to or for the benefit of his surviving spouse of any or all securities of the Company or of New Valley Corporation beneficially owned by him as of his date of death so long as, following the bequest, the event referenced in Section 6(f)(ii) of such Employment Agreement shall not have occurred, all installments of the Option (to the extent not previously exercised) shall become immediately exercisable at any time prior to the earlier of three months after the termination of your employment or the expiration of the Option.

5. The Option is not transferable otherwise than by will or by the applicable laws of descent and distribution and may be exercised during your lifetime only by you (or in the event of your Disability, by your personal representative or representatives).

6. In the event of your death, the Option may be exercised by your personal representative or representatives or by the person or persons to whom your rights under the Option shall pass by will or by the applicable laws of descent or distribution.

7. In the event of any change in the outstanding Common Stock by reason of a stock dividend, recapitalization, merger, consolidation, split-up, subdivision, combination or exchange of shares, or the like, the aggregate number and kind of shares subject to the Option and the exercise price thereof shall be proportionately adjusted by the Company.

8. Unless at the time of the exercise of the Option a registration statement under the Securities Act of 1933, as amended (the "Act"), is in effect as to the Shares, the Shares shall be acquired for investment and not for sale or distribution, and if the Company so requests, upon any exercise of the Option, in whole or in part, you agree to execute and deliver to the Company a certificate to such effect.

9. You understand and acknowledge that, under existing law, unless at the time of the exercise of the Option a registration statement under the Act is in effect as to the Shares so issuable: (i) any Shares purchased by you upon exercise of the Option may be required to be held indefinitely unless such Shares are subsequently registered under the Act or an exemption from such registration is available; (ii) any sales of such Shares made in reliance upon Rule 144 promulgated under the Act may be made only in accordance with the terms and conditions of that Rule (which, under certain circumstances, restrict the number of shares which may be sold and the manner in which shares may be sold); (iii) in the case of securities to which Rule 144 is not

applicable, compliance with Regulation A promulgated under the Act or some other disclosure exemption shall be required; (iv) certificates for Shares to be issued to you hereunder shall bear a legend to the effect that the Shares have not been registered under the Act and that the Shares may not be sold, hypothecated or otherwise transferred in the absence of an effective registration statement under the Act relating thereto or an opinion of counsel satisfactory to the Company that such registration is not required; and (v) the Company shall place an appropriate "stop transfer" order with its transfer agent with respect to such Shares.

10. Promptly following the date hereof, the Company shall use its best efforts to file and keep in effect a Registration Statement on Form S-8, Form S-3 or other applicable form to register under the Act the Shares issuable to you upon exercise of the Option and the resale thereof by you.

Would you kindly evidence your acceptance of the Option and your agreement to comply with the provisions hereof by executing this letter in the space provided below.

Very truly yours,

BROOKE GROUP LTD.

By: /s/ Bennett S. LeBow

Bennett S. LeBow
Chairman, President
and Chief Executive Officer

AGREED TO AND ACCEPTED:

/s/ Joselynn D. Van Siclen
- -------------------------------
Joselynn D. Van Siclen

EXHIBIT A

Brooke Group Ltd.
100 S.E. Second Street, 32nd Floor
Miami, Florida 33131

Gentlemen:

Notice is hereby given of my election to purchase __________ shares of Common Stock, $.10 par value (the "Shares"), of Brooke Group Ltd., at a price of $5.00 per Share, pursuant to the provisions of the stock option granted to me on January 1, 1998. Enclosed in payment for the Shares is:

[ ] my check in the amount of $ ____________________.

[ ] _______________ Shares having a total value of $______________, such value being based on the closing price(s) of the Shares on the date hereof.

The following information is supplied for use in issuing an registering the Shares purchased hereby:

Number of Certificates and Denominations _________________________

Name _________________________

Address _________________________

____

Social Security _________________________

Dated:

Very truly yours,

Joselynn D. Van Siclen

EXHIBIT 10.56

BROOKE GROUP LTD.

STOCK OPTION AGREEMENT

THIS AGREEMENT is made and entered into as of the 12th day of March, 1998, by and between BROOKE GROUP LTD., a Delaware corporation (the "Company"), and KASOWITZ, BENSON, TORRES & FRIEDMAN LLP, a New York limited liability partnership, MARC E. KASOWITZ and DANIEL R. BENSON (collectively, the "Holder").

WHEREAS, the Company desires to issue, and the Holder desires to receive, a nonqualified non-transferable option to purchase shares of the Common Stock, $.10 par value, of the Company (the "Common Stock"), pursuant to the terms described herein.

NOW, THEREFORE, in consideration of the terms and conditions contained herein and other good and valuable consideration the receipt of which is hereby acknowledged, and intending to be legally bound hereby, the parties agree as follows:

1. GRANT OF OPTION. The Company hereby grants to the Holder an option (the "Option") to purchase, in accordance with the terms hereof, at an option price of $17.50 per share, (i) commencing May 1, 1998, up to 250,000 (two hundred and fifty thousand) shares of the Common Stock and (ii) commencing on the earlier of a Change of Control or April 1, 1999, up to an additional 1,000,000 (one million) shares of the Common Stock. The Option will expire at the close of business on March 31, 2003.

For purposes of this Agreement, a "Change of Control" shall occur if or upon the occurrence of:

(i) Any "Person" (as the term person is used for purposes of Section 13(d) or 14(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) acquires "Beneficial Ownership" (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of any securities of the Company which generally entitles the holder thereof to vote for the election of directors of the Company (the "Voting Securities"), which, when added to the Voting Securities then "Beneficially Owned" by such person, would result in such Person "Beneficially Owning" forty percent (40%) or more of the combined voting power of the Company's then outstanding Voting Securities; provided, however, that for purposes of this paragraph (i), a Person shall not be deemed to have made an acquisition of Voting Securities if such Person: (a) acquires Voting Securities as a result of a stock split, stock dividend or other corporate restructuring in which all stockholders of the class of such Voting Securities are treated on a pro rata basis: (b) acquires the Voting Securities directly from the Company; (c) becomes the Beneficial Owner of more than the permitted percentage of Voting Securities solely as a result of the acquisition of Voting Securities by the Company which, by

reducing the number of Voting Securities outstanding, increases the proportional number of shares Beneficially Owned by such Person; (d) is the Company or any corporation or other Person of which a majority of its voting power or its equity securities or equity interest is owned directly or indirectly by the Company (a "Controlled Entity"); or (e) acquires Voting Securities in connection with a "Non-Control Transaction" (as defined in paragraph (iii) below); or

(ii) The individuals who, as of March 12, 1998, are members of the Board (the "Incumbent Board") cease for any reason to constitute at least two-thirds of the Incumbent Board; provided, however, that if either the election of any new director or the nomination for election of any new director was approved by a vote of more than two-thirds of the Incumbent Board, such new director shall be considered as a member of the Incumbent Board; provided further, however, that no individual shall be considered a member of the Incumbent Board if such individual initially assumed office as a result of either an actual or threatened "Election Contest" (as described in Rule 14a-11 promulgated under the Exchange Act) or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board (a "Proxy Contest"), including by reason of any agreement intended to avoid or settle any Election Contest or Proxy Contest; or

(iii) Shareholder approval of:

(a) A merger, consolidation or reorganization involving the Company (a "Business Combination"), unless

(1) the stockholders of the Company immediately before the Business Combination, own, directly or indirectly immediately following the Business Combination, at least fifty-one percent (51%) of the combined voting power of the outstanding Voting Securities of the corporation resulting from the Business Combination (the "Surviving Corporation") in substantially the same proportion as their ownership of the Voting Securities immediately before the Business Combination, and

(2) the individuals who were members of the Incumbent Board immediately prior to the execution of the agreement providing for the Business Combination constitute at least a majority of the members of the Board of Directors of the Surviving Corporation, and

(3) no Person (other than the Company or any Controlled Entity, a trustee or other fiduciary holding securities under one or more employee benefit plans or arrangements (or any trust forming a part thereof) maintained by the Company, the Surviving Corporation or any Controlled Entity, or any Person who, immediately prior to the Business Combination, had Beneficial Ownership of forty percent (40%) or more of the then outstanding Voting Securities) has Beneficial Ownership of forty percent (40%) or more of the combined voting power

of the Surviving Corporation's then outstanding voting securities (a transaction described in this subparagraph (a) shall be referred to as a "Non-Control Transaction");

(b) A complete liquidation or dissolution of the Company; or

(c) The sale or other disposition of all or substantially all of the assets of the Company to any Person (other than a transfer to a Controlled Entity).

Notwithstanding the foregoing, (x) a Change in Control shall not be deemed to occur solely because forty percent (40%) or more of the then outstanding Voting Securities is Beneficially Owned by (A) a trustee or other fiduciary holding securities under one or more employee benefit plans or arrangements (or any trust forming a part thereof) maintained by the Company or any Controlled Entity or (B) any corporation which, immediately prior to its acquisition of such interest, is owned directly or indirectly by the stockholders of the Company in the same proportion as their ownership of stock in the Company immediately prior to such acquisition; and (y) a Change of Control shall not be deemed to occur by reason of a testamentary bequest by Bennett S. LeBow to or for the benefit of his surviving spouse of any or all securities of the Company beneficially owned by him as of his date of death.

2. ACCEPTANCE OF GRANT OF OPTION. The Holder accepts the grant of the Option confirmed hereby and agrees to be bound by the terms and conditions of this Agreement.

3. INVESTMENT PURPOSE. The Holder represents to the Company that the Holder is acquiring the Option and any securities which may be acquired pursuant to the Option for investment and not with a view to or for sale in connection with any distribution thereof. The Holder represents that it will not sell or transfer any securities acquired pursuant to the Option in violation of the Securities Act of 1933, as amended (the "Act"), or the rules and regulations promulgated thereunder. Without limiting the scope of the foregoing representation and warranty, the Holder agrees that it will not sell or transfer any such securities unless either (a) a registration statement under the Act shall be in effect with respect to such securities and the Holder shall comply with the provisions of the Act in connection with the sale of such securities; or (b) the Holder has, prior to any transfer or attempt to transfer such securities, obtained an opinion of counsel satisfactory to the Company, stating that such transfer may be effected without registration of such securities under the Act.

4. LEGEND. The Holder of the Option agrees that the Company may place a legend reflecting the provisions of Section 3 on each certificate evidencing any securities delivered to the Holder pursuant to the Option and the Company may place an appropriate "stop transfer" order with its transfer agent with respect to such securities.

5. RECAPITALIZATION, ETC. In the event of any change in the outstanding Common Stock by reason of a stock dividend, recapitalization, merger, consolidation, split-up, subdivision, combination or exchange of shares, or the like, the aggregate number and kind of shares subject to the Option and the exercise price thereof shall be proportionately adjusted by the Company.

6. REGISTRATION. The Company agrees to use its best efforts to file and keep effective during the entire term of the Option, a Registration Statement on Form S-8, Form S-3 or other applicable form with respect to the shares of Common Stock issuable upon the exercise of the Option.

7. PROCEDURE FOR EXERCISE OF OPTION. The Option may be exercised only by (a) delivery by the Holder to the Company of written notice of exercise and (b) surrender of this Agreement to the Company. Each exercise notice must set forth the number of shares of Common Stock for which the Option is exercised and must be dated and signed on behalf of the Holder by both Marc E. Kasowitz and Daniel R. Benson. Upon partial exercise hereof, a new Agreement containing the same provisions as this Agreement shall be issued by the Company to the Holder for the number of shares of Common Stock with respect to which the Option shall not have been exercised.

Subject to the last paragraph of this Section 7, the exercise is not effective until the Company receives payment of the full option price for the number of shares of Common Stock for which the Option is exercised. The option price shall be paid to the Company in full in cash.

The date of exercise of the Option is the date on which notice of exercise and payment of the option price are received by the Company.

8. ISSUANCE OF CERTIFICATES. Subject to Section 7 above and this Section 8, the Company will issue, without transfer or issue tax or other incidental expense, a certificate or certificates representing the number of shares of Common Stock for which the Option is exercised as soon as practicable after the date of exercise. Unless otherwise directed, the certificate(s) will be registered in the name of the person exercising the Option and delivered to such person.

9. NON-TRANSFERABILITY OF OPTION. Without the prior written consent of the Company, the Option is not transferable.

10. BINDING EFFECT. This Agreement shall be binding upon the successors and assigns of the Company and inure to and be binding upon the legal representatives, heirs and legatees of the Holder.

11. ENTIRE AGREEMENT. This Agreement constitutes the entire agreement between the parties and supersedes all prior agreements and understandings, oral or written, between the parties with respect to the subject matter of this Agreement.

12. AMENDMENT. This Agreement may be amended only a written instrument signed by the Company and the Holders.

13. GOVERNING LAW. This Agreement shall be governed by and construed and enforced in accordance with the laws of the State of New York.

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

BROOKE GROUP LTD.

By: /s/ Bennett S. LeBow

Name: Bennett S. LeBow
Title: Chairman, President and Chief Executive Officer

KASOWITZ, BENSON, TORRES & FRIEDMAN LLP

By: /s/ Marc E. Kasowitz

Name: Marc E. Kasowitz
Title:

By: /s/ Daniel R. Benson

Name: Daniel R. Benson
Title:

/s/ Marc E. Kasowitz

Marc E. Kasowitz

/s/ Daniel R. Benson

Daniel R. Benson

Exhibit 21

SUBSIDIARIES OF THE COMPANY

The following is a list of the active subsidiaries of the Company as of March 30, 1998, indicating the jurisdiction of incorporation of each and the names under which such subsidiaries conduct business. In the case of each subsidiary which is indented, its immediate parent owns beneficially all of the voting securities.

NAME OF SUBSIDIARY	JURISDICTION OF INCORPORATION
BGLS Inc.	Delaware
Liggett Group Inc.	Delaware
Brooke (Overseas) Ltd.	Delaware
New Valley Holdings, Inc.	Delaware

Not included above are other subsidiaries which, if considered in the aggregate as a single subsidiary, would not constitute a significant subsidiary, as such term is defined by Rule 1-02(w) of Regulation S-X.

Exhibit 23.1

CONSENT OF INDEPENDENT ACCOUNTS

We consent to the incorporation by reference in the registration statements of Brooke Group Ltd. on Form S-3 (File No. 33-38869 and File No. 33-63119) and Form S-8 (File No. 333-24217) of: (i) our report, dated April 8, 1998, on our audits of the consolidated financial statements and financial statements schedule of Brooke Group Ltd. and Subsidiaries as of December 31, 1997 and 1996, and for the years ended December 31, 1997, 1996 and 1995 and (ii) our report, dated March 31, 1998 on our audits of the consolidated financial statements of New Valley Corporation and Subsidiaries as of December 31, 1997 and 1996, and for the years ended December 31, 1997, 1996, and 1995, which reports are included in this Annual Report on Form 10-K.

Coopers & Lybrand L.L.P.

Miami, Florida
April 8, 1998

Exhibit 23.2

ARTHUR ANDERSEN LLP

CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

The Board of Directors
Brooke Group Ltd.

We consent to the incorporation by reference of our report dated January 23, 1998 in the registration statements on Form S-3 (No. 33-38869 and No. 33-63119) and Form S-8 (No. 333-24217) of Brooke Group Ltd., relating to the consolidated balance sheets of Thinking Machines Corporation and subsidiaries as of December 31, 1997 and 1996, and the related consolidated statements of operations, stockholders' equity and cash flows for the year ended December 31, 1997 and the period from February 8, 1996 (inception) to December 31, 1996, which report appears in the December 31, 1997 annual report on Form 10-K of New Valley Corporation.

Arthur Andersen LLP

/s/ Arthur Andersen LLP
- -----------------------

Boston, Massachusetts
April 3, 1998

5
0000927388
BGLS INC.
1,000

YEAR
DEC-31-1997
JAN-01-1997
DEC-31-1997
4,754
0
10,462
0
39,312
67,985
45,943
0
202,323
139,704
400,635
0
0
1,850
(490,247)
126,460
389,615
389,615
202,121
202,121
27,035
0
61,778
(50,687)
1,123
(51,810)
1,925
0
0
(49,885)
(2.74)
(2.74)

5
0000059440
BROOKE GROUP, LTD.
1,000

YEAR
DEC-31-1997
JAN-01-1997
DEC-31-1997
4,754
0
10,462
0
39,312
67,366
45,775
0
128,916
160,675
400,635
0
0
0
(513,115)
128,916
389,615
389,615
202,121
202,121
27,035
0
65,581
(53,665)
1,135
(54,800)
1,925
0
0
(52,875)
0
0

EXHIBIT 99.1

MATERIAL LEGAL PROCEEDINGS

STATE MEDICAID REIMBURSEMENT CASES

STATE OF MINNESOTA, ET AL. V. PHILIP MORRIS, ET AL., Case No. C1-94-8565, District Court, County of Ramsey, 2nd Judicial District (case filed on August 18, 1994). This case was settled by Liggett and Brooke as to the State of Minnesota on March 20, 1997. The case remains pending as to claims by Blue Cross/Shield of Minnesota.

COMMONWEALTH OF PUERTO RICO, ET AL. V. BROWN & WILLIAMSON, ET AL., Case No. 97-1910 (JAF), USDC, District Court of Puerto Rico (case filed on June 27, 1997). This case brought on behalf of the Commonwealth of Puerto Rico seeks compensatory and injunctive relief for damages incurred by the Commonwealth in paying for the medicaid expenses of indigent smokers. This case is presently stayed.

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

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

STATE OF VERMONT V. PHILIP MORRIS, ET AL., Case No. 744-97CnC, Chittenden County Superior Court (case filed on May 29, 1997). This case brought on behalf of the State of Vermont seeks compensatory and injunctive relief for damages incurred by the state in paying for the medicaid expenses of indigent smokers.

CLASS ACTION CASES

FLETCHER, ET AL. V. BROOKE GROUP, LTD., ET AL., Case No. CV-97-913, Circuit Court of Mobile County, Alabama (case filed on March 20, 1997). Nationwide class certified and limited fund class action settlement preliminarily approved with respect to Liggett and Brooke Group on March 20, 1997.

HANSEN, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. LR-C-96-881, USDC, Eastern District of Arkansas (case filed on April 4, 1997). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated addicted smokers resident in Arkansas. Plaintiffs filed a motion for class certification on September 15, 1997, which motion remains pending.

BROWN, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 711400, Superior Court of San Diego, California (case filed on October 1, 1997). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in California. No motion for class certification has been brought by plaintiff.

FINELLI, ET AL. V. PHILIP MORRIS, ET AL., Case No. 96-04348, DC, Superior Court of District of Columbia. Liggett is named as a defendant in this putative class action, but has not been served.

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

BROIN, ET AL. V. PHILIP MORRIS, ET AL., Case No. 91-49738 CA 22, FL, Circuit Court Dade County (case filed on October 31, 1991). This action brought on behalf of all flight attendants that have been injured by exposure to environmental tobacco smoke was certified as a class action on December 12, 1994. This case was settled with respect to all defendants on October 10, 1997, which settlement was finally approved by the court on February 2, 1998. A notice of appeal is currently pending.

ENGLE, ET AL. V. R.J. REYNOLDS, ET AL., Case No. 94-08273 CA 20, FL, Circuit Court, Dade County (case filed on May 5, 1994). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in Florida. The case was certified

as a class action on October 31, 1994, and trial is expected to commence during the Summer, 1998.

PETERSON, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 97-0490-02, First Circuit Court, Honolulu, Hawaii (case filed on February 6, 1997). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated addicted smokers resident in Hawaii.

CLAY, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 97-4167-JPG, USDC, Southern District of Illinois (case filed on May 22, 1997). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated addicted smokers resident in 34 states. No motion for class certification has been brought by plaintiff.

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

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

EMIG, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 97-1121-MLB, USDC, District of Kansas (case filed on April 11, 1997). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated addicted smokers resident in Kansas. Plaintiff's motion for class certification currently is pending.

CASTANO, ET AL. V. THE AMERICAN TOBACCO COMPANY ET AL., Case No. 95-30725, USDC, Eastern District of Louisiana (case filed on March 29, 1994). This case was certified as a class action by the district could on February 17, 1995. This case was settled by Liggett and Brooke on March 12, 1996. The class was decertified by the Fifth Circuit in May 1996. Plaintiffs' motion for approval of the settlement was withdrawn on September 6, 1996.

GRANIER, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., USDC, Eastern District of Louisiana (case filed on September 29, 1994). This case is currently stayed pursuant to a decision in Castano.

YOUNG, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 2:97-CV-03851, Civil District Court, Parish of Orleans, Louisiana (case filed on November 12, 1997). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in Louisiana. No motion for class certification has been brought by plaintiff.

RICHARDSON, ET AL. V. PHILIP MORRIS, ET AL., Case No. 96145050/CL212596, Circuit Court, Baltimore City, Maryland (case filed on May 29, 1996). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated addicted smokers resident in Maryland. This class action was certified by the court on January 28, 1998.

Exhibit 99.2

LIGGETT GROUP INC.

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 1997

LIGGETT GROUP, INC.
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REPORT OF INDEPENDENT ACCOUNTANTS

Board of Directors and Stockholder
Liggett Group Inc.

We have audited the consolidated financial statements and the financial statement schedule of Liggett Group Inc. listed in the index on page 15 of this Form 10-K. These financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and the financial schedule based on our audits.

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 provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Liggett Group Inc. as of December 31, 1997 and 1996 and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1997 in conformity with generally accepted accounting principles. In addition, in our opinion, the financial statement schedule referred to above, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all materially respects, the information required to be included therein.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2a to the financial statements, the Company suffered a loss of $14,179,000 for the year ended December 31, 1997 and had net capital and working capital deficiencies of $192,857,000 and $17,542,000, respectively, at December 31, 1997. The Company also has a $144,891,000 principal payment due on its Senior Secured Notes on February 1, 1999 and the Company's revolving credit facility (the "Facility"), which had a balance of $23,427,000 at December 31, 1997, is due on March 8, 1999. The Company's financial resources are not sufficient to repay the Senior Secured Notes when they become due, nor will the Company be able to repay the Facility when it becomes due. In addition, as disclosed in Note 2a to the financial statements, due to the many risk and uncertainties associated with the cigarette industry and the impact of tobacco litigation, there can be no assurance that the Company will be able to meet its future earnings or cash flow goals. These facts raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2a. The financial statements do not include any adjustments that might result from the outcome of these uncertainties.

COOPERS & LYBRAND L.L.P.

Miami, Florida
April 8, 1998

LIGGETT GROUP INC.

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share amounts)

	December 31, 1997	December 31, 1996
ASSETS		
Current assets:		
Accounts receivable:		
Trade, less allowances of $1,062 and $1,280,respectively.	$ 9,572	$19,316
Other	743	744
Inventories	35,057	50,122
Other current assets (Note 6)	738	1,205
Total current assets	46,110	71,387
Property, plant and equipment, at cost, less accumulated depreciation of $29,452 and $29,511, respectively	17,756	18,705
Intangible assets, at cost, less accumulated amortization of $19,111 and $17,388, respectively	1,609	3,327
Other assets and deferred charges, at cost, less accumulated amortization of $9,000 and $7,410, respectively	3,000	4,258
Total assets	$68,475	$97,677

(continued)

LIGGETT GROUP INC.

CONSOLIDATED BALANCE SHEETS (Continued)

(Dollars in thousands, except per share amounts)

	December 31, 1997	December 31, 1996
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Current liabilities:		
Current maturities of long-term debt	$ 28	$ 31,807
Cash overdraft	891	6
Accounts payable, principally trade	6,413	18,505
Accrued expenses:		
Promotional	26,993	30,257
Taxes, principally excise taxes	3,643	7,565
Estimated allowance for sales returns	4,750	5,000
Interest	8,070	8,435
Settlement accruals	4,030	--
Other	8,834	10,506
Total current liabilities	63,652	112,081
Long-term debt, less current maturities	168,112	144,698
Non-current employee benefits	11,168	11,340
Other long-term liabilities	18,400	6,036
Commitments and contingencies (Notes 5 and 12)		
Stockholder's equity (deficit):		
Redeemable preferred stock (par value $1.00 per share; authorized 1,000 shares; no shares issued and outstanding)		
Common stock (par value $0.10 per share; authorized 2,000 shares; issued and outstanding 1,000 shares) and contributed capital	47,640	49,840
Accumulated deficit	(240,497)	(226,318)
Total stockholder's deficit	(192,857)	(176,478)
Total liabilities and stockholder's equity (deficit)	$ 68,475	$ 97,677

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

LIGGETT GROUP INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands)

	Year Ended December 31,		
	1997	1996	1995
Net sales*	$ 312,268	$ 401,062	$ 455,666
Cost of sales*	139,310	187,799	212,314
Gross profit	172,958	213,263	243,352
Selling, general and administrative expenses	151,186	203,214	212,830
Settlement charges	16,527	--	3,976
Restructuring	1,557	3,296	1,927
Operating income	3,688	6,753	24,619
Other income (expense):			
Interest income	60	23	3
Interest expense	(23,755)	(23,901)	(23,449)
Equity in income (loss) of affiliates	498	(1,116)	--
Sale of assets	3,595	3,669	--
Miscellaneous, net	1,735	--	1,133
(Loss) income before income taxes	(14,179)	(14,572)	2,306
Income tax provision	--	3,800	1,751
Net (loss) income	$ (14,179)	$ (18,372)	$ 555

*Net sales and cost of sales include federal excise taxes of $75,316, $104,518 and $123,420 respectively.

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

LIGGETT GROUP INC.
STATEMENTS OF STOCKHOLDER'S EQUITY (DEFICIT)

(Dollars in thousands)

	Common Stock and Contributed Capital	Deficit	Total Stockholder's Equity (Deficit)
Balance at December 31, 1994	$ 53,240	$(207,703)	$(154,463)
Net income	--	555	555
Excess of investment over cost basis of net assets acquired from indirect parent ...	--	(798)	(798)
Balance at December 31, 1995	53,240	(207,946)	(154,706)
Net loss	--	(18,372)	(18,372)
Consideration for option to acquire affiliate stock in excess of its net assets (Note 13).	(3,400)	--	(3,400)
Balance at December 31, 1996	49,840	(226,318)	(176,478)
Net loss	--	(14,179)	(14,179)
Excess of investment over cost basis of net assets acquired from indirect parent ...	(2,200)	--	(2,200)
Balance at December 31, 1997	$ 47,640	$(240,497)	$(192,857)

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

LIGGETT GROUP INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	Year Ended December 31,		
	1997	1996	1995
Cash flows from operating activities:			
Net income (loss)	$ (14,179)	$ (18,372)	$ 555
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	7,025	7,969	7,972
Deferred income taxes	--	3,800	1,259
Gain on sale of property, plant and equipment	(3,595)	(3,669)	(375)
Gain on retirement of notes	(2,963)	--	(1,273)
Deferred finance charges and debt discount written off	130	--	160
Equity in (income) loss of affiliate	(498)	1,116	--
Changes in assets and liabilities:			
Accounts receivable	9,745	4,691	7,060
Inventories	15,065	4,220	(7,658)
Accounts payable	(12,092)	(330)	7,671
Accrued expenses	(5,442)	8,479	(10,638)
Non-current employee benefits	(172)	(276)	(225)
Other, net	12,027	(1,461)	9,079
Net cash provided by operating activities	5,051	6,167	13,587
Cash flows from investing activities:			
Proceeds from sale of property, plant and equipment	4,494	4,424	570
Capital expenditures	(2,462)	(4,319)	(1,104)
Investment in affiliates	(2,200)	(5,500)	(800)
Net cash used in investing activities	(168)	(5,395)	(1,334)
Cash flows from financing activities:			
Repayments of long-term debt	(4,775)	(254)	(8,208)
Borrowings under revolving credit facility	278,442	351,428	397,873
Repayments under revolving credit facility	(279,286)	(348,173)	(401,703)
Deferred finance charges	(149)	(18)	--
Increase (decrease) in cash overdraft	885	(3,755)	(215)
Net cash used in financing activities	(4,883)	(772)	(12,253)
Net change in cash and cash equivalents	--	--	--
Cash and cash equivalents:			
Beginning of period	--	--	--
End of period	$ --	$ --	$ --
Supplemental cash flow information:			
Cash payments during the period for:			
Interest	$ 23,491	$ 23,228	$ 23,196
Income taxes	$ 162	$ 189	$ 130

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

LIGGETT GROUP INC.

Notes to Consolidated Financial Statements

(Dollars in thousands, except per share amounts)

1. Basis of Presentation

Liggett Group Inc. ("Liggett" or the "Company") is a wholly-owned subsidiary of BGLS Inc. ("BGLS"), a wholly-owned subsidiary of Brooke Group Ltd. ("BGL"). Liggett is engaged primarily in the manufacture and sale of cigarettes, principally in the United States. Certain management and administrative functions are performed by affiliates (see Note 13).

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

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

In February 1998, SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits" was issued which revises required disclosures about pensions and postretirement benefit plans. SFAS No. 132 is effective for the Company for the year ended 1998. The Company has not yet determined the impact of its implementation.

2. Summary of Significant Accounting Policies

a. Going Concern

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. Liggett had a net capital deficiency of $192,857 as of December 31, 1997, is highly leveraged and has substantial near-term debt service requirements. (See Note 10.) Due to the many risks and uncertainties associated with the cigarette industry and the impact of tobacco litigation (see Note 12), there can be no assurance that the Company will be able to meet its future earnings or cash flow goals. Consequently, the Company could be in violation of its debt covenants, including covenants limiting the maximum permitted net worth and working capital deficiencies, and if its lenders were to exercise acceleration rights under its revolving credit facility (the

"Facility") or the indenture for the 11.50% Secured Notes due February 1, 1999 and the Variable Rate Series C Senior Secured Notes due February 1, 1999 (together, the "Liggett Notes") or refuse to lend under the Facility, the Company would not be able to satisfy such demands or its working capital requirements.

On January 30, 1998, the Company obtained the consents of the required majority of the holders of the Liggett Notes to various amendments to the Indenture governing the Liggett Notes. The amendments provide, among other things, for a deferral of the February 1, 1998 mandatory redemption of $37,500 principal amount of the Liggett Notes to the date of final maturity, February 1, 1999. (Refer to Note 10.) At maturity, the Liggett Notes will require a principal payment of $144,891. Based on Liggett's results of operations for 1997, the Company does not anticipate it will be able to generate sufficient cash from operations to make such payments. In addition, the Company has a $40,000 Facility expiring March 8, 1999 under which $23,427 was outstanding at December 31, 1997. While management currently intends to refinance and/or restructure with the Company's note holders the maturity requirements on the Liggett Notes and to extend the Facility, there are no refinancing or restructuring arrangements for the notes or commitments to extend the Facility at this time, and no assurances can be given in this regard. If the Company is unable to refinance or restructure the terms of the Liggett Notes or otherwise make all payments thereon, substantially all of the Company's long-term debt and the Facility would be in default and holders of such debt could accelerate the maturity of such debt. In such event, Liggett may be forced to seek protection from creditors under applicable laws. These matters raise substantial doubt about the Company meeting its liquidity needs and its ability to continue as a going concern.

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

b. Principles of Consolidation

The consolidated financial statements include the accounts of Liggett and its wholly-owned subsidiaries, Eve Holdings Inc. ("Eve"), Cigarette Exporting Company of America Ltd. ("CECOA") and Carolina Tobacco Express Company ("CTEC"). Intercompany accounts and transactions have been eliminated.

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 at December 31, 1997 and 1996 and the reported amounts of revenues and expenses during the three year period ended December 31, 1997. Significant estimates subject to material changes in the near term include deferred tax assets, allowance for doubtful accounts, promotion accruals, sales returns and allowances, actuarial assumptions of pension plans and litigation and defense costs. Actual results could differ from those estimates.

d. Per Share Data

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

e. Inventories

Inventories are valued at the lower of cost (LIFO) or market. 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.

f. 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 twenty years for buildings and four to ten 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.

The Company is 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. Accordingly, when indicators of impairment are present, the Company evaluates the carrying value of property, plant and equipment and intangibles in relation to the operating performance and estimates of future discounted cash flows of the underlying business.

g. Trademarks

Trademarks are amortized using the straight-line method over twelve years. Amortization expense for the years ended December 31, 1997, 1996 and 1995 amounted to $1,723, $1,726 and $1,725, respectively. Management periodically reviews the carrying value of trademarks to determine whether asset values are impaired.

h. Sales and Sales Returns

Revenue from sales is recognized upon the shipment of finished goods to customers. The Company provides for expected sales returns, net of related inventory cost recoveries. As Liggett does not have any other lines of business, the Company's financial position and its results of operations could be materially adversely affected by significant unit sales volume declines, litigation and defense costs, increased tobacco costs or reductions in the selling price of cigarettes.

i. Advertising and Promotional Costs

Advertising and promotional costs are expensed as incurred. Advertising expenses were $40,534, $74,238 and $75,713 for the years ended December 31, 1997, 1996 and 1995, respectively.

j. Employee Benefits

The Company 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, 1997 and 1996 which are subject to significant fluctuations in the near term.

BGLS maintains defined benefit retirement plans for substantially all of the Company's employees. The Company records as an expense the portion of BGLS' annual funding requirements applicable to the Company.

The Company sponsors a postretirement benefit plan and records an actuarially determined liability and charges operations for the estimated cost of postretirement benefits for current employees and retirees.

k. Income Taxes

Deferred taxes reflect the impact of temporary differences between the amounts of assets and liabilities recognized for financial reporting purposes and the amounts recognized for tax purposes as well as tax credit carryforwards and loss carryforwards. These deferred taxes are measured by applying currently enacted tax rates. A valuation allowance reduces deferred tax assets when it is deemed more likely than not that future taxable income will be insufficient to realize some portion or all of the deferred tax assets.

l. Legal Costs

The Company's accounting policy is to accrue legal and other costs related to contingencies as services are performed.

2. Fair Value of Financial Instruments

The fair values of the Company's Senior Secured Notes have been based upon market quotations (see Note 10). The carrying amount of borrowings outstanding under the revolving credit facility and other long-term debt is a reasonable estimate of fair value, based upon estimated current borrowing rates for loans with similar terms and maturities. The estimates 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.

3. Changes in Accounting Estimates

In September 1995, the Company adjusted an accrual estimate recorded in prior years which had the effect of increasing operating income by approximately $1,214 for the year ended December 31, 1995. Liggett increased its valuation allowance for deferred tax assets by $443 in the fourth quarter of 1995.

Liggett increased its valuation allowance for deferred tax assets by $3,800 in the third quarter of 1996. In December 1996, Liggett increased its estimate of coupon promotions which resulted in a decrease in the Company's operating income of $1,800 for the year ended December 31, 1996.

As a consequence of certain litigation settlements (see Note 12), Liggett charged approximately $16,421 to operations in the fourth quarter of 1997. 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 the Company's operating results are known.

4. Concentrations of Credit Risk

Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of trade receivables.

Liggett's customers are primarily candy and tobacco distributors, the military and large grocery, drug and convenience store chains. Liggett's largest single customer accounted for approximately 19.4% in 1997, approximately 13.9% of net sales in 1996 and approximately 11.6% of net sales in 1995. Sales to this customer were primarily in the private label discount market segment. Concentrations of credit risk with respect to trade receivables are limited due to the large number of customers comprising the remainder of the Company's customer base. Ongoing credit evaluations of customers' financial condition

are performed and, generally, no collateral is required. The Company maintains reserves for potential credit losses and such losses, in the aggregate, have not exceeded management's estimates.

5. Inventories

Inventories consist of:

	December 31, 1997	December 31, 1996
Finished goods	$ 13,273	$ 15,304
Work-in-process	1,926	4,382
Raw materials	21,211	31,338
Replacement parts and supplies	3,545	3,554
Inventories at current cost	39,955	54,578
LIFO adjustment	(4,898)	(4,456)
Inventories at LIFO cost	$ 35,057	$ 50,122

The Company has a leaf inventory management program whereby, among other things, it is committed to purchase certain quantities of leaf tobacco. The purchase commitments are for quantities not in excess of anticipated requirements and are at prices, including carrying costs, established at the date of the commitment. Liggett had leaf tobacco purchase commitments of approximately $10,200 at December 31, 1997.

6. Sale of Assets

On May 14, 1996, Liggett sold to the County of Durham certain surplus realty in Durham, North Carolina, for a sale price of $4,300 and recognized a gain of approximately $3,600.

On April 29, 1996, Liggett executed a definitive agreement (as amended) with Blue Devil Ventures, a North Carolina limited liability partnership, for the sale by Liggett to Blue Devil Ventures of certain surplus realty in Durham, North Carolina, for a sale price of $2,200. The net book value of those assets ($309) for which the agreement was signed was classified as current assets on the Company's Consolidated Balance Sheet as of December 31, 1996. The transaction closed on March 11, 1997. A gain of $1,147 was recognized, net of costs required to prepare the properties for sale and selling costs. (See Note 13 for sales to affiliates.)

7. Property, Plant and Equipment

Property, plant and equipment consists of the following:

	December 31, 1997	December 31, 1996
Land and improvements	$ 411	$ 455
Buildings	6,228	5,848
Machinery and equipment	40,569	41,913
Property, plant and equipment	47,208	48,216
Less accumulated depreciation	(29,452)	(29,511)
Property, plant and equipment, net	$ 17,756	$ 18,705

8. Employee Benefits Plans

Defined Benefit Retirement Plans

Prior to 1994, substantially all of Liggett's employees participated in two noncontributory defined benefit retirement plans sponsored by BGLS. The Company records as an expense the portion of BGLS' annual funding requirements applicable to the Company. There was no pension expense recorded in 1997, 1996 or 1995.

Future Pension Benefits to be Funded by BGLS

Actuarial estimates of the total future minimum pension benefits to be funded by BGLS, prior to the effect of unamortized purchase accounting adjustments, are as follows:

1998	$ 350
1999	300
2000	300
2001	250
2002	200
Thereafter	2,000
Total	$3,400

Postretirement Medical and Life Insurance Plans

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

The components of net periodic postretirement benefit expense are as follows:

	Year Ended December 31,		
	1997	1996	1995
Service cost, benefits attributed to employee service during the year	$ 24	$ 68	$ 68
Interest cost on accumulated postretirement benefit obligation	703	829	970
Charge for special termination benefits	47	137	489
Amortization of net gain	(193)	(92)	(26)
Net periodic postretirement benefit expense	$ 581	$ 942	$ 1,501

The following sets forth the actuarial present value of the Accumulated Postretirement Benefit Obligation ("APBO") applicable to each employee group for benefits:

	December 31, 1997	December 31, 1996
Retired employees	$ 6,870	$ 7,899
Active employees - fully eligible	498	674
Active employees - not fully eligible	810	515
	8,178	9,088
APBO	3,992	3,324
Purchase accounting valuation adjustment related to income taxes	(963)	(1,072)
Postretirement liability	$ 11,207	$ 11,340

The APBO at December 31, 1997 and 1996 was determined using discount rates of 7.5% and 8%, respectively, and a health care cost trend rate of 4% in 1997 and 1996. A 1% increase in the trend rate for health care costs would have increased the APBO and net periodic postretirement benefit expense by $360 and $26, respectively, for the year ended December 31, 1997. The Company does not hold any assets reserved for use in the plan.

Profit Sharing Plans

Liggett's 401(k) plans originally called for Company contributions matching up to a 3% employee contribution, plus additional Company contributions of up to 6% of salary based on the achievement of Company profit objectives. Effective January 1, 1994, the Company suspended the 3% match for the salaried employees' 401(k) Plan, but reinstated it on April 1, 1996. The Company contributed and expensed $497, $591 and $900 to the 401(k) plans for the years ended December 31, 1997, 1996 and 1995, respectively.

9. Income Taxes

Liggett's operations are included in the consolidated federal income tax return of its indirect parent, BGL. Pursuant to a tax allocation agreement, the Company's federal income tax provision is calculated as if the Company filed a separate federal income tax return except that the tax sharing agreement with BGL effectively limits the ability of the Company to carry back losses for refunds.

The amounts provided for income taxes are as follows:

	Year Ended December 31, 1997	1996	1995
Current:			
Federal	$ --	$ --	$ (233)
State	--	--	216
Deferred:			
Federal	--	3,800	1,768
State	--	--	--
Total tax provision	$ --	$3,800	$ 1,751

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

	1997 Deferred Tax Asset	1997 Deferred Tax Liability	1996 Deferred Tax Asset	1996 Deferred Tax Liability
Sales and product allowances	$ 1,738	$ --	$ 2,504	$ --
Inventory	457	1,568	1,269	683
Coupon accruals	2,369	--	4,492	--
Property, plant and equipment	--	4,427	--	4,890
Employee benefit plan accruals	4,680	--	5,303	--
USDA marketing assessment	1,312	--	1,681	--
Tobacco litigation settlements	7,872	--	1,229	--
Difference in basis in investment	2,535	--	1,864	--
Net operating loss carryforward	11,506	--	7,244	--
Valuation allowance	(26,474)	--	(20,013)	--
Reclassifications	(5,995)	(5,995)	(5,573)	(5,573)
Total deferred taxes.....................	$ -	$ -	$ -	$ -

The $26,474 net valuation allowance at December 31, 1997 is composed of $24,265 for net deferred assets arising from items which have been reflected in book income or loss and $2,209 for deferred assets arising for basis differences in the investments which were reflected as direct entries to equity.

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

	Year Ended December 31, 1997	1996	1995
(Loss) income before income taxes	$(14,179)	$(14,572)	$2,306
Federal income tax at statutory rates	$ (4,963)	$ (5,100)	$ 807
Increases (decreases) resulting from:			
State income tax expense (benefit) net of federal income tax expense (benefit)..........	--	(634)	216
Other, net	(1,498)	(247)	285
Change in valuation allowance	6,461	9,781	443
Total tax provision	$ --	$ 3,800	$1,751

As of December 31, 1997, the Company's net operating loss ("NOL") carryforward pursuant to its tax sharing agreement with BGL is approximately $29,000 which expires from 2008 to 2012. However, if the Company were deconsolidated from BGL, its allocable share of NOL could be significantly different. The liability method of accounting for deferred income taxes requires a valuation allowance against deferred tax assets if, based on the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. The Company established a valuation allowance against deferred tax assets of $26,474 and $20,013 at December 31, 1997 and 1996, respectively.

10. Long-Term Debt

Long-term debt consists of the following:

	December 31,		
	1997		1996
	Estimated Fair Value	Carrying Value	Carrying Value
11.5% Senior Secured Notes due February 1, 1999 net of unamortized discount of $206 and $424, respectively	$ 75,312	$ 112,406	$ 119,688
Variable Rate Series C Senior Secured Notes due February 1, 1999	23,564	32,279	32,279
Borrowings outstanding under revolving credit facility	23,427	23,427	24,272
Other	28	28	266
	122,331	168,140	176,505
Current portion	(28)	(28)	(31,807)
Amount Due After One Year	$ 122,303	$ 168,112	$ 144,698

Maturities of long-term debt, net of discount, at December 31, 1997 are as follows:

1998	$ 28
1999	168,112
Total	$168,140

Senior Secured Notes

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

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

On January 30, 1998, with the consent of the required majority of the holders of the Liggett Notes, Liggett entered into various amendments to the Indenture governing the Liggett Notes, which provided, among other things, for a deferral of the February 1, 1998 mandatory redemption payment of $37,500 to the date of final maturity of the Liggett Notes on February 1, 1999. In connection with the deferral, BGL agreed to issue 482,970 shares of BGL's common stock to the

holders of record on January 15, 1998 of the Liggett Notes. As a result of this transaction, the Company will record a non-cash charge of approximately $4,100 during the first quarter of 1998 reflecting the fair value of the instruments issued. The Indenture under which the Liggett Notes are outstanding was also amended to prohibit, with limited exceptions, payments of dividends and incurrence of new debt by Liggett and to tighten restrictions on the disposition of proceeds of asset sales. BGL and BGLS also agreed to guarantee the payment by Liggett of the August 1, 1998 interest payment on the Liggett Notes and to subordinate, until repayment in full of all amounts outstanding in respect of the Liggett Notes, their reimbursement rights with respect to the guarantee of borrowings under the Facility made in connection with the Company's August 1, 1997 interest installment and any future advances in connection with the guarantee of the August 1, 1998 interest payment. In consideration of, among other things, the contribution of the BGL common stock, the waiver of certain management and other fees, the guarantee of the interest payments and subordination of certain reimbursement rights, the Company transferred its ownership interest in, and options to acquire additional shares of stock of Liggett-Ducat Ltd. ("Liggett-Ducat") to Brooke (Overseas) Ltd. ("BOL"). In addition, the Liggett Noteholders were granted a security interest in 16% of the stock of Liggett-Ducat or a successor entity held by BOL.

On February 1, 1999, all of the Liggett Notes, approximately $144,891, will reach maturity. There are no refinancing or restructuring arrangements in place at this time for the notes and no assurances can be given in this regard. (Refer to Note 2 (a).)

Revolving Credit Facility

On March 8, 1994, Liggett entered into the Facility under which it can borrow up to $40,000 (depending on the amount of eligible inventory and receivables as determined by the lenders) from a syndicate of commercial lenders. Availability under the Facility was approximately $7,728 based upon eligible collateral at December 31, 1997. The Facility is collateralized by all inventories and receivables of the Company. Borrowings under the Facility are charged interest calculated at a rate equal to 1.5% above Philadelphia National Bank's (the indirect parent of Congress Financial Corporation, the lead lender) prime rate. Liggett's interest rate is currently 10.0%. The Facility contains certain financial covenants similar to those contained in the Liggett Notes Indenture, including restrictions on Liggett's ability to declare or pay cash dividends, incur additional debt, grant liens and enter into any new agreements with affiliates, among others. In addition, the Facility, as amended April 7, 1998, imposes requirements with respect to the Company's adjusted net worth (not to fall below a deficit of $195,000 as computed in accordance with the agreement, this computation is currently $187,959) and working capital (not to fall below a deficit of $17,000 as computed in accordance with the agreement, this computation is currently $12,616).

During the first quarter of 1997, the Company violated the working capital covenant contained in the Facility as a result of the 1998 mandatory redemption payment on the Liggett Notes becoming due within one year. On March 19, 1997, the lead lender agreed to waive this covenant default, and the Facility was amended as follows: (i) the working capital definition was changed to exclude the current portion of the Liggett Notes; (ii) the maximum permitted working capital deficit, as defined, was reduced to $12,000; (iii) the maximum permitted adjusted net worth deficit was increased to $180,000; and (iv) the permitted advance rates under the Facility for eligible inventory were reduced by five percent. On April 7, 1998, the Facility was further amended to increase the maximum permitted adjusted net worth and net working capital deficiencies to $195,000 and $17,000, respectively.

On August 29, 1997, the Facility was amended to permit the Company to borrow an additional $6,000 which was used on that date in making the interest payment of $9,700 due on August 1, 1997 to the Liggett note holders. BGLS guaranteed the additional $6,000 advance under the Facility and collateralized the guarantee with $6,000 in cash, deposited with Liggett's lenders.

In November 1997, the Facility was extended until March 8, 1999. For information concerning Liggett's substantial near-term debt service requirements and other related matters, see Note 2(a).

11. Operating Leases

At December 31, 1997, the Company has operating leases for building space and computer equipment. The future minimum lease payments are as follows:

1998	$1,651
1999	653
2000	198
2001	185
2002	62
Total	$2,749

Rental expense for the years ended December 31, 1997, 1996 and 1995 amounted to approximately $2,919, $3,121 and $3,112, respectively.

12. Commitments and Contingencies

TOBACCO-RELATED LITIGATION:

OVERVIEW. Since 1954, Liggett and other United States cigarette manufacturers have been named as defendants in a number of direct and third-party actions predicated on the theory that they should be liable for damages from cancer and other adverse health effects alleged to have been caused by cigarette smoking or by exposure to secondary smoke (environmental tobacco smoke, "ETS") from cigarettes. These cases are reported hereinafter as though having been commenced against Liggett (without regard to whether such cases were actually commenced against Liggett or BGL). There has been a noteworthy increase in the number of cases pending against both Liggett and the other tobacco companies. The cases generally fall into three categories: (i) smoking and health cases alleging personal injury brought on behalf of individual smokers ("Individual Actions"), (ii) smoking and health cases alleging personal injury and purporting to be brought on behalf of a class of plaintiffs ("Class Actions") and (iii) health care cost recovery actions brought by state and local governments, although recently numerous health care cost recovery actions have been commenced on behalf of other third-party payors including asbestos manufacturers, unions and taxpayers ("Attorneys General Actions"). As new cases are commenced, the costs associated with defending such cases and the risks attendant to the inherent unpredictability of litigation continue to increase. Liggett had been receiving assistance from others in the industry in defraying the costs and other burdens incurred in the defense of smoking and health litigation and related proceedings, which, for the most part, consisted of the payment of counsel fees and costs, but this assistance terminated in 1997. In 1995 and 1996, approximately $1,500 and $6,500, respectively, in counsel fees and costs were paid. In 1995 and 1996, Liggett incurred additional fees and costs in connection with tobacco-related litigation in the amount of approximately $4,500 and $3,500, respectively. In 1997, Liggett incurred fees and costs in the amount of approximately $5,750. The future financial impact on Liggett of the termination of this assistance and the effects of the tobacco litigation settlements discussed below is not quantifiable at this time.

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

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

INDIVIDUAL ACTIONS. As of December 31, 1997, there were approximately 250 cases pending against Liggett, and in most cases the other tobacco companies, where individual plaintiffs allege injury resulting from cigarette smoking, addiction to cigarette smoking or exposure to ETS and seek compensatory and, in some cases, punitive damages. Of these, 108 are pending in the State of Florida, 82 are pending in the State of New York and 19 are pending in the State of Texas. The balance of individual cases are pending in 16 states. There are four individual cases pending where Liggett is the only named defendant.

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

On September 10, 1993, an action entitled Sackman v. Liggett Group Inc., United States District Court, Eastern District of New York, was filed against Liggett alleging as injury lung cancer. On October 6, 1997, the parties settled this matter.

CLASS ACTIONS. As of December 31, 1997, there were approximately 40 actions pending, for which either a class has been certified or plaintiffs are seeking class certification, where Liggett, among others, was a named defendant. Two of these cases, Fletcher, et al. v. Brooke Group Ltd., et al. and Walker, et al. v. Liggett Group Inc., et al. have been settled, subject to court approval. These two settlements are more fully discussed below under the "Settlements" section.

On October 31, 1991, an action entitled Broin, et al. v. Philip Morris Incorporated, et al., Circuit Court of the Eleventh Judicial District in and for Dade County, Florida, was filed against Liggett and others. This case has been brought by plaintiffs on behalf of all flight attendants that have worked or are presently working for airlines based in the United States and who have never regularly smoked cigarettes but allege that they have been damaged by involuntary exposure to ETS. On October 10, 1997, the other major tobacco companies settled this matter which settlement provides for a release of Liggett and BGL. In February 1998, the Circuit Court approved the settlement, however, a Notice of Appeal was filed in the Third District Court of Appeal by an objector to the settlement.

On March 25, 1994, an action entitled Castano, et al. v. The American Tobacco Company Inc., et al., United States District Court, Eastern District of Louisiana, was filed against Liggett and others. The class action complaint sought relief for a nationwide class of smokers based on their alleged addiction to nicotine. On February 17, 1995, the District Court granted plaintiffs' motion for class certification (the "Class Certification Order").

On May 23, 1996, the Court of Appeals for the Fifth Circuit reversed the Class Certification Order and instructed the District Court to dismiss the class complaint. The Fifth Circuit ruled that the District Court erred in its analysis of the class certification issues by failing to consider how variations in state law affect predominance of common questions and the superiority of the class action mechanism. The appeals panel also held that the District Court's predominance inquiry did not include consideration

of how a trial on the merits in Castano would be conducted. The Fifth Circuit further ruled that the "addiction-as-injury" tort is immature and, accordingly, the District Court could not know whether common issues would be a "significant" portion of the individual trials. According to the Fifth Circuit, any savings in judicial resources that class certification may bring about is speculative and would likely be overwhelmed by the procedural problems certification brings. Finally, the Fifth Circuit held that in order to make the class action manageable, the District Court would be forced to bifurcate issues in violation of the Seventh Amendment.

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

ATTORNEYS GENERAL ACTIONS. As of December 31, 1997, 39 Attorneys General actions were filed against Liggett and BGL. In February 1998, one additional action was commenced. As more fully discussed below, through March 1998, Liggett has settled 37 of these actions. In addition, Liggett has reached settlements with 6 Attorneys General representing states or territories which have not yet commenced litigation. As of December 31, 1997, there were approximately 35 additional third-party payor actions pending. In certain of the pending proceedings, state and local government entities and others seek reimbursement for Medicaid and other health care expenditures allegedly caused by use of tobacco products. The claims asserted in these health care cost recovery actions vary. In most of these cases, plaintiffs assert the equitable claim that the tobacco industry was "unjustly enriched" by plaintiffs' payment of health care costs allegedly attributable to smoking and seek reimbursement of those costs. Other claims made by some but not all plaintiffs include the equitable claim of indemnity, common law claims of negligence, strict liability, breach of express and implied warranty, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under state and federal statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under RICO.

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

settlement agreement. If Liggett or its affiliates enter into any such transaction, then the Castano plaintiffs will be entitled to receive $250,000 within 30 days from the transacting party. On May 11, 1996, the Castano Plaintiffs Legal Committee filed a motion with the United States District Court for the Eastern District of Louisiana seeking preliminary approval of the Castano settlement. On September 6, 1996, shortly after the class was decertified, the Castano plaintiffs withdrew the motion for approval of the Castano settlement.

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

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

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

On March 20, 1997, Liggett, BGL and the five settling states executed an addendum pursuant to which Liggett and BGL agreed to provide to the five settling states, among other things, the additional cooperation and compliance with advertising restrictions that is provided for in the March 1997 Settlements (discussed below). Also, pursuant to the addendum, the initial settling states agreed to use best efforts to ensure that in the event of a global tobacco settlement enacted through federal legislation or otherwise, Liggett's and BGL's financial obligations under such a global settlement would be no more onerous than under this settlement.

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

In March 1997, Liggett and BGL entered into a comprehensive settlement of tobacco litigation through parallel agreements with the Attorneys General of 17 states and with a nationwide class of individuals and entities that allege smoking-related claims. Thereafter, during 1997, settlements were

reached with four more states through their respective Attorneys General (settlements with these 21 Attorneys General and with the nationwide class are hereinafter referred to as the "March 1997 Settlements"). On March 12, 1998, Liggett and BGL, announced settlements with the Attorneys General of 14 states, the District of Columbia and the U.S. Virgin Islands (the "March 1998 Settlements"). On March 26, 1998, Liggett and BGL settled with the Attorney General of Georgia. The foregoing settlements cover all smoking-related claims, including both addiction-based and tobacco injury claims against Liggett and BGL, brought by the Attorneys General and, upon court approval, the nationwide class.

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

As mentioned above, in March 1997, Liggett, BGL and plaintiffs filed the mandatory class settlement agreement in an action entitled Fletcher, et al. v. Brooke Group Ltd., et al., Circuit Court of Mobile County, Alabama, where the court granted preliminary approval and preliminary certification of the class, and on May 15, 1997, a similar mandatory class settlement agreement was filed in an action entitled Walker, et al. v. Liggett Group Inc., et al., United States District Court, Southern District of West Virginia. The Company anticipates that should the court in Fletcher, after dissemination of notice to the class of the pending limited fund class action settlement and a full fairness hearing with respect thereto, issue a final order and judgment approving the settlement, such an order would preclude further prosecution by class members of tobacco-related claims against Liggett and BGL. Under the Full Faith and Credit Act, a final judgment entered in a nationwide class action pending in a state court has a preclusive effect against any class member with respect to the claims settled and released in the nationwide class action. As the class definition in Fletcher encompasses all individual and third party-payor claimants, it is anticipated that upon final order and judgment, all such class members would be barred from further prosecution of tobacco-related claims against Liggett and BGL.

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

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

After the Amchem opinion was issued by the Supreme Court on June 25, 1997, objectors to Liggett's settlement in Walker moved for decertification. Although Liggett's settlements, particularly in

the Walker action, are "limited fund" class action settlements proceeding under Rule 23(b)(1), and Amchem was a Rule 23(b)(3) case, the court in the Walker action, nonetheless, decertified the Walker class. Applying Amchem to the Walker case, the District Court, in a decision issued on August 5, 1997, determined that while plaintiffs in Walker have a common interest in "maximizing the limited fund available from the defendants," there remained "substantial conflicts among class members relating to distribution of the fund and other key concerns" that made class certification inappropriate.

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

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

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

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

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

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

Pursuant to the March 1998 Settlements, Liggett is required to pay each of settling states and territories their relative share (based on the Medicaid population of each state over the total Medicaid population of the United States) of between 27.5% and 30% of Liggett's pre-tax income each year for 25 years, with a minimum payment guarantee of $1,000 per state over the first nine years of the agreement. The liability was computed using a discount rate of 18%. The aggregate liability under the March 1996 Settlements, the March 1997 Settlements, and the March 1998 Settlements is $39,556, the present value of which, when discounted at the rate of 18% per annum, is $19,365 at December 31, 1997. Minimum payments to be made for these settlements over the next five years and thereafter are: 1998: $4,044; 1999: $4,406; 2000: $4,406; 2001: $4,465: 2002: $4,518; thereafter: $17,717. The annual percentage is subject to increase, pro rata from 27.5% up to 30%, depending on the number of additional states joining the settlement. Pursuant to the "most favored nation" provisions under the March 1996 Settlements and the March 1997 Settlements, each of the states settling under those settlements could benefit from the economic terms of the March 1998 Settlements. In the case of the March 1997 Settlements, in the event that the Fletcher class is approved, monies collected in the settlement fund will be overseen by a court-appointed committee and utilized to compensate state health care programs and settlement class members and to provide counter-market advertising. In all settlements, Liggett agreed to phase-in compliance with certain proposed FDA regulations regarding smoking by children and adolescents, including a prohibition on the use of cartoon characters in tobacco advertising and limitations on the use of promotional materials and distribution of sample packages where minors are present. The March 1998 Settlements provide for additional restrictions and regulations on Liggett's advertising, including a prohibition on outdoor advertising and product advertising on the Internet and on payments for product placement in movies and television.

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

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

TRIALS. Liggett is a defendant in trials currently proceeding in the State of Minnesota by Hubert H. Humphrey, III, its Attorney General and Blue Cross and Blue Shield of Minnesota v. Philip Morris Incorporated, et al., District Court of the Second Judicial District, Ramsey County, Minnesota, which commenced on January 20, 1998. Liggett settled the claims of the State of Minnesota on March 20, 1997, but still remains a defendant in the case with respect to the State's co-plaintiff, Blue Cross and Blue Shield of Minnesota. Liggett is also a defendant in Dunn and Wiley v. RJR Nabisco Holdings Corp., et al., Superior Court, Delaware County, Indiana, which trial commenced on February 9, 1998. There are several other trial dates scheduled during 1998 for individual cases; however, trial dates are subject to change.

PROPOSED RESOLUTION. In June 1997, Philip Morris Incorporated ("Philip Morris"), R. J. Reynolds Tobacco Company ("RJR"), B&W, Lorillard Tobacco Company ("Lorillard") and the United States Tobacco Company, along with the Attorneys General for the States of Arizona, Connecticut, Florida, Mississippi, New York and Washington and the Castano Plaintiffs' Litigation Committee executed a Memorandum of Understanding to support the adoption of federal legislation and necessary

ancillary undertakings, incorporating the features described in a proposed resolution (the "Resolution"). The proposed Resolution mandates a total reformation and restructuring of how tobacco products are manufactured, marketed and distributed in the United States.

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

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

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

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

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

Under the proposed Resolution, the rights of individuals to sue the tobacco industry would be preserved, except as expressly changed by implementing federal legislation. Claims, however, could not be maintained on a class or other aggregated basis, and could be maintained only against tobacco manufacturing companies (and not their retailers, distributors or affiliated companies). In addition, all

punitive damage claims based on past conduct would be resolved as part of the proposed Resolution, and future claimants could seek punitive damages only with respect to claims predicated upon conduct taking place after the effective date of implementing federal legislation. Finally, except with respect to actions pending as of June 9, 1997, third-party payor (and similar) claims could be maintained only if based on subrogation of individual claims. Under subrogation principles, a payor of medical costs can seek recovery from a third party only by "standing in the shoes" of the injured party and being subject to all defenses available against the injured party.

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

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

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

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

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

In March 1996, and in each of March, July, October and December 1997, Liggett and/or BGL received subpoenas from a Federal grand jury in connection with an investigation by the United States

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

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

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

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

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

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

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

LEGISLATION AND REGULATION:

On August 28, 1996, the FDA filed in the Federal Register a Final Rule (the "FDA Rule") classifying tobacco as a drug, asserting jurisdiction by the FDA over the manufacture and marketing of tobacco products and imposing restrictions on the sale, advertising and promotion of tobacco products. Litigation was commenced in the United States District Court for the Middle District of North Carolina challenging the legal authority of the FDA to assert such jurisdiction, as well as challenging the

constitutionality of the rules. The court, after argument, granted plaintiffs' motion for summary judgment prohibiting the FDA from regulating or restricting the promotion and advertising of tobacco products and denied plaintiffs' motion for summary judgment on the issue of whether the FDA has the authority to regulate access to, and labeling of, tobacco products. The four major cigarette manufacturers and the FDA have filed notices of appeal. Liggett and BGL support the FDA Rule and have begun to phase in compliance with certain of the proposed interim FDA regulations. See discussions of the Castano and Attorneys General settlements above.

In August 1996, the Commonwealth of Massachusetts enacted legislation requiring tobacco companies to publish information regarding the ingredients in cigarettes and other tobacco products sold in that state. In December 1997, the United States District Court for the District of Massachusetts enjoined this legislation from going into effect, however, on December 15, 1997, Liggett began complying with this legislation by providing ingredient information to the Massachusetts Department of Public Health.

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

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

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

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

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

13. Related Party Transactions

On July 5, 1996, Liggett purchased 140,000 shares (19.97%) of Liggett-Ducat's tobacco operations from BOL, for $2,100. Liggett-Ducat produces and markets cigarettes in Russia. Liggett also acquired on that date for $3,400 a ten-year option to purchase from BOL at the same per share price up to 292,407 additional shares of Liggett-Ducat, thereby entitling Liggett to increase its interest in Liggett-Ducat to approximately 62%. On March 13, 1997, Liggett acquired a second ten-year option to purchase BOL's remaining shares in Liggett-Ducat (an additional 33%) for $2,200 of which $2,049 was paid in cash. Liggett accounted for its investment in Liggett-Ducat under the equity method of accounting. Liggett's equity in the net income of Liggett-Ducat amounted to $498 for the year ended December 31, 1997. On December 31, 1997, the carrying value of Liggett-Ducat amounted to $1,208. The excess of the cost of the option over carrying amount of net assets to be acquired under the option has been charged to stockholder's deficit. On January 30, 1998, in connection with the restructuring of the Liggett Notes, BOL acquired the Liggett-Ducat shares and options held by Liggett. (Refer to Note 10.)

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

During 1995 and 1996, Liggett provided certain administrative and technical support to Liggett-Ducat in exchange for which Liggett-Ducat provided assistance to Liggett in its pursuit of selling cigarettes in the Russian Republic. The expenses associated with Liggett's activities amounted to $76 and $229 for the years ended December 31, 1996 and 1995, respectively.

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

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

Liggett has entered into an annually renewable Corporate Services Agreement with BGLS wherein BGLS agreed to provide corporate services to the Company at an annual fee paid in monthly installments. Corporate services provided by BGLS under this agreement include the provision of administrative services related to Liggett's participation in its parent company's multi-employer benefit plan, external publication of financial results, preparation of consolidated financial statements and tax returns and such other administrative and managerial services as may be reasonably requested by Liggett. The charges for services rendered under the agreement amounted to $3,318 in 1997, $3,160 in 1996 and $3,010 in 1995. This fee is in addition to the management fee and overhead reimbursements described above. In connection with the January 30, 1998 amendment to the Liggett Notes Indenture, BGL and BGLS agreed to waive corporate services and management fees above $3,600 per year, effective January 1, 1998.

Since April 1994, the Company has leased equipment from BGLS for $50 per month.

The Company acquired CTEC from its indirect parent during 1995 for $800. The excess of cost over the carrying amount of the net assets acquired has been charged to stockholder's equity (deficit). The effect of the accounting treatment presents the investment in CTEC at carryover basis. Accounts receivable from affiliates relate principally to advances for expenses paid by the Company on behalf of its affiliates.

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

During 1996, the Company reduced its headcount by 38 positions and recorded a $3,428 restructuring charge to operations ($132 of which was included in cost of sales) for severance programs, primarily salary continuation and related benefits for terminated employees. Of the total restructuring recorded during 1996, $1,416 was funded during 1996, leaving $2,012 remaining to be funded in subsequent years.

During 1995, Liggett continued its efforts towards reducing costs by, among other things, offering voluntary retirement programs to eligible employees. The Company's 1995 cost reduction programs reduced the Company's headcount by approximately 120 positions. In connection therewith, the Company recorded charges totaling $2,548 to operating income including $621 relating to manufacturing operations which has been charged to cost of sales.

REPORT OF INDEPENDENT ACCOUNTANTS

Board of Directors and Stockholder
Eve Holdings Inc.

We have audited the accompanying balance sheets of Eve Holdings Inc. (the "Company") as of December 31, 1997 and 1996 and the related statements of operations, stockholder's equity (deficit) and cash flows for each of the three years in the period ended December 31, 1997. 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 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 provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Eve Holdings Inc. at December 31, 1997 and 1996 and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1997 in conformity with generally accepted accounting principles.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2a to the financial statements, the Company's revenues are comprised solely of royalties and interest from Liggett Group Inc. ("Liggett"). Liggett suffered a lost of $14,179,000 for the year ended December 31, 1997 and had net capital and working capital deficiencies of $192,857,000 and $17,542,000, respectively, at December 31, 1997. Liggett also has a $144,891,000 principal payment due on its Senior Secured Notes on February 1, 1999 and Liggett's revolving credit facility (the "Facility"), which has a balance of $23,427,000 at December 31, 1997, is due on March 8, 1999. Liggett's financial resources are not sufficient to repay the Senior Secured Notes when they become due, nor will Liggett be able to repay the Facility when it becomes due. In addition, due to the many risk and uncertainties associated with the cigarette industry and the impact of tobacco litigation, there can be no assurance that Liggett will be able to meet its future earnings or cash flow goals. These facts raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of these uncertainties.

COOPERS & LYBRAND L.L.P.

Miami, Florida
April 8, 1998

EVE HOLDINGS INC.

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

	December 31, 1997	December 31, 1996
ASSETS		
Cash	$ 1	$ --
Office equipment	2	2
Trademarks, at cost, less accumulated amortization of $18,995 and $17,294, respectively	1,418	3,119
Total assets	$ 1,421	$ 3,121
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Federal income taxes currently payable to parent	$ 91	$ --
Dividends payable	1,273	4,623
Cash overdraft	--	92
Other current liabilities	3	19
Deferred income taxes	496	1,092
Total liabilities	1,863	5,826
Stockholder's equity (deficit):		
Common stock (par value $1.00 per share; authorized, issued and outstanding 100 shares) and contributed capital	45,442	46,548
Receivables from parent:		
Note receivable - interest at 14%, due no sooner than February 1, 1999	(44,520)	(44,520)
Other	(1,364)	(4,733)
Total stockholder's equity (deficit)	(442)	(2,705)
Total liabilities and stockholder's equity (deficit)	$ 1,421	$ 3,121

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

EVE HOLDINGS INC.

STATEMENTS OF OPERATIONS

(Dollars in thousands)

	Year Ended December 31,		
	1997	1996	1995
Revenues:			
Royalties - parent	$ 7,122	$ 8,608	$ 10,452
Interest - parent	6,306	6,306	6,306
	13,428	14,914	16,758
Expenses:			
Amortization of trademarks	1,701	1,701	1,702
Miscellaneous	83	129	93
Operating income	11,644	13,084	14,963
Interest expense	--	49	--
Income before income taxes	11,644	13,035	14,963
Income tax provision	1,886	2,480	5,237
Net income	$ 9,758	$10,555	$ 9,726

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

EVE HOLDINGS INC.

STATEMENTS OF STOCKHOLDER'S EQUITY (DEFICIT)

(Dollars in thousands)

	Common Stock and Capital in Excess of Par	Retained Earnings	Receivables From Parent	Total Stockholder's Equity
Balance at December 31, 1994	$ 48,759	$ --	$(47,272)	$ 1,487
Net income	--	9,726	--	9,726
Dividends/capital distributions	(1,106)	(9,726)	--	(10,832)
Net change in receivables from parent	--	--	62	62
Balance at December 31, 1995	47,653	--	(47,210)	443
Net income	--	10,555	--	10,555
Dividends/capital distributions	(1,105)	(10,555)	--	(11,660)
Net change in receivables from parent	--	--	(2,043)	(2,043)
Balance at December 31, 1996	46,548	--	(49,253)	(2,705)
Net income	--	9,758	--	9,758
Dividends/capital distributions	(1,106)	(9,758)	--	(10,864)
Net change in receivables from parent	--	--	3,369	3,369
Balance at December 31, 1997	$ 45,442	$ --	$(45,884)	$ (442)

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

EVE HOLDINGS INC.

STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	Year Ended December 31,		
	1997	1996	1995
Cash flows from operating activities:			
Net income	$ 9,758	$ 10,555	$ 9,726
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	1,701	1,701	1,703
Deferred income taxes	(596)	(595)	(596)
Changes in assets and liabilities:			
Federal income taxes currently payable to parent	91	(164)	157
Other current liabilities	(16)	19	--
Net cash provided by operating activities	10,938	11,516	10,990
Cash flows from investing activities:			
Capital expenditures	--	--	--
Net cash used in investing activities	--	--	--
Cash flows from financing activities:			
(Decrease) increase in cash overdraft	(92)	92	--
Dividends/capital distributions	(14,214)	(9,573)	(11,046)
Decrease (increase) in receivable from parent	3,369	(2,043)	62
Net cash used in financing activities	(10,937)	(11,524)	(10,984)
Net increase (decrease) in cash	1	(8)	6
Cash:			
Beginning of period	--	8	2
End of period	$ 1	$ --	$ 8
Supplemental cash flow information:			
Payments of income taxes through receivable from parent	$ 2,424	$ 5,159	$ 5,676
Dividends/capital distributions declared but not paid	$ 1,273	$ 4,623	$ 2,536

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

EVE HOLDINGS INC.

Notes to Financial Statements

(Dollars in thousands, except per share amounts)

1. The Company

Eve Holdings Inc. ("Eve" or the "Company") is a wholly-owned subsidiary of Liggett Group Inc. ("Liggett"). Eve's predecessor, Chesterfield Assets Inc., was organized in March 1987. Eve, formed in June 1990, is the proprietor of, and has all right, title and interest in, certain federal trademark registrations (the "Trademarks"). Eve has entered into an exclusive licensing agreement with Liggett (effective until 2010) whereby Eve grants the use of the Trademarks to Liggett in exchange for royalties, computed based upon Liggett's annual net sales, excluding excise taxes of $236,952, $296,544 and $332,246 for the years ended December 31, 1997, 1996 and 1995, respectively. Generally, royalties are earned based on a rate of either 2% of sales for generic product trademarks and 5% of sales for branded product trademarks. In recent fiscal years, Liggett has experienced greater growth in the sales of generic rather than branded products resulting in a lower overall royalty rate. The Trademarks are pledged as collateral for borrowings under the Liggett Notes (see Note 3).

2. Summary of Significant Accounting Policies

a. Going Concern

The accompanying financial statements have been prepared assuming that Eve will continue as a going concern. Eve's revenues are comprised solely of royalties and interest income from Liggett. In addition, Eve holds a note receivable from Liggett for $44,520 due no sooner than February 1, 1999. Liggett had a working capital deficiency of $17,542 and a net capital deficiency of $192,857 as of December 31, 1997, is highly leveraged and has substantial near-term debt service requirements. These matters raise substantial doubt about Eve and Liggett meeting their liquidity needs and their ability to continue as going concerns.

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

b. Basis of Presentation

On February 11, 1992, Eve consummated an Agreement and Plan of Merger (the "Merger Agreement") with LGC Corp. (a wholly-owned subsidiary of Liggett) whereby the operations of LGC Corp., consisting primarily of holding an unsecured $44,250 note receivable (bearing interest at 14%, due November 2, 1996) from Liggett and related interest thereon, were merged into those of Eve. The merger was accounted for at historical cost similar to that in pooling of interests accounting. On March 7, 1994, Liggett and Eve agreed to extend the due date of the note to no sooner than February 1, 1999 from November 2, 1996. All other terms of the note remained the same.

c. Per Share Data

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

d. Trademarks

Trademarks are amortized using the straight-line method over 12 years. Management periodically reviews the carrying value of trademarks to determine whether asset values are impaired.

e. 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.

3. Guarantee of Liggett Notes

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

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

4. Income Taxes

Eve's operations are included in the consolidated federal income tax return of its indirect parent, Brooke Group Ltd. ("Brooke"). Eve's federal income tax provisions are calculated as if it filed a separate federal income tax return. SFAS No. 109 "Accounting for Income Taxes" requires that deferred taxes be recorded under the liability method.

The amounts provided for income taxes are as follows:

	Year Ended December 31,		
	1997	1996	1995
Current:			
Federal	$ 2,455	$ 2,883	$ 5,832
State	27	192	--
Deferred:			
Federal	(596)	(595)	(595)
State	--	--	--
Total tax provision	$ 1,886	$ 2,480	$ 5,237

Eve's deferred tax liability relates entirely to the difference in the basis of the Trademarks for book and tax purposes. As permitted in SFAS No. 109, Eve has not adjusted the basis of the Trademarks that were previously adjusted to net of tax amounts to be consistent with the accounting treatment adopted by Liggett.

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

	Year Ended December 31,		
	1997	1996	1995
Income before income taxes	$ 11,644	$ 13,035	$14,963
Federal income tax at statutory rates	4,075	4,563	5,237
(Decreases) increases resulting from:			
Exclusion of interest income between related parties	(2,207)	(2,207)	--
State income taxes, net of federal	18	124	--
Total tax provision	$ 1,886	$ 2,480	$ 5,237

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

LIGGETT GROUP INC.

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

(Dollars in thousands)

	Balance at Beginning of Period	Additions: Charged to Costs and Expenses	Additions: Charged to Net Sales	Deductions	Balance at End of Period
Year ended December 31, 1997					
Allowances for:					
Doubtful accounts	$ 750	$ 226	$ --	$ 156(a)	$ 820
Cash discounts	530	10,998	--	11,286(b)	242
Total	$1,280	$11,224	$ --	$11,442	$1,062
Sales returns allowance	$5,000	$ --	$ --	$ 250(c)	$4,750
Provision for inventory obsolescence	$3,218	$ 221	$ --	$ 2,282(d)	$1,157
Year ended December 31, 1996					
Allowances for:					
Doubtful accounts	$ 200	$ 903	$ --	$ 353(a)	$ 750
Cash discounts	615	13,929	--	14,014(b)	530
Total	$ 815	$14,832	$ --	$14,367	$1,280
Sales returns allowance	$5,000	$ --	$ --	$ --(c)	$5,000
Provision for inventory obsolescence	$2,069	$ 1,341	$ --	$ 192(d)	$3,218
Year ended December 31, 1995					
Allowances for:					
Doubtful accounts	$ 249	$ 231	$ --	$ 280(a)	$ 200
Cash discounts	720	14,579	--	14,684(b)	615
Total	$ 969	$14,810	$ --	$14,964	$ 815
Sales returns allowance	$5,800	$ 1,030	$ (800)	$ 1,030(c)	$5,000
Provision for inventory obsolescence	$1,369	$ 911	$ --	$ 211(d)	$2,069

(a) Represents uncollectible accounts written off.
(b) Represents cash discounts taken.
(c) Represents adjustments to lower the allowance based on revised estimates of sales returns by management.
(d) Represents inventory written off, disposed of, or written down to lower of cost or market value.

Exhibit 99.3

NEW VALLEY HOLDINGS, INC.

FINANCIAL STATEMENTS

DECEMBER 31, 1997

NEW VALLEY HOLDINGS, INC.

FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholder
of New Valley Holdings, Inc.

We have audited the accompanying balance sheets of New Valley Holdings, Inc. (the "Company") as of December 31, 1997 and 1996 and the related statements of operations, stockholder's equity (deficit) and cash flows for each of the three years in the period ended December 31, 1997. 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 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 provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of New Valley Holdings, Inc. at December 31, 1997 and 1996 and the results of their operations and its cash flows for each of the three years in the period ended December 31, 1997 in conformity with generally accepted accounting principles.

COOPERS & LYBRAND L.L.P.

Miami, Florida
April 8, 1998

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

	December 31, 1997	December 31, 1996
ASSETS		
Cash and cash equivalents	$ 6	$ 1
Investment in New Valley:		
Redeemable preferred stock	59,359	72,962
Common stock	(59,359)	(72,962)
Total investment in New Valley	--------	--------
Total assets	$ 6	$ 1
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Payable to parent	$ 56	$ 4
Accrued expenses		7
Current income taxes payable to parent	6,298	6,312
Total liabilities	6,354	6,323
Commitments and contingencies		
Common stock, $0.01 par value, 100 shares authorized, issued and outstanding		
Additional paid-in capital	7,633	7,633
Deficit	(25,737)	(727)
Other	11,756	(13,228)
Total stockholder's equity (deficit)	(6,348)	(6,322)
Total liabilities and stockholder's equity (deficit)	$ 6	$ 1

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

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

	December 31, 1997	December 31, 1996	December 31, 1995
Equity in (loss) earnings of New Valley	$(26,908)	$(7,877)	$ 330
Interest income	6	55	429
General and administrative expenses	(47)	(28)	(20)
(Loss) income from continuing operations before income taxes	(26,949)	(7,850)	739
(Benefit) provision for income taxes:			
Current	(14)	1,840	4,472
Deferred	(673)	(800)	(12,799)
Income tax (benefit) provision	(687)	1,040	(8,327)
(Loss) income from continuing operations	(26,262)	(8,890)	9,066
Income from discontinued operations of New Valley net of taxes of $673 and $800 in 1997 and 1996, respectively	1,252	1,542	4,553
Net (loss) income	$(25,010)	$(7,348)	$ 13,619

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

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

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings (Deficit)	Other	Stock Subscription Receivable	Retained Earnings (Deficit)
Balance, December 31, 1994	100		$ 10	$ 80,012	$ 7,257	$ (10)	$ 87,269
Increase in capital from New Valley's repurchase of Class A Shares and other capital transactions, net of tax			11,020				11,020
Reduction of unrealized holding gain on investment in New Valley, net of tax					(2,432)		(2,432)
Proportionate share of New Valley's unrealized appreciation in investments, net of tax					716		716
Net income				13,619			13,619
Dividends				(61,503)			(61,503)
Satisfaction of stock subscription receivable			(10)			10	
Balance, December 31, 1995	100		11,020	32,128	5,541		48,689
Increase in capital from New Valley's repurchase of Class A Shares, net of tax			1,152				1,152
Proportionate share of New Valley's unrealized appreciation in investments, net of tax					2,227		2,227
Increase in unrealized holding loss on investment in New Valley, net of tax					(20,996)		(20,996)
Net loss				(7,348)			(7,348)
Increase in valuation allowance on deferred tax assets			(4,539)				(4,539)
Dividends				(25,507)			(25,507)
Balance, December 31, 1996	100		7,633	(727)	(13,228)		(6,322)
Proportionate share of New Valley's unrealized appreciation in investments,					3,179		3,179
Reduction of unrealized holding loss on investment in New Valley					21,805		21,805
Net loss				(25,010)			(25,010)
Balance, December 31, 1997			$ 7,633	$(25,737)	$ 11,756		$ (6,348)

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

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

	December 31, 1997	December 31, 1996	December 31, 1995
Cash flows from operating activities:			
Net (loss) income	$(25,010)	$(7,348)	$ 13,619
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Equity in (loss) earnings of New Valley	26,908	7,877	(330)
Deferred income taxes	(673)	(800)	(12,799)
Income from discontinued operations of New Valley	(1,252)	(1,542)	(4,553)
(Decrease) increase in income taxes payable	(14)	1,840	4,472
Other	46	10	
Net cash provided by operating activities	5	37	409
Cash flows from investing activities:			
Dividends received from New Valley		24,733	61,832
Net cash provided by investing activities		24,733	61,832
Cash flows from financing activities:			
Distributions paid to parent		(25,507)	(61,503)
Net cash used in financing activities		(25,507)	(61,503)
Net increase (decrease) in cash and cash equivalents	5	(737)	738
Cash and cash equivalents at beginning of period	1	738	
Cash and cash equivalents at end of period	$ 6	$ 1	$ 738

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

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

1. BASIS OF PRESENTATION OF FINANCIAL STATEMENTS

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

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

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

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

2. INVESTMENT IN NEW VALLEY CORPORATION

At December 31, 1997 and 1996, the Company's investment in New Valley consisted of a 41.5% voting interest. At December 31, 1997 and 1996, the Company owned 57.7% of the outstanding $15.00 Class A Increasing Rate Cumulative Senior Preferred Shares ($100 Liquidation Value) $.01 par value (the "Class A Preferred Shares"), and 41.5% of New Valley's common shares, $.01 par value (the "Common Shares").

The Class A Preferred Shares are accounted for as debt and equity securities pursuant to the requirements of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities", and are classified as available-for-sale. The Common Shares are accounted for pursuant to Accounting Principles Board Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock".

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

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

The Company's investment in New Valley at December 31, 1997 and 1996, respectively, is summarized below:

	Number of Shares	Fair Value	Carrying Amount	Unrealized Holding Gain (Loss)
1997				
Class A Preferred Shares.......	618,326	$59,359	$59,359	$ (3,083)
Common Shares..................	3,969,962(A)	1,995	(59,359)	
		$61,354	$	$ (3,083)
1996				
Class A Preferred Shares.......	618,326	$72,962	$72,962	$(24,881)
Common Shares..................	3,969,962(A)	5,955	(72,962)	
		$78,917	$	$(24,881)

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

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

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

The Class A Preferred Shares of New Valley are required to be redeemed on January 1, 2003 for $100.00 per share plus dividends accrued to the redemption date. The shares are redeemable, at any time, at the option of New Valley, at $100.00 per share plus accrued dividends. The holders of Class A Preferred Shares are entitled to receive a quarterly dividend, as declared by the Board of Directors, payable at the rate of $19.00 per annum. At December 31, 1997 and 1996, respectively, the accrued and unpaid dividends arrearage was $163,302 ($152.41 per share) and $117,117 ($109.31 per share). The Company received $24,733 ($40.00 per share) and $61,832 ($100.00 per share) in dividend distributions in 1996 and 1995, respectively.

3. NEW VALLEY CORPORATION

Summarized financial information for New Valley as of and for the years ended December 31, 1997, 1996 and 1995 follows:

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

	1997	1996	1995
Current assets, primarily cash and marketable securities......	$118,474	$183,720	
Noncurrent assets..	322,749	222,820	
Current liabilities..	128,128	98,110	
Noncurrent liabilities.......................................	185,024	170,223	
Redeemable preferred stock...................................	258,638	210,571	
Shareholders' equity (deficit)...............................	(130,399)	(72,364)	
Revenues...	108,441	111,954	$67,730
Costs and expenses...	136,685	128,209	66,064
(Loss) income from continuing operations.....................	(25,193)	(13,216)	1,374
Income from discontinued operations..........................	4,620	5,726	16,873
Net (loss) income applicable to common shares(A).............	(89,048)	(65,160)	(13,714)
Company's share of discontinued operations...................	1,925	2,373	7,005

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

On January 31, 1997, New Valley entered into a stock purchase agreement with Brooke (Overseas) Ltd. ("BOL"), a wholly-owned subsidiary of BGLS, and acquired all of BOL's shares (the "BML Shares") in BrookeMil Ltd. ("BML"), representing 99.1% of the common stock of BML, which is engaged in real estate development in Russia. New Valley paid BOL a purchase price of $55,000 for the BML Shares, consisting of $21,500 in cash and a New Valley $33,500 9% promissory note. The note was paid in full in 1997.

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

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

The organization of Western Realty was effected pursuant to the LLC Agreement. On January 11, 1996, New Valley acquired from an affiliate of Apollo eight shopping centers for $72,500. New Valley and pension plans sponsored by BGL have invested in investment partnerships managed by an affiliate of Apollo. Apollo's affiliate owns a substantial amount of debt securities of Brooke and warrants to purchase common stock of the Company.

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

Western Realty will seek to make additional real estate and other investments in Russia. New Valley and Apollo have agreed to invest, through Western Realty or another entity, up to $25,000 in the aggregate for the potential development of a real estate project in Moscow. In addition, Western Realty has agreed to acquire for $20,000 a 30% profits interest in a company organized by BOL which, among other things, owns an interest in a new factory being constructed on the outskirts of Moscow by a subsidiary of BOL.

4. RJR NABISCO HOLDINGS CORP.

As of December 31, 1997 and 1996, New Valley held approximately 612,650 and 1,700,000 shares of RJR Nabisco Holdings Corp. ("RJR Nabisco") common stock, respectively, with a market value of $22,898 and $59,200 (cost of approximately $18,780 and $53,400). During 1997, 1996 and 1995 New Valley expensed $100, $11,724 and $3,879, respectively, for costs relating to its RJR Nabisco investment.

In June 1996, various agreements between High River Limited Partnership ("High River"), the Company, BGLS and New Valley were terminated by mutual consent. Pursuant to these agreements, the parties had agreed to take certain actions during late 1995 and in 1996 designed to cause RJR Nabisco to effectuate a spinoff of its food business, Nabisco Holdings Corp. ("Nabisco"). The terminations of the High River agreements left in effect for one year certain provisions concerning payments to be made to High River in the event New Valley achieved a profit (after deducting certain expenses) on the sale of the shares of RJR Nabisco common stock which were held by it or they were valued at the end of such year at higher than their purchase price or in the event the Company or its affiliates engaged in certain transactions with RJR Nabisco. Based on the market price of RJR Nabisco common stock, no amounts were payable by New Valley under these agreements.

Pursuant to an agreement between Brooke and New Valley whereby New Valley agreed to reimburse Brooke and its subsidiaries for reasonable out-of-pocket expenses in connection with RJR Nabisco, New Valley paid Brooke and its subsidiaries a total of $17 and $2,370 in 1997 and 1996, respectively.

On February 29, 1996, New Valley entered into a total return equity swap transaction (the "Swap") with an unaffiliated company relating to 1,000,000 shares of RJR Nabisco common stock. During the third quarter of 1996, the Swap was terminated. New Valley recognized a loss on the Swap of $7,305 for the year ended December 31, 1996.

5. FEDERAL INCOME TAX

The Company's operations are included in the consolidated tax return of Brooke. Income taxes in these financial statements are shown as if the Company filed a separate tax return.

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

The amounts provided for income taxes are as follows:

	December 31, 1997	1996	1995
Current:			
U.S. Federal	$ (14)	$1,840	$ 4,472
State			
Deferred:			
U.S. Federal	(673)	(800)	(12,799)
State			
Total provision (benefit) for continuing operations	$(687)	$1,040	$ (8,327)

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

December 31, 1997	Deferred Tax Asset	Deferred Tax Liability
Excess of tax basis over book basis of non-consolidated entities	$ 8,400	$
Valuation allowance	(8,400)	
Total	$	$

December 31, 1996	Deferred Tax Asset	Deferred Tax Liability
Excess of book basis over tax basis of non-consolidated entities	$ 8,400	$
Valuation allowance	(8,400)	
Total	$	$

Differences between the amounts provided for income taxes and amounts computed at the federal statutory rate of 35% are summarized as follows:

	December 31, 1997	1996	1995
(Loss) income from continuing operations before income taxes	$(26,949)	$(7,850)	$ 739
Federal income tax (benefit) provision at statutory rate	(9,432)	(2,748)	259
Decrease resulting from 80% dividends received deduction under Internal Revenue Code Section 243			(8,586)
Net effect of equity transactions	8,745		
Establishment of valuation allowance		3,788	
Total	$ (687)	$ 1,040	$ 8,327

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

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

6. CONTINGENCIES

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

On March 2, 1998, BGLS entered into an agreement with AIF II, L.P. and an affiliated investment manager on behalf of a managed account (together, the "Apollo Holders") who hold approximately 41.9% of the BGLS Notes in which the Apollo Holders agreed to defer the payment of interest on the BGLS Notes held by them, commencing with the interest payment that was due July 31, 1997, which they had previously agreed to defer, through the interest payment due July 31, 2000. The deferred interest payments will be payable at final maturity of the BGLS Notes on January 31, 2001 or upon an event of default under the Indenture for the BGLS Notes.

BAKER, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No.97-703444-NP, Wayne County Circuit Court, Michigan (case filed on February 4, 1997). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated addicted smokers resident in Michigan. No motion for class certification has been brought by plaintiff.

TAYLOR, TERRY, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 97-715975, Wayne County Circuit Court, Michigan (case filed on July 28, 1997). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in Michigan. No motion for class certification has been brought by plaintiff.

WHITE, HENRY LEE, ET AL. V. PHILIP MORRIS, ET AL., Case No. 5:97-CV-91BRS, Chancery Court of Jefferson County, Mississippi (case filed on April 24, 1997). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in Mississippi. No motion for class certification has been brought by plaintiff.

BADILLO, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. CV-N-97-573-HDM (RAM), USDC, District of Nevada (case filed on November 4, 1997). This action is brought on behalf of all Nevada casino workers that have been injured by exposure to environmental tobacco smoke. No motion for class certification has been brought by plaintiff.

DIENNO, VITO AND MARTIN N. HALLNAN, ET AL. V. LIGGETT GROUP INC., ET AL., Case No. unknown, District Court, Clark County, Nevada (case filed on December 22, 1997). This action is brought on behalf of all Nevada casino workers that have been injured by exposure to environmental tobacco smoke. No motion for class certification has been brought by plaintiff.

SELCER, ET AL. V. R.J. REYNOLDS, ET AL., Case No. CV-S-97-00334-PMP (RLH), USDC, District of Nevada (case filed on September 3, 1997). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in Nevada. No motion for class certification has been brought by plaintiff.

PISCITELLO, HELEN, ET AL. V. PHILIP MORRIS INC., ET AL., Case No. 98-CIV-4613, Superior Court, Middlesex County, New Jersey (case filed on March 6, 1998). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in New Jersey. No motion for class certification has been brought by plaintiff.

TEPPER AND WATKINS, ET AL. V. PHILIP MORRIS INC., ET AL., Case No. BER-L-4983-97-E, Middlesex County Superior Court, New Jersey (case filed on May 28, 1997). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated addicted smokers resident in New Jersey. To date, no motion for class certification has been filed by plaintiff.

Exhibit 99.4

BROOKE (OVERSEAS) LTD. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 1997

BROOKE (OVERSEAS) LTD. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

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

	December 31, 1997	December 31, 1996
ASSETS		
Current assets:		
Cash and cash equivalents	$ 968	$ 1,875
Accounts receivable - trade	1,584	166
Inventories	4,255	3,569
Prepaid expenses	9,290	2,640
Total current assets	16,097	8,250
Property, plant and equipment, at cost, less accumulated depreciation of $1,020 and $676	29,122	59,607
Goodwill, net	1,001	1,094
Deferred finance costs		2,805
Other	2	540
Total assets	$ 46,222	$ 72,296
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Current liabilities:		
Notes payable and current portion of long-term debt	$ 5,000	$ 21,658
Accounts payable - trade	3,798	13,074
Due to affiliates	67,539	48,875
Unearned revenue	1	7,406
Accrued taxes	18,077	8,474
Accrued interest		597
Other accrued liabilities	8,397	2,692
Total current liabilities	102,812	102,776
Deferred gain	25,498	1,494
Unearned revenue		9,458
Other liabilities	2,000	
Commitments and contingencies		
Stockholder's equity (deficit):		
Common stock, par value $1 per share, 701,000 shares authorized, issued and outstanding	701	701
Additional paid-in-capital	5,600	3,400
Deficit	(90,389)	(45,533)
Total stockholder's equity (deficit)	(84,088)	(41,432)
Total liabilities and stockholder's equity (deficit)	$ 46,222	$ 72,296

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

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholder
of Brooke (Overseas) Ltd.

We have audited the accompanying consolidated balance sheets of Brooke (Overseas) Ltd. and Subsidiaries (the "Company") as of December 31, 1997 and 1996 and the related consolidated statements of operations, stockholder's equity (deficit) and cash flows for each of the three years in the period ended December 31, 1997. 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 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 provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Brooke (Overseas) Ltd. and Subsidiaries at December 31, 1997 and 1996 and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 1997 in conformity with generally accepted accounting principles.

COOPERS & LYBRAND L.L.P.

Miami, Florida
April 8, 1998

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

	December 31, 1997	December 31, 1996	December 31, 1995
Net sales*	$ 77,349	$ 56,835	$ 44,752
Cost of sales*	63,819	52,799	34,304
Gross profit	13,530	4,036	10,448
Operating, selling, administrative and general expenses	9,293	14,008	5,621
Operating income (loss)	4,237	(9,972)	4,827
Other income (expense):			
Interest income	1,508		
Interest expense	(10,187)	(7,548)	(6,286)
Gain on sale of BML	27,055		
Gain on foreign currency exchange	80	1,199	503
Other, net	(126)	(3,027)	(853)
Income (loss) before income taxes	22,567	(19,348)	(1,809)
Provision for income taxes	11,868	1,454	1,669
Net income (loss)	$ 10,699	$(20,802)	$ (3,478)

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*Net sales and Cost of sales include excise taxes of $12,367, $7,700 and $6,000 for the years ended December 31, 1997, 1996 and 1995, respectively.

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

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

	Common Stock		Additional Paid-in		
	Shares	Amount	Capital	Deficit	Total
Balance, December 31, 1994	701,000	$ 701	$	$(12,528)	$(11,827)
Net loss				(3,478)	(3,478)
Distributions to parent				(8,725)	(8,725)
Balance, December 31, 1995	701,000	701		(24,731)	(24,030)
Net loss				(20,802)	(20,802)
Capital contribution			3,400		3,400
Balance, December 31, 1996	701,000	701	3,400	(45,533)	(41,432)
Net income				10,699	10,699
Distributions to parent				(55,555)	(55,555)
Capital contribution			2,200		2,200
Balance, December 31, 1997	701,000	$ 701	$ 5,600	$(90,389)	$(84,088)

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

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

	December 31, 1997	December 31, 1996	December 31, 1995
Cash flows from operating activities:			
Net income (loss)	$ 10,699	$(20,802)	$ (3,478)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	783	1,399	870
Gain on sale of assets	(27,055)		
Deferred taxes		1,061	(1,061)
Provision for doubtful accounts			(495)
Provision for loss on inventory			(105)
Provision for obsolete equipment			47
Changes in assets and liabilities (net of effect of disposition):			
Accounts receivable	(1,418)	796	852
Inventories	(686)	2,364	(3,046)
Accounts payable and accrued liabilities	5,463	12,717	2,395
Deferred gain	(2,985)		
Due to affiliates	30,404	7,606	15,716
Unearned revenue		9,227	4,728
Other assets and liabilities, net	(2,093)	1,490	(6,123)
Net cash provided by operating activities	13,112	15,858	10,300
Cash flows from investing activities:			
Capital expenditures	(20,680)	(29,860)	(16,755)
Proceeds from sale of BML, net	55,000		
Purchase of stock in Liggett-Ducat	(25)	(2,829)	(435)
Proceeds from sale of stock in Liggett-Ducat, net		2,100	
Proceeds from sale of option to purchase stock in Liggett-Ducat	2,200	3,400	
Net cash provided by (used in) investing activities	36,495	(27,189)	(17,190)
Cash flows from financing activities:			
Proceeds from debt	10,305	12,995	10,841
Repayments of debt	(5,345)	(1,329)	(1,044)
Borrowings under credit facility		1,677	798
Repayments on credit facility		(1,672)	(2,198)
Distributions paid to parent	(55,555)		
Net cash (used in) provided by financing activities	(50,595)	11,671	8,397
Effect of exchange rate changes on cash and cash equivalents	81	(125)	(395)
Net (decrease) increase in cash and cash equivalents	(907)	215	1,112
Cash and cash equivalents, beginning of period	1,875	1,660	548
Cash and cash equivalents, end of period	$ 968	$ 1,875	$ 1,660
Supplemental cash flow information:			
Cash payments during the period for:			
Interest	$ 1,919	$ 5,573	$ 3,636
Income taxes	1,280	393	58

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

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

1. ORGANIZATION

Brooke (Overseas) Ltd. ("the Company"), a Delaware corporation, is a wholly-owned subsidiary of BGLS Inc. ("BGLS") and an indirect subsidiary of Brooke Group Ltd. ("Brooke"). Prior to October 1, 1993, Brooke and Ducat Factory were operating a Russian cigarette factory under a joint venture agreement (the "Joint Venture") in Moscow, Russia. On October 1, 1993, the parties to the Joint Venture agreed to form a Russian closed joint stock company, Liggett-Ducat Ltd. ("Liggett-Ducat"), an entity predominantly engaged in the manufacture of cigarettes. Brooke then transferred ownership of the stock it held of Liggett-Ducat to the Company. At December 31, 1997 and 1996, the Company owned 75% of the stock of Liggett-Ducat. The business of Liggett-Ducat included the cigarette operations, Liggett-Ducat Tobacco ("LDT"), a wholly-owned subsidiary engaged in the construction of a new cigarette factory, and, prior to December 1996, BrookeMil Ltd. ("BML"), a wholly-owned subsidiary engaged in construction of office buildings and property management in Moscow, Russia. In December 1996, the Company cancelled BML intercompany debt in exchange for 10,483 shares of newly issued BML common stock. These shares represent 99.1% of the outstanding shares of BML. (Refer to Note 3.)

On July 5, 1996, Liggett Group Inc. ("Liggett"), a wholly-owned subsidiary of BGLS, purchased from the Company 140,000 shares (19.97%) of the tobacco operations of Liggett-Ducat for $2,100. Ten-year option agreements then in place enabled Liggett to increase its ownership in Liggett-Ducat to 95%. (Refer to Note 10.)

On January 30, 1998, in connection with the restructuring of Liggett's long-term debt, Liggett agreed to transfer to the Company all of its shares of Liggett-Ducat and to cancel its option agreements to acquire additional shares of Liggett-Ducat. At January 30, 1998 the Company owned approximately 96% of the shares of common stock of Liggett-Ducat; however, holders of Liggett's debt were granted a security interest in 16% of the stock of Liggett-Ducat or a successor entity held by the Company.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Basis of Presentation:

The consolidated financial statements and accompanying notes include the accounts of the Company and its subsidiaries. Significant intercompany accounts and transactions have been eliminated in consolidation.

b) Liquidity:

The Company has historically relied on Brooke and BGLS for sources of financing. At December 31, 1997 and 1996, the Company had a working capital deficiency of $86,715 and $94,526, respectively, and a net capital deficiency of $84,088 and $41,432, respectively. On February 2, 1998, Brooke and BGLS cancelled a note and interest which amounted to $20,384 at December 31, 1997. On February 5, 1998, Brooke made a capital contribution of $9,000 to the Company,

which was used to repay intercompany indebtedness to BGLS. These contributions to capital reduced the net capital deficiency and amounts due affiliates by $29,384. Management believes that it will continue to receive financing from BGLS as needed. In addition to a new factory under construction, the Company has upgraded the present cigarette operations' tobacco processing complex, increased production with over 14 billion units sold in 1997 as compared with 11.3 billion units sold in 1996, and is continuing to implement cost-saving measures. Liggett-Ducat plans to begin the manufacture and marketing of western style cigarettes in late 1998. Management believes that such activities will result in improved operations and cash flow, but there can be no assurances in this regard. (Refer to Note 13.)

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) Foreign Currency Translation:

The Company's Russian subsidiaries historically operate in a highly inflationary economy and use the U.S. dollar as the functional currency. Therefore, certain assets (principally inventories and property, plant 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.

e) 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.

f) Inventories:

Inventories are stated at the lower of cost or market. Cost is determined on a first-in, first-out (FIFO) basis.

g) Property, Plant and Equipment:

Property, plant and equipment are stated at cost. Depreciation has been calculated on the straight-line method based upon the following useful lives: buildings - 20 years, factory machinery and equipment - 10 years, office furniture and equipment - 5 years, and computers and vehicles - 3 years. Depreciation is not provided on construction-in-progress until the related assets are placed in service.

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

Interest costs are capitalized in connection with the construction of major facilities. Capitalized interest is recorded as part of the asset to which it relates and is amortized over the asset's estimated useful life. In 1997, 1996 and 1995, interest costs of $693, $6,157 and $1,004, respectively, were capitalized.

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

h) Goodwill:

Goodwill is being amortized using the straight-line method over ten years and relates to the purchase by the Company of additional shares of Liggett-Ducat stock. Amortization expense for the years ended December 31, 1997, 1996 and 1995 was $118, $51 and $68, respectively.

i) Impairment of Long-Lived Assets:

Impairment losses on long-lived assets are recognized when expected future cash flows are less than the assets' carrying value. Accordingly, when indicators of impairment are present, the Company evaluates the carrying value of property, plant and equipment and intangibles in relation to the operating performance and future undiscounted cash flows of the underlying business. The Company adjusts the net book value of the underlying assets by the excess of the assets' carrying values over the sum of expected discounted future cash flows.

j) Deferred Finance Costs:

Deferred finance costs consist of the discounts on lease prepayments which are being amortized over the life of the leases and the fees incurred in obtaining a bank loan which are being amortized over the term of the loan.

k) Revenue Recognition:

Sales, net of sales returns and discounts are recognized upon the shipment of finished goods to customers. Rental income is recognized ratably over the life of the lease.

l) Income Taxes:

Applicable income and deferred taxes have been provided for based on tax rates applicable to the Company in the United States and Russia. A valuation allowance is provided against Russian deferred tax assets when it is

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

deemed more likely than not that some portion or all of the deferred tax assets will not be realized.

m) Concentration of Credit and Other Risks:

The Company sells its products primarily to companies in the wholesale distribution and retail industries in the Russian Federation. Two distributors account for 24.9% and 22.0% of sales in 1997. Prepayment for goods and services is a customary business practice in Russia and the Company receives payment in advance for the majority of its sales. Although the Company does not require collateral and, as a consequence, is exposed to credit risk with respect to its tobacco operations, the Company does perform ongoing credit evaluations of its customers and believes that its trade accounts receivable risk exposure is limited. At December 31, 1997, 1996 and 1995, the Company had approximately $9,290, $2,141 and $2,500, respectively, in prepayments made to suppliers of raw materials.

The Company maintains its cash deposits with United States, various foreign and Russian banks. Management assesses the financial condition of the institutions on an on-going basis.

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

3. SALE OF BROOKEMIL

On January 31, 1997, the Company sold its 99.1% of the outstanding shares of BML to New Valley Corporation ("New Valley") for $21,500 in cash and a promissory note of $33,500, collateralized by the BML shares. The note, with an annual interest rate of 9%, was paid in full in 1997. The consideration received exceeded the carrying value of the Company's investment in BML by $52,500. The Company recognized a gain on the sale in 1997 in the amount of $25,500. The remaining $27,000 was deferred, reflecting recognition that the Company's parent, BGLS, retains an interest in BML through its 42% equity ownership in New Valley, and, further, that a portion of the property sold (the site of the third phase of the Ducat Place real estate project being developed by BML, which is currently used by Liggett-Ducat for its existing cigarette factory) is subject to a put option held by New Valley. The option allows New Valley to put this site back to the Company at the greater of the appraised fair value of the property at the date of exercise or $13,600, during the period Liggett-Ducat operates the factory on such site. The Company distributed the $21,500 cash proceeds and the proceeds from the $33,500 promissory note received from the sale of BML to BGLS.

On April 18, 1997, BML sold one of its office buildings, Ducat Place I, to a third party. Accordingly, the Company recognized approximately $1,490 of the deferred gain. At December 31, 1997, the balance of the deferred gain was approximately $25,500.

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

In connection with the sale of the BML shares, certain specified liabilities aggregating $40,800, including a Russian bank loan with a balance of $20,418, remained with BML. The bank loan was paid in full during the third quarter, 1997. Further, the Company, Brooke and BGLS each contributed to the capital of BML, through cancellation of all indebtedness of BML to each such entity, the aggregate amount of which was $19,275 including accrued interest thereon. In addition, Liggett-Ducat entered into a Use Agreement with BML whereby Liggett-Ducat is permitted to continue to utilize the existing factory site on the same basis as in the past which includes obligations for costs involved in carrying the site. The Use Agreement is terminable by BML on 270 days' prior notice.

4. NON-MONETARY TRANSACTIONS

During 1997, 1996 and 1995, certain supplies and inventory purchase transactions were made whereby payment for such transactions was facilitated by the Company's customers who forwarded payment on the Company's behalf to raw material suppliers. Such transactions amounted to approximately $4,753, $3,040 and $8,200 in 1997, 1996 and 1995, respectively. Sales and purchases were priced at what management believes are normal sales price for cigarettes and the normal market price for tobacco and other raw materials.

5. INVENTORIES

Inventories consist of:

	December 31, 1997	December 31, 1996
Finished goods...........................	$	$
Work-in-process..........................	50	53
Raw materials............................	3,284	2,664
Replacement parts and supplies...........	921	852
	$4,255	$3,569

Purchase commitments are for quantities not in excess of anticipated requirements and are at prices, including carrying costs, established at the date of the commitment. At December 31, 1997, the Company had leaf tobacco purchase commitments of approximately $27,800.

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

6. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consists of:

	December 31, 1997	December 31, 1996
Buildings	$	$ 8,064
Factory machinery and equipment	10,864	4,419
Computers and software	293	289
Office furniture and equipment	272	129
Vehicles	534	416
Construction-in-progress	18,179	46,966
	30,142	60,283
Less accumulated depreciation	(1,020)	(676)
	$29,122	$59,607

The amounts provided for depreciation for the years ended December 31, 1997, 1996 and 1995 were $641, $469 and $352, respectively.

On December 29, 1995, Liggett-Ducat relinquished its 59.4% ownership in a joint real estate venture, Neftecominvest Ltd., in exchange for 100% ownership of a partially constructed manufacturing facility owned by the venture. Liggett-Ducat is developing this facility, located on the outskirts of Moscow, into a new cigarette factory. In connection with this exchange, a 49-year land lease was renegotiated in 1996 for the site on which the factory is being constructed. Liggett-Ducat's cost basis in the joint real estate venture of $2,675 was transferred to its basis in the new cigarette factory.

Further, Liggett-Ducat has entered into a construction contract for the new factory. The remaining liability under that contract at December 31, 1997 is approximately $11,500. Equipment purchase agreements in place at December 31, 1997 total $26,955 of which $22,950 will be financed by the manufacturers. In February 1998, additional equipment for the new factory was purchased for $7,400 of which $5,841 will be financed by the manufacturers. Brooke has guaranteed this obligation.

Subsequent Event:

In February 1998, New Valley and Apollo Real Estate Investment Fund III, L.P. organized Western Realty Development LLC ("Western Realty") to make real estate and other investments in Russia. Among other things, Western Realty agreed to acquire for $20,000, a 30% profits interest in a company organized by the Company, which will, among things, acquire an interest in the new factory discussed above.

7. EMPLOYEE BENEFITS

The Company complies with Russian Federation regulations covering pensions, education, day care, medical and other benefits to employees. These items are funded as a percentage of gross wages and are paid on a current basis. Medical clinic and day

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

care facilities are provided on site and related costs are expensed as incurred. All Russian citizen employees are required to participate in the pension fund. The total expense for these programs recognized in 1997, 1996 and 1995 was approximately $2,638, $860 and $1,050, respectively.

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

Current and long-term debt consist of the following:

	December 31, 1997	December 31, 1996
Revolving credit facilities	$5,000	$
Bank loan		20,418
Deferred financing fees		1,240
	5,000	21,658
Less:		
Current maturities	5,000	21,658
Amount due after one year	$	$

In connection with the sale of its BML shares to New Valley, certain specified liabilities aggregating $40,800 remained with BML, including a Russian bank loan with a balance of $20,418, which was paid in full during the third quarter, 1997.

At December 31, 1997, Liggett-Ducat had two 6-month credit facilities open with a Russian bank. The first, for $2,000, expires on April 30, 1998, initially bore an interest rate of 21%, subsequently raised to 28% on December 2, 1997. The second, for $3,000, expires on May 16, 1998, initially bore an interest rate of 25%, subsequently raised to 28% on December 2, 1997.

9. COMMITMENTS

The following is a schedule of the Company's future minimum rental payments required under operating leases with noncancelable lease terms in excess of one year as of December 31, 1997:

Year ending December 31:	
1998	$ 440
1999	82
2000	82
2001	82
2002	81
Thereafter	2,155
	$2,922

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

The Company's rental expense for the years ended December 31, 1997, 1996 and 1995 was $375, $1,026 and $1,107, respectively.

10. STOCK OF LIGGETT-DUCAT

During the second quarter of 1996, the Company further increased its ownership of Liggett-Ducat through the purchase of an additional 142,558 shares for approximately $2,143. In July 1996, the Company sold 140,000 shares (19.97%) of Liggett-Ducat's tobacco operations to Liggett for $2,100. Liggett also acquired a ten-year option to buy up to an additional 292,407 shares for $3,400, which has been accounted for as a capital contribution, thereby entitling Liggett to increase its interest in Liggett-Ducat to approximately 62%. The option fee would be credited against the purchase price. As part of the same transaction, Liggett acquired on March 13, 1997 for $2,200 another ten-year option from the Company on the same terms to purchase the remaining shares, approximately 33%, of Liggett-Ducat owned by the Company.

In 1997 and 1996, the Company purchased 1,666 and 46,337 additional shares of Liggett-Ducat stock from other shareholders for $25 and $695, respectively. At December 31, 1997, the Company owned 75.3% of the stock of Liggett-Ducat and Liggett owned 19.97%. In connection with 1996 purchases of Liggett-Ducat common stock, the Company recorded goodwill in the amount of $729. Unamortized goodwill is $1,001 and $1,094 at December 31, 1997 and 1996, respectively.

On January 30, 1998, in connection with the restructuring of Liggett's long-term debt, Liggett agreed to transfer to the Company all of its shares and to cancel its option agreements to acquire additional shares. At January 30, 1998, the Company owned approximately 96% of the shares of common stock of Liggett-Ducat.

11. RELATED PARTY TRANSACTIONS

The Company has obtained funding through a revolving credit facility with Brooke and BGLS at an annual interest rate of 20% to cover certain expenses including the cost of certain administrative services and personnel, tobacco and material purchases and upgrades of factory equipment. In addition, Brooke and BGLS have advanced funds to BML for its real estate developments projects. Amounts due to Brooke and BGLS under this facility at December 31, 1997 and 1996 were $68,437 and $48,875 including interest of $19,367 and $12,725, respectively. In January and February 1998, Brooke and BGLS contributed $29,384 to the Company, reducing the liability to $39,053. (Refer to Note 2(b).)

On March 2, 1995, the Company dividended to Brooke certain notes receivable of the Company from Liggett-Ducat and BML in the amount of $8,725, including interest.

On July 2, 1996, the Company repaid portions of outstanding loans to BGLS in principal amount of $3,679 together with accrued interest of $1,521.

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

During 1996, indebtedness relating to the real estate development business including the loan agreement between a Russian bank and Liggett-Ducat (refer to Note 8) and intercompany indebtedness in the amount of $3,586 together with accrued interest of $1,270 was assigned by Liggett-Ducat to BML.

Liggett has provided certain administrative and technical support to Liggett-Ducat. Liggett's expenses associated with these activities were $0, $76 and $229 for the years ended December 31, 1997, 1996 and 1995, respectively.

On April 3, 1996, the Company entered into a stock purchase agreement (the "purchase agreement") with the former chairman of Liggett-Ducat. Under the purchase agreement, the Company acquired the 84,540 shares for $15 per share ($1,268). The stock purchase price was paid in installments during 1996 and the shares of Liggett-Ducat stock collateralizing the installment payments were released, ratably, as payments were made.

Concurrently, the Company entered into a consulting and non-compete agreement with the former chairman for services through December 31, 1998. Under the terms of the agreements, the Company will pay him approximately $5,232 over five years. At December 31, 1997, 43,285 shares of Liggett-Ducat stock collateralizing the Company's obligations under the agreements had been released to the Company and 41,255 shares of Liggett-Ducat stock remain as collateral under the terms of the agreements.

On June 14, 1996, the Company entered into a second stock purchase agreement with the former General Director (the "Director") of the cigarette manufacturing operations. Under this purchase agreement, the Company acquired the 58,018 shares held by the Director for approximately $15 per share ($875). The stock purchase price was paid in installments during 1996.

Concurrently, the Company entered into a consulting and non-compete agreement with the Director for services through December 31, 1998. Under the terms of the agreement, the Company paid the Director approximately $1,000 during 1997 and will pay him $1,000 during 1998. Also, Liggett-Ducat extended the Director's employment agreement with Liggett-Ducat until December 31, 1998 at $175 annually. At December 31, 1997, 39,893 shares of Liggett-Ducat stock collateralizing the Company's obligations under the agreements had been released; 18,125 shares of Liggett-Ducat stock remain as collateral under the terms of the agreements.

12. INCOME TAXES

The provision for income taxes relates to income taxes payable in United States and Russian jurisdictions.

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

The provision for income taxes consists of the following:

	1997	1996	1995
Current	$11,868	$ 393	$2,730
Deferred		1,061	(1,061)
	$11,868	$1,454	$1,669

Deferred taxes have been recognized for significant temporary differences arising between the financial statement and tax basis of assets and liabilities. The principal items giving rise to temporary differences relate to management fees and interest expense incurred during 1997 and 1996 which are not deductible for Russian tax purposes until paid. The tax effect of these temporary differences and net deferred taxes recorded as of December 31, 1997 and 1996 are summarized as follows:

	1997	1996
Deferred tax assets	$2,151	$1,566
Deferred tax liability		(305)
Net deferred tax asset	2,151	1,261
Valuation allowance	(2,151)	(1,261)
Net deferred taxes	$	$

In 1996, Russian tax authorities assessed Liggett-Ducat $7,600 for outstanding tax liabilities relating to 1995. The liability is payable in two parts, 50% within 2-1/2 years, the remaining 50% over the succeeding five years. At December 31, 1997, the remaining liability was $4,405.

13. CONTINGENCIES

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

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

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

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

GEIGER, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Index No. 10657/97, Supreme Court, Queens County, New York (case filed on January 12, 1997). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in New York. The case was certified as a class action on May 1, 1997, and currently is stayed pending appeal.

NWANZE, ET AL. V. PHILIP MORRIS, ET AL., Case No. 97-CIV-7344, USDC, Southern District of New York (case filed on October 17, 1997). This action is brought on behalf of all prisoners nationwide that have been injured by exposure to environmental tobacco smoke. No motion for class certification has been brought by plaintiff.

WOODS, DELISA, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 97-CVS-7869, General Court of Justice, Superior Ct. Div., North Carolina (case filed on July 10, 1997). This personal injury action is brought on behalf of plaintiff and all similarly situated injured smokers resident in North Carolina.

CHAMBERLAIN, ET AL. V. THE AMERICAN TOBACCO COMPANY, Case No. 1:96CV2005, USDC, Northern District of Ohio (case filed on August 20, 1997). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated addicted smokers resident in Ohio. To date, no motion for class certification has been filed by plaintiff.

BARNES, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 96-5903, USDC, Eastern District of Pennsylvania (case filed on August 8, 1996). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated addicted smokers resident in Pennsylvania. The district court decertified the class in this case on October 17, 1997.

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

NEWBORN, ET AL. V. BROWN & WILLIAMSON, ET AL., Case No. 97-2938 GV, USDC, Western District of Tennessee (case filed on October 1, 1997). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in Tennessee. No motion for class certification has been brought by plaintiff.

MASON, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 7-97CV-293-X, USDC, Northern District of Texas (case filed on December 23, 1997). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated addicted smokers resident in Texas. To date, no motion for class certification has been filed by plaintiff.

HERRERA, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 2:98-CV-00126, USDC, District of Utah (case filed on January 28, 1998). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in Utah. No motion for class certification has been brought by plaintiff.

JACKSON ET AL. V. PHILIP MORRIS INC., Case No. 980901634PI, 3rd Judicial Court, Salt Lake City County, Utah (case filed on March 10, 1998). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in Utah. No motion for class certification has been brought by plaintiff.

INGLE, ET AL. V. PHILIP MORRIS, ET AL., Case No. 97-C-21-S, Circuit Court of McDowell County, West Virginia (case filed on February 4, 1997). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in West Virginia. No motion for class certification has been brought by plaintiff.

MCCUNE, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 97-C-204, Circuit Court of Kanawha County, West Virginia (case filed on January 30, 1997). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated addicted smokers resident in West Virginia. To date, no motion for class certification has been filed by plaintiff.

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

INSOLIA, ET AL. V. PHILIP MORRIS, ET AL., Case No. 97-CV-230-J, Rock County Circuit Court, Wisconsin (case filed on April 4, 1997). This personal injury class action is brought on behalf of plaintiff and all similarly situated injured smokers resident in Wisconsin. No motion for class certification has been brought by plaintiff.

OTHER REIMBURSEMENT ACTIONS

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

COUNTY OF LOS ANGELES V. R.J.REYNOLDS, ET AL., Case No. 707651, Superior Court of San Diego (case filed on 8/5/97). County seeks to obtain declaratory and equitable relief and restitution as well as to recover money damages resulting from payment by the County for tobacco-related medical treatment for its citizens and health insurance for its employees.

ELLIS, ON BEHALF OF THE GENERAL PUBLIC V. R.J. REYNOLDS, ET AL., Case No. 00706458, Superior Court of San Diego (case filed on 12/13/96). Plaintiffs, two individuals, seek equitable and injunctive relief for damages incurred by the State of California in paying for the expenses of indigent smokers.

COUNTY OF COOK V. PHILIP MORRIS, ET AL., Case No. 97L04550, Circuit Court, Cook County (case filed on 7/21/97). County of Cook seeks to obtain declaratory and equitable relief and restitution as well as to recover money damages resulting from payment by the County for tobacco-related medical treatment for its citizens and health insurance for its employees.

CITY OF NEW YORK, ET AL. V. THE TOBACCO INSTITUTE, ET AL., Case No. 97-CIV-0904, Supreme Court of New York, New York County (case filed on 10/17/96). City of New York seeks to obtain declaratory and equitable relief and restitution as well as to recover money damages resulting from payment by the City for tobacco-related medical treatment for its citizens and health insurance for its employees.

STATE OF TENNESSEE V. THE AMERICAN TOBACCO CO., ET AL., Case No. 12,263, Monroe County Chancery Court (case filed on 5/7/97). Individual seeks equitable and injunctive relief for damages incurred by the State of Tennessee in paying for the expenses of indigent smokers.

THE CROW CREEK SIOUX TRIBE V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. CV 97-09-082, Tribal Court of The Crow Creek Sioux Tribe (case filed on 9/26/97). Indian tribe seeks equitable and injunctive relief for damages incurred by the tribe in paying for the expenses of indigent smokers.

THE REPUBLIC OF MARSHALL ISLANDS V. THE AMERICAN TOBACCO CO., ET AL., Case No. 1997-261, Republic of the Marshall Islands, The High Court (case filed on 10/30/97). Republic seeks equitable and injunctive relief for damages incurred by the Republic in paying for the expenses of indigent smokers.

SCREEN ACTORS GUILD - PRODUCERS HEALTH PLAN, ET AL. V. PHILIP MORRIS, ET AL., Case No. DC181603, Superior Court of Los Angeles County (case filed on 11/20/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

STATIONARY ENGINEERS LOCAL 39 HEALTH & WELFARE TRUST FUND V. PHILIP MORRIS, ET AL., Case No. C-97-1519-DLJ, USDC, Northern District of California (case filed on 4/25/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

STEAMFITTERS LOCAL UNION NO. 614 HEALTH AND WELFARE FUND V. PHILIP MORRIS, ET AL., Case No. 92260-2, Circuit Court for 30th Judicial District at Memphis (case filed on 1/7/98). Union Health and Welfare Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

TEXAS CARPENTERS HEALTH BENEFIT FUND, ET AL. V. PHILIP MORRIS, ET AL., Case No. 1:97C0625, USDC, Eastern District of Texas (case filed on 11/7/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

NORTHWEST LABORERS-EMPLOYERS HEALTH & SECURITY TRUST FUND, ET AL. V. PHILIP MORRIS, ET AL., Case No. C97-849-WD, WA, USDC, Western District (case filed on 6/26/97). Health and Welfare Trust Fund seeks economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

IRON WORKERS LOCAL UNION NO.17 INSURANCE FUND, ET AL. V. PHILIP MORRIS, ET AL., Case No. 1:97CV 1422, USDC, Northern District of Ohio, Eastern Div. (case filed on 5/20/97). Union Insurance Trust Fund seeks economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

STEAMFITTERS LOCAL UNION NO. 420 WELFARE FUND, ET AL. V. PHILIP MORRIS, INC, ET AL., Case No. 97-CV-5344, USDC, Eastern District of Pennsylvania (case filed on 10/7/97). Union Health and Welfare Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

RHODE ISLAND LABORERS' HEALTH & WELFARE FUND V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 97-500L, USDC, District of Rhode Island (case filed on 10/24/97). Union Health and Welfare Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

TEAMSTERS UNION NO. 142, ET AL. V. PHILIP MORRIS, ET AL., Case No. 71C019709CP01281, USDC, Northern District of Indiana (case filed on 9/15/97). Union seeks injunctive relief and economic reimbursement to recover moneys expended by Union Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

KENTUCKY LABORERS DISTRICT COUNCIL HEALTH & WELFARE TRUST FUND V. PHILIP MORRIS, ET AL., Case No.3-97-394, USDC, Western District of Kentucky (case filed on 6/20/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Trust Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

ARK-LA-MISS LABORERS WELFARE FUND, ET AL. V. PHILIP MORRIS, ET AL., Case No. 97-1944, USDC, Eastern District of Louisiana (case filed on 6/20/97). Welfare Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

NEW JERSEY CARPENTERS HEALTH FUND, ET AL. V. PHILIP MORRIS, ET AL., Case No. 97-3421, USDC, District of New Jersey (case filed on 10/7/97). Health Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

LABORERS' LOCAL 17 HEALTH BENEFIT FUND, ET AL. V. PHILIP MORRIS, ET AL., Case No. 97-CIV-4550, USDC, Southern District of New York (case filed on 7/17/97). Health Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

OPERATING ENGINEERS LOCAL 12 HEALTH AND WELFARE TRUST V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. CV-97-7620 TJH, USDC, Central District of California (case filed on 11/6/97). Health and Welfare Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide pmedical treatment to its participants and benefactors suffering from smoking-related illnesses.

CONNECTICUT PIPE TRADES HEALTH FUND, ET AL. V. PHILIP MORRIS, ET AL., Case No. 397CV01305CT, USDC, District of Connecticut (case filed on 7/17/97). Health Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

SOUTHEAST FLORIDA LABORERS DISTRICT COUNCIL HEALTH AND WELFARE TRUST FUND V. PHILIP MORRIS, ET AL., Case No. 97-8715 Circuit Court, Dade County (case filed 10/7/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

CENTRAL ILLINOIS LABORERS HEALTH & WELFARE TRUST FUND, ET AL. V. PHILIP MORRIS, ET AL., Case No. 97-L516, USDC, Southern District of Illinois (case filed on 5/22/97). Laborers' Union Health Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

LABORERS' AND OPERATING ENGINEERS UTILITY AGREEMENT V. PHILIP MORRIS, ET AL., Case No. CIV97-1406 PHX, USDC, District of Arizona (case filed on 7/29/97). Union Health and Welfare Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

ARKANSAS CARPENTERS HEALTH & WELFARE FUND V. PHILIP MORRIS, ET AL., Case No. LR-C-97-0754, USDC, Eastern District of Arkansas (case filed on 9/4/97). Union's Health and Welfare Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

WEST VIRGINIA LABORERS' PENSION TRUST FUND V. PHILIP MORRIS, ET AL., Case No. 397-0708, USDC, Southern District of West Virginia (case filed on 8/27/97). Laborers' Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

WEST VIRGINIA - OHIO VALLEY AREA I.B.E.W., ET AL. V. LIGGETT GROUP INC., ET AL., Case No. 97-C-2135, USDC, Southern District of West Virginia (case filed on 9/19/97).

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

MASSACHUSETTS LABORERS' HEALTH & WELFARE FUND, ET AL. V. PHILIP MORRIS, ET AL., Case No. C.A. 97-2892G, Superior Court, Suffolk County (case filed on 6/2/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

B.A.C. LOCAL NO. 32 INSURANCE TRUST FUND, ET AL. V. PHILIP MORRIS, ET AL., Case No. 97-75675MI, USDC, Eastern District of Michigan (case filed on 11/18/97). Health Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

OPERATING ENGINEERS LOCAL 324 HEALTH CARE FUND, ET AL. V. PHILIP MORRIS, INC., ET AL., Case No. 598--CV-60020, Circuit Court, Wayne County (case filed on 3/9/98). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

NEW MEXICO AND WEST TEXAS MULTI-CRAFT HEALTH AND WELFARE TRUST FUND, ET AL. V. PHILIP MORRIS, ET AL., Case No. CV97 0009118NM, Second Judicial District Court, Bernalillo County (case filed on 1/29/98). Health Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

OREGON LABORERS-EMPLOYERS HEALTH & WELFARE TRUST FUND, ET AL. V. PHILIP MORRIS, ET AL., Case No. 97-1051-HA, USDC, District of Oregon (case filed on 6/18/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

CENTRAL STATES JOINT BOARD HEALTH & WELFARE FUND V. PHILIP MORRIS, ET AL., Case No. 97L12855, USDC, Northern District of Illinois (case filed on 10/30/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

INTERNATIONAL BROTHERHOOD OF TEAMSTERS, LOCAL 734 HEALTH & WELFARE TRUST FUND V. PHILIP MORRIS, ET AL., Case No. 97L12852, USDC, Northern District of Illinois (case filed on 10/30/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

SEAFARERS WELFARE PLAN AND UNITED INDUSTRIAL WORKERS WELFARE PLAN V. PHILIP MORRIS, ET AL., Case No. MJG-97-2127MD, USDC, District of Maryland (case filed on 8/8/97). Welfare Plan seeks injunctive relief and economic reimbursement to recover moneys expended by Plan to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

CARPENTERS & JOINERS WELFARE FUND, ET AL. V. PHILIP MORRIS, ET AL., Case No. 60,633-001, USDC, District of Minnesota (case filed on 12/31/97). Health and Welfare Trust Plan seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and benefactors suffering from smoking-related illnesses.

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

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

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

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

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

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

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

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

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

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

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

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

RAYMARK INDUSTRIES, INC. V. BROWN & WILLIAMSON, ET AL., Case No.

1:97-CV-2711-RCF, Circuit Court of the Fourth Judicial Circuit, Duval County (case filed on 11/5/97). Asbestos company seeks reimbursement for damages paid to asbestos victims for medical and other relief, which damages allegedly are attributable to the tobacco companies.

FIBREBOARD CORPORATION, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 791919-8, CA, Superior Court of Alameda (case filed on 11/10/97). Asbestos company seeks reimbursement for damages paid to asbestos victims for medical and other relief, which damages allegedly are attributable to the tobacco companies.

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