

=====

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

FORM 10-Q

JOINT QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE
SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 1996

COMMISSION FILE NUMBER 1-5759

COMMISSION FILE NUMBER 33-93576

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

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

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

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

DELAWARE
(State or other jurisdiction of incorporation
or organization)

DELAWARE
(State or other jurisdiction of incorporation
or organization)

100 S.E. SECOND STREET
MIAMI, FLORIDA 33131
(Address of principal executive offices including Zip Code)

100 S.E. SECOND STREET
MIAMI, FLORIDA 33131
(Address of principal executive offices including Zip Code)

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

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

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 registrant was 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.

As of May 10, 1996, there were 18,497,096 shares of Brooke Group Ltd.'s
common stock outstanding.

As of May 10, 1996, there were 100 shares of BGLS Inc.'s common stock
outstanding, all of which were owned by Brooke Group Ltd.

=====

BROOKE GROUP LTD.
BGLS INC.

FORM 10-Q

TABLE OF CONTENTS

	Page

PART I. FINANCIAL INFORMATION	
Item 1. Brooke Group Ltd./BGLS Inc. Consolidated Financial Statements:	
Brooke Group Ltd. Consolidated Balance Sheets as of March 31, 1996 and December 31, 1995.....	3
BGLS Inc. Consolidated Balance Sheets as of March 31, 1996 and December 31, 1995.	4
Brooke Group Ltd. Consolidated Statements of Operations for the three months ended March 31, 1996 and March 31, 1995.....	5
BGLS Inc. Consolidated Statements of Operations for the three months ended March 31, 1996 and March 31, 1995.....	6
Brooke Group Ltd. Consolidated Statement of Stockholders' Equity (Deficit) for the three months ended March 31, 1996.....	7
BGLS Inc. Consolidated Statement of Stockholder's Equity (Deficit) for the three months ended March 31, 1996.....	8
Brooke Group Ltd. Consolidated Statements of Cash Flows for the three months ended March 31, 1996 and March 31, 1995.....	9
BGLS Inc. Consolidated Statements of Cash Flows for the three months ended March 31, 1996 and March 31, 1995.....	10
Notes to Consolidated Financial Statements.....	11
New Valley Holdings, Inc. Financial Statements:	
Balance Sheets as of March 31, 1996 and December 31, 1995.....	25
Statements of Operations for the three months ended March 31, 1996 and March 31, 1995.....	26
Statements of Stockholder's Equity for the three months ended March 31, 1996.....	27
Statement of Cash Flows for the three months ended March 31, 1996 and March 31, 1995.....	28
Notes to Financial Statements.....	29
Item 2 . Management's Discussion and Analysis of Financial Condition and Results of Operations.....	33
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings.....	42
Item 3. Defaults Upon Senior Securities.....	42
Item 6. Exhibits and Reports on Form 8-K.....	42
SIGNATURE.....	43

Item 1. Consolidated Financial Statements

BROOKE GROUP LTD. AND SUBSIDIARY

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

	March 31, 1996	December 31, 1995

ASSETS:		
Current assets:		
Cash and cash equivalents.....	\$ 5,377	\$ 3,370
Accounts receivable - trade.....	14,293	23,844
Other receivables.....	1,350	1,448
Receivables from affiliates.....	1,130	1,502
Inventories.....	62,430	60,522
Deferred tax assets.....	1,014	1,061
Other current assets.....	4,882	4,155
	-----	-----
Total current assets.....	90,476	95,902
Property, plant and equipment, at cost, less accumulated depreciation of \$28,231 and \$27,868.....	53,811	49,065
Intangible assets, at cost, less accumulated amortization of \$22,055 and \$15,679.....	5,014	5,453
Investment in affiliate.....	42,897	63,901
Other assets.....	10,125	11,299
	-----	-----
Total assets.....	\$ 202,323	\$ 225,620
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT):		
Current liabilities:		
Notes payable and current portion of long-term debt.....	\$ 43,714	\$ 2,387
Accounts payable.....	20,986	22,762
Cash overdraft.....	3,817	4,266
Accrued promotional expenses.....	23,119	25,519
Accrued taxes payable.....	18,919	25,928
Accrued interest.....	20,879	16,863
Other accrued liabilities.....	23,706	21,452
	-----	-----
Total current liabilities.....	155,140	119,177
Notes payable, long-term debt and other obligations, less current portion....	390,617	406,744
Noncurrent employee benefits.....	30,943	31,672
Other liabilities.....	14,293	24,131
Commitments and contingencies.....		
Stockholders' equity (deficit):		
Common stock, par value \$0.10 per share, authorized 40,000,000 shares, issued 24,998,043 shares, outstanding 18,497,096 shares.....	1,850	1,850
Additional paid-in capital.....	93,599	93,186
Deficit.....	(445,950)	(428,173)
Other.....	(5,830)	9,372
Less: 6,500,947 shares of common stock in treasury, at cost.....	(32,339)	(32,339)
	-----	-----
Total stockholders' equity (deficit)	(388,670)	(356,104)
	-----	-----
Total liabilities and stockholders' equity (deficit).....	\$ 202,323	\$ 225,620
	=====	=====

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

Item 1. Consolidated Financial Statements (Continued)

BGLS INC. AND SUBSIDIARIES

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

	March 31, 1996	December 31, 1995
	-----	-----
ASSETS:		
Current assets:		
Cash and cash equivalents.....	\$ 5,339	\$ 3,370
Accounts receivable - trade.....	14,293	23,844
Other receivables.....	1,309	1,481
Receivables from affiliates.....	1,125	1,130
Inventories.....	62,430	60,522
Deferred tax assets.....	4,814	4,861
Other current assets.....	4,715	3,722
	-----	-----
Total current assets.....	94,025	98,930
Property, plant and equipment, at cost, less accumulated depreciation of \$28,053 and \$27,726.....	53,394	48,613
Intangible assets, at cost, less accumulated amortization of \$22,055 and \$15,679.....	5,014	5,453
Investment in affiliate.....	42,897	63,901
Other assets.....	11,171	12,345
	-----	-----
Total assets.....	\$ 206,501	\$ 229,242
	=====	=====
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT):		
Current liabilities:		
Notes payable and current portion of long-term debt.....	\$ 43,586	\$ 2,132
Accounts payable.....	20,861	22,637
Cash overdraft.....	3,817	3,761
Due to Brooke.....	23,985	26,054
Accrued promotional expenses.....	23,119	25,519
Accrued taxes payable.....	18,919	25,928
Accrued interest.....	20,879	16,863
Other accrued liabilities.....	22,337	19,991
	-----	-----
Total current liabilities.....	177,503	142,885
Notes payable, long-term debt and other obligations, less current portion...	390,617	420,449
Noncurrent employee benefits.....	30,943	31,672
Other liabilities.....	17,547	24,131
Commitments and contingencies.....		
Stockholder's equity (deficit):		
Common stock, par value \$0.01 per share; authorized 100 shares, issued 100 shares, outstanding 100 shares.....		23,594
Additional paid-in capital.....	39,081	(423,424)
Deficit.....	(443,875)	9,935
Other.....	(5,315)	
	-----	-----
Total stockholder's deficit.....	(410,109)	(389,895)
	-----	-----
Total liabilities and stockholder's equity (deficit).....	\$ 206,501	\$ 229,242
	=====	=====

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

Item 1. Consolidated Financial Statements (Continued)

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

	Three Months Ended	
	March 31, 1996	March 31, 1995
Revenues*	\$ 90,516	\$ 95,290
Cost of goods sold*	47,048	46,378
	43,468	48,912
Gross profit		
Operating, selling, administrative and general expenses	44,892	49,308
	(1,424)	(396)
Operating (loss)		
Other income (expenses):		
Interest income	18	389
Interest expense	(14,777)	(14,715)
Equity in (loss) earnings of affiliate	(1,274)	1,683
Other, net	115	115
	(17,342)	(12,924)
(Loss) from continuing operations before income taxes		
Provision (benefit) for income taxes	435	(14)
	(17,777)	(12,910)
(Loss) from continuing operations		
Discontinued operations:		
Income from discontinued operations		1,648
Gain on disposal		13,138
		14,786
Income from discontinued operations		
Net (loss) income	(17,777)	1,876
Proportionate share of New Valley capital transaction, retirement of Class A Preferred Shares	1,782	3,069
	\$ (15,995)	\$ 4,945
Net (loss) income applicable to common shares		
Per common share:		
(Loss) from continuing operations	\$ (0.86)	\$ (0.53)
	\$	\$ 0.80
Income from discontinued operations		
	\$ (0.86)	\$ 0.27
Net (loss) income applicable to common shares		
Weighted average common shares and common share equivalents outstanding	18,497,096	18,501,830

* Revenues and Cost of goods sold include federal excise taxes of \$21,197 and \$26,392 for the periods ended March 31, 1996 and 1995, respectively.

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

Item 1. Consolidated Financial Statements (Continued)

BGLS INC. AND SUBSIDIARIES

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

	Three Months Ended	
	March 31, 1996	March 31, 1995
Revenues*.....	\$ 90,516	\$ 95,290
Cost of goods sold*.....	47,048	46,378
	-----	-----
Gross profit.....	43,468	48,912
Operating, selling, administrative and general expenses.....	44,587	48,775
	-----	-----
Operating (loss) income.....	(1,119)	137
Other income (expenses):		
Interest income.....	18	389
Interest expense.....	(15,668)	(15,483)
Equity in (loss) earnings of affiliate.....	(1,274)	1,683
Other, net.....	(35)	15
	-----	-----
(Loss) from continuing operations before income taxes.....	(18,078)	(13,259)
Provision (benefit) for income taxes.....	451	(355)
	-----	-----
(Loss) from continuing operations.....	(18,529)	(12,904)
	-----	-----
Discontinued operations:		
Income from discontinued operations.....		1,648
Gain on disposal.....		13,138
	-----	-----
Income from discontinued operations.....		14,786
	-----	-----
Net (loss) income.....	\$ (18,529)	\$ 1,882
	=====	=====

* Revenues and Cost of goods sold include federal excise taxes of \$21,197 and \$26,392 for the periods ended March 31, 1996 and 1995, respectively.

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

Item 1. Consolidated Financial Statements (Continued)

BROOKE GROUP LTD. AND SUBSIDIARY

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	Common Stock		Additional Paid-In Capital	Deficit	Treasury Stock	Other	Total
	Shares	Amount					
Balance, December 31, 1995.....	18,497,096	\$1,850	\$93,186	\$(428,173)	\$(32,339)	\$ 9,372	\$(356,104)
Net (loss).....				(17,777)			(17,777)
Distributions on common stock (\$0.075 per share).....			(1,369)				(1,369)
Stock options granted to consultant.....						48	48
Reduction of unrealized holding gain on investment in New Valley.....						(13,398)	(13,398)
Effect of New Valley capital transactions.....			1,782			(1,852)	(70)
Balance, March 31, 1996.....	18,497,096	\$1,850	\$93,599	\$(445,950)	\$(32,339)	\$(5,830)	\$(388,670)

=====

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

Item 1. Consolidated Financial Statements (Continued)

BGLS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY (DEFICIT)
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	Common Stock		Additional Paid-In Capital	Deficit	Other	Total
	Shares	Amount				
Balance, December 31, 1995.....	100		\$23,594	\$ (423,424)	\$ 9,935	\$ (389,895)
Distributions paid to parent.....				(1,922)		(1,922)
Net (loss).....				(18,529)		(18,529)
Reduction of unrealized holding gain on investment in New Valley.....					(13,398)	(13,398)
Effect of New Valley capital transactions.....			1,782		(1,852)	(70)
Forgiveness of debt by parent.....			13,705			13,705
Balance, March 31, 1996.....	100	\$	\$39,081	\$ (443,875)	\$ (5,315)	\$ (410,109)

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

Item 1. Consolidated Financial Statements (Continued)

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

	Three Months Ended	
	March 31, 1996	March 31, 1995
Net cash (used in) operating activities.....	\$ (11,568)	\$ (5,263)
Cash flows from investing activities:		
Proceeds from sale of businesses and assets.....		4,034
Investments.....		(365)
Capital expenditures.....	(6,939)	(511)
Dividends from New Valley.....	6,183	30,916
Other, net.....	174	
	(582)	34,074
Net cash (used in) provided by investing activities.....		
Cash flows from financing activities:		
Proceeds from debt.....	22,512	3,821
Repayments of debt.....	(6,537)	(389)
(Decrease) increase in cash overdraft.....	(449)	900
Distributions on common stock.....	(1,369)	(1,368)
Treasury stock purchases.....		(135)
Other, net.....		(39)
	14,157	2,790
Net cash provided by financing activities.....		
Net increase in cash and cash equivalents.....	2,007	31,601
Cash and cash equivalents, beginning of period.....	3,370	4,276
	\$ 5,377	\$ 35,877
Cash and cash equivalents, end of period.....	\$ 5,377	\$ 35,877
Supplemental non-cash financing activities:		
Exchange of Series 2 Senior Secured Notes for Series A Notes.....	\$ 99,154	
Exchange of 14.50% Subordinated Debentures for Series B Notes.....	125,495	
Issuance of Series A Notes for options.....	822	
Exchange of Series A Notes for Series B Notes.....	99,976	

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

Item 1. Consolidated Financial Statements (Continued)

BGLS INC. AND SUBSIDIARIES

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

	Three Months Ended	
	March 31, 1996	March 31, 1995
Net cash (used in) operating activities.....	\$ (11,685)	\$ (2,481)
Cash flows from investing activities:		
Proceeds from sale of business and assets.....		4,034
Investments.....		(365)
Capital expenditures.....	(6,939)	(334)
Dividends from New Valley.....	6,183	30,916
Other, net.....	174	(88)
	-----	-----
Net cash (used in) provided by investing activities.....	(582)	34,163
Cash flows from financing activities:		
Proceeds from debt.....	22,512	3,819
Repayments of debt.....	(6,410)	(104)
Increase in cash overdraft.....	56	955
Distributions paid to parent.....	(1,922)	(4,531)
Other, net.....		(204)
	-----	-----
Net cash provided by (used in) financing activities.....	14,236	(65)
Net increase in cash and cash equivalents.....	1,969	31,617
Cash and cash equivalents, beginning of period.....	3,370	4,259
	-----	-----
Cash and cash equivalents, end of period.....	\$ 5,339	\$ 35,876
	=====	=====
Supplemental non-cash financing activities:		
Exchange of Series 2 Senior Secured Notes for Series A Notes.....	\$ 99,154	
Exchange of 14.50% Subordinated Debentures for Series B Notes.....	125,495	
Issuance of Series A Notes for options.....	822	
Exchange of Series A Notes for Series B Notes.....	99,976	
Forgiveness of debt by parent.....	13,705	

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

BROOKE GROUP LTD.
BGLS INC.

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

1. PRINCIPLES OF REPORTING

The consolidated financial statements of Brooke Group Ltd. (the "Company") include the consolidated statements of its wholly owned subsidiary, BGLS Inc. ("BGLS"). The consolidated statements of BGLS include the accounts of Liggett Group Inc. ("Liggett"), Brooke (Overseas) Ltd. ("BOL"), New Valley Holdings, Inc. ("NV Holdings"), Liggett-Ducat Ltd. ("LDL") and other less significant subsidiaries.

The interim consolidated financial statements of the Company and BGLS are unaudited and, in the opinion of management, reflect all adjustments necessary (which are normal and recurring) to present fairly the Company's and BGLS' consolidated financial position, results of operations and cash flows. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's and BGLS' Annual Reports on Form 10-K, as amended, for the year ended December 31, 1995, as filed with the Securities and Exchange Commission ("SEC"). The consolidated results of operations for interim periods should not be regarded as necessarily indicative of the results that may be expected for the entire year.

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

2. INVESTMENT IN NEW VALLEY CORPORATION

Summarized financial information for New Valley Corporation ("New Valley") as of March 31, 1996 and December 31, 1995 and for the three months' ended March 31, 1996 and 1995 is as follows:

	March 31, 1996	December 31, 1995

Current assets.....	\$326,766	\$333,485
Investment in real estate.....	183,874	
Other non-current assets.....	42,229	52,337
Current liabilities.....	208,516	177,920
Notes payable.....	159,653	
Other long-term liabilities.....	19,180	11,967
Redeemable preferred stock.....	211,759	226,396
Common shareholders' deficit.....	(46,239)	(30,461)

	March 31,	

	1996	1995

Revenues.....	\$ 36,684	\$ 7,669
Cost and expenses.....	41,668	298
(Loss) income from continuing operations.	(4,884)	6,631
Income from discontinued operations.....		1,398
Net (loss) applicable to common shares(A)	(16,067)	(5,024)

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

Item 1. Consolidated Financial Statements - (Continued)

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

The Company's and BGLS' investment in New Valley at March 31, 1996 is summarized as follows:

	Number of Shares	Fair Value	Carrying Amount	Unrealized Holding Gain (Loss)	Earnings (Loss)
	-----	-----	-----	-----	-----
Class A Preferred Shares	618,326	\$ 96,459	\$ 96,459	\$ (6,257)	\$ 6,938
Class B Preferred Shares	50,885	3,545	3,545	1,691	
Common Shares.....	79,794,229	21,943	(57,107)		(8,212)
		-----	-----	-----	-----
		\$121,947	\$ 42,897	\$ (4,566)	\$ (1,274)
		=====	=====	=====	=====

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 Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities", and are classified as available-for-sale. Prior to January 1, 1996, the Class A Preferred Shares' fair value had been estimated with reference to the securities' preference features, including dividend and liquidation preferences, and the composition and nature of the underlying net assets of New Valley. In January 1996, however, New Valley became engaged in the ownership and management of commercial real estate and, in February 1996, acquired a controlling interest in Thinking Machines Corporation. Because these businesses affect the composition and nature of the underlying net assets of New Valley, the Company and BGLS have determined the fair value of the Class A Preferred Shares based on the quoted market price commencing with the quarter ended March 31, 1996. The New Valley common shares are accounted for under the equity method.

In the first quarter of 1996, New Valley repurchased 72,104 Class A Preferred Shares for a total amount of \$10,530. As a result of this transaction, the Company and BGLS now own 59.72% of the outstanding Class A Preferred Shares. The Company and BGLS have recorded their 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 of \$1,782 along with other New Valley capital transactions of \$1,852 for the three months ended March 31, 1996.

On March 13, 1996, New Valley declared a cash dividend of \$10.00 per share on its Class A Preferred Shares payable on March 27, 1996. NV Holdings received \$6,183 in the distribution. At March 31, 1996, the accrued and unpaid dividends arrearage on the Class A Preferred Shares was \$113,938 or \$110.04 per share.

At March 31, 1996, the accrued and unpaid dividends arrearage on Class B Preferred Shares was \$100,053 or \$35.85 per share.

As a result of asset dispositions pursuant to New Valley's First Amended Joint Chapter 11 Plan of Reorganization, as amended (the "Joint Plan"), New Valley accumulated a significant amount of cash which it was required to reinvest in operating companies by January 18, 1996 in order to avoid potentially burdensome regulation under the Investment Company Act of 1940, as amended (the "Investment Company Act"). The Investment Company Act and the rules and regulations thereunder require the registration of, and impose various substantive restrictions on, companies that engage primarily in the business of investing, reinvesting or trading in securities or engage in the business of investing, reinvesting, owning, holding or trading in securities and own or propose to acquire "investment securities" having "a value" in excess of 40% of a company's "total

Item 1. Consolidated Financial Statements - (Continued)

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

assets (exclusive of Government securities and cash items)" on an unconsolidated basis. Following dispositions of its then operating businesses pursuant to the Joint Plan, New Valley was above this threshold and relied on the one-year exemption from registration under the Investment Company Act provided by Rule 3a-2 thereunder, which exemption expired on January 18, 1996. Prior to such date, through New Valley's acquisition of the investment banking and brokerage business of Ladenburg, Thalmann & Co., Inc. and its acquisition of a portfolio of office buildings and shopping centers, New Valley was engaged primarily in a business or businesses other than that of investing, reinvesting, owning, holding or trading in securities, and the value of its investment securities was below the 40% threshold. Under the Investment Company Act, New Valley is required to determine the value of its total assets for purposes of the 40% threshold based on "market" or "fair" values, depending on the nature of the asset, at the end of the last preceding fiscal quarter and based on cost for assets acquired since that date. If New Valley were required to register in the future, under the Investment Company Act, it would be subject to a number of severe restrictions on its operations, capital structure and management, including without limitation entering into transactions with affiliates. If New Valley were required to register under the Investment Company Act, the Company and BGLS may be in violation of the Investment Company Act and may be adversely affected by the restrictions of the Investment Company Act. In addition, registration under the Investment Company Act by BGLS would constitute a violation of the indenture to which BGLS is a party.

3. RJR NABISCO HOLDINGS CORP.

At March 31, 1996, New Valley held 5,161,750 shares of RJR Nabisco Holdings Corp. ("RJR Nabisco") common stock with a market value of \$156,143 (cost of \$158,225) collateralizing margin loan financing of \$83,535. The unrealized loss on New Valley's investment in RJR Nabisco common stock was \$2,082 and \$4,663 at March 31, 1996 and May 3, 1996, respectively.

On February 29, 1996, New Valley entered into a total return equity swap transaction with an unaffiliated company (the "Counterparty") relating to an additional 1,000,000 shares of RJR Nabisco common stock. The transaction is for a period of up to six months, subject to earlier termination at the election of New Valley and provided for New Valley to make payment to the Counterparty of approximately \$1,537 upon commencement of the swap. At the termination of the transaction, if the price of the common stock during a specified period prior to such date (the "Final Price") exceeds \$34.42, the price of the RJR Nabisco common stock during a specified period following the commencement of the swap (the "Initial Price"), the Counterparty will pay New Valley an amount in cash equal to the amount of such appreciation with respect to 1,000,000 shares of RJR Nabisco common stock plus the value of any dividends with a record date occurring during the swap period. If the Final Price is less than the Initial Price, then New Valley will pay the Counterparty at the termination of the transaction an amount in cash equal to the amount of such decline with respect to 1,000,000 shares of RJR Nabisco common stock, offset by the value of any dividends, provided that, with respect to approximately 225,000 shares of RJR Nabisco common stock, New Valley will not be required to pay any amount in excess of an approximate 25% decline in

Item 1. Consolidated Financial Statements - (Continued)

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

the value of the shares. The potential obligations of the Counterparty under the swap are being guaranteed by the Counterparty's parent, a large foreign bank, and New Valley has pledged certain collateral in respect of its potential obligations under the swap and has agreed to pledge additional collateral under certain conditions. As of March 31, 1996, New Valley recorded a charge to operations of \$3,964 representing the unrealized loss on this swap transaction and had pledged collateral of \$11,806.

On March 4, 1996, the Company filed a definitive Proxy Statement with the SEC and commenced solicitation of proxies in favor of its previously nominated slate of directors to replace RJR Nabisco's incumbent Board of Directors at its 1996 annual meeting of stockholders. As of March 31, 1996, New Valley had expensed approximately \$10,000 for costs relating to its RJR Nabisco investment, of which approximately \$4,000 was expensed in 1995.

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

Subsequent Event: On April 16, 1996, the Company announced that, based on the analysis of its proxy solicitors, its nominees for election to the RJR Nabisco Board of Directors would not be elected at RJR Nabisco's 1996 annual meeting of stockholders. The official vote tabulation is not yet available.

4. INVENTORIES

Inventories consist of:

	March 31, 1996	December 31, 1995

Finished goods.....	\$23,431	\$19,129
Work-in-process.....	3,967	3,570
Raw materials.....	27,165	29,021
Replacement parts and supplies...	5,144	4,903

Inventories at current costs....	59,707	56,623
LIFO adjustments.....	2,723	3,899

	\$62,430	\$60,522
	=====	

At March 31, 1996, the Company had leaf tobacco purchase commitments of approximately \$27,500.

5. INCOME TAXES

The provision for taxes for the three month periods ended March 31, 1996 and 1995 does not bear the customary relationship to the pretax loss/income for the Company and BGLS due principally to the effects of taxes provided for foreign operations and an increase in the valuation allowance related to U.S. operations.

Item 1. Consolidated Financial Statements - (Continued)

BROOKE GROUP LTD.
BGLS INC.

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

6. CONTINGENCIES

Liggett:

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

In the action entitled *Cipollone v. Liggett Group Inc., et al.*, the United States Supreme Court on June 24, 1992, issued an opinion regarding federal preemption of state law damage actions. The Supreme Court in *Cipollone* concluded that The Federal Cigarette Labeling and Advertising Act (the "1965 Act") did not preempt any state common law damage claims. Relying on The Public Health Cigarette Smoking Act of 1969 (the "1969 Act"), however, the Supreme Court concluded that the 1969 Act preempted certain, but not all, common law damage claims. Accordingly, the decision bars plaintiff from asserting claims that, after the effective date of the 1969 Act, the tobacco companies either failed to warn adequately of the claimed health risks of cigarette smoking or sought to neutralize those claimed risks in their advertising or promotion of cigarettes. It does permit, however, claims for fraudulent misrepresentation (other than a claim of fraudulently neutralizing the warning), concealment (other than in advertising and promotion of cigarettes), conspiracy and breach of express warranty after 1969. The Court expressed no opinion as to whether any of these claims are viable under state law, but assumed *arguendo* that they are viable.

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

On September 10, 1993, an action entitled *Sackman v. Liggett Group Inc.*, United States District Court, Eastern District of New York, was filed against Liggett alone alleging as injury lung cancer. Fact discovery closed on August 31, 1995 and expert discovery is scheduled to close on July 3, 1996. It is possible that the case will be scheduled for trial during late 1996. On March 19, 1996, the

Item 1. Consolidated Financial Statements - (Continued)

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

Magistrate Judge assigned to the case ordered Liggett to produce certain of its documents with respect to which Liggett has asserted various claims of privilege. Liggett intends to appeal the decision and order. Upon Liggett's motion, the Court has enlarged the time to and including May 15, 1996 for Liggett to file its appeal. The other major cigarette manufacturers and The Council for Tobacco Research U.S.A., Inc. have moved to intervene.

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

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

On October 31, 1991, an action entitled Broin et al v. Philip Morris Companies, Inc., et al., Circuit Court of the 11th Judicial District in and for Dade County, Florida, was filed against Liggett and others. This case was the first class action commenced against the industry, and has been brought by plaintiffs on behalf of all flight attendants that have worked or are presently working for airlines based in the United States and who have never regularly smoked cigarettes but allege that they have been damaged by involuntary exposure to ETS. On December 12, 1994, plaintiffs' motion to certify the action as a class action was granted. Defendants have appealed this ruling and on January 3, 1996, the Third District of the Florida Court of Appeals affirmed the ruling of the trial court. On January 18, 1996, defendants filed a petition for rehearing, for rehearing en banc and for certification to the Florida Supreme Court. On May 10, 1996, defendants' petition was denied. The defendants intend to appeal the decision to the Florida Supreme Court.

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

Item 1. Consolidated Financial Statements - (Continued)

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

granted in part Plaintiffs' motion for class certification for certain claims, together with punitive damages to the end of establishing a multiplier to compute punitive damage awards. Defendants' application for discretionary appeal to the Court of Appeals for the Fifth Circuit was granted. Oral argument was held on April 2, 1996.

On May 5, 1994, an action entitled Engle, et al v. R. J. Reynolds Tobacco Company, et al., Circuit Court of the 11th Judicial District in and for Dade County, Florida, was filed against Liggett and others. The class action complaint was brought on behalf of plaintiffs and all persons in the United States who allegedly have become addicted to cigarette products and allegedly have suffered personal injury as a result thereof. Plaintiffs seek compensatory and punitive damages together with equitable relief including but not limited to a medical fund for future health care costs, attorneys' fees and costs. On October 31, 1994, plaintiffs' motion to certify the action as a class action was granted. Defendants have appealed this ruling. On January 31, 1996, the Third District of the Florida Court of Appeals affirmed the ruling of the trial court certifying the action as a class action, but modified the trial court ruling to limit the class to Florida citizens and residents. Defendants have filed a petition for rehearing, for rehearing en banc and for certification to the Florida Supreme Court. On May 10, 1996, defendants' petition was denied. The defendants intend to appeal the decision to the Florida Supreme Court.

On May 3, 1996, an action entitled Norton, et al. v. R. J. Reynolds Tobacco Company, et al., Superior Court of Madison County, State of Indiana, was filed against Liggett and others. The class action complaint was brought on behalf of plaintiffs and all similarly situated citizens of the State of Indiana who allegedly have become addicted to cigarette products as a result of defendants allegedly having controlled and manipulated the amount of nicotine in the cigarettes manufactured by them for the purpose of addicting users and sustaining such addiction. Plaintiffs seek compensatory and punitive damages, together with equitable relief including, but not limited to, disgorgement of profits received from the sale of such cigarettes and the creation of a medical monitoring fund, attorneys' fees and costs. The action presently is in the pleading stage and discovery has not as yet commenced.

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

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

Item 1. Consolidated Financial Statements - (Continued)

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

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

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

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

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

Item 1. Consolidated Financial Statements - (Continued)

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

state seeking such restitution and indemnity, alleging that the commencement and prosecution of such a civil action by the Attorney General of the state was and is outside the authority of the Attorney General.

On November 28, 1995, each of the major manufacturers in the industry, including Liggett, filed suit in both the Commonwealth of Massachusetts and in the State of Texas seeking declaratory relief to the effect that the commencement of any such litigation (as had been filed by Florida, Mississippi, West Virginia and Minnesota and now by Massachusetts, Louisiana, Texas and Maryland) seeking to recover Medicaid expenses against the manufacturers by either the Commonwealth of Massachusetts or the State of Texas would be unlawful. On January 22, 1996, a suit seeking substantially similar declaratory relief was filed in the State of Maryland.

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

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

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

Item 1. Consolidated Financial Statements - (Continued)

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

(subject to extension of such period by the settling defendants). Certain of the terms of the settlement are summarized below.

Under the settlement, the states would share an initial \$5,000 (\$1,000 of which was paid on March 22, 1996, with the balance payable over nine years and indexed and adjusted for inflation), provided that any unpaid amount will be due sixty days after either a default by Liggett in its payment obligations under the settlement or a merger or other transaction by Liggett with another defendant in the lawsuits. In addition, Liggett will be required to pay the states a percentage of Liggett's pretax income (income before income taxes) each year from the second through the twenty-fifth year. This annual percentage would range from 2-1/2% to 7-1/2% of Liggett's pretax income depending on the number of additional states joining the settlement. All of Liggett's payments are subject to certain reductions provided for in the agreement. Liggett has also agreed to pay to the states \$5,000 if the Company or Liggett fails to consummate a merger or other transaction with another defendant in the lawsuits within three years of the date of the settlement. At December 31, 1995, Liggett accrued approximately \$4,000 for the settlement with the Attorneys General.

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

The Company and Liggett have the right to terminate the settlement with respect to any state participating in the settlement if any of the remaining defendants in the litigation succeed on the merits in that state's Attorney General action. The Company and Liggett may also terminate the settlement if they conclude that too many states have filed Attorney General actions and have not resolved such cases as to the settling defendants by joining in the settlement. In the event of any such termination by the Company and Liggett, the named plaintiffs would be at liberty to renew the prosecution of such civil action against the Company and Liggett.

Currently, in addition to Cordova, approximately 94 product liability lawsuits, which have been filed in various jurisdictions, are pending and active in which Liggett is a defendant. Of these, approximately 74 are pending in the State of Florida. In most of these lawsuits, plaintiffs seek punitive as well as compensatory damages. In the product liability lawsuits presently pending in Florida against Liggett and others, four are scheduled for trial during 1996.

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

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

Item 1. Consolidated Financial Statements - (Continued)

BROOKE GROUP LTD.
BGLS INC.

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

In March and April 1994, the Health and the Environmental Subcommittee of the Energy and Commerce Committee of the House of Representatives held hearings regarding nicotine in cigarettes. On March 25, 1994, Commissioner David A. Kessler of the Food and Drug Administration (the "FDA") gave testimony as to the potential regulation of nicotine under the Food, Drug and Cosmetic Act, and the potential for jurisdiction over the regulation of cigarettes to be accorded to the FDA. In response to Commissioner Kessler's allegations about manipulation of nicotine by cigarette manufacturers, the chief executive of each of the major cigarette manufacturers, including Liggett, testified before the subcommittee on April 14, 1994, denying Commissioner Kessler's claims. An FDA advisory panel has stated that it believes nicotine is addictive. On August 10, 1995, the FDA filed in the Federal Register a Notice of Proposed Rule-Making (the "Proposed Rule-Making") which would classify tobacco as a drug, assert jurisdiction by the FDA over the manufacture and marketing of tobacco products and impose restrictions on the sale, advertising and promotion of tobacco products. The FDA's stated objective and focus for its initiative is to limit access to cigarettes by minors by measures beyond the restrictions either mandated by existing federal, state and local laws or voluntarily implemented by major manufacturers in the industry. Liggett and the other major manufacturers in the industry responded by filing a civil action in the United States District Court for the Middle District of North Carolina on that day challenging the legal authority of the FDA to assert such jurisdiction. In addition thereto, Liggett and the other four major cigarette manufacturers, as well as others, have filed comments in opposition to the Proposed Rule-Making. Management is unable to predict whether such a classification will be made. Management is also unable to predict the effects of such a classification, were it to occur, or of such regulations, if implemented, on Liggett's operations, but such actions could have an unfavorable impact thereon.

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

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

On February 14, 1995, Liggett filed with the United States Department of Agriculture (the "USDA") its certification as to usage of domestic and imported tobaccos during 1994 and an audit was conducted by the USDA to verify this certification. Liggett has received from the USDA the results of the audit which states that Liggett did not satisfy the 75% domestic tobacco usage requirement for 1994 and, therefore, may be subject to a marketing assessment estimated at approximately \$5,500, which amount is disputed by the Company. It is the understanding of the Company that the levels of

Item 1. Consolidated Financial Statements - (Continued)

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

domestic tobacco inventories currently on hand at the tobacco stabilization organizations are below reserve stock levels, and for such reason, the Company is of the opinion that it will not be obligated to make such purchases of domestic tobacco from the tobacco stabilization cooperatives. Liggett is currently engaged in negotiations with the USDA in an effort to resolve this matter on satisfactory terms. At December 31, 1995, Liggett accrued approximately \$4,900 representing its best estimate for the USDA marketing assessment.

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

On February 20, 1996, the United States Trade Representative issued an "advance notice of rule making" concerning how tobaccos imported under the TRQ should be allocated. Currently, tobacco imported under the TRQ is allocated on a "first-come, first-served" basis, meaning that entry is allowed on an open basis to those first requesting entry in the quota year. Others in the cigarette industry have suggested an "end-user licensing" system under which the right to import tobacco under the quota would be initially assigned on the basis of domestic market share. Such an approach, if adopted, could have a materially adverse effect on the Company. The Company believes it is unlikely that an end-user licensing system will be adopted because it would likely lead to another GATT proceeding. The end-user licensing system has not been authorized by legislation and it could create significant problems for United States exports in other product markets. However, no assurances can be made that an end-user licensing system will not be adopted.

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

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

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

Item 1. Consolidated Financial Statements - (Continued)

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

BGLS and the Company:

On September 20, 1993, a group of CVR holders and the CVR trustee filed an action in the Delaware Court of Chancery, New Castle County, against the Company and certain of its present and former directors, challenging and seeking to enjoin or rescind the Distribution. Pursuant to notice given on October 15, 1993, the Company redeemed its CVRs on December 9, 1993 for a payment of \$.36 per CVR. On June 2, 1994, the Company and the director defendants entered into a Stipulation and Agreement of Compromise and Settlement (the "Stipulation") pursuant to which a class of CVR holders, which includes the plaintiff CVR holders and all other persons who held CVRs at any time between September 20, 1993 and June 2, 1994, were to receive a total of \$4,000 plus an award of attorneys' and experts' fees and expenses, as approved by the Court of Chancery, not to exceed \$900. The \$4,000 settlement fund has been deposited into an escrow account for eventual disbursement to all eligible CVR holders.

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

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

On November 20, 1995, RJR Nabisco filed an action against the Company and Messrs. LeBow and Icahn in the United States District Court for the Middle District of North Carolina alleging violations of the federal securities laws. Specifically, RJR Nabisco alleges that the Company and Messrs. LeBow and Icahn violated sections 14(a) and 10(b) of the Securities Exchange Act of 1934, as amended, and Rules 14a-9 and 10b-5 promulgated thereunder, by purportedly making materially false or incomplete statements concerning the purpose and background of the consent solicitation.

The Company and LeBow asserted counterclaims against RJR Nabisco, alleging that RJR Nabisco had made false statements and material omissions in its opposition to the Company's consent solicitation. On March 5, 1996, RJR Nabisco voluntarily dismissed, without prejudice, its claims

Item 1. Consolidated Financial Statements - (Continued)

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

asserted against Icahn, and on May 6, 1996 both RJR Nabisco and the Company filed a stipulation and order of dismissal, without prejudice, of the action.

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

7. SUBSEQUENT EVENTS

Assets Under Agreement for Sale:

On April 9, 1996, Liggett executed a definitive agreement with the County of Durham for the sale of certain surplus realty in the amount of \$4,300. It is anticipated that closing will occur on or before May 31, 1996. Such assets have been reclassified as current assets at March 31, 1996.

On April 29, 1996, Liggett executed a definitive agreement with Blue Devil Ventures, a North Carolina limited liability partnership, for the sale of additional surplus realty in the amount of \$2,200. While it is anticipated that closing will occur on or before July 31, 1996, Blue Devil Ventures has the option to forfeit its deposit of \$50 and not close if it determines that its development project is not feasible. Such assets for which the agreement was signed have been classified as current assets at March 31, 1996.

NEW VALLEY HOLDINGS, INC.

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

	March 31, 1996	December 31, 1995
	-----	-----
ASSETS		
Cash and cash equivalents.....	\$ 4,074	\$ 738
Investment in New Valley Corporation:		
Redeemable preferred stock.....	96,459	109,386
Common stock.....	(60,549)	(52,045)
	-----	-----
Total investment in New Valley Corporation.....	35,910	57,341
Deferred tax assets.....	2,583	-----
	-----	-----
Total assets.....	\$ 42,567	\$ 58,079
	=====	=====
LIABILITIES AND STOCKHOLDER'S EQUITY		
Current income taxes payable to parent.....	\$ 4,906	\$ 4,472
Deferred income taxes.....	-----	4,918
	-----	-----
Total liabilities.....	4,906	9,390
	-----	-----
Commitments and contingencies		
Common stock, \$0.01 par value, 100 shares authorized, issued and outstanding....		
Additional paid-in capital.....	12,172	11,020
Retained earnings.....	30,040	32,128
Unrealized holding (loss) gain, net of income tax benefit of \$2,450 and income taxes of \$2,983.....	(4,551)	5,541
	-----	-----
Total stockholder's equity.....	37,661	48,689
	-----	-----
Total liabilities and stockholder's equity.....	\$ 42,567	\$ 58,079
	=====	=====

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

NEW VALLEY HOLDINGS, INC.

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

	For the three months ended March 31, 1996	For the three months ended March 31, 1995
	-----	-----
Equity in (loss) earnings of affiliate.....	\$(1,495)	\$ 1,683
Interest income.....	7	381
General and administrative expenses.....	(2)	(3)
	-----	-----
(Loss) income from continuing operations before income taxes.....	(1,490)	2,061
	-----	-----
(Benefit) provision for income taxes:		
Current.....	435	2,166
Deferred.....	(2,688)	(591)
	-----	-----
Income tax (benefit) expense.....	(2,253)	1,575
	-----	-----
Income from continuing operations.....	763	486
Income from discontinued operations of affiliate, net of income taxes of \$206...		382
	-----	-----
Net income.....	\$ 763	\$ 868
	=====	=====

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

NEW VALLEY HOLDINGS, INC.

STATEMENT OF STOCKHOLDER'S EQUITY
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(Unaudited)

	Common Stock Shares	Stock Amount	Additional Paid-In Capital	Retained Earnings	Unrealized Holding Gain (Loss)	Total
Balance, December 31, 1995.....	100		\$11,020	\$32,128	\$ 5,541	\$48,689
Increase in capital from New Valley Corporation's repurchase of Class A Shares and other capital transactions, net of taxes of \$621.....			1,152			1,152
Proportionate share of New Valley's unrealized depreciation in investments, net of tax benefit of \$646.....					(1,199)	(1,199)
Increase in unrealized holding loss on investment in New Valley Corporation, net of tax benefit of \$4,788.....					(8,893)	(8,893)
Net income.....				763		763
Dividends.....				(2,851)		(2,851)
Balance, March 31, 1996.....	100	\$	\$12,172	\$30,040	\$(4,551)	\$37,661

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

NEW VALLEY HOLDINGS, INC.

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

	For the three months ended March 31, 1996	For the three months ended March 31, 1995
Net cash provided by operating activities...	\$ 4	\$ 378
Cash flows from investing activities:		
Dividends received from New Valley Corporation.....	6,183	30,916
Net cash provided by investing activities..	6,183	30,916
Cash flows from financing activities:		
Payment of dividends.....	(2,851)	(111)
Net cash used for financing activities.....	(2,851)	(111)
Net increase in cash.....	3,336	31,183
Cash and cash equivalents at beginning of period.....	738	
Cash and cash equivalents at end of period..	\$ 4,074	\$31,183

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

NEW VALLEY HOLDINGS, INC.

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

1. PRINCIPLES OF REPORTING

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

The interim financial statements of the Company are unaudited and, in the opinion of management, reflect all adjustments necessary (which are normal and recurring) to present fairly the Company's financial position, results of operations and cash flows. These financial statements should be read in conjunction with the financial statements and the notes thereto included in BGLS' Annual Report on Form 10-K, as amended, for the year ended December 31, 1995, as filed with the Securities and Exchange Commission. The results of operations for interim periods should not be regarded as necessarily indicative of the results that may be expected for the entire year.

2. INVESTMENT IN NEW VALLEY CORPORATION

Summarized financial information for New Valley as of March 31, 1996 and December 31, 1995 for the three month periods ended March 31, 1996 and 1995 follows:

	March 31, 1996	December 31, 1995
Current assets.....	\$326,766	\$333,485
Investment in real estate.....	183,874	
Other non-current assets.....	42,229	52,337
Current liabilities.....	208,516	177,920
Notes payable.....	159,653	
Other long-term liabilities.....	19,180	11,967
Redeemable preferred stock.....	211,759	226,396
Common shareholders' deficit.....	(46,239)	(30,461)

	March 31, 1996	March 31, 1995
Revenues.....	\$ 36,684	\$ 7,669
Cost and expenses.....	41,668	298
(Loss) income from continuing operations.....	(4,884)	6,631
Income from discontinued operations.....		1,398
Net (loss) income applicable to common shares(A)	(16,067)	(5,024)

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

NEW VALLEY HOLDINGS, INC.

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

The Company's investment in New Valley at March 31, 1996 is summarized as follows:

	Number of Shares	Fair Value	Carrying Value	Unrealized Holding Loss	Earnings/ Loss
	-----	-----	-----	-----	-----
Class A Preferred Shares	618,326	\$ 96,459	\$96,459	\$ (6,257)	\$ 6,938
Common Shares.....	79,399,254	21,835	(60,549)		(8,433)
		-----	-----	-----	-----
		\$118,294	\$35,910	\$ (6,257)	\$ (1,495)
		=====	=====	=====	=====

The Class A Preferred Shares are accounted for as debt securities pursuant to the requirements of Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities", and are classified as available-for-sale. Prior to January 1, 1996, the Class A Preferred Shares' fair value had been estimated with reference to the securities' preference features, including dividend and liquidation preferences, and the composition and nature of the underlying net assets of New Valley. In January 1996, however, New Valley became engaged in the ownership and management of commercial real estate and, in February 1996, acquired a controlling interest in Thinking Machines Corporation. Because these businesses affect the composition and nature of the underlying net assets of New Valley, the Company has determined the fair value of the Class A Preferred Shares based on the quoted market price commencing with the quarter ended March 31, 1996. The New Valley common shares are accounted for under the equity method.

In the first quarter of 1996, New Valley repurchased 72,104 Class A Preferred Shares for a total amount of \$10,530. The Company now owns 59.72% of the outstanding Class A Preferred Shares. 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 of \$1,199 net of a tax benefit of \$646 along with other New Valley capital transactions of \$1,843 for the three months ended March 31, 1996.

On March 13, 1996, New Valley declared a cash dividend of \$10.00 per share on the Class A Preferred Shares payable on March 27, 1996. The Company received \$6,183 in the distribution. At March 31, 1996, the accrued and unpaid dividends arrearage on the Class A Preferred Shares was \$113,938 or \$110.04 per share.

As a result of asset dispositions pursuant to New Valley's First Amended Joint Chapter 11 Plan of Reorganization, as amended (the "Joint Plan"), New Valley accumulated a significant amount of cash which it was required to reinvest in operating companies by January 18, 1996 in order to avoid potentially burdensome regulation under the Investment Company Act of 1940, as amended (the "Investment Company Act"). The Investment Company Act and the rules and regulations thereunder require the registration of, and impose various substantive restrictions on, companies that engage primarily in the business of investing, reinvesting or trading in securities or engage in the business of investing, reinvesting, owning, holding or trading in securities and own or propose to acquire "investment securities" having "a value" in excess of 40% of a company's "total assets (exclusive of Government securities and cash items)" on an unconsolidated basis. Following dispositions of its then operating businesses pursuant to the Joint Plan, New Valley was above this threshold and relied on the one-year exemption from registration under the Investment Company Act provided by Rule 3a-2 thereunder, which exemption expired on January 18, 1996. Prior to such date, through New Valley's acquisition of the investment banking and brokerage business of Ladenburg, Thalmann & Co., Inc. and its acquisition of a portfolio of office buildings and shopping centers, New Valley was engaged primarily in a business or businesses other than that of investing, reinvesting, owning, holding or trading in securities, and the value of its investment securities was below the 40% threshold. Under the Investment Company Act, New Valley is required to determine the value of its

NEW VALLEY HOLDINGS, INC.

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

total assets for purposes of the 40% threshold based on "market" or "fair" values, depending on the nature of the asset, at the end of the last preceding fiscal quarter and based on cost for assets acquired since that date. If New Valley were required to register in the future, under the Investment Company Act, it would be subject to a number of severe restrictions on its operations, capital structure and management, including without limitation entering into transactions with affiliates. If New Valley were required to register under the Investment Company Act, the Company, as well as BGLS and Brooke, may be in violation of the Investment Company Act and may be adversely affected by the restrictions of the Investment Company Act. In addition, registration under the Investment Company Act by BGLS would constitute a violation of the indenture to which BGLS is a party.

3. RJR NABISCO HOLDINGS CORP.

At March 31, 1996, New Valley held 5,161,570 shares of RJR Nabisco Holdings Corp. ("RJR Nabisco") common stock with a market value of \$156,143 (cost of \$158,225) collateralizing margin loan financing of \$83,535. The unrealized loss on New Valley's investment in RJR Nabisco common stock was \$2,082 and \$4,663 at March 31, 1996 and May 3, 1996, respectively.

On February 29, 1996, New Valley entered into a total return equity swap transaction with an unaffiliated company (the "Counterparty") relating to 1,000,000 shares of RJR Nabisco Common Stock. The transaction is for a period of up to six months, subject to earlier termination at the election of New Valley and provided for New Valley to make payment to the Counterparty of approximately \$1,537 upon commencement of the swap. At the termination of the transaction, if the price of the common stock during a specified period prior to such date (the "Final Price") exceeds \$34.42, the price of the RJR Nabisco Common Stock during a specified period following the commencement of the swap (the "Initial Price"), the Counterparty will pay New Valley an amount in cash equal to the amount of such appreciation with respect to 1,000,000 shares of RJR Nabisco Common Stock plus the value of any dividends with a record date occurring during the swap period. If the Final Price is less than the Initial Price, then New Valley will pay the Counterparty at the termination of the transaction an amount in cash equal to the amount of such decline with respect to 1,000,000 shares of RJR Nabisco Common Stock, offset by the value of any dividends, provided that, with respect to approximately 225,000 shares of RJR Nabisco Common Stock, New Valley will not be required to pay any amount in excess of an approximate 25% decline in the value of the shares. The potential obligations of the Counterparty under the swap are being guaranteed by the Counterparty's parent, a large foreign bank, and New Valley has pledged certain collateral in respect of its potential obligations under the swap and has agreed to pledge additional collateral under certain conditions. As of March 31, 1996, New Valley recorded a charge to operations of \$3,964 representing the unrealized loss on this swap transaction and had pledged collateral of \$11,806.

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

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

NEW VALLEY HOLDINGS, INC.

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

Subsequent Events: On April 16, 1996, Brooke announced that, based on the analysis of its proxy solicitors, its nominees for election to the RJR Nabisco Board of Directors would not be elected at RJR Nabisco's 1996 annual meeting of stockholders. The official vote tabulation is not yet available.

4. FEDERAL INCOME TAX

At March 31, 1996, the Company has recorded a deferred tax asset of \$2,583 based on the determination that it is more likely than not that the deferred tax asset will be realized through future taxable earnings or alternative tax strategies. The provision for taxes for the three month periods ended March 31, 1996 and 1995 does not bear a customary relationship to the pretax income for the Company due principally to the effects of the 80% dividends received deduction for Federal taxes.

5. CONTINGENCIES

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

ITEM 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Dollars in Thousands, Except Per Share Amounts)

INTRODUCTION

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

For purposes of this discussion and other consolidated financial reporting, the Company's significant business segments are tobacco and real estate.

RECENT DEVELOPMENTS

Certain Matters Relating to RJR Nabisco Holdings Corp.

As of May 3, 1996, New Valley held 5,161,750 shares of RJR Nabisco Holdings Corp. ("RJR Nabisco") common stock. New Valley's costs for such shares and the amount of related margin loan financing were \$158,225 and \$81,572, respectively. The unrealized loss was \$4,663.

On February 29, 1996, New Valley entered into a total return equity swap transaction with an unaffiliated company (the "Counterparty") relating to 1,000,000 shares of RJR Nabisco common stock. The transaction is for a period of up to six months, subject to earlier termination at the election of New Valley, and provided for New Valley to make payment to the Counterparty of approximately \$1,537 upon commencement of the swap. At the termination of the transaction, if the price of the common stock during a specified period prior to such date (the "Final Price") exceeds \$34.42, the price of the common stock during a specified period following the commencement of the swap (the "Initial Price"), the Counterparty will pay New Valley an amount in cash equal to the amount of such appreciation with respect to 1,000,000 shares of common stock plus the value of any dividends with a record date occurring during the swap period. If the Final Price is less than the Initial Price, then New Valley will pay the Counterparty at the termination of the transaction an amount in cash equal to the amount of such decline with respect to the 1,000,000 shares of common stock, offset by the value of any dividends, provided that, with respect to approximately 225,000 shares of common stock, New Valley will not be required to pay any amount in excess of an approximate 25% decline in the value of the shares. The potential obligations of the Counterparty under the swap are being guaranteed by the Counterparty's parent, a large foreign bank, and New Valley has pledged certain collateral in respect of its potential obligations under the swap and has agreed to pledge additional collateral under certain conditions. As of March 31, 1996, New Valley had an unrealized loss on this swap transaction of \$3,964 and had pledged collateral of \$11,806.

On March 4, 1996, the Company filed a definitive Proxy Statement with the SEC and commenced solicitation of proxies in favor of its previously nominated slate of directors to replace RJR Nabisco incumbent Board of Directors at its annual meeting of stockholders. As of March 31, 1996, New Valley had expensed approximately \$10,000 for costs relating to the investment in RJR Nabisco common stock, of which approximately \$4,000 was expensed in 1995.

On April 16, 1996, the Company announced that, based on the analysis of its proxy solicitors, its nominees for election to the RJR Nabisco Board of Directors would not be elected at RJR Nabisco's 1996 annual meeting of stockholders. The official vote tabulation is not yet available.

RECENT DEVELOPMENTS (continued)

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

On January 11, 1996, New Valley's newly formed division, New Valley Realty, completed the acquisition of four office buildings and eight shopping centers for an aggregate purchase price of \$183,900 which consisted of \$23,900 in cash and \$160,000 in mortgage financing.

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

RECENT DEVELOPMENTS IN THE CIGARETTE INDUSTRY

Pricing Activity.

On April 8, 1996, Philip Morris announced a list price increase on all brands of \$.40 per carton. The other manufacturers, including Liggett, matched the price increase.

On May 5, 1995, RJ Reynolds Tobacco Company ("RJR") initiated a list price increase on all brands of \$.30 per carton. The other manufacturers, including Liggett, matched the price increase.

Legislation and Litigation.

New cases continue to be commenced against Liggett and other cigarette manufacturers. As new cases are commenced, the costs associated with defending such cases and the risks attendant to the inherent unpredictability of litigation continue to increase. Recently, there have been a number of restrictive regulatory actions, adverse political decisions and other unfavorable developments concerning cigarette smoking and the tobacco industry, including the commencement of class actions. These developments generally receive widespread media attention. Liggett is not able to evaluate the effect of these developing matters on pending litigation or the possible commencement of additional litigation, but it is possible that the Company's consolidated financial position, results of operations and cash flows could be materially adversely affected by an ultimate unfavorable outcome in any of such pending litigation. See Note 6 to the Company's consolidated financial statements for a description of legal proceedings.

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

On February 14, 1995, Liggett filed with the United States Department of Agriculture (the "USDA") its certification as to usage of domestic and imported tobaccos during 1994 and an audit was conducted by the USDA to verify this certification. Liggett has received from the USDA the results of the audit, which states that Liggett did not satisfy the 75% domestic tobacco usage requirement for 1994 and, therefore, may be subject to a marketing assessment estimated at approximately \$5,500, which amount is disputed by Liggett. It is the understanding of Liggett that the levels of domestic tobacco inventories currently on hand at the tobacco stabilization organizations are below reserve stock levels, and for such reason, Liggett is of the

RECENT DEVELOPMENTS IN THE CIGARETTE INDUSTRY (continued)

opinion that it will not be obligated to make such purchases of domestic tobacco from the tobacco stabilization cooperatives. Liggett is currently engaged in negotiations with the USDA to resolve this matter on satisfactory terms. At December 31, 1995 Liggett accrued approximately \$4,900 representing its best estimate of its obligation for the USDA marketing assessment.

On September 13, 1995, the President of the United States, after negotiations with the affected countries, declared a Tariff Rate Quota ("TRQ") on certain imported tobacco, imposing prohibitive tariffs on imports of flue-cured and burley tobaccos in excess of certain levels which vary from country to country. Oriental tobacco is exempt from the quota as well as all tobacco originating from Canada, Mexico or Israel. Management believes that the TRQ levels are sufficiently high to allow Liggett to operate without material disruption to its business. However, increasing tobacco costs due to a 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 could have an unfavorable impact on Liggett's operations during 1996.

On February 20, 1996, the United States Trade Representative issued an "advance notice of rule making" concerning how tobaccos imported under the TRQ should be allocated. Currently, tobacco imported under the TRQ is allocated on a "first-come, first-served" basis, meaning that entry is allowed on an open basis to those first requesting entry in the quota year. Others in the cigarette industry have suggested an "end-user licensing" system under which the right to import tobacco under the quota would be initially assigned on the basis of domestic market share. Such an approach, if adopted, could have a materially adverse effect on Liggett. Liggett believes it is unlikely that an end-user licensing system will be adopted because it would likely lead to another GATT proceeding. The end-user licensing system has not been authorized by legislation and it could create significant problems for United States exports in other product markets. However, no assurances can be made that an end-user licensing system will not be adopted.

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

The Food and Drug Administration (the "FDA") has announced that it is considering classifying tobacco as a drug, and an FDA advisory panel has stated that it believes nicotine is addictive. On August 10, 1995, the FDA announced that it intended to propose regulations (the "Proposed Rule-Making") under which the FDA would assert jurisdiction over the manufacture and marketing of tobacco products. Liggett and the other major manufacturers in the industry responded by the filing of a civil action in the United States District Court for the Middle District of North Carolina challenging the legal authority of the FDA to assert such jurisdiction. In addition thereto, Liggett and the other four major cigarette manufacturers, as well as others, have filed comments in opposition to the Proposed Rule-Making. Management is unable to predict whether such a classification will be made. Management is also unable to predict the effects of such a classification, were it to occur, or of such regulations, if implemented, on Liggett's operations, but such actions could have an unfavorable impact thereon.

On March 12, 1996, Liggett, together with the Company, entered into an agreement to settle the Castano class action tobacco litigation, and on March 15, 1996, Liggett, together with the Company, entered into an

RECENT DEVELOPMENTS IN THE CIGARETTE INDUSTRY (continued)

agreement with the Attorneys General of the State of West Virginia, State of Florida, State of Mississippi, Commonwealth of Massachusetts and the State of Louisiana to settle certain actions brought against Liggett by such states. In these two settlements, Liggett and the Company, while neither consenting to FDA jurisdiction nor waiving their objections thereto, agreed to withdraw their objections and opposition to the Proposed Rule-Making and to phase in compliance with certain of the proposed interim FDA regulations. See discussions of the Castano and Attorneys General settlements appearing hereinafter.

In 1994, four class action lawsuits were brought against Liggett and other cigarette manufacturers, representing the first time class actions were brought against the cigarette industry. In the three cases which remain pending against the industry, plaintiffs' motions for class certification were granted in whole or in part, and the defendants have appealed each of these rulings. In two of these cases, the rulings of the trial courts certifying a class have been affirmed by an intermediate appellate court. In both of these cases, defendants have filed petitions for rehearing, for rehearing en banc, and for further discretionary appellate review. On May 10, 1996, defendants' petitions were denied. Defendants intend to appeal these decisions. On May 3, 1996, another class action lawsuit was brought against Liggett and other cigarette manufacturers. This action presently is in the pleading stage and discovery has not yet commenced.

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

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

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

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

The foregoing summary of the settlement and letter agreements with the Castano plaintiffs is qualified in its entirety by reference to the text of such agreements, which was incorporated as Exhibit 10.26 to the Company's Annual Report on Form 10-K, as amended, for the year ended December 31, 1995 and is incorporated herein by reference.

RECENT DEVELOPMENTS IN THE CIGARETTE INDUSTRY (continued)

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

The States of Mississippi, Minnesota, West Virginia, Massachusetts, Louisiana, Texas and Maryland also have brought actions against Liggett and other cigarette manufacturers seeking restitution and indemnity for certain Medicaid costs allegedly incurred as a result of tobacco-related illnesses. In West Virginia, the trial court, in a ruling issued on May 3, 1995, dismissed eight of the ten counts of the complaint filed therein, leaving only two counts of an alleged conspiracy to control the market and the market price of tobacco products and an alleged consumer protection claim. In a recent ruling, the trial court has adjudged the contingent fee agreement entered into by the State of West Virginia and its counsel to be unconstitutional under the Constitution of the State of West Virginia. In Mississippi, the Governor has recently commenced an action in the Mississippi Supreme Court against the Attorney General of the state, making application for a writ of prohibition to bar further prosecution and to seek dismissal of the suit brought by the Attorney General of the state for such restitution and indemnity, alleging that the commencement and prosecution of such a civil action by the Attorney General of the state was and is outside the authority of the Attorney General.

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

On November 28, 1995, each of the major manufacturers in the industry, including Liggett, filed suit in both the Commonwealth of Massachusetts and in the State of Texas seeking declaratory relief to the effect that the commencement of any such litigation (as had been filed by Florida, Mississippi, West Virginia and

RECENT DEVELOPMENTS IN THE CIGARETTE INDUSTRY (continued)

Minnesota and now by Massachusetts, Louisiana, Texas and Maryland) seeking to recover Medicaid expenses against the manufacturers by either the Commonwealth of Massachusetts or the State of Texas would be unlawful. On January 22, 1996, a suit seeking substantially similar declaratory relief was filed in the State of Maryland.

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

Under the settlement, the states would share an initial \$5,000 (\$1,000 of which was paid on March 22, 1996, with the balance payable over nine years and indexed and adjusted for inflation), provided that any unpaid amount will be due sixty days after either a default by Liggett in its payment obligations under the settlement or a merger or other transaction by Liggett with another defendant in the lawsuits. In addition, Liggett will be required to pay the states a percentage of Liggett's pretax income (income before income taxes) each year from the second through the twenty-fifth year. This annual percentage would range from 2-1/2% to 7-1/2% of Liggett's pretax income, depending on the number of additional states joining the settlement. All of Liggett's payments are subject to certain reductions provided for in the agreement. Liggett has also agreed to pay to the states \$5,000 if the Company or Liggett fails to consummate a merger or other transaction with another defendant in the lawsuits within three years of the date of the settlement. At December 31, 1995, the Company accrued approximately \$4,000 for the settlement with the Attorneys General.

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

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

The foregoing summary of the settlement agreement with the Attorneys General is qualified in its entirety by reference to the text of such agreement, which was incorporated as Exhibit 10.27 to the Company's Annual Report on Form 10-K, as amended, for the year ended December 31, 1995 and is incorporated herein by reference.

Liggett has been receiving certain financial and other assistance from others in the industry in defraying the costs and other burdens incurred in the defense of smoking and health litigation and related proceedings. The future financial benefit to the Company is not quantifiable at this time since the arrangements for assistance can be terminated on limited notice, or under certain circumstances, certain of which have occurred, without notice, and the amount of assistance received, if any, would be a function of the level of costs incurred. Certain joint defense arrangements, and the financial benefits incident thereto, have ended. No assurances can be made that other arrangements will continue. Liggett expects that the level of financial and other assistance which it may receive, if any, will be clarified over the ensuing months.

RESULTS OF OPERATIONS

Three months ended March 31, 1996 compared to three months ended March 31, 1995.

Total revenues were \$90,516 for the three months ended March 31, 1996 compared to \$95,290 for the three months ended March 31, 1995. This 5.0% decrease in revenues was primarily due to a \$15,300 or 16.3% decrease in revenues at Liggett reflecting a 20.4% decrease in Liggett's unit sales volume, partially offset by revenues of approximately \$10,000 at LDL, a subsidiary which was not consolidated in 1995. The decrease in unit sales volume at Liggett was comprised of declines in both the premium segment of 16.6% and discount segment (which includes generic, control label and branded discount products) of 21.0%. The decline in premium and discount unit sales volume was due primarily to the aggressive trade programs offered by Liggett at the end of the fourth quarter of 1995 and due to certain competitors continuing leveraging rebate programs tied to their premium products.

Gross profit was \$43,468 for the three months ended March 31, 1996 compared to \$48,912 for the three months ended March 31, 1995, a decrease of \$5,444 when compared to the same period last year, due primarily to the decline in unit sales volume at Liggett discussed above. Overall, the Company's gross profit as a percent of revenues decreased to 48.0% in the current period from 51.3% in the same period in the prior year because of the inclusion of BOL in the consolidated operations while Liggett's gross profit as a percent of revenues (excluding federal excise taxes) for the period increased to 73.7% compared to 71.9% in the same period in the prior year.

Selling, general and administrative expenses were \$44,892 for the three months ended March 31, 1996 compared to \$49,308 for the same period last year. The decrease of \$4,416 includes reduced legal expenses at both the corporate level and Liggett, and reduced pension and other compensation-related expenses, and offset by the inclusion of BOL in the consolidated group.

Interest expense was \$14,777 for the three months ended March 31, 1996 compared to \$14,715 for the same period last year.

Equity in earnings of affiliate was a loss of \$1,274 for the three months ended March 31, 1996 compared to a gain of \$1,683 for the three months ended March 31, 1995 and relates primarily to New Valley's net loss of \$4,884 in 1996 compared to net income of \$8,029 in 1995.

CAPITAL RESOURCES AND LIQUIDITY

Net cash used in operations for the three months ended March 31, 1996 was \$11,568 compared to net cash used in operations of \$5,263 for the comparable period of 1995. The net loss for the three month period ended March 31, 1996 is due primarily to a decline in net revenues at Liggett when compared to the same period in the prior year.

Liggett is of the opinion that the positive effects on its cash flow from operations resulting from the April 1996 price increase (see "Recent Developments in the Cigarette Industry - Pricing Activity") and the continuing effects of Liggett's 1995 restructuring program will be offset by increased tobacco costs, the USDA marketing assessment, increased legal expense and settlement of certain tobacco litigation. Further, the Castano settlement agreement commits the Company to pay legal fees to the plaintiffs' attorneys in the Castano class action. The amount and timing of such payment is unknown.

Cash used in investing activities of \$582 for the period ended March 31, 1996 includes capital expenditures of \$5,500 and \$1,350 for real estate development at BOL and for equipment modernization at Liggett, respectively. Liggett is projecting further capital expenditures of \$3,600 for equipment modernization in 1996 while BOL anticipates using the remaining availability of approximately \$7,800 on its Russian bank loan to continue real estate development. Capital expenditures were offset by dividends from New Valley to NV Holdings of \$6,183 or \$10.00 per share on the Class A Preferred Shares. In the three month period ended March 31, 1995, cash provided by investing activities was \$34,074 which included a special dividend from New Valley of \$30,916 or \$50.00 per share and the redemption of SkyBox International Inc.'s preferred stock of \$4,000.

CAPITAL RESOURCES AND LIQUIDITY (continued)

Further, on April 9, 1996, Liggett executed a definitive agreement with the County of Durham for the sale of Liggett to the County of Durham of certain surplus realty for a sale price of \$4,300. It is anticipated that closing will occur on or before May 31, 1996. In addition, on April 29, 1996, Liggett executed a definitive agreement with Blue Devil Ventures, a North Carolina limited liability partnership, for the sale by Liggett to Blue Devil Ventures of certain surplus realty for a sale price of \$2,200. While it is anticipated that closing will occur on or before July 31, 1996, Blue Devil Ventures has the option, if it determines that its development project is not feasible, to forfeit its deposit of \$50 and not close.

Cash provided by financing activities was \$14,157 for the three months ended March 31, 1996 compared to cash provided of \$2,790 for the same period in 1995. Proceeds from debt in 1996 includes the private placement of the Series A Notes (later exchanged for Series B Notes) for net cash proceeds of \$6,065, borrowings by BOL for real estate development of \$5,282 and borrowings of \$11,015 by Liggett under its revolving credit facility. These transactions were primarily offset by the redemption for approximately \$6,300 of the 16.125% Senior Subordinated Reset Notes, including premium and accrued interest thereon, and distributions to the Company's shareholders of \$1,369. In the 1995 period, proceeds from debt were \$3,821, offset primarily by distributions of \$1,368 to the Company's shareholders.

Availability under the Liggett revolving credit (the "facility") was approximately \$4,510 based on eligible collateral at March 31, 1996. The facility expires on March 8, 1997 and is collateralized by all accounts receivable and inventories of Liggett. Borrowings under the facility bear interest at a rate equal to 1.5% above Philadelphia National Bank's (the indirect parent of Congress Financial Corporation, the lead lender) prime rate, which was 8.75% at March 31, 1996. The facility requires Liggett's compliance with certain financial and other covenants and limits the amount of cash dividends and payments which can be made by Liggett. At March 31, 1996, Liggett was in compliance with all debt covenants under the facility. Management anticipates the facility will be refinanced with substantially similar terms in March 1997, although there can be no assurance that this will be accomplished. Accordingly, the facility's outstanding balance of approximately \$32,000 was reclassified to current liabilities at March 31, 1996. In December 1995, purchases by Liggett of \$7,000 of Series B Notes using revolver availability were credited against the mandatory redemption requirement for February 1, 1996. The remaining \$500 mandatory redemption requirement for February 1, 1996 was met by retiring the \$500 of Series C Notes held in Liggett's treasury. Management anticipates that the 1997 mandatory redemption will be funded by cash flows from operations and borrowings under the facility.

As of March 31, 1995, Liggett had a net capital deficiency of \$160,496 and is highly leveraged. Due to the many risks and uncertainties associated with the cigarette industry, impact of recent tobacco litigation settlements and anticipated 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 of certain debt covenants and if their lenders were to exercise acceleration rights under the revolving credit facility or the Liggett senior secured notes indentures or refuse to lend under the revolving credit facility, Liggett would not be able to satisfy such demands or its working capital requirements.

The Series B Notes Indenture limits the amount of restricted payments BGLS is permitted to make to the Company during the calendar year. At March 31, 1996, the remaining amount available through December 31, 1996 in the Restricted Payment Basket related to BGLS' payment of dividends to the Company (as defined by BGLS' Series B Notes Indenture) is \$4,631.

Prior to completion of the 1995 Exchange Offer on January 30, 1996, the Company had substantial near-term 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 and the redemption of the Reset Notes pursuant to the terms of the Reset Note Indenture on March 29, 1996, BGLS decreased its scheduled debt maturities to \$81,942 due in the years 1996-1998; approximately \$79,000 of this debt relates to Liggett and LDL. In addition, BGLS cancelled all of the subordinated debentures (\$13,705) held by the Company. The Company believes that it will have sufficient liquidity for 1996. Company expenditures (exclusive of Liggett

CAPITAL RESOURCES AND LIQUIDITY (continued)

and LDL) in 1996 include debt service estimated at \$29,000. Redemption of the remaining Reset Notes was effectuated on March 29, 1996 through use of proceeds from the sale of the additional \$7,397 of Series A Notes on March 4, 1996 discussed above. In March 1996, New Valley declared and paid a dividend on its Class A Preferred Shares in which NV Holdings received \$6,183, also discussed above. Distributions to BGLS and the Company are limited by terms of the Series B Notes Indenture. The Company expects to finance its long-term growth, working capital requirements, capital expenditures and debt service requirements through a combination of cash provided from operations, additional public or private debt financing and distributions from New Valley. 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.

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 statement 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 LDL, 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 LDL's cigarette and real estate development operations in Russia are each affected by uncertainties in Russia which include, among others, political or diplomatic developments, regional tensions, currency repatriation restrictions, foreign exchange fluctuations, inflation, and an undeveloped system of commercial laws and legislative reform relating to foreign ownership in Russia. In addition, the Company has a high degree of leverage and substantial near-term debt service requirements, as well as a net worth deficiency and recent losses from continuing operations. The Indenture for BGLS' Series B Notes provides for, among other things, the restriction of certain affiliated transactions between the Company and its affiliates, as well as for certain restrictions on the use of future distributions received from New Valley. Due to such uncertainties and risks, readers are cautioned not to place undue reliance on such forward-looking statements, which speak only as of the date on which such statements are made. The Company does not undertake to update any forward-looking statement that may be made from time to time by or on behalf of the Company.

PART II
OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 3. Defaults Upon Senior Securities

As of March 31, 1996, New Valley Corporation, the Companies' affiliate, had the following respective accrued and unpaid dividend arrearages on its 1,035,462 outstanding shares of \$15.00 Class A Increasing Rate Cumulative Senior Preferred Shares (\$100 Liquidation Value), \$.01 par value per share (the "Class A Shares") and 2,790,776 outstanding shares of \$3.00 Class B Cumulative Convertible Preferred Shares (\$25 Liquidation Value), \$.10 par value per share (the "Class B Shares"): (1) \$113.93 million or \$110.04 per Class A Share; and (2) \$100.05 million or \$35.85 per Class B Share.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

27.1 Brooke Group Ltd.'s Financial Data Schedule
(for SEC use only)

27.2 BGLS Inc.'s Financial Data Schedule (for SEC use only)

99.1 Liggett Group Inc.'s Interim Consolidated Financial
Statements for the quarterly period ended
March 31, 1996.

99.2 New Valley Corporation's Interim Consolidated Financial
Statements for the quarterly period ended March 31, 1996.

(b) Reports on Form 8-K

No current reports on Form 8-K were filed by either Company during the first quarter of 1996.

SIGNATURES

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

BROOKE GROUP LTD.
(REGISTRANT)

By: /s/ Joselynn D. Van Siclen

Joselynn D. Van Siclen
Vice President and Chief
Financial Officer

Date: May 15, 1996

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.

BGLS INC.
(REGISTRANT)

By: /s/ Joselynn D. Van Siclen

Joselynn D. Van Siclen
Vice President and Chief
Financial Officer

Date: May 15, 1996

5
0000059440
BROOKE GROUP LTD.
1,000
U.S. DOLLARS

3-MOS
DEC-31-1996
JAN-01-1996
MAR-31-1996
1
5,377
0
14,293
0
62,430
90,476
53,811
0
202,323
155,140
390,617
0
0
1,850
(390,520)
202,323
90,516
90,516
47,048
47,048
1,274
0
14,777
(17,342)
435
(17,777)
0
0
0
(17,777)
(0.86)
(0.86)

5
0000927388
BGLS INC.
1,000
U.S. DOLLARS

3-MOS
DEC-31-1996
JAN-01-1996
MAR-31-1996
1
5,339
0
14,293
0
62,430
94,025
53,394
0
206,501
177,503
390,617
0
0
(410,109)
206,509
90,516
90,516
47,048
47,048
1,274
0
15,668
(18,078)
451
(18,529)
0
0
0
(18,529)
0
0

TABLE OF CONTENTS

PART 1 - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

LIGGETT GROUP INC.

CONSOLIDATED BALANCE SHEETS

(Unaudited)

(Dollars in thousands, except per share amounts)

ASSETS

	March 31, 1996 ----	December 31, 1995 ----
Current assets:		
Accounts Receivable:		
Trade less allowances of \$451 and \$815, respectively.....	\$ 12,352	\$ 22,279
Other.....	1,334	1,367
Affiliates.....	914	1,105
Inventories.....	56,457	54,342
Assets under agreements for sale (Note 4).....	1,025	713
Deferred income taxes.....	3,800	3,800
Other current assets.....	899	990
Total current assets.....	----- 76,781	----- 84,596
Property, plant and equipment, at cost, less accumulated depreciation of \$27,265 and \$26,545, respectively.....	18,418	18,352
Intangible assets, at cost, less accumulated amortization of \$16,093 and \$15,661, respectively.....	4,608	5,036
Other assets and deferred charges, at cost, less accumulated amortization of \$5,933 and \$5,440, respectively.....	4,838	5,330
Total assets.....	----- \$104,645 =====	----- \$113,314 =====

(continued)

LIGGETT GROUP INC.

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

LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)

	March 31, 1996 ----	December 31, 1995 ----
Current liabilities:		
Current maturities of long-term debt.....	\$ 39,583	\$ 50
Cash overdraft.....	3,817	3,761
Accounts payable, principally trade.....	16,550	18,921
Accrued expenses:		
Promotional.....	23,119	25,519
Compensation and related items.....	154	1,175
Taxes, principally excise taxes.....	4,765	7,006
Estimated allowance for sales returns.....	5,000	5,000
Interest.....	3,365	8,412
Other.....	5,398	5,728
	-----	-----
Total current liabilities.....	101,751	75,572
Long-term debt, less current maturities.....	144,720	173,251
Non-current employee benefits and other liabilities.....	18,670	19,197
Commitments and contingencies (Notes 5 and 8)		
Stockholder's equity (deficit):		
Redeemable preferred stock (par value \$1.00 per share; authorized 1,000 shares; no shares issued and out- standing)		
Common stock (par value \$0.10 per share; authorized 2,000 shares; issued and outstanding 1,000 shares) and contributed capital.....	53,240	53,240
Accumulated deficit.....	(213,736)	(207,946)
	-----	-----
Total stockholder's equity (deficit).....	(160,496)	(154,706)
	-----	-----
Total liabilities and stockholder's equity (deficit).....	\$104,645	\$113,314
	=====	=====

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

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

	Three Months Ended	
	1996	1995
	March 31,	
	-----	-----
Net sales(*)	\$78,488	\$93,760
Cost of sales(*)	36,292	45,354
	-----	-----
Gross profit	42,196	48,406
Selling, general and administrative expenses	42,118	43,193
	-----	-----
Operating income	78	5,213
Other income (expense):		
Interest expense	(5,856)	(5,851)
Miscellaneous, net	(12)	(333)
	-----	-----
Loss before income taxes	(5,790)	(971)
Income tax benefit	-	(339)
	-----	-----
Net loss	\$ (5,790)	\$ (632)
	=====	=====

(*)Net sales and cost of sales include federal excise taxes of \$21,197 and \$26,392, respectively.

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

LIGGETT GROUP INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(Dollars in thousands)

	Three Months Ended	
	March 31,	
	1996	1995
	----	----
Cash flows from operating activities:		
Net loss	\$ (5,790)	\$ (632)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization.....	1,990	2,025
Deferred income taxes.....	(57)	-
Loss on sale of equipment.....	16	7
Changes in assets and liabilities:		
Accounts receivable.....	10,151	13,682
Inventories.....	(2,115)	(4,672)
Accounts payable.....	(2,335)	1,849
Accrued expenses.....	(10,982)	(14,147)
Non-current employee benefits.....	(348)	135
Other, net.....	(187)	(155)
	-----	-----
Net cash used in operating activities.....	(9,657)	(1,908)
	-----	-----
Cash flows from investing activities:		
Proceeds from sale of equipment.....	-	34
Capital expenditures.....	(1,350)	(334)
	-----	-----
Net cash used in investing activities.....	(1,350)	(300)
	-----	-----
Cash flows from financing activities:		
Repayments of long-term debt.....	(64)	(225)
Net borrowings under revolving credit facility.....	11,015	1,478
Increase in cash overdraft.....	56	955
	-----	-----
Net cash provided by financing activities.....	11,007	2,208
	-----	-----
Net change in cash and cash equivalents.....	-	-
Cash and cash equivalents:		
Beginning of period.....	-	-
	-----	-----
End of period.....	\$ -	\$ -
	=====	=====
Supplemental cash flow information:		
Cash payments (refunds) during the period for:		
Interest.....	\$10,793	\$10,615
Income taxes.....	\$ 15	\$ (8)

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

LIGGETT GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Dollars in thousands, except per share amounts)

1. The Company

Liggett Group Inc. ("Liggett" or the "Company") is a wholly-owned subsidiary of BGLS Inc. ("BGLS"), a wholly-owned subsidiary of Brooke Group Ltd. ("BGL"). Liggett is engaged primarily in the manufacture and sale of cigarettes, principally in the United States.

The consolidated financial statements included herein are unaudited and, in the opinion of management, reflect all adjustments necessary (which are normal and recurring) to present fairly the Company's consolidated financial position, results of operations and cash flows. The December 31, 1995 balance sheet has been derived from audited financial statements. These consolidated financial statements should be read in conjunction with the consolidated financial statements included in the Company's Annual Report on Form 10-K (Commission File No. 33-75224) as filed with the Securities and Exchange Commission on April 16, 1996. The results of operations for interim periods should not be regarded as necessarily indicative of the results that may be expected for the entire year.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. Liggett had a net capital deficiency of \$160,496 as of March 31, 1996 and is highly leveraged. Due to the many risks and uncertainties associated with the cigarette industry, impact of recent tobacco litigation settlements and increased tobacco costs, there can be no assurance that the Company will be able to meet its future earnings goals. Consequently, the Company could be in violation of certain debt covenants and if the lenders were to exercise acceleration rights under the revolving credit facility or senior secured notes indentures or refuse to lend under the revolving credit facility, the Company would not be able to satisfy such demands or its working capital requirements.

2. Estimates and Assumptions

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

3. Per Share Data

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

4. Assets Under Agreements for Sale

On April 9, 1996, Liggett executed a definitive agreement with the County of Durham for the sale by Liggett to the County of Durham of certain surplus realty for a sale price of \$4,300. It is anticipated that closing will occur on or before May 31, 1996. The net book value of those assets for which the agreement was signed have been classified as current assets on the Company's Consolidated Balance Sheets as of March 31, 1996 and December 31, 1995.

On April 29, 1996, Liggett executed a definitive agreement with Blue Devil Ventures, a North Carolina limited liability partnership, for the sale by Liggett to Blue Devil Ventures of certain surplus realty for a sale price of \$2,200. While it is anticipated that closing will occur on or before July 31, 1996, Blue Devil Ventures has the option, if it determines that its development project is not feasible, to forfeit its deposit and not close. The net book value of those assets for which the agreement was signed have been classified as current assets on the Company's Consolidated Balance Sheet as of March 31, 1996.

5. Inventories

Inventories consist of the following:

	March 31, 1996 ----	December 31, 1995 ----
Finished goods.....	\$23,139	\$18,240
Work-in-process.....	3,676	3,331
Raw materials.....	22,974	24,946
Replacement parts and supplies.....	3,945	3,926
	-----	-----
Inventories at current cost.....	53,734	50,443
LIFO adjustment.....	2,723	3,899
	-----	-----
Inventories at LIFO cost.....	\$56,457	\$54,342
	=====	=====

The Company has a leaf inventory management program whereby, among other things, it is committed to purchase certain quantities of leaf tobacco. The purchase commitments are for quantities not in excess of anticipated requirements and are at prices, including carrying costs, established at the date of the commitment. Liggett normally purchases all of its tobacco requirements from domestic and foreign leaf tobacco dealers, much of it under long-term purchase commitments of which approximately 67% of current commitments expire in December 1996. Liggett had leaf tobacco purchase commitments of approximately \$27,500 at March 31, 1996 compared to approximately \$25,500 at December 31, 1995.

6. Property, Plant and Equipment

Property, plant and equipment consist of the following:

	March 31, 1996 ----	December 31, 1995 ----
Land and improvements.....	\$ 455	\$ 542
Buildings.....	5,538	6,011
Machinery and equipment.....	39,690	38,344
	-----	-----
Property, plant and equipment.....	45,683	44,897
Less accumulated depreciation.....	(27,265)	(26,545)
	-----	-----
Property, plant and equipment, net.....	\$18,418	\$18,352
	=====	=====

7. Long-Term Debt

Long-term debt consists of the following:

	March 31, 1996		December 31, 1995
	Estimated Fair Value	Carrying Value	Carrying Value
11.5% Senior Secured Notes due February 1, 1999, net of unamortized discount of \$0, \$576 and \$627, respectively.....	\$106,299	\$119,536	\$119,485
Variable Rate Series C Senior Secured Notes due February 1, 1999.....	32,602	32,279	32,279
Borrowings outstanding under revolving credit facility.....	32,032	32,032	21,017
Other.....	456	456	520
	-----	-----	-----
Current portion.....	171,389 (6,892)	184,303 (39,583)	173,301 (50)
	-----	-----	-----
Amount due after one year.....	\$164,497	\$144,720	\$173,251
	=====	=====	=====

Senior Secured Notes

On February 14, 1992, Liggett issued \$150,000 in Senior Secured Notes (the "Series B Notes"). Interest on the Series B Notes is payable semiannually on February 1 and August 1 at an annual rate of 11.5%. The Series B Notes and Series C Notes referred to below (collectively, the "Notes") require mandatory principal redemptions of \$7,500 on February 1 in each of the years 1993 through 1997 and \$37,500 on February 1, 1998 with the balance of the Notes due on February 1, 1999. The Notes are collateralized by substantially all of the assets of the Company, excluding accounts receivable and inventory. Eve is a guarantor for the Notes. The Notes may be redeemed, in whole or in part, at a price equal to 104%, 102% and 100% of the principal amount in the years 1996, 1997 and 1998, respectively, at the option of the Company at any time on or after February 1, 1996. The Notes contain restrictions on Liggett's ability to declare or pay cash dividends, incur additional debt, grant liens and enter into any new agreements with affiliates, among others.

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

BGLS purchased \$4,500 of the Series C Notes which were subsequently sold.

Revolving Credit Facility

On March 8, 1994, Liggett entered into a revolving credit facility ("the facility") under which it can borrow up to \$40,000 (depending on the amount of eligible inventory and receivables as determined by the lenders) from a syndicate of commercial lenders. Availability under the facility was approximately \$4,510 based upon eligible collateral at March 31, 1996. The facility expires on March 8, 1997 and is collateralized by all accounts receivable and inventories of the Company. Borrowings under the facility bear interest at a rate equal to 1.5% above Philadelphia National Bank's (the indirect parent of Congress Financial Corporation, the lead lender) prime rate, which was 8.75% at March 31, 1996. The facility requires Liggett's compliance with certain financial and other covenants and limits the amount of cash dividends and payments which can be made by Liggett.

8. Commitments and Contingencies

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

In the action entitled *Cipollone v. Liggett Group Inc., et al.*, the United States Supreme Court, on June 24, 1992, issued an opinion regarding federal preemption of state law damage actions. The Supreme Court in *Cipollone* concluded that The Federal Cigarette Labeling and Advertising Act (the "1965 Act") did not preempt any state common law damage claims. Relying on The Public Health Cigarette Smoking Act of 1969 (the "1969 Act"), however, the Supreme Court concluded that the 1969 Act preempted certain, but not all, common law damage claims. Accordingly, the decision bars 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. It does permit, however, claims for fraudulent misrepresentation (other than a claim of fraudulently neutralizing the warning), concealment (other than in advertising and promotion of cigarettes), conspiracy and breach of express warranty after 1969. The Court expressed no opinion as to whether any of these claims are viable under state law but assumed *arguendo* that they are viable.

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

On September 10, 1993, an action entitled Sackman v. Liggett Group Inc., United States District Court, Eastern District of New York, was filed against Liggett alone alleging as injury lung cancer. Fact discovery closed on August 31, 1995 and expert discovery is scheduled to close on July 3, 1996. It is possible that the case will be scheduled for trial during late 1996. On March 19, 1996, the Magistrate Judge assigned to the case ordered Liggett to produce certain of its documents with respect to which Liggett has asserted various claims of privilege. Liggett intends to appeal the decision and order. Upon Liggett's motion, the Court enlarged the time to and including May 15, 1996 for Liggett to file its appeal. The other major cigarette manufacturers and The Council for Tobacco Research-U.S.A., Inc. have moved to intervene.

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

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

On October 31, 1991, an action entitled Broin, et al. v. Philip Morris Companies, Inc., et al., Circuit Court of the 11th Judicial District in and for Dade County, Florida, was filed against Liggett and others. This case was the first class action commenced against the industry, and has been brought by plaintiffs on behalf of all flight attendants that have worked or are presently working for airlines based in the United States and who have never regularly smoked cigarettes but allege that they have been damaged by involuntary exposure to ETS. On December 12, 1994, plaintiffs' motion to certify the action as a class action was granted. Defendants appealed this ruling and on January 3, 1996, the Third District of the Florida Court of Appeals affirmed the ruling of the trial court. On January 18, 1996, defendants filed a petition for rehearing, for rehearing en banc and for certification to the Florida Supreme Court. On May 10, 1996, defendants' petition was denied. The defendants intend to appeal this decision to the Florida Supreme Court.

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

punitive damage awards. Defendants' application for discretionary appeal to the Court of Appeals for the Fifth Circuit was granted. Oral argument was held on April 2, 1996.

On May 5, 1994, an action entitled Engle, et al. v. R. J. Reynolds Tobacco Company, et al., Circuit Court of the 11th Judicial District in and for Dade County, Florida, was filed against Liggett and others. The class action complaint was brought on behalf of plaintiffs and all persons in the United States who allegedly have become addicted to cigarette products and allegedly have suffered personal injury as a result thereof. Plaintiffs seeks compensatory and punitive damages, together with equitable relief including but not limited to a medical fund for future health care costs, attorney's fees and costs. On October 31, 1994, plaintiffs' motion to certify the action as a class action was granted. Defendants appealed this ruling. On January 31, 1996, the Third District of the Florida Court of Appeals affirmed the ruling of the trial court certifying the action as a class action, but modified the trial court ruling to limit the class to Florida citizens and residents. Defendants have filed a petition for rehearing, for rehearing en banc and for certification to the Florida Supreme Court. On May 10, 1996, defendants' petition was denied. The defendants intend to appeal this decision to the Florida Supreme Court.

On May 3, 1996, an action entitled Norton, et al. v. R. J. Reynolds Tobacco Company, et al., Superior Court of Madison County, State of Indiana, was filed against Liggett and others. The class action complaint was brought on behalf of plaintiffs and all similarly situated citizens of the State of Indiana who allegedly have become addicted to cigarette products as a result of defendants allegedly having controlled and manipulated the amount of nicotine in the cigarettes manufactured by them for the purpose of addicting users and sustaining such addiction. Plaintiffs seek compensatory and punitive damages, together with equitable relief including, but not limited to, disgorgement of profits received from the sale of such cigarettes and the creation of a medical monitoring fund, attorneys' fees and costs. The action presently is in the pleading stage and discovery has not as yet commenced.

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

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

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

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

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

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

On November 28, 1995, each of the major manufacturers in the industry, including Liggett, filed suit in both the Commonwealth of Massachusetts and in the State of Texas seeking declaratory relief to the effect that the commencement of any such litigation (as had been filed by Mississippi, West Virginia and Minnesota and now by Massachusetts, Louisiana, Texas and Maryland) seeking to recover Medicaid expenses against the manufacturers by either the Commonwealth of Massachusetts or the State of Texas would be unlawful. On January 22, 1996, a suit seeking substantially similar declaratory relief was filed in the State of Maryland.

The State of Florida enacted legislation effective July 1, 1994 allowing certain state authorities or entities to commence litigation seeking recovery of certain Medicaid payments made on behalf of Medicaid recipients as a result of diseases (including, but not limited to, diseases allegedly caused by cigarette smoking) allegedly caused by liable third parties (including, but not limited to, the tobacco industry). This statute purportedly abrogates certain defenses typically available to defendants. This

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

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

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

Under the settlement, the states would share an initial \$5,000 (\$1,000 of which was paid on March 22, 1996, with the balance payable over nine years and indexed and adjusted for inflation), provided that any unpaid amount will be due sixty days after either a default by Liggett in its payment obligations under the settlement or a merger or other transaction by Liggett with another defendant in the lawsuits. In addition, Liggett will be required to pay the states a percentage of Liggett's pretax income (income before income taxes) each year from the second through the twenty-fifth year. This annual percentage would range from 2-1/2% to 7-1/2% of Liggett's pretax income, depending on the number of additional states joining the settlement. All of Liggett's payments are subject to certain reductions provided for in the agreement. Liggett has also agreed to pay to the states \$5,000 if BGL or Liggett fails to consummate a merger or other transaction with another defendant in the lawsuits within three years of the date of the settlement. At December 31, 1995, the Company accrued approximately \$4,000 for the settlement with the Attorneys General.

Settlement funds received by the Attorneys General will be used to reimburse the states' smoking-related healthcare costs. While neither consenting to FDA jurisdiction nor waiving their objections thereto, BGL 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.

BGL and Liggett have the right to terminate the settlement with respect to any state participating in the settlement if any of the remaining defendants in the litigation succeed on the merits in that state's Attorney General action. BGL and Liggett may also terminate the settlement if they conclude that too

many states have filed Attorney General actions and have not resolved such cases as to the settling defendants by joining in the settlement.

Currently in addition to Cordova, approximately 94 product liability lawsuits, which have been filed in various jurisdictions, are pending and active in which Liggett is a defendant. Of these, approximately 74 are pending in the State of Florida. In most of these lawsuits, plaintiffs seek punitive as well as compensatory damages. In the product liability lawsuits presently pending in Florida against Liggett and others, three of such which are pending in the Circuit Court of Duval County (Jacksonville), Florida are scheduled for trial during 1996, these being: Clark, August, 1996; Thompson, October, 1996; and Walters, November, 1996, and another, Weisholtz, which is pending in the United States District Court for the Southern District of Florida, is scheduled for trial commencing November 12, 1996.

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

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

In March and April 1994, the Health and the Environmental Subcommittee of the Energy and Commerce Committee of the House of Representatives held hearings regarding nicotine in cigarettes. On March 25, 1994, Commissioner David A. Kessler of the Food and Drug Administration (the "FDA") gave testimony as to the potential regulation of nicotine under the Food, Drug and Cosmetic Act, and the potential for jurisdiction over the regulation of cigarettes to be accorded to the FDA. In response to Commissioner Kessler's allegations about manipulation of nicotine by cigarette manufacturers, the chief executive of each of the major cigarette manufacturers, including Liggett, testified before the subcommittee on April 14, 1994, denying Commissioner Kessler's claims. An FDA advisory panel has stated that it believes nicotine is addictive. On August 10, 1995, the FDA filed in the Federal Register a Notice of Proposed Rule-Making (the "Proposed Rule-Making") which would classify tobacco as a drug, assert jurisdiction by the FDA over the manufacture and marketing of tobacco products and impose restrictions on the sale, advertising and promotion of tobacco products. The FDA's stated objective and focus for its initiative is to limit access to cigarettes by minors by measures beyond the restrictions either mandated by existing federal, state and local laws or voluntarily implemented by major manufacturers in the industry. Liggett and the other major manufacturers in the industry responded by filing a civil action in the United States District Court for the Middle District of North Carolina challenging the legal authority of the FDA to assert such jurisdiction. In addition thereto, Liggett and the other four major cigarette manufacturers, as well as others, have filed comments in opposition to the Proposed Rule-Making. Management is unable to predict whether such a classification will be made. Management is also unable to predict the effects of such a classification, were it to occur, or of such regulations, if implemented, on Liggett's operations, but such actions could have an unfavorable impact thereon.

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

See discussions of the Castano Settlement Agreement and the Attorneys General Settlement Agreement appearing hereinabove.

The Omnibus Budget Reconciliation Act of 1993 ("OBRA") required 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 "marketing assessment" based upon price differentials between foreign and domestic tobacco and, under certain circumstances, make purchases of domestic tobacco from the stabilization cooperatives organized by the United States government. OBRA was repealed retroactively (as of December 31, 1994) coincident in time with the issuance of a Presidential proclamation, effective September 13, 1995, imposing tariffs on imported tobacco in excess of certain quotas.

On February 14, 1995, Liggett filed with the United States Department of Agriculture (the "USDA") its certification as to usage of domestic and imported tobaccos during 1994, and an audit was conducted by the USDA to verify this certification. Liggett has received from the USDA the results of the audit, which states that Liggett did not satisfy the 75% domestic tobacco usage requirement for 1994 and therefore may be subject to a marketing assessment estimated at approximately \$5,500, which amount is disputed by the Company. It is the understanding of the Company that the levels of domestic tobacco inventories currently on hand at the tobacco stabilization organizations are below reserve stock levels, and for such reason, the Company is of the opinion that it will not be obligated to make such purchases of domestic tobacco from the tobacco stabilization cooperatives. The Company is currently engaged in negotiations with the USDA in an effort to resolve this matter on satisfactory terms. At December 31, 1995, the Company accrued approximately \$4,900 representing its best estimate for the USDA marketing assessment.

On September 13, 1995, the President of the United States, after negotiations with the affected countries, declared a tariff rate quota ("TRQ") on certain imported tobacco, imposing prohibitive tariffs on imports of flue-cured and burley tobaccos in excess of certain levels which levels vary from country to country. Oriental tobacco is exempt from the quota, as well as all tobacco originating from Canada, Mexico or Israel. Management believes that the TRQ levels are sufficiently high to allow the Company to operate without material disruption to its business.

On February 20, 1996, the United States Trade Representative issued an "advance notice of rule making" concerning how tobaccos imported under the TRQ should be allocated. Currently, tobacco imported under the TRQ is allocated on a "first-come, first-served" basis, meaning that entry is allowed on an open basis to those first requesting entry in the quota year. Others in the cigarette industry have suggested an "end-user licensing" system under which the right to import tobacco under the quota would be initially assigned on the basis of domestic market share. Such an approach, if adopted, could have a materially adverse effect on the Company. The Company believes it is unlikely that an end-user licensing system will be adopted because it would likely lead to another GATT proceeding. The end-user licensing system has not been authorized by legislation and it could create significant problems for United States exports in other product markets. However, no assurances can be made that an end-user licensing system will not be adopted.

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

As to each of the cases referred to above which is pending against the Company, the Company believes, and has been so advised by counsel handling the respective cases, that the Company has a number of valid defenses to the claim or claims asserted against the Company. Litigation is subject to many uncertainties, and it is possible that some of these actions could be decided unfavorably. An

unfavorable outcome of a pending smoking and health case could encourage the commencement of additional similar litigation. Recently, there have been a number of restrictive regulatory actions, adverse political decisions and other unfavorable developments concerning cigarette smoking and the tobacco industry, including the commencement of the purported class actions referred to above. These developments generally receive widespread media attention. The Company is not able to evaluate the effect of these developing matters on pending litigation or the possible commencement of additional litigation.

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

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

9. Related Party Transactions

Liggett provides certain administrative and technical support to Liggett-Ducat Ltd., a Russian joint stock company, which is majority owned by an affiliate, in exchange for which such company provides assistance to Liggett in its pursuit of selling cigarettes in the Russian Republic. The expenses associated with Liggett's activities amounted to \$2 and \$26 for the three months ended March 31, 1996 and 1995, respectively.

Liggett is a party to an agreement dated February 26, 1991, as amended October 1, 1995, with entities related through common control, 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. The expenses associated with Liggett's activities amounted to \$441 in both of the three-month periods ended March 31, 1996 and 1995.

Effective January 1, 1992, Liggett entered into a Corporate Services Agreement with BGLS wherein BGLS agreed to provide corporate services to the Company at an annual fee of \$2,600 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 agreement had an initial term of one year, with annual renewals thereafter subject to a 5% fee increase. The expenses associated with Liggett's activities amounted to \$790 and \$752 for the three months ended March 31, 1996 and 1995, respectively. This fee is in addition to the management fee and overhead reimbursements described above.

Since April 1994, the Company has leased equipment from BGLS for \$50 per month.

Accounts receivable from affiliates relate principally to advances for expenses paid by Liggett on behalf of its affiliates. The Company expects to be reimbursed in the near term.

10. Restructuring Charges

During the first quarter of 1995, Liggett, in an effort to reduce costs, offered voluntary retirement programs to eligible employees, among other things, and reduced the Company's headcount by

approximately 63 positions. In connection therewith, the Company recorded a \$487 charge to operations (which is included as a component of cost of sales) in the first quarter of 1995.

11. Subsequent Events

On April 8, 1996, Philip Morris announced a list price increase on all brands of 40 cents per carton. The other manufacturers, including Liggett, matched the price increase.

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

On April 29, 1996, Liggett executed a definitive agreement with Blue Devil Ventures, a North Carolina limited liability partnership, for the sale by Liggett to Blue Devil Ventures of certain surplus realty for a sale price of \$2,200. While it is anticipated that closing will occur on or before July 31, 1996, Blue Devil Ventures has the option, if it determines that its development project is not feasible, to forfeit its deposit and not close.

EVE HOLDINGS INC.

BALANCE SHEETS
(Unaudited)

(Dollars in thousands, except per share amounts)

	March 31, 1996 ----	December 31, 1995 ----
ASSETS		
Cash.....	\$ 3	\$ 8
Office equipment.....	2	2
Trademarks, at cost, less accumulated amortization of \$16,018 and \$15,593, respectively.....	4,395	4,820
	-----	-----
Total assets.....	\$ 4,400	\$4,830
	=====	=====
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)		
Federal income taxes currently payable to parent.....	\$ 1,142	\$ 164
Dividends payable.....	2,122	2,536
Deferred income taxes.....	1,538	1,687
	-----	-----
Total liabilities.....	4,802	4,387
	-----	-----
Stockholder's equity (deficit):		
Common stock (par value \$1.00 per share; authorized, issued and outstanding 100 shares) and contributed capital.....	47,377	47,653
Receivables from parent:		
Note receivable - interest at 14%, due no sooner than February 1, 1999.....	(44,520)	(44,520)
Other.....	(3,259)	(2,690)
	-----	-----
Total stockholder's equity (deficit).....	(402)	443
	-----	-----
Total liabilities and stockholder's equity (deficit).....	\$ 4,400	\$ 4,830
	=====	=====

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

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

	Three Months Ended March 31,	
	1996	1995
Revenues:		
Royalties - parent.....	\$1,713	\$2,186
Interest - parent.....	1,576	1,576
	3,289	3,762
Expenses:		
Amortization of trademarks.....	425	425
Miscellaneous.....	24	11
	2,840	3,326
Income before income taxes.....		
Income tax provision.....	994	1,170
Net income.....	\$1,846	\$2,156

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

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

Caption>

	Three Months Ended March 31,	
	1996	1995
	-----	-----
Cash flows from operating activities:		
Net income.....	\$1,846	\$2,156
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization.....	425	425
Deferred income taxes.....	(149)	(149)
Changes in assets and liabilities:		
Federal income taxes currently payable.....	978	1,310
Dividends payable.....	-	(318)
	-----	-----
Net cash provided by operating activities.....	3,100	3,424
	-----	-----
Cash flows from financing activities:		
Dividends/capital distributions.....	(2,536)	(2,432)
Increase in due from parent.....	(569)	(992)
	-----	-----
Net cash used in financing activities.....	(3,105)	(3,424)
	-----	-----
Net increase (decrease) in cash.....	(5)	-
Cash:		
Beginning of period.....	8	2
	-----	-----
End of period.....	\$ 3	\$ 2
	=====	=====
Supplemental cash flow information:		
Payments of income taxes through receivable from parent.....	\$ 164	\$ -
Dividends/capital distributions declared but not paid.....	\$2,122	\$ -

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

EVE HOLDINGS INC.

NOTES TO FINANCIAL STATEMENTS
(Unaudited)
(Dollars in thousands, except per share amounts)

1. The Company

Eve Holdings Inc. ("Eve") is a wholly-owned subsidiary of Liggett Group Inc. ("Liggett"). Eve, formed in June 1990, is the proprietor of, and has all right, title and interest in, certain federal trademark registrations (the "Trademarks"). Eve has entered into an exclusive licensing agreement with Liggett (effective until 2010) whereby Eve grants the use of the Trademarks to Liggett in exchange for royalties, computed based upon Liggett's annual net sales, excluding excise taxes. The Trademarks are pledged as collateral for Liggett's borrowings under the notes indentures (see Note 3).

2. Per Share Data

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

3. Guarantee of Liggett Notes

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

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

TABLE OF CONTENTS

FINANCIAL STATEMENTS - NEW VALLEY CORPORATION

	Page

Consolidated Balance Sheets as of March 31, 1996 and December 31, 1995.....	1
Consolidated Statements of Operations for the three months ended March 31, 1996 and 1995.....	2
Consolidated Statement of Changes in Non-Redeemable Preferred Shares, Common Shares and Other Capital (Deficit) for the three months ended March 31, 1996.....	3
Consolidated Statements of Cash Flows for the three months ended March 31, 1996 and 1995.....	4
Notes to the Quarterly Consolidated Financial Statements.....	5

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

	March 31,	December 31,
	----- 1996	----- 1995
	-----	-----
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 13,458	\$ 51,742
Investment securities	244,113	241,526
Restricted assets	35,388	22,919
Receivable from clearing brokers	15,247	13,752
Other current assets	18,560	3,546
	-----	-----
Total current assets	326,766	333,485
	-----	-----
Investment in real estate	183,874	
Investment securities	499	517
Restricted assets	15,143	15,086
Long-term investments	15,625	29,512
Other assets	10,962	7,222
	-----	-----
Total assets	\$552,869	\$385,822
	=====	=====
LIABILITIES AND CAPITAL (DEFICIT)		
Current liabilities:		
Margin loans payable	\$ 92,374	\$ 75,119
Accounts payable and accrued liabilities	35,792	27,712
Prepetition claims and restructuring accruals	32,884	33,392
Income taxes	16,810	20,283
Securities sold, not yet purchased	20,531	13,047
Current portion of long-term obligations	10,125	8,367
	-----	-----
Total current liabilities	208,516	177,920
	-----	-----
Notes payable	159,653	
Other long-term obligations	19,180	11,967
Redeemable preferred shares	211,759	226,396
Non-redeemable preferred shares, Common Shares and capital (deficit):		
Cumulative preferred shares; liquidation preference of \$69,769, dividends in arrears; \$100,053 and \$95,118	279	279
Common Shares, \$.01 par value; 850,000,000 shares authorized; 191,552,476 and 191,551,586 shares outstanding	1,916	1,916
Additional paid-in capital	672,811	679,058
Accumulated deficit	(719,248)	(714,364)
Unrealized appreciation (depreciation) on investment securities, net of taxes	(1,997)	2,650
	-----	-----
Total non-redeemable preferred shares, Common Shares and other capital (deficit)	(46,239)	(30,461)
	-----	-----
Total liabilities and capital (deficit)	\$552,869	\$385,822
	=====	=====

See accompanying Notes to Quarterly Consolidated Financial Statements

NEW VALLEY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	Three Months Ended March 31,	
	1996	1995
Revenues:		
Principal transactions, net	\$ 8,738	
Commissions	3,863	
Real estate leasing	5,706	
Computer sales and service	4,699	
Interest and dividends	5,184	\$ 6,631
Other income	8,494	1,038
	-----	-----
Total revenues	36,684	7,669
	-----	-----
Cost and expenses:		
Operating, general and administrative	37,144	2,342
Interest	4,524	
Reversal of restructuring accruals		(2,044)
	-----	-----
Total costs and expenses	41,668	298
	-----	-----
(Loss) income from continuing operations before income taxes	(4,984)	7,371
(Benefit) provision for income taxes	(100)	740
	-----	-----
(Loss) income from continuing operations	(4,884)	6,631
Discontinued operations:		
Income from discontinued operations, net of income taxes of \$155		1,398
	-----	-----
Net (loss) income	(4,884)	8,029
Dividends on preferred shares - undeclared	(15,462)	(20,411)
Excess of carrying value of redeemable preferred shares over cost of shares purchased	4,279	7,358
	-----	-----
Net loss applicable to Common Shares	\$ (16,067)	\$ (5,024)
	=====	=====
Loss per common and equivalent share:		
From continuing operations	\$ (.08)	\$ (.04)
	=====	=====
Discontinued operations		\$.01
		=====
Net loss per Common Share	\$ (.08)	\$ (.03)
	=====	=====
Number of shares used in computation	191,552	189,585
	=====	=====
Supplemental information:		
Additional interest absent Chapter 11 filing		\$ 2,314
		=====

See accompanying Notes to Quarterly Consolidated Financial Statements

NEW VALLEY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN NON-REDEEMABLE PREFERRED
SHARES, COMMON SHARES AND OTHER CAPITAL (DEFICIT)
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	\$3.00 Class B Preferred Shares		Common Shares		Additional Paid-In Capital	Accumulated Deficit	Unrealized Appreciation (Depreciation)
	Shares	Amount	Shares	Amount			
Balance, December 31, 1995	2,791	\$279	191,551	\$1,916	\$679,058	\$(714,364)	\$ 2,650
Net loss						(4,884)	
Undeclared dividends and accretion on redeemable preferred shares					(10,526)		
Purchase of redeemable preferred shares					4,279		
Unrealized depreciation in marketable securities							(4,647)
Conversion of preferred shares			1				
Balance, March 31, 1996	2,791	\$279	191,552	\$1,916	\$672,811	\$(719,248)	\$(1,997)

See accompanying Notes to Quarterly Consolidated Financial Statements

NEW VALLEY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	Three Months Ended	
	March 31,	
	----- 1996	1995 -----
Cash flows from operating activities:		
Net income (loss)	\$ (4,884)	\$ 8,029
Adjustments to reconcile net income to net cash used for operating activities:		
Income from discontinued operations		(1,398)
Depreciation and amortization	1,090	
Reversal of restructuring accruals		(2,044)
Changes in assets and liabilities, net of effects from acquisition:		
Decrease (increase) in receivables and other assets	(7,420)	6,484
Decrease in income taxes	(3,473)	(29,541)
Increase in accounts payable and accrued liabilities	9,652	2,773
	-----	-----
Net cash used for operating activities	(5,035)	(15,697)
	-----	-----
Cash flows from investing activities:		
Purchase of real estate	(24,732)	
Payment of prepetition claims	(508)	(564,551)
Collection of contract receivable		300,000
Decrease (increase) in restricted assets	(12,526)	332,229
Sale or maturity of investment securities	8,627	
Purchase of investment securities	(15,844)	(175,091)
Sale or liquidation of long-term investments	13,887	
Purchase of long-term investments		(54,086)
Payment for acquisition, net of cash acquired	1,915	
	-----	-----
Net cash used for investing activities	(29,181)	(161,499)
	-----	-----
Cash flows from financing activities:		
Payment of preferred dividends	(10,354)	(75,041)
Purchase of Class A preferred stock	(10,530)	(4,356)
Increase in margin loans payable	17,255	
Repayment of other obligations	(439)	(8,719)
Exercise of stock options		335
	-----	-----
Net cash used for financing activities	(4,068)	(87,781)
	-----	-----
Net cash provided from discontinued operations		376
	-----	-----
Net decrease in cash and cash equivalents	(38,284)	(264,601)
Cash and cash equivalents, beginning of period	51,742	376,170
	-----	-----
Cash and cash equivalents, end of period	\$13,458	\$111,569
	=====	=====
Supplemental Cash Flow Information:		
Cash payments for income taxes	\$ 3,773	\$ 30,476
	=====	=====

See accompanying Notes to Quarterly Consolidated Financial Statements

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

1. PRINCIPLES OF REPORTING

The consolidated financial statements include the accounts of New Valley Corporation and Subsidiaries (the "Company"). The consolidated financial statements as of March 31, 1996 presented herein have been prepared by the Company without an audit. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the financial position as of March 31, 1996 and the results of operations and cash flows for all periods presented have been made. Results for the interim periods are not necessarily indicative of the results for an entire year.

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

These financial statements should be read in conjunction with the consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 1995, as filed with the Securities and Exchange Commission.

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 generally 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.

Revenue Recognition of Computer Sales and Services. Product revenues are recognized when the equipment is shipped or, in certain circumstances, upon product acceptance by the customer if it occurs prior to shipment. Contract revenues are recognized as the related costs are incurred. Service revenues are recognized over the period in which the services are provided.

2. ACQUISITIONS

On January 10 and January 11, 1996, the Company acquired four commercial office buildings (the "Office Buildings") and eight shopping centers (the "Shopping Centers") for an aggregate purchase price of \$183,900, consisting of \$23,900 in cash and \$160,000 in non-recourse mortgage financing. In addition, the Company has capitalized approximately \$800 in costs related to the acquisition. The Company paid \$11,400 in cash and executed four promissory notes aggregating \$100,000 for the Office Buildings. The Office Building notes bear interest at 7.5% and have terms of ten to fifteen years. These Office Buildings consist of two adjacent commercial office buildings in Troy, Michigan and two adjacent commercial office buildings in Bernards Township, New Jersey. 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. Each Shopping Center note has a term of five years, and

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

bears interest 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. 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.

The components of the Company's investment in real estate at March 31, 1996 are as follows:

Land	\$ 38,921
Buildings	145,789
Construction in progress	22

Total	184,732
Less: accumulated depreciation	(858)

Net investment in real estate	\$183,874
	=====

On January 11, 1996, the Company provided a \$10,600 convertible bridge loan to finance Thinking Machines Corporation ("TMC"), a developer and marketer of parallel software of high-end and networked computer systems. In February 1996, the bridge loan was converted into a controlling interest in a partnership which holds 3.3 million common shares of TMC which represent 61.4% of the outstanding shares. The acquisition of TMC through the conversion of the bridge loan was accounted for as a purchase for financial reporting purposes, and accordingly, the operations of TMC 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 \$16,705, including minority interest of \$9,082.

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

	Three Months Ended	
	March 31, 1996	March 31, 1995
	-----	-----
Revenues	\$ 38,115	\$ 37,709
	=====	=====
Net (loss) income	\$ (5,268)	\$ 6,920
	=====	=====
Net loss applicable to common shares	\$ (16,451)	\$ (6,133)
	=====	=====
Net loss per common share	\$ (.09)	\$ (.03)
	=====	=====

3. DISCONTINUED OPERATIONS

Effective October 1, 1995, the Company sold its messaging services business. Accordingly, the financial statements reflect the financial position and the results of operations of the messaging services business as discontinued operations for the periods prior to the sale.

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

Operating results of the messaging services business for the three months ended March 31, 1995 were as follows: revenues - \$12,027, operating income - \$1,553, and net income - \$1,398.

4. INCOME TAXES

At March 31, 1996, the Company had net operating loss carryforwards of approximately \$190,000 which expire at various dates through 2007. A valuation allowance has been provided against the amount as it is deemed more likely than not that the benefit of the tax asset will not be utilized. The Company continues to evaluate the realizability of the deferred tax assets. The provision (benefit) for income taxes, which represented the effects of the alternative minimum tax and state income taxes, for the three months ended March 31, 1996 and 1995, does not bear a customary relationship with pre-tax accounting income principally as a consequence of the change in the valuation allowance relating to deferred tax assets.

5. INVESTMENT SECURITIES

Investment securities classified as available for sale are carried at fair value, with net unrealized losses of \$1,997 (\$351 of unrealized gains and \$2,348 of unrealized losses) included as a separate component of stockholders' equity (deficit). The Company had net realized gains on sales of investment securities available for sale of \$3,134 for the three months ended March 31, 1996.

In August 1995, the Company received approval from the Federal Trade Commission to purchase up to 15% of the voting securities of RJR Nabisco Holdings Corp. ("RJR Nabisco"). As of March 31, 1996, the Company, through a wholly-owned subsidiary, held approximately 5.16 million shares of RJR Nabisco common stock, par value \$.01 per share (the "RJR Nabisco Common Stock"), with a market value of \$156,143 (cost of \$158,225). The Company's investment in RJR Nabisco collateralizes margin loan financing of \$83,535 at March 31, 1996. This margin loan bears interest at .25% below the broker's call rate (6.0% at March 31, 1996). In addition, the Company's investment in certain U.S. government securities collateralizes margin loan financing of \$8,839 which loan was repaid in April 1996 upon maturity of the U.S. government securities.

During 1996, the Company has expensed \$6,854 relating to the RJR Nabisco investment. Included in this amount is \$58 owed to Brooke pursuant to the December 27, 1995 agreement with Brooke pursuant to which the Company agreed, among other things, to pay directly or reimburse Brooke and its subsidiaries for out-of-pocket expenses in connection with Brooke's solicitation of consents and proxies from the shareholders of RJR Nabisco. At March 31, 1996, the Company owed Brooke and its subsidiaries a total of \$1,042 pursuant to the Brooke agreement, which amount was expensed in 1995. The Company's investment in RJR Nabisco decreased from a \$1,440 unrealized gain at December 31, 1995 to an unrealized loss of \$2,082 and \$4,663 at March 31, 1996 and May 3, 1996, respectively.

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

The details of the investment categories by type of security at March 31, 1996 are as follows:

	Cost	Fair Value
Available for Sale:		
Marketable equity securities:		
RJR Nabisco Common Stock	\$158,225	\$156,143
Other marketable securities	2,142	2,227
Total marketable securities	160,367	158,370
U.S. government securities	49,949	49,949
Marketable debt securities (long-term)	499	499
Total securities available for sale	210,815	208,818
Trading Securities (Ladenburg):		
Marketable equity securities	22,189	21,925
Equity and index options	11,370	11,172
Other securities	2,443	2,697
Total trading securities	36,002	35,794
Total Investment securities	246,817	244,612
Less long-term portion of investment securities	499	499
Investment securities - current portion	\$246,318	\$244,113

The long-term portion of investment securities at cost consists of marketable debt securities which mature in three years.

Long-Term Investments. At March 31, 1996, long-term investments included investments in limited partnerships of \$4,828, equity in a joint venture of \$3,796, equity investments in foreign corporations of \$6,000 and a software company of \$1,001. During the three months ended March 31, 1996, the Company liquidated its position in two limited partnerships with an aggregate carrying amount of \$14,500 and recognized a gain on such liquidations of \$4,086. The fair value of the Company's long-term investments approximates its carrying amount. The Company's estimate of the fair value of its long-term investments are subject to judgment and are not necessarily indicative of the amounts that could be realized in the current market.

RJR Nabisco Equity Swap. On February 29, 1996, New Valley entered into a total return equity swap transaction with an unaffiliated company (the "Counterparty") relating to 1,000,000 shares of RJR Nabisco Common Stock. The transaction is for a period of up to six months, subject to earlier termination at the election of New Valley, and provides for New Valley to make 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") exceeds \$34.42, the price of the RJR Nabisco Common Stock during a specified period following the commencement of the swap (the "Initial Price"), the Counterparty will pay New Valley an amount in cash equal to the amount of such appreciation with respect to 1,000,000 shares of RJR Nabisco Common Stock plus the value of any dividends with a record date occurring during the swap period. If the Final Price is less than the Initial Price, then New Valley will pay the Counterparty at the termination of the transaction an amount in cash equal to the amount of such decline with respect to 1,000,000 shares of RJR Nabisco Common Stock, offset by the value of any

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

dividends, provided that, with respect to approximately 225,000 shares of RJR Nabisco Common Stock, New Valley will not be required to pay any amount in excess of an approximate 25% decline in the value of the shares. The potential obligations of the Counterparty under the swap are being guaranteed by the Counterparty's parent, a large foreign bank, and New Valley has pledged certain collateral in respect of its potential obligations under the swap and has agreed to pledge additional collateral under certain conditions. At March 31, 1996, the Company marked its obligation with respect to the equity swap to fair value which resulted in a charge to operations of \$3,964 representing the unrealized loss on this swap transaction. The Company has pledged U.S. government securities of \$11,806 at March 31, 1996 as collateral for this transaction.

6. REDEEMABLE PREFERRED SHARES

At March 31, 1996, the Company had authorized and outstanding 2,000,000 and 1,035,462, respectively, of its Class A Senior Preferred Shares. At March 31, 1996 and December 31, 1995, respectively, the carrying value of such shares amounted to \$211,759 and \$226,396, including undeclared dividends of \$113,938 and \$121,893, or \$110.04 and \$110.06 per share.

In January and February, 1996, the Company repurchased 72,104 of such shares for \$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.

As of March 31, 1996, the unamortized discount on the Class A Senior Preferred Shares was \$5,700.

In March 1996, Company declared and paid a dividend on the Class A Senior Preferred Shares of \$10.00 per share.

7. PREFERRED SHARES NOT SUBJECT TO REDEMPTION REQUIREMENTS

The undeclared dividends, as adjusted for conversions of Class B Preferred Shares into Common Shares, cumulatively amounted to \$100,053 and \$95,118 at March 31, 1996 and December 31, 1995, respectively. These undeclared dividends represent \$35.85 and \$34.08 per share as of the end of each period. No accrual was recorded for such undeclared dividends as the Class B Preferred Shares are not mandatorily redeemable.

8. RESTRICTED ASSETS

The current and noncurrent portions of restricted assets consist primarily of the remaining \$28,508 held in escrow pursuant to the sale of the Company's money transfer business on November 15, 1994, which have been classified based on the terms of the related purchase agreement and the anticipated release of the escrow, and the \$11,802 pledged as collateral for the RJR Nabisco equity swap as described in Note 5.

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

9. PREPETITION CLAIMS UNDER CHAPTER 11 AND RESTRUCTURING ACCRUALS

Those liabilities that are expected to be resolved as part of the Company's First Amended Joint Chapter 11 Plan of Reorganization, as amended (the "Joint Plan"), are classified in the Consolidated Balance Sheets as prepetition claims and restructuring accruals. On January 18, 1995, approximately \$550 million of prepetition claims were paid pursuant to the Joint Plan. As of March 31, 1996 and December 31, 1995, the Company had \$32,884 and \$33,392, respectively, of prepetition claims and restructuring accruals. The prepetition claims remaining as of March 31, 1996 may be subject to future adjustments depending on pending discussions with the various parties and the decisions of the Bankruptcy Court.

10. CONTINGENCIES

Litigation

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 or results of operations.

Investment Company Act

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