THE HALLWOOD GROUP, INC.

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LADENBURG, THALMANN & CO. INC.

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MEMBERS ALL PRINCIPAL EXCHANGES

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UPDATE

THE HALLWOOD GROUP
(HWG Cm. @ 1 1/2 , HWG Conv. Pr. @ 9 3/4, NYSE)

Dividend on cm	- $0.08	Dividend on Pr.	- $0.56
Yield	- 5.3%	Yield	- 5.7%

Rarely in this writer's thirty-five years involvement with the financial community, have I witnessed such a transformation of a corporation in such a short time span as is occurring in Hallwood.

In our original analysis, dated December 5, 1984, it was stated " We are impressed by Mr. Gumbiner and the fundamental concepts of this merchant/investment banking operation as conceived by him and Mr.Troup. We have confidence in the integrity of the principals involved. They enjoy a good reputation both here and abroad. We believe that the commitment to achieve continued and growing success of Hallwood is implicit in their conduct of business and that they are dedicated to its accomplishment."

"The business is indeed "one-of-a-kind". The principals are expert in its pursuit, since they were the creators. Eight years of experience has likewise provided them with a comfortable lead time over any possible developing competition."

"Their affiliation with some of the most respected names in finance and industry throughout the world is an invaluable asset."

The key to the summary is the passage above "we believe that the commitment to achieve continued and growing success of Hallwood is implicit in their conduct of business and that they are dedicated to its accomplishment."

The following developments, assuming fruition, evidence the transformation of Hallwood into a full-fledged U.S. merchant banking entity, indeed a "one-of-a-kind" business and validates our contention as stated above.

NEW COMPANY

In order to capitalize on the many merchant/investment banking opportunities available, a new holding company is to be created.

COMPONENTS

Initially, it will consist of three divisions and/or subsidiaries : (1) Hallwood Securities; (2) Hallwood Merchant Bank; and (3) Hallwood Properties.

Hallwood Securities - A division that will be a registered broker-dealer. Its primary objective will be to develop a significant business for Hallwood in effecting the raising of additional capital for businesses through common stock rights offerings at the lowest cost existing in the U.S. today.

Two individuals, with another pending, have already been employed and a new office has been established at 101 Park Avenue, New York City.

When application for approval is granted, Hallwood Securities will then be a nucleus for other financial undertakings as well.

Hallwood Merchant Bank - Impelled by Mr. Gumbiner and Mr. Troup, its initial effort will be the expansion of corporate rescue financing. The concept and method of implementation were explained in detail in the original report. It is anticipated that this, too, will be a significant source of revenue for the company.

Hallwood Properties - Under the impressive and most successful leadership of Tom Hartigan, President of The Hallwood Group, all real estate transactions will be effected by this division. Headquarters of this operation will remain in Cleveland, Ohio.

RECENT DEVELOPMENTS

REAL ESTATE - In its second quarter report for the period ended Jan. 31, 1985, HWG reported sales of two properties resulting in cash receipts of almost $6 million and a capital gain approximating $750,000.

Further sales of properties have occurred and more are in process. It is Hallwood's intention to liquidate all properties and selected mortgages as quickly as possible; this, in order to take advantage of the current strength existing in these markets.

While attempting to complete all its contemplated transactions during this fiscal year, that will be nearly impossible. Some sales, therefore, will fall into the first quarter of the new fiscal year. Upon completion, Hallwood projects the receipt of $60 - $65 million cash , with between $40 and $45 million expected to be received by the end of the current fiscal year.

It is anticipated that contemplated sales of properties in this fiscal year and selected mortgages will result in a significant profit to Hallwood, perhaps exceeding $7 million.

GREAT BRITAIN - The U. K. properties consist of approximately 300 private residences located primarily in London. Sales are occuring at the rate of 10% per annum as vacancies occur.

Such sales, as they transpire, while profitable, are not expected to be significant to the company on an annual basis.

SAXON OIL - Due to current conditions existing for oil world-wide, the bids Hallwood has received for its Saxon Oil holdings have been deemed unacceptable by management, even though they had exceeded the price paid for their shares.

Another result of these conditions, chiefly the current lower price for oil, has resulted in a downward adjustment of Saxon's reserves by their independent petroleum engineers. Saxon has filed a new reserve report with the SEC showing estimated proven reserves of 4.2 million barrels of oil, down from 4.6 MBO,and gas of 10.9 million MCF down from 13.1 million MCF, with a parallel sharp decline of estimated future net revenue from $49 mil. to $38.4 mil.

" From adversity springs opportunity " and Hallwood has moved to take advantage of it . Last week, Saxon announced that it would form a Master Limited Partnership , together with its 28 public limited partnership funds; hopefully, the 7000 individual partners will likewise participate . Approximately 600 wells are involved.

It is contemplated that new depositary units will be issued in exchange and that they will be listed on the American Stock Exchange, will yield 12 %, and be tax-free. The latter status arises from the fact that partnership tax passthrough available in the MLP vehicle and certain loss carryforwards currently existing in Saxon will be assumed by the holder of the Master Limited Partnership units. Additionally, of course, the MLP will continue to realize tax benefits derived from intangibles, depletion and depreciation.

The depository units should be exceedingly attractive for other reasons as well. Analysis reveals that if all partnerships convert to the Master Limited Partnership, under present conditions and pricing structure, that approximately $9 - 10 million of surplus cash flow should be available annually to the MLP. This will fund the continued infill drilling in the prolific Sprayberry Field of 25 new wells per year with each well expected to generate reserves of about 60,000 barrels of oil. Saxon will receive a 15% promote for each well; additionally, Saxon is to receive a management fee approximating $2 1/2 million per year for managing the 600+ wells. This, in addition to its ownership participation of approximately 25% of the Master Limited Partnership units.

It is immediately apparent that this proposal has still another major characteristic, besides those enumerated above, which should make the depository receipts extremely attractive and that is the expectation that the net new addition of reserves will exceed production yearly; thus, the investor will have an asset that increases in value rather than depleting.

Should this plan develop as briefly outlined, there are sufficient infill drilling locations to last a minimum of 5 years, drilling 25 wells per year.

There are other financial aspects involved, but, perhaps, the above will be sufficient to provide the investor with an overview of the plan.

It is presently contemplated that Hallwood's Saxon management fee of $1.8 million over five years may be paid in full during the third quarter on a discounted basis.

MORTGAGE PORTFOLIO OPPORTUNITY - HWG presently is engaged in negotiations with a major institution to purchase a mortgage portfolio approximating $150 million at a price commensurate with current market conditions. The discounted price should be substantially below the face value. Assuming success , HWG will act as a broker in resale of the portfolio to foreign investors. For its efforts, HWG will receive a fee that could approximate as much as $5 million.

OTHER PENDING DEVELOPMENTS - As of now, one stock rights contract is pending completion as is one financial rescue undertaking. Other similar transactions are in various stages of discussion and/or negotiation.

While the individual investor may be partial to dollar stocks representing good value of solid companies, institutional investors are basically precluded from purchasing them. For that reason, and other considerations, it would not be surprising to see a reverse split of Hallwood's common stock on a 1 - 7 or a 1 - 14 basis. Should this occur, we would construe it favorably.

EARNINGS - From the foregoing, one can readily recognize the virtual impossiblity of attempting to forecast earnings in this current fiscal year - there are not only many variables, but many imponderables as well. With the many proposed transactions in process, quarterly projections near-term become almost meaningless; nevertheless, some attempt must be made to estimate earnings expectations based upon reasonable assumptions within the time frames projected. The following are our projections on a "best efforts basis" :

Financial Services

Interest Income	-	$1.5 million
Fees	-	$4.0 million

Real Estate

Mortgage Income	-	$4.0 million
Property Income	-	$4.1 million
Land & Property Sales	-	$7.0 million

Total Estimated Revenues	-	$20.6 million
Total Estimated Operating Expenses and Depreciation	-	$ 9.0 million
Estimated Pre-Tax Net	-	$11.6 million or $0.18/share

SUMMARY

Of the myriad investments to which this writer has been exposed over the 30 years, this is one of the most unique and intriguing. In my opinion, equity commitment can only intelligently be made based upon one's conviction that the management team of Gumbiner, Troup and Hartigan will continue to be imaginative, determined, and sound in the pursuit of their corporate goals. The Company, in its present form, is not even a year old. Earnings basically consist of a series of non-recurring events, thus, earnings visibility is blurred and projections of a steady income stream impossible.

Why, then, do we, nevertheless, believe that Hallwood is not only a valid commitment for one's equity funds but also , that it should prove most rewarding ? Our reasons embrace the following : (1) Our conviction that the managment is, indeed, capable, experienced and committed; (2) that Hallwood is a "one-of-a-kind" situation; (3) that this is the only vehicle available for public participation in a merchant bank; (4) management's substantial commitment to not only preserving shareholder's equity but, even more so, to increasing it; (5) that finances are sound and the dividend amply covered; (6) that management, ala Boone Pickens, formulates its policies on the basis of what is good for the shareholder; (7) that management "runs a tight ship" with operating expenses minimized; (8) that management is opportunistic, in that it seeks opportunities in its fields and moves quickly to capitalize on them; (9) that the world's current unsettlement and financial vulnerability (unfortunatley) is conducive for Hallwood's businesses.

The common is selling at its high, while the convertible preferred is selling at a discount. For that reason, we recommend purchase of the preferred by those investors who are sophisticated and willing to assume the inherent risks involved in a major corporate re-structuring. We also recommend purchase of the common for those desiring a lower priced stock.

Frank F. Reinhardt