

VECTOR GROUP LTD
Form 10-Q
November 09, 2015

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

FORM 10-Q

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

For The Quarterly Period Ended September 30, 2015

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

Delaware (State or other jurisdiction of incorporation incorporation or organization)	1-5759 Commission File Number	65-0949535 (I.R.S. Employer Identification No.)
--	--------------------------------------	--

4400 Biscayne Boulevard
Miami, Florida 33137
305-579-8000
(Address, including zip code and telephone number, including area code,
of the principal executive offices)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934, 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) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Edgar Filing: VECTOR GROUP LTD - Form 10-Q

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the Registrant is a shell company as defined in Rule 12b-2 of the Exchange Act.
 Yes No

At November 9, 2015, Vector Group Ltd. had 122,592,329 shares of common stock outstanding.

VECTOR GROUP LTD.

FORM 10-Q

TABLE OF CONTENTS

	Page
PART I. FINANCIAL INFORMATION	
Item 1. Vector Group Ltd. Condensed Consolidated Financial Statements (Unaudited):	
<u>Condensed Consolidated Balance Sheets as of September 30, 2015 and December 31, 2014</u>	<u>2</u>
<u>Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2015 and September 30, 2014</u>	<u>3</u>
<u>Condensed Consolidated Statements of Comprehensive (Loss) Income for the three and nine months ended September 30, 2015 and September 30, 2014</u>	<u>4</u>
<u>Condensed Consolidated Statements of Stockholders' (Deficiency) Equity for the nine months ended September 30, 2015</u>	<u>5</u>
<u>Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2015 and September 30, 2014</u>	<u>6</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>7</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>50</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>63</u>
<u>Item 4. Controls and Procedures</u>	<u>63</u>
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	<u>65</u>
<u>Item 1A. Risk Factors</u>	<u>65</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>68</u>
<u>Item 6. Exhibits</u>	<u>69</u>
<u>SIGNATURE</u>	<u>70</u>

VECTOR GROUP LTD. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands, Except Per Share Amounts)

Unaudited

	September 30, 2015	December 31, 2014
ASSETS:		
Current assets:		
Cash and cash equivalents	\$246,347	\$326,365
Investment securities available for sale	288,376	346,043
Accounts receivable - trade, net	20,112	23,328
Inventories	90,695	90,323
Income taxes receivable, net	—	3,282
Restricted assets	2,834	2,595
Other current assets	37,824	36,718
Total current assets	686,188	828,654
Property, plant and equipment, net	76,367	84,112
Real estate held for sale, net	22,963	10,643
Long-term investments	53,648	40,292
Investments in real estate ventures	194,052	163,460
Restricted assets	18,647	12,013
Goodwill and other intangible assets, net	265,480	269,972
Prepaid pension costs	27,440	25,032
Other assets	54,016	58,893
Total assets	\$1,398,801	\$1,493,071
LIABILITIES AND STOCKHOLDERS' (DEFICIENCY) EQUITY:		
Current liabilities:		
Current portion of notes payable and long-term debt	\$7,957	\$52,640
Current portion of fair value of derivatives embedded within convertible debt	—	884
Current payments due under the Master Settlement Agreement	92,952	26,322
Current portion of employee benefits	931	931
Income taxes payable, net	186	1,743
Litigation accruals	7,640	3,149
Deferred income taxes, net	7,321	28,479
Other current liabilities	111,803	126,755
Total current liabilities	228,790	240,903
Notes payable, long-term debt and other obligations, less current portion	879,690	860,711
Fair value of derivatives embedded within convertible debt	149,739	168,502
Non-current employee benefits	49,913	49,314
Deferred income taxes, net	96,497	94,510
Payments due under the Master Settlement Agreement	20,094	25,809
Litigation accruals	24,072	25,700
Other liabilities	6,833	5,570
Total liabilities	1,455,628	1,471,019
Commitments and contingencies (Note 7)		
Stockholders' (deficiency) equity:		
Preferred stock, par value \$1.00 per share, 10,000,000 shares authorized	—	—
Common stock, par value \$0.10 per share, 250,000,000 and 250,000,000 shares authorized, 122,592,329 and 118,646,261 shares issued and 122,592,329 and 114,501,014 shares outstanding	12,259	11,450

Edgar Filing: VECTOR GROUP LTD - Form 10-Q

Additional paid-in capital	—	—
Accumulated deficit	(163,914	) (90,160)
Accumulated other comprehensive income	9,868	34,540
Treasury shares, at cost, 0 and 4,145,247	—	(12,857)
Total Vector Group Ltd. stockholders' deficiency	(141,787	) (57,027)
Non-controlling interest	84,960	79,079
Total stockholders' (deficiency) equity	(56,827	) 22,052
Total liabilities and stockholders' (deficiency) equity	\$ 1,398,801	\$ 1,493,071

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

2

VECTOR GROUP LTD. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in Thousands, Except Per Share Amounts)

Unaudited

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenues:				
Tobacco*	\$264,170	\$264,520	\$747,145	\$748,468
Real estate	185,563	153,748	478,841	415,280
E-Cigarettes	201	1,608	881	9,977
Total revenues	449,934	419,876	1,226,867	1,173,725
Expenses:				
Cost of sales:				
Tobacco*	174,418	189,728	506,315	537,667
Real estate	121,078	96,442	309,306	261,531
E-Cigarettes	421	1,066	1,518	6,357
Total cost of sales	295,917	287,236	817,139	805,555
Operating, selling, administrative and general expenses	79,114	69,431	232,737	200,431
Litigation settlement and judgment expense	3,750	225	5,843	1,725
Restructuring expenses	1,548	—	1,548	—
Operating income	69,605	62,984	169,600	166,014
Other income (expenses):				
Interest expense	(32,898)	(44,034)	(96,405)	(123,670)
Change in fair value of derivatives embedded within convertible debt	7,044	7,127	18,760	7,447
Acceleration of interest expense related to debt conversion	—	(994)	—	(5,112)
Equity (loss) income from real estate ventures	(916)	3,258	1,278	3,002
Equity (loss) income from investments	(579)	829	(2,273)	1,462
(Loss) gain on sale of investment securities available for sale	(821)	33	12,018	(38)
Impairment of investment securities available for sale	(12,211)	—	(12,211)	—
Other, net	133	2,466	3,554	8,167
Income before provision for income taxes	29,357	31,669	94,321	57,272
Income tax expense	13,508	11,964	37,551	21,007
Net income	15,849	19,705	56,770	36,265
Net income attributed to non-controlling interest	(3,644)	(4,826)	(5,741)	(10,881)
Net income attributed to Vector Group Ltd.	\$12,205	\$14,879	\$51,029	\$25,384
Per basic common share:				
Net income applicable to common shares attributed to Vector Group Ltd.	\$0.10	\$0.13	\$0.42	\$0.23

Edgar Filing: VECTOR GROUP LTD - Form 10-Q

Per diluted common share:

Net income applicable to common shares attributed to Vector Group Ltd.	\$0.10	\$0.13	\$0.42	\$0.23
Cash distributions and dividends declared per share	\$0.38	\$0.36	\$1.14	\$1.09

* Revenues and cost of sales include excise taxes of \$112,773, \$115,323, \$319,044 and \$327,434, respectively.

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

3

VECTOR GROUP LTD. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

	Three Months Ended September 30, 2015		2014		Nine Months Ended September 30, 2015		2014	
Net income	\$ 15,849		\$ 19,705		\$ 56,770		\$ 36,265	
Net unrealized (losses) gains on investment securities available for sale:								
Change in net unrealized (losses) gains	(50,067	) 19,184	(43,550	) 22,292				
Net unrealized losses (gains) reclassified into net income	9,091	(33	) (3,748	) 38				
Net unrealized (losses) gains on investment securities available for sale	(40,976	) 19,151	(47,298	) 22,330				
Net unrealized (losses) gains on long-term investments accounted for under the equity method:								
Change in net unrealized (losses) gains	—	(4,694	) 1,190	3,920				
Net unrealized losses reclassified into net income	—	—	1,624	—				
Net unrealized (losses) gains on long-term investments accounted for under the equity method	—	(4,694	) 2,814	3,920				
Net change in forward contracts	15	16	47	48				
Net change in pension-related amounts								
Net loss arising during the year	—	—	1,607	—				
Amortization of loss	229	147	750	442				
Net change in pension-related amounts	229	147	2,357	442				
Other comprehensive (loss) income	(40,732	) 14,620	(42,080	) 26,740				
Income tax effect on:								
Change in net unrealized (losses) gains on investment securities	20,702	(7,438	) 18,008	(9,218)			
Net unrealized losses (gains) reclassified into net income on investment securities	(3,759	) 13	1,550	(16)			
Change in unrealized (losses) gains on long-term investments accounted for under the equity method	—	1,933	(484	) (1,621)			
Net unrealized losses reclassified into net income on long-term investments accounted for under the equity method	—	—	(672) —				
Forward contracts	(6	) (8	) (19	) (20)			
Pension-related amounts	(95	) (105	) (975	) (31)			
	16,842	(5,605	) 17,408	(10,906)			

Edgar Filing: VECTOR GROUP LTD - Form 10-Q

Income tax provision on other comprehensive (loss)
income

Other comprehensive (loss) income, net of tax	(23,890	) 9,015	(24,672	) 15,834
Comprehensive (loss) income	(8,041	) 28,720	32,098	52,099
Comprehensive income attributed to non-controlling interest	(3,644	) (4,826	) (5,741	) (10,881
Comprehensive (loss) income attributed to Vector Group Ltd.	\$(11,685	) \$23,894	\$26,357	\$41,218

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

4

VECTOR GROUP LTD. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' (DEFICIENCY) EQUITY
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

	Vector Group Ltd. Stockholders' (Deficiency) Equity							
	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Additional Accumulated Deficit	Accumulated Other Comprehensive Income	Treasury Stock	Non-controlling Interest	Total
Balance, January 1, 2015	114,501,014	\$11,450	\$—	\$(90,160)	\$ 34,540	\$(12,857)	\$ 79,079	\$22,052
Net income	—	—	—	51,029	—	—	5,741	56,770
Total other comprehensive loss	—	—	—	—	(24,672)	—	—	(24,672)
Total comprehensive income	—	—	—	—	—	—	—	32,098
Distributions and dividends on common stock	—	—	(16,082)	(124,199)	—	—	—	(140,281)
Surrender of shares in connection with restricted stock vesting	(83,411)	(8)	(2,075)	—	—	—	—	(2,083)
Effect of stock dividend	5,837,144	584	—	(584)	—	—	—	—
Note conversions, net of taxes \$367	2,227,552	223	25,299	—	—	—	—	25,522
Cancellation of treasury shares	—	—	(12,857)	—	—	12,857	—	—
Exercise of stock options	110,030	10	1,311	—	—	—	—	1,321
Tax benefit of options exercised	—	—	756	—	—	—	—	756
Stock-based compensation	—	—	3,648	—	—	—	—	3,648
Contributions made by non-controlling interest	—	—	—	—	—	—	704	704
Distributions to non-controlling interest	—	—	—	—	—	—	(564)	(564)
Balance as of September 30, 2015	122,592,329	\$12,259	\$—	\$(163,914)	\$ 9,868	\$—	\$ 84,960	\$(56,827)

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

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

	Nine Months Ended September 30, 2015	Nine Months Ended September 30, 2014	
Net cash provided by operating activities	\$ 140,018	\$ 100,044	
Cash flows from investing activities:			
Sale of investment securities	161,029	173,046	
Maturities of investment securities	2,653	517	
Purchase of investment securities	(162,845)	(312,919))
Proceeds from sale or liquidation of long-term investments	182	549	
Purchase of long-term investments	(10,000)	(12,000))
Investments in real estate ventures	(43,280)	(29,378))
Distributions from investments in real estate ventures	11,205	5,540	
Increase in cash surrender value of life insurance policies	(1,225)	(435))
Increase in restricted assets	(6,872)	(1,108))
Issuance of notes receivable	(4,410)	(250))
Proceeds from sale of fixed assets	3	4	
Capital expenditures	(7,859)	(20,746))
Repayments of notes receivable	5,106	933	
Purchase of subsidiaries	—	(250))
Pay downs of investment securities	5,743	690	
Proceeds from sale of preferred securities	1,000	—	
Investments in real estate held for sale	(12,512)	—)
Net cash used in investing activities	(62,082)	(195,807))
Cash flows from financing activities:			
Proceeds from issuance of debt	1,519	413,918	
Deferred financing costs	(624)	(12,360))
Repayments of debt	(4,968)	(10,305))
Borrowings under revolver	130,691	645,894	
Repayments on revolver	(146,655)	(673,866))
Dividends and distributions on common stock	(139,430)	(122,051))
Distributions to non-controlling interest	(564)	(4,861))
Proceeds from exercise of Vector options	1,321	4,407	
Tax benefit of options exercised	756	937	
Net cash (used in) provided by financing activities	(157,954)	241,713)
Net (decrease) increase in cash and cash equivalents	(80,018)	145,950)
Cash and cash equivalents, beginning of period	326,365	234,466	
Cash and cash equivalents, end of period	\$ 246,347	\$ 380,416	

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

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation:

The condensed consolidated financial statements of Vector Group Ltd. (the “Company” or “Vector”) include the accounts of VGR Holding LLC (“VGR Holding”), Liggett Group LLC (“Liggett”), Vector Tobacco Inc. (“Vector Tobacco”), Liggett Vector Brands LLC (“Liggett Vector Brands”), Zoom E-Cigs LLC (“Zoom”), New Valley LLC (“New Valley”) and other less significant subsidiaries. New Valley includes the accounts of Douglas Elliman Realty, LLC (“Douglas Elliman”) and other less significant subsidiaries. All significant intercompany balances and transactions have been eliminated. Liggett and Vector Tobacco are engaged in the manufacture and sale of cigarettes in the United States. Zoom is engaged in the sale of electronic cigarettes in the United States. New Valley is engaged in the real estate business. The unaudited, interim condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and, in management’s opinion, contain all adjustments, consisting only of normal recurring items, necessary for a fair statement of the results for the periods presented. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014 filed with the Securities and Exchange Commission. 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.

Revisions to December 31, 2014 Consolidated Balance Sheet. The Company has revised its December 31, 2014 Consolidated Balance Sheet, which originally presented deferred income tax assets and liabilities (current and noncurrent) on a gross basis, rather than a net basis. The revisions conform to ASC 740-10-45-6 which states all current deferred tax liabilities and assets shall be offset and presented as a single amount and all noncurrent deferred tax liabilities and assets shall be offset and presented as a single amount. The Company assessed the materiality of this error on previously issued financial statements and concluded that the error was immaterial.

The revisions are presented in the table below:

	December 31, 2014		
	As		
	Previously	Revision	As Revised
	Reported		
Deferred income taxes	\$29,192	\$(29,192)	\$—
Total current assets	857,846	(29,192)	828,654
Deferred income taxes	51,129	(51,129)	—
Total assets	\$1,573,392	\$(80,321)	\$1,493,071
Deferred income taxes, net	\$57,671	\$(29,192)	\$28,479
Total current liabilities	270,095	(29,192)	240,903
Deferred income taxes, net	145,639	(51,129)	94,510

Edgar Filing: VECTOR GROUP LTD - Form 10-Q

Total liabilities	1,551,340	(80,321)	1,471,019
Total stockholders' equity	22,052	—	22,052
Total liabilities and stockholders' equity	\$1,573,392	\$(80,321)	\$1,493,071

7

VECTOR GROUP LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)

Unaudited

(b) Distributions and Dividends on Common Stock:

The Company records distributions on its common stock as dividends in its condensed consolidated statement of stockholders' deficiency to the extent of retained earnings and accumulated paid-in capital. Any amounts exceeding retained earnings are recorded as a reduction to additional paid-in capital. Any amounts then exceeding accumulated paid-in capital are recorded as an increase to accumulated deficit.

(c) Revenue Recognition:

Tobacco and E-Cigarettes sales: Revenues from sales are recognized upon the shipment of finished goods when title and risk of loss have passed to the customer, there is persuasive evidence of an arrangement, the sale price is fixed or determinable and collectibility is reasonably assured. The Company provides an allowance for expected sales returns, net of any related inventory cost recoveries. Certain sales incentives, including promotional price discounts, are classified as reductions of net sales. The Company includes federal excise taxes on tobacco sales in revenues and cost of goods sold. Since the Company's primary line of business is tobacco, the Company's financial position and its results of operations and cash flows have been and could continue to be materially adversely affected by significant unit sales volume declines at the Company and industry levels, regulation, litigation and defense costs, increased tobacco costs or reductions in the selling price of cigarettes in the near term.

Real estate sales: Revenue is recognized only when persuasive evidence of an arrangement exists, the price is fixed or determinable, the transaction has been completed and collectibility of the resulting receivable is reasonably assured. Real estate commissions earned by the Company's real estate businesses are recorded as revenue on a gross basis upon the closing of a real estate transaction as evidenced when the escrow or similar account is closed, the transaction documents have been recorded and funds are distributed to all appropriate parties. Commissions expenses are recognized concurrently with related revenues. Property management fees earned are recorded as revenue when the related services are performed.

(d) Earnings Per Share ("EPS"):

Information concerning the Company's common stock has been adjusted to give retroactive effect to the 5% stock dividend paid to Company stockholders on September 29, 2015. All per share amounts and references to share amounts have been updated to reflect the retrospective effect of the stock dividends.

Net income for purposes of determining basic and diluted EPS was as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Net income attributed to Vector Group Ltd.	\$ 12,205	\$ 14,879	\$ 51,029	\$ 25,384
Expense attributed to participating securities	(360	) (423	) (1,510	) (739
Net income attributed to Vector Group Ltd. available to common stockholders	\$ 11,845	\$ 14,456	\$ 49,519	\$ 24,645

Basic and diluted EPS were calculated using the following shares:

Edgar Filing: VECTOR GROUP LTD - Form 10-Q

	Three Months Ended		Nine Months Ended	
	September 30, 2015	2014	September 30, 2015	2014
Weighted-average shares for basic EPS	118,023,224	108,374,350	117,660,001	106,464,835
Plus incremental shares related to stock options and non-vested restricted stock	134,315	120,354	175,097	118,724
Weighted-average shares for diluted EPS	118,157,539	108,494,704	117,835,098	106,583,559

8

VECTOR GROUP LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)

Unaudited

The following were outstanding during the three and nine months ended September 30, 2015 and 2014, but were not included in the computation of diluted EPS because the effect was anti-dilutive.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Weighted-average number of shares issuable upon conversion of debt	24,895,477	34,229,687	25,186,773	32,820,165
Weighted-average conversion price	\$ 19.63	\$ 17.49	\$ 19.53	\$ 16.48

(e) Fair Value of Derivatives Embedded within Convertible Debt:

The Company has estimated the fair market value of the embedded derivatives based principally on the results of a valuation model. The estimated fair value of the derivatives embedded within the convertible debt is based principally on the present value of future dividend payments expected to be received by the convertible debt holders over the term of the debt. The discount rate applied to the future cash flows is estimated based on a spread in the yield of the Company's debt when compared to risk-free securities with the same duration. A readily determinable fair market value of the embedded derivatives is not available. The valuation model assumes future dividend payments by the Company and utilizes interest rates and credit spreads for secured to unsecured debt, unsecured to subordinated debt and subordinated debt to preferred stock to determine the fair value of the derivatives embedded within the convertible debt. The valuation also considers other items, including current and future dividends and the volatility of the Company's stock price. At September 30, 2015, the range of estimated fair market values of the Company's embedded derivatives was between \$148,769 and \$150,125. The Company recorded the fair market value of its embedded derivatives at the approximate midpoint of the range at \$149,739 as of September 30, 2015. At December 31, 2014, the range of estimated fair market values of the Company's embedded derivatives was between \$167,593 and \$171,215. The Company recorded the fair market value of its embedded derivatives at the midpoint of the range at \$169,386 as of December 31, 2014. The estimated fair market value of the Company's embedded derivatives could change significantly based on future market conditions. (See Note 6.)

(f) Investment in Real Estate Ventures:

The Company's interest in Variable Interest Entities ("VIE") is primarily in the form of equity ownership. The Company examines specific criteria and uses judgment when determining if the Company is the primary beneficiary of a VIE. Factors considered include risk and reward sharing, experience and financial condition of other partner(s), voting rights, involvement in day-to-day capital and operating decisions, representation on a VIE's executive committee, existence of unilateral kick-out rights exclusive of protective rights or voting rights and level of economic disproportionality between the Company and its other partner(s).

Accounting guidance requires the consolidation of VIEs in which the Company is the primary beneficiary. The guidance requires consolidation of VIEs that an enterprise has a controlling financial interest. A controlling financial interest will have both of the following characteristics: (a) the power to direct the activities of a VIE that most significantly impact the VIE's economic performance and (b) the obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant

to the VIE.

The Company's maximum exposure to loss in its investments in unconsolidated VIEs is limited to its investment in the unconsolidated VIEs which is the carrying value. The Company's maximum exposure to loss in its investment in its consolidated VIEs is limited to its investment which is the carrying value of the investment net of the non-controlling interest. Creditors of the consolidated VIEs have no recourse to the general credit of the primary beneficiary.

9

VECTOR GROUP LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)

Unaudited

(g) Other Income, Net:

Other income, net consisted of:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
(Loss) gain on warrants	\$(1,282	) \$991	\$(1,765	) \$868
Interest and dividend income	1,578	1,476	5,185	3,665
Accretion of interest income from debt discount on notes receivable	5	11	79	87
Gain on long-term investment	137	—	361	—
Out-of-period adjustment	—	—	—	1,231
Acceleration of closing fee related to termination of Douglas Elliman joint venture	—	—	—	2,335
Provision for loss on real estate held for sale	(229	) —	(229) —
Loss on sale of assets	(75	) —	(75) —
Other expense	(1	) (12	) (2	) (19
Other income, net	\$133	\$2,466	\$3,554	\$8,167

The out-of-period adjustment related to a non-accrual of a receivable from Douglas Elliman in the fourth quarter of 2013 and would have increased the Company's gain on acquisition of Douglas Elliman in 2013. The Company assessed the materiality of this error on all previously issued financial statements and concluded that the error was immaterial to all previously issued financial statements. The impact of correcting this error in 2014 was not material to the Company's 2014 consolidated financial statements.

(h) Other Current Liabilities:

Other current liabilities consisted of:

	September 30, 2015	December 31, 2014
Accounts payable	\$11,966	\$10,856
Accrued promotional expenses	20,053	20,191
Accrued excise and payroll taxes payable, net	5,034	23,172
Accrued interest	16,121	28,321
Commissions payable	14,942	9,523
Accrued salary and benefits	17,232	16,009
Other current liabilities	26,455	18,683
Total other current liabilities	\$111,803	\$126,755

VECTOR GROUP LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)

Unaudited

(i) Goodwill and Other Intangible Assets:

The components of “Goodwill and other intangible assets, net” were as follows:

	September 30, 2015	December 31, 2014
Goodwill	\$70,791	\$70,791
Indefinite life intangibles:		
Intangible asset associated with benefit under the MSA	107,511	107,511
Trademark - Douglas Elliman	80,000	80,000
Intangibles with a finite life, net	7,178	11,670
Total goodwill and other intangible assets, net	\$265,480	\$269,972

(j) Treasury shares:

On September 4, 2015, the Company canceled all of its 4,145,247 treasury shares with a cost basis of \$12,857. The Company reduced Additional paid-in-capital in the Condensed Statement of Stockholders' Deficiency by its cost basis in the Treasury Stock.

(k) New Accounting Pronouncements:

In September 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard Update (“ASU”) 2015-16, Business Combination (Topic 805): Simplifying the Accounting for Measurement Period Adjustments (“ASU 2015-16”), which requires adjustments to provisional amounts initially recorded in a business combination that are identified during the measurement period to be recognized in the reporting period in which the adjustment amounts are determined. This includes any effect on earnings of changes in depreciation, amortization, or other income effects as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. ASU 2015-15 also requires the disclosure of the nature and amount of measurement-period adjustments recognized in the current period, including separately the amounts in current-period income statement line items that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. The guidance is effective for the Company beginning January 1, 2016. The Company will apply the guidance prospectively for all business combinations that occur subsequent to the adoption date.

In August 2015, FASB issued ASU 2015-15, Interest - Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measure of Debt Issuance Costs Associated with Line-of-Credit Arrangements (Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting), which codifies an Securities and Exchange Commission staff announcement that entities are permitted to defer and present debt issuance costs related to line-of-credit arrangement as assets. Given the absence of authoritative guidance within ASU 2015-03 for debt issuance costs related to line-of-credit arrangements, ASU 2015-15 clarifies that the Securities and Exchange Commission staff would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement,

regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. This guidance is effective immediately and will be applied prospectively to any line-of-credit arrangements entered into subsequent to the effective date.

In April 2015, FASB issued ASU 2015-03, Simplifying the Presentation of Debt Issuance Costs (“ASU 2015-03”), which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected. Upon adoption, the Company will apply the new guidance on a retrospective basis and adjust the balance sheet of each individual period presented to reflect the period-specific effects of applying the new guidance. This guidance

VECTOR GROUP LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)

Unaudited

is effective for the Company beginning January 1, 2016. The Company is evaluating the effect that this guidance will have on its consolidated financial statements.

In February 2015, FASB issued ASU 2015-02, Consolidation: Amendments to the Consolidation Analysis (“ASU 2015-02”). ASU 2015-02 amends the consolidation requirements and significantly changes the consolidation analysis required. ASU 2015-02 requires management to reevaluate all legal entities under a revised consolidation model specifically (1) modify the evaluation of whether limited partnership and similar legal entities are Variable Interest Entities (“VIEs”), (2) eliminate the presumption that a general partner should consolidate a limited partnership, (3) affect the consolidation analysis of reporting entities that are involved with VIEs particularly those that have fee arrangements and related party relationships, and (4) provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Act of 1940 for registered money market funds. The guidance is effective for the Company beginning January 1, 2016. Early adoption is permitted. The Company is evaluating the effect that this guidance will have on its consolidated financial statements.

In May 2014, FASB issued ASU 2014-9, Revenue from Contracts with Customers (Topic 606), (“ASU 2014-9”). ASU 2014-9 outlines a new, single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. Under the new model, recognition of revenue occurs when a customer obtains control of promised goods or services in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, the new standard requires that reporting companies disclose the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. As amended by ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date the new standard is effective for annual reporting periods beginning after December 15, 2018, with early adoption permitted for annual reporting periods beginning subsequent to December 15, 2016. The new standard is required to be applied retrospectively to each prior reporting period presented or with the cumulative effect of initially applying it recognized at the date of initial application. The Company has not yet selected a transition method and it has not determined the impact of the new standard on its consolidated financial statements.

2. INVENTORIES

Inventories consist of:

	September 30, 2015	December 31, 2014
Leaf tobacco	\$50,672	\$49,948
Other raw materials	4,184	3,532
Work-in-process	624	879
Finished goods	66,266	62,876
E-Cigarettes	106	3,079
Inventories at current cost	121,852	120,314
LIFO adjustments	(31,157	) (29,991
	\$90,695	\$90,323

All of the Company's inventories at September 30, 2015 and December 31, 2014 are reported under the LIFO method. The \$31,157 LIFO adjustment as of September 30, 2015 decreases the current cost of inventories by \$20,321 for Leaf tobacco, \$900 for Other raw materials, \$41 for Work-in-Process, \$9,887 for Finished goods and \$8 for E-Cigarettes. The \$29,991 LIFO adjustment as of December 31, 2014 decreased the current cost of inventories by \$19,941 for Leaf tobacco, \$861 for Other raw materials, \$39 for Work-in-Process, \$9,054 for Finished goods and \$96 for E-Cigarettes.

Liggett enters into purchase commitments for leaf tobacco that will be used entirely for future production. The future quantities of leaf tobacco and prices are established at the date of the commitments. At September 30, 2015, Liggett had tobacco purchase commitments of approximately \$14,796. Liggett has a single source supply agreement for fire safe cigarette paper through 2019.

VECTOR GROUP LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)

Unaudited

The Company capitalizes the incremental prepaid cost of the MSA in ending inventory. Each year, the Company capitalizes in inventory that portion of its MSA liability that relates to cigarettes shipped to public warehouses but not sold. The amount of capitalized MSA cost in “Finished goods” inventory was \$15,906 and \$14,369 at September 30, 2015 and December 31, 2014, respectively.

3. INVESTMENT SECURITIES AVAILABLE FOR SALE

The components of investment securities available for sale at September 30, 2015 were as follows:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Marketable equity securities	\$63,524	\$44,623	\$(1,171)	) \$106,976
Mutual funds invested in fixed income securities	54,864	—	—	) 54,864
Marketable debt securities	126,080	456	—	) 126,536
Total investment securities available for sale	\$244,468	\$45,079	\$(1,171)	) \$288,376

The components of investment securities available for sale at December 31, 2014 were as follows:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Marketable equity securities	\$63,041	\$92,255	\$(1,104)	) \$154,192
Mutual funds invested in fixed income securities	61,485	—	(1,659)	) 59,826
Marketable debt securities	130,311	2,630	(916)	) 132,025
Total investment securities available for sale	\$254,837	\$94,885	\$(3,679)	) \$346,043

The table below summarizes the maturity dates of marketable debt securities at September 30, 2015.

Investment Type:	Market Value	Under 1 Year	1 Year up to 5 Years	More than 5 Years
U.S. Government securities	\$35,433	\$—	\$35,433	\$—
Corporate securities	54,741	6,917	47,565	259
U.S. mortgage-backed securities	6,351	1,061	5,132	158
Commercial mortgage-backed securities	14,537	6,632	1,793	6,112
U.S. asset-backed securities	13,360	2,342	10,343	675
Index-linked U.S. bonds	2,114	—	2,114	—
Total marketable debt securities by maturity dates	\$126,536	\$16,952	\$102,380	\$7,204

The available-for-sale investment securities with continuous unrealized losses for less than 12 months and 12 months or greater and their related fair values were as follows:

VECTOR GROUP LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)

Unaudited

	In loss position for Less than 12 months		12 months or more		Total Fair Value	Total Unrealized Losses
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses		
September 30, 2015						
Marketable equity securities	\$9,159	\$(1,171)	\$—	\$—	\$9,159	\$(1,171)
	\$9,159	\$(1,171)	\$—	\$—	\$9,159	\$(1,171)
December 31, 2014						
Marketable equity securities	\$6,599	\$(138)	\$3,534	\$(966)	\$10,133	\$(1,104)
Mutual funds invested in fixed income securities	59,826	(1,659)	—	—	59,826	(1,659)
Marketable debt securities						
U.S. Government securities	22,375	(18)	—	—	22,375	(18)
Corporate securities	30,896	(204)	7,224	(131)	38,120	(335)
U.S. mortgage-backed securities	3,370	(26)	—	—	3,370	(26)
Commercial mortgage-backed securities	11,332	(46)	5,176	(432)	16,508	(478)
U.S. asset-backed securities	15,228	(29)	—	—	15,228	(29)
Index-linked U.S. bonds	2,098	(30)	—	—	2,098	(30)
	\$151,724	\$(2,150)	\$15,934	\$(1,529)	\$167,658	\$(3,679)

Unrealized losses from fixed-income securities are primarily attributable to changes in interest rates. Unrealized losses from equity and debt securities are due to market price movements. The Company believes the unrealized losses associated with the Company's equity securities will be recovered in the future.

Gross realized gains and losses on available-for-sale investment securities were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Gross realized gains on sales	\$129	\$100	\$13,601	\$151
Gross realized losses on sales	(950)	(67)	(1,583)	(189)
(Loss) gain on sale of investment securities available for sale	\$(821)	\$33	\$12,018	\$(38)
Gross realized losses on other-than-temporary impairments	\$(12,211)	\$—	\$(12,211)	\$—

The Company recorded an “Other-than-temporary-impairment” charge of \$12,211 during the three and nine months ended September 30, 2015. The largest component of this charge was \$6,895 related to Morgans Hotel Group Co., a company where Vector's President and Chief Executive Officer also serves as Chairman of the Board of Directors.

Although management generally does not have the intent to sell any specific securities at the end of the period, in the ordinary course of managing the Company's investment securities portfolio, management may sell securities prior to their maturities for a variety of reasons, including diversification, credit quality, yield and liquidity requirements and the funding of claims and obligations to policyholders.

VECTOR GROUP LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)

Unaudited

Proceeds from investment securities sales totaled \$42,768 and \$124,342 and proceeds from early redemptions by issuers totaled \$3,130 and \$615 in the three months ended September 30, 2015 and 2014, respectively, mainly from sales of Corporate securities and U.S. Government securities.

Proceeds from investment securities sales totaled \$161,029 and \$173,046 and proceeds from early redemptions by issuers totaled \$8,397 and \$1,207 in the nine months ended September 30, 2015 and 2014, respectively, mainly from sales of Corporate securities and U.S. Government securities.

4. LONG-TERM INVESTMENTS

Long-term investments consisted of the following:

	September 30, 2015	December 31, 2014
Investments accounted at cost	\$42,056	\$32,239
Investments accounted under the equity method	11,592	8,053
	\$53,648	\$40,292

Long-term investments accounted for at cost are summarized as follows:

	September 30, 2015		December 31, 2014	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Long-term investments	\$41,541	\$46,435	\$31,541	\$38,039
Real estate partnership	515	587	698	1,108
	\$42,056	\$47,022	\$32,239	\$39,147

The Company accounts for investments which it has significant influence under the equity method. The Company recorded an equity loss of \$579 and equity income of \$829 for the three months ended September 30, 2015 and September 30, 2014, respectively. The Company recorded an equity loss of \$2,273 and equity income of \$1,462 for the nine months ended September 30, 2015 and September 30, 2014, respectively. The fair value of the investments in investment companies accounted for under the equity method was approximately \$11,592 and \$8,053 as of September 30, 2015 and December 31, 2014.

The Company's investments under the equity method contains an investment in the common stock of Boyar Value Fund ("Boyar"). As of September 30, 2015, the Company owned approximately 30% of the outstanding stock of Boyar. The carrying value of the investment based on the quoted market price as of September 30, 2015 was \$6,984. Ladenburg Thalmann Fund Management, LLC, an indirect subsidiary of Ladenburg Thalmann Financial Services Inc. is the manager of Boyar.

5. NEW VALLEY LLC

Residential Brokerage Business Acquisition. New Valley is engaged in the real estate business and is seeking to acquire additional real estate properties and operating companies. The Company owns a 70.59% interest in Douglas Elliman and the condensed consolidated financial statements of the Company include the account balances of Douglas Elliman.

Investments in real estate ventures. New Valley also holds equity investments in various real estate projects domestically and internationally. The components of “Investments in real estate ventures” were as follows:

15

VECTOR GROUP LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)

Unaudited

	September 30, 2015	December 31, 2014
Milanosesto Holdings (Sesto Holdings)	\$5,037	\$5,037
Land Development	5,037	5,037
10 Madison Square Park West (1107 Broadway)	9,522	6,383
The Marquand	13,900	12,000
11 Beach Street	11,928	12,328
20 Times Square (701 Seventh Avenue)	13,095	12,481
111 Murray Street	16,114	27,319
357 West (160 Leroy Street)	1,950	1,467
PUBLIC Chrystie House (Chrystie Street)	5,297	3,300
The Dutch (25-19 43rd Avenue)	980	733
Queens Plaza (23-10 Queens Plaza South)	14,732	11,082
87 Park (8701 Collins Avenue)	5,654	6,144
125 Greenwich Street	11,193	9,308
West Hollywood Edition (9040 Sunset Boulevard)	5,604	5,604
76 Eleventh Avenue	17,000	—
Monad Terrace	6,438	—
Condominium and Mixed Use Development	133,407	108,149
Maryland Portfolio	1,377	3,234
ST Portfolio	16,881	15,283
Apartment Buildings	18,258	18,517
Park Lane Hotel	19,373	19,341
Hotel Taiwana	7,337	7,629
Coral Beach and Tennis Club	3,023	2,816
Hotels	29,733	29,786
The Plaza at Harmon Meadow	5,638	