VECTOR GROUP LTD
Form 10-Q
August 01, 2013

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 June 30, 2013

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

Delaware	1-5759	65-0949535
(State or other jurisdiction of incorporation incorporation or organization)	Commission File Number	(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)

100 S.E. Second Street
Miami, Florida 33131
(Former address, if changed since last report)

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.
x Yes o 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).
x Yes o 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.

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

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

At July 31, 2013, Vector Group Ltd. had 89,983,587 shares of common stock outstanding.

VECTOR GROUP LTD.

FORM 10-Q

TABLE OF CONTENTS

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

	June 30, 2013	December 31, 2012
ASSETS:		
Current assets:		
Cash and cash equivalents	$281,713	$405,855
Investment securities available for sale	134,141	69,984
Accounts receivable - trade, net	12,495	11,247
Inventories	96,761	100,392
Deferred income taxes	32,017	36,609
Income taxes receivable, net	16,631	6,779
Restricted assets	1,241	2,469
Other current assets	5,220	5,721
Total current assets	580,219	639,056
Property, plant and equipment, net	58,067	57,153
Investment in consolidated real estate businesses, net	23,200	13,295
Long-term investments accounted for at cost	21,292	16,367
Long-term investments accounted for under the equity method	6,671	6,432
Investments in non-consolidated real estate businesses	142,878	119,219
Restricted assets	12,288	9,792
Deferred income taxes	54,140	49,142
Intangible asset	107,511	107,511
Prepaid pension costs	13,787	12,870
Other assets	49,490	55,894
Total assets	$1,069,543	$1,086,731
LIABILITIES AND STOCKHOLDERS' DEFICIENCY:		
Current liabilities:		
Current portion of notes payable and long-term debt	$33,906	$36,778
Current payments due under the Master Settlement Agreement	59,685	32,970
Current portion of employee benefits	2,824	2,824
Accounts payable	5,920	6,099
Accrued promotional expenses	17,618	18,730
Income taxes payable	6,423	6,269
Accrued excise and payroll taxes payable, net	1,208	20,419
Litigation accruals	281	1,470
Deferred income taxes	32,030	27,299
Accrued interest	22,398	25,410
Other current liabilities	13,080	16,891
Total current liabilities	195,373	195,159
Notes payable, long-term debt and other obligations, less current portion	638,352	586,946
Fair value of derivatives embedded within convertible debt	166,629	172,128
Non-current employee benefits	46,377	45,860
Deferred income taxes	112,444	109,532
Payments due under the Master Settlement Agreement	35,630	52,639
Litigation accruals	1,738	1,862
Other liabilities	2,502	1,857
Total liabilities	1,199,045	1,165,983

Commitments and contingencies		
Stockholders' deficiency:		
Preferred stock, par value $1.00 per share, 10,000,000 shares authorized	—	—
Common stock, par value $0.10 per share, 150,000,000 shares authorized, 93,708,273 and 93,658,273 shares issued and 89,948,411 and 89,898,411 shares outstanding	8,994	8,989
Additional paid-in capital	—	—
Accumulated deficit	(123,554)	(65,116)
Accumulated other comprehensive loss	(3,232)	(10,268)
Less: 3,759,862 shares of common stock in treasury, at cost	(12,857)	(12,857)
Total Vector Group Ltd. stockholders' deficiency	(130,649)	(79,252)
Non-controlling interest	1,147	—
Total stockholders' deficiency	(129,502)	(79,252)
Total liabilities and stockholders' deficiency	$1,069,543	$1,086,731

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 June 30, 2013	2012	Six Months Ended June 30, 2013	2012
Revenues*	$249,120	$276,594	$489,522	$534,200
Expenses:				
Cost of goods sold*	180,430	211,752	353,386	411,933
Operating, selling, administrative and general expenses	24,450	23,914	48,800	47,893
Operating income	44,240	40,928	87,336	74,374
Other income (expenses):				
Interest expense	(32,086)	(26,509)	(65,462)	(52,761)
Loss on extinguishment of debt	—	—	(21,458)	—
Change in fair value of derivatives embedded within convertible debt	2,450	(6,003)	5,499	(27,060)
Acceleration of interest expense related to debt conversion	—	(7,888)	—	(7,888)
Equity income from non-consolidated real estate businesses	6,804	5,232	7,285	8,095
Equity income (loss) on long-term investments	846	(1,215)	823	(1,329)
(Loss) gain on sale of investment securities available for sale	(197)	—	5,209	—
Other, net	1,471	583	2,280	515
Income (loss) before provision for income taxes	23,528	5,128	21,512	(6,054)
Income tax expense (benefit)	10,017	1,233	9,682	(2,259)
Net income (loss)	13,511	3,895	11,830	(3,795)
Net income (loss) attributed to non-controlling interest	—	—	—	—
Net income (loss) attributed to Vector Group Ltd.	$13,511	$3,895	$11,830	$(3,795)
Per basic common share:				
Net income (loss) applicable to common shares attributed to Vector Group Ltd.	$0.15	$0.05	$0.13	$(0.05)
Per diluted common share:				
Net income (loss) applicable to common shares attributed to Vector Group Ltd.	$0.15	$0.05	$0.13	$(0.05)

Cash distributions and dividends declared per share	$0.40	$0.38	$0.80	$0.76

* Revenues and Cost of goods sold include excise taxes of $112,596, $130,967, $221,507 and $252,892, 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 INCOME
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net income (loss)	$13,511	$3,895	$11,830	$(3,795)
Net unrealized gains (losses) on investment securities available for sale:				
Change in net unrealized gains (losses)	2,866	(3,025)	16,904	(14,269)
Net unrealized losses (gains) reclassified into net income	197	—	(5,209)	—
Net unrealized gains (losses) on investment securities available for sale	3,063	(3,025)	11,695	(14,269)
Net unrealized gains on long-term investments accounted for under the equity method:				
Change in net unrealized (losses) gains	(1,542)	(2,505)	(584)	542
Net unrealized gains reclassified into net income	—	—	—	—
Net unrealized (losses) gains on long-term investments accounted for under the equity method	(1,542)	(2,505)	(584)	542
Net change in forward contracts	16	17	31	32
Net change in pension-related amounts	351	871	702	1,741
Other comprehensive income (loss)	1,888	(4,642)	11,844	(11,954)
Income tax effect on:				
Change in net unrealized gains (losses) on investment securities	(1,163)	1,228	(6,863)	5,793
Net unrealized losses (gains) reclassified into net income on investment securities	(80)	—	2,115	—
Change in unrealized (losses) gains on long-term investments	626	1,017	237	(220)
Net unrealized gains reclassified into net income on long-term investments	—	—	—	—
Forward contracts	(6)	(7)	(12)	(13)
Pension-related amounts	(143)	(354)	(285)	(707)
Income tax (provision) benefit on other comprehensive income (loss)	(766)	1,884	(4,808)	4,853
Other comprehensive income (loss), net of tax	1,122	(2,758)	7,036	(7,101)

Comprehensive income (loss)	14,633	1,137	18,866	(10,896)
Less: Comprehensive income attributed to non-controlling interest	—	—	—	—
Comprehensive income (loss) attributed to Vector Group Ltd.	$14,633	$1,137	$18,866	$(10,896)

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

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

	Vector Group Ltd. Deficiency							
	Common Stock		Additional Paid-In	Accumulated	Accumulated Other Comprehensive	Treasury	Non-controlling	
	Shares	Amount	Capital	Deficit	(Loss) Income	Stock	Interest	Total
Balance, December 31, 2012	89,898,411	$8,989	$ —	$ (65,116)	$ (10,268)	$(12,857)	$ —	$(79,252)
Net income	—	—	—	11,830	—	—	—	11,830
Change in net loss and prior service cost, net of income taxes	—	—	—	—	417	—	—	417
Forward contract adjustments, net of income taxes	—	—	—	—	19	—	—	19
Unrealized loss on long-term investment securities accounted for under the equity method, net of income taxes	—	—	—	—	(347)	—	—	(347)
Change in net unrealized gain on investment securities, net of income taxes	—	—	—	—	10,041	—	—	10,041
Net unrealized gains reclassified into net income, net of income taxes	—	—	—	—	(3,094)	—	—	(3,094)
Unrealized gain on investment securities, net of income taxes	—	—	—	—	—	—	—	6,947
Total other comprehensive income	—	—	—	—	—	—	—	7,036
Total comprehensive income	—	—	—	—	—	—	—	18,866
Distributions and dividends on common stock	—	—	(1,250)	(70,268)	—	—	—	(71,518)
Restricted stock grant	50,000	5	(5)	—	—	—	—	—
Stock-based compensation	—	—	1,255	—	—	—	—	1,255
	—	—	—	—	—	—	1,914	1,914

Contributions to non-controlling interest								
Distributions to non-controlling interest	—	—	—	—	—	—	(767)	(767)
Balance as of June 30, 2013	89,948,411	$ 8,994	$ —	$ (123,554)	$ (3,232)	$ (12,857)	$ 1,147	$ (129,502)

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

	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Net cash provided by operating activities	$5,190	$57,829
Cash flows from investing activities:		
Sale of investment securities	43,115	—
Purchase of investment securities	(90,368)	(1,148)
Proceeds from sale or liquidation of long-term investments	75	72
Purchase of long-term investments	(5,000)	(5,000)
Investments in non-consolidated real estate businesses	(19,048)	(9,667)
Investments in consolidated real estate businesses	(7,657)	—
Distributions from non-consolidated real estate businesses	—	6,221
Increase in cash surrender value of life insurance policies	(303)	(620)
Increase in restricted assets	(1,268)	(53)
Issuance of notes receivable	—	(234)
Proceeds from sale of fixed assets	13	404
Capital expenditures	(5,995)	(7,394)
Repayments of notes receivable	8,433	—
Net cash used in investing activities	(78,003)	(17,419)
Cash flows from financing activities:		
Proceeds from debt issuance	453,080	14,018
Deferred financing costs	(11,663)	(315)
Repayments of debt	(418,833)	(13,493)
Borrowings under revolver	474,493	525,350
Repayments on revolver	(476,888)	(532,082)
Dividends and distributions on common stock	(71,518)	(66,112)
Proceeds from exercise of employee stock options	—	45
Tax benefit of employee stock options exercised	—	4
Net cash used in financing activities	(51,329)	(72,585)
Net decrease in cash and cash equivalents	(124,142)	(32,175)
Cash and cash equivalents, beginning of period	405,855	240,923
Cash and cash equivalents, end of period	$281,713	$208,748

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

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(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”), New Valley LLC (“New Valley”) 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. New Valley is engaged in the real estate business and is seeking to acquire additional operating companies and real estate properties.

The accompanying 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 and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 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.

Certain reclassifications have been made to the 2012 financial information to conform to the 2013 presentation.

(b) Distributions and Dividends on Common Stock:

The Company records distributions on its common stock as dividends in its condensed consolidated statement of stockholders' equity 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) 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 28, 2012. All per share amounts and references to share amounts have been updated to reflect the retrospective effect of the stock dividends.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net income (loss) attributed to Vector Group Ltd.	$13,511	$3,895	$11,830	$(3,795)

Income attributed to participating securities	(374)	(79)	(328)	—
Net income (loss) available to common stockholders	$13,137	$3,816	$11,502	$(3,795)

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

Basic and diluted EPS were calculated using the following shares:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Weighted-average shares for basic EPS	86,826,428	83,345,002	86,824,463	83,179,283
Plus incremental shares related to stock options and non-vested restricted stock	206,562	203,118	195,925	—
Weighted-average shares for basic and fully diluted EPS	87,032,990	83,548,120	87,020,388	83,179,283

The following stock options, non-vested restricted stock and shares issuable upon the conversion of convertible debt were outstanding during the three and six months ended June 30, 2013 and 2012 but were not included in the computation of diluted EPS because the effect was anti-dilutive.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Number of stock options	N/A	N/A	N/A	2,299,640
Weighted-average exercise price	N/A	N/A	N/A	$13.09
Weighted-average shares of non-vested restricted stock	53,500	3,500	53,500	383,587
Weighted-average expense per share	16.36	$17.12	$16.36	$10.86
Weighted-average number of shares issuable upon conversion of debt	26,962,402	17,854,218	26,962,402	18,017,309
Weighted-average conversion price	$15.98	$14.09	$15.98	$14.10

(d) 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; thus, 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. The range of estimated fair market values of the Company's embedded derivatives was between $163,949 and $169,391. The Company recorded the fair market value of its embedded derivatives at the midpoint of the inputs at $166,629 as of June 30, 2013. At December 31, 2012, the range of estimated fair market values of the Company's embedded derivatives was between $169,424 and $174,909. The Company recorded the fair market value of its embedded derivatives at the midpoint of the inputs at $172,128 as of December 31, 2012. The estimated fair market value of the Company's embedded derivatives could change significantly based on future market conditions. (See Note 5.)

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

(e) Other Income, Net:

Other income, net consists of:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
(Loss) gain on warrants	$(28)	$(210)	$37	$(853)
Interest income	826	499	1,476	1,041
Accretion of interest income of debt discount on notes receivable	588	32	623	63
Gain on long-term investment	142	135	142	135
Other (loss) income	(57)	127	2	129
Other income, net	$1,471	$583	$2,280	$515

(f) New Accounting Pronouncements:

In July 2012, the FASB issued amendments to the indefinite-lived intangible asset impairment guidance which provides an option for companies to use a qualitative approach to test indefinite-lived intangible assets for impairment if certain conditions are met. The amendments are effective for annual and interim indefinite-lived intangible asset impairment tests performed for fiscal years beginning after September 15, 2012 (early adoption was permitted). The implementation of the amended accounting guidance is not expected to have a material impact on the Company's consolidated financial statements.

In February 2013, the FASB issued amendments to the accounting guidance for presentation of comprehensive income to improve the reporting of reclassifications out of accumulated other comprehensive income. The amendments do not change the current requirements for reporting net income or other comprehensive income, but do require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where the net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under GAAP that provide additional detail about these amounts. For public companies, these amendments are effective prospectively for reporting periods beginning after December 15, 2012. The implementation of the amended accounting guidance did not have a material impact on the Company's consolidated financial statements.

2. INVENTORIES

Inventories consist of:

	June 30, 2013	December 31, 2012
Leaf tobacco	$48,425	$59,130
Other raw materials	4,534	3,151
Work-in-process	396	210
Finished goods	68,916	64,396
Inventories at current cost	122,271	126,887
LIFO adjustments	(25,510)	(26,495)
	$96,761	$100,392

9

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

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 commitment date. At June 30, 2013, Liggett had tobacco purchase commitments of approximately $35,255.

All of the Company's inventories at June 30, 2013 and December 31, 2012 have been reported under the LIFO method.

3. INVESTMENT SECURITIES AVAILABLE FOR SALE

The components of investment securities available for sale at June 30, 2013 were as follows:

	Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Equity securities	$52,921	$34,700	$(930)	$86,691
Fixed income securities	47,638	350	(538)	47,450
Total investment securities available for sale	$100,559	$35,050	$(1,468)	$134,141

The table below summarizes the maturity dates of fixed income securities at June 30, 2013.

Fixed Interest by Maturity:	Cost	Fair Value
Under 1 Year	$497	$496
1 Year up to 5 Years	33,760	33,394
5 Year up to 10 Years	1,535	1,514
More than 10 Years	11,846	12,046
Total	$47,638	$47,450

4. LONG-TERM INVESTMENTS

Long-term investments accounted for at cost:

	June 30, 2013		December 31, 2012	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Investment partnerships	$20,540	$22,648	$15,540	$16,962
Real estate partnership	752	1,142	827	1,391
Investments accounted for at cost	$21,292	$23,790	$16,367	$18,353

Long-term investment partnership accounted for under the equity method:

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

	June 30, 2013	December 31, 2012
Investment partnership	$6,671	$6,432

The Company recorded equity income of $846 and $823 for the three and six months ended June 30, 2013, respectively, related to the limited partnership. The Company recorded an equity loss of $1,215 and $1,329 for the three and six months ended June 30, 2012, respectively, related to the limited partnership.

The carrying value of the investment was approximately $6,671 and $6,432 as of June 30, 2013 and December 31, 2012, respectively, which approximated the investment's fair value.

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

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

	June 30, 2013	December 31, 2012
Vector:		
7.75% Senior Secured Notes due 2021	$450,000	$—
11% Senior Secured Notes due 2015, net of unamortized discount of $0 and $408	—	414,592
6.75% Variable Interest Senior Convertible Note due 2014, net of unamortized discount of $25,883 and $30,383*	24,117	19,617
6.75% Variable Interest Senior Convertible Exchange Notes due 2014, net of unamortized discount of $36,646 and $45,038*	70,884	62,492
3.875% Variable Interest Senior Convertible Debentures due 2026, net of unamortized discount of $35,998 and $36,107*	7,224	7,115
7.5% Variable Interest Senior Convertible Notes due 2019, net of unamortized discount of $159,009 and $161,795*	70,991	68,205
Liggett:		
Revolving credit facility	27,034	29,430
Term loan under credit facility	4,032	4,179
Equipment loans	14,211	17,810
Other	3,765	284
Total notes payable, long-term debt and other obligations	672,258	623,724
Less:		
Current maturities	(33,906)	(36,778)
Amount due after one year	$638,352	$586,946

* The fair value of the derivatives embedded within the 6.75% Variable Interest Senior Convertible Note ($9,007 at June 30, 2013 and $11,682 at December 31, 2012, respectively), the 6.75% Variable Interest Senior Convertible Exchange Notes ($17,075 at June 30, 2013 and $22,146 at December 31, 2012, respectively), the 3.875% Variable Interest Senior Convertible Debentures ($42,985 at June 30, 2013 and $39,714 at December 31, 2012, respectively), and the 7.50% Variable Interest Senior Convertible Debentures ($97,562 at June 30, 2013 and $98,586 at

December 31, 2012, respectively), is separately classified as a derivative liability in the condensed consolidated balance sheets.

Credit Facility - Liggett:

In February 2012, Liggett and Wells Fargo Bank, National Association ("Wells Fargo") renewed the $50,000 credit facility (the "Credit Facility"). The Credit Facility is collateralized by all inventories and receivables of Liggett and a mortgage on its manufacturing facility. The Credit Facility expires on March 8, 2015; provided that Liggett may terminate the Credit Facility prior to March 8, 2015 at any time by giving at least 30 days prior written notice to Wells Fargo, and Wells Fargo

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

may, at Well Fargo's option, terminate the Credit Facility at any time upon the occurrence and during the continuance of an Event of Default.

Prime rate loans under the Credit Facility bear interest at a rate equal to the prime rate of Wells Fargo and Eurodollar rate loans bear interest at a rate equal to 2.0% more than Wells Fargo's adjusted Eurodollar rate. The Credit Facility contains covenants that provide that Liggett's earnings before interest, taxes, depreciation and amortization, as defined under the Credit Facility, on a trailing twelve month basis, shall not be less than $100,000 if Liggett's Excess Availability, as defined under the Credit Facility, is less than $20,000. The covenants also require that annual Capital Expenditures, as defined under the Credit Facility (before a maximum carryover amount of $2,500), shall not exceed $15,000 during any fiscal year.

Term Loan under Credit Facility - Liggett:

In February 2012, Wells Fargo amended and restated the existing $5,600 term loan (the “Term Loan”) made to 100 Maple LLC (“Maple”), a subsidiary of Liggett, within the commitment under the Credit Facility. In connection with the amendment and restatement the maturity date of the Term Loan was extended to March 1, 2015 and the outstanding principal amount was paid down to $4,425. The Term Loan bears an interest rate equal to 1.75% more than Wells Fargo's adjusted Eurodollar rate. Monthly payments of $25 are due under the Term Loan from March 1, 2012 to February 1, 2015 ($885 in total) with the balance of $3,540 due at maturity on March 1, 2015.

The Term Loan is collateralized by the existing collateral securing the Credit Facility, including, without limitation, certain real property owned by Maple. The Term Loan did not increase the $50,000 borrowing amount of the Credit Facility, but did increase the outstanding amounts under the Credit Facility by the amount of the term loan and proportionately reduces the maximum borrowing availability under the Credit Facility.

As of June 30, 2013, a total of $31,066 was outstanding under the revolving and term loan portions of the credit facility. Availability as determined under the facility was approximately $18,934 based on eligible collateral at June 30, 2013.

7.75% Senior Secured Notes due 2021 - Vector:

In February 2013, the Company issued $450,000 of its 7.75% Senior Secured Notes due 2021 in a private offering to qualified institutional investors in accordance with Rule 144A of the Securities Act of 1933. The aggregate net proceeds from the issuance of the 7.75% Senior Secured Notes were approximately $438,250 after deducting offering expenses. The Company used the net proceeds of the issuance for a cash tender offer announced on January 29, 2013, with respect to any and all of its outstanding 11% Senior Secured Notes due 2015. The Company retired $336,315 of the 11% Senior Secured Notes at a premium of 104.292%, plus accrued and unpaid interest on February 12, 2013. The remaining $78,685 of the 11% Senior Secured Notes were called and retired on March 14, 2013 at a redemption price of 103.667% plus accrued and unpaid interest.

The 7.75% Senior Secured Notes pay interest on a semi-annual basis at a rate of 7.75% per year and mature on February 15, 2021. The Company may redeem some or all of the 7.75% Senior Secured Notes at any time prior to February 15, 2016 at a make-whole redemption price. On or after February 15, 2016 the Company may redeem some or all of the 7.75% Senior Secured Notes at a premium that will decrease over time, plus accrued and unpaid interest and liquidated damages, if any, to the redemption date. At any time prior to February 15, 2016, the Company may on any one or more occasions redeem up to 35% of the aggregate principal amount of the 7.75% Senior Secured Notes with the net proceeds of certain equity offerings at 107.75% of the aggregate principal amount thereof, plus accrued and unpaid interest and liquidated damages, if any, to the redemption date. In the event of a change of control, as defined in the indenture governing the 7.75% Senior Secured Notes, each holder of the 7.75% Senior Secured Notes may require the Company to repurchase some or all of its 7.75% Senior Secured Notes at a repurchase price equal to 101% of their aggregate principal amount plus accrued and unpaid interest and liquidated damages, if any to the date of purchase.

The 7.75% Senior Secured Notes are guaranteed subject to certain customary automatic release provisions on a joint and several basis by all of the 100% owned domestic subsidiaries of the Company that are engaged in the conduct of the Company's cigarette businesses. (See Note 12.) In addition, some of the guarantees are collateralized by second priority or first priority security interests in certain collateral of some of the subsidiary guarantors, including their common stock, pursuant to security and pledge agreements.

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

In connection with the issuance of the 7.75% Senior Secured Notes, the Company entered into a Registration Rights Agreement. The Company agreed to consummate a registered exchange offer for the 7.75% Senior Secured Notes within 360 days after the date of the initial issuance of the 7.75% Senior Secured Notes. In June 2013, the Company completed an offer to exchange the 7.75% Senior Secured Notes issued in February 2013 for an equal amount of newly issued 7.75% Senior Secured Notes due 2021. The new 7.75% Senior Secured Notes have substantially the same terms as the original notes, except that the new 7.75% Senior Secured Notes have been registered under the Securities Act.
The indenture contains covenants that restrict the payment of dividends by the Company if the Company's consolidated earnings before interest, taxes, depreciation and amortization, as defined in the indenture, for the most recently ended four full quarters is less than $75,000. The indenture also restricts the incurrence of debt if the Company's Leverage Ratio and its Secured Leverage Ratio, as defined in the indenture, exceed 3.0 and 1.5, respectively. The Company's Leverage Ratio is defined in the indenture as the ratio of the Company's and the guaranteeing subsidiaries' total debt less the fair market value of the Company's cash, investments in marketable securities and long-term investments to Consolidated EBITDA, as defined in the indenture. The Company's Secured Leverage Ratio is defined in the indenture in the same manner as the Leverage Ratio, except that secured indebtedness is substituted for indebtedness.

11% Senior Secured Notes due 2015 - Vector:

On January 29, 2013, the Company announced a cash tender offer with respect to any and all of its outstanding $415,000 principal amount of its 11% Senior Secured Notes due 2015. The Company retired $336,315 of the 11% Senior Secured Notes at a premium of 104.292%, plus accrued and unpaid interest on February 12, 2013. The remaining $78,685 of the 11% Senior Secured Notes were called and retired on March 14, 2013 at a redemption price of 103.667% plus accrued and unpaid interest. The Company recorded a loss on the extinguishment of the debt of $21,458 for the six months ended June 30, 2013. The loss included premium and tender costs of $17,820 and non-cash interest expense of $3,638 related to the write-off of net unamortized debt discount and deferred finance costs.

3.875% Variable Interest Senior Convertible Debentures due 2026 - Vector:

Holders of the Debentures converted $2 principal amount of the Debentures into 131 shares of the Company's common stock in February 2012 and $31,370 principal amount into 2,053,065 shares of common stock in June 2012. The Company recorded non-cash accelerated interest expense related to the converted debt of $7,888 for the three and six months ended June 30, 2012. The debt conversion resulted in a reclassification from debt to equity in the amount of $31,372. As of June 30, 2012, the principal amount of the Debentures outstanding was $67,628.

The holders of the Debentures had the option to put all of the remaining senior convertible notes on June 15, 2012. None of the Debentures were surrendered for repurchase by the Company. The holders of the Debentures next have the option to put all or part of the remaining Debentures to the Company on June 15, 2016. Accordingly, the Company reclassified the Debentures and related fair value of derivatives embedded within convertible debt from current liabilities to long-term liabilities.

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

Non-cash Interest Expense - Vector:

Components of non-cash interest expense are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Amortization of debt discount	$8,464	$4,004	$15,812	$7,441
Amortization of deferred finance costs	447	751	1,044	1,461
Loss on extinguishment of 11% Senior Secured Notes	—	—	3,638	—
Accelerated interest expense on 3.875% Variable Interest Senior Convertible Debentures converted	—	7,888	—	7,888
	$8,911	$12,643	$20,494	$16,790

Fair Value of Notes Payable and Long-term Debt:

	June 30, 2013		December 31, 2012	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Notes payable and long-term debt	$672,258	$1,030,462	$623,724	$963,672

Notes payable and long-term debt are carried on the condensed balance sheet at amortized cost. The fair value determination disclosed above would be classified as Level 2 under the fair value hierarchy disclosed in Note 9 if such liabilities were recorded on the condensed balance sheet at fair value. The estimated fair value of the Company's notes payable and long-term debt has been determined by the Company using available market information and appropriate valuation methodologies including the evaluation of the Company's credit risk as described in Note 1. However, considerable judgment is required to develop the estimates of fair value and, accordingly, the estimate presented herein are not necessarily indicative of the amount that could be realized in a current market exchange.

6. CONTINGENCIES

Tobacco-Related Litigation:

Overview
Since 1954, Liggett and other United States cigarette manufacturers have been named as defendants in numerous direct, third-party and purported class actions predicated on the theory that cigarette manufacturers should be liable for damages alleged to have been caused by cigarette smoking or by exposure to secondary smoke from cigarettes. New cases continue to be commenced against Liggett and other cigarette manufacturers. The cases have generally fallen into the following categories: (i) smoking and health cases alleging personal injury brought on behalf of individual plaintiffs (“Individual Actions”); (ii) lawsuits by individuals requesting the benefit of the Engle ruling ("Engle progeny cases"); (iii) smoking and health cases primarily alleging personal injury or seeking court-supervised programs for ongoing medical monitoring, as well as cases alleging the use of the terms “lights” and/or “ultra lights” constitutes a

deceptive and unfair trade practice, common law fraud or violation of federal law, purporting to be brought on behalf of a class of individual plaintiffs (“Class Actions”); and (iv) health care cost recovery actions brought by various foreign and domestic governmental plaintiffs and non-governmental plaintiffs seeking reimbursement for health care expenditures allegedly caused by cigarette smoking and/or disgorgement of profits (“Health Care Cost Recovery Actions”). As new cases are commenced, the costs associated with defending these cases and the risks relating to the inherent unpredictability of litigation continue to increase. The future financial impact of the risks and expenses of litigation are not quantifiable at this time. For the six months ended June 30,

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

2013 and 2012, Liggett incurred legal expenses and other litigation costs totaling approximately $3,562 and $4,030, respectively.

Litigation is subject to uncertainty and it is possible that there could be adverse developments in pending or future cases. Management reviews on a quarterly basis with counsel all pending litigation and evaluates whether an estimate can be made of the possible loss or range of loss that could result from an unfavorable outcome. An unfavorable outcome or settlement of pending tobacco-related or other litigation could encourage the commencement of additional litigation. Damages awarded in some tobacco-related litigation can be significant.

Bonds. Although Liggett has been able to obtain required bonds or relief from bonding requirements in order to prevent plaintiffs from seeking to collect judgments while adverse verdicts are on appeal, there remains a risk that such relief may not be obtainable in all cases. This risk has been reduced given that a majority of states now limit the dollar amount of bonds or require no bond at all. To obtain stays on judgments pending current appeals, Liggett has secured approximately $7,577 in bonds as of June 30, 2013.

In June 2009, Florida amended its existing bond cap statute by adding a $200,000 bond cap that applies to all Engle progeny cases in the aggregate and establishes individual bond caps for individual Engle progeny cases in amounts that vary depending on the number of judgments in effect at a given time. Plaintiffs, in several cases, have challenged the constitutionality of the bond cap statute, but to date, the courts that have addressed the issue have upheld the constitutionality of the statute. The plaintiffs have appealed some of these rulings and the Florida Supreme Court, after granting review of the Hall decision denying plaintiff's challenge to the bond cap statute, subsequently dismissed the matter prior to the scheduled argument as moot. No federal court has yet addressed the issue. Although the Company cannot predict the outcome of such challenges, it is possible that the Company's consolidated financial position, results of operations, and cash flows could be materially affected by an unfavorable outcome of such challenges.

Accounting Policy. The Company and its subsidiaries record provisions in their consolidated financial statements for pending litigation when they determine that an unfavorable outcome is probable and the amount of loss can be reasonably estimated. At the present time, while it is reasonably possible that an unfavorable outcome in a case may occur, except as disclosed in this Note 6: (i) management has concluded that it is not probable that a loss has been incurred in any of the pending tobacco-related cases; or (ii) management is unable to estimate the possible loss or range of loss that could result from an unfavorable outcome of any of the pending tobacco-related cases and, therefore, management has not provided any amounts in the consolidated financial statements for unfavorable outcomes, if any. Legal defense costs are expensed as incurred.

Cautionary Statement About Engle Progeny Cases. Judgments have been entered against Liggett and other industry defendants in Engle progeny cases. Several of the judgments have been affirmed on appeal. To date, the United States Supreme Court has declined to review these cases. At June 30, 2013, Liggett and the Company were defendants in 3,043 state and 1,257 federal Engle progeny cases. As of June 30, 2013, 14 Engle progeny cases where Liggett was a defendant at trial resulted in verdicts, exclusive of the Lukacs case, discussed below. Thirteen of these cases were in state court and one was in federal court. Nine verdicts were returned in favor of the plaintiffs and five in favor of Liggett. Other cases have either been voluntarily dismissed by plaintiffs, dismissed by the court on summary judgment or a mistrial was declared. Excluding the Lukacs case, the compensatory verdicts against Liggett have ranged from $1 to $3,008. In certain cases, the judgments entered have been joint and several with other defendants. In two of the cases, punitive damages were awarded against Liggett for $1,000 and $7,600. After exhausting all appeals, Liggett paid the judgments and related costs and interest in the Campbell and Clay cases. Since February 2009, when Engle progeny trials commenced, 85 state cases and 13 federal cases have been tried to a verdict. Based on the current rate of trials per year, it would require decades to resolve the remaining cases. Except as discussed in this Note 6, with respect to the seven cases where an adverse verdict was entered against Liggett and which are currently on appeal, management is unable to estimate the possible loss or range of loss from the remaining Engle progeny cases as there are currently multiple defendants in each case and, in most cases, discovery has not occurred or is limited. As a result, the Company lacks information about whether plaintiffs are in fact Engle class members (non-class members' claims are generally time-barred), the relevant smoking history, the nature of the alleged injury and the availability of various defenses, among other things. Further, plaintiffs typically do not specify their demand for damages. The Company believes that the process under which Engle progeny cases are tried is unconstitutional and continues to pursue its appellate rights.

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

Although Liggett has generally been successful in managing litigation, litigation is subject to uncertainty and significant challenges remain, particularly with respect to the Engle progeny cases. There can be no assurances that Liggett's past litigation experience will be representative of future results. Judgments have been entered against Liggett in the past, in Individual Actions and Engle progeny cases, and several of those judgments were affirmed on appeal and satisfied by Liggett. Litigation is subject to many uncertainties. It is possible that the consolidated financial position, results of operations and cash flows of the Company could be materially adversely affected by an unfavorable outcome or settlement of certain pending smoking-related litigation. Liggett believes, and has been so advised by counsel, that it has valid defenses to the litigation pending against it, as well as valid bases for appeal of adverse verdicts. All such cases are, and will continue to be, vigorously defended. Liggett may, however, enter into settlement discussions in particular cases if it believes it is in its best interest to do so. In connection with the Engle progeny cases, Liggett has been receptive to opportunities to settle these cases, individually or on some aggregated basis, on terms it believes are economically favorable to Liggett and will continue to explore such opportunities. Recently, the federal court ordered the parties to engage in mediation to explore the prospect for a global resolution of the federal cases. As of June 30, 2013, Liggett (and in certain cases the Company), has settled 144 Engle progeny cases for approximately $1,146, in the aggregate. If Liggett were able to resolve the Engle progeny cases on an aggregated basis, Liggett believes the range of loss could be between $34,000 and $85,000, but there can be no assurances that the Engle progeny cases can be resolved on an aggregated basis, nor can there be any assurances that Liggett's settlement experience to date will be representative of future results or intentions.
Individual Actions
As of June 30, 2013, there were 63 Individual Actions pending against Liggett and, in certain cases, the Company, where one or more individual plaintiffs allege injury resulting from cigarette smoking, addiction to cigarette smoking or exposure to secondary smoke and seek compensatory and, in some cases, punitive damages. These cases do not include Engle progeny cases or the approximately 100 individual cases pending in West Virginia state court as part of a consolidated action. The following table lists the number of Individual Actions, by state, that are pending against Liggett or the Company as of June 30, 2013:

State	Number of Cases
Florida	45
New York	9
Louisiana	3
Maryland	2
West Virginia	2
Missouri	1
Ohio	1

The plaintiffs' allegations of liability in cases in which individuals seek recovery for injuries allegedly caused by cigarette smoking are based on various theories of recovery, including negligence, gross negligence, breach of special duty, strict liability, fraud, concealment, misrepresentation, design defect, failure to warn, breach of express and implied warranties, conspiracy, aiding and abetting, concert of action, unjust enrichment, common law public nuisance, property damage, invasion of privacy, mental anguish, emotional distress, disability, shock, indemnity and violations of deceptive trade practice laws, the federal Racketeer Influenced and Corrupt Organizations Act (“RICO”), state RICO statutes and antitrust statutes. In many of these cases, in addition to compensatory damages, plaintiffs also seek other forms of relief including treble/multiple damages, medical monitoring, disgorgement of profits and punitive damages. Although alleged damages often are not determinable from a complaint, and the law governing the pleading and calculation of damages varies from state to state and jurisdiction to jurisdiction, compensatory and punitive damages have been specifically pleaded in a number of cases, sometimes in amounts ranging into the hundreds of millions and even billions of dollars.

Defenses raised in Individual Actions include lack of proximate cause, assumption of the risk, comparative fault and/or contributory negligence, lack of design defect, statute of limitations, equitable defenses such as “unclean hands” and lack of benefit, failure to state a claim and federal preemption.

Engle Progeny Cases

Engle Case. In May 1994, Engle was filed against Liggett and others in Miami-Dade County, Florida. The class consisted of all Florida residents who, by November 21, 1996, "have suffered, presently suffer or have died from diseases and medical conditions caused by their addiction to cigarette smoking." In July 1999, after the conclusion of Phase I of the trial, the jury returned a verdict against Liggett and other cigarette manufacturers on certain issues determined by the trial court to be "common" to the causes of action of the plaintiff class. The jury made several findings adverse to the defendants including that defendants' conduct "rose to a level that would permit a potential award or entitlement to punitive damages." Phase II of the trial was a causation and damages trial for three of the class plaintiffs and a punitive damages trial on a class-wide basis before the same jury that returned the verdict in Phase I. In April 2000, the jury awarded compensatory damages of $12,704 to the three class plaintiffs, to be reduced in proportion to the respective plaintiff's fault. In July 2000, the jury awarded approximately $145,000,000 in punitive damages, including $790,000 against Liggett.

In May 2003, Florida's Third District Court of Appeal reversed the trial court and remanded the case with instructions to decertify the class. The judgment in favor of one of the three class plaintiffs, in the amount of $5,831, was overturned as time barred and the court found that Liggett was not liable to the other two class plaintiffs.

In July 2006, the Florida Supreme Court affirmed the decision vacating the punitive damages award and held that the class should be decertified prospectively, but determined that the following Phase I findings are entitled to res judicata effect in Engle progeny cases: (i) that smoking causes lung cancer, among other diseases; (ii) that nicotine in cigarettes is addictive; (iii) that defendants placed cigarettes on the market that were defective and unreasonably dangerous; (iv) that defendants concealed material information knowing that the information was false or misleading or failed to disclose a material fact concerning the health effects or addictive nature of smoking; (v) that defendants agreed to conceal or omit information regarding the health effects of cigarettes or their addictive nature with the intention that smokers would rely on the information to their detriment; (vi) that defendants sold or supplied cigarettes that were defective; and (vii) that defendants were negligent. The Florida Supreme Court decision also allowed former class members to proceed to trial on individual liability issues (using the above findings) and compensatory and punitive damage issues, provided they filed their individual lawsuits by January 2008. In December 2006, the Florida Supreme Court added the finding that defendants sold or supplied cigarettes that, at the time of sale or supply, did not conform to the representations made by defendants. In October 2007, the United States Supreme Court denied defendants' petition for writ of certiorari.

Pursuant to the Florida Supreme Court's July 2006 ruling in Engle, which decertified the class on a prospective basis, and affirmed the appellate court's reversal of the punitive damages award, former class members had until January 2008 in which to file individual lawsuits. As of June 30, 2013, Liggett and the Company are named defendants in 4,300 Engle progeny cases in both federal (1,257 cases) and state (3,043 cases) courts in Florida. These cases include approximately 5,481 plaintiffs. Other cigarette manufacturers are also named as defendants in these cases, although as a case proceeds, one or more defendants may ultimately be dismissed from the action. The number of state court Engle progeny cases may increase as multi-plaintiff cases continue to be severed into individual cases. The number of federal cases may increase as plaintiffs have appealed the dismissal of over 800 cases by the federal court. The total number of plaintiffs may also increase as a result of attempts by existing plaintiffs to add additional parties. Although the Company was not named as a defendant in the Engle case, it has been named as a defendant in most of the Engle progeny cases where Liggett is named as a defendant.

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

As of June 30, 2013, the following Engle progeny cases have resulted in judgments against Liggett:

Date	Case Name	County	Net Compensatory Damages	Punitive Damages	Status
June 2002	Lukacs v. R.J. Reynolds	Miami-Dade	$12,418	None	Affirmed by the Third District Court of Appeal. Liggett satisfied the judgment and the case is concluded.
August 2009	Campbell v. R.J. Reynolds	Escambia	$156	None	Affirmed by the First District Court of Appeal. The US Supreme Court declined to review the case. Liggett satisfied the judgment and the case is concluded.
March 2010	Douglas v. R.J. Reynolds	Hillsborough	$1,350	None	Affirmed by the Second District Court of Appeal. In March 2013, the Florida Supreme Court affirmed. Liggett intends to file a petition for writ of certiorari to the US Supreme Court.
April 2010	Clay v. R.J. Reynolds	Escambia	$349	$1,000	Affirmed by the First District Court of Appeal. The US Supreme Court declined to review the case. Liggett satisfied the judgment and the case is concluded.
April 2010	Putney v. R.J. Reynolds	Broward	$3,008	None	On June 12, 2013, the Fourth District Court of Appeal reversed and remanded the case for further proceedings. Plaintiff filed a motion for rehearing.
April 2011	Tullo v. R.J. Reynolds	Palm Beach	$225	None	On appeal to the Fourth District Court of Appeal. Oral argument occurred on June 19, 2013. A decision is pending.
January 2012	Ward v. R.J. Reynolds	Escambia	$1	None	A joint and several judgment for $487 was entered against Liggett and RJR. On appeal to the First District Court of Appeal. Oral argument occurred on July 17, 2013.
May 2012	Calloway v. R.J. Reynolds	Broward	$1,947	$7,600	A joint and several judgment for $16,100 was entered against all defendants. On appeal to the Fourth District Court of Appeal.
		Leon	$2,035	None	

December 2012	Buchanan v. R.J. Reynolds				A joint and several judgment for $5,500 was entered against Liggett and Philip Morris. On appeal to the First District Court of Appeal.
May 2013	Cohen v. R.J. Reynolds	Palm Beach	$205	None	Defendants' motion seeking a new trial was granted by the trial court on June 24, 2013.

The Company's potential range of loss in the Douglas, Putney, Tullo, Ward, Calloway, Buchanan and Cohen cases is between $0 and $16,371 in the aggregate, plus accrued interest and legal fees. In determining the range of loss, the Company considers potential settlements as well as future appellate relief. Except as disclosed elsewhere in this Note 6, the Company is unable to determine a range of loss related to the remaining Engle progeny cases. No amounts have been expensed or accrued in the accompanying consolidated financial statements for these cases. However, as cases proceed through the appellate process, the Company will consider accruals on a case-by-case basis if an unfavorable outcome becomes probable and the amount can be reasonably estimated.
Lukacs Case. In June 2002, the jury in a Florida state court action entitled Lukacs v. R.J. Reynolds Tobacco Co., awarded $37,500 in compensatory damages, jointly and severally, in a case involving Liggett and two other cigarette manufacturers, which amount was subsequently reduced by the court. The jury found Liggett 50% responsible for the damages incurred by the plaintiff. The Lukacs case was the first case to be tried as an individual Engle progeny case, but was tried almost five years prior to the Florida Supreme Court's final decision in Engle. In November 2008, the court entered final judgment in the amount of $24,835, plus interest from June 2002. In March 2010, the Third District Court of Appeal affirmed the decision, per curiam. Liggett satisfied its share of the judgment, including attorneys' fees and accrued interest, for $14,361.

Federal Engle Progeny Cases. Three federal judges (in the Merlob, B. Brown and Burr cases) ruled that the findings in Phase I of the Engle proceedings could not be used to satisfy elements of plaintiffs' claims, and two of those rulings (B. Brown and Burr) were certified by the trial court for interlocutory review. The certification was granted by the United States Court of Appeals for the Eleventh Circuit and the appeals were consolidated (in February 2009, the appeal in Burr was dismissed for lack of prosecution). In July 2010, the Eleventh Circuit ruled that plaintiffs do not have an unlimited right to use the findings from the original Engle trial to meet their burden of establishing the elements of their claims at trial. Rather, plaintiffs may only use the findings to establish specific facts that they demonstrate with a reasonable degree of certainty

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

were actually decided by the original Engle jury. The Eleventh Circuit remanded the case to the district court to determine what specific factual findings the Engle jury actually made. All federal cases were stayed pending review by the Eleventh Circuit. The stays were subsequently lifted in a number of cases. At present, Liggett is a defendant in eight of the active cases.

Appeals of Engle Progeny Verdicts. In December 2010, in the Martin case, a state court case against R.J. Reynolds, the First District Court of Appeal issued the first ruling by a Florida intermediate appellate court to address the B. Brown decision discussed above. The panel held that the trial court correctly construed the Florida Supreme Court's 2006 decision in Engle in instructing the jury on the preclusive effect of the Phase I Engle proceedings, expressly disagreeing with certain aspects of the B. Brown decision. In July 2011, the Florida Supreme Court declined to review the First District Court of Appeal's decision. In March 2012, the United States Supreme Court declined to review the Martin case, along with the Campbell case and two other Engle progeny cases. This decision could lead to other adverse rulings by state appellate courts.

In the Waggoner case, the United States District Court for the Middle District of Florida directed the parties to brief the applicability of the Engle findings to all Middle District cases. Liggett and the Company are not defendants in Waggoner, but nonetheless, were directed to submit motions on the issues. In December 2011, the district court ruled that it was bound by Martin and Jimmie Lee Brown (discussed below) and that the application of the Phase I findings did not deprive defendants of any constitutional due process rights. The court ruled, however, that plaintiffs must establish legal causation to establish liability. With respect to punitive damages, the district court held that the plaintiffs could rely on the findings in support of their punitive damages claims but that, in addition, plaintiffs must demonstrate specific conduct by specific defendants, independent of the Engle findings, that satisfies the standards for awards of punitive damages. The Waggoner ruling applies to all of the cases pending in the Middle District of Florida. The Waggoner court declined to address certain issues raised by Liggett and the Company and directed that their motion be re-filed in a case in which they were named as defendants. As a result, Liggett filed a motion in the Young-McCray case raising issues specific to Liggett. The court denied the motion and adopted the Waggoner ruling as to Liggett. Liggett was subsequently dropped as a defendant before trial. These issues are on appeal to the United States Court of Appeals for the Eleventh Circuit in Walker and Duke, cases in which Liggett is not a party. Oral argument is scheduled for July 31, 2013.

In Jimmie Lee Brown, a state court case against R.J. Reynolds, the trial court tried the case in two phases. In the first phase, the jury determined that the smoker was addicted to cigarettes that contained nicotine and that his addiction was a legal cause of his death, thereby establishing he was an Engle class member. In the second phase, the jury determined whether the plaintiff established legal cause and damages with regard to each of the underlying claims. The jury found in favor of plaintiff in both phases. In September 2011, the Fourth District Court of Appeal affirmed the judgment entered in plaintiff's favor and approved the trial court's procedure of bifurcating the trial. The Fourth District Court of Appeal agreed with Martin that individual post-Engle plaintiffs need not prove conduct elements as part of their burden of proof, but disagreed with Martin to the extent that the First District Court of Appeal only required a finding that the smoker was a class member to establish legal causation as to addiction and the underlying claims. The Fourth District Court of Appeal held that in addition to establishing class membership, Engle progeny plaintiffs must also establish legal causation and damages as to each claim asserted. In so finding, the Fourth District Court of Appeal's decision in Jimmie Lee Brown is in conflict with Martin. In dicta, the Fourth District Court of Appeal further voiced concern that the preclusive effect of the Engle findings violates the tobacco company defendants' due process rights and, in the special concurring opinion, the court emphasized that until the Florida Supreme Court gives trial courts guidance as to what it intended by its Engle decision, trial courts will continue to play “a form of legal poker.” In September 2011, R.J. Reynolds filed a motion asking the Fourth District Court of Appeal to certify the case to the Florida Supreme Court for review. The motion was denied in October 2011.

In the Rey case, a state court Engle progeny case, the trial court entered final summary judgment on all claims in favor of the Company, Liggett and Lorillard based on what has been referred to in the Engle progeny litigation as the "Liggett Rule." The Liggett Rule stands for the proposition that a manufacturer cannot have liability to a smoker under any asserted claim if the smoker did not use a product manufactured by that particular defendant. The Liggett Rule is based on the entry of final judgment in favor of Liggett/Brooke Group in Engle on all of the claims asserted against them by class representatives Mary Farnan and Angie Della Vecchia, even though the Florida Supreme Court upheld, as res judicata, the generic finding that Liggett/Brooke Group engaged in a conspiracy to commit fraud by concealment. In September 2011, the Third District Court of Appeal affirmed in part and reversed in part holding that the defendants were entitled to summary judgment on all claims asserted against them other than the claim for civil conspiracy. Defendants' motions for rehearing were denied with regard to the Liggett Rule issues. Defendants sought further review by the Florida Supreme Court and on August 20, 2012, the petition for review was denied. In March 2012, the Fifth District Court of Appeal, in other progeny cases, followed the

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

Third District Court of Appeal and reversed summary judgment on the conspiracy claims. The Florida Supreme Court refused to accept jurisdiction of defendants' appeals.
In March 2012, in Douglas, the Second District Court of Appeal issued a decision affirming the judgment of the trial court in favor of the plaintiff and upholding the use of the Engle jury findings but certified to the Florida Supreme Court the question of whether granting res judicata effect to the Engle jury findings violates defendants' federal due process rights. In March 2013, the Florida Supreme Court affirmed the use of Engle jury findings and determined that there is no violation of the defendants' due process rights. The defendants intend to file a petition for writ of certiorari to the United States Supreme Court.

In June 2013, in Capone, the Florida Supreme Court held that the Florida Wrongful Death Act does not require the filing of a new action for wrongful death. Rather, upon the death of a party plaintiff in a personal injury action, the personal representative of the decedent's estate may be substituted as plaintiff and, thereafter, shall have a reasonable opportunity to file an amended pleading that alleges new or amended claims and causes of action.

In June 2013, in Sury, the First District Court of Appeal held that where the jury found defendants liable under both negligence and intentional tort theories, the trial court did not abuse its discretion in refusing to reduce the damages awarded by the jury by the percentage of fault attributable to decedent.

Liggett Only Cases. There are currently five cases pending where Liggett is the only remaining tobacco company defendant. These cases consist of three Individual Actions and two Engle progeny cases. In one of the Individual Actions, Hausrath (NY state court), plaintiff moved to restore the case to the active docket calendar. The motion was granted by the court. There has been no recent activity in the other two Individual Actions. One of the Engle progeny cases, Katz, is currently set for trial on January 6, 2014. Cases where Liggett is the only defendant could increase substantially as a result of the Engle progeny cases.
Class Actions
As of June 30, 2013, there were four actions pending for which either a class had been certified or plaintiffs were seeking class certification, where Liggett is a named defendant, including one alleged price fixing case. Other cigarette manufacturers are also named in these actions.
Plaintiffs' allegations of liability in class action cases are based on various theories of recovery, including negligence, gross negligence, strict liability, fraud, misrepresentation, design defect, failure to warn, nuisance, breach of express and implied warranties, breach of special duty, conspiracy, concert of action, violation of deceptive trade practice laws and consumer protection statutes and claims under the federal and state anti-racketeering statutes. Plaintiffs in the class actions seek various forms of relief, including compensatory and punitive damages, treble/multiple damages and other statutory damages and penalties, creation of medical monitoring and smoking cessation funds, disgorgement of profits, and injunctive and equitable relief.
Defenses raised in these cases include, among others, lack of proximate cause, individual issues predominate, assumption of the risk, comparative fault and/or contributory negligence, statute of limitations and federal preemption.
In Smith v. Philip Morris, a Kansas state court case filed in February 2000, plaintiffs allege that cigarette manufacturers conspired to fix cigarette prices in violation of antitrust laws. Plaintiffs seek to recover an unspecified amount in actual and punitive damages. Class certification was granted in November 2001. In January 2012, the trial court heard oral argument on defendants' motions for summary judgment and in March 2012, the court granted the motions and dismissed plaintiffs' claims with prejudice. In July 2012, plaintiffs noticed an appeal. The appeal is pending.

In November 1997, in Young v. American Tobacco Co., a purported personal injury class action was commenced on behalf of plaintiff and all similarly situated residents in Louisiana who, though not themselves cigarette smokers, are alleged to have been exposed to secondhand smoke from cigarettes which were manufactured by the defendants, and who suffered injury as a result of that exposure. The plaintiffs seek to recover an unspecified amount of compensatory and punitive damages. In October 2004, the trial court stayed this case pending the outcome of an appeal in another matter, which has been concluded. There has been no further activity in this case.

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

In February 1998, in Parsons v. AC & S Inc., a case pending in West Virginia, a class was commenced on behalf of all West Virginia residents who allegedly have personal injury claims arising from exposure to cigarette smoke and asbestos fibers. The complaint seeks to recover $1,000 in compensatory and punitive damages individually and unspecified compensatory and punitive damages for the class. The case is stayed as a result of the December 2000 bankruptcy of three of the defendants.

Although not technically a class action, in In Re: Tobacco Litigation (Personal Injury Cases), a West Virginia state court consolidated approximately 750 individual smoker actions that were pending prior to 2001 for trial of certain common issues. In January 2002, the court severed Liggett from the trial of the consolidated action, which commenced in June 2010 and ended in a mistrial. The rescheduled trial commenced in October 2011 and it, too, ended in a mistrial. A new trial commenced on April 15, 2013. On May 15, 2013, the jury rejected all but one of the plaintiffs' claims, finding for the plaintiffs on the claim that ventilated filter cigarettes, sold between 1964 and July 1, 1969, should have included instructions on how to use them. On July 15, 2013, plaintiffs filed a renewed motion for judgment as a matter of law and a motion for a new trial. Defendants filed a motion for judgment notwithstanding the verdict. The issue of damages was reserved for further proceedings that have not yet been scheduled. If the case were to proceed against Liggett, it is estimated that Liggett could be a defendant in approximately 100 of the individual cases.

Class action suits have been filed in a number of states against cigarette manufacturers, alleging, among other things, that use of the terms “lights” and “ultra lights” constitutes unfair and deceptive trade practices. In December 2008, the United States Supreme Court, in Altria Group v. Good, ruled that the Federal Cigarette Labeling and Advertising Act did not preempt the state law claims asserted by the plaintiffs and that they could proceed with their claims under the Maine Unfair Trade Practices Act. The Good decision has resulted in the filing of additional “lights” class action cases in other states against other cigarette manufacturers. Although Liggett was not a defendant in the Good case, and is not currently a defendant in any other “lights” class actions, an adverse ruling or commencement of additional “lights” related class actions could have a material adverse effect on the Company.

In addition to the cases described above, numerous class actions remain certified against other cigarette manufacturers. Adverse decisions in these cases could have a material adverse affect on Liggett’s sales volume, operating income and cash flows.

Health Care Cost Recovery Actions

As of June 30, 2013, there was one Health Care Cost Recovery Action pending against Liggett, Crow Creek Sioux Tribe v. American Tobacco Company, a South Dakota case filed in 1997, where the plaintiff seeks to recover damages based on various theories of recovery as a result of alleged sales of tobacco products to minors. The case is inactive. Other cigarette manufacturers are also named as defendants.

The claims asserted in health care cost recovery actions vary. Although, typically, no specific damage amounts are pled, it is possible that requested damages might be in the billions of dollars. In these cases, plaintiffs typically assert equitable claims that the tobacco industry was “unjustly enriched” by their payment of health care costs allegedly attributable to smoking and seek reimbursement of those costs. Relief sought by some, but not all, plaintiffs include punitive damages, multiple damages and other statutory damages and penalties, injunctions prohibiting alleged marketing and sales to minors, disclosure of research, disgorgement of profits, funding of anti-smoking programs, additional disclosure of nicotine yields, and payment of attorney and expert witness fees.

Other claims asserted include the equitable claim of indemnity, common law claims of negligence, strict liability, breach of express and implied warranty, breach of special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under state and federal statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under RICO.

Department of Justice Lawsuit. In September 1999, the United States government commenced litigation against Liggett and other cigarette manufacturers in the United States District Court for the District of Columbia. The action sought to recover an unspecified amount of health care costs paid and to be paid by the federal government for lung cancer, heart disease, emphysema and other smoking-related illnesses allegedly caused by the fraudulent and tortious conduct of defendants, to restrain defendants and co-conspirators from engaging in alleged fraud and other allegedly unlawful conduct in the future, and to compel defendants to disgorge the proceeds of their unlawful conduct. Claims were asserted under RICO.

In August 2006, the trial court entered a Final Judgment against each of the cigarette manufacturing defendants, except Liggett. In May 2009, the United States Court of Appeals for the District of Columbia affirmed most of the district court's decision. The United States Supreme Court denied review. As a result, the cigarette manufacturing defendants, other than

Liggett, are now subject to the trial court's Final Judgment which ordered the following relief: (i) an injunction against “committing any act of racketeering” relating to the manufacturing, marketing, promotion, health consequences or sale of cigarettes in the United States; (ii) an injunction against participating directly or indirectly in the management or control of the Council for Tobacco Research, the Tobacco Institute, or the Center for Indoor Air Research, or any successor or affiliated entities of each; (iii) an injunction against “making, or causing to be made in any way, any material false, misleading, or deceptive statement or representation or engaging in any public relations or marketing endeavor that is disseminated to the United States' public and that misrepresents or suppresses information concerning cigarettes”; (iv) an injunction against conveying any express or implied health message through use of descriptors on cigarette packaging or in cigarette advertising or promotional material, including “lights,” “ultra lights,” and “low tar,” which the court found could cause consumers to believe one cigarette brand is less hazardous than another brand; (v) the issuance of “corrective statements” in various media regarding the adverse health effects of smoking, the addictiveness of smoking and nicotine, the lack of any significant health benefit from smoking “low tar” or “lights” cigarettes, defendants' manipulation of cigarette design to ensure optimum nicotine delivery and the adverse health effects of exposure to environmental tobacco smoke; (vi) the disclosure of defendants' public document websites and the production of all documents produced to the government or produced in any future court or administrative action concerning smoking and health; (vii) the disclosure of disaggregated marketing data to the government in the same form and on the same schedules as defendants now follow in disclosing such data to the Federal Trade Commission for a period of ten years; (viii) certain restrictions on the sale or transfer by defendants of any cigarette brands, brand names, formulas or cigarette business within the United States; and (ix) payment of the government's costs in bringing the action.

It is unclear what impact, if any, the Final Judgment will have on the cigarette industry as a whole. To the extent that the Final Judgment leads to a decline in industry-wide shipments of cigarettes in the United States or otherwise results in restrictions that adversely affect the industry, Liggett's sales volume, operating income and cash flows could be materially adversely affected.

Upcoming Trials

As of June 30, 2013, there were 34 Engle progeny cases scheduled for trial through June 30, 2014, where Liggett and/or the Company are named defendants. There are additional cases against other cigarette manufacturers that are also scheduled for trial through June 30, 2014. Trial dates are, however, subject to change.

MSA and Other State Settlement Agreements

In March 1996, March 1997 and March 1998, Liggett entered into settlements of smoking-related litigation with 45 states and territories. The settlements released Liggett from all smoking-related claims made by those states and territories, including claims for health care cost reimbursement and claims concerning sales of cigarettes to minors.

In November 1998, Philip Morris, Brown & Williamson, R.J. Reynolds and Lorillard (the “Original Participating Manufacturers” or “OPMs”) and Liggett (together with any other tobacco product manufacturer that becomes a signatory, the “Subsequent Participating Manufacturers” or “SPMs”) (the OPMs and SPMs are hereinafter referred to jointly as the “Participating Manufacturers”) entered into the Master Settlement Agreement (the “MSA”) with 46 states, the District of Columbia, Puerto Rico, Guam, the United States Virgin Islands, American Samoa and the Northern Mariana Islands (collectively, the “Settling States”) to settle the asserted and unasserted health care cost recovery and certain other claims of the Settling States. The MSA received final judicial approval in each Settling State.

As a result of the MSA, the Settling States released Liggett from:

- all claims of the Settling States and their respective political subdivisions and other recipients of state health care funds, relating to: (i) past conduct arising out of the use, sale, distribution, manufacture, development, advertising and marketing of tobacco products; (ii) the health effects of, the exposure to, or research, statements or warnings about, tobacco products; and

- all monetary claims of the Settling States and their respective subdivisions and other recipients of state health care funds relating to future conduct arising out of the use of, or exposure to, tobacco products that have been manufactured in the ordinary course of business.

The MSA restricts tobacco product advertising and marketing within the Settling States and otherwise restricts the activities of Participating Manufacturers. Among other things, the MSA prohibits the targeting of youth in the advertising, promotion or marketing of tobacco products; bans the use of cartoon characters in all tobacco advertising and promotion; limits each Participating Manufacturer to one tobacco brand name sponsorship during any 12-month period; bans all outdoor advertising, with certain limited exceptions; prohibits payments for tobacco product placement in various media; bans gift offers based on the purchase of tobacco products without sufficient proof that the intended recipient is an adult; prohibits Participating Manufacturers from licensing third parties to advertise tobacco brand names in any manner prohibited under the MSA; and prohibits Participating Manufacturers from using as a tobacco product brand name any nationally recognized non-tobacco brand or trade name or the names of sports teams, entertainment groups or individual celebrities.

The MSA also requires Participating Manufacturers to affirm corporate principles to comply with the MSA and to reduce underage use of tobacco products and imposes restrictions on lobbying activities conducted on behalf of Participating Manufacturers. In addition, the MSA provides for the appointment of an independent auditor to calculate and determine the amounts of payments owed pursuant to the MSA.

Under the payment provisions of the MSA, the Participating Manufacturers are required to make annual payments of $9,000,000 (subject to applicable adjustments, offsets and reductions). These annual payments are allocated based on unit volume of domestic cigarette shipments. The payment obligations under the MSA are the several, and not joint, obligation of each Participating Manufacturer and are not the responsibility of any parent or affiliate of a Participating Manufacturer.

Liggett has no payment obligations under the MSA except to the extent its market share exceeds a market share exemption of approximately 1.65% of total cigarettes sold in the United States. Vector Tobacco has no payment obligations under the MSA except to the extent its market share exceeds a market share exemption of approximately 0.28% of total cigarettes sold in the United States. Liggett and Vector Tobacco's domestic shipments accounted for 3.5% of the total cigarettes sold in the United States in 2012. If Liggett's or Vector Tobacco's market share exceeds their respective market share exemption in a given year, then on April 15 of the following year, Liggett and/or Vector Tobacco, as the case may be, must pay on each excess unit an amount equal (on a per-unit basis) to that due from the OPMs for that year. On December 31, 2012, Liggett paid $105,000 of its $138,900 2012 MSA payment obligation. On April 15, 2013, Liggett and Vector Tobacco paid an additional $30,800, of which approximately $18,700 was paid into the disputed payments account. Liggett disputed, and withheld, approximately $3,100.

Certain MSA Disputes

NPM Adjustment. In March 2006, an economic consulting firm selected pursuant to the MSA determined that the MSA was a “significant factor contributing to” the loss of market share of Participating Manufacturers, to non-participating manufacturers, for 2003. This is known as the “NPM Adjustment.” The economic consulting firm subsequently rendered the same decision with respect to 2004 and 2005. In March 2009, a different economic consulting firm made the same determination for 2006. As a result, the manufacturers are entitled to potential NPM Adjustments to each of their 2003 - 2006 MSA payments. The Participating Manufacturers are also entitled to potential NPM Adjustments to their 2007 - 2012 payments pursuant to agreements entered into between the OPMs and the Settling States under which the OPMs agreed to make certain payments for the benefit of the Settling States, in exchange for which the Settling States stipulated that the MSA was a “significant factor contributing to” the loss of market share of Participating Manufacturers for each of those years. A Settling State that has diligently enforced its qualifying escrow statute in the year in question may be able to avoid application of the NPM Adjustment to the payments made by the manufacturers for the benefit of that Settling State.

For 2003 through 2012, Liggett and Vector Tobacco, as applicable, disputed that they owed the Settling States the NPM Adjustments as calculated by the Independent Auditor. As permitted by the MSA, Liggett and Vector Tobacco withheld payment or paid into a disputed payment account the amounts associated with these NPM Adjustments. Notwithstanding provisions in the MSA requiring arbitration, litigation was filed in 49 Settling States regarding whether the application of the NPM Adjustment for 2003 was to be determined through litigation or arbitration. These actions related to the potential NPM Adjustment for 2003, which the independent auditor under the MSA previously determined to be as much as $1,200,000 for all Participating Manufacturers. All but one of the 48 courts that decided the issue ruled that the 2003 NPM Adjustment dispute was arbitrable. One court, the Montana Supreme Court, ruled that Montana’s claim of diligent enforcement must be litigated. The United States Supreme Court denied certiorari with respect to that opinion. In June 2012, Montana and the Participating Manufacturers reached an agreement that the Participating Manufacturers will not contest Montana's diligent enforcement for 2003.

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

In response to a proposal from the OPMs and many of the SPMs, 45 of the Settling States, representing approximately 90% of the allocable share of the Settling States, entered into an agreement providing for a nationwide arbitration of the dispute with respect to the NPM Adjustment for 2003. Because states representing more than 80% of the allocable share signed the agreement, signing states will receive a 20% reduction of any 2003 NPM adjustment awarded in the arbitration. In June 2010, the three person arbitration panel was selected. In November 2011, the Participating Manufacturers advised the arbitration panel that they were not contesting diligent enforcement of 16 Settling States. Substantive hearings commenced in April 2012 and were completed in June 2013. Decisions from the arbitration panel are pending. There can be no assurance that Liggett or Vector Tobacco will receive any adjustment as a result of these proceedings, other than as described below in connection with the settlement reached with certain Settling States.

Effective December 17, 2012, the Participating Manufacturers entered into a “term sheet” with 20 Settling States setting out terms for settlement of the NPM Adjustment for 2003 through 2012 and addressing the NPM Adjustment mechanism for those states for future years. Certain non-signatory states objected to the settlement. In March 2013, the arbitration panel entered a Stipulated Partial Settlement and Award which, among other things, overrules the objections of the non-signatory states and directed the independent auditor to implement the terms of the term sheet effective with the April 15, 2013 MSA payments. In May 2013, two additional states joined the settlement. Several non-signatory states are attempting to vacate the settlement award by filing state court actions. Although certain terms of the settlement were implemented by the independent auditor on April 15, 2013, no assurance can be given as to the ultimate outcome of the non-signatory states' challenges.

As a result of the settlement, in the first quarter of 2013 Liggett and Vector Tobacco recognized income of $5,602. Following the additional two states joining the settlement in May 2013, Liggett and Vector Tobacco recognized an additional $1,345 of income in the second quarter of 2013. The remaining NPM Adjustment accrual of $27,600 at June 30, 2013 relates to the disputed amounts Liggett and Vector Tobacco have withheld from the non-signatory states for 2004 through 2010. Approximately $16,600 remains in the disputed payments accounts relating to the dispute with these non-signatory states.

"Gross" v. "Net" Calculations. In October 2004, the independent auditor notified Liggett and all other Participating Manufacturers that their payment obligations under the MSA, dating from the agreement’s execution in late 1998, had been recalculated using “net” units, rather than “gross” units (which had been used since 1999).
Liggett objected to this retroactive change and disputed the change in methodology. Liggett contends that the retroactive change from “gross” to “net” units is impermissible for several reasons, including:

- use of “net” units is not required by the MSA (as reflected by, among other things, the use of “gross” units through 2005);
- such a change is not authorized without the consent of affected parties to the MSA;
- the MSA provides for four-year time limitation periods for revisiting calculations and determinations, which precludes recalculating Liggett’s 1997 Market Share (and thus, Liggett’s market share exemption); and
- Liggett and others have relied upon the calculations based on “gross” units since 1998.

The change in the method of calculation could have resulted in Liggett owing as much as $38,800 of additional MSA payments for prior years, including interest, because the proposed change from “gross” to “net” units would have lowered Liggett’s grandfathered market share exemption under the MSA. The Company estimated that Liggett’s future annual MSA payments would have been at least approximately $2,500 higher if the method of calculation was changed. In August 2011, Liggett received notice from several states seeking to initiate arbitration as to this matter. In December 2012, the parties arbitrated the dispute before a panel of three arbitrators. On February 14, 2013, the arbitrators issued a decision granting the relief sought by Liggett. The arbitrators ruled that the limitations provisions of the MSA precluded the independent auditor from recalculating Liggett's grandfathered market share exemption or Liggett's payment obligations beyond the last four years. The arbitrators further ruled that, for purposes of calculating Liggett's payment obligations for the applicable years, Liggett's market share should be calculated on a net basis, increased by a factor of 1.25%. Liggett filed a motion seeking reconsideration of the part of the arbitrators' decision that would require the 1.25% increase in Liggett's market share. The states objected to Liggett's motion and seek additional relief from the panel declaring that any adjustment ordered by the panel is not limited by the four year limitations set forth in the MSA. If the arbitrator's ruling is not modified, Liggett would be required to pay approximately $16,200 for the previous five years. If the relief requested by the states is granted, Liggett could be required to pay up to approximately $36,200. The panel had agreed to hear arguments on the motions on May 29, 2013, but due to the conditional settlement described below, the parties agreed to adjourn the hearing. In June 2013, Liggett and a negotiating group on behalf of the Settling States reached an agreement in principle to resolve all disputes regarding "gross" v. "net", subject to definitive documentation and approval thereof by each Settling State. The proposed settlement requires that Liggett pay $8,000 to the Settling States and agree to reduce its market share exemption from 1.645% to 1.63% starting in 2013 and for all years thereafter. In exchange, the Settling States will release Liggett from all claims in connection with the "gross" v. "net" dispute. The Company previously accrued $9,300 for the “gross” v. “net” dispute. There can be no assurance that the settlement will be approved and if it is not, that Liggett will be successful in seeking modification of the award by the panel or that Liggett will not be required to make additional payments, which could adversely affect the Company’s consolidated financial position, results of operations and cash flows.

Litigation Challenging the MSA. Litigation challenging the validity of the MSA, including claims that the MSA violates antitrust laws, has not been successful to date, although several cases are pending. Participating Manufacturers are not typically named as defendants in these cases.

Other State Settlements. The MSA replaced Liggett’s prior settlements with all states and territories except for Florida, Mississippi, Texas and Minnesota. Each of these four states, prior to the effective date of the MSA, negotiated and executed settlement agreements with each of the other major tobacco companies, separate from those settlements reached previously with Liggett. Except as described below, Liggett's agreements with these states remain in full force and effect. These states' settlement agreements with Liggett contained most favored nation provisions which could reduce Liggett's payment obligations based on subsequent settlements or resolutions by those states with certain other tobacco companies. Beginning in 1999, Liggett determined that, based on each of these four states' settlements with United States Tobacco Company, Liggett's payment obligations to those states had been eliminated. With respect to all non-economic obligations under the previous settlements, Liggett believes it is entitled to the most favorable provisions as between the MSA and each state's respective settlement with the other major tobacco companies. Therefore, Liggett's non-economic obligations to all states and territories are now defined by the MSA.

In 2003, as a result of a dispute with Minnesota regarding its settlement agreement, Liggett agreed to pay $100 a year, in any year cigarettes manufactured by Liggett are sold in that state. In 2003 and 2004, the Attorneys General for Florida, Mississippi and Texas advised Liggett that they believed that Liggett had failed to make certain required payments under the respective settlement agreements with these states. In December 2010, Liggett settled with Florida and agreed to pay $1,200 and to make further annual payments of $250 for a period of 21 years, starting in March 2011. The payments in years 12 – 21 will be subject to an inflation adjustment. These payments are in lieu of any other payments allegedly due to Florida under the original settlement agreement. The Company accrued approximately $3,200 for this matter in 2010. In February 2012, Mississippi provided Liggett with a 60-day notice that the state intended to pursue its remedies if Liggett did not cure the alleged defaults. Liggett responded to Mississippi's letter denying the existence of any defaults. There can be no assurance that Liggett will be able to resolve the matters with Texas and Mississippi or that Liggett will not be required to make additional payments which could adversely affect the Company's consolidated financial position, results of operations and cash flows.

Cautionary Statement. Management is not able to predict the outcome of the litigation pending or threatened against Liggett or the Company. Litigation is subject to many uncertainties. Through June 30, 2013, Liggett has been found liable in ten Engle progeny cases. In three of the cases, the verdicts were affirmed on appeal and the judgments were satisfied by Liggett. Although Liggett has appealed the remaining adverse verdicts, appellate efforts to date have not been successful. Liggett has also had judgments entered against it in Individual Actions, which were affirmed on appeal and satisfied by Liggett. It is possible that other cases could be decided unfavorably against Liggett and that Liggett will be unsuccessful on appeal. Liggett may attempt to settle particular cases if it believes it is in its best interest to do so.

Management cannot predict the cash requirements related to any future defense costs, settlements or judgments, including cash required to bond any appeals, and there is a risk that those requirements will not be able to be met. An unfavorable outcome of a pending smoking-related case could encourage the commencement of additional litigation, or could lead to adverse decisions in the Engle progeny cases. Except as discussed in this Note 6, management is unable to estimate the loss or range of loss that could result from an unfavorable outcome of the cases pending against Liggett or the costs of defending such cases and as a result has not provided any amounts in its consolidated financial statements for unfavorable outcomes.

The tobacco industry is subject to a wide range of laws and regulations regarding the marketing, sale, taxation and use of tobacco products imposed by local, state and federal governments. There have been a number of restrictive regulatory actions, adverse legislative and political decisions and other unfavorable developments concerning cigarette smoking and the tobacco industry. These developments may negatively affect the perception of potential triers of fact with respect to the

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

tobacco industry, possibly to the detriment of certain pending litigation, and may prompt the commencement of additional litigation or legislation.
It is possible that the Company’s consolidated financial position, results of operations and cash flows could be materially adversely affected by an unfavorable outcome in any of the smoking-related litigation.
The activity in the Company's accruals for tobacco litigation for the six months ended June 30, 2013 were as follows:

	Current Liabilities			Non-Current Liabilities		
	Payments due under Master Settlement Agreement	Litigation Accruals	Total	Payments due under Master Settlement Agreement	Litigation Accruals	Total
Balance at January 1, 2013	$32,970	$1,470	$34,440	$52,639	$1,862	$54,501
Expenses	56,907	147	57,054	—	—	—
NPM Settlement adjustment	—	—	—	(13,489)	—	(13,489)
Change in MSA obligations capitalized as inventory	364	—	364	—	—	—
Payments	(34,077)	(1,577)	(35,654)	—	—	—
Reclassification from non-current liabilities	3,521	223	3,744	(3,520)	(223)	(3,743)
Interest on withholding	—	18	18	—	99	99
Balance as of June 30, 2013	$59,685	$281	$59,966	$35,630	$1,738	$37,368

The activity in the Company's accruals for tobacco litigation for the six months ended June 30, 2012 were as follows:

	Current Liabilities			Non-Current Liabilities		
	Payments due under Master Settlement Agreement	Litigation Accruals	Total	Payments due under Master Settlement Agreement	Litigation Accruals	Total
Balance at January 1, 2012	$51,174	$1,551	$52,725	$49,338	$1,600	$50,938
Expenses	69,956	179	70,135	—	—	—
Change in MSA obligations capitalized as inventory	173	—	173	—	—	—
Payments	(50,094)	(574)	(50,668)	—	—	—
Reclassification from non-current liabilities	(905)	224	(681)	905	(224)	681
Interest on withholding	—	24	24	1,172	385	1,557
Balance as of June 30, 2012	$70,304	$1,404	$71,708	$51,415	$1,761	$53,176

26

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

Other Matters:

Liggett’s and Vector Tobacco’s management are unaware of any material environmental conditions affecting their existing facilities. Liggett’s and Vector Tobacco’s management believe that current operations are conducted in material compliance with all environmental laws and regulations and other laws and regulations governing cigarette manufacturers. Compliance with federal, state and local provisions regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, has not had a material effect on the capital expenditures, results of operations or competitive position of Liggett or Vector Tobacco.
In February 2004, Liggett Vector Brands entered into a five year agreement with a subsidiary of the American Wholesale Marketers Association to support a program to permit certain tobacco distributors to secure, on reasonable terms, tax stamp bonds required by state and local governments for the distribution of cigarettes. This agreement has been extended through February 2016. Under the agreement, Liggett Vector Brands has agreed to pay a portion of losses incurred by the surety under the bond program, with a maximum loss exposure of $500 for Liggett Vector Brands. To secure its potential obligations under the agreement, Liggett Vector Brands has delivered to the subsidiary of the association a $100 letter of credit and agreed to fund up to an additional $400. The Company believes the fair value of Liggett Vector Brands’ obligation under the agreement was immaterial at June 30, 2013.
There may be several other proceedings, lawsuits and claims pending against the Company and certain of its consolidated subsidiaries unrelated to tobacco or tobacco product liability. Management is of the opinion that the liabilities, if any, ultimately resulting from such other proceedings, lawsuits and claims should not materially affect the Company’s financial position, results of operations or cash flows.

7. INCOME TAXES

The Company's provision for income taxes in interim periods is based on an estimated annual effective income tax rate derived, in part, from estimated annual pre-tax results from ordinary operations. The annual effective income tax rate is reviewed and, if necessary, adjusted on a quarterly basis.

The Company's income tax expense (benefit) consisted of the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Income (loss) before provision for income taxes	$23,528	$5,128	$21,512	$(6,054)
Income tax expense (benefit) using estimated annual effective income tax rate	9,575	1,904	8,755	(2,247)
Changes in effective tax rates	321	98	—	—
Out-of-period adjustment related to non-deductible expenses in 2011	—	—	—	757
Impact of discrete items, net	121	(769)	927	(769)
Income tax expense (benefit)	$10,017	$1,233	$9,682	$(2,259)

The discrete item for the three months ended June 30, 2013 is related to the accrual of an unrecognized tax benefit and the discrete items for the six months ended June 30, 2013 is related to the impact of the Company's loss on the extinguishment of the 11% Senior Secured Notes due to the differences in the Company's marginal tax rate and its anticipated effective annual income tax rate at June 30, 2013 and the accrual of an unrecognized tax benefit. The discrete item for the three and six months ended June 30, 2012 is related to the conversion of the Company's 3.875% Senior Convertible Debentures due 2026. The out-of-period adjustment for the six months ended June 30, 2012 is related to a non-accrual of a non-deductible expense related to permanent difference for income taxes in the fourth quarter of 2011.

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

8. NEW VALLEY LLC

The components of “Investments in non-consolidated real estate businesses” were as follows:

	June 30, 2013	December 31, 2012
Douglas Elliman Realty LLC	$69,974	$65,171
Sesto Holdings	5,037	5,037
1107 Broadway	6,579	5,566
Lofts 21	900	900
Hotel Taiwana	6,313	2,658
East 68th Street	7,000	7,000
11 Beach Street	10,508	9,642
Maryland Portfolio	4,206	4,615
701 Seventh Avenue	9,888	9,307
Queens Plaza	7,350	7,350
Chrystie Street	1,992	1,973
Leroy Street	1,150	—
101 Murray Street	11,981	—
Investments in non-consolidated real estate businesses	$142,878	$119,219

Residential Brokerage Business. New Valley recorded income of $6,815 and $4,929 for the three months ended June 30, 2013 and 2012, respectively, associated with Douglas Elliman Realty, LLC. New Valley recorded income of $7,438 and $6,373 for the six months ended June 30, 2013 and 2012, respectively, associated with Douglas Elliman Realty, LLC. New Valley received cash distributions from Douglas Elliman Realty, LLC of $1,311 and $564 for the three months ended June 30, 2013 and 2012, respectively. New Valley received cash distributions from Douglas Elliman Realty, LLC of $2,636 and $2,889 for the six months ended June 30, 2013 and 2012, respectively. The summarized financial information of Douglas Elliman Realty, LLC is as follows:

	June 30, 2013	December 31, 2012
Cash	$89,491	$78,015
Other current assets	8,665	8,543
Property, plant and equipment, net	15,645	15,796
Trademarks	21,663	21,663
Goodwill	38,539	38,523
Other intangible assets, net	785	897
Other non-current assets	3,420	3,182
Notes payable - current	378	466
Other current liabilities	62,380	22,065
Notes payable - long term	283	334
Other long-term liabilities	9,420	9,614
Members' equity	105,747	134,140

28

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Revenues	$113,647	$97,955	$188,184	$169,130
Costs and expenses	100,093	88,568	173,707	157,794
Depreciation expense	985	831	1,958	1,646
Amortization expense	55	61	111	121
Other income	261	490	403	1,232
Interest (income) expense, net	(8)	9	(8)	32
Income tax expense	301	269	242	323
Net income	$12,482	$8,707	$12,577	$10,446

Douglas Elliman Realty is in discussions with Prudential to redeem the approximate 20% equity interest owned by a former affiliate of Prudential. The redemption price for such equity interest is to be determined through an appraisal process in accordance with the terms of Douglas Elliman Realty's Limited Liability Company Operating Agreement. Upon completion of the redemption, Vector will own more than 50% of Douglas Elliman Realty and will consolidate Douglas Elliman Realty accordingly.

Chelsea Eleven. New Valley recorded equity income of $451 and $2,118 for the three and six months ended June 30, 2012, respectively, and received net distributions of $8,439 for the six months ended June 30, 2012, related to New Valley Chelsea. New Valley had no exposure to loss as a result of its investment in Chelsea as of June 30, 2013.

Hotel Taiwana. New Valley contributed additional capital of $567 in February 2013 and $3,088 in April 2013, along with contributions of additional capital by the other investment partners of Hill Street Partners LLP ("Hill"). New Valley's investment percentage did not change from year end. Hill used the contributions to purchase the remaining interest in Hotel Taiwana.

101 Murray Street. In May 2013, a subsidiary of New Valley acquired a 25% interest in a joint venture, which had the rights to acquire a 15-story building on a 31,000 square-foot lot in the Tribeca neighborhood of Manhattan, NY. The former owner will vacate the building by July 2014. The joint venture plans to build a 150-unit, luxury condominium building on the building's site. Development will begin in 2014 and is expected to be completed in September 2017. In July 2013, the joint venture closed on the acquisition of the property. New Valley had invested $11,981 in the joint venture as of June 30, 2013 in the form of capital contributions and a loan bearing interest at 12% per annum, compounded quarterly, to the joint venture partner. New Valley contributed another $7,275 in July 2013 in the form of capital contributions and a loan, bearing interest at 12% per annum, compounded quarterly, to the same joint venture partner.

Park Lane Hotel. In July 2013, a subsidiary of New Valley acquired an 18% interest in a joint venture that has agreed to acquire the Park Lane Hotel, which is presently a 47-story, 605-key independent hotel owned and operated by the Helmsley Family Trust and Estate. The joint venture is developing plans for a hotel and luxury residential condominiums. The development is estimated to take approximately 30 months from commencement of construction.

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

Consolidated real estate investments:
The components of "Investments in consolidated real estate businesses, net" were as follows:

	June 30, 2013	December 31, 2012
Escena, net	$13,139	$13,295
Indian Creek	10,061	—
Investment in consolidated real estate businesses, net	$23,200	$13,295

Investment in Escena. The components of the Company's investment in Escena are as follows:

	June 30, 2013	December 31, 2012
Land and land improvements	$11,430	$11,430
Building and building improvements	1,530	1,530
Other	1,403	1,374
	14,363	14,334
Less accumulated depreciation	(1,224)	(1,039)
	$13,139	$13,295

The Company recorded an operating loss of $307 and $123 for the three months ended June 30, 2013 and 2012, respectively, from Escena. The Company recorded operating income of $76 and $487 for the six months ended June 30, 2013 and 2012, respectively, from Escena.

Investment in Indian Creek. In March 2013, New Valley invested $7,616 for an approximate 80% interest in Timbo LLC ("Indian Creek") which owns a residential real estate conversion project located on Indian Creek, Florida. As a result of the 80% ownership interest, the consolidated financial statements of the Company include the balances of Indian Creek which included land and building of approximately $9,719, a line of credit of $3,570, equity interest of $4,576 and a minority interest of $1,147 as of June 30, 2013. New Valley received a distribution of $3,080 during the six months ended June 30, 2013, while $767 is payable to the minority interest shareholder as of June 30, 2013.

In May 2013, Indian Creek entered into a $8,400 line of credit for a construction loan, that bears interest at the Overnight LIBOR rate plus 250 basis points, floating, per annum. A total of $3,570 was outstanding under the facility and has been classified as a component of Notes payable on the Company's Condensed Consolidated Balance Sheet as of June 30, 2013.

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

9. INVESTMENTS AND FAIR VALUE MEASUREMENTS

The Company's recurring financial assets and liabilities subject to fair value measurements are as follows:

	Fair Value Measurements as of June 30, 2013			
Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money market funds	$219,533	$219,533	$—	$—
Certificates of deposit	2,234	—	2,234	—
Bonds	7,577	7,577	—	—
Investment securities available for sale				—
Equity securities	86,691	79,947	6,744	—
Fixed income securities				
U.S. Government securities	10,094	—	10,094	—
Corporate securities	30,031	—	30,031	—
U.S. mortgage backed securities	589	—	589	—
Commercial mortgage-backed securities	5,886	—	5,886	—
U.S. asset backed securities	850	—	850	—
Total fixed income securities	47,450	—	47,450	—
Warrants	806	—	—	806
Total	$364,291	$307,057	$56,428	$806
Liabilities:				
Fair value of derivatives embedded within convertible debt	166,629	—	—	166,629
Total	$166,629	$—	$—	$166,629

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

	Fair Value Measurements as of December 31, 2012			
Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money market funds	$372,718	$372,718	$—	$—
Certificates of deposit	2,240	—	2,240	—
Bonds	6,306	6,306	—	—
Investment securities available for sale:				
Equity securities	69,984	69,107	877	—
Warrants	769	—	—	769
Total	$452,017	$448,131	$3,117	$769
Liabilities:				
Fair value of derivatives embedded within convertible debt	172,128	—	—	172,128
Total	$172,128	$—	$—	$172,128

The fair value of the Level 2 certificates of deposit are based on prices posted by the financial institutions. The fair value of investment securities available for sale included in Level 1 are based on quoted market prices from various stock exchanges. The Level 2 investment securities available for sale are equity securities based on quoted market prices of securities that are thinly traded and debt securities based on evaluated prices using observable, market-based inputs.

The fair value of derivatives embedded within convertible debt was derived using a valuation model and have been classified as Level 3. The valuation model assumes future dividend payments by the Company and utilizes interest rates and credit spreads based upon the implied debt rate of the 7.5% Convertible Notes to determine the fair value of the derivatives embedded within the convertible debt. The changes in fair value of derivatives embedded within convertible debt are presented on the Condensed Consolidated Statements of Operations.

The value of the embedded derivatives is contingent on changes in implied interest rates of the convertible debt, the Company's stock price, stock volatility as well as projections of future cash and stock dividends over the term of the debt. The interest rate component of the value of the embedded derivative is computed by calculating an equivalent non-convertible, unsecured and subordinated borrowing cost. This rate is determined by calculating the implied rate on the Company's 2019 Convertible Notes when removing the embedded option value within the convertible security. This rate is based upon market observable inputs and influenced by the Company's stock price, convertible bond trading price, risk free interest rates and stock volatility.

The Company recognized income of $5,499 and charges of $27,060 for the six months ended June 30, 2013 and 2012, respectively.

The fair value of the warrants was derived using the Black-Scholes model and has been classified as Level 3. The assumptions used under the Black-Scholes model in computing the fair value of the warrants are based on contractual term of the warrants, volatility of the underlying stock based on the historical quoted prices of the underlying stock, assumed future dividend payments and a risk-free rate of return.

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

The unobservable inputs related to the valuations of the Level 3 assets and liabilities are as follows at June 30, 2013:

	Quantitative Information about Level 3 Fair Value Measurements				
	Fair Value at June 30, 2013	Valuation Technique	Unobservable Input	Range (Actual)	
Warrants	$806	Option model	Stock price	$1.54	
			Exercise price	$1.68	
			Term (in years)	4.4	
			Volatility	95.19	%
			Dividend rate	—	
			Risk-free return	0.64	%
Fair value of derivatives embedded within convertible debt	$166,629	Discounted cash flow	Assumed annual stock dividend	5	%
			Assumed annual cash dividend	$1.60	
			Stock price	$16.22	
			Convertible trading price	117.94	%
			Volatility	18	%
			Implied credit spread	8% - 9% (8.5%)	

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

The unobservable inputs related to the valuations of the Level 3 assets and liabilities are as follows at December 31, 2012:

	Quantitative Information about Level 3 Fair Value Measurements				
	Fair Value at December 31, 2012	Valuation Technique	Unobservable Input	Range (Actual)	
Warrants	$769	Option model	Stock price	$1.40	
			Exercise price	$1.68	
			Term (in years)	3.8	
			Volatility	76.87	%
			Dividend rate	—	
			Risk-free return	0.50	%
Fair value of derivatives embedded within convertible debt	$172,128	Discounted cash flow	Assumed annual stock dividend	5	%
			Assumed annual cash dividend	$1.60	
			Stock price	$14.87	
			Convertible trading price	109.00	%
			Volatility	18	%
			Implied credit spread	10% - 11% (10.5%)	

In addition to assets and liabilities that are recorded at fair value on a recurring basis, the Company is required to record assets and liabilities at fair value on a nonrecurring basis. Generally, assets and liabilities are recorded at fair value on a nonrecurring basis as a result of impairment charges. The Company had no nonrecurring nonfinancial assets subject to fair value measurements as of June 30, 2013 and December 31, 2012, respectively.

10. SEGMENT INFORMATION

The Company's significant business segments for the three and six months ended June 30, 2013 and 2012 were Tobacco and Real Estate. The Tobacco segment consists of the manufacture and sale of cigarettes. The Real Estate segment includes the Company's investment in Escena, Indian Creek and investments in non-consolidated real estate businesses. The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

Financial information for the Company's operations before taxes for the three and six months ended June 30, 2013 and 2012 follows:

	Tobacco	Real Estate	Corporate and Other	Total
Three months ended June 30, 2013				
Revenues	$249,120	$—	$—	$249,120
Operating income (loss)	48,294 (1)	(407)	(3,647)	44,240
Equity income from non-consolidated real estate businesses	—	6,804	—	6,804
Depreciation and amortization	2,368	152	117	2,637
Three months ended June 30, 2012				
Revenues	$276,594	$—	$—	$276,594
Operating income (loss)	44,590	(249)	(3,413)	40,928
Equity income from non-consolidated real estate businesses	—	5,232	—	5,232
Depreciation and amortization	2,383	88	68	2,539
Six months ended June 30, 2013				
Revenues	$489,522	$—	$—	$489,522
Operating income (loss)	95,454 (2)	(321)	(7,797)	87,336
Equity income from non-consolidated real estate businesses	—	7,285	—	7,285
Depreciation and amortization	4,753	280	200	5,233
Capital expenditures	3,319	429	2,247	5,995
Six months ended June 30, 2012				
Revenues	$534,200	$—	$—	$534,200
Operating income (loss)	82,105	272	(8,003)	74,374
Equity income from non-consolidated real estate businesses	—	8,095	—	8,095
Depreciation and amortization	4,878	173	259	5,310
Capital expenditures	6,334	99	961	7,394

(1) Operating income includes $1,345 of income from a NPM Settlement.
(2) Operating income includes $6,947 of income from NPM Settlements.

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

11. LADENBURG THALMANN FINANCIAL SERVICES INC.

Vector presently beneficially owns approximately 8.1% of Ladenburg Thalmann Financial Services Inc. ("LTS"). Vector lent $15,000 to LTS in November 2011. In May and June 2013, LTS paid Vector $8,433 of principal plus related interest on the loan. In connection with the principal reduction, the Company recognized $552 of interest income related to the acceleration of the amortization of note discount. As of June 30, 2013, the outstanding principal balance on the loan to LTS was $6,567.

On May 22, 2013, Vector purchased 240,000 shares of LTS 8% Series A Cumulative Redeemable Preferred Stock (Liquidation Preference $25.00 Per Share) ("LTS-A") for $6,000. LTS will pay a monthly cumulative dividend of 8% on the LTS-A on a monthly basis. LTS, at its option, may redeem any or all of the LTS-A at $25.00 per share plus any accumulated and unpaid dividends on or after May 24, 2018. As of June 30, 2013, the LTS-A investment was included in "Investment securities available for sale" and had a carrying value of $6,007 in Vector's Condensed Consolidated Balance Sheet..

12. CONDENSED CONSOLIDATING FINANCIAL INFORMATION

The accompanying condensed consolidating financial information has been prepared and presented pursuant to Securities and Exchange Commission Regulation S-X, Rule 3-10, “Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered”. Each of the subsidiary guarantors are 100% owned, directly or indirectly, by the Company, and all guarantees are joint and several and subject to certain automatic release provisions. Relief from the financial statement requirements under Rule 3-10 is being provided because the Company's guarantee release provisions are considered customary pursuant to Section 2510.5 of the SEC Division of Corporation Finance Financial Reporting Manual. The Company's investments in its consolidated subsidiaries are presented under the equity method of accounting.

The indenture of the 7.75% Senior Secured Notes contains similar guarantees and covenants to those of the 11% Senior Secured Notes, except the indenture has covenants that restrict the payment of dividends by the Company if the Company's consolidated earnings before interest, taxes, depreciation and amortization, as defined in the indenture, for the most recently ended four full quarters is less than $75,000 and the indenture also restricts the incurrence of debt if the Company's Leverage Ratio and its Secured Leverage Ratio, as defined in the indenture, exceed 3.0 and 1.5, respectively.

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

CONDENSED CONSOLIDATING BALANCE SHEETS

	June 30, 2013				
	Parent/ Issuer	Subsidiary Guarantors	Subsidiary Non- Guarantors	Consolidating Adjustments	Consolidated Vector Group Ltd.
ASSETS:					
Current assets:					
Cash and cash equivalents	$273,219	$7,779	$715	$—	$281,713
Investment securities available for sale	83,019	51,122	—	—	134,141
Accounts receivable - trade, net	—	12,257	238	—	12,495
Intercompany receivables	879	—	—	(879)	—
Inventories	—	96,761	—	—	96,761
Deferred income taxes	28,804	3,213	—	—	32,017
Income taxes receivable, net	44,764	—	—	(28,133)	16,631
Restricted assets	—	1,241	—	—	1,241
Other current assets	479	4,548	193	—	5,220
Total current assets	431,164	176,921	1,146	(29,012)	580,219
Property, plant and equipment, net	4,115	53,408	544	—	58,067
Investment in consolidated real estate businesses, net	—	—	23,200	—	23,200
Long-term investments accounted for at cost	20,540	—	752	—	21,292
Long-term investments accounted for under the equity method	6,671	—	—	—	6,671
Investments in non-consolidated real estate businesses	—	—	142,878	—	142,878
Investments in consolidated subsidiaries	265,105	—	—	(265,105)	—
Restricted assets	1,892	10,365	31	—	12,288
Deferred income taxes	39,627	8,643	5,870	—	54,140
Intangible asset	—	107,511	—	—	107,511
Prepaid pension costs	—	13,787	—	—	13,787
Other assets	39,568	9,920	2	—	49,490
Total assets	$808,682	$380,555	$174,423	$(294,117)	$1,069,543
LIABILITIES AND STOCKHOLDERS' DEFICIENCY:					
Current liabilities:					
Current portion of notes payable and long-term debt	$—	$33,752	$154	$—	$33,906
Current portion of employee benefits	—	2,824	—	—	2,824
Accounts payable	782	5,025	113	—	5,920
Intercompany payables	—	493	386	(879)	—
Accrued promotional expenses	—	17,618	—	—	17,618
Income taxes payable	—	449	34,107	(28,133)	6,423
Accrued excise and payroll taxes payable, net	—	1,208	—	—	1,208

Litigation accruals and current payments due under the Master Settlement Agreement	—	59,966	—	—	59,966
Deferred income taxes	21,328	10,702	—	—	32,030
Accrued interest	22,398	—	—	—	22,398
Other current liabilities	3,872	7,917	1,291	—	13,080
Total current liabilities	48,380	139,954	36,051	(29,012)	195,373
Notes payable, long-term debt and other obligations, less current portion	623,215	11,567	3,570	—	638,352
Fair value of derivatives embedded within convertible debt	166,629	—	—	—	166,629
Non-current employee benefits	26,436	19,941	—	—	46,377
Deferred income taxes	72,616	35,306	4,522	—	112,444
Other liabilities, primarily litigation accruals and payments due under the Master Settlement Agreement	908	37,504	1,458	—	39,870
Total liabilities	938,184	244,272	45,601	(29,012)	1,199,045
Commitments and contingencies					
Stockholders' deficiency	(129,502)	136,283	128,822	(265,105)	(129,502)
Total liabilities and stockholders' deficiency	$808,682	$380,555	$174,423	$(294,117)	$1,069,543

37

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)
Unaudited

CONDENSED CONSOLIDATING BALANCE SHEETS

	December 31, 2012				
	Parent/ Issuer	Subsidiary	Subsidiary Non-	Consolidating	Consolidated Vector Group