

VECTOR GROUP LTD
Form 10-Q
May 06, 2010

**VECTOR GROUP LTD.
FORM 10-Q
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VECTOR GROUP LTD. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

	March 31, 2010	December 31, 2009
ASSETS:		
Current assets:		
Cash and cash equivalents	\$ 202,957	\$ 209,454
Investment securities available for sale	61,615	51,743
Accounts receivable trade	7,154	8,098
Inventories	101,613	98,486
Deferred income taxes	16,409	14,154
Restricted assets	1,378	3,138
Other current assets	3,478	4,135
Total current assets	394,604	389,208
Property, plant and equipment, net	43,821	42,986
Investment in Escena, net	13,488	13,244
Long-term investments accounted for at cost	50,323	50,323
Investments in non-consolidated real estate businesses	51,809	49,566
Restricted assets	5,166	4,835
Deferred income taxes	38,580	39,838
Intangible asset	107,511	107,511
Prepaid pension costs	9,237	8,994
Other assets	28,541	29,037
Total assets	\$ 743,080	\$ 735,542
LIABILITIES AND STOCKHOLDERS DEFICIENCY:		
Current liabilities:		
Current portion of notes payable and long-term debt	\$ 29,787	\$ 21,889
Current portion of employee benefits	1,029	1,029
Accounts payable	4,819	4,355
Accrued promotional expenses	10,687	12,745
Income taxes payable, net	19,193	19,924
Accrued excise and payroll taxes payable, net	14,812	24,093
Settlement accruals	42,247	18,803
Deferred income taxes	22,283	17,254
Accrued interest	6,967	13,840
Other current liabilities	11,250	15,076
Total current liabilities	163,074	149,008
Notes payable, long-term debt and other obligations, less current portion	335,064	334,920

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Fair value of derivatives embedded within convertible debt	155,729	153,016
Non-current employee benefits	34,598	34,247
Deferred income taxes	44,286	45,120
Other liabilities	23,692	23,913
Total liabilities	756,443	740,224
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, 74,520,642 and 74,510,595 shares issued and 71,272,731 and 71,262,684 shares outstanding	7,127	7,126
Additional paid-in capital		15,928
Accumulated deficit	(461)	
Accumulated other comprehensive loss	(7,172)	(14,879)
Less: 3,247,911 shares of common stock in treasury, at cost	(12,857)	(12,857)
Total stockholders' deficiency	(13,363)	(4,682)
Total liabilities and stockholders' deficiency	\$ 743,080	\$ 735,542

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

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

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Revenues*	\$ 222,087	\$ 121,216
Expenses:		
Cost of goods sold*	169,911	72,526
Operating, selling, administrative and general expenses	21,158	21,530
Gain on brand transaction		(5,000)
Restructuring charges		1,000
Operating income	31,018	31,160
Other income (expenses):		
Interest and dividend income	65	150
Interest expense	(18,805)	(16,074)
Change in fair value of derivatives embedded within convertible debt	(2,714)	(303)
Impairment charges on investments		(8,500)
Equity income (loss) from non-consolidated real estate businesses	4,571	(995)
Gain on the sale of investment securities available for sale	4,664	
Other, net	61	
Income before provision for income taxes	18,860	5,438
Income tax expense	6,922	2,338
Net income	\$ 11,938	\$ 3,100
Per basic common share:		
Net income applicable to common shares	\$ 0.17	\$ 0.04
Per diluted common share:		
Net income applicable to common shares	\$ 0.15	\$ 0.04
Cash distributions and dividends declared per share	\$ 0.40	\$ 0.38

* Revenues and
Cost of goods
sold include
excise taxes of
\$111,193 and
\$33,712,
respectively.

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

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

	Common Stock		Additional		Accumulated	Other	Treasury	
	Shares	Amount	Paid-In	Accumulated	Comprehensive	Loss	Stock	Total
			Capital	Deficit				
Balance, December 31, 2009	71,262,684	\$ 7,126	\$ 15,928	\$		\$ (14,879)	\$ (12,857)	\$ (4,682)
Net income				11,938				11,938
Pension-related minimum liability adjustments, net of income taxes						486		486
Forward contract adjustments, net of income taxes						9		9
Change in net unrealized gain on investment securities, net of income taxes						9,983		9,983
Net unrealized gains reclassified into net income, net of income taxes						(2,771)		(2,771)
Net unrealized gain on investment securities, net of income taxes						7,212		7,212
Total other comprehensive income								19,645
Total comprehensive income								14,963
Distributions and dividends on common stock			(16,755)	(12,399)				(29,154)
Exercise of stock options	10,047	1	138					139

Amortization of deferred compensation				689					689
Balance, March 31, 2010	71,272,731	\$ 7,127	\$	\$ (461)	\$ (7,172)	\$ (12,857)	\$ (13,363)		

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

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

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Net cash provided by operating activities	\$ 13,163	\$ 21,088
Cash flows from investing activities:		
Sale or maturity of investment securities	6,933	
Proceeds from sale or liquidation of long-term investments		908
Investments in non-consolidated real estate businesses	(605)	
Distributions from non-consolidated real estate businesses	2,154	1,182
Increase in cash surrender value of life insurance policies	(536)	(356)
(Increase) decrease in non-current restricted assets	(331)	452
Proceeds from sale of fixed assets	3	
Capital expenditures	(3,795)	(803)
Net cash provided by investing activities	3,823	1,383
Cash flows from financing activities:		
Proceeds from debt issuance	2,112	10
Repayments of debt	(1,168)	(1,604)
Borrowings under revolver	216,456	123,724
Repayments on revolver	(210,997)	(123,291)
Dividends and distributions on common stock	(30,024)	(30,076)
Proceeds from exercise of Vector options and warrants	138	10
Net cash used in financing activities	(23,483)	(31,227)
Net decrease in cash and cash equivalents	(6,497)	(8,756)
Cash and cash equivalents, beginning of period	209,454	211,105
Cash and cash equivalents, end of period	\$ 202,957	\$ 202,349

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

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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 Inc. (Liggett Vector Brands), New Valley LLC (New Valley) and other less significant subsidiaries. All significant intercompany balances and transactions have been eliminated.

Liggett is engaged in the manufacture and sale of cigarettes in the United States. Vector Tobacco is engaged in research related to reduced risk cigarette products. New Valley is engaged in the real estate business and is seeking to acquire additional operating companies and real estate properties.

The interim condensed consolidated financial statements of the Company are unaudited and, in the opinion of management, reflect all adjustments necessary (which are normal and recurring) to state fairly the Company's consolidated financial position, results of operations and cash flows. 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, 2009 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 2009 financial information to conform to the 2010 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 29, 2009. All per share amounts have been presented as if the stock dividends had occurred on January 1, 2009.

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

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Net income	\$ 11,938	\$ 3,100
Income attributable to participating securities	(263)	(142)
Net income available to common stockholders	\$ 11,675	\$ 2,958

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VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)

Unaudited

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

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Net income	\$ 11,938	\$ 3,100
Income attributable to 6.75% Variable Interest Senior Convertible Exchange Notes	(257)	
Income attributable to participating securities	(263)	(142)
Net income available to common stockholders	\$ 11,418	\$ 2,958

Basic and diluted EPS were calculated using the following shares:

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Weighted-average shares for basic EPS	70,722,468	69,093,052
Plus incremental shares related to stock options	147,798	17,015
Plus incremental shares related to convertible debt	6,617,278	
Weighted-average shares for fully diluted EPS	77,487,544	69,110,067

The following stock options, non-vested restricted stock and shares issuable upon the conversion of convertible debt were outstanding during the three months ended March 31, 2010 and 2009 but were not included in the computation of diluted EPS.

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Number of stock options	509,442	663,997
Weighted-average exercise price	\$ 18.14	\$ 17.44

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Weighted-average shares of non- vested restricted stock	15,440	221,880
Weighted-average expense per share	\$ 17.11	\$ 16.30
Weighted-average number of shares issuable upon conversion of debt	9,709,561	13,579,184
Weighted-average conversion price	\$ 16.48	\$ 16.34

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VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

(d) Comprehensive Income:

Other comprehensive income is a component of stockholders' equity and includes such items as the unrealized gains and losses on investment securities available for sale, forward foreign contracts and minimum pension liability adjustments. The Company's comprehensive income (loss) was income of \$19,645 for the three months ended March 31, 2010 and a loss of \$1,213 for the three months ended March 31, 2009.

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

The Company has estimated the fair market value of the embedded derivatives based principally on the results of a valuation model. The estimated fair value of the derivatives embedded within the convertible debt is based principally on the present value of future dividend payments expected to be received by the convertible debt holders over the term of the debt. The discount rate applied to the future cash flows is estimated based on a spread in the yield of the Company's debt when compared to risk-free securities with the same duration; 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 Vector's stock price. The range of estimated fair market values of the Company's embedded derivatives was between \$159,252 and \$152,346. The Company recorded the fair market value of its embedded derivatives at the midpoint of the inputs at \$155,729 as of March 31, 2010. The estimated fair market value of the Company's embedded derivatives could change significantly based on future market conditions. (See Note 4.)

(f) New Accounting Pronouncements:

In June 2009, the FASB issued an amendment to the accounting and disclosure requirements for transfers of financial assets. The guidance requires additional disclosures for transfers of financial assets and changes the requirements for derecognizing financial assets. The Company adopted this guidance for interim and annual reporting periods beginning on January 1, 2010. The adoption of this guidance did not impact the Company's condensed consolidated financial statements.

In June 2009, the FASB issued an amendment to the accounting and disclosure requirements for the consolidation of variable interest entities. The amended guidance eliminates exceptions to consolidating qualifying special purpose entities, contains new criteria for determining the primary beneficiary, and increases the frequency of required reassessments to determine whether a company is the primary beneficiary of a variable interest entity. This guidance also contains a new requirement that any term, transaction, or arrangement that does not have a substantive effect on an entity's status as a variable interest entity, a company's power over a variable interest entity, or a company's obligation to absorb losses or its right to receive benefits of an entity must be disregarded. The elimination of the qualifying special-purpose entity concept and its consolidation exception means more entities will be subject to consolidation assessments and reassessments. The Company adopted this guidance for interim and annual reporting periods beginning on January 1, 2010. The adoption of this guidance did not impact the Company's condensed consolidated financial statements.

In January 2010, the FASB issued authoritative guidance intended to improve disclosure about fair value measurements. The guidance requires entities to disclose significant transfers in and out of fair value hierarchy levels and the reasons for the transfers and to present information about purchases, sales, issuances, and

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VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)

Unaudited

settlements separately in the reconciliation of fair value measurements using significant unobservable inputs (Level 3). Additionally, the guidance clarifies that a reporting entity should provide fair value measurements for each class of assets and liabilities and disclose the inputs and valuation techniques used for fair value measurements using significant other observable inputs (Level 2) and significant unobservable inputs (Level 3). This guidance is effective for interim and annual periods beginning after December 15, 2009 except for the disclosure about purchases, sales, issuances and settlements in the Level 3 reconciliation, which will be effective for interim and annual periods beginning after December 15, 2010. As this guidance provides only disclosure requirements, the adoption of this guidance did not impact the Company's condensed consolidated financial statements.

2. INVENTORIES

Inventories consist of:

	March 31, 2010	December 31, 2009
Leaf tobacco	\$ 47,023	\$ 48,942
Other raw materials	3,916	3,497
Work-in-process	398	2,388
Finished goods	67,126	59,293
Inventories at current cost	118,463	114,120
LIFO adjustments	(16,850)	(15,635)
	\$ 101,613	\$ 98,485

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 March 31, 2010, Liggett had leaf tobacco purchase commitments of approximately \$30,300. During 2007, the Company entered into a single source supply agreement for fire safe cigarette paper through 2012.

All of the Company's inventories at March 31, 2010 and December 31, 2009 have been reported under the LIFO method.

3. LONG-TERM INVESTMENTS

Long-term investments consist of investments in the following:

	March 31, 2010		December 31, 2009	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Investment partnerships	\$ 49,486	\$ 69,699	\$ 49,486	\$ 68,679
Real estate partnership	837	1,259	837	1,261
	\$ 50,323	\$ 70,958	\$ 50,323	