

VECTOR GROUP LTD
Form 10-Q
October 30, 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 September 30, 2013

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

Delaware (State or other jurisdiction of incorporation incorporation or organization)	1-5759 Commission File Number	65-0949535 (I.R.S. Employer Identification No.)
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4400 Biscayne Boulevard
Miami, Florida 33137
305/579-8000
(Address, including zip code and telephone number, including area code,
of the principal executive offices)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

Yes No

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

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

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

At October 30, 2013, Vector Group Ltd. had 94,484,521 shares of common stock outstanding.

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

	September 30, 2013	December 31, 2012
ASSETS:		
Current assets:		
Cash and cash equivalents	\$260,461	\$405,855
Investment securities available for sale	145,569	69,984
Accounts receivable - trade, net	11,931	11,247
Inventories	95,006	100,392
Deferred income taxes	53,052	36,609
Income taxes receivable, net	10,664	6,779
Restricted assets	1,605	2,469
Other current assets	8,189	5,721
Total current assets	586,477	639,056
Property, plant and equipment, net	58,035	57,153
Investments in consolidated real estate businesses, net	23,241	13,295
Long-term investments accounted for at cost	21,293	16,367
Long-term investments accounted for under the equity method	8,372	6,432
Investments in non-consolidated real estate businesses	176,383	119,219
Restricted assets	11,208	9,792
Deferred income taxes	65,357	49,142
Intangible asset	107,511	107,511
Prepaid pension costs	14,246	12,870
Other assets	48,832	55,894
Total assets	\$1,120,955	\$1,086,731
LIABILITIES AND STOCKHOLDERS' DEFICIENCY:		
Current liabilities:		
Current portion of notes payable and long-term debt	\$23,911	\$36,778
Litigation accruals	63,201	1,470
Current payments due under the Master Settlement Agreement	84,871	32,970
Current portion of employee benefits	1,005	2,824
Accounts payable	3,928	6,099
Accrued promotional expenses	18,420	18,730
Income taxes payable	5,739	6,269
Accrued excise and payroll taxes payable, net	3,307	20,419
Deferred income taxes	36,828	27,299
Accrued interest	13,388	25,410
Other current liabilities	15,182	16,891
Total current liabilities	269,780	195,159
Notes payable, long-term debt and other obligations, less current portion	647,178	586,946
Fair value of derivatives embedded within convertible debt	163,829	172,128
Non-current employee benefits	46,511	45,860
Deferred income taxes	120,949	109,532
Payments due under the Master Settlement Agreement	35,630	52,639
Litigation accruals	27,008	1,862
Other liabilities	2,646	1,857
Total liabilities	1,313,531	1,165,983

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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, 98,431,567 and 93,658,273 shares issued and 94,483,712 and 89,898,411 shares outstanding	9,448	8,989
Additional paid-in capital	—	—
Accumulated deficit	(195,444)	(65,116)
Accumulated other comprehensive income (loss)	5,123	(10,268)
Less: 3,947,855 and 3,759,862 shares of common stock in treasury, at cost	(12,857)	(12,857)
Total Vector Group Ltd. stockholders' deficiency	(193,730)	(79,252)
Non-controlling interest	1,154	—
Total stockholders' deficiency	(192,576)	(79,252)
Total liabilities and stockholders' deficiency	\$ 1,120,955	\$ 1,086,731

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

VECTOR GROUP LTD. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in Thousands, Except Per Share Amounts)

Unaudited

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Revenues*	\$271,516	\$272,783	\$761,038	\$806,983
Expenses:				
Cost of goods sold*	194,991	203,749	548,377	615,682
Operating, selling, administrative and general expenses	25,897	25,841	74,697	73,734
Litigation settlement and judgment expense	87,913	—	87,913	—
Operating (loss) income	(37,285	) 43,193	50,051	117,567
Other income (expenses):				
Interest expense	(33,583	) (25,906	) (99,045	) (78,667
Loss on extinguishment of debt	—	—	(21,458) —
Change in fair value of derivatives embedded within convertible debt	2,800	6,040	8,299	(21,020
Acceleration of interest expense related to debt conversion	—	(7,072	) —	(14,960
Equity income from non-consolidated real estate businesses	9,489	12,874	16,774	20,969
Equity (loss) income on long-term investments	(53	) 124	770	(1,205
(Loss) gain on sale of investment securities available for sale	(99	) 1,640	5,110	1,640
Other, net	2,871	341	5,151	856
(Loss) income before provision for income taxes	(55,860	) 31,234	(34,348	) 25,180
Income tax (benefit) expense	(18,969	) 13,302	(9,287	) 11,043
Net (loss) income	(36,891	) 17,932	(25,061	) 14,137
Net (loss) income attributed to non-controlling interest	—	—	—	—
Net (loss) income attributed to Vector Group Ltd.	\$(36,891	) \$17,932	\$(25,061	) \$14,137
Per basic common share:				
Net (loss) income applicable to common shares attributed to Vector Group Ltd.	\$(0.40	) \$0.20	\$(0.27	) \$0.16
Per diluted common share:				
Net (loss) income applicable to common shares attributed to Vector Group Ltd.	\$(0.40) \$0.20	\$(0.27) \$0.16

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Cash distributions and dividends declared per share	\$0.38	\$0.36	\$1.14	\$1.09
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* Revenues and Cost of goods sold include excise taxes of \$121,787, \$126,389, \$343,294 and \$379,281, 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 COMPREHENSIVE INCOME
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

	Three Months Ended September 30, 2013		Nine Months Ended September 30, 2012	
Net (loss) income	\$(36,891	) \$17,932	\$(25,061	) \$14,137
Net unrealized gains (losses) on investment securities available for sale:				
Change in net unrealized gains (losses)	11,848	883	28,752	(13,386
Net unrealized losses (gains) reclassified into net income	99	(1,640	) (5,110	) (1,640
Net unrealized gains (losses) on investment securities available for sale	11,947	(757	) 23,642	(15,026
Net unrealized gains on long-term investments accounted for under the equity method:				
Change in net unrealized gains	1,754	476	1,170	1,018
Net unrealized gains reclassified into net income	—	—	—	—
Net unrealized gains on long-term investments accounted for under the equity method	1,754	476	1,170	1,018
Net change in forward contracts	16	15	47	47
Net change in pension-related amounts	350	870	1,052	2,611
Other comprehensive income (loss)	14,067	604	25,911	(11,350
Income tax effect on:				
Change in net unrealized gains (losses) on investment securities	(4,810	) (358	) (11,673	) 5,435
Net unrealized losses (gains) reclassified into net income on investment securities	(41	) 665	2,074	665
Change in unrealized gains on long-term investments	(712	) (193	) (475	) (413
Net unrealized gains reclassified into net income on long-term investments	—	—	—	—
Forward contracts	(7	) (6	) (19	) (19
Pension-related amounts	(142	) (353	) (427	) (1,060
Income tax (provision) benefit on other comprehensive income (loss)	(5,712) (245) (10,520) 4,608
Other comprehensive income (loss), net of tax	8,355	359	15,391	(6,742

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Comprehensive (loss) income	(28,536) 18,291	(9,670) 7,395
Less: Comprehensive income attributed to non-controlling interest	—	—	—	—
Comprehensive (loss) income attributed to Vector Group Ltd.	\$(28,536	) \$18,291	\$(9,670	) \$7,395

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. Stockholders' Deficiency							
	Common Stock Shares	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive (Loss) Income	Treasury Stock	Non-controlling Interest	Total	
Balance, December 31, 2012	89,898,411	\$8,989	\$ —	\$(65,116)	\$(10,268)	\$(12,857)	\$ —	\$(79,252)
Net loss	—	—	—	(25,061)	—	—	—	(25,061)
Change in net loss and prior service cost, net of income taxes	—	—	—	—	625	—	—	625
Forward contract adjustments, net of income taxes	—	—	—	—	28	—	—	28
Unrealized gain on long-term investment securities accounted for under the equity method, net of income taxes	—	—	—	—	695	—	—	695
Change in net unrealized gain on investment securities, net of income taxes	—	—	—	—	17,079	—	—	17,079
Net unrealized gains reclassified into net income, net of income taxes	—	—	—	—	(3,036)	—	—	(3,036)
Unrealized gain on investment securities, net of income taxes	—	—	—	—	—	—	—	14,043
Total other comprehensive income	—	—	—	—	—	—	—	15,391
Total comprehensive loss	—	—	—	—	—	—	—	(9,670)
Distributions and dividends on common stock	—	—	(2,485)	(104,817)	—	—	—	(107,302)
Restricted stock grant	50,000	5	(5)	—	—	—	—	—
Effect of stock dividend	4,498,579	450	—	(450)	—	—	—	—
	36,722	4	524	—	—	—	—	528

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Exercise of stock options								
Tax benefit of options exercised	—	—	33	—	—	—	—	33
Stock-based compensation	—	—	1,933	—	—	—	—	1,933
Contributions to non-controlling interest	—	—	—	—	—	—	1,924	1,924
Distributions to non-controlling interest	—	—	—	—	—	—	(770)	(770)
Balance as of September 30, 2013	94,483,712	\$9,448	\$—	\$(195,444)	\$ 5,123	\$(12,857)	\$ 1,154	\$(192,576)

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

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

	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012	
Net cash provided by operating activities	\$55,244	\$97,245	
Cash flows from investing activities:			
Sale of investment securities	82,649	3,831	
Purchase of investment securities	(129,483)	(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	(45,977)	(22,467))
Investments in consolidated real estate businesses	(7,697)	—	
Distributions from non-consolidated real estate businesses	2,463	31,221	
Increase in cash surrender value of life insurance policies	(470)	(831))
Increase in restricted assets	(553)	(1,126))
Issuance of notes receivable	—	(355))
Proceeds from sale of fixed assets	11	418	
Capital expenditures	(8,686)	(8,268))
Repayments of notes receivable	9,460	—	
Net cash used in investing activities	(103,208)	(3,653))
Cash flows from financing activities:			
Proceeds from debt issuance	454,200	14,018	
Deferred financing costs	(11,750)	(315))
Repayments of debt	(420,710)	(15,440))
Borrowings under revolver	723,578	794,249	
Repayments on revolver	(736,007)	(809,567))
Dividends and distributions on common stock	(107,302)	(100,392))
Proceeds from exercise of employee stock options	528	140	
Tax benefit of employee stock options exercised	33	48	
Net cash used in financing activities	(97,430)	(117,259))
Net decrease in cash and cash equivalents	(145,394)	(23,667))
Cash and cash equivalents, beginning of period	405,855	240,923	
Cash and cash equivalents, end of period	\$260,461	\$217,256	

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

VECTOR GROUP LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in Thousands, Except Per Share Amounts)

Unaudited

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation:

The condensed consolidated financial statements of Vector Group Ltd. (the “Company” or “Vector”) include the accounts of VGR Holding LLC (“VGR Holding”), Liggett Group LLC (“Liggett”), Vector Tobacco Inc. (“Vector Tobacco”), Liggett Vector Brands LLC (“Liggett Vector Brands”), 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 27, 2013 and September 28, 2012. The dividends were recorded at par value of \$450 and \$414 since the Company did not have retained earnings at September 30, 2013 and 2012, respectively. All per share amounts and references to share amounts have been updated to reflect the retrospective effect of the stock dividends.

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

Three Months Ended		Nine Months Ended	
September 30,		September 30,	
2013	2012	2013	2012

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Net (loss) income attributed to Vector Group Ltd.	\$(36,891)	\$17,932	\$(25,061)	\$14,137	
Income attributed to participating securities	—		(350)	—	(284)
Net (loss) income available to common stockholders	\$(36,891)	\$17,582	\$(25,061)	\$13,853	

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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		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Weighted-average shares for basic EPS	91,214,709	89,564,627	91,182,208	88,085,793
Plus incremental shares related to stock options and non-vested restricted stock	—	174,009	—	201,573
Weighted-average shares for basic and fully diluted EPS	91,214,709	89,738,636	91,182,208	88,287,366

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Number of stock options	499,892	N/A	499,892	N/A
Weighted-average exercise price	\$ 12.47	N/A	\$ 12.47	N/A
Weighted-average shares of non-vested restricted stock	52,500	3,675	52,500	3,675
Weighted-average expense per share	16.30	\$ 16.30	\$ 16.30	\$ 16.30
Weighted-average number of shares issuable upon conversion of debt	28,310,521	16,726,043	28,310,521	18,182,131
Weighted-average conversion price	\$ 15.22	\$ 13.29	\$ 15.22	\$ 13.38

VECTOR GROUP LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)

Unaudited

(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 \$161,135 and \$166,607. The Company recorded the fair market value of its embedded derivatives at the midpoint of the inputs at \$163,829 as of September 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.)

(e) Other Income, Net:

Other income, net consists of:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Gain (loss) on warrants	\$ 135	\$(214)	\$ 172	\$(1,067)
Interest income	2,647	519	4,123	1,560
Accretion of interest income from debt discount on notes receivable	81	32	704	95
Gain on long-term investment	—	—	142	135
Other income	8	4	10	133
Other income, net	\$2,871	\$341	\$5,151	\$856

(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,

VECTOR GROUP LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)

Unaudited

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:

	September 30, 2013	December 31, 2012
Leaf tobacco	\$53,265	\$59,130
Other raw materials	3,739	3,151
Work-in-process	159	210
Finished goods	66,619	64,396
Inventories at current cost	123,782	126,887
LIFO adjustments	(28,776	) (26,495
	\$95,006	\$100,392

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 September 30, 2013, Liggett had tobacco and other inventory purchase commitments of approximately \$29,053.

All of the Company's inventories at September 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 September 30, 2013 were as follows:

	Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Equity securities	\$53,422	\$45,465	\$(942	) \$97,945
Fixed income securities	46,619	1,400	(395	) 47,624
Total investment securities available for sale	\$100,041	\$46,865	\$(1,337	) \$145,569

The components of investment securities available for sale at December 31, 2012 were as follows:

	Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Equity securities	\$48,097	\$23,621	\$(1,734	) \$69,984

VECTOR GROUP LTD.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Dollars in Thousands, Except Per Share Amounts)

Unaudited

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

Investment Type:	Market Value	Under 1 Year	1 Year up to 5 Years	More than 5 years
U.S. Government securities	\$ 10,273	\$—	\$ 10,273	\$—
Corporate securities	28,318	737	20,637	6,944
U.S. mortgage backed securities	741	—	—	741
Commercial mortgage-backed securities	5,959	—	—	5,959
U.S. asset backed securities	851	—	851	—
Index-linked U.S. bonds	1,482	—	1,482	—
Total fixed income securities by maturity dates	\$ 47,624	\$ 737	\$ 33,243	\$ 13,644

4. LONG-TERM INVESTMENTS

Long-term investments accounted for at cost:

	September 30, 2013		December 31, 2012	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Investment partnerships	\$20,541	\$23,463	\$15,540	\$16,962
Real estate partnership	752	1,140	827	1,391