VECTOR GROUP LTD
Form 10-Q
November 09, 2009

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, 2009

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

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

100 S.E. Second Street
Miami, Florida 33131
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. þ 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). o 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. (Check one):

þ 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 þ No

At November 9, 2009, Vector Group Ltd. had 71,262,684 shares of common stock outstanding.

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

	September 30, 2009	December 31, 2008
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 237,468	$ 211,105
Investment securities available for sale	62,094	28,518
Accounts receivable trade	6,824	9,506
Inventories	100,021	92,581
Deferred income taxes	4,199	3,642
Restricted assets	3,545	2,653
Other current assets	3,114	7,278
Total current assets	417,265	355,283
Property, plant and equipment, net	45,851	50,691
Mortgage receivable		17,704
Investment in real estate	12,204	
Long-term investments accounted for at cost	51,170	51,118
Investments in non-consolidated real estate businesses	45,628	50,775
Restricted assets	4,586	6,555
Deferred income taxes	58,211	45,222
Intangible asset	107,511	107,511
Prepaid pension costs	3,171	2,901
Other assets	29,783	29,952
Total assets	$ 775,380	$ 717,712
LIABILITIES AND STOCKHOLDERS EQUITY:		
Current liabilities:		
Current portion of notes payable and long-term debt	$ 20,892	$ 97,498
Current portion of employee benefits	1,051	21,840
Accounts payable	9,769	6,104
Accrued promotional expenses	12,081	10,131
Income taxes payable, net	31,112	11,803
Accrued excise and payroll taxes payable, net	568	7,004
Settlement accruals	46,787	20,668
Deferred income taxes	17,203	92,507
Accrued interest	6,861	9,612
Other current liabilities	12,215	18,992
Total current liabilities	158,539	296,159

Notes payable, long-term debt and other obligations, less current portion	334,502	210,301
Fair value of derivatives embedded within convertible debt	142,850	77,245
Non-current employee benefits	36,933	34,856
Deferred income taxes	68,492	48,807
Other liabilities	24,042	16,739
Total liabilities	765,358	684,107
Commitments and contingencies		
Stockholders equity:		
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, 74,220,968 and 69,107,320 shares issued and 70,973,057 and and 66,014,070 shares outstanding	7,097	6,601
Additional paid-in capital	30,293	65,103
Retained earnings		
Accumulated other comprehensive loss	(14,511)	(25,242)
Less: 3,247,911 and 3,093,250 shares of common stock in treasury, at cost	(12,857)	(12,857)
Total stockholders equity	10,022	33,605
Total liabilities and stockholders equity	$ 775,380	$ 717,712

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 September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Revenues*	$ 236,736	$ 145,601	$ 564,746	$ 420,766
Expenses:				
Cost of goods sold*	177,798	84,999	398,088	251,036
Operating, selling, administrative and general expenses	21,966	23,067	63,679	69,809
Gain on brand transaction			(5,000)	
Restructuring charges			1,000	
Operating income	36,972	37,535	106,979	99,921
Other income (expenses):				
Interest and dividend income	51	1,094	277	4,440
Interest expense	(16,808)	(15,515)	(49,968)	(46,025)
Loss on extinguishment of debt			(18,444)	
Change in fair value of derivatives embedded within convertible debt	(6,054)	522	(25,845)	7,837
Impairment charges on investments		(7,000)	(8,500)	(7,000)
Equity income from non-consolidated real estate businesses	4,712	5,202	5,528	22,706
Other, net		(1)		(578)
Income before provision for income taxes	18,873	21,837	10,027	81,301
Income tax expense (benefit)	2,654	7,010	(1,346)	33,042
Net income	$ 16,219	$ 14,827	$ 11,373	$ 48,259
Per basic common share:				
Net income applicable to common shares	$ 0.22	$ 0.21	$ 0.16	$ 0.68
Per diluted common share:				
Net income applicable to common shares	$ 0.22	$ 0.20	$ 0.16	$ 0.67
Cash distributions and dividends declared per share	$ 0.38	$ 0.36	$ 1.14	$ 1.09

* Revenues and Cost of goods sold include excise taxes of $119,643, $43,327, $256,813 and $127,050, 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 DEFICIT
(Dollars in Thousands, Except Share Amounts)
Unaudited

	Common Stock		Additional Paid-In	Retained	Accumulated Other Comprehensive Income	Treasury	
	Shares	Amount	Capital	Earnings	(Loss)	Stock	Total
Balance, December 31, 2008	66,014,070	$ 6,601	$ 65,103	$	$ (25,242)	$ (12,857)	$ 33,605
Net income				11,373			11,373
Pension-related minimum liability adjustments, net of taxes					464		464
Forward contract adjustments, net of taxes					(7)		(7)
Unrealized gain on investment securities, net of taxes					10,274		10,274
Total other comprehensive income							10,731
Total comprehensive income							22,104
Distributions and dividends on common stock			(72,427)	(11,040)			(83,467)
Restricted stock grant	500,000	50					50
Effect of stock dividend	3,326,623	333		(333)			
Exercise of options, net of 2,120,479 shares delivered to pay exercise price	1,132,364	113	234				347
Excess tax benefit of options exercised			6,944				6,944

Amortization of deferred compensation			3,097				3,097
Beneficial conversion feature of notes payable, net of taxes			27,342				27,342
Balance, September 30, 2009	70,973,057	$ 7,097	$ 30,293	$	$ (14,511)	$ (12,857)	$ 10,022

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, 2009	Nine Months Ended September 30, 2008
Net cash provided by operating activities	$ 9,334	$ 70,435
Cash flows from investing activities:		
Purchase of investment securities	(12,300)	(5,682)
Proceeds from sale or liquidation of long-term investments	1,407	8,334
Purchase of long-term investments	(51)	(51)
Purchase of mortgage receivable		(21,704)
Distributions from non-consolidated real estate businesses	5,548	17,628
Investment in non-consolidated real estate businesses	(467)	(22,000)
Increase in cash surrender value of life insurance policies	(839)	(766)
Decrease in non-current restricted assets	1,969	838
Proceeds from sale of fixed assets		403
Capital expenditures	(3,005)	(5,426)
Net cash used in investing activities	(7,738)	(28,426)
Cash flows from financing activities:		
Proceeds from debt issuance	118,782	2,830
Repayments of debt	(4,516)	(4,666)
Deferred financing charges	(5,573)	(137)
Borrowings under revolver	526,949	386,499
Repayments on revolver	(530,766)	(397,892)
Dividends and distributions on common stock	(87,451)	(78,581)
Excess tax benefit of options exercised	6,944	18,304
Proceeds from exercise of options	398	26
Net cash provided by (used in) financing activities	24,767	(73,617)
Net increase (decrease) in cash and cash equivalents	26,363	(31,608)
Cash and cash equivalents, beginning of period	211,105	238,117
Cash and cash equivalents, end of period	$ 237,468	$ 206,509

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)
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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 the development of 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, 2008 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.

(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. Any amounts exceeding retained earnings are recorded as reductions to additional paid-in capital.

(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 and 2008, respectively The dividends were recorded at par value of $333 and $314 since the Company did not have retained earnings at September 30, 2009 and 2008, respectively. All per share amounts have been presented as if the stock dividends had occurred on January 1, 2008.

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The Company has stock option awards which provide for common stock dividends at the same rate as paid on the common stock with respect to the shares underlying the unexercised portion of the options. As a result, in its calculation of basic EPS for the three and nine months ended September 30, 2009 and 2008, the Company has adjusted its net income for the effect of its participating securities as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net income	$ 16,219	$ 14,827	$ 11,373	$ 48,259
Income attributable to participating securities	(740)	(675)	(519)	(2,228)
Net income available to common stockholders	$ 15,479	$ 14,152	$ 10,854	$ 46,031

Basic EPS is computed by dividing net income available to common stockholders by the weighted-average number of shares outstanding.

Diluted EPS is computed by dividing net income available to common stockholders by the diluted weighted-average number of shares outstanding, which includes dilutive non-vested restricted stock grants, stock options and convertible securities. Diluted EPS includes the dilutive effect of stock options, unvested restricted stock grants and convertible securities. However, in its calculation of diluted EPS for the three and nine months ended September 30, 2009 and 2008, the Company has adjusted its net income for the effect of the participating securities, stock options, unvested restricted stock grants and convertible securities as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net income	$ 16,219	$ 14,827	$ 11,373	$ 48,259
Expenses attributable to 5% convertible debentures	13			
Income attributable to participating securities	(741)	(675)	(519)	(2,228)
Net income available to common stockholders	$ 15,491	$ 14,152	$ 10,854	$ 46,031

VECTOR GROUP LTD.
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Basic and diluted EPS were calculated using the following shares for the three and nine months ended September 30, 2009 and 2008:

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Weighted-average shares for basic EPS	69,232,323	68,926,087	69,143,505	67,245,435
Plus incremental shares related to stock options and non-vested restricted stock	125,311	1,308,592	60,315	1,466,227
Plus incremental shares related to convertible debt	60,183			
Weighted-average shares for fully diluted EPS	69,417,817	70,234,679	69,203,820	68,711,662

The Company s non-vested restricted share grants contain rights to receive forfeitable dividends, and thus are not participating securities requiring the two class method of computing EPS.

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, 2009 and 2008 but were not included in the computation of diluted EPS because the exercise prices of the options and the per share expense associated with the restricted stock were greater than the average market price of the common shares during the respective periods, and the impact of common shares issuable under the convertible debt were anti-dilutive to EPS.

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Number of stock options	509,442	540,472	546,489	540,472
Weighted-average exercise price	$ 18.77	$ 18.30	$ 17.84	$ 18.30
Weighted-average shares of non-vested restricted stock	177,784	85,134	196,789	237,073
Weighted-average expense per share	$ 16.26	$ 16.78	$ 16.25	$ 16.33

Weighted-average number of shares issuable upon conversion of debt	16,350,285	13,579,184	15,018,085	13,579,184
Weighted-average conversion price	$ 16.38	$ 16.34	$ 16.29	$ 16.34

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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(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 was $27,199 and $22,104 for the three and nine months ended September 30, 2009. The Company s comprehensive income was $19,843 and $45,287 for the three and nine months ended September 30, 2008.

(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 $140,058 and $145,750. The Company recorded the fair market value of its embedded derivatives at the midpoint of the inputs at $142,850 as of September 30, 2009. The estimated fair market value of the Company s embedded derivatives could change significantly based on future market conditions. (See Note 6.)

(f) Capital and Credit Market Crisis

During the recent capital and credit market crisis, the Company has performed additional assessments to determine the impact, if any, of market developments, on the Company s consolidated condensed financial statements. The Company s additional assessments have included a review of access to liquidity in the capital and credit markets, counterparty creditworthiness, value of the Company s investments (including long-term investments, mortgage receivable and employee benefit plans) and macroeconomic conditions. The recent unprecedented volatility in capital and credit markets may create additional risks in the upcoming months and possibly years and the Company will continue to perform additional assessments to determine the impact, if any, on the Company s condensed consolidated financial statements. Thus, future impairment charges may occur.

On a quarterly basis, the Company evaluates its investments to determine whether an impairment has occurred. If so, the Company also makes a determination of whether such impairment is considered temporary or other-than-temporary. The Company believes that the assessment of temporary or other-than-temporary impairment is facts and circumstances driven. However, among the matters that are considered in making such a determination are the period of time the investment has remained below its cost or carrying value, the likelihood of recovery given the reason for the decrease in market value and the Company s original expected holding period of the investment.

(g) Contingencies:

The Company records Liggett s product liability legal expenses and other litigation costs as operating, selling, general and administrative expenses as those costs are incurred. As discussed in Note 8, legal proceedings covering a wide range of matters are pending or threatened in various jurisdictions against Liggett.

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 discussed elsewhere in Note 8., (i) management has concluded that it is not probable that a loss has been incurred in any of the pending tobacco-related cases; (ii) management is unable to estimate the possible loss or range of loss that could result from an unfavorable outcome in any of the pending tobacco-related cases; and (iii) accordingly, management has not provided any amounts in the consolidated financial statements for unfavorable outcomes, if any, unless specified in Note 8. Legal defense costs are expensed as incurred.

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

In June 2009, the Financial Accounting Standards Board (FASB) issued the FASB Accounting Standards Codification (the Codification). The Codification is the single source of authoritative nongovernmental U.S. GAAP, superseding existing FASB, American Institute of Certified Public Accountants (AICPA), Emerging Issues Task Force (EITF) and related literature. The Codification eliminates the GAAP hierarchy contained in Statement of Financial Accounting Standard and establishes one level of authoritative GAAP. All other literature is considered non-authoritative. The Codification is effective for financial statements issued for interim and annual periods ending after September 15, 2009. In response, the Company has used plain English or included the references to the Codification, as appropriate, in these condensed consolidated financial statements.

On January 1, 2008, the FASB issued new accounting guidance on fair value measurement. The guidance does not require any new fair value measurements but provides a definition of fair value, establishes a framework for measuring fair value, and expands disclosure about fair value measurements. On January 1, 2009, the Company adopted the guidance as it relates to nonfinancial assets and nonfinancial liabilities that are not recognized or disclosed at fair value in the financial statements on at least an annual basis. The guidance defines fair value, establishes a framework for measuring fair value in accounting principles generally accepted in the United States of America (GAAP), and expands disclosures about fair value measurements. The provisions of this standard apply to other accounting pronouncements that require or permit fair value measurements and are to be applied prospectively with limited exceptions. The adoption of the guidance did not have a material impact on the Company s condensed consolidated financial statements. (See Note 11.)

In April 2009, the FASB issued a staff position providing additional guidance that clarifies the methodology used to determine fair value when there is no active market or where the price inputs being used represent distressed sales. The staff position guidance reaffirms the objective of fair value measurement, as stated in the original guidance which is to reflect how much an asset would be sold for in an orderly transaction. It also reaffirms the need to use judgment to determine if a formerly active market has become inactive, as well as to determine fair values when markets have become inactive. The adoption of the staff position guidance had no impact on the Company s condensed consolidated financial statements.

On January 1, 2009, the FASB s revised guidance on business combinations became effective. The revision is intended to simplify existing guidance and converge rulemaking under U.S. GAAP with international accounting rules. The adoption of this standard did not have a material impact on the Company s condensed consolidated financial statements.

On January 1, 2009, the FASB issued guidance on the disclosures about derivative instruments and hedging activities. The guidance seeks qualitative disclosures about the objectives and strategies for using derivatives, quantitative data about the fair value of and gains and losses on derivative contracts, and details of credit-risk-related contingent features in hedged positions. The guidance also seeks enhanced disclosure around how derivative instruments and related hedged items are accounted for under the standard and its related interpretations and how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. The adoption of the guidance did not have a material impact on the Company s condensed consolidated financial statements.

On May 9, 2008, the FASB issued guidance on the accounting for convertible debt Instruments that may be settled in cash upon conversion. The adoption of the guidance had no impact on the Company s condensed consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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On January 1, 2009, the FASB s amended guidance on determining whether instruments granted in share-based payment transactions are participating securities became effective for the Company. The amended guidance states that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. The adoption of the amended guidance had no impact on the Company s condensed consolidated financial statements.

In April 2009, the FASB issued authoritative guidance on the methodology for determining whether an other-than-temporary impairment exists for debt securities and the amount of the impairment to be recorded in earnings through increased consistency in the timing of impairment recognition and enhanced disclosures related to the credit and noncredit components of impaired debt securities that are not expected to be sold. In addition, increased disclosures are required for both debt and equity securities regarding expected cash flows, credit losses, and an aging of securities with unrealized losses. The adoption of the guidance did not have an impact on the condensed consolidated financial statements.

In April 2009, FASB issued authoritative guidance on disclosures about fair value of financial instruments whenever summarized financial information for interim reporting periods is presented in order to provide more timely information about the effects of current market conditions on financial instruments. Prior to the new guidance, the fair values of those assets and liabilities were disclosed only once each year. With the new guidance, the Company discloses this information on a quarterly basis, providing quantitative and qualitative information about fair value estimates for all financial instruments not measured in the condensed consolidated balance sheets at fair value. The adoption of the guidance did not have a material impact on the Company s condensed consolidated financial statements.

In December 2008, the FASB issued authoritative guidance on employer s disclosures about plan assets of a defined benefit pension or other postretirement plan. The objective of the guidance is to provide users of financial statements with an understanding of how investment allocation decisions are made, the major categories of plan assets held by the plans, the inputs and valuation techniques used to measure the fair value of plan assets, significant concentration of risk within the company s plan assets, and for fair value measurements determined using significant unobservable inputs a reconciliation of changes between the beginning and ending balances. The Company will adopt the new disclosure requirements in the 2009 annual reporting period.

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 will adopt these Statements for interim and annual reporting periods beginning on January 1, 2010. The Company is currently assessing the impact, if any, of the amended guidance on its 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 will adopt these statements for interim and annual reporting periods beginning on January 1, 2010. The Company is currently assessing the impact, if any, the amended guidance on its condensed consolidated financial statements.

In May 2009, the FASB issued guidance which establishes general standards of: 1) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements; 2) the circumstances under which an entity

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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should recognize events or transactions occurring after the balance sheet date in its financial statements; and 3) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. The adoption of this guidance did not impact the Company s condensed consolidated financial statements.

2. RESTRUCTURING

In March 2009, Vector Tobacco eliminated nine full-time positions in connection with the decision by the Company s Board of Directors in 2006 to discontinue the genetics operation and not to pursue FDA approval of QUEST as a smoking cessation aide, due to the projected significant additional time and expense involved in seeking such approval.

The Company recognized pre-tax restructuring charges of $1,000, during the first quarter of 2009. The restructuring charges primarily related to employee severance and benefit costs. The remaining balance of the severance and benefit costs restructuring charges was $437 as of September 30, 2009. Approximately $352 and $563 was utilized during the three and nine months ended September 30, 2009, respectively.

The only remaining component of the 2004 Liggett Vector Brands restructuring at September 30, 2009 and December 31, 2008 was contract termination and exit costs of $353 and $461, respectively. Approximately $43 and $108 was utilized during the three and nine months ended September 30, 2009, respectively.

3. INVESTMENT SECURITIES AVAILABLE FOR SALE

Investment securities classified as available for sale are carried at fair value, with net unrealized gains or losses included as a component of stockholders equity, net of income taxes. The components of investment securities available for sale at September 30, 2009 were as follows:

	Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Marketable equity securities	$ 41,255	$ 22,226	$ (1,387)	$ 62,094

Investment securities available for sale as of September 30, 2009 and December 31, 2008 include New Valley s 13,891,205 shares of Ladenburg Thalmann Financial Services Inc. (LTS) common stock, which were carried at $10,002 and $10,000, respectively.

4. INVENTORIES

Inventories consist of:

	September 30, 2009	December 31, 2008
Leaf tobacco	$ 51,376	$ 48,880
Other raw materials	3,359	5,128
Work-in-process	406	314
Finished goods	59,526	46,202
Inventories at current cost	114,667	100,524
LIFO adjustments	(14,646)	(7,943)
	$ 100,021	$ 92,581

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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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, 2009, Liggett had leaf tobacco purchase commitments of approximately $15,513. There were no leaf tobacco purchase commitments at Vector Tobacco at that date. During 2007, the Company entered into a single source supply agreement for fire safe cigarette paper through 2012.

The Company capitalizes the incremental prepaid cost of the Master Settlement Agreement in ending inventory. For the nine months ended September 30, 2009 and 2008, the Company s MSA expense was increased by approximately $650 for 2008 and reduced by approximately $1,300 for 2007, respectively, as a result of a change in estimate to the MSA assessment.

LIFO inventories represent approximately 95% of total inventories at September 30, 2009 and December 31, 2008, respectively.

5. LONG-TERM INVESTMENTS

Long-term investments consist of investments in the following:

	September 30, 2009		December 31, 2008	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Investment partnerships accounted for at cost	$51,170	$69,987	$51,118	$54,997

The principal business of these investment partnerships is investing in investment securities and real estate. The estimated fair value of the investment partnerships was provided by the partnerships based on the indicated market values of the underlying assets or investment portfolio. The investments in these investment partnerships are illiquid and the ultimate realization of these investments is subject to the performance of the underlying partnership and its management by the general partners.

The long-term investments are carried on the condensed consolidated balance sheet at cost. The fair value determination disclosed above would be classified as Level 3 under the fair value authoritative guidance hierarchy disclosed in Note 11 if such assets were recorded on the condensed consolidated balance sheet at fair value. The fair values were determined based on unobservable inputs and were based on company assumptions, and information obtained from the partnerships based on the indicated market values of the underlying assets of the investment portfolio.

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The changes in the fair value of these investments as of September 30, 2009 were as follows:

	Investment Partnerships Accounted for at Cost
Balance as of January 1, 2009	$ 54,997
Unrealized loss on long-term investments	(357)
Balance as of March 31, 2009	54,640
Unrealized gain on long-term investments	8,432
Balance as of June 30, 2009	63,072
Contributions	52
Unrealized gain on long-term investments	6,863
Balance as of September 30, 2009	$ 69,987

The changes in the fair value of these investments as of September 30, 2008 were as follows:

	Investment Partnerships Accounted for at Cost	Investment Partnerships Accounted for on the Equity Method
Balance as of January 1, 2008	$ 89,007	$ 10,495
Unrealized loss on long-term investments	(2,034)	(675)
Realized loss on long-term investments		(567)
Balance as of March 31, 2008	86,973	9,253
Contributions (distributions)	47	(8,328)
Unrealized loss on long-term investments	(3,767)	
Realized gain on long-term investments	14	
Receivable classified as Other currents assets		(925)
Balance as of June 30, 2008	83,267	
Unrealized loss on long-term investments	(7,778)	
Impairment loss on long-term investments	(3,000)	
Balance as of September 30, 2008	$ 72,489	$

The Company will continue to perform additional assessments of the investments and the current condition of capital and credit markets to determine the impact, if any, on the Company s condensed consolidated financial statements. Thus, future impairment charges may occur.

The Company received a distribution of approximately $847 from one of the limited partnerships in the fourth quarter of 2009.

In the future, the Company may invest in other investments, including limited partnerships, real estate investments, equity securities, debt securities, derivatives and certificates of deposit, depending on risk factors and potential rates of return.

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

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

	September 30, 2009	December 31, 2008
Vector:		
11% Senior Secured Notes due 2015, net of unamortized discount of $5,037 and $0	$ 244,963	$ 165,000
6.75% Variable Interest Senior Convertible Note due 2014, net of unamortized discount of $39,999 and $0*	10,001	
6.75% Variable Interest Senior Convertible Exchange Notes due 2014, net of unamortized discount of $70,309 and $0*	36,628	
3.875% Variable Interest Senior Convertible Debentures due 2026, net of unamortized discount of $83,687 and $83,993*	26,313	26,007
5% Variable Interest Senior Convertible Notes due 2011, net of unamortized net discount of $246 and $39,565*	669	72,299
Liggett:		
Revolving credit facility	15,698	19,515
Term loan under credit facility	6,889	7,290
Equipment loans	5,521	8,307
V.T. Aviation:		
Note payable	4,232	5,266
VGR Aviation:		
Note payable	3,781	4,053
Other	699	62
Total notes payable, long-term debt and other obligations	355,394	307,799
Less:		
Current maturities	(20,892)	(97,498)
Amount due after one year	$ 334,502	$ 210,301

* The fair value of the derivatives embedded within the 6.75% Variable Interest Senior

Convertible Exchange Notes ($42,710 at September 30, 2009 and $0 at December 31, 2008), 6.75% Variable Interest Convertible Note ($23,783 at September 30, 2009 and $0 at December 31, 2008), 3.875% Variable Interest Senior Convertible Debentures ($76,187 at September 30, 2009 and $51,829 at December 31, 2008) and the 5% Variable Interest Senior Convertible Notes ($170 at September 30, 2009 and $25,416 at December 31, 2008) is separately classified as a derivative liability in the condensed consolidated balance sheets.

11% Senior Secured Notes due 2015 Vector:

In August 2007, the Company sold $165,000 of its 11% Senior Secured Notes due 2015 (the Senior Secured Notes) in a private offering to qualified institutional investors in accordance with Rule 144A of the Securities Act of 1933. On May 28, 2008, the Company completed an offer to exchange the Senior Secured Notes for an equal amount of newly issued 11% Senior Secured Notes due 2015. The new Senior Secured Notes have substantially the same terms as the original notes, except that the new Senior Secured Notes have been registered under the Securities Act. In September 2009, the Company sold an additional $85,000 principal amount of the Senior Secured Notes at 94% of face value in a private offering to qualified institutional investors in accordance with Rule 144A of the Securities Act of 1933. The Company received net proceeds from the offering of approximately $79,900. The Company will amortize the deferred costs and debt discount related to the additional Senior Secured Notes over the estimated life of the debt. In connection with the September 2009 offering, the Company agreed to consummate a registered exchange offer for these Senior Secured Notes within 360 days after the date of their initial issuance.

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If the Company fails to timely comply with its registration obligations, it will be required to pay additional interest on these Senior Secured Notes until it complies.

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 (Consolidated EBITDA), as defined in the indenture, for the most recently ended four full quarters is less than $50,000. 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.

The following table summarizes the requirements of these financial covenants and the results of the calculation, as defined by the indenture.

Covenant	Indenture Requirement	September 30, 2009	December 31, 2008
Consolidated EBITDA, as defined	$50,000	$160,232	$154,053
Leverage ratio, as defined	<3.0 to 1	Negative	0.1 to 1
Secured leverage ratio, as defined	<1.5 to 1	Negative	Negative

Variable Interest Senior Convertible Debt Vector:

Vector has issued four series of variable interest senior convertible debt. All four series of debt pay interest on a quarterly basis at a stated rate plus an additional amount of interest on each payment date. The additional amount is based on the amount of cash dividends paid during the prior three-month period ending on the record date for such interest payment multiplied by the total number of shares of its common stock into which the debt would be convertible on such record date.

5% Variable Interest Senior Convertible Notes due November 2011:

Between November 2004 and April 2005, the Company sold $111,864 principal amount of its 5% Variable Interest Senior Convertible Notes due November 15, 2011 (the 5% Notes). In May 2009, the holder of $11,005 principal amount of the 5% Notes exchanged its 5% Notes for $11,775 principal amount of the Company s 6.75% Variable Interest Senior Convertible Note due 2014 (the 6.75% Note) as discussed below. In June 2009, certain holders of $99,944 principal amount of the 5% Notes exchanged their 5% Notes for $106,940 principal amount of the Company s 6.75% Variable Interest Senior Convertible Exchange Notes due 2014 of the Company (the 6.75% Exchange Notes). As of September 30, 2009, a total of $915 principal amount of the 5% Notes remained outstanding after these exchanges.

6.75% Variable Interest Senior Convertible Note due 2014:

On May 11, 2009, the Company issued in a private placement the 6.75% Note in the principal amount of $50,000. The purchase price was paid in cash ($38,225) and by tendering $11,005 principal amount of the 5% Notes, valued at 107% of principal amount. The note pays interest (Total Interest) on a quarterly basis at a rate of 3.75% per annum plus additional interest, which is based on the amount of cash dividends paid during the prior three-month period ending on the record date for such interest payment multiplied by the total number of shares of its common stock into which the debt will be convertible on such record date. Notwithstanding the foregoing, however, the interest payable on each interest payment date shall be the higher of (i) the Total Interest and (ii) 6.75% per annum. The note is convertible into the Company s common stock at the holder s option. The conversion price of $14.32 per share (approximately 69.8139 shares of common stock per $1,000 principal amount of the note) is

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subject to adjustment for various events, including the issuance of stock dividends. The note will mature on November 15, 2014. The Company will redeem on May 11, 2014 and at the end of each interest accrual period thereafter an additional amount, if any, of the note necessary to prevent the note from being treated as an Applicable High Yield Discount Obligation under the Internal Revenue Code. If a fundamental change (as defined in the note) occurs, the Company will be required to offer to repurchase the note at 100% of its principal amount, plus accrued interest.

The purchaser of the 6.75% Note is an entity affiliated with Dr. Phillip Frost, who reported, after the consummation of the sale, beneficial ownership of approximately 11.5% of the Company s common stock.

6.75% Variable Interest Senior Convertible Exchange Notes due 2014:

In June 2009, the Company entered into agreements with certain holders of the 5% Notes to exchange their 5% notes for the Company s 6.75% Exchange Notes. On June 30, 2009, the Company accepted for exchange $99,944 principal amount of the 5% Notes for $106,940 of its 6.75% Exchange Notes. The Company issued its 6.75% Exchange Notes to the holders in reliance on the exemption from the registration requirements of the Securities Act of 1933, as amended, afforded by Section 3(a)(9) thereof. The notes pay interest (Total Interest) on a quarterly basis beginning August 15, 2009 at a rate of 3.75% per annum plus additional interest, which is based on the amount of cash dividends paid during the prior three-month period ending on the record date for such interest payment multiplied by the total number of shares of its common stock into which the debt will be convertible on such record date. Notwithstanding the foregoing, however, the interest payable on each interest payment date shall be the higher of (i) the Total Interest and (ii) 6.75% per annum. The notes are convertible into the Company s common stock at the holder s option. The conversion price of $16.25 per share (approximately 61.5366 shares of common stock per $1,000 principal amount of notes) is subject to adjustment for various events, including the issuance of stock dividends. The notes will mature on November 15, 2014. The Company will redeem on June 30, 2014 and at the end of each interest accrual period thereafter an additional amount, if any, of the notes necessary to prevent the notes from being treated as an Applicable High Yield Discount Obligation under the Internal Revenue Code. If a fundamental change (as defined in the indenture) occurs, the Company will be required to offer to repurchase the notes at 100% of their principal amount, plus accrued interest and, under certain circumstances, a make whole payment.

Embedded Derivatives on the Variable Interest Senior Convertible Debt:

The portion of the interest on the Company s convertible debt which is computed by reference to the cash dividends paid on the Company s common stock is considered an embedded derivative within the convertible debt, which the Company is required to separately value. In accordance with authoritative guidance on accounting for derivatives and hedging, the Company has bifurcated these embedded derivatives and estimated the fair value of the embedded derivative liability including using a third party valuation. The resulting discount created by allocating a portion of the issuance proceeds to the embedded derivative is then amortized to interest expense over the term of the debt using the effective interest method. Changes to the fair value of these embedded derivatives are reflected quarterly in the Company s consolidated statements of operations as Change in fair value of derivatives embedded within convertible debt. The value of the embedded derivative is contingent on changes in interest rates of debt instruments maturing over the duration of the convertible debt as well as projections of future cash and stock dividends over the term of the debt.

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A summary of non-cash interest expense associated with the amortization of the debt discount created by the embedded derivative liability associated with the Company s variable interest senior convertible debt is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
6.75% Note	$ 131	$	$ 201	$
6.75% exchange notes	608		608	
3.875% convertible debentures	114	89	339	269
5% convertible notes	16	1,423	3,385	3,904
Interest expense associated with embedded derivatives	$ 869	$ 1,512	$ 4,533	$ 4,173

A summary of non-cash changes in fair value of derivatives embedded within convertible debt is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008

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