

VECTOR GROUP LTD  
 Form 10-K  
 March 04, 2015  
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SECURITIES AND EXCHANGE COMMISSION  
 Washington, D.C. 20549

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Form 10-K

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ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
 SECURITIES EXCHANGE ACT OF 1934  
 For The Fiscal Year Ended December 31, 2014

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

|  |                        |                                      |
|--|------------------------|--------------------------------------|
| Delaware   | 1-5759                 | 65-0949535                           |
| (State or other jurisdiction of<br>incorporation<br>incorporation or organization) | Commission File Number | (I.R.S. Employer Identification No.) |
| 4400 Biscayne Boulevard, Miami, Florida  | 33137                  |                                      |
| (Address of principal executive offices)   | (Zip Code)             |                                      |
| (305) 579-8000   |                        |                                      |
| (Registrant's telephone number, including area code)                               |                        |                                      |

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Securities registered pursuant to Section 12(b) of the Act:

|  |  |
|--|--|
| Title of each class                        | Name of each exchange on which<br>registered |
| Common Stock, par value \$.10 per<br>share | New York Stock Exchange                      |

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. R Yes  No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.  Yes  No

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. R 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). R Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statement incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. R

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

Large accelerated filer R Accelerated filer  Non-accelerated filer  Smaller reporting company

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(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

The aggregate market value of the common stock held by non-affiliates of Vector Group Ltd. as of June 30, 2014 was approximately \$1.451 billion.

At March 4, 2015, Vector Group Ltd. had 116,728,566 shares of common stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE:**

Part III (Items 10, 11, 12, 13 and 14) from the definitive Proxy Statement for the 2015 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission no later than 120 days after the end of the Registrant's fiscal year covered by this report.

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PART I

ITEM 1. BUSINESS

Overview

Vector Group Ltd., a Delaware corporation, is a holding company and is principally engaged in: the manufacture and sale of cigarettes in the United States through our Liggett Group LLC (“Liggett”) and Vector Tobacco Inc. (“Vector Tobacco”) subsidiaries, the sale of electronic cigarettes (“e-cigarettes”) in the United States through our Zoom E-Cigs LLC (“Zoom”) subsidiary, and the real estate business through our New Valley LLC subsidiary, which is seeking to acquire additional operating companies and real estate properties. New Valley owns 70.59% of Douglas Elliman Realty, LLC (“Douglas Elliman Realty”), which operates the largest residential brokerage company in the New York metropolitan area. Financial information relating to our business segments can be found in Note 18 to our consolidated financial statements. Our significant business segments for the year ended December 31, 2014 were Tobacco, E-Cigarettes, and Real Estate. The Tobacco segment consists of the manufacture and sale of cigarettes. The E-Cigarettes segment includes the operations of the Company's e-cigarette business. The Real Estate segment includes the Company's investments in consolidated and non-consolidated real estate businesses.

Strategy

Our strategy is to maximize stockholder value by increasing the profitability of our subsidiaries in the following ways: Liggett and Vector Tobacco

- Capitalize upon our tobacco subsidiaries' cost advantage in the U.S. cigarette market due to the favorable treatment that they receive under the Master Settlement Agreement (“MSA”);

- Focus marketing and selling efforts on the discount segment, continue to build volume and margin in core discount brands (EAGLE 20's, PYRAMID, GRAND PRIX, LIGGETT SELECT and EVE) and utilize core brand equity to selectively build distribution;

- Continue product development to provide the best quality products relative to other discount products in the marketplace;

- Increase efficiency by developing and adopting an organizational structure to maximize profit potential;

- Selectively expand the portfolio of private and control label partner brands utilizing a pricing strategy that offers long-term list price stability for customers;

- Identify, develop and launch relevant new tobacco products to the market in the future; and

- Pursue strategic acquisitions of smaller tobacco manufacturers.

New Valley

- Continue to grow Douglas Elliman Realty's operations by utilizing its strong brand name recognition and pursuing strategic and financial opportunities;

- Continue to leverage our expertise as direct investors by actively pursuing real estate investments in the United States and abroad which we believe will generate above-market returns;

- Acquire operating companies through mergers, asset purchases, stock acquisitions or other means; and

- Invest our excess funds opportunistically in situations that we believe can maximize stockholder value.

Tobacco Operations

General. Liggett is the operating successor to Liggett & Myers Tobacco Company, which was founded in 1873. In April 2002, we acquired The Medallion Company, Inc. (“Medallion”), which is now known as Vector Tobacco and is a discount cigarette manufacturer selling product in the deep discount category, primarily under the USA and EAGLE brand names. In this report, certain references to “Liggett” refer to our tobacco operations, including the business of Liggett and Vector Tobacco, unless otherwise specified.

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For the year ended December 31, 2014, Liggett was the fourth-largest manufacturer of cigarettes in the United States in terms of unit sales. Liggett's manufacturing facilities are located in Mebane, North Carolina where it manufactures most of Vector Tobacco's cigarettes pursuant to a contract manufacturing agreement. At the present time, Liggett and Vector Tobacco have no foreign operations.

Liggett and Vector Tobacco manufacture and sell cigarettes in the United States. According to data from Management Science Associates, Inc., Liggett's domestic shipments of approximately 8.9 billion cigarettes during 2014 accounted for 3.4% of the total cigarettes shipped in the United States during such year. Liggett's market share increased 0.1% in 2014 from 3.3% in 2013. Market share in 2012 was 3.5%. Historically, Liggett produced premium cigarettes as well as discount cigarettes (which include among others, control label, private label, branded discount and generic cigarettes). Premium cigarettes are generally marketed under well-recognized brand names at higher retail prices to adult smokers with a strong preference for branded products, whereas discount cigarettes are marketed at lower retail prices to adult smokers who are more cost conscious. In recent years, the discounting of premium cigarettes has become far more significant in the marketplace. This has led to some brands that were traditionally considered premium brands becoming more appropriately categorized as branded discount, following list price reductions. Liggett's EVE brand falls into that category. All of Liggett's unit sales volume in 2014, 2013 and 2012 was in the discount segment, which Liggett's management believes has been the primary growth segment in the industry for more than a decade.

Liggett produces cigarettes in 117 combinations of length, style and packaging. Liggett's current brand portfolio includes:

- **EAGLE 20's** — a brand positioned in the deep discount segment for long-term growth re-launched as a national brand in 2013,
- **PYRAMID** — the industry's first deep discount product with a brand identity relaunched in the second quarter of 2009,
- **GRAND PRIX** — re-launched as a national brand in 2005,
- **LIGGETT SELECT** — a leading brand in the deep discount category,
- **EVE** — a leading brand of 120 millimeter cigarettes in the branded discount category, and
- **USA** and various Partner Brands and private label brands.

In 1999, Liggett introduced LIGGETT SELECT, one of the leading brands in the deep discount category. LIGGETT SELECT represented 4.5% in 2014, 5.5% in 2013 and 7.0% in 2012 of Liggett's unit volume. In September 2005, Liggett repositioned GRAND PRIX to distributors and retailers nationwide. GRAND PRIX represented 5.6% in 2014, 7.2% in 2013 and 9.6% in 2012 of Liggett's unit volume. In April 2009, Liggett repositioned PYRAMID as a box-only brand with a low price to specifically compete with brands which are priced at the lowest level of the deep discount segment. PYRAMID is now the largest seller in Liggett's family of brands with 61.1% of Liggett's unit volume in 2014, 65.5% in 2013 and 62.7% in 2012. In January 2013, Liggett repackaged and relaunched EAGLE 20's to distributors and retailers on a national basis. EAGLE 20's is marketed to compete with brands positioned in the deep discount segment. EAGLE 20's represented 13.4% in 2014 and 6.6% in 2013 of Liggett's unit volume. According to Management Science Associates, Liggett held a share of approximately 11.8% of the overall discount market segment for 2014 compared to 11.6% for 2013 and 12.1% for 2012.

Under the MSA reached in November 1998 with 46 states and various territories, the three largest cigarette manufacturers must make settlement payments to the states and territories based on how many cigarettes they sell annually. Liggett, however, is not required to make any payments unless its market share exceeds approximately 1.65% of the U.S. cigarette market. Additionally, Vector Tobacco has no payment obligation unless its market share exceeds approximately 0.28% of the U.S. cigarette market. We believe our tobacco subsidiaries have a sustainable cost advantage over their competitors as a result of the settlement.

Liggett's and Vector Tobacco's payments under the MSA are based on each respective company's incremental market share above the minimum threshold applicable to each respective company. Thus, if Liggett's total market share is 3%, its MSA payment is based on 1.35%, which is the difference between Liggett's total market share of 3% and its approximate applicable grandfathered share of 1.65%. We anticipate that both Liggett's and Vector Tobacco's payment exemptions will be fully utilized in the foreseeable future.

The source of industry data in this report is Management Science Associates, Inc., an independent third-party database management organization that collects wholesale shipment data from various cigarette manufacturers and distributors and provides analysis of market share, unit sales volume and premium versus discount mix for individual companies and the industry as a whole. Management Science Associates' information relating to unit sales volume and market share of certain of the smaller, primarily deep discount, cigarette manufacturers is based on estimates developed by Management Science Associates.

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**Business Strategy.** Liggett's business strategy is to capitalize upon its cost advantage in the United States cigarette market resulting from the favorable treatment our tobacco subsidiaries receive under settlement agreements with the states and the MSA. Liggett's long-term business strategy is to continue to focus its marketing and selling efforts on the discount segment of the market, to continue to build volume and margin in its core discount brands (EAGLE 20's, PYRAMID, GRAND PRIX, LIGGETT SELECT and EVE) and to utilize its core brand equity to selectively build distribution. Liggett intends to continue its product development to provide the best quality products relative to other discount products in the market place. Liggett will continue to seek increases in efficiency by developing and adapting its organizational structure to maximize profit potential.

**Sales, Marketing and Distribution.** Liggett's products are distributed from a central distribution center in Mebane, North Carolina to 17 public warehouses located throughout the United States. These warehouses serve as local distribution centers for Liggett's customers. Liggett's products are transported from the central distribution center to the public warehouses by third-party trucking companies to meet pre-existing contractual obligations to its customers. Liggett's customers are primarily candy and tobacco distributors, the military and large grocery, drug and convenience store chains. One customer, McLane Company, Inc. ("McLane") accounted for 19% of Liggett's revenues in 2014. Two customers, McLane and Core Mark International ("Core Mark"), accounted for 18% and 10%, respectively, of Liggett's revenues in 2013. One customer, McLane, accounted for 17% of Liggett's revenue in 2012. Concentrations of credit risk with respect to trade receivables are generally limited due to the large number of customers comprising Liggett's customer base. Liggett's largest customer represented approximately 11% of net accounts receivable at December 31, 2014. Liggett's two largest customers, McLane and Core Mark, represented approximately 5% and 1%, respectively of net accounts receivable at December 31, 2013. Ongoing credit evaluations of customers' financial condition are performed and, generally, no security is required. Liggett maintains reserves for potential credit losses and such losses, in the aggregate, have generally not exceeded management's expectations.

**Trademarks.** All of the major trademarks used by Liggett are federally registered or are in the process of being registered in the United States and other markets. Trademark registrations typically have a duration of ten years and can be renewed at Liggett's option prior to their expiration date.

In view of the significance of cigarette brand awareness among consumers, management believes that the protection afforded by these trademarks is material to the conduct of its business. These trademarks are pledged as collateral for certain of our senior secured debt.

**Manufacturing.** Liggett purchases and maintains leaf tobacco inventory to support its cigarette manufacturing requirements. Liggett believes that there is a sufficient supply of tobacco within the worldwide tobacco market to satisfy its current production requirements. Liggett stores its leaf tobacco inventory in warehouses in North Carolina and Virginia. There are several different types of tobacco, including flue-cured leaf, burley leaf, Maryland leaf, oriental leaf, cut stems and reconstituted sheet. Leaf components of American-style cigarettes are generally the flue-cured and burley tobaccos. While premium and discount brands use many of the same tobacco products, input ratios of tobacco products may vary between premium and discount products. Foreign flue-cured and burley tobaccos, some of which are used in the manufacture of Liggett's cigarettes, have historically been 30% to 35% less expensive than comparable domestic tobaccos. However, in recent years, domestic and foreign tobacco prices have begun to equalize. Liggett purchases its tobacco requirements from both domestic and foreign leaf tobacco dealers, much of it under long-term purchase commitments. As of December 31, 2014, the majority of Liggett's commitments were for the purchase of foreign tobacco.

Liggett's cigarette manufacturing facility was designed for the execution of short production runs in a cost-effective manner, which enables Liggett to manufacture and market 117 different cigarette brand styles including private labels for other companies, typically retail or wholesale distributors who supply supermarkets and convenience stores. Liggett's facility produced approximately 8.9 billion cigarettes in 2014, but maintains the capacity to produce approximately 17.0 billion cigarettes per year. Vector Tobacco has contracted with Liggett to produce most of its cigarettes at Liggett's manufacturing facility in Mebane.

**Competition.** Liggett's competition is divided into two segments. The first segment is made up of the three largest manufacturers of cigarettes in the United States: Philip Morris USA Inc., RJ Reynolds Tobacco Company (which is now part of Reynolds American) ("RJ Reynolds") and Lorillard Tobacco Company. These three manufacturers, while



primarily premium cigarette-based companies, also produce and sell discount cigarettes.

In July 2014, RJ Reynolds and Lorillard announced plans to merge and approval of the transaction is currently pending with the United States Federal Trade Commission. Consolidation in the industry could have a material adverse effect on our ability to compete in the U.S. cigarette market.

The second segment of competition is comprised of a group of smaller manufacturers and importers, most of which sell deep discount cigarettes. Our largest competitor in this segment is Commonwealth Brands, Inc., which was acquired by Imperial Tobacco in 2007.

Historically, there have been substantial barriers to entry into the cigarette business, including extensive distribution organizations, large capital outlays for sophisticated production equipment, substantial inventory investment, costly promotional

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spending, regulated advertising and, for premium brands, strong brand loyalty. However, after the MSA was signed, some smaller manufacturers and importers that are not parties to the MSA were able to overcome these competitive barriers due to their cost advantage resulting from the MSA. These smaller manufacturers and importers that are not parties to the MSA have been impacted in recent years by the state statutes enacted pursuant to the MSA and have seen a decline in volume after years of growth. However, these companies still have significant market share through competitive discounting in this segment.

In the cigarette business, Liggett competes on a dual front. The three major manufacturers compete among themselves for premium brand market share based on advertising and promotional activities and trade rebates and incentives and compete with Liggett and others for discount market share, on the basis of brand loyalty. These three competitors have substantially greater financial resources than Liggett, and most of their brands have greater sales and consumer recognition than Liggett's products. Liggett's discount brands must also compete in the marketplace with the smaller manufacturers' and importers' deep discount brands.

According to Management Science Associates' data, the unit sales of Philip Morris, RJ Reynolds, and Lorillard accounted in the aggregate for approximately 84.9% and 85.3% of the domestic cigarette market in 2014 and 2013, respectively. Liggett's domestic shipments of approximately 8.9 billion cigarettes during 2014 accounted for 3.4% of the approximately 265 billion cigarettes shipped in the United States, compared to 9.1 billion cigarettes in 2013 (3.3%) and 10.1 billion cigarettes in 2012 (3.5%).

Industry-wide shipments of cigarettes in the United States have been declining for a number of years, with Management Science Associates' data indicating that domestic industry-wide shipments declined by approximately 3.0% (approximately 8.0 billion units) and 4.7% (approximately 13.4 billion units) in 2014 and 2013, respectively. Liggett's management believes that industry-wide shipments of cigarettes in the United States will continue to decline as a result of numerous factors. These factors include health considerations, diminishing social acceptance of smoking, and a wide variety of federal, state and local laws limiting smoking in restaurants, bars and other public places, as well as increases in federal and state excise taxes and settlement-related expenses which have contributed to higher cigarette prices in recent years.

Historically, because of their dominant market share, Philip Morris and RJ Reynolds, the two largest cigarette manufacturers, have been able to determine cigarette prices for the various pricing tiers within the industry. Market pressures have historically caused the other cigarette manufacturers to bring their prices in line with the levels established by these two major manufacturers. Off-list price discounting and similar promotional activity by manufacturers, however, has substantially affected the average price differential at retail, which can be significantly less than the manufacturers' list price gap. Recent discounting by manufacturers has been far greater than historical levels, and the actual price gap between premium and deep-discount cigarettes has changed accordingly. This has led to shifts in price segment performance depending upon the actual price gaps of products at retail.

Philip Morris and RJ Reynolds dominate the domestic cigarette market with a combined market share of approximately 70.4% at December 31, 2014. Further, the proposed merger of RJ Reynolds and Lorillard Tobacco Company would consolidate more than 80% of the United States cigarette market within the control of two cigarette manufacturers. This concentration of United States market share makes it more difficult for Liggett to compete for shelf space in retail outlets and could impact price competition in the market, either of which could have a material adverse effect on its sales volume, operating income and cash flows.

E-Cigarettes

Our subsidiary, Zoom, entered the emerging United States e-cigarette market in limited retail distribution outlets in January 2014 with a cautious plan to minimize expense. In January of 2014, we announced the national rollout of our Zoom e-cigarette brand. Uncertainties regarding e-cigarettes are significantly greater today than they were a year ago and, at this point, the trend lines do not predict a bright future. In fact, we have seen significant changes in the e-cigarette market over the past year with disposable e-cigarettes in rapid decline, rechargeable e-cigarettes appearing to be in decline and open system vapor products, that feature refillable tanks and use low-cost flavored liquids, demonstrating mixed results with limited category volume growth but rapidly declining prices. Additionally, we believe uncertainties related to the regulation of e-cigarettes, including open system vapor products, exist. Given this backdrop, our primary focus on the e-cigarette product is to limit risk while staying prepared to pursue opportunities if

they occur and, for the time being, seeking to maintain our existing distribution. Zoom incurred approximately \$1.0 million in operating losses during 2013 relating to startup costs and operating losses of \$13.1 million in 2014.

#### Legislation, Regulation and Litigation

In the United States, tobacco products are subject to substantial and increasing legislation, regulation and taxation, which have a negative effect on revenue and profitability. In June 2009, legislation was passed providing for regulation of the tobacco

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industry by the United States Food and Drug Administration. See Item 7. “Management Discussion and Analysis of Financial Condition and Results of Operations — Legislation and Regulation.”

The cigarette industry continues to be challenged on numerous fronts. The industry is facing increased pressure from anti-smoking groups and continued smoking and health litigation, the effects of which, at this time, we are unable to quantify. Product liability litigation, particularly in Florida in the Engle progeny cases, continues to adversely affect the cigarette industry. See Item 1A. “Risk Factors,” Item 3. “Legal Proceedings” and Note 14 to our consolidated financial statements, which contain a description of litigation.

It is possible that our consolidated financial position, results of operations or cash flows could be materially adversely affected by an unfavorable outcome in any tobacco-related litigation or as a result of additional federal or state regulation relating to the manufacture, sale, distribution, advertising or labeling of tobacco products.

Liggett’s management believes that it is in compliance in all material respects with the laws regulating cigarette manufacturers.

**The MSA and Other State Settlement Agreements**

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

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

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

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

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

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

Under the payment provisions of the MSA, the Participating Manufacturers are required to make annual payments of \$9.0 billion (subject to applicable adjustments, offsets and reductions). These annual payments are allocated based on unit volume of domestic cigarette shipments. The payment obligations under the MSA are the several, and not joint, obligations of each Participating Manufacturer and are not the responsibility of any parent or affiliate of a

Participating Manufacturer.

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Liggett has no payment obligations under the MSA except to the extent its market share exceeds a market share exemption of approximately 1.65% of total cigarettes sold in the United States. Vector Tobacco has no payment obligations under the MSA except to the extent its market share exceeds a market share exemption of approximately 0.28% of total cigarettes sold in the United States. Liggett and Vector Tobacco's domestic shipments accounted for 3.4% of the total cigarettes sold in the United States in 2014. If Liggett's or Vector Tobacco's market share exceeds their respective market share exemption in a given year, then on April 15 of the following year, Liggett and/or Vector Tobacco, as the case may be, must pay on each excess unit an amount equal (on a per-unit basis) to that due from the OPMs for that year.

Liggett may have additional payment obligations under the MSA and its other settlement agreements with the states. See Item 1A. "Risk Factors" and Note 14 to our consolidated financial statements.

### New Valley LLC

New Valley LLC, a Delaware limited liability company, is engaged in the real estate business and is seeking to acquire additional real estate properties and operating companies. New Valley owns a 70.59% interest in Douglas Elliman Realty which operates the largest residential brokerage company in the New York City metropolitan area, which is known as Douglas Elliman Real Estate. New Valley also holds investment interests in various real estate projects domestically and internationally.

### Business Strategy

The business strategy of New Valley is to continue to operate its real estate business, to acquire additional real estate properties and to acquire operating companies through merger, purchase of assets, stock acquisition or other means, or to acquire control of operating companies through one of such means. New Valley may also seek from time to time to dispose of such businesses and properties when favorable market conditions exist. New Valley's cash and investments are available for general corporate purposes, including for acquisition purposes.

### Douglas Elliman Realty, LLC

In addition to owning the largest residential brokerage company in the New York City metropolitan area, Douglas Elliman Realty owns Residential Management Group LLC, which conducts business as Douglass Elliman Property Management and is the New York metropolitan area's largest manager of rental, co-op and condominium housing, Title Services business and a 49.9% interest in a joint venture, which conducts business as a residential mortgage lender.

Prior to December 2013, New Valley owned a 50% interest in Douglas Elliman and on December 13, 2013, an affiliate of New Valley LLC acquired an additional 20.59% interest in Douglas Elliman Realty from Prudential Real Estate Financial Services of America, Inc. for \$60 million. The acquisition increased our ownership in Douglas Elliman Realty to 70.59%. Consequently, after December 13, 2013, we consolidate in our financial statements the operations and financial position of Douglas Elliman Realty.

Prior to December 31, 2013, we accounted for our interest in Douglas Elliman under the equity method. We recorded income of \$23.0 million for the period from January 1, 2013 to December 13, 2013 and \$16.7 million in 2012 associated with Douglas Elliman Realty.

**Real Estate Brokerage Business.** Douglas Elliman Real Estate is engaged in the real estate brokerage business through its seven subsidiaries. The seven brokerage companies have 79 offices with approximately 5,500 real estate agents in the metropolitan New York area as well as South Florida, Beverly Hills, California and Aspen. The companies achieved combined sales of approximately \$18.2 billion of real estate in 2014, approximately \$14.9 billion of real estate in 2013 and approximately \$12.4 billion of real estate in 2012. Douglas Elliman Real Estate was ranked as the fourth-largest residential brokerage company in the United States in 2012 based on closed sales volume by the Real Trends broker survey. Douglas Elliman had revenues of \$543.2 million in 2014, \$435.6 million in 2013, and \$378.2 million in 2012.

The New York City brokerage operation was founded in 1911 and has grown to be one of Manhattan's leading residential brokers by specializing in the highest end of the sales and rental marketplaces. It has 21 New York City offices, with approximately 2,749 real estate agents, and had sales volume of approximately \$11.5 billion of real estate in 2014, approximately \$9.6 billion of real estate in 2013, and approximately \$8.4 billion of real estate in 2012.

The Long Island brokerage operation is headquartered in Huntington, New York and is the largest residential brokerage company on Long Island with 37 offices and approximately 1,927 real estate agents. During 2014, the Long Island brokerage operation closed approximately 7,950 transactions, representing sales volume of approximately \$4.9 billion of real estate. This compared to approximately 7,650 transactions, representing sales volume of approximately \$4.2 billion of real estate in 2013, and approximately 6,350 transactions closed in 2012, representing approximately \$3.6 billion of real estate. Douglas Elliman of LI serves approximately 250 communities in Long Island and Queens, New York.

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The Westchester brokerage operation operates in Northern Westchester County, a suburban area north of New York City, with six offices located in the towns of Chappaqua, Armonk, Bedford, Sommers, Pleasantville and Katonah. The offices had approximately 189 real estate agents and closed approximately 590 transactions, representing sales volume of \$453.5 million of real estate in 2014.

In December 2013, Douglas Elliman Realty acquired from an affiliate of New Valley the membership interest in the Florida brokerage operation. Douglas Elliman Florida, LLC operates in South Florida with nine offices located in downtown Miami, Miami Beach, North Miami, Ft. Lauderdale, Boca Raton and Palm Beach. The offices have approximately 600 real estate agents and closed approximately 1,100 transactions, representing sales volume of \$1.2 billion of real estate in 2014.

Douglas Elliman also had operations in California, Colorado and Connecticut and these operations generated sales volume of approximately \$190 million in 2014.

Douglas Elliman Real Estate operates as a broker in residential real estate transactions. In performing these services, the company has historically represented the seller, either as the listing broker, or as a co-broker in the sale. In acting as a broker for the seller, their services include assisting the seller in pricing the property and preparing it for sale, advertising the property, showing the property to prospective buyers, and assisting the seller in negotiating the terms of the sale and in closing the transaction. In exchange for these services, the seller pays to the company a commission, which is generally a fixed percentage of the sales price. In a co-brokered arrangement, the listing broker typically splits its commission with the other co-broker involved in the transaction. The company also offers buyer brokerage services. When acting as a broker for the buyer, its services include assisting the buyer in locating properties that meet the buyer's personal and financial specifications, showing the buyer properties, and assisting the buyer in negotiating the terms of the purchase and closing the transaction. In exchange for these services, a commission is paid to the company which also is generally a fixed percentage of the purchase price and is usually, based upon a co-brokerage agreement with the listing broker, deducted from, and payable out of, the commission payable to the listing broker. With the consent of a buyer and seller, subject to certain conditions, the company may, in certain circumstances, act as a selling broker and as a buying broker in the same transaction. The company's sales and marketing services are provided by licensed real estate sales persons or associate brokers who have entered into independent contractor agreements with the company. The company recognizes revenue and commission expenses upon the consummation of the real estate sale.

Douglas Elliman Real Estate also offers relocation services to employers, which provide a variety of specialized services primarily concerned with facilitating the resettlement of transferred employees. These services include sales and marketing of transferees' existing homes for their corporate employer, assistance in finding new homes, moving services, educational and school placement counseling, customized videos, property marketing assistance, rental assistance, area tours, international relocation, group move services, marketing and management of foreclosed properties, career counseling, spouse/partner employment assistance, and financial services. Clients can select these programs and services on a fee basis according to their needs.

DE Title Services. DE Title Services provides full-service title and settlement (i.e., closing and escrow) services to real estate companies and financial institutions. DE Title Services acts in the capacity of a title agent and sells title insurance to property buyers and mortgage lenders. DE Title Services is licensed as a title agent in New York. elliman.com and AskElliman.com. Douglas Elliman Real Estate's website, elliman.com, serves as a destination where consumers can search properties throughout the entire New York and South Florida markets and access current market information as well as comprehensive building and neighborhood guides and other interactive content. We have also recently launched AskElliman.com, our new web site that facilitates communication with consumers, providing them with access to information from real estate to mortgage financing, to specific neighborhoods.

Marketing. Douglas Elliman Real Estate offers real estate sales and marketing and relocation services, which are marketed by a multimedia program. This program includes direct mail, newspaper, internet, catalog, radio and television advertising and is conducted throughout Manhattan and Long Island. In addition, the integrated nature of the real estate brokerage companies services is designed to produce a flow of customers between their real estate sales and marketing business and their mortgage business.



Competition. The real estate brokerage business is highly competitive. However, Douglas Elliman Real Estate believes that its ability to offer their customers a range of inter-related services and its level of residential real estate sales and marketing help position them to meet the competition and improve their market share.

In the brokerage company's traditional business of residential real estate sales and marketing, it competes with multi-office independent real estate organizations and, to some extent, with franchise real estate organizations, such as Century-21, ERA, RE/MAX International, Sotheby's International Realty, Better Homes and Gardens Real Estate, Berkshire Hathaway HomeServices, and Coldwell Banker. Douglas Elliman believes that its major competitors in 2015 will also increasingly include multi-office real estate organizations, such as GMAC Home Services, NRT LLC (whose affiliates include the New York City-based Corcoran Group) and other privately-owned companies.

Residential brokerage firms compete for sales and marketing business primarily on the basis of services offered, reputation, personal contacts, and, recently to a greater degree, price.

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In its mortgage loan origination business, DE Capital competes with other mortgage originators. These include mortgage brokers, mortgage bankers, state and national banks, and thrift institutions.

Government Regulation. Several facets of real estate brokerage businesses are subject to government regulation. For example, their real estate sales and marketing divisions are licensed as real estate brokers in the states in which they conduct their real estate brokerage businesses. In addition, their real estate sales associates must be licensed as real estate brokers or salespersons in the states in which they do business. Future expansion of the real estate brokerage operations of Douglas Elliman Real Estate into new geographic markets may subject it to similar licensing requirements in other states.

A number of states and localities have adopted laws and regulations imposing environmental controls, disclosure rules, zoning and other land use restrictions, which can materially impact the marketability of certain real estate. However, Douglas Elliman Real Estate does not believe that compliance with environmental, zoning and land use laws and regulations has had, or will have, a materially adverse effect on its financial condition or operations.

RESPA and state real estate brokerage laws restrict payments that real estate brokers, title agencies, mortgage bankers, mortgage brokers and other settlement service providers may receive or pay in connection with the sales of residences and referral of settlement services (e.g., mortgages, homeowners insurance and title insurance). Such laws may, to some extent, restrict preferred alliance and other arrangements involving our real estate franchise, real estate brokerage, settlement services and relocation businesses. In addition, our relocation and title and settlement services businesses, RESPA and similar state laws require timely disclosure of certain relationships or financial interests with providers of real estate settlement services.

On November 17, 2008, the United States Department of Housing and Urban Development (“HUD”) published a rule that seeks to simplify and improve disclosures regarding mortgage settlement services and encourage consumers to compare prices for such services by consumers. The material provisions of the rule include: new Good Faith Estimate (“GFE”) and HUD-1 forms, permissibility of average cost pricing by settlement service providers, implementation of tolerance limits on various fees from the issuance of the GFE and the HUD-1 provided at closing, and disclosure of the title agent and title underwriter premium splits. To date, there has not been any material impact (financial or otherwise) to us arising out of compliance with these new rules.

Pursuant to the Dodd-Frank Act, administration of RESPA has been moved from HUD to the new Consumer Financial Protection Bureau (“CFPB”) and it is possible that the practices of HUD, taking very expansive broad readings of RESPA, will continue or accelerate at the CFPB creating increased regulatory risk. RESPA also has been invoked by plaintiffs in private litigation for various purposes.

Title Services Regulation. Many states license and regulate title agencies/settlement service providers or certain employees and underwriters through their Departments of Insurance or other regulatory body. In many states, title insurance rates are either promulgated by the state or are required to be filed with each state by the agent or underwriter, and some states promulgate the split of title insurance premiums between the agent and underwriter. States sometimes unilaterally lower the insurance rates relative to loss experience and other relevant factors. States also require title agencies and title underwriters to meet certain minimum financial requirements for net worth and working capital.

Franchises and Trade Names. Prior to March 2013, Douglas Elliman Real Estate operated under various franchise agreements with Prudential. The franchise agreements expired on March 13, 2013. In connection with the termination of the franchise agreements, on December 13, 2013, we acquired an additional 20.59% interest in Douglas Elliman for a purchase price of \$60 million. The acquisition increased our ownership position in Douglas Elliman to 70.59%.

The “Douglas Elliman” trade name is a registered trademark in the United States. The name has been synonymous with the most exacting standards of excellence in the real estate industry since Douglas Elliman’s formation in 1911. Other trademarks used extensively in Douglas Elliman’s business, which are owned by Douglas Elliman and registered in the United States, include “We are New York,” “Bringing People and Places Together,” “If You Clicked Here You’d Be Home Now” and “Picture Yourself in the Perfect Home.”

The taglines “From Manhattan to Montauk” and “askelliman.com” are used extensively in the Douglas Elliman’s brokerage operations. In addition, Douglas Elliman’s brokerage operation continues to use the trade names of certain companies that it has acquired.

Residential Property Management Business. Douglas Elliman Realty is also engaged in the management of cooperatives, condominiums and apartments through its subsidiary, Residential Management Group, LLC, which conducts business as Douglas Elliman Property Management and is the leading New York City based manager of apartments, cooperatives and condominiums in the New York metropolitan area according to a survey in the September 2013 issue of The Real Deal. Residential Management Group provides full service third-party fee management for approximately 330 properties, representing approximately 45,600 units in New York City, Nassau County, Northern New Jersey and Westchester County. Among the notable properties currently managed are the Dakota, Museum Tower, London Terrace, Olympic Tower Condominium, Manhattan House, CitySpire Condominium and The Sovereign buildings in New York City. Residential Management Group employs approximately 265 people, of whom

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approximately 186 work at Residential Management Group's headquarters and the remainder at remote offices in the New York metropolitan area.

Real Estate Investments

We own, and seek to acquire investment interests in various domestic and international real estate projects through debt and equity investments. Our current real estate investments include the following projects:

Land Development

Escena. We are developing a 450-acre approved master planned community in Palm Springs, California. The development presently has 667 residential lots, which include both single and multi-family lots, an 18-hole golf course, clubhouse restaurant, golf shop and seven-acre site approved for a 450-room hotel. In October 2013, we sold 200 single family lots for \$22.7 million.

Indian Creek. We owned an 80% interest in a residential real estate project located in Indian Creek Village, Florida. In May 2014, we sold the Indian Creek property for \$14.4 million.

Milanosesto Holdings. We own an approximate 7.2% interest in an entity that is developing a 322-acre site in Milan, Italy into multi-parcel, multi-building mixed use urban regeneration project.

Condominium and Mixed-Use Development

10 Madison Square Park West. We own an approximate 5% interest in a joint venture that is developing 10 Madison Square West. The joint venture is converting a 260,000-square-foot office building into a luxury residential condominium in the Flatiron District / NoMad neighborhood of Manhattan and is expected to be completed by February 2016.

The Whitman. We own an approximate 12% interest in a joint venture which owns The Whitman, a luxury residential condominium, which is located in the Flatiron District / NoMad neighborhood of Manhattan in New York City. Construction has been completed and three of the four units have been sold in 2013 and the remaining unit was sold in 2014.

The Marquand. We own an approximate 18% interest in a joint venture that is converting a 12-story residential rental building into a luxury residential condominium. The building is located in Manhattan's Upper East Side. Eight of the 29 units were sold in 2014 and construction is expected to be completed by August 2015.

11 Beach Street. We own an approximate 49.5% interest in a joint venture that is converting a 10-story, 250,000-square-foot office building into a luxury residential condominium. The building is located in the TriBeCa neighborhood of Manhattan and construction began in May 2014 and is expected to be completed by July 2016.

20 Times Square. We own an approximate 11.5% interest in a joint venture that is developing a 340,000-square-foot multi-use project located in Times Square in Manhattan. The development includes retail space, hotel space and signage. Construction has started and is expected to be completed by August 2017.

111 Murray Street. We own a 25% interest (and a related note receivable) in a joint venture that is developing a mixed-use property that includes both commercial space and a 139-unit luxury residential condominium in the TriBeCa neighborhood of Manhattan. Development began in 2014 and is expected to be completed by March 2018.

160 Leroy Street. We own an approximate 5% interest in a development site in the West Greenwich Village neighborhood of Manhattan. The site is being developed as a high-rise condominium that will face the Hudson River. Development is expected to begin in July 2015 and be completed by March 2018.

PUBLIC Chrystie House. We own an approximate 18.4% interest in a joint venture that owns a land development site in the Lower East Side neighborhood of Manhattan. The joint venture plans to develop the property into a 29-story mixed-use property with PUBLIC, an Ian Schrager-branded boutique hotel, and luxury condominium residences. Development began in 2014 and is expected to be completed by February 2017.

25-19 43rd Avenue - The Dutch LIC. New Valley owns a 9.9% interest in a nine story, 87,000 square foot, condominium development in Long Island City, New York. Construction of the 86-unit building commenced in September 2014 and is anticipated to be completed by December 2016.

Queens Plaza South. We own an approximate 45.4% interest in a joint venture that has purchased a pre-war Art Deco-style building and a neighboring building in Queens, New York. The joint venture plans to develop a new apartment tower with 287,000 square feet of residential space and 10,000 square feet of retail space. Development

began in 2014 and is expected to be completed by February 2016.

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8701 Collins Avenue. We own a 15% interest in the Howard Johnson's Dezerland Beach hotel in Miami Beach, Florida, which will be redeveloped into modern hotel and residential condominium units. Development is expected to begin in 2015 and be completed by July 2017.

125 Greenwich Street. We own a 10.4% interest in land near the World Trade Center Assemblage building which will be developed into a high-rise condominium site along with a retail base. Development is expected to begin in 2015.

9040 Sunset Boulevard. We own a 48.5% interest in a property at 9040 Sunset Boulevard which will be developed into a high-rise hotel and condominium complex. Development is expected to begin in 2015 and be completed by April 2018.

### Apartment Buildings

Maryland Portfolio. We own an approximate 7.5% indirect interest in a joint venture that owns approximately 5,500 apartment units primarily located in Baltimore County, Maryland.

ST Portfolio. We own a 16.4% interest in four Class A multi-family rental assets in partnership with Winthrop Realty Trust. The four buildings are located in: Houston, Texas; Phoenix, Arizona; San Pedro, California; and Stamford, Connecticut. The buildings include 761 apartment units and 25,000 square feet of retail space. The San Pedro, California building was sold in 2014 and the proceeds were used to pay down debt.

### Hotels

Park Lane Hotel. We own an approximate 5% interest in a joint venture that has agreed to acquire the Park Lane Hotel, which is presently a 47-story, 605-room independent hotel owned and operated by the Helmsley Family Trust and Estate. The joint venture is developing plans for a hotel and luxury residential condominiums. The development is estimated to take approximately 30 months to complete from commencement of construction.

Hotel Taiwana. We own an approximate 17% interest in a joint venture that owns a luxury hotel located in St. Barthelemy, French West Indies that has been recently renovated.

Coral Beach. We own a 49% interest in a joint venture that owns a 52-acre site in Bermuda. The property consists of the Horizons Hotel, which includes 56 hotel units, and Coral Beach and Tennis Club, which includes 31 hotel units, in Bermuda. The Coral Beach and Tennis Club is open while the Horizons hotel is closed. Renovation began on the Coral Beach and Tennis Club in 2014.

In our real estate investment business, we seek to acquire investment interests in domestic and international real estate projects through debt and equity investments. We focus on investing in well-located real estate assets that generate, or have the potential to generate, long-term, predictable and sustainable cash flows with attractive growth and development potential. We believe our ownership of Douglas Elliman provides us with a strategic advantage through its relationships with developers in New York City as well as its knowledge of the New York City residential real estate market. We and our partners seek to enhance the cash flows and returns from our investments by using varying levels of leverage. In addition, we and our partners may earn incentives on certain investments if the investments achieve rates of return that exceed targeted thresholds. Our real estate investments are located in the United States, Italy, Bermuda and the French West Indies and we may pursue growth in other markets where we identify attractive opportunities to invest in or acquire assets and to achieve strong risk-adjusted returns. We strive to invest at attractive valuations, capitalize on distressed situations where possible, create opportunities for superior valuation gains and cash flow returns and monetize assets at appropriate times to realize value. Our portfolio as of December 31, 2014 included interests in the 18 properties discussed above. As of December 31, 2014, our real estate investment business held interests in joint ventures recorded on our financial statements at approximately \$163.5 million and approximately \$10.6 million in consolidated real estate investments.

For additional information concerning these investments, see Note 7 to our consolidated financial statements.

### Ladenburg Thalmann

We own 14,191,205 common shares of Ladenburg Thalmann Financial Services Inc. (NYSE MKT: LTS), which represents beneficial ownership of approximately 8.2% of the LTS shares. LTS is engaged in independent brokerage and advisory services, investment banking, equity research, institutional sales and trading, asset management services,

life insurance brokerage and trust services through New Valley's former subsidiary Ladenburg Thalmann & Co. Inc. and LTS's other principal subsidiaries, Securities America, Inc., Triad Advisors, Inc., Investacorp, Inc., KMS Financial Services Inc., Securities Service Network, Inc., Highland Capital Brokerage, Inc., Ladenburg Thalmann Asset Management Inc. and Premier Trust, Inc. LTS is registered under the Securities Act of 1934 and files periodic reports and other information with the SEC.

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Three of our directors, Howard M. Lorber, Henry C. Beinstein and Jeffrey S. Podell, also serve as directors of LTS. Mr. Lorber also serves as Vice Chairman of LTS. Richard J. Lampen, who along with Mr. Lorber is an executive officer of ours, also serves as a director of LTS and has served as the President and Chief Executive Officer of LTS since September 2006. See Note 16 to our consolidated financial statements.

In November 2011, we were part of a consortium, which included Dr. Phillip Frost, who is the beneficial owner of approximately 15.3% of our common stock, and Mr. Lampen, that agreed to provide a five-year loan to LTS of approximately \$160.7 million. The loan is due November 4, 2016 and bears an interest rate of 11% per annum. The lenders received a 0.50% funding fee and warrants to purchase a total of 10,713,333 LTS shares at \$1.68 per share. We lent LTS \$15 million and received 1,000,000 warrants. As of December 31, 2014, \$2.8 million of principal of the LTS loan remained outstanding.

On May 22, 2013, we purchased in a public offering 240,000 shares of LTS's 8% Series A Cumulative Redeemable Preferred Stock (Liquidation Preference \$25.00 Per Share) ("LTS Preferred") for \$6.0 million. LTS pays a monthly cumulative dividend of 8% per annum on the LTS Preferred. LTS, at its option, may redeem any or all of the LTS Preferred at \$25.00 per share plus any accumulated and unpaid dividends on or after May 24, 2018.

### Other Investments

**Castle Brands.** We own 12,671,159 shares of Castle Brands Inc. (NYSE MKT: ROX), a publicly-traded developer and importer of premium branded spirits, which represents beneficial ownership of approximately 8.0% of the Castle shares. Mr. Lampen is serving as the President, Chief Executive Officer and a director of Castle. Mr. Beinstein, a director of Vector, is also a director of Castle. See Note 16 to our consolidated financial statements. In 2013, we purchased in a private placement \$200,000 of Castle's convertible debt, which bears interest at 5% per annum, is convertible into 222,222 shares of Castle common stock and is due on December 15, 2018.

**Long-Term Investments.** As of December 31, 2014, long-term investments consisted primarily of investments in investment partnerships of approximately \$40.3 million. In the future, we may invest in other investments including limited partnerships, real estate investments, equity securities, debt securities and certificates of deposit depending on risk factors and potential rates of return.

### Employees

At December 31, 2014, we had 1,090 employees, of which approximately 483 were employed by Douglas Elliman primarily in the New York area, 296 were employed at Liggett's Mebane facility and approximately 289 were employed in sales and administrative functions at Liggett Vector Brands LLC ("LVB"), which coordinates our tobacco and e-cigarettes subsidiaries' sales and marketing efforts, along with certain support functions. Approximately 20% of our employees are hourly employees, who are represented by unions. We have not experienced any significant work stoppages since 1977, and we believe that relations with our employees and their unions are satisfactory.

### Available Information

Our website address is [www.vectorgrouppltd.com](http://www.vectorgrouppltd.com). We make available free of charge on the Investor Relations section of our website (<http://vectorgrouppltd.com/investorrelations>) our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with the Securities and Exchange Commission. We also make available through our website other reports filed with the SEC under the Exchange Act, including our proxy statements and reports filed by officers and directors under Section 16(a) of that Act. Copies of our Code of Business Conduct and Ethics, Corporate Governance Guidelines, Audit Committee charter, Compensation Committee charter and Corporate Governance and Nominating Committee charter have been posted on the Investor Relations section of our website and are also available in print to any shareholder who requests it. We do not intend for information contained in our website to be part of this Annual Report on Form 10-K.

## ITEM 1A. RISK FACTORS

Our business faces many risks. We have described below the known material risks that we and our subsidiaries face. There may be additional risks that we do not yet know of or that we do not currently perceive to be significant that may also impact our business or the business of our subsidiaries. Each of the risks and uncertainties described below



could lead to events or circumstances that have a material adverse effect on the business, results of operations, cash flows, financial condition or equity of us or one or more of our subsidiaries, which in turn could negatively affect the value of our common stock. You should carefully consider and evaluate all of the information included in this report and any subsequent reports that we may file with the Securities and Exchange Commission or make available to the public before investing in any securities issued by us.

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We have significant liquidity commitments.

During 2015, we have certain liquidity commitments that could require the use of our existing cash resources. As of December 31, 2014, our corporate expenditures (exclusive of Liggett, Vector Tobacco and New Valley) and other potential liquidity requirements over the next 12 months include the following:

- cash interest expense of approximately \$95.8 million,
- \$25.0 million of our 6.75% convertible notes mature in 2015, which were converted into 2,227,553 shares of our common stock in February 2015,
- \$3.5 million Engle progeny installment payment to be paid in 2015,
- dividends on our outstanding common shares of approximately \$193.9 million, and
- other corporate expenses and taxes.

In order to meet the above liquidity requirements as well as other liquidity needs in the normal course of business, we will be required to use cash flows from operations and existing cash and cash equivalents. Should these resources be insufficient to meet the upcoming liquidity needs, we may also be required to liquidate investment securities available for sale and other long-term investments, or, if available, draw on Liggett's credit facility. While there are actions we can take to reduce our liquidity needs, there can be no assurance that such measures will be successful.

We and our subsidiaries have a substantial amount of indebtedness.

We and our subsidiaries have significant indebtedness and debt service obligations. At December 31, 2014, we and our subsidiaries had total outstanding indebtedness of \$1.1 billion. In addition, the indenture governing our 7.75% senior secured notes due 2021 contains covenants that, among other things, restrict our ability to take specific actions, even if we believe them to be in our best interest, including restrictions on our ability to incur additional indebtedness.

In addition, subject to the terms of any future agreements, we and our subsidiaries will be able to incur additional indebtedness in the future. There is a risk that we will not be able to generate sufficient funds to repay our debt. If we cannot service our fixed charges, it would have a material adverse effect on our business and results of operations. Our high level of debt may adversely affect our ability to satisfy our obligations.

There can be no assurance that we will be able to meet our debt service obligations. A default in our debt obligations, including a breach of any restrictive covenant imposed by the terms of our indebtedness, could result in the acceleration of the affected debt as well as other of our indebtedness. In such a situation, it is unlikely that we would be able to fulfill our obligations under the debt or such other indebtedness or that we would otherwise be able to repay the accelerated indebtedness or make other required payments. Even in the absence of an acceleration of our indebtedness, a default under the terms of our indebtedness could have an adverse impact on our ability to satisfy our debt service obligations and on the trading price of our debt and our common stock.

Our high level of indebtedness could have important consequences. For example, it could:

- make it more difficult for us to satisfy our other obligations with respect to our debt, including repurchase obligations upon the occurrence of specified change of control events;
- increase our vulnerability to general adverse economic and industry conditions;
- limit our ability to obtain additional financing;
- require us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, reducing the amount of our cash flow available for dividends on our common stock and other general corporate purposes;
- require us to sell other securities or to sell some or all of our assets, possibly on unfavorable terms, to meet payment obligations;
- restrict us from making strategic acquisitions, investing in new capital assets or taking advantage of business opportunities;
- limit our flexibility in planning for, or reacting to, changes in our business and industry; and
- place us at a competitive disadvantage compared to competitors that have less debt.

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We are a holding company and depend on cash payments from our subsidiaries, which are subject to contractual and other restrictions, in order to service our debt and to pay dividends on our common stock.

We are a holding company and have no operations of our own. We hold our interests in our various businesses through our wholly-owned subsidiaries, VGR Holding LLC and New Valley. In addition to our own cash resources, our ability to pay interest on our debt and to pay dividends on our common stock depends on the ability of VGR Holding and New Valley to make cash available to us. VGR Holding's ability to pay dividends to us depends primarily on the ability of Liggett, its wholly-owned subsidiary, to generate cash and make it available to VGR Holding. Liggett's revolving credit agreement with Wells Fargo Bank, N.A. contains a restricted payments test that limits the ability of Liggett to pay cash dividends to VGR Holding. The ability of Liggett to meet the restricted payments test may be affected by factors beyond its control, including Wells Fargo's unilateral discretion, if acting in good faith, to modify elements of such test.

Our receipt of cash payments, as dividends or otherwise, from our subsidiaries is an important source of our liquidity and capital resources. If we do not have sufficient cash resources of our own and do not receive payments from our subsidiaries in an amount sufficient to repay our debts and to pay dividends on our common stock, we must obtain additional funds from other sources. There is a risk that we will not be able to obtain additional funds at all or on terms acceptable to us. Our inability to service these obligations and to continue to pay dividends on our common stock would significantly harm us and the value of our common stock.

Our 7.75% senior secured notes contain restrictive covenants that limit our operating flexibility.

The indenture governing our 7.75% senior secured notes due 2021 contains covenants that, among other things, restrict our ability to take specific actions, even if we believe them to be in our best interest, including restrictions on our ability to:

- incur or guarantee additional indebtedness or issue preferred stock;
- pay dividends or distributions on, or redeem or repurchase, capital stock;
- create liens with respect to our assets;
- make investments, loans or advances;
- prepay subordinated indebtedness;
- enter into transactions with affiliates; and
- merge, consolidate, reorganize or sell our assets.

In addition, Liggett's revolving credit agreement requires us to meet specified financial ratios. These covenants may restrict our ability to expand or fully pursue our business strategies. Our ability to comply with these and other provisions of the indenture governing the senior secured notes and the Liggett revolving credit agreement may be affected by changes in our operating and financial performance, changes in general business and economic conditions, adverse regulatory developments or other events beyond our control. The breach of any of these covenants, including those contained in the indenture governing the senior secured notes and the Liggett's credit agreement, could result in a default under our indebtedness, which could cause those and other obligations to become due and payable. If any of our indebtedness is accelerated, we may not be able to repay it.

The indenture governing the senior secured notes contain restrictive covenants, which, among other things, restrict our ability to pay certain dividends or make other restricted payments or enter into transactions with affiliates if our Consolidated EBITDA, as defined in the indenture, is less than \$75 million for the four quarters prior to such transaction. Our Consolidated EBITDA for the four quarters ended December 31, 2014 exceeded \$75 million.

Changes in respect of the debt ratings of our notes may materially and adversely affect the availability, the cost and the terms and conditions of our debt.

Both we and several issues of our notes have been publicly rated by Moody's Investors Service, Inc., or Moody's, and Standard & Poor's Rating Services, or S&P, independent rating agencies. In addition, future debt instruments may be publicly rated. These debt ratings may affect our ability to raise debt. Any future downgrading of the notes or our other debt by Moody's or S&P may affect the cost and terms and conditions of our financings and could adversely affect the value and trading of the notes.

Liggett faces intense competition in the domestic tobacco industry.

Liggett is considerably smaller and has fewer resources than its major competitors, and, as a result, has a more limited ability to respond to market developments. Management Science Associates' data indicate that the three largest cigarette manufacturers controlled approximately 84.9% of the United States cigarette market during 2014. Philip Morris is the largest manufacturer in the market, and its profits are derived principally from its sale of premium cigarettes. Philip Morris had approximately 60.8% of

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the premium segment and 47.3% of the total domestic market during 2014. During 2014, all of Liggett's sales were in the discount segment, and its share of the total domestic cigarette market was 3.4%. Philip Morris and RJ Reynolds, the two largest cigarette manufacturers, historically, because of their dominant market share, have been able to determine cigarette prices for the various pricing tiers within the industry.

Consolidation in the industry could adversely affect our ability to compete in the U.S. cigarette market. For example, RJ Reynolds' proposed merger with Lorillard Tobacco Company, which would consolidate more than 80% of the United States cigarette market within the control of two cigarette manufacturers, could make it more difficult for Liggett and Vector Tobacco to compete for shelf space in retail outlets and could impact price competition in the market, either of which could have a material adverse effect on our sales volume, operating income and cash flows. Further, as part of the proposed merger, RJ Reynolds and Lorillard Tobacco Company will divest four of their brands to Imperial Tobacco PLC, our largest competitor for the sale of deep discount cigarettes.

Liggett's business is highly dependent on the discount cigarette segment.

Liggett depends more on sales in the discount cigarette segment of the market, relative to the full-price premium segment, than its major competitors. Since 2004, all of Liggett's unit volume was generated in the discount segment. The discount segment is highly competitive, with consumers having less brand loyalty and placing greater emphasis on price. While the three major manufacturers all compete with Liggett in the discount segment of the market, the strongest competition for market share has come from a group of smaller manufacturers and importers, most of which sell low quality, deep discount cigarettes. While Liggett's share of the discount market was 11.8% in 2014, 11.6% in 2013 and 12.1% in 2012, Management Science Associates' data indicate that the discount market share of these other smaller manufacturers and importers was approximately 34.1% in 2014, 33.7% in 2013, and 34.4% in 2012. If pricing in the discount market continues to be impacted by these smaller manufacturers and importers, margins in Liggett's only current market segment could be negatively affected, which in turn could negatively affect the value of our common stock.

Liggett's market share is susceptible to decline.

For a number of years prior to 2000, Liggett suffered a substantial decline in market share. Liggett's market share increased in 2014, after having declined in 2013 and 2012. Liggett's market share increased during each of the years between 2000 and 2011 (except for 2008, which was unchanged). This earlier market share erosion resulted in part from Liggett's highly leveraged capital structure that existed until December 1998 and its limited ability to match other competitors' wholesale and retail trade programs, obtain retail shelf space for its products and advertise its brands. These declines also resulted from adverse developments in the tobacco industry, intense competition and changes in consumer preferences which have continued up to the current time. According to Management Science Associates' data, Liggett's overall domestic market share during 2014 was 3.4% compared to 3.3% during 2013, and 3.5% during 2012. Liggett's share of the discount segment was 11.8% during 2014, 11.6% during 2013 and 12.1% during 2012. Liggett's overall market share increased by 0.1% in 2014 after declining by 0.2% in 2013. If it were to decline substantially in the future, Liggett's sales volume, operating income and cash flows could be materially adversely affected, which in turn could negatively affect the value of our common stock.

The domestic cigarette industry has experienced declining unit sales in recent periods.

Industry-wide shipments of cigarettes in the United States have been declining for a number of years, with Management Science Associates' data indicating that domestic industry-wide shipments decreased by approximately 3.0% in 2014 as compared to 2013, and by approximately 4.7% in 2013 as compared to 2012. We believe that industry-wide shipments of cigarettes in the United States will continue to decline as a result of numerous factors. These factors include health considerations, diminishing social acceptance of smoking, and a wide variety of federal, state and local laws limiting smoking in restaurants, bars and other public places, as well as increases in federal and state excise taxes and settlement-related expenses which have contributed to high cigarette price levels in recent years plus the growing popularity of e-cigarettes. If this decline in industry-wide shipments continues and Liggett is unable to capture market share from its competitors, or if the industry as a whole is unable to offset the decline in unit sales with price increases, Liggett's sales volume, operating income and cash flows could be materially adversely affected, which in turn could negatively affect the value of our common stock.

Our tobacco operations are subject to substantial and increasing legislation, regulation and taxation, which has a negative effect on revenue and profitability.

Tobacco products are subject to substantial federal and state excise taxes in the United States. These taxes may continue to increase. On April 1, 2009, the federal excise tax increased from \$0.39 to \$1.01 per pack of cigarettes, and significant tax increases on other tobacco products, to fund expansion of the State Children's Health Insurance Program, referred to as SCHIP. The increases in federal excise tax under SCHIP are substantial, and, as a result, Liggett's sales volume and profitability has been and may continue to be adversely impacted. In addition, SCHIP created certain tax differentials between certain types of tobacco products.

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This has caused a dramatic increase in the sale of mis-labeled pipe tobacco as a substitute for roll-your-own, which has directly impacted sales of cigarettes.

In addition to federal and state excise taxes, certain city and county governments also impose substantial excise taxes on tobacco products sold. Increased excise taxes are likely to result in declines in overall sales volume and shifts by consumers to less expensive brands.

A wide variety of federal, state and local laws limiting the advertising, sale and use of cigarettes have proliferated in recent years. For example, many local laws prohibit smoking in restaurants and other public places. Private businesses also have adopted regulations that prohibit or restrict, or are intended to discourage, smoking. Such laws and regulations also are likely to result in a decline in the overall sales volume of cigarettes.

Over the years, various state and local governments have continued to regulate tobacco products. These regulations relate to, among other things, disclosure of ingredient information, the imposition of significantly higher taxes, increases in the minimum age to purchase tobacco products, sampling and advertising bans or restrictions, ingredient and constituent disclosure requirements and significant tobacco control media campaigns. Additional state and local legislative and regulatory actions will likely be considered in the future, including, among other things, restrictions on the use of flavorings.

In addition to the foregoing, there have been a number of other restrictive regulatory actions from various federal administrative bodies, including the United States Environmental Protection Agency and the Food and Drug Administration (“FDA”). There have also been adverse legislative and political decisions and other unfavorable developments concerning cigarette smoking and the tobacco industry. In 2009, legislation was passed by Congress providing for regulation of cigarettes by FDA. These developments generally receive widespread media attention. Additionally, a majority of states have passed legislation providing for reduced ignition propensity standards for cigarettes. These developments may negatively affect the perception of potential triers of fact with respect to the tobacco industry, possibly to the detriment of certain pending litigation, and may prompt the commencement of additional similar litigation or legislation. We are not able to evaluate the effect of these developing matters on pending litigation or the possible commencement of additional litigation, but our consolidated financial position, results of operations or cash flows could be materially adversely affected.

Additional federal or state regulation relating to the manufacture, sale, distribution, advertising, labeling, or information disclosure of tobacco products could further reduce sales, increase costs and have a material adverse effect on our business.

The Family Smoking Prevention and Tobacco Control Act may adversely affect our sales and operating profit. On June 22, 2009, the President signed into law the Family Smoking Prevention and Tobacco Control Act (the “Tobacco Control Act”). The law grants FDA broad authority over the manufacture, sale, marketing and packaging of tobacco products, although FDA is prohibited from banning all cigarettes or all smokeless tobacco products. Among other measures, the law (under various deadlines):

- increases the number of health warnings required on cigarette and smokeless tobacco products, increases the size of warnings on packaging and in advertising, requires FDA to develop graphic warnings for cigarette packages, and grants FDA authority to require new warnings;
- imposes new restrictions on the sale and distribution of tobacco products, including significant new restrictions on tobacco product advertising and promotion, as well as the use of brand and trade names;
- bans the use of “light,” “mild,” “low” or similar descriptors on tobacco products;
- bans the use of “characterizing flavors” in cigarettes other than tobacco or menthol;
- gives FDA the authority to impose tobacco product standards that are appropriate for the protection of the public health (by, for example, requiring reduction or elimination of the use of particular constituents or components, requiring product testing, or addressing other aspects of tobacco product construction, constituents, properties or labeling);
- requires manufacturers to obtain FDA review and authorization for the marketing of certain new or modified tobacco products;
- requires pre-market approval by FDA for tobacco products represented (through labels, labeling, advertising, or other means) as presenting a lower risk of harm or tobacco-related disease;

requires manufacturers to report ingredients and harmful constituents and requires FDA to disclose certain constituent information to the public;

- mandates that manufacturers test and report on ingredients and constituents identified by FDA as requiring such testing to protect the public health, and allows FDA to require the disclosure of testing results to the public;



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- requires manufacturers to submit to FDA certain information regarding the health, toxicological, behavioral or physiological effects of tobacco products;
- prohibits use of tobacco containing a pesticide chemical residue at a level greater than allowed under federal law;
- requires FDA to establish “good manufacturing practices” to be followed at tobacco manufacturing facilities;
- requires tobacco product manufacturers (and certain other entities) to register with FDA;
- authorizes FDA to require the reduction of nicotine (although it may not require the reduction of nicotine yields of a tobacco product to zero) and the potential reduction or elimination of other constituents, including menthol;
- imposes (and allows FDA to impose) various recordkeeping and reporting requirements on tobacco product manufacturers; and
- grants FDA the regulatory authority to impose broad additional restrictions.

It is likely that the new tobacco law could result in a decrease in cigarette sales in the United States, including sales of Liggett’s and Vector Tobacco’s brands. Total compliance and related costs are not possible to predict and depend substantially on the future requirements imposed by FDA under the new tobacco law. Costs, however, could be substantial and could have a material adverse affect on the companies’ financial condition, results of operations, and cash flows. In addition, FDA has a number of investigatory and enforcement tools available to it. Failure to comply with the new tobacco law and with FDA regulatory requirements could result in significant financial penalties and could have a material adverse effect on the business, financial condition and results of operation of both Liggett and Vector Tobacco. At present, we are not able to predict whether the new tobacco law will impact Liggett and Vector Tobacco to a greater degree than other companies in the industry, thus affecting our competitive position.

Litigation will continue to harm the tobacco industry.

Liggett could be subjected to substantial liabilities and bonding requirements from litigation relating to cigarette products. Adverse judgments could have a negative impact on our ability to operate due to their impact on cash flows. We and our Liggett subsidiary, as well as the entire cigarette industry, continue to be challenged on numerous fronts, particularly with respect to the Engle progeny cases in Florida (described below). New cases continue to be commenced against Liggett and other cigarette manufacturers. As of December 31, 2014, in addition to the Engle progeny cases, there were 47 individual product liability lawsuits, four purported class actions and one health care cost recovery action pending in the United States in which Liggett and/or us were named defendants. It is likely that similar legal actions, proceedings and claims will continue to be filed against Liggett. Punitive damages, often in amounts ranging into the billions of dollars, are specifically pled in certain cases, in addition to compensatory and other damages. It is possible that there could be adverse developments in pending cases including the certification of additional class actions. An unfavorable outcome or settlement of pending tobacco-related litigation could encourage the commencement of additional litigation. In addition, an unfavorable outcome in any tobacco-related litigation could have a material adverse effect on our consolidated financial position, results of operations or cash flows. Liggett could face difficulties in obtaining a bond to stay execution of a judgment pending appeal.

**Liggett Only Cases.** There are currently five cases pending where Liggett is the only remaining tobacco company defendant. Cases where Liggett is the only defendant could increase substantially as a result of the Engle progeny cases.

As new product liability cases are commenced against Liggett, the costs associated with defending these cases and the risks relating to the inherent unpredictability of litigation continue to increase.

Individual tobacco-related cases have increased as a result of the Florida Supreme Court’s ruling in Engle.

In May 2003, a Florida intermediate appellate court overturned a \$790.0 million punitive damages award against Liggett and decertified the Engle v. R. J. Reynolds Tobacco Co. smoking and health class action. In July 2006, the Florida Supreme Court affirmed in part and reversed in part the May 2003 intermediate appellate court decision. Among other things, the Florida Supreme Court affirmed the decision decertifying the class on a prospective basis and the order vacating the punitive damages award, but preserved several of the trial court’s Phase I findings (including that: (i) smoking causes lung cancer, among other diseases; (ii) nicotine in cigarettes is addictive; (iii) defendants placed cigarettes on the market that were defective and unreasonably dangerous; (iv) the defendants concealed material information; (v) all defendants sold or supplied cigarettes that were defective; and (vi) all defendants were negligent) and allowed plaintiffs to proceed to trial on individual liability issues (using the above findings) and

compensatory and punitive damage issues, provided they commence their individual lawsuits within one year of the date the court's decision became final on January 11, 2007, the date of the court's mandate. In December 2006, the Florida Supreme Court added the finding that defendants sold or supplied cigarettes that, at the time of sale or supply, did not conform to the representations made by defendants.

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Pursuant to the Florida Supreme Court's July 2006 ruling in Engle, former class members had until January 2008 to file individual lawsuits. Cases were commenced on behalf of approximately 8,000 plaintiffs. Lawsuits by individuals requesting the benefit of the Engle ruling are referred to as the "Engle progeny cases." In October 2013, the Company announced a settlement of the claims of approximately 4,900 of the remaining 5,300 Engle progeny plaintiffs. Notwithstanding this comprehensive settlement, the claims of approximately 320 state court Engle progeny plaintiffs remain outstanding. As of December 31, 2014, there were 13 Engle progeny cases currently scheduled for trial in 2015. Through December 31, 2014, 14 adverse verdicts had been entered against Liggett in Engle progeny cases. Several of these were affirmed on appeal and were satisfied by Liggett. The remaining verdicts are at various stages of appeal although appellate efforts, to date, have not been successful. Liggett faces outstanding judgments of \$28.2 million, plus interest and attorney fees, for the cases currently on appeal. We cannot predict the cash requirements related to any future settlements and judgments, including cash required to bond any appeals, and there is a risk that those requirements will not be able to be met.

Excise tax increases adversely affect cigarette sales.

Cigarettes are subject to substantial and increasing federal, state and local excise taxes. In February 2009, Federal legislation to reauthorize SCHIP, which includes funding provisions that increase the federal cigarette excise tax from \$0.39 to \$1.01 per pack, was enacted, effective April 1, 2009. Additional increases in the federal cigarette excise tax have been proposed by Congress. State excise taxes vary considerably and, when combined with sales taxes, local taxes and the federal excise tax, may exceed \$4.00 per pack. Various states and other jurisdictions are considering, or have pending, legislation proposing further state excise tax increases.