VECTOR GROUP LTD
Form 10-Q
November 09, 2009

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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.

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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.

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation:

The condensed consolidated financial statements of Vector Group Ltd. (the Company or Vector) include the accounts of VGR Holding LLC (VGR Holding), Liggett Group LLC (Liggett), Vector Tobacco Inc. (Vector Tobacco), Liggett Vector Brands 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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VECTOR GROUP LTD.
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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

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VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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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,		Nine Months Ended September 30,	
	2009	2008	2009	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,		Nine Months Ended September 30,	
	2009	2008	2009	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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VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
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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.

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(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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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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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

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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
6.75% Note	$ (407)	$	$ (2,216)	$
6.75% exchange notes	1,360		1,360	
3.875% convertible debentures	(7,029)	43	(24,358)	2,925
5% convertible notes	22	479	(631)	4,912
(Loss) gain on changes in fair value of embedded within convertible debt	$ (6,054)	$ 522	$ (25,845)	$ 7,837

The following table reconciles the fair value of derivatives embedded within convertible debt at September 30, 2009.

	6.75% Note	6.75% Exchange Notes	3.875% Convertible Debentures	5% Convertible Debentures	Total
Balance at December 31, 2008	$	$	$ 51,829	$ 25,416	$ 77,245
Loss (gain) from changes in fair value of embedded derivatives			1,752	(1,449)	303
Balance at March 31, 2009			53,581	23,967	77,548
Issuance of 6.75% Note	21,567			(2,485)	19,082
Issuance of 6.75% Exchange Notes		44,070		(23,392)	20,678
	1,809		15,577	2,102	19,488

Loss from changes in fair value of embedded derivatives					
Balance at June 30, 2009	23,376	44,070	69,158	192	136,796
Loss (gain) from changes in fair value of embedded derivatives	407	(1,360)	7,029	(22)	6,054
Balance at September 30, 2009	$ 23,783	$ 42,710	$ 76,187	$ 170	$ 142,850

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Beneficial Conversion Feature on Variable Interest Senior Convertible Debt:

After giving effect to the recording of the embedded derivative liability as a discount to the convertible debt, the Company s common stock had a fair value at the issuance date of the debt in excess of the conversion price resulting in a beneficial conversion feature. The accounting guidance on debt with conversion and other options requires that the intrinsic value of the beneficial conversion feature be recorded to additional paid-in capital and as a discount on the debt. The discount is then amortized to interest expense over the term of the debt using the effective interest method. The beneficial conversion feature has been recorded, net of income taxes, as an increase to stockholders equity.

A summary of non-cash interest expense associated with the amortization of the debt discount created by the beneficial conversion feature on the Company s variable interest senior convertible debt for the three and nine months ended September 30, 2009 and 2008 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Amortization of beneficial conversion feature:				
6.75% Note	$ 115	$	$ 175	$
6.75% exchange notes	375		375	
3.875% convertible debentures	(16)	(17)	(33)	(36)
5% convertible notes	8	789	1,878	2,162
Interest expense associated with beneficial conversion feature	$ 482	$ 772	$ 2,395	$ 2,126

Unamortized Debt Discount on Variable Interest Senior Convertible Debt:

The following table reconciles unamortized debt discount within convertible debt at September 30, 2009:

	6.75% Note	6.75% Exchange Notes	3.875% Convertible Debentures	5% Convertible Notes	Total
Balance at December 31, 2008	$	$	$ 83,993	$ 39,565	$ 123,558
Amortization of embedded derivatives			(112)	(1,657)	(1,769)
Amortization of beneficial conversion feature			7	(919)	(912)
Balance at March 31, 2009			83,888	36,989	120,877
Issuance of convertible notes - embedded derivative	21,567	44,070			65,637
Issuance of convertible notes - beneficial conversion feature	18,808	27,222			46,030
				(3,311)	(3,311)

Issuance of 6.75% Note write-off of unamortized debt discount					
Issuance of 6.75% Exchange Notes write-off of unamortized debt discount				(30,745)	(30,745)
Amortization of embedded derivatives	(70)		(113)	(1,712)	(1,895)
Amortization of beneficial conversion feature	(60)		10	(951)	(1,001)
Balance at June 30, 2009	40,245	71,292	83,785	270	195,592
Amortization of embedded derivatives	(131)	(608)	(114)	(16)	(869)
Amortization of beneficial conversion feature	(115)	(375)	16	(8)	(482)
Balance at September 30, 2009	$ 39,999	$ 70,309	$ 83,687	$ 246	$ 194,241

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Loss on Extinguishment of Debt:
The exchange of the 5% Notes for the 6.75% Notes and the 6.75% Exchange Notes qualifies as extinguishment of debt due to the significant change in terms. The loss was $0 and $18,444 for the three and nine months ended September 30, 2009. A summary of the Company s loss on the extinguishment of the 5% Notes for the nine months ended September 30, 2009 is as follows:

	6.75% Note	6.75% Exchange Notes	Total
Issuance of additional notes payable	$ 770	$ 6,996	$ 7,766
Termination of embedded derivative	(2,485)	(23,392)	(25,877)
Write-off of deferred finance costs	257	2,242	2,499
Write-off of unamortized debt discount, net	3,311	30,745	34,056
Loss on extinguishment of debt	$ 1,853	$ 16,591	$ 18,444

Revolving Credit Facility Liggett:
Liggett has a $50,000 credit facility with Wachovia Bank, N.A. under which $15,698 was outstanding at September 30, 2009. Availability as determined under the facility was approximately $20,300 based on eligible collateral at September 30, 2009.
Fair Value of Notes Payable and Long-term Debt:

The estimated fair value of the Company s notes payable and long-term debt has been determined by the Company using available market information and appropriate valuation methodologies described in Note 1. However, considerable judgment is required to develop the estimates of fair value and, accordingly, the estimate presented herein are not necessarily indicative of the amount that could be realized in a current market exchange.

	September 30, 2009		December 31, 2008	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Notes payable and long-term debt	$ 355,394	$ 568,034	$ 307,799	$ 447,520

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Scheduled Maturities:

Scheduled maturities of long-term debt as of September 30, 2009 are as follows:

	Principal	Unamortized Discount	Net
Year Ending December 31:			
2009	$ 17,919	$ 246	$ 17,673
2010	4,499		4,499
2011	16,250	1,458	14,792
2012	108,490	82,229	26,261
2013	505		505
Thereafter	407,009	115,345	291,664
Total	$ 554,672	$ 199,278	$ 355,394

The scheduled maturities of $108,490 (principal amount) in 2012 reflect $99,000 (principal amount), which may be required to be redeemed in 2012 in accordance with the terms of its 3.875% Variable Interest Senior Convertible Debentures due 2026.

7. EMPLOYEE BENEFIT PLANS

Defined Benefit and Postretirement Plans:

Net periodic benefit cost for the Company s pension and other postretirement benefit plans consists of the following:

	Pension Benefits			
	Three Months Ended		Nine Months Ended	
	September 30, 2009	September 30, 2008	September 30, 2009	September 30, 2008
Service cost benefits earned during the period	$ 330	$ 1,035	$ 990	$ 3,105
Interest cost on projected benefit obligation	1,894	2,381	5,681	7,143
Expected return on plan assets	(1,954)	(3,036)	(5,862)	(9,108)
Amortization of prior service cost	200	350	600	1,050
Amortization of net loss	534	25	1,602	75
Net expense	$ 1,004	$ 755	$ 3,011	$ 2,265

	Other Postretirement Benefits			
	Three Months Ended		Nine Months Ended	
	September 30, 2009	September 30, 2008	September 30, 2009	September 30, 2008

Service cost benefits earned during the period	$ 4	$ 4	$ 12	$ 12
Interest cost on projected benefit obligation	142	148	426	444
Amortization of net loss	(41)	(45)	(123)	(135)
Net expense	$ 105	$ 107	$ 315	$ 321

The increase of $249 in the Company s pension expense for the three months ended September 30, 2009 was the result of increased defined benefit expense at the Liggett segment of approximately $1,600 due primarily to the amortization of losses experienced in 2008 on the investment portfolio underlying Liggett s defined benefit

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plans. The amount was offset by lower expenses of approximately $1,400 at the corporate segment due to the retirement of the Company s former Executive Chairman on December 30, 2008. The increase of $746 in the Company s pension expense for the nine months ended September 30, 2009 was the result of increased defined benefit expense at the Liggett segment of approximately $4,800 due primarily to the amortization of losses experienced in 2008 on the investment portfolio underlying Liggett s defined benefit plans. The amount was offset by lower expenses of approximately $4,000 at the corporate segment due to the retirement of the Executive Chairman on December 30, 2008. The Company did not make contributions to its pension benefits plans for the three and nine months ended September 30, 2009 and does not anticipate making any contributions to such plans in 2009. The Company anticipates paying approximately $750 in other postretirement benefits in 2009.

In connection with the retirement of the Executive Chairman, he received in July 2009 a payment of $20,860 under the terms of the Company s Supplemental Retirement Plan. The payment was partially funded by approximately $1,554 held in a separate trust.

8. CONTINGENCIES

Tobacco-Related Litigation:

Overview

Since 1954, Liggett and other United States cigarette manufacturers have been named as defendants in numerous direct, third-party and purported class actions predicated on the theory that cigarette manufacturers should be liable for damages alleged to have been caused by cigarette smoking or by exposure to secondary smoke from cigarettes. New cases continue to be commenced against Liggett and other cigarette manufacturers. The cases generally fall into the following categories: (i) smoking and health cases alleging personal injury brought on behalf of individual plaintiffs (Individual Actions); (ii) smoking and health cases primarily alleging personal injury or seeking court-supervised programs for ongoing medical monitoring, as well as cases alleging the use of the terms lights and/or ultra lights constitutes a deceptive and unfair trade practice, common law fraud or violation of federal law, purporting to be brought on behalf of a class of individual plaintiffs (Class Actions); (iii) health care cost recovery actions brought by various foreign and domestic governmental entities (Governmental Actions); and (iv) health care cost recovery actions brought by third-party payors including insurance companies, union health and welfare trust funds, asbestos manufacturers and others (Third-Party Payor Actions). As new cases are commenced, the costs associated with defending these cases and the risks relating to the inherent unpredictability of litigation continue to increase. The future financial impact of the risks and expenses of litigation and the effects of the tobacco litigation settlements discussed below are not quantifiable at this time. Liggett incurred legal expenses and other litigation costs totaling approximately $4,286 and $4,806, for the nine months ended September 30, 2009 and 2008 respectively.

Litigation is subject to uncertainty and it is possible that there could be adverse developments in pending or future cases. An unfavorable outcome or settlement of pending tobacco-related or other litigation could encourage the commencement of additional litigation. Damages claimed in some tobacco-related or other litigation are or can be significant.

Although Liggett has been able to obtain required bonds or relief from bonding requirements in order to prevent plaintiffs from seeking to collect judgments while adverse verdicts have been appealed, there remains a risk that such relief may not be obtainable in all cases. This risk has been substantially reduced given that 43 states now limit the dollar amount of bonds or require no bond at all. Liggett has secured approximately $2,950 in bonds as of September 30, 2009.

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,

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except as discussed elsewhere in this note: (i) management has concluded that it is not probable that a loss has been incurred in any of the pending tobacco-related cases; or (ii) management is unable to estimate the possible loss or range of loss that could result from an unfavorable outcome of any of the pending tobacco-related cases and, therefore, management has not provided any amounts in the consolidated financial statements for unfavorable outcomes, if any. Liggett believes, and has been so advised by counsel, that it has valid defenses to the litigation pending against it, as well as valid bases for appeal of adverse verdicts. All such cases are, and will continue to be vigorously defended. However, Liggett may enter into settlement discussions in particular cases if it believes it is in the best interest of the Company to do so.

Individual Actions

As of September 30, 2009, there were 37 individual cases pending against Liggett and/or the Company, where one or more individual plaintiffs allege injury resulting from cigarette smoking, addiction to cigarette smoking or exposure to secondary smoke and seek compensatory and, in some cases, punitive damages. In addition, there were approximately 3,300 *Engle* progeny cases (defined below) pending against Liggett and/or the Company, in state and federal courts in Florida, and approximately 100 individual cases pending in West Virginia state court as part of a consolidated action. The following table lists the number of individual cases by state that are pending against Liggett or its affiliates as of September 30, 2009 (excluding *Engle* progeny cases and the cases consolidated in West Virginia):

State	Number of Cases
Florida	15
New York	9
Louisiana	5
Maryland	2
West Virginia	2
Illinois	1
Mississippi	1
Missouri	1
Ohio	1

Liggett Only Cases. There are currently six cases pending where Liggett is the only tobacco company defendant. Cases where Liggett is the only defendant could increase substantially as a result of the *Engle* progeny cases. In April 2004, in *Davis v. Liggett Group,* a Florida state court jury awarded compensatory damages of $540 against Liggett, plus interest. In addition, the court awarded plaintiff s counsel legal fees of $752. Liggett appealed both the compensatory and the legal fee awards. In October 2007, the compensatory award was affirmed by the Fourth District Court of Appeal and, thereafter, was paid by Liggett. In March 2008, the Fourth District Court of Appeal reversed and remanded the legal fee award for further proceedings in the trial court. In July 2009, the trial court awarded approximately $1,650 in legal fees, inclusive of interest and costs, which has been paid by Liggett. *In Ferlanti v. Liggett Group*, in February 2009, a Florida state court jury awarded compensatory damages of $1,200 against Liggett, but found that the plaintiff was 40% at fault. Therefore, plaintiff was awarded $720 in compensatory damages plus $96 in expenses. Punitive damages were not awarded. Liggett has appealed the award. On May 1, 2009, the court granted plaintiff s motion for an award of attorneys fees but the amount has not yet been determined. In *Hausrath v. Philip Morris*, a case pending in New York state court, plaintiffs recently dismissed all defendants other than Liggett. The other three individual actions, in which Liggett is the only tobacco company defendant, are dormant.

The plaintiffs allegations of liability in those cases in which individuals seek recovery for injuries allegedly caused by cigarette smoking are based on various theories of recovery, including negligence, gross negligence, breach of special duty, strict liability, fraud, concealment, misrepresentation, design defect, failure to warn, breach of express and implied warranties, conspiracy, aiding and abetting, concert of action, unjust enrichment, common law public nuisance, property damage, invasion of privacy, mental anguish, emotional distress, disability, shock,

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indemnity and violations of deceptive trade practice laws, the federal Racketeer Influenced and Corrupt Organizations Act (RICO), state RICO statutes and antitrust statutes. In many of these cases, in addition to compensatory damages, plaintiffs also seek other forms of relief including treble/multiple damages, medical monitoring, disgorgement of profits and punitive damages. Although alleged damages often are not determinable from a complaint, and the law governing the pleading and calculation of damages varies from state to state and jurisdiction to jurisdiction, compensatory and punitive damages have been specifically pleaded in a number of cases, sometimes in amounts ranging into the hundreds of millions and even billions of dollars.

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

In addition to the awards against Liggett in *Davis* and *Ferlanti* (described above), jury awards in individual cases have also been returned against other cigarette manufacturers in recent years. The awards in these individual actions, often in excess of millions of dollars, are for both compensatory and punitive damages. There are several significant jury awards against other cigarette manufacturers which are currently on appeal.

Engle Progeny Cases. In 2000, a jury in *Engle v. R.J. Reynolds Tobacco Co.* rendered a $145,000,000 punitive damages verdict in favor of a Florida Class against certain cigarette manufacturers, including Liggett. Pursuant to the Florida Supreme Court s July 2006 ruling in *Engle*, which decertified the class on a prospective basis, and affirmed the appellate court s reversal of the punitive damages award, former class members had one year from January 11, 2007 in which to file individual lawsuits. In addition, some individuals who filed suit prior to January 11, 2007, and who claim they meet the conditions in *Engle*, are attempting to avail themselves of the *Engle* ruling. Lawsuits by individuals requesting the benefit of the *Engle* ruling, whether filed before or after the January 11, 2007 deadline, are referred to as the *Engle* progeny cases. Liggett and/or the Company have been named in approximately 3,200 *Engle* progeny cases in both state and federal courts in Florida. Other cigarette manufacturers have also been named as defendants in most of these cases. These cases include approximately 8,585 plaintiffs, approximately 3,300 of whom have claims pending in federal court. Duplicate cases were filed in federal and state court on behalf of approximately 660 plaintiffs. The majority of the cases pending in federal court are stayed pending the outcome of an appeal to the United States Court of Appeals for the Eleventh Circuit of several district court orders in which it was found that the Florida Supreme Court s decision in *Engle* was unconstitutional. The number of progeny cases will likely increase as the courts may require multi-plaintiff cases to be severed into individual cases. The total number of plaintiffs may also increase as a result of attempts by existing plaintiffs to add additional parties. As of September 30, 2009, there were approximately 43 *Engle* progeny cases scheduled for trial, or likely to be scheduled for trial, in 2009 and 2010. As of September 30, 2009, eight *Engle* progeny cases have been tried resulting in six plaintiff verdicts and two defense verdicts. In one of these cases, judgment was entered against Liggett for $156. For further information on the *Engle* case and on *Engle* progeny cases, see Class Actions *Engle* Case, below.

Class Actions

As of September 30, 2009, there were seven actions pending for which either a class had been certified or plaintiffs were seeking class certification, where Liggett is a named defendant, including one alleged price fixing case. Other cigarette manufacturers are also named in these actions. Many of these actions purport to constitute statewide class actions and were filed after May 1996 when the United States Court of Appeals for the Fifth Circuit, in *Castano v. American Tobacco Co., Inc.*, reversed a federal district court s certification of a purported nationwide class action on

behalf of persons who were allegedly addicted to tobacco products.

Plaintiffs allegations of liability in class action cases are based on various theories of recovery, including negligence, gross negligence, strict liability, fraud, misrepresentation, design defect, failure to warn, nuisance, breach of express and implied warranties, breach of special duty, conspiracy, concert of action, violation of deceptive trade practice laws and consumer protection statutes and claims under the federal and state anti-racketeering statutes. Plaintiffs in the class actions seek various forms of relief, including compensatory and

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punitive damages, treble/multiple damages and other statutory damages and penalties, creation of medical monitoring and smoking cessation funds, disgorgement of profits, and injunctive and equitable relief. Defenses raised in these cases include, among others, lack of proximate cause, individual issues predominate, assumption of the risk, comparative fault and/or contributory negligence, statutes of limitations and preemption by the Federal Cigarette Labeling and Advertising Act.

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

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

In July 2006, the Florida Supreme Court affirmed the decision vacating the punitive damages award and held that the class should be decertified prospectively, but 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) defendants concealed material information knowing that the information was false or misleading or failed to disclose a material fact concerning the health effects or addictive nature of smoking; (v) defendants agreed to conceal or omit information regarding the health effects of cigarettes or their addictive nature with the intention that smokers would rely on the information to their detriment; (vi) defendants sold or supplied cigarettes that were defective; and (vii) defendants were negligent. The Florida Supreme Court decision also allowed former class members to proceed to trial on individual liability issues (using the above findings) and compensatory and punitive damage issues, provided they file their individual lawsuits by January 2008. In December 2006, the Florida Supreme Court added the finding that defendants sold or supplied cigarettes that, at the time of sale or supply, did not conform to the representations made by defendants. As a result of the decision, approximately 8,585 former *Engle* class members have suits pending against the Company and/or Liggett as well as other cigarette manufacturers.

Three federal district courts (in the *Merlob, Brown* and *Burr* cases) have ruled that the findings in the first phase of the *Engle* proceedings cannot be used to satisfy elements of plaintiffs claims, and two of those rulings (*Brown* and *Burr*, which has since been dismissed for lack of prosecution) were certified by the trial court for interlocutory review. The certification was granted by the United States Court of Appeals for the Eleventh Circuit and oral argument is scheduled for January 2010. *Engle* progeny cases pending in the federal district courts in the Middle District of Florida have been stayed pending interlocutory review by the Eleventh Circuit. Several state trial court judges have issued contrary rulings that allowed plaintiffs to use the *Engle* findings to establish elements of their

claims and required certain defenses to be stricken.

In June 2002, the jury in a Florida state court action entitled *Lukacs v. R.J. Reynolds Tobacco Co.,* awarded $37,500 in compensatory damages, jointly and severally, in a case involving Liggett and two other cigarette manufacturers, which amount was subsequently reduced by the court. The jury found Liggett 50% responsible for the damages incurred by the plaintiff. The *Lukacs* case was the first case to be tried as an individual *Engle* progeny case, but was tried almost five years prior to the Florida Supreme Court s final decision in *Engle*. In November 2008, the court entered final judgment in the amount of $24,835 (for which Liggett is 50% responsible),

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plus interest from June 2002 which, as of September 30, 2009, was in excess of $13,000. Defendants filed a notice of appeal in December 2008. Briefing is underway. In addition, plaintiff filed a motion seeking an award of attorneys fees from Liggett based on plaintiff s prior proposal for settlement. All proceedings relating to the motion for attorneys fees are stayed pending a final resolution of appellate proceedings.

Other Class Actions. Smith v. Philip Morris, a Kansas state court case, is an action in which plaintiffs allege that cigarette manufacturers conspired to fix cigarette prices in violation of antitrust laws. Class certification was granted in *Smith* in November 2001. Discovery is ongoing.

Class action suits have been filed in a number of states against cigarette manufacturers, alleging, among other things, that use of the terms light and ultra light constitutes unfair and deceptive trade practices, among other things. One such suit, *Schwab [McLaughlin] v. Philip Morris,* pending in federal court in New York since 2004, sought to create a nationwide class of light cigarette smokers. In September 2006, the United States District Court for the Eastern District of New York certified the class. In April 2008, the United States Court of Appeals for the Second Circuit decertified the class. The case was returned to the trial court for further proceedings (see discussion of *Cleary* case below). In December 2008, the United States Supreme Court, in *Altria Group v. Good*, ruled that the Federal Cigarette Labeling and Advertising Act did not preempt the state law claims asserted by the plaintiffs and that they could proceed with their claims under the Maine Unfair Trade Practices Act. This ruling may result in additional class action cases in other states. Although Liggett is not a party in the *Good* case, an adverse ruling or commencement of additional lights related class actions could have a material adverse effect on the Company.

In November 1997, in *Young v. American Tobacco Co.,* a purported personal injury class action was commenced on behalf of plaintiff and all similarly situated residents in Louisiana who, though not themselves cigarette smokers, are alleged to have been exposed to secondhand smoke from cigarettes which were manufactured by the defendants, and who suffered injury as a result of that exposure. The plaintiffs seek to recover an unspecified amount of compensatory and punitive damages. In October 2004, the trial court stayed this case pending the outcome of the appeal in *Scott v. American Tobacco Co.* (see description below).

In June 1998, in *Cleary v. Philip Morris,* a putative class action was brought in Illinois state court on behalf of persons who were allegedly injured by: (i) defendants purported conspiracy to conceal material facts regarding the addictive nature of nicotine; (ii) defendants alleged acts of targeting their advertising and marketing to minors; and (iii) defendants claimed breach of the public s right to defendants compliance with laws prohibiting the distribution of cigarettes to minors. Plaintiffs request that defendants be required to disgorge all profits unjustly received through their sale of cigarettes to plaintiffs and the class. In July 2006, the plaintiffs filed a motion for class certification. A class certification hearing occurred in September 2007 and the parties are awaiting a decision. Merits discovery is stayed pending a ruling by the court. In March 2009, plaintiffs filed a third amended complaint adding, among other things, allegations regarding defendants sale of light cigarettes. In April 2009, plaintiffs in 11 lights class actions, including *Cleary* and *Schwab,* moved to consolidate pretrial proceedings in these 11 cases in a Multidistrict Litigation. In September 2009, the court denied the motion to consolidate the *Cleary* and *Schwab* cases.

In April 2001, in *Brown v. Philip Morris USA,* a California state court granted in part plaintiffs motion for class certification and certified a class comprised of adult residents of California who smoked at least one of defendants cigarettes during the applicable time period and who were exposed to defendants marketing and advertising activities in California. In March 2005, the court granted defendants motion to decertify the class based on a recent change in California law. In June 2009, the California Supreme Court reversed and remanded. Defendants motion

for rehearing was denied. In September 2009, plaintiffs advised the court that they intend to seek reconsideration of the court s order finding that plaintiffs allegations regarding lights cigarettes were preempted by federal law, in light of the recent United States Supreme Court decision in *Altria Group v. Good*.

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Although not technically a class action, in *In Re: Tobacco Litigation (Personal Injury Cases)*, a West Virginia state court consolidated approximately 750 individual smoker actions that were pending prior to 2001 for trial of certain common issues. In January 2002, the court severed Liggett from the trial of the consolidated action, which is scheduled for February 2010. If the case were to proceed against Liggett, it is estimated that Liggett could be a defendant in approximately 100 of the individual cases.

Class certification motions are pending in a number of other cases and a number of orders denying class certification are on appeal. In addition to the cases described above, numerous class actions remain certified against other cigarette manufacturers, including *Scott.* In that case, a Louisiana jury returned a $591,000 verdict (subsequently reduced by the court to $263,500 plus interest from June 2004) against other cigarette manufacturers to fund medical monitoring or smoking cessation programs for members of the class. The case is on appeal.

Governmental Actions

As of September 30, 2009, there was one active Governmental Action pending against Liggett. The claims asserted in health care cost recovery actions vary. In these cases, the governmental entities typically assert equitable claims that the tobacco industry was unjustly enriched by their payment of health care costs allegedly attributable to smoking and seek reimbursement of those costs. Other claims made by some but not all plaintiffs include the equitable claim of indemnity, common law claims of negligence, strict liability, breach of express and implied warranty, breach of special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under state and federal statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under RICO.

In *City of St. Louis v. American Tobacco Company*, a case pending in Missouri state court since December 1998, the City of St. Louis and approximately 40 hospitals seek recovery of costs expended by the hospitals on behalf of patients who suffer, or have suffered, from illnesses allegedly resulting from the use of cigarettes. In June 2005, the court granted defendants motion for summary judgment as to claims for damages which accrued prior to November 16, 1993. The claims for damages which accrued after November 16, 1993 are pending. Discovery is ongoing. In September 2008, the court heard argument on motions for summary judgment filed by the parties. A decision is pending. Trial is currently scheduled to commence June 7, 2010.

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

In August 2006, the trial court entered a Final Judgment and Remedial Order against each of the cigarette manufacturing defendants, except Liggett. The Final Judgment, among other things, enjoined the non-Liggett defendants from using lights , low tar , ultra lights , mild , or natural descriptors, or conveying any other express implied health messages in connection with the marketing or sale of cigarettes. In May 2009, the United States Court of Appeals for the District of Columbia Circuit affirmed most of the district court s decision. The defendants, other than Liggett, have appealed to the United States Supreme Court. Although this case has been concluded as to Liggett, it is unclear what impact, if any, the Final Judgment will have on the cigarette industry as a whole. To the

extent that the Final Judgment leads to a decline in industry-wide shipments of cigarettes in the United States or otherwise results in restrictions that adversely affect the industry, Liggett s sales volume, operating income and cash flows could be materially adversely affected.

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Third-Party Payor Actions

As of September 30, 2009, there were two Third-Party Payor Actions pending against Liggett and other cigarette manufacturers. Third-Party Payor Actions typically have been filed by insurance companies, union health and welfare trust funds, asbestos manufacturers and others. In Third-Party Payor Actions, plaintiffs seek damages for funding of corrective public education campaigns relating to issues of smoking and health; funding for clinical smoking cessation programs; disgorgement of profits from sales of cigarettes; restitution; treble damages; and attorneys fees. Although no specific amounts are provided, it is possible that requested damages against cigarette manufacturers in these cases might be in the billions of dollars.

Several federal circuit courts of appeals and state appellate courts have ruled that Third-Party Payors do not have standing to bring lawsuits against cigarette manufacturers, relying primarily on grounds that plaintiffs claims were too remote. The United States Supreme Court has refused to consider plaintiffs appeals from the cases decided by five federal circuit courts of appeals.

In June 2005, the Jerusalem District Court in Israel added Liggett as a defendant in an action commenced in 1998 by the largest private insurer in that country, General Health Services, against the major United States cigarette manufacturers. The plaintiff seeks to recover the past and future value of the total expenditures for health care services provided to residents of Israel resulting from tobacco related diseases, court ordered interest for past expenditures from the date of filing the statement of claim, increased and/or punitive and/or exemplary damages and costs. The court ruled that, although Liggett had not sold product in Israel since at least 1978, it might still have liability for cigarettes sold prior to that time. Motions filed by defendants are pending before the Israel Supreme Court seeking appeal from a lower court s decision granting leave to plaintiff for foreign service of process.

In May 2008, in *National Committee to Preserve Social Security and Medicare v. Philip Morris USA,* a case pending in the United States District Court for the Eastern District of New York, plaintiffs commenced an action to recover twice the amount paid by Medicare for the health care services provided to Medicare beneficiaries to treat diseases allegedly attributable to smoking defendants cigarettes from May 21, 2002 to the present, for which treatment defendants allegedly were required to make payment under the Medicare Secondary Payer provisions of the Social Security Act . Defendants Motion to Dismiss and plaintiffs Motion for Partial Summary Judgment were filed in July 2008 and in March 2009, the court dismissed the case. Plaintiffs appealed the decision.

Upcoming Trials

As of September 30, 2009, there were approximately 43 *Engle* progeny cases that may be set for trial during 2009 or 2010. The Company and/or Liggett and other cigarette manufacturers are currently named as defendants in each of these cases. Trial dates are subject to change.

MSA and Other State Settlement Agreements

In March 1996, March 1997 and March 1998, Liggett entered into settlements of smoking-related litigation with 45 states and territories. The settlements released Liggett from all smoking-related claims 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 Master Settlement Agreement (the MSA) with 46 states, the District of Columbia, Puerto Rico, Guam, the United States Virgin Islands, American Samoa and the Northern Mariana Islands (collectively, the Settling States) to settle the asserted and unasserted health care

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cost recovery and certain other claims of the Settling States. The MSA received final judicial approval in each Settling State.

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

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

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

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

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

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. According to data from Management Science Associates, Inc., domestic shipments by Liggett and Vector Tobacco accounted for approximately 2.4%, 2.5% and 2.5% of the total cigarettes shipped in the United States in 2006, 2007 and 2008 respectively. 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. In April 2007, Liggett and Vector Tobacco paid $38,743 for their 2006 MSA obligations and in April 2008, paid $35,995 for their 2007 MSA obligations, having prepaid $34,500 of that amount in December 2007. In December 2008, Liggett and Vector Tobacco prepaid $34,000 of their 2008 MSA obligations and paid an additional $8,799 in April 2009 after withholding certain disputed amounts.

Under the payment provisions of the MSA, the Participating Manufacturers are required to pay a base annual amount of $9,000,000 in 2009 and each year thereafter (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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Certain MSA Disputes

In 2005, the independent auditor under the MSA calculated that Liggett owed $28,668 for its 2004 sales. In April 2005, Liggett paid $11,678 and disputed the balance, as permitted by the MSA. Liggett subsequently paid $9,304 of the disputed amount, although Liggett continues to dispute that this amount is owed. This $9,304 relates to an adjustment to its 2003 payment obligation claimed by Liggett for the market share loss to non-participating manufacturers, which is known as the NPM Adjustment. At September 30, 2009, included in Other assets on the Company s consolidated balance sheet, was a noncurrent receivable of $6,513 relating to such amount. The remaining balance in dispute of $7,686 is comprised of $5,318 claimed for a 2004 NPM Adjustment and $2,368 relating to the independent auditor s retroactive change from gross to net units in calculating MSA payments, which Liggett contends is improper, as discussed below. From their April 2006 payment, Liggett and Vector Tobacco withheld approximately $1,600 claimed for the 2005 NPM Adjustment and $2,949 relating to the retroactive change from gross to net units. Liggett and Vector Tobacco withheld approximately $4,200 from their April 2007 payments related to the 2006 NPM Adjustment and approximately $3,950 relating to the retroactive change from gross to net units. From their April 2008 payment, Liggett and Vector Tobacco withheld approximately $4,000 for the 2007 NPM Adjustment and approximately $3,696 relating to the retroactive change from gross to net units. Vector Tobacco paid approximately $200 into the disputed payments account for the 2007 NPM Adjustment. From their April 2009 payment, Liggett and Vector Tobacco withheld approximately $6,100 relating to the 2008 NPM adjustment and approximately $3,300 relating to the retroactive change from gross to net units.

The following amounts have not been expensed by the Company as they relate to Liggett s and Vector Tobacco s claim for an NPM adjustment: $6,513 for 2003, $3,789 for 2004 and $800 for 2005.

NPM Adjustment. In March 2006, an economic consulting firm selected pursuant to the MSA rendered its final and non-appealable decision that the MSA was a significant factor contributing to the loss of market share of Participating Manufacturers for 2003. The economic consulting firm subsequently rendered the same decision with respect to 2004, 2005 and 2006. As a result, the manufacturers are entitled to potential NPM Adjustments to their 2003, 2004, 2005 and 2006 MSA payments. The Participating Manufacturers are also entitled to potential NPM Adjustments to their 2007, 2008 and 2009 payments pursuant to an agreement entered into in June 2009 between the OPMs and the Settling States under which the OPMs agreed to make certain payments for the benefit of the Settling States, in exchange for which the Settling States stipulated that the MSA was a significant factor contributing to the loss of market share of Participating Manufacturers in 2007, 2008 and 2009. A Settling State that has diligently enforced its qualifying escrow statute in the year in question may be able to avoid application of the NPM Adjustment to the payments made by the manufacturers for the benefit of that state or territory.

Since April 2006, notwithstanding provisions in the MSA requiring arbitration, litigation has been filed in 49 Settling States over the issue of whether the application of the NPM Adjustment for 2003 is to be determined through litigation or arbitration. These actions relate to the potential NPM Adjustment for 2003, which the independent auditor under the MSA previously determined to be as much as $1,200,000 for all Participating Manufacturers. All but one of the 48 courts that have decided the issue have ruled that the 2003 NPM Adjustment dispute is arbitrable. All 47 of those decisions are final and non-appealable. One court, the Montana Supreme Court, ruled that Montana s claim of diligent enforcement must be litigated. In response to a proposal from the OPMs and many of the SPMs, 45 of the Settling States, representing approximately 90% of the allocable share of the Settling States, entered into an agreement providing for a nationwide arbitration of the dispute with respect to the NPM Adjustment for 2003. The agreement provides for selection of the arbitration panel beginning November 1, 2009 and that the parties and the arbitrators will thereafter establish the schedule and procedures for the arbitration.

Because states representing more than 80% of the allocable share signed the agreement, signing states will receive a 20% reduction of any potential 2003 NPM adjustment. It is anticipated that the arbitration will begin in 2010. There can be no assurance that Liggett or Vector Tobacco will receive any adjustment as a result of these proceedings.

Gross v. Net Calculations. In October 2004, the independent auditor notified Liggett and all other Participating Manufacturers that their payment obligations under the MSA, dating from the agreement s execution in late 1998, had been recalculated using net unit amounts, rather than gross unit amounts (which had been used since

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1999). The change in the method of calculation could, among other things, require additional MSA payments by Liggett of approximately $26,200, including interest, for 2001 through 2008, and require additional amounts in future periods because the proposed change from gross to net units would serve to lower Liggett s market share exemption under the MSA.

Liggett has objected to this retroactive change and has disputed the change in methodology. Liggett contends that the retroactive change from using gross to net unit amounts is impermissible for several reasons, including:

use of net unit amounts is not required by the MSA (as reflected by, among other things, the use of gross unit amounts through 2005);

such a change is not authorized without the consent of affected parties to the MSA;

the MSA provides for four-year time limitation periods for revisiting calculations and determinations, which precludes recalculating Liggett s 1997 Market Share (and thus, Liggett s market share exemption); and

Liggett and others have relied upon the calculations based on gross unit amounts since 1998.

No amounts have been expensed or accrued in the accompanying consolidated financial statements for any potential liability relating to the gross versus net dispute.

QUEST 3. Vector Tobacco has not made MSA payments on sales of its QUEST 3 product as Vector Tobacco believes that QUEST 3 does not fall within the definition of a cigarette under the MSA. Quest is no longer being sold by Vector Tobacco. There can be no assurance that additional payments under the MSA for QUEST 3 will not be owed.

Litigation Challenging the MSA. In *Freedom Holdings Inc. v. Cuomo*, litigation pending in federal court in New York, certain importers of cigarettes allege that the MSA and certain related New York statutes violate federal antitrust and constitutional law. The district court granted New York s motion to dismiss the complaint for failure to state a claim. On appeal, the United States Court of Appeals for the Second Circuit held that if all of the allegations of the complaint were assumed to be true, plaintiffs had stated a claim for relief on antitrust grounds. In January 2009, the district court granted New York s motion for summary judgment, dismissing all claims brought by the plaintiffs, and dissolving the preliminary injunction. The plaintiffs have appealed.

In *Grand River Enterprises Six Nations, Ltd. v. Pryor*, another proceeding pending in federal court in New York, plaintiffs seek to enjoin the statutes enacted by New York and other states in connection with the MSA on the grounds that the statutes violate the Commerce Clause of the United States Constitution and federal antitrust laws. In September 2005, the United States Court of Appeals for the Second Circuit held that if all of the allegations of the complaint were assumed to be true, plaintiffs had stated a claim for relief and that the New York federal court had jurisdiction over the other defendant states. On remand, the trial court held that plaintiffs are unlikely to succeed on the merits. Discovery is pending. Similar challenges to the MSA and MSA-related state statutes are pending in Kentucky, Arkansas, Kansas, Louisiana, Tennessee and Oklahoma. Liggett and the other cigarette manufacturers are not defendants in these cases. Litigation challenging the validity of the MSA, including claims that the MSA violates antitrust laws, has not been successful to date.

In October 2008, Vibo Corporation, Inc., d/b/a General Tobacco (Vibo) commenced litigation in the United States District Court for the Western District of Kentucky against each of the Settling States and certain Participating Manufacturers. Vibo alleged, among other things, that the market share exemptions (i.e., grandfathered shares)

provided to certain SPMs under the MSA, including Liggett and Vector Tobacco, violate federal antitrust and constitutional law. In January 2009, the court issued a memorandum opinion and order

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granting the defendants motions and dismissing Vibo s lawsuit. In December 2008, Vibo filed a second lawsuit, seeking declaratory relief under the MSA, in California state court against California and certain cigarette manufacturers, including Liggett and Vector Tobacco, seeking a determination that the proposed amendment to Vibo s agreement to join the MSA, under which it would no longer have to make certain MSA payments, did not trigger the MSA s most favored nation provision. In March 2009, the OPMs and SPMs each filed motions for summary judgment. In July 2009, the trial court granted the OPMs and SPMs motions for summary judgment. Vibo appealed the final judgment.

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

In 2003, in order to resolve any potential issues with Minnesota as to Liggett s ongoing economic settlement obligations, Liggett negotiated a $100 a year payment to Minnesota, to be paid any year cigarettes manufactured by Liggett are sold in that state. In 2004, the Attorneys General for Florida, Mississippi and Texas advised Liggett that they believed that Liggett had failed to make all required payments under the respective settlement agreements with these states for the period 1998 through 2003 and that additional payments may be due for 2004 and subsequent years. Liggett believes the states allegations are without merit, based, among other things, on the language of the most favored nation provisions of the settlement agreements.

Except for $2,500 accrued at September 30, 2009, in connection with the foregoing matters, no other amounts have been accrued in the accompanying condensed consolidated financial statements for any additional amounts that may be payable by Liggett under the settlement agreements with Florida, Mississippi and Texas. The previous settlement demands made by these states are substantially in excess of the $2,500 accrual. There can be no assurance that Liggett will resolve these matters or that Liggett will not be required to make additional material payments, which payments could adversely affect the Company s consolidated financial position, results of operations or cash flows.

Cautionary Statement. Management is not able to predict the outcome of the litigation pending or threatened against Liggett. Litigation is subject to many uncertainties. For example, in addition to $540 awarded in the *Davis* case, plus legal fees, and $816 awarded in the *Ferlanti* case, plus legal fees, in June 2002, the jury in the *Lukacs* case, an individual case brought under the third phase of the *Engle* case, awarded compensatory damages against Liggett and two other defendants and found Liggett 50% responsible for the damages. In November 2008, the court entered final judgment in favor of the plaintiff for $24,835, plus interest from June 11, 2002 which, as of September 30, 2009, exceeded

$13,000. Recently, Liggett was found liable in an *Engle* progeny case and its portion of the total award was $156. It is possible that additional cases could be decided unfavorably against Liggett. As a result of the *Engle* decision, approximately 8,585 former *Engle* class members commenced suit against Liggett and/or the Company and other cigarette manufacturers. Liggett may enter into discussions in an attempt to settle particular cases if it believes it is in its best interest to do so.

Management cannot predict the cash requirements related to any future defense costs, settlements or judgments, including cash required to bond any appeals, and there is a risk that those requirements will not be able to be met. An unfavorable outcome of a pending smoking and health case could encourage the commencement of

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additional similar litigation, or could lead to multiple adverse decisions in the *Engle* progeny cases. Adverse verdicts have been rendered in six *Engle* progeny cases out of eight that have been tried. Management is unable to make a reasonable estimate with respect to the amount or range of loss that could result from an unfavorable outcome of the cases pending against Liggett or the costs of defending such cases and as a result has not provided any amounts in its condensed consolidated financial statements for unfavorable outcomes. The complaints filed in these cases rarely detail alleged damages. Typically, the claims set forth in an individual s complaint against the tobacco industry seek money damages in an amount to be determined by a jury, plus punitive damages and costs.

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

It is possible that the Company s consolidated financial position, results of operations or cash flows could be materially adversely affected by an unfavorable outcome in any of the smoking-related litigation.

Liggett s and Vector Tobacco s management are unaware of any material environmental conditions affecting their existing facilities. Liggett s and Vector Tobacco s management believe that current operations are conducted in material compliance with all environmental laws and regulations and other laws and regulations governing cigarette manufacturers. Compliance with federal, state and local provisions regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, has not had a material effect on the capital expenditures, results of operations or competitive position of Liggett or Vector Tobacco.

Other Matters:

In February 2004, Liggett Vector Brands and another cigarette manufacturer entered into a five year agreement with a subsidiary of the American Wholesale Marketers Association to support a program to permit certain tobacco distributors to secure, on reasonable terms, tax stamp bonds required by state and local governments for the distribution of cigarettes. This agreement was extended through 2014. Under the agreement, Liggett Vector Brands has agreed to pay a portion of losses, if any, incurred by the surety under the bond program, with a maximum loss exposure of $500 for Liggett Vector Brands. To secure its potential obligations under the agreement, Liggett Vector Brands has delivered to the subsidiary of the association a $100 letter of credit and agreed to fund up to an additional $400. Liggett Vector Brands has incurred no losses to date under this agreement, and the Company believes the fair value of Liggett Vector Brands obligation under the agreement was immaterial at September 30, 2009.

There may be several other proceedings, lawsuits and claims pending against the Company and certain of its consolidated subsidiaries unrelated to tobacco or tobacco product liability. Management is of the opinion that the liabilities, if any, ultimately resulting from such other proceedings, lawsuits and claims should not materially affect the Company s financial position, results of operations or cash flows.

9. INCOME TAXES

For the three and nine months ended September 30, 2009, the Company s income tax provision was an expense of $2,654 and a benefit of $1,346 compared to an expense of $7,010 and $33,042 for the three and nine months ended

September 30, 2008.

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

Vector s income tax rates for the three and nine months ended September 30, 2009 and 2008 do not bear a customary relationship to statutory income tax rates as a result of the impact of nondeductible expenses, state income taxes and interest and penalties accrued on unrecognized tax benefits offset by the impact of the domestic production activities deduction. In addition, the Company recorded a benefit of $6,166 for the three and nine months ended September 30, 2009 resulting from the reduction of a previously established valuation allowance of a deferred tax asset. The valuation allowance was reduced for the recognition of state tax net operating losses at Vector Tobacco Inc. after evaluating the impact of the negative and positive evidence that such asset would be realized. The Company based its conclusion on the fact that Vector Tobacco is anticipated to report state taxable income on a separate company basis for the second consecutive year in 2009.

For the nine months ended September 30, 2009, the Company s tax provision was reduced because of the impact of the loss on extinguishment of debt and reduced income tax benefit by approximately $535 due to differences in the Company s marginal tax rate and its anticipated effective annual income tax rate from ordinary operations.

For the three and nine months ended September 30, 2008, the Company s income tax provision was increased by approximately $240 because of the impact of the impairment charges. For the nine months ended September 30, 2008, the Company s income tax provision was reduced by approximately $370 because of the impact of the income from the Company s investment in the St. Regis Hotel.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Income before provision for income taxes	$ 18,873	$ 21,837	$ 10,027	$ 81,301
Income tax expense using estimated annual effective income tax rate	8,210	9,608	4,362	35,772
Changes in effective tax rates	610	(238)	(77)	
Impact of discrete items, net		240	535	(130)
Reduction of valuation allowance	(6,166)		(6,166)	
Reversal of unrecognized tax benefits		(2,600)		(2,600)
Income tax expense (benefit)	$ 2,654	$ 7,010	$ (1,346)	$ 33,042

The Company s current portion of deferred income taxes payable decreased by approximately $75,500 as a result of taxable income of approximately $197,000 from exercise by Philip Morris of an option associated with the brands transaction.

The Internal Revenue Service concluded an audit of the Company s income tax return for the year ended December 31, 2005. There was no material impact on the Company s condensed consolidated financial statements as a result of the audit.

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10. NEW VALLEY

Investments in Non-Consolidated Real Estate Businesses:

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

	September 30, 2009	December 31, 2008
Douglas Elliman Realty LLC	$ 33,657	$ 33,175
Aberdeen Townhomes LLC	1,248	6,500
New Valley Oaktree Chelsea Eleven LLC	10,723	11,100
Investments in non-consolidated real estate businesses	$ 45,628	$ 50,775

Residential Brokerage Business. New Valley recorded income of $4,712 and $4,727 for the three months ended September 30, 2009 and 2008, respectively, and income of $5,328 and $10,249 for the nine months ended September 30, 2009 and 2008, respectively, associated with Douglas Elliman Realty. New Valley s income or loss includes 50% of Douglas Elliman s net income or loss, as well as interest income earned by New Valley on a subordinated loan to Douglas Elliman Realty, income resulting from management fees and other adjustments. New Valley received cash distributions from Douglas Elliman Realty LLC of $1,370 and $3,200 for the three months ended September 30, 2009 and 2008, respectively, and $4,846 and $5,757 for the nine months ended September 30, 2009 and 2008, respectively.

Summarized financial information for Douglas Elliman Realty for the three and nine months ended September 30, 2009 and 2008 and as of September 30, 2009 and December 31, 2008 is presented below.

	September 30, 2009	**December 31, 2008**
Cash	$ 22,334	$ 22,125
Other current assets	9,925	7,496
Property, plant and equipment, net	12,793	15,868
Trademarks	21,663	21,663
Goodwill	38,342	38,325
Other intangible assets, net	1,043	1,311
Other non-current assets	2,759	904
Notes payable current	1,175	1,413
Current portion of notes payable to member Prudential Real Estate Financial Services of America, Inc.	3,589	4,729
Current portion of notes payable to member New Valley	3,589	4,729
Other current liabilities	23,270	23,294
Notes payable long term	627	1,805
Notes payable to member Prudential Real Estate Financial Services of America, Inc.		2,030
Notes payable to member New Valley		2,030

Other long-term liabilities	8,252	6,939
Members equity	68,357	60,723

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	Three Months Ended September 30,		Nine months Ended September 30,	
	2009	2008	2009	2008
Revenues	$ 80,484	$ 99,259	$ 189,813	$ 281,515
Costs and expenses	71,271	88,564	177,597	256,803
Depreciation expense	1,075	1,373	3,408	4,080
Amortization expense	64	74	192	223
Other income	1,000		1,000	
Interest expense, net	732	800	2,025	2,465
Income tax expense (benefit)	323	76	(42)	422
Net income	$ 8,019	$ 8,372	$ 7,633	$ 17,522

Douglas Elliman Realty has been negatively impacted by the current downturn in the residential real estate market. The residential real estate market is cyclical and is affected by changes in the general economic conditions that are beyond Douglas Elliman Realty s control. Since 2008, the U.S. residential real estate market, including the market in the New York metropolitan area where Douglas Elliman operates, has been negatively impacted by various factors including downward pressure on housing prices, the impact of the recent contraction in the subprime and mortgage markets generally and an exceptionally large inventory of unsold homes at the same time that sales volumes are decreasing. The depth and length of the current downturn in the real estate industry has proved exceedingly difficult to predict. The Company cannot predict whether the downturn will worsen or when the market and related economic forces will return the U.S. residential real estate industry to a growth period.

All of Douglas Elliman Realty s current operations are located in the New York metropolitan area. Local and regional economic and general business conditions in this market could differ materially from prevailing conditions in other parts of the country. Among other things, the New York metropolitan residential real estate market has been impacted by the significant decline in the financial services industry. A continued downturn in the residential real estate market or economic conditions in that region could have a material adverse effect on Douglas Elliman Realty.

Aberdeen Townhomes LLC. In June 2008, a subsidiary of New Valley purchased a preferred equity interest in Aberdeen Townhomes LLC (Aberdeen) for $10,000. Aberdeen acquired five town home residences located in Manhattan, New York, which it is in the process of rehabilitating and selling. The Company had recorded an impairment loss of $3,500 related to Aberdeen at December 31, 2008. The Company s investment in Aberdeen Townhomes consists of the following:

Balance as of January 1, 2009	$ 6,500
Impairment loss recorded in first quarter of 2009	(3,500)
Preferred return distribution	(1,752)
Balance as of September 30, 2009	$ 1,248

In September 2009, one of the five townhomes was sold and the mortgage of approximately $8,700 was retired. The Company received a preferred return distribution of approximately $1,752. The Company did not record a gain or loss on the sale.

Mortgages on three of the four Aberdeen town homes with a balance of approximately $27,400 matured on March 1, 2009 and have not been refinanced or paid and are in default. Aberdeen is currently in discussions with the lender. The remaining mortgage with a balance of approximately $4,550, which matured on September 30, 2009, was also in default as of that date due to non-payment of interest.

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In February 2009, the managing member of Aberdeen Townhomes resigned, and a subsidiary of New Valley became the new managing member as of March 1, 2009. Aberdeen is a variable interest entity; however even as the managing member, the Company is not the primary beneficiary as other parties to the investment would absorb a majority of the variable interest entity s losses under the current arrangement. The Company s maximum exposure to loss on its investment in Aberdeen is $1,248 at September 30, 2009.

On June 15, 2009, the Company entered into a line of credit in the amount of $250 on behalf of Aberdeen. No amounts were outstanding on the line of credit as of September 30, 2009.

New Valley Oaktree Chelsea Eleven, LLC. In September 2008, a subsidiary of New Valley (New Valley Chelsea) purchased for $12,000 a 40% interest in New Valley Oaktree Chelsea Eleven, LLC (New Valley Oaktree). New Valley Oaktree lent $29,000 and contributed $1,000 for 29% of the capital in Chelsea Eleven LLC (Chelsea), which is developing a condominium project in Manhattan, New York. The development consists of 72 luxury residential units and one commercial unit. Approximately 75% of the units are pre-sold and there is approximately $35,000 in deposits held in escrow. The loan from New Valley Oaktree is subordinate to a $110,000 construction loan and a $24,000 mezzanine loan plus accrued interest. The loan from New Valley Oaktree to Chelsea bears interest at 60.25% per annum, compounded monthly, with $3,750 initially being held in an interest reserve, from which five monthly payments of $300 were paid to New Valley.

New Valley Chelsea is a variable interest entity; however, the Company is not the primary beneficiary. The Company s maximum exposure to loss as a result of its investment in Chelsea is $10,723. This investment is being accounted for under the equity method. New Valley Chelsea operates as an investment vehicle for the Chelsea real estate development project. During the first three months of 2009, the Company received a distribution of $594. In July 2009, the Company lent $467 to New Valley Oaktree of which $250 was repaid in August 2009.

A temporary certificate of occupancy was obtained in October 2009 and, as of November 9, 2009, the sale of one unit has closed. As of September 30, 2009 and December 31, 2008, Chelsea had approximately $256,323 and $206,778 of total assets, respectively and $235,818 and $185,665 of total liabilities, respectively. No income has been recorded as all amounts have been capitalized in the construction project.

Investment in Real Estate:

Escena. In March 2008, a subsidiary of New Valley purchased a loan collateralized by a substantial portion of a 450-acre approved master planned community in Palm Springs, California known as Escena. The loan, which was in foreclosure, was purchased for its $20,000 face value plus accrued interest and other costs of $1,445. The collateral consists of 867 residential lots with site and public infrastructure, an 18-hole golf course, a substantially completed clubhouse, and a seven-acre site approved for a 450-room hotel.

In April 2009, New Valley s subsidiary entered into a settlement agreement with Lennar Corporation, a guarantor of the loan, which requires the guarantor to satisfy its obligations under a completion guaranty by completing improvements to the project in settlement, among other things, of its payment guarantees. In addition, the guarantor agreed to pay approximately $250 in legal fees and $1,000 of delinquent taxes and penalties and post a letter of credit to secure its construction obligations. As a result of this settlement, the Company calculated the fair market value of the investment as of March 31, 2009, utilizing the most recent as is appraisal of the collateral and the value of the completion guaranty less estimated costs to dispose of the property. Based on these estimates, the Company determined that the fair market value was less than the carrying amount of the mortgage receivable at March 31, 2009 by approximately $5,000. Accordingly, a charge of $5,000 was recorded during the three months ended March 31, 2009, which resulted in the loan being carried at its net basis of $12,704 as of March 31, 2009.

On April 15, 2009 New Valley completed the foreclosure process and on April 16, 2009, took title to the collateral. In June 2009, the Company received $500 from the guarantor pursuant to the settlement agreement. The

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assets have been classified as an Investment in real estate , and were carried on the Company s condensed consolidated balance sheet at $12,204 as of September 30, 2009.

The Company recorded a loss of $204 for the three and nine months ended September 30, 2009 from Escena s operations.

Real Estate Market Conditions. Because real estate markets may continue to worsen, the Company will continue to perform additional assessments to determine the impact of the markets, if any, on the Company s consolidated financial statements. Thus, future impairment charges may occur.

11. INVESTMENTS AND FAIR VALUE MEASUREMENTS

The Company utilizes a three-tier framework for assets and liabilities required to be measured at fair value. In addition, the Company uses valuation techniques, such as the market approach (comparable market prices), the income approach (present value of future income or cash flow), and the cost approach (cost to replace the service capacity of an asset or replacement cost) to value these assets and liabilities as appropriate. The Company uses an exit price when determining the fair value. The exit price represents amounts that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

The Company utilizes a three-tier fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

Level 1	Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.
Level 2	Inputs other than quoted prices that are observable for the assets or liability, either directory or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.
Level 3	Unobservable inputs in which there is little market data, which requires the reporting entity to develop their own assumptions

This hierarchy requires the use of observable market data, when available, and to minimize the use of unobservable inputs when determining fair value.

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

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	Fair Value Measurements as of September 30, 2009			
Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money market funds	$ 225,971	$ 225,971	$	$
Certificates of deposit	2,429		2,429	
Bonds	2,947	2,947		
Investment securities available for sale	62,094	45,930	16,164	
Total	$ 293,441	$ 274,848	$ 18,593	$
Liabilities:				
Fair value of derivatives embedded within convertible debt	$ 142,850	$	$	$ 142,850

	Fair Value Measurements as of December 31, 2008			
Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money market funds	$ 192,348	$ 192,348	$	$
Investment securities available for sale	28,518	20,627	7,891	
Total	$ 220,866	$ 212,975	$ 7,891	$
Liabilities:				
Fair value of derivatives embedded within convertible debt	$ 77,245	$	$	$ 77,245

The fair value of investment securities available for sale included in Level 1 are based on quoted market prices from various stock exchanges. The Level 2 investment securities available for sale were not registered and therefore do not have direct market quotes or have certain restrictions.

The fair value of derivatives embedded within convertible debt were derived using a valuation model and have been classified as Level 3. The valuation model assumes future dividend payments by the Company and utilizes interest rates and credit spreads 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 changes in fair value of derivatives embedded within convertible debt as of September 30, 2009 are disclosed. (See Note 6.)

In addition to assets and liabilities that are recorded at fair value on a recurring basis, the Company is required to record assets and liabilities at fair value on a nonrecurring basis. Generally, assets and liabilities are recorded at fair value on a nonrecurring basis as a result of impairment charges.

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The Company s nonrecurring nonfinancial assets subject to fair value measurements are as follows:

		Fair Value Measurements as of September 30, 2009			
Description	Nine months Ended September 30, 2009 Impairment Charge	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:					
Investment in real estate	$ 5,000	$ 12,204	$	$	$ 12,204
Investment in non-consolidated real estate businesses	3,500	1,248			1,248
Total	$ 8,500	$ 13,452	$	$	$ 13,452

The Company estimated the fair value of its mortgage receivable and non-consolidated real estate using observable inputs such as market pricing based on recent events, however, significant judgment was required to select certain inputs from observed market data. The decrease in the mortgage receivable and the non-consolidated real estate were attributed to the decline in the New York and California real estate markets due to various factors including downward pressure on housing prices, the impact of the recent contraction in the subprime and mortgage markets generally and a large inventory of unsold homes at the same time that sales volumes were decreasing. The $8,500 of impairment charges taken in the first quarter of 2009 were included in the results from operations for the nine months ended September 30, 2009.

12. RESTRICTED STOCK AWARD

On April 7, 2009, the President and Chief Executive Officer of the Company was awarded a restricted stock grant of 525,000 shares of Vector s common stock pursuant to Vector s Amended and Restated 1999 Long-Term Incentive Plan. Under the terms of the award, one-fifth of the shares vest on September 15, 2010, with an additional one-fifth vesting on each of the four succeeding one-year anniversaries of the first vesting date through September 15, 2014. In the event that his employment with the Company is terminated for any reason other than his death, his disability or a change of control (as defined in this Restricted Share Agreement) of the Company, any remaining balance of the shares not previously vested will be forfeited by him. The fair market value of the restricted shares on the date of grant was $6,467 is being amortized over the vesting period as a charge to compensation expense.

13. SEGMENT INFORMATION

The Company s significant business segments for the three and nine months ended September 30, 2009 and 2008 were Liggett, Vector Tobacco and New Valley. The Liggett segment consists of the manufacture and sale of conventional cigarettes and, for segment reporting purposes, includes the operations of Medallion (which operations are held for legal purposes as part of Vector Tobacco). The Vector Tobacco segment includes the development and marketing of the low nicotine and nicotine-free cigarette products for segment reporting purposes, excludes the operations of Medallion. The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The New Valley segment includes the Company s equity income and investments in non-consolidated real estate businesses and mortgage receivable.

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Financial information for the Company s operations before taxes for the three and nine months ended September 30, 2009 and 2008 follows:

	Liggett	Vector Tobacco	Real Estate	Corporate and Other	Total
Three months ended September 30, 2009					
Revenues	$236,335	$ 401			$236,736
Operating income (loss)	43,380	(1,738)	(194)	(4,476)	36,972
Depreciation and amortization	1,969	22	25	634	2,650
Equity income from non-consolidated real estate businesses			4,712		4,712
Three months ended September 30, 2008					
Revenues	$144,841	$ 760			$145,601
Operating income (loss)	45,924	(2,439)		(5,950)	37,535
Depreciation and amortization	1,910	30		588	2,528
Equity income from non-consolidated real estate businesses			5,202		5,202
Nine months ended September 30, 2009					
Revenues	$563,293	$ 1,453			$564,746
Operating income (loss)	125,100[1]	(5,885) [2]	(194)	(12,042)	106,979
Equity income from non-consolidated real estate businesses			5,528		5,528
Identifiable assets	301,474	11,685	63,374	398,847	775,380
Depreciation and amortization	5,927	75	25	1,741	7,768
Capital expenditures	2,117	12	876		3,005
Nine months ended September 30, 2008					
Revenues	$418,816	$ 1,950			$420,766
Operating income (loss)	126,960	(6,775)		(20,264)	99,921
Equity income from non-consolidated real estate businesses			22,706		22,706
Identifiable assets	312,188	2,317	57,383	417,807	789,695
Depreciation and amortization	5,682	89		1,757	7,528
Capital expenditures	5,341	85			5,426

(1) Operating income includes a gain of $5,000 on the Philip Morris brand transaction completed February 2009.

(2) Operating income includes restructuring costs of $1,000.

14. SUBSEQUENT EVENTS

The Company has evaluated events that occurred subsequent to September 30, 2009, through the financial statement issue date of November 9, 2009, and determined that there were no recordable or reportable subsequent events.

15. CONDENSED CONSOLIDATING FINANCIAL INFORMATION

The accompanying condensed consolidating financial information has been prepared and presented pursuant to Securities and Exchange Commission Regulation S-X, Rule 3-10, Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered . Each of the subsidiary guarantors are 100% owned, directly or indirectly, by the Company, and all guaranties are full and unconditional and joint and several. The Company s investments in its consolidated subsidiaries are presented under the equity method of accounting.

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The 11% Senior Secured Notes due 2015, $165,000, principal amount, issued in August 2007 and $85,000, principal amount, issued in September 2009 by Vector, are fully and unconditionally guaranteed on a joint and several basis by all of the 100%-owned domestic subsidiaries of the Company that are engaged in the conduct of its cigarette businesses. (See Note 6.) The notes are not guaranteed by any of the Company s subsidiaries engaged in the real estate businesses conducted through its subsidiary New Valley. Presented herein are unaudited condensed consolidating balance sheets as of September 30, 2009 and December 31, 2008, the related unaudited condensed consolidating statements of operations for the three and nine months ended September 30, 2009 and 2008 and the unaudited condensed consolidated statements of cash flows for the nine months ended September 30, 2009 and 2008 of the Company (Parent/Issuer), the guarantor subsidiaries (Subsidiary Guarantors) and the subsidiaries that are not guarantors (Subsidiary Non-Guarantors).

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 guarantying subsidiaries total debt less the fair market value of the Company s and the guarantying subsidiaries cash and cash equivalents, investments in 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.

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

	September 30, 2009				
	Parent/ Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantors	Consolidating Adjustments	Consolidated Vector Group Ltd.
ASSETS:					
Current assets:					
Cash and cash equivalents	$ 230,020	$ 7,239	$ 209	$	$ 237,468
Investment securities available for sale	62,016		78		62,094
Accounts receivable trade		6,824			6,824
Intercompany receivables	100			(100)	
Inventories		100,021			100,021
Deferred income taxes	3,764	435			4,199
Income taxes receivable		9,398		(9,398)	
Restricted assets		3,545			3,545
Other current assets	271	2,785	58		3,114
Total current assets	296,171	130,247	345	(9,498)	417,265
Property, plant and equipment, net	650	44,351	850		45,851
Investment in real estate			12,204		12,204
Long-term investments accounted for at cost	50,333		837		51,170
Investments in non- consolidated real estate businesses			45,628		45,628
Investments in consolidated subsidiaries	163,603			(163,603)	
Restricted assets	2,428	2,158			4,586
Deferred income taxes	41,514	7,073	9,624		58,211
Intangible asset		107,511			107,511
Prepaid pension costs		3,171			3,171
Other assets	15,634	14,149			29,783
Total assets	$ 570,333	$ 308,660	$ 69,488	$ (173,101)	$ 775,380
LIABILITIES AND STOCKHOLDERS EQUITY:					
Current liabilities:					
Current portion of notes payable and long-term debt	$ 670	$ 20,222	$	$	$ 20,892
Current portion of employee benefits		1,051			1,051

Accounts payable	1,959	7,232	578		9,769
Intercompany payables		100		(100)	
Accrued promotional expenses		12,081			12,081
Income taxes payable, net	20,311		20,199	(9,398)	31,112
Accrued excise and payroll taxes payable, net		568			568
Settlement accruals		46,787			46,787
Deferred income taxes	15,083	2,120			17,203
Accrued interest	6,861				6,861
Other current liabilities	3,172	9,038	5		12,215
Total current liabilities	48,056	99,199	20,782	(9,498)	158,539
Notes payable, long-term debt and other obligations, less current portion	317,907	15,959	636		334,502
Fair value of derivatives embedded within convertible debt	142,850				142,850
Non-current employee benefits	12,034	24,899			36,933
Deferred income taxes	39,112	22,257	7,123		68,492
Other liabilities	352	22,793	897		24,042
Total liabilities	560,311	185,107	29,438	(9,498)	765,358
Commitments and contingencies					
Stockholders equity	10,022	123,553	40,050	(163,603)	10,022
Total liabilities and stockholders equity	$ 570,333	$ 308,660	$ 69,488	$ (173,101)	$ 775,380

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

	December 31, 2008				
	Parent/ Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantors	Consolidating Adjustments	Consolidated Vector Group Ltd.
ASSETS:					
Current assets:					
Cash and cash equivalents	$ 200,066	$ 11,039	$	$	$ 211,105
Investment securities available for sale	28,440		78		28,518
Accounts receivable trade		9,506			9,506
Intercompany receivables	1,938			(1,938)	
Inventories		92,581			92,581
Deferred income taxes	3,304	338			3,642
Income taxes receivable	25,125			(25,125)	
Other current assets	3,962	5,969			9,931
Total current assets	262,835	119,433	78	(27,063)	355,283
Property, plant and equipment, net	735	49,956			50,691
Mortgage receivable			17,704		17,704
Long-term investments accounted for at cost	50,332		786		51,118
Long-term investments accounted under the equity method					
Investments in non- consolidated real estate businesses			50,775		50,775
Investments in consolidated subsidiaries	164,917			(164,917)	
Restricted assets	3,845	2,710			6,555
Deferred income taxes	37,177	870	7,175		45,222
Intangible asset		107,511			107,511
Prepaid pension costs		2,901			2,901
Other assets	16,295	13,657			29,952
Total assets	$ 536,136	$ 297,038	$ 76,518	$ (191,980)	$ 717,712
LIABILITIES AND STOCKHOLDERS EQUITY:					
Current liabilities:					
Current portion of notes payable and long-term debt	$ 72,299	$ 25,199	$	$	$ 97,498

Current portion of employee benefits	20,789	1,051			21,840
Accounts payable	3,219	2,885			6,104
Intercompany payables		3		(3)	
Accrued promotional expenses		10,131			10,131
Income taxes payable, net		10,754	26,174	(25,125)	11,803
Accrued excise and payroll taxes payable, net		7,004			7,004
Settlement accruals		20,668			20,668
Deferred income taxes	81,961	10,546			92,507
Accrued interest	9,612				9,612
Other current liabilities		20,017	910	(1,935)	18,992
Total current liabilities	187,880	108,258	27,084	(27,063)	296,159
Notes payable, long-term debt and other obligations, less current portion	191,007	19,294			210,301
Fair value of derivatives embedded within convertible debt	77,245				77,245
Non-current employee benefits	17,388	17,468			34,856
Deferred income taxes	28,573	20,125	109		48,807
Other liabilities	438	15,219	1,082		16,739
Total liabilities	502,531	180,364	28,275	(27,063)	684,107
Commitments and contingencies					
Stockholders equity	33,605	116,674	48,243	(164,917)	33,605
Total liabilities and stockholders equity	$ 536,136	$ 297,038	$ 76,518	$ (191,980)	$ 717,712

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

	Three Months Ended September 30, 2009				
	Parent/ Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantors	Consolidating Adjustments	Consolidated Vector Group Ltd.
Revenues	$	$ 236,736	$	$	$ 236,736
Expenses:					
Cost of goods sold		177,798			177,798
Operating, selling, administrative and general expenses	4,944	16,756	266		21,966
Management fee expense		2,055		(2,055)	
Operating income (loss)	(4,944)	40,127	(266)	2,055	36,972
Other income (expenses):					
Interest and dividend income	43	8			51
Interest expense	(16,465)	(332)	(11)		(16,808)
Changes in fair value of derivatives embedded within convertible debt	(6,054)				(6,054)
Equity income on non-consolidated real estate businesses			4,712		4,712
Equity income in consolidated subsidiaries	33,308			(33,308)	
Management fee income	2,055			(2,055)	
Other, net					
Income (loss) before provision for income taxes	7,943	39,803	4,435	(33,308)	18,873
Income tax benefit (expense)	8,276	(9,238)	(1,692)		(2,654)
Net income (loss)	$ 16,219	$ 30,565	$ 2,743	$ (33,308)	$ 16,219

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

	Three Months Ended September 30, 2008				
			Subsidiary		Consolidated Vector
	Parent/ Issuer	Subsidiary Guarantors	Non-Guarantors	Consolidating Adjustments	Group Ltd.
Revenues	$	$ 145,601	$	$	$ 145,601
Expenses:					
Cost of goods sold		84,999			84,999
Operating, selling, administrative and general expenses	7,554	16,738	(1,225)		23,067
Management fee expense		1,984		(1,984)	
Operating (loss) income	(7,554)	41,880	1,225	1,984	37,535
Other income (expenses):					
Interest and dividend income	977	117			1,094
Interest expense	(15,149)	(366)			(15,515)
Changes in fair value of derivatives embedded within convertible debt	522				522
Provision for loss on investments	(3,000)		(4,000)		(7,000)
Equity income from non-consolidated real estate businesses			5,202		5,202
Equity income in consolidated subsidiaries	26,819			(26,819)	
Management fee income	1,984			(1,984)	
Other, net	(1)				(1)
Income before provision for income taxes	4,598	41,631	2,427	(26,819)	21,837
Income tax benefit (expense)	10,229	(16,224)	(1,015)		(7,010)
Net income	$ 14,827	$ 25,407	$ 1,412	$ (26,819)	$ 14,827

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

	Nine Months Ended September 30, 2009				
			Subsidiary		Consolidated Vector
	Parent/ Issuer	Subsidiary Guarantors	Non-Guarantors	Consolidating Adjustments	Group Ltd.
Revenues	$	$ 564,746	$	$	$ 564,746
Expenses:					
Cost of goods sold		398,088			398,088
Operating, selling, administrative and general expenses	14,596	48,616	467		63,679
Gain on brand transaction		(5,000)			(5,000)
Restructuring charges		1,000			1,000
Management fee expense		6,167		(6,167)	
Operating income (loss)	(14,596)	115,875	(467)	6,167	106,979
Other income (expenses):					
Interest and dividend income	180	97			277
Interest expense	(49,097)	(860)	(11)		(49,968)
Loss on extinguishment of debt	(18,444)				(18,444)
Changes in fair value of derivatives embedded within convertible debt	(25,845)				(25,845)
Impairment charges on investments			(8,500)		(8,500)
Equity income from non-consolidated real estate businesses			5,528		5,528
Equity income in consolidated subsidiaries	75,060			(75,060)	
Management fee income	6,167			(6,167)	
Other, net					
Income (loss) before provision for income taxes	(26,575)	115,112	(3,450)	(75,060)	10,027
Income tax benefit (expense)	37,948	(38,013)	1,411		1,346
Net income (loss)	$ 11,373	$ 77,099	$ (2,039)	$ (75,060)	$ 11,373

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

	Nine Months Ended September 30, 2008				
	Parent/ Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantors	Consolidating Adjustments	Consolidated Vector Group Ltd.
Revenues	$	$ 420,766	$	$	$ 420,766
Expenses:					
Cost of goods sold		251,036			251,036
Operating, selling, administrative and general expenses	22,725	47,610	(526)		69,809
Management fee expense		5,954		(5,954)	
Operating income (loss)	(22,725)	116,166	526	5,954	99,921
Other income (expenses):					
Interest and dividend income	4,017	423			4,440
Interest expense	(44,699)	(1,326)			(46,025)
Changes in fair value of derivatives embedded within convertible debt	7,837				7,837
Provision for loss on investments	(3,000)		(4,000)		(7,000)
Equity income from non-consolidated real estate businesses			22,706		22,706
Equity income in consolidated subsidiaries	82,036			(82,036)	
Management fee income	5,954			(5,954)	
Other, net	(574)		(4)		(578)
Income before provision for income taxes	28,846	115,263	19,228	(82,036)	81,301
Income tax benefit (expense)	19,413	(44,568)	(7,887)		(33,042)
Net income	$ 48,259	$ 70,695	$ 11,341	$ (82,036)	$ 48,259

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

	Nine Months Ended September 30, 2009				
	Parent/ Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantors	Consolidating Adjustments	Consolidated Vector Group Ltd.
Net cash provided by operating activities	$ 10,444	$ 78,046	$ 1,572	$ (80,728)	$ 9,334
Cash flows from investing activities:					
Purchase of investment securities	(12,300)				(12,300)
Proceeds from sale or liquidation of long-term investments	1,407				1,407
Purchase of long-term investments			(51)		(51)
Distributions from non-consolidated real estate businesses			5,548		5,548
Investments in non-consolidated real estate businesses			(467)		(467)
Investments in subsidiaries	(3,050)			3,050	
Increase in cash surrender value of life insurance policies	(413)	(426)			(839)
(Increase) decrease in non-current restricted assets	1,417	552			1,969
Capital expenditures		(2,129)	(876)		(3,005)
Net cash (used in) provided by investing activities	(12,939)	(2,003)	4,154	3,050	(7,738)
Cash flows from financing activities:					
Proceeds from debt Issuance	118,125	21	636		118,782
Repayments of debt		(4,516)			(4,516)
Deferred financing charges	(5,567)	(6)			(5,573)
Borrowings under revolver		526,949			526,949
Repayments on revolver		(530,766)			(530,766)
Capital contributions received		3,050		(3,050)	
Intercompany dividends paid		(74,575)	(6,153)	80,728	
Dividends and distributions on common stock	(87,451)				(87,451)
Proceeds from exercise of Vector options and warrants	398				398

Tax benefit of options exercised	6,944				6,944
Net cash (used in) financing activities	32,449	(79,843)	(5,517)	77,678	24,767
Net increase (decrease) in cash and cash equivalents	29,954	(3,800)	209		26,363
Cash and cash equivalents, beginning of period	200,066	11,039			211,105
Cash and cash equivalents, end of period	$ 230,020	$ 7,239	$ 209	$	$ 237,468

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

	Nine Months Ended September 30, 2008				
	Parent/ Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantors	Consolidating Adjustments	Consolidated Vector Group Ltd.
Net cash provided by operating activities	$ 54,155	$ 97,863	$ 4,167	$ (85,750)	$ 70,435
Cash flows from investing activities:					
Purchase of investment securities	(5,682)				(5,682)
Proceeds from sale or liquidation of long-term investments	8,334				8,334
Purchase of long-term investments			(51)		(51)
Purchase of mortgage receivable			(21,704)		(21,704)
Distributions from non-consolidated real estate businesses			17,628		17,628
Investment in non- consolidated real estate businesses			(22,000)		(22,000)
Increase in cash surrender value of life insurance policies	(386)	(380)			(766)
Decrease in non-current restricted assets	154	684			838
Investments in subsidiaries	(26,060)			26,060	
Proceeds from the sale of fixed assets		403			403
Capital expenditures		(5,426)			(5,426)
Net cash used in investing activities	(23,640)	(4,719)	(26,127)	26,060	(28,426)
Cash flows from financing activities:					
Proceeds from debt		2,830			2,830
Repayments of debt		(4,666)			(4,666)
Deferred financing charges	(137)				(137)
Borrowings under revolver		386,499			386,499
Repayments on revolver		(397,892)			(397,892)
Capital contributions received		4,100	21,960	(26,060)	
Intercompany dividends paid		(85,750)		85,750	
Dividends and distributions on common stock	(78,581)				(78,581)

Proceeds from exercise of Vector options and warrants	26				26
Excess tax benefit of options exercised	18,304				18,304
Net cash (used in) provided by financing activities	(60,388)	(94,879)	21,960	59,690	(73,617)
Net decrease in cash and cash equivalents	(29,873)	(1,735)			(31,608)
Cash and cash equivalents, beginning of period	228,901	9,216			238,117
Cash and cash equivalents, end of period	$ 199,028	$ 7,481	$	$	$ 206,509

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Dollars in Thousands, Except Per Share Amounts)

Overview

We are a holding company and are engaged principally in:

the manufacture and sale of cigarettes in the United States through our subsidiary Liggett Group LLC,

the development of reduced risk cigarette products through our subsidiary Vector Tobacco Inc., and

the real estate business through our subsidiary, New Valley LLC, which is seeking to acquire additional operating companies and real estate properties. New Valley owns 50% of Douglas Elliman Realty, LLC, which operates the largest residential brokerage company in the New York metropolitan area.

All of Liggett s unit sales volume in 2008 and the first nine months of 2009 was in the discount segment, which Liggett s management believes has been the primary growth segment in the industry for over a decade. The significant discounting of premium cigarettes in recent years has led to brands, such as EVE, that were traditionally considered premium brands to become more appropriately categorized as discount, following list price reductions.

Liggett s cigarettes are produced in approximately 180 combinations of length, style and packaging. Liggett s current brand portfolio includes:

LIGGETT SELECT a leading brand in the deep discount category,

GRAND PRIX re-launched as a national brand in 2005,

EVE a leading brand of 120 millimeter cigarettes in the branded discount category,

PYRAMID the industry s first deep discount product with a brand identity relaunched in the second quarter of 2009, 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 s unit volume was 30.1% and 22.8% of Liggett s unit volume for the year ended December 31, 2008 and for the nine months ended September 30, 2009, respectively. GRAND PRIX is now the largest seller in Liggett s family of brands with 32.6% and 29.3% of Liggett s unit volume for the year ended December 31, 2008 and the nine months ended September 30, 2009, respectively. In April 2009, Liggett repositioned PYRAMID as a box only brand in specific targeted markets with a new low price to specifically compete with brands which are priced at the lowest level of the deep discount segment.

Under the Master Settlement Agreement reached in November 1998 with 45 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. market. Liggett s and Vector Tobacco s payments under the Master Settlement Agreement are based on each company s incremental market share above the

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minimum threshold applicable to such company. We believe that Liggett has gained a sustainable cost advantage over its competitors as a result of the settlement.

The discount segment is a challenging marketplace, with consumers having less brand loyalty and placing greater emphasis on price. Liggett s competition is now 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., Reynolds America Inc., and Lorillard Tobacco Company, as well as the fourth largest, Commonwealth Brands, Inc. (which Imperial Tobacco PLC acquired in 2007). The three largest manufacturers, while primarily premium cigarette based companies, also produce and sell discount cigarettes. The second segment of competition is comprised of a group of smaller manufacturers and importers, most of which sell lower quality, deep discount cigarettes.

Recent Developments

5% Variable Interest Senior Convertible Notes Due November 2011. Between November 2004 and April 2005, we sold $111,864 principal amount of our 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 our 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 our 6.75% Variable Interest Senior Convertible Exchange Notes due 2014 (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.

We recorded a loss of $18,444 associated with the extinguishment of the 5% Notes in the second quarter of 2009.

6.75% Variable Interest Senior Convertible Note due 2014. On May 11, 2009, we 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. We will use the net proceeds of the offering for general corporate purposes. 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 or (ii) 6.75% per annum. The note is convertible into our 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 subject to adjustment for various events, including the issuance of stock dividends. The note matures on November 15, 2014. We 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, we will be required to offer to repurchase the note at 100% of its principal amount, plus accrued interest.

The purchaser of this 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 our common stock.

6.75% Variable Interest Senior Convertible Exchange Notes due 2014. On June 15, 2009, we entered into agreements with certain holders of the 5% Notes to exchange their 5% notes for our 6.75% Exchange Notes. On June 30, 2009, we accepted for exchange $99,944 principal amount of the 5% Notes for $106,940 principal amount of our 6.75% Exchange Notes. We issued the 6.75%

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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 or (ii) 6.75% per annum. The notes are convertible into our 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. We 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, we 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.

11% Senior Secured Notes due 2015. In September 2009, we sold an additional $85,000 principal amount of our 11% Senior Secured Notes due 2015 at 94% of face value in a private offering to qualified institutional investors in accordance with Rule 144A of the Securities Act of 1933. We agreed to consummate a registered exchange offer for the additional Senior Secured Notes within 360 days after the date of their initial issuance. If we fail to timely comply with our registration obligations, we will be required to pay additional interest on these notes until we comply. We received net proceeds from the offering of approximately $79,900. We will amortize the deferred costs and debt discount related to the New Senior Secured Notes over the estimated life of the debt.

Enacted and proposed excise tax increases. Effective April 1, 2009, the federal cigarette excise tax was increased from $3.90 per carton ($0.39 per pack) to $10.07 per carton ($1.01 per pack). Wholesale shipment volume for the nine months ended September 30, 2009 compared to the same period in 2008 for Liggett and for the total industry was negatively impacted by tax-driven trade purchasing patterns in anticipation of the increase in the federal excise taxes on cigarettes. This legislation included provisions that imposed this increase in excise taxes on inventory held as of April 1, 2009. As a result, many wholesalers and retailers significantly reduced their inventory levels as of March 31, 2009 to minimize any such taxes owed on such inventory. In 2009, 15 states enacted increases to state excise taxes and further increases in states excise taxes are expected.

Family Smoking Prevention and Tobacco Control Act (FDA Legislation). On June 22, 2009, President Barrack Obama signed into law the Family Smoking Prevention and Tobacco Control Act, referred to as the FDA Legislation. Under the FDA Legislation, the U.S. Food and Drug Administration has been granted broad authority over the manufacture, sale, marketing and packaging of tobacco products. Provisions of the FDA Legislation are effective over a time period ranging from 90 days to over 39 months. We recorded expenses associated with the FDA Legislation of $536 and $589 for the three and nine months ended September 30, 2009. See Legislation and Regulation below.

Long-term Investments. We recorded a loss of $3,000 for the three and nine months ended September 30, 2008 due to the performance of two of our long-term investments, which was included in Impairment charges on investments on our condensed consolidated statements of operations and a loss of $0 and $567 during the three and nine months ended September 30, 2008 associated with the liquidation of a long-term investment, which was included as Other expense on our condensed statement of operations for the nine months ended September 30, 2008.

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Philip Morris Brand Transaction. In November 1998, we and Liggett granted Philip Morris options to purchase interests in Trademarks LLC which holds three domestic cigarette brands, L&M, CHESTERFIELD and LARK, formerly held by Liggett s subsidiary, Eve Holdings Inc.

Under the terms of the Philip Morris agreements, Eve contributed the three brands to Trademarks, a newly-formed limited liability company, in exchange for 100% of two classes of Trademarks interests, the Class A Voting Interest and the Class B Redeemable Nonvoting Interest. Philip Morris acquired two options to purchase the interests from Eve.

The Class B option became exercisable during the 90-day period beginning December 2, 2008 and was exercised by Philip Morris on February 19, 2009. This option entitled Philip Morris to purchase the Class B interest for $139,900, reduced by the amount previously distributed to Eve of $134,900. In connection with the exercise of the Class B option, Philip Morris paid to Eve approximately $5,000 (including a pro-rata share of its guaranteed payment) and Eve was released from its guaranty. We recognized a gain of $5,000 in connection with the transaction in the first quarter of 2009.

Vector Tobacco Restructuring. In March 2009, Vector Research eliminated nine full-time positions in connection with the Board of Directors 2006 decision 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.

We recognized pre-tax restructuring charges of $1,000, during the first quarter of 2009. The restructuring charges relate primarily to employee severance and benefit costs.

Issuance of Restricted Shares. On April 7, 2009, our President and Chief Executive Officer was awarded a restricted stock grant of 525,000 shares of our common stock pursuant to our Amended and Restated 1999 Long-Term Incentive Plan. Under the terms of the award, one-fifth of the shares vest on September 15, 2010, with an additional one-fifth vesting on each of the four succeeding one-year anniversaries of the first vesting date through September 15, 2014. In the event that his employment with us is terminated for any reason other than his death, his disability or a change of control (as defined in this Restricted Share Agreement) of ours, any remaining balance of the shares not previously vested will be forfeited by him. The fair market value of the restricted shares on the date of grant was $6,467 which is being amortized over the vesting period as a charge to compensation expense.

Investment in Real Estate. In March 2008, a subsidiary of New Valley purchased a loan collateralized by a substantial portion of a 450-acre approved master planned community in Palm Springs, California known as Escena. The loan, which was in foreclosure, was purchased for its $20,000 face value plus accrued interest and other costs of $1,445. The collateral consists of 867 residential lots with site and public infrastructure, an 18-hole golf course, a substantially completed clubhouse, and a seven-acre site approved for a 450-room hotel.

In April 2009, New Valley s subsidiary entered into a settlement agreement with a guarantor of the loan, which requires the guarantor to satisfy its obligations under a completion guaranty by completing improvements to the project in settlement, among other things, of its payment guarantees. In addition, the guarantor agreed to pay approximately $250 in legal fees and $1,000 of delinquent taxes and penalties and post a letter of credit to secure its construction obligations. As a result of this settlement, we calculated the fair market value of the investment as of March 31, 2009, utilizing the most recent as is appraisal of the collateral and the value of the completion guaranty less estimated costs to dispose of the property. Based on these estimates, we determined that the fair market value was less than the carrying amount of the mortgage receivable at March 31, 2009, by approximately $5,000. Accordingly, the reserve was increased and a charge of $5,000 was recorded in the first quarter of 2009. On April 15, 2009 New Valley completed the foreclosure process and on April 16, 2009, took title to the property. We reclassified the loan from

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Mortgage receivable at March 31, 2009 to Investment in real estate at June 30, 2009 on our condensed consolidated balance sheet. It was carried at $12,204 as of September 30, 2009.

We recorded a loss of $204 for the three and nine months ended September 30, 2009 from the Escena operations.

Aberdeen Townhomes LLC. In June 2008, a subsidiary of New Valley purchased a preferred equity interest in Aberdeen Townhomes LLC for $10,000. Aberdeen acquired five town home residences located in Manhattan, New York, which it is in the process of rehabilitating and selling. In the event that Aberdeen makes distributions of cash, New Valley is entitled to a priority preferred return of 15% per annum until it has recovered its invested capital. New Valley is entitled to 25% of subsequent cash distributions of profits until it has achieved an annual 18% internal rate of return. New Valley is then entitled to 20% of subsequent cash distributions of profits until it has achieved an annual 23% IRR. After New Valley has achieved an annual 23% IRR, it is then entitled to 10% of any remaining cash distributions of profits.

In September 2009, one of the five townhomes was sold and the mortgage of approximately $8,700 was retired. New Valley received a preferred return distribution of approximately $1,752 and did not record a gain or loss on the sale.

Mortgages on three of the four Aberdeen town homes with a balance of approximately $27,400 matured on March 1, 2009 and have not been refinanced or paid and are in default. Aberdeen is currently in discussions with the lender. The remaining mortgage with a balance of approximately $4,550, which matured on September 30, 2009, was also in default as of that date due to non-payment of interest.

In February 2009, the managing member of Aberdeen Townhomes resigned, and a subsidiary of New Valley became the new managing member as of March 1, 2009. Aberdeen is a variable interest entity; however even as the managing member, we are not the primary beneficiary as other parties to the investment would absorb a majority of the variable interest entity s losses under the current arrangement. Our maximum exposure to loss on its investment in Aberdeen is $1,248 at September 30, 2009.

On June 15, 2009, we entered into a line of credit in the amount of $250 on behalf of Aberdeen. No amounts were outstanding on the line of credit as of September 30, 2009.

New Valley Oaktree Chelsea Eleven, LLC. In September 2008, a subsidiary of New Valley LLC (New Valley Chelsea) purchased for $12,000 a 40% interest in New Valley Oaktree Chelsea Eleven, LLC, which lent $29,000 and contributed $1,000 in capital to Chelsea Eleven LLC, which is developing a condominium project in Manhattan, New York. The development consists of 72 luxury residential units and one commercial unit. Approximately 75% of the units have been pre-sold and there is approximately $35,000 in deposits held in escrow. The loan from New Valley Oaktree is subordinate to a $110,000 construction loan and a $24,000 mezzanine loan plus accrued interest. The loan from New Valley Oaktree to Chelsea Eleven bears interest at 60.25% per annum, compounded monthly, with $3,750 initially being held in an interest reserve, from which five monthly payments of $300 have been paid to New Valley.

New Valley Chelsea is a variable interest entity; however, we are not the primary beneficiary. Our maximum exposure to loss as a result of our investment in Chelsea is $10,723. This investment is being accounted for under the equity method. During the first three months of 2009, we received a distribution of $594. In July 2009, we lent $467 to New Valley Oaktree of which $250 was repaid in August 2009.

A temporary certificate of occupancy was obtained in October 2009 and, as of November 9, 2009, the sale of one unit has closed. As of September 30, 2009, Chelsea had approximately

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$256,323 of total assets and $235,818 of total liabilities. No income has been recorded as all amounts have been capitalized in the construction project.

Sale of St. Regis Hotel. In March 2008, 16th and K Holdings LLC closed on the sale of 90% of the St. Regis Hotel. In addition to retaining a 3% interest, net of incentives, in the St. Regis Hotel, New Valley received $16,406, of which $15,822 was received in the nine months ended September 30, 2008, upon the sale of the hotel. New Valley anticipates receiving an additional $3,400 in various installments between 2009 and 2012. We recorded the $15,822 as an investing activity in the consolidated statement of cash flows for the nine months ended September 30, 2008. New Valley recorded equity losses of $0 and $3,796 for the three and nine months ended September 30, 2008, respectively, associated with 16th and K Holdings LLC. For the nine months ended September 30, 2008, New Valley also recorded equity income of $15,779 in connection with the distributions received in excess of the carrying amount of the investment in St. Regis and we have no legal obligation to make additional investments to the investment.

Tobacco Settlement Agreements. In October 2004, the independent auditor under the Master Settlement Agreement notified Liggett and all other Participating Manufacturers that their payment obligations under the Master Settlement Agreement, dating from the agreement s execution in late 1998, had been recalculated using net unit amounts, rather than gross unit amounts (which had been used since 1999 to calculate market share and the allocation of the base amount of payments under the Master Settlement Agreement). The change in the method of calculation could, among other things, require additional Master Settlement Agreement payments by Liggett of approximately $26,200, including interest, for 2001 through 2008, require an additional payment of approximately $3,100 for 2009 and require additional amounts in future periods because the proposed change from gross to net units would serve to lower Liggett s market share exemption under the Master Settlement Agreement. Liggett has objected to this retroactive change and has disputed the change in methodology. No amounts have been accrued or expensed in our condensed financial statements for any potential liability relating to the gross versus net dispute because we do not believe an unfavorable outcome is probable.

In 2005, the independent auditor under the Master Settlement Agreement calculated that Liggett owed $28,668 for its 2004 sales. Liggett paid $11,678 and disputed the balance, as permitted by the Master Settlement Agreement. Liggett subsequently paid $9,304 of the disputed amount, although Liggett continues to dispute that this amount is owed. This $9,304 relates to an adjustment to its 2003 payment obligation claimed by Liggett for the market share loss to non-participating manufacturers, which is known as the NPM Adjustment. At September 30, 2009, included in Other assets on our condensed balance sheet was a receivable of $6,513 relating to such amount. The remaining balance in dispute of $7,686 is comprised of $5,318 claimed for a 2004 NPM Adjustment and $2,368 relating to the independent auditor s retroactive change from gross to net units in calculating Master Settlement Agreement payments, which Liggett contends is improper, as discussed above. From its April 2006 payment, Liggett and Vector Tobacco withheld approximately $1,600 claimed for the 2005 NPM Adjustment and $2,949 relating to the retroactive change from gross to net units. Liggett and Vector Tobacco withheld approximately $4,200 from their April 2007 payments related to the 2006 NPM Adjustment and approximately $3,950 relating to the retroactive change from gross to net units. From their April 2008 payment, Liggett and Vector Tobacco withheld approximately $4,000 for the 2007 NPM Adjustment and approximately $3,696 related to the retroactive change from gross to net units. Vector Tobacco paid approximately $200 into the disputed payments account for the 2007 NPM Adjustment. From their April 2009 payment, Liggett and Vector Tobacco withheld approximately $6,100 relating to the 2008 NPM adjustment and approximately $3,300 relating to the retroactive change from gross to net units.

The following amounts have not been expensed by us as they relate to Liggett s and Vector Tobacco s claim for an NPM Adjustment: $6,513 for 2003, $3,789 for 2004 and $800 for 2005.

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In March 2006, an economic consulting firm selected pursuant to the Master Settlement Agreement rendered its final and non-appealable decision that the Master Settlement Agreement was a significant factor contributing to the loss of market share of Participating Manufacturers for 2003. The economic consulting firm subsequently rendered the same decision with respect to 2004, 2005 and 2006. As a result, the manufacturers are entitled to potential NPM Adjustments to their 2003, 2004, 2005 and 2006 Master Settlement Agreement payments. The Participating Manufacturers are also entitled to potential NPM Adjustments to their 2007, 2008 and 2009 payments pursuant to an agreement entered into in June 2009 between the OPMs and the Settling States under which the OPMs agreed to make certain payments for the benefit of the Settling States, in exchange for which the Settling States stipulated that the MSA was a significant factor contributing to the loss of market share of Participating Manufacturers in 2007, 2008 and 2009. A Settling State that has diligently enforced its qualifying escrow statute in the year in question may be able to avoid application of the NPM Adjustment to the payments made by the manufacturers for the benefit of that state or territory.

Since April 2006, notwithstanding provisions in the Master Settlement Agreement requiring arbitration, litigation has been filed in 49 Settling States and territories over the issue of whether the application of the NPM Adjustment for 2003 is to be determined through litigation or arbitration. These actions relate to the potential NPM Adjustment for 2003, which the independent auditor under the Master Settlement Agreement previously determined to be as much as $1,200,000 for all Participating Manufacturers. All but one of the 48 courts that have decided the issue have ruled that the 2003 NPM Adjustment dispute is arbitrable. All 47 of these decisions are final and non-appealable. One court, the Montana Supreme Court, ruled that Montana s claim of diligent enforcement must be litigated. In response to a proposal from the Original Participating Manufacturers and many of the Subsequent Participating Manufacturers, 45 of the Settling States, representing approximately 90% of the allocable share of the Settling States, entered into an agreement providing for a nationwide arbitration of the dispute with respect to the NPM Adjustment for 2003. The agreement provides for selection of the arbitration panel beginning October 1, 2009 and that the parties and the arbitrators will thereafter establish the schedule and procedures for the arbitration. Because states representing more than 80% of the allocable share signed the agreement, signing states will receive a 20% reduction of any potential 2003 NPM adjustment. It is anticipated that the arbitration will begin in 2010. There can be no assurance that Liggett or Vector Tobacco will receive any adjustment as a result of these proceedings.

Recent Developments in Tobacco-Related Litigation

The cigarette industry continues to be challenged on numerous fronts. New cases continue to be commenced against Liggett and other cigarette manufacturers. As of September 30, 2009, there were 37 individual cases pending against Liggett and/or us, where one or more individual plaintiffs allege injury resulting from cigarette smoking, addiction to cigarette smoking or exposure to secondary smoke and seek compensatory and, in some cases, punitive damages. In addition, there were approximately 3,300 *Engle* progeny cases pending against Liggett and/or us, in state and federal courts in Florida, and approximately 100 individual cases pending in West Virginia state court as part of a consolidated action. There are seven purported class actions and three governmental and other third-party payor health care reimbursement actions pending in which Liggett or us, or both, were named as a defendant.

Class action suits have been filed in a number of states against cigarette manufacturers, alleging, among other things, that use of the terms light and ultra light constitutes unfair and deceptive trade practices, among other things. One such suit, *Schwab [McLaughlin] v. Philip Morris,* pending in federal court in New York since 2004, sought to create a nationwide class of light cigarette smokers. In September 2006, the United States District Court for the Eastern District of New York certified the class. In April 2008, the United States Court of Appeals for the Second Circuit decertified the class. The case was returned to the trial court for further proceedings. In December 2008, the United States Supreme Court, in *Altria Group v. Good*, ruled

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that the Federal Cigarette Labeling and Advertising Act did not preempt the state law claims asserted by the plaintiffs and that they could proceed with their claims under the Maine Unfair Trade Practices Act. This ruling may result in additional class action cases in other states. Although Liggett is not a party in the *Good* case, an adverse ruling or commencement of additional lights related class actions could have a material adverse effect on us.

There are currently six cases pending where Liggett is the only tobacco company defendant. Three of the cases are dormant and there is no trial date in the fourth case. Cases where Liggett is the only defendant could increase substantially as a result of the *Engle* progeny cases. Two of the cases have been tried and have resulted in adverse verdicts against Liggett. These two cases are discussed below.

In April 2004, in *Davis v. Liggett Group,* a Florida state court jury awarded compensatory damages of $540 against Liggett, plus interest. In addition, the court awarded plaintiff s counsel legal fees of $752. Liggett appealed both the compensatory and the legal fee awards. In October 2007, the compensatory award was affirmed by the Fourth District Court of Appeal and, thereafter, was paid by Liggett. In March 2008, the Fourth District Court of Appeal reversed and remanded the legal fee award for further proceedings in the trial court. In July 2009, the trial court awarded approximately $1,650 in legal fees, inclusive of interest and costs, which has been paid by Liggett. *In Ferlanti v. Liggett Group*, in February 2009, a Florida state court jury awarded compensatory damages of $1,200 against Liggett, but found that the plaintiff was 40% at fault. Therefore, plaintiff was awarded $720 in compensatory damages plus $96 in expenses. Punitive damages were not awarded. Liggett appealed the award. On May 1, 2009, the court granted plaintiff s motion for an award of attorneys fees but the amount has not yet been determined.

In 2000, a jury in *Engle v. R.J. Reynolds Tobacco Co.* rendered a $145,000,000 punitive damages verdict in favor of a Florida Class against certain cigarette manufacturers, including Liggett. Pursuant to the Florida Supreme Court s July 2006 ruling in *Engle*, which decertified the class on a prospective basis, and affirmed the appellate court s reversal of the punitive damages award, former class members had one year from January 11, 2007 in which to file individual lawsuits. In addition, some individuals who filed suit prior to January 11, 2007, and who claim they meet the conditions in *Engle*, are attempting to avail themselves of the *Engle* ruling. Lawsuits by individuals requesting the benefit of the *Engle* ruling, whether filed before or after the January 11, 2007 deadline, are referred to as the *Engle* progeny cases. Liggett and/or the Company have been named in approximately 3,300 *Engle* progeny cases in both state and federal courts in Florida. Other cigarette manufacturers have also been named as defendants in most of these cases. These cases include approximately 8,585 plaintiffs, approximately 3,200 of whom have claims pending in federal court. Duplicate cases were filed in federal and state court on behalf of approximately 660 plaintiffs. The majority of the cases pending in federal court are stayed pending the outcome of an appeal to the United States Court of Appeals for the Eleventh Circuit of several district court orders in which it was found that the Florida Supreme Court s decision in *Engle* was unconstitutional. The number of progeny cases will likely increase as the courts may require multi-plaintiff cases to be severed into individual cases. The total number of plaintiffs may also increase as a result of attempts by existing plaintiffs to add additional parties. As of September 30, 2009, there were approximately 43 *Engle* progeny cases scheduled for trial, or likely to be scheduled for trial, in 2009 and 2010. As of September 30, 2009, eight *Engle* progeny cases have been tried resulting in six plaintiff verdicts and two defense verdicts. In one of these cases, judgment was entered against Liggett for $156. In June 2002, the jury in *Lukacs v. R. J. Reynolds Tobacco Company*, an individual case brought under the third phase of the *Engle* case, awarded $37,500, plus interest, (subsequently reduced by the court to $24,835) of compensatory damages, jointly and severally, against Liggett and two other cigarette manufacturers and found Liggett 50% responsible for the damages. In November 2008, the court entered final judgment in the amount of $24,935 plus interest from June 2002 which as of September 30, 2009 was in excess of $13,000. The defendants appealed. The plaintiffs are seeking an award of attorney s fees from Liggett. It is possible that additional cases could be

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decided unfavorably and that there could be further adverse developments in the *Engle* case. Liggett may enter into discussions in an attempt to settle particular cases if it believes it is appropriate to do so. 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.

These developments generally receive widespread media attention. We are not able to evaluate the effect of these developing matters on pending litigation or the possible commencement of additional litigation, but our condensed consolidated financial position, results of operations or cash flows could be materially adversely affected by an unfavorable outcome in any tobacco-related litigation.

Critical Accounting Policies

There are no material changes from the critical accounting policies set forth in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, of our Annual Report on Form 10-K, for the year ended December 31, 2008, except for the changes set forth below. Please refer to that section and the information below for disclosures regarding the critical accounting policies related to our business.

Results of Operations

The following discussion provides an assessment of our results of operations, capital resources and liquidity and should be read in conjunction with our condensed consolidated financial statements and related notes included elsewhere in this report. The condensed consolidated financial statements include the accounts of VGR Holding, Liggett, Vector Tobacco, Liggett Vector Brands, New Valley and other less significant subsidiaries.

For purposes of this discussion and other condensed consolidated financial reporting, our significant business segments for the three and nine months ended September 30, 2009 and 2008 were Liggett and Vector Tobacco. The Liggett segment consists of the manufacture and sale of conventional cigarettes and, for segment reporting purposes, includes the operations of the Medallion Company, Inc. (which operations are held for legal purposes as part of Vector Tobacco). The Vector Tobacco segment includes the development and marketing of the low nicotine and nicotine-free cigarette products as well as the development of reduced risk cigarette products and, for segment reporting purposes, excludes the operations of Medallion.

	Three Months Ended		Nine Months Ended	
	September 30, 2009	September 30 2008	September 30, 2009	September 30, 2008
Revenues:				
Liggett	$ 236,335	$ 144,841	$ 563,293	$ 418,816
Vector Tobacco	401	760	1,453	1,950
Total revenues	$ 236,736	$ 145,601	$ 564,746	$ 420,766
Operating income (loss):				
Liggett	$ 43,380	$ 45,924	$ 125,100	$ 126,960
Vector Tobacco	(1,738)	(2,439)	(5,885)	(6,775)
Total tobacco	41,642	43,485	119,215	120,185
Real estate	(194)		(194)	
Corporate and other	(4,476)	(5,950)	(12,042)	(20,264)
Total operating income	$ 36,972	$ 37,535	$ 106,979	$ 99,921

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Three Months Ended September 30, 2009 Compared to Three Months Ended September 30, 2008

Revenues. Total revenues were $236,736 for the three months ended September 30, 2009 compared to $145,601 for the three months ended September 30, 2008. This $91,135 (62.6%) increase in revenues was due to $91,494 (63.2%) increase in revenues at Liggett and $359 (47.2%) decrease in revenues at Vector Tobacco for the three months ended September 30, 2009.

Tobacco Revenues. In June 2009, Liggett increased the list price of all brands by $0.10 per carton in conjunction with the user fees imposed by the passage of the bill granting the FDA jurisdiction over tobacco. In April 2008, Liggett increased the list price of GRAND PRIX by $0.40 per carton. In addition, in April 2008, Liggett decreased the early payment terms on its cigarettes from 2.75% to 2.25% of invoice amount. In August 2008, Liggett increased the list price of LIGGETT SELECT, EVE and GRAND PRIX by $1.00 per carton. Liggett increased the list price of LIGGETT SELECT and EVE by $0.90 per carton in February 2009 and an additional $7.10 per carton in March 2009. Liggett increased the list price of GRAND PRIX by $7.20 per carton in March 2009.

All of Liggett s sales for the third quarter of 2009 and 2008 were in the discount category. For the three months ended September 30, 2009, net sales at Liggett totaled $236,335, compared to $144,841 for the three months ended September 30, 2008. Revenues increased by 63.2% ($91,494) due to a favorable price variance of $75,782 primarily related to increases in price of LIGGETT SELECT and GRAND PRIX (primarily associated with the increase in federal excise taxes on cigarettes), a favorable sales mix of $5,472 and volume variance of $10,346 (approximately 158.4 million units).

Net revenues of the LIGGETT SELECT brand increased $4,382 for the third quarter of 2009 compared to 2008 due to a favorable variance from pricing of $19,427 offset by a decrease in unit volume of 31.0% (213.8 million units) in 2009 period compared to 2008. Net revenues of the GRAND PRIX brand increased $18,577 for the third quarter of 2009 compared to the 2008 due to a favorable variance from pricing of $24,428 offset by a decrease in unit volume of 12.5% (93.4 million units). Net revenues of Liggett s repositioned PYRAMID brand increased $38,612 due to increased volume of 445.8 million units.

Revenues at Vector Tobacco for the three months ended September 30, 2009 were $401 compared to $760 in the 2008 period due to volume declines partially offset by increased prices associated with the increased federal excise tax. Vector Tobacco s revenues in both periods related to sales of QUEST.

Tobacco Gross Profit. Tobacco gross profit was $58,937 for the three months ended September 30, 2009 compared to $60,602 for the three months ended September 30, 2008. This represented a decrease of $1,665 (2.7%) when compared to the same period last year, due primarily to a volume decrease in the higher margin brands for the three months ended September 30, 2009. Liggett s brands contributed 100% to our gross profit for the three months ended September 30, 2009. Liggett s brands contributed 99.6% to our gross profit and Vector Tobacco contributed 0.4% for the three months ended September 30, 2008.

Liggett s gross profit of $59,221 for the three months ended September 30, 2009 decreased $1,122 from gross profit of $60,343 for the three months ended September 30, 2008. As a percent of revenues (excluding federal excise taxes), gross profit at Liggett decreased to 50.7% for the three months ended September 30, 2009 compared to gross profit of 59.4% for the three months

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ended September 30, 2008. This decrease in Liggett s gross profit in the 2009 period was attributable primarily to volume decreases in the higher margin brands.

Vector Tobacco had negative gross profit of $284 for the three months ended September 30, 2009 compared to gross profit of $259 for the same period in 2008. The negative gross profit was due primarily to higher cost of sales and lower sales volumes.

Expenses. Operating, selling, general and administrative expenses were $21,966 for the three months ended September 30, 2009 compared to $23,067 for the same period last year, a decrease of $1,101 (4.8%). Expenses at Liggett were $15,841 for the three months ended September 30, 2009 compared to $14,419 for the same period in the prior year, an increase of $1,422 (9.9%). The increase related to higher pension expense in the 2009 period compared to the 2008 period. Liggett s product liability expenses and other litigation costs were $1,325 and $1,737 for the three months ended September 30, 2009 and 2008, respectively. Expenses at Vector Tobacco for the three months ended September 30, 2009 were $1,454 compared to expenses of $2,697 for the three months ended September 30, 2008. Expenses at the corporate level decreased from $5,951 to $4,476 due primarily to lower compensation expense and expenses associated with our Supplemental Retirement Plan in 2009 due to the retirement of our former Executive Chairman on December 30, 2008 offset by payroll taxes of approximately $550 associated with the exercise of options and a lump sum payment under the Supplemental Retirement Plan during the three months ended September 30, 2009. The real estate segment expenses of $194 in the 2009 period relate to expenses incurred in connection with Escena s operations.

For the three months ended September 30, 2009, Liggett s operating income decreased $2,544 to $43,380 compared to $45,924 for the same period in 2008. For the three months ended September 30, 2009 and 2008, Vector Tobacco s operating loss was $1,738 and $2,439, respectively.

Other Income (Expenses). Other expenses were $18,099 and $15,698 for the three months ended September 30, 2009 and 2008, respectively. For the three months ended September 30, 2009, other expenses primarily consisted of interest expense of $16,808 and a loss of $6,054 for changes in fair value of derivatives embedded within convertible debt offset by equity income of $4,712 on non-consolidated real estate businesses and interest income of $51. For the three months ended September 30, 2008, other expenses consisted of interest expense of $15,515 and losses of $7,000 associated with the performance of two investment partnerships ($1,500 each) and a decline in value in the mortgage receivable ($4,000) and was offset by other income of equity income from non-consolidated real estate businesses of $5,202, interest and dividend income of $1,094, and $522 for changes in fair value of derivatives embedded within convertible debt. The equity income of $5,202 for the 2008 period resulted from New Valley s investment in Douglas Elliman Realty which contributed $4,727 and Aberdeen, which contributed $475.

The value of the embedded derivatives is contingent on changes in interest rates of debt instruments maturing over the duration of the convertible debt, our stock price as well as projections of future cash and stock dividends over the term of the debt. The losses for the changes in fair value of the embedded derivatives in the three months ended September 30, 2009 was primarily the result of narrowing credit spreads in both the United States corporate credit markets and the market for our debt in the 2009 period. The gain from the embedded derivatives in the three months ended September 30, 2008 was primarily the result of interest payments during the period and increasing long-term interest rates.

Income before income taxes. Income before income taxes for the three months ended September 30, 2009 was $18,873 compared to $21,837 for the three months ended September 30, 2008.

Income tax provision. For the three months ended September 30, 2009, our income tax provision was $2,654 compared to $7,010 for the 2008 period. Our provision for income taxes in interim periods is based on an estimated annual effective income tax rate derived, in part, from

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estimated annual pre-tax results from ordinary operations. The annual effective income tax rate is reviewed and, if necessary, adjusted on a quarterly basis.

Our income tax rates for the three months ended September 30, 2009 and 2008 do not bear a customary relationship to statutory income tax rates as a result of the impact of nondeductible expenses, state income taxes and interest and penalties accrued on unrecognized tax benefits offset by the impact of the domestic production activities deduction. In addition, we recorded a benefit of $6,166 for the three months ended September 30, 2009 resulting from the reduction of a previously established valuation allowance of a deferred tax asset. The net deferred tax asset has been recognized for state tax net operating losses at Vector Tobacco Inc. after evaluating the impact of the negative and positive evidence that such asset would be realized. We based our conclusion on the fact that Vector Tobacco is anticipated to report state taxable income on a separate company basis for the second consecutive year in 2009. For the three months ended September 30, 2008, our income tax provision was increased by approximately $240 because of the impact of the impairment charges, which was not anticipated when the estimated annual effective tax rate was developed.

The Internal Revenue Service concluded an audit of our income tax return for the year ended December 31, 2005. There was no material impact on our condensed consolidated financial statements as a result of the audit.

Nine Months Ended September 30, 2009 Compared to Nine Months Ended September 30, 2008

Revenues. Total revenues were $564,746 for the nine months ended September 30, 2009 compared to $420,766 for the nine months ended September 30, 2008. This $143,980 (34.2%) increase in revenues was due to a $144,477 (34.5%) increase in revenues at Liggett and a $497 (25.5%) decrease in revenues at Vector Tobacco.

Tobacco Revenues. In June 2009, Liggett increased the list price of all brands by $0.10 per carton in conjunction with the user fees imposed by the passage of the bill granting the FDA jurisdiction over tobacco. In April 2008, Liggett increased the list price of GRAND PRIX by $0.40 per carton. In addition, in April 2008, Liggett decreased the early payment terms on its cigarettes from 2.75% to 2.25% of invoice amount. In August 2008, Liggett increased the list price of LIGGETT SELECT, EVE and GRAND PRIX by $1.00 per carton. Liggett increased the list price of LIGGETT SELECT and EVE by $0.90 per carton in February 2009 and an additional $7.10 per carton in March 2009. Liggett increased the list price of GRAND PRIX by $7.20 per carton in March 2009.

All of Liggett s sales for the first nine months of 2009 and 2008 were in the discount category. For the nine months ended September 30, 2009, net sales at Liggett totaled $563,293, compared to $418,816, for the nine months ended September 30, 2008. Revenues increased by 34.5% ($144,477) due to a favorable price variance of $161,056 and sales mix of $6,293 primarily related to LIGGETT SELECT and GRAND PRIX (primarily associated with the increase in federal excise taxes on cigarettes) offset by an unfavorable volume variance of $22,461 (approximately 348.9 million units). Net revenues of the LIGGETT SELECT brand increased $2,948 for the first nine months of 2009 compared to 2008 from a favorable variance from pricing of $43,908 offset by a decrease in unit volume of 29.8% (593.2 million units). Net revenues of the GRAND PRIX brand increased $31,522 for the first nine months of 2009 compared to 2008 from a favorable variance from pricing of $51,159 offset by a decrease in volume of 15.1% (320.9 million units). Net revenues of Liggett s repositioned PYRAMID brand increased $51,618 due to increased volume of 1,546.6% (600.1 million units).

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Revenues at Vector Tobacco for the nine months ended September 30, 2009 were $1,453 compared to $1,950 in the 2008 period due to decreased sales volume. Vector Tobacco s revenues in both periods related to sales of QUEST.

Tobacco Gross Profit. Tobacco gross profit was $166,658 for the nine months ended September 30, 2009 compared to $169,730 for the nine months ended September 30, 2008. This represented a decrease of $3,072 (1.8%) when compared to the same period last year, due primarily to decreased volume for the nine months ended September 30, 2009. Liggett s brands contributed 100% to our gross profit for the nine months ended September 30, 2009. Over the same period in 2008, Liggett s brands contributed 99.6% to tobacco gross profit and Vector Tobacco contributed 0.4%.

Liggett s gross profit of $166,773 for the nine months ended September 30, 2009 decreased $2,347 from gross profit of $169,120 for the nine months ended September 30, 2008. As a percent of revenues (excluding federal excise taxes), gross profit at Liggett decreased to 54.3% for the nine months ended September 30, 2009 compared to gross profit of 57.9% for the nine months ended September 30, 2008. This decrease in Liggett s gross profit in the 2009 period was attributable primarily to decreased unit sales.

Vector Tobacco s gross loss was $115 for the nine months ended September 30, 2009 compared to gross profit of $610 for the same period in 2008. The decrease was due primarily to the reduced sales volume.

Expenses. Operating, selling, general and administrative expenses were $63,679 for the nine months ended September 30, 2009 compared to $69,809 for the same period last year, a decrease of $6,130 (8.8%). Expenses at Liggett were $46,673 for the nine months ended September 30, 2009 compared to $42,160 for the same period in the prior year, an increase of $4,513 or 10.7%. The increase related to pension expense in the 2009 period compared to the 2008 period. Liggett s product liability expenses and other litigation costs were $4,285 and $4,806 for the nine months ended September 30, 2009 and 2008, respectively. Expenses at Vector Tobacco for the nine months ended September 30, 2009 were $5,770 compared to expenses of $7,384 for the nine months ended September 30, 2008. Expenses at the corporate level decreased from $20,265 in the 2008 period to $12,042 in the 2009 period due primarily to lower compensation expense and expenses associated with our Supplemental Retirement Plan in 2009 due to the retirement of our former Executive Chairman on December 30, 2008. The real estate segment expenses of $194 in the 2009 period relate to expenses incurred in connection with Escena s operations.

For the nine months ended September 30, 2009, Liggett s operating income decreased $1,860 to $125,100 compared to $126,960 for the same period in 2008. For the nine months ended September 30, 2009, Vector Tobacco s operating loss was $5,885 compared to a loss of $6,775 for the nine months ended September 30, 2008.

Other Income (Expenses). Other expenses were $96,952 and $18,620 for the nine months ended September 30, 2009 and 2008, respectively. For the nine months ended September 30, 2009, other expenses primarily consisted of interest expense of $49,968, a loss on the extinguishment of the 5% Notes of $18,444, a loss of $8,500 associated with a decline in value in the former Escena mortgage receivable ($5,000) and the Aberdeen real estate investment ($3,500), a loss of $25,845 for changes in fair value of derivatives embedded within convertible debt , equity income of $5,528 on non-consolidated real estate businesses, and interest income of $277. For the nine months ended September 30, 2008, other expenses consisted of interest expense of $46,025 and losses of $7,000 associated with the performance of two investment partnerships ($1,500 each) and a decline in value in the former mortgage receivable ($4,000) which was offset by equity income from non-consolidated real estate businesses of $22,706, changes in fair value of derivatives embedded within convertible debt of $7,837, and interest and dividend income of $4,440. The equity income of $22,706 for the 2008 period resulted from New Valley s investment in Douglas Elliman Realty which contributed $10,249, $11,982 from 16th and K, which consisted

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of equity losses from the operations of the St. Regis Hotel of $3,796 and income of $15,779 in connection with the gain on the disposal of 16th and K s interest in 90% of the St. Regis Hotel in Washington, D.C., and $475 from Aberdeen.

The value of the embedded derivatives is contingent on changes in interest rates of debt instruments maturing over the duration of the convertible debt, our stock price as well as projections of future cash and stock dividends over the term of the debt. The losses for the changes in fair value of the embedded derivatives in the three months ended September 30, 2009 was primarily the result of narrowing credit spreads in both the United States corporate credit markets and the market for our debt in the 2009 period offset by interest payments. The gain from the embedded derivatives in the first nine months of 2008 was primarily the result of interest payments during the period and increasing long-term interest rates.

Income before income taxes. Income before income taxes for the nine months ended September 30, 2009 was $10,027 compared to income before income taxes of $81,301 for the nine months ended September 30, 2008.

Income tax provision. The income tax benefit was $1,346 for the nine months ended September 30, 2009 compared to an expense of $33,042 for the same period in 2008. Our provision for income taxes in interim periods is based on an estimated annual effective income tax rate derived, in part, from estimated annual pre-tax results from ordinary operations. The annual effective income tax rate is reviewed and, if necessary, adjusted on a quarterly basis.

Vector s income tax rates for the nine months ended September 30, 2009 and 2008 do not bear a customary relationship to statutory income tax rates as a result of the impact of nondeductible expenses, state income taxes and interest and penalties accrued on unrecognized tax benefits offset by the impact of the domestic production activities deduction. In addition, we recorded a benefit of $6,166 for the nine months ended September 30, 2009 resulting from the reduction of a previously established valuation allowance of a deferred tax asset. For the nine months ended September 30, 2009, our tax provision was reduced because of the impact of the loss on extinguishment of debt, which was not anticipated when the estimated annual effective tax rate was developed, and reduced income tax benefit by approximately $535 due to differences in our marginal tax rate of approximately 40.6% and our anticipated effective annual income tax rate from ordinary operations of approximately 43.5%. For the nine months ended September 30, 2008, our income tax provision was reduced by $130 due to differences in our marginal tax rate of approximately 40.9% and our anticipated effective annual income tax rate of approximately 44% due to items not considered when the estimated annual effective tax rate was developed. These items were the income from our investment in the St. Regis Hotel ($370), which was offset by the impairment charges on our investments ($240).

Liquidity and Capital Resources

Net cash and cash equivalents increased $26,363 for the nine months ended September 30, 2009 and decreased $31,608 for the nine months ended September 30, 2008.

Net cash provided from operations was $9,334 and $70,435 for the nine months ended September 30, 2009 and 2008, respectively. The decrease was primarily due to additional income tax payments in the 2009 period and the payment to the Executive Chairman upon his retirement in accordance with the our Supplemental Retirement Plan offset by increased operating income.

Cash used in investing activities was $7,738 and $28,426 for the nine months ended September 30, 2009 and 2008, respectively. In the first nine months of 2009, cash was used for the purchase of investment securities of $12,300, capital expenditures of $3,005, an increase in cash surrender value of corporate-owned life insurance policies of $839, an investment in non-consolidated real estate assets of $467, a purchase of long-term investments of $51, offset by

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distributions from non-consolidated real estate businesses of $5,548, proceeds from the liquidation of long-term investments of $1,407 and a decrease in restricted assets of $1,969. In the first nine months of 2008, cash was used for the purchase of the mortgage receivable of $21,704, the investment in Aberdeen for $10,000 and Chelsea for $12,000, the purchase of investment securities of $5,682, capital expenditures of $5,426, increase in the cash surrender value of corporate-owned life insurance policies of $766, and the purchase of long-term investments of $51 offset by the distributions from non-consolidated real estate businesses of $17,628 and from the proceeds from the liquidation of long-term investments of $8,334, a decrease in restricted assets of $838, and the proceeds from the sale of fixed assets of $403.

Cash provided by financing activities for the nine months ended September 30, 2009 was $24,767 compared to cash used in financing activities of $73,617 for the same period in 2008 In the first nine months of 2009, cash provided by financing activities came from proceeds of debt issuance of $118,782, excess tax benefit of options exercised of $6,944, and the proceeds from exercise of stock options of $398, offset by cash used for distributions on common stock of $87,451, repayment of debt of $4,516, deferred financing charges of $5,573, and net borrowings of debt under the revolver of $3,817. In the first nine months of 2008, cash was primarily used for distributions on common stock of $78,581, repayments on debt of $4,666, net payments of debt under the revolver of $11,393 and deferred financing charges of $137, offset by the excess tax benefit of options exercised of $18,304, debt issuance of $2,830, and the proceeds from the exercise of options of $26.

Liggett. Liggett has a $50,000 credit facility with Wachovia Bank, N.A. under which $15,700 was outstanding at September 30, 2009. Availability as determined under the facility was approximately $20,300 based on eligible collateral at September 30, 2009. The facility contains covenants that provide that Liggett s earnings before interest, taxes, depreciation and amortization, as defined under the facility, on a trailing twelve-month basis, shall not be less than $100,000 if Liggett s excess availability, as defined, under the facility is less than $20,000. The covenants also require that annual capital expenditures, as defined under the facility, (before a maximum carryover amount of $2,500) shall not exceed $10,000 during any fiscal year. At September 30, 2009, management believed that Liggett was in compliance with all covenants under the credit facility; Liggett s EBITDA, as defined, were approximately $152,000 for the twelve months ended September 30, 2009.

Liggett and other United States cigarette manufacturers have been named as defendants in a number of direct, third-party and purported class actions predicated on the theory that they should be liable for damages alleged to have been caused by cigarette smoking or by exposure to secondary smoke from cigarettes. We believe, and have been so advised by counsel handling the respective cases, that Liggett has a number of valid defenses to claims asserted against it, however, litigation is subject to many uncertainties. In June 2002, the jury in an individual case brought under the third phase of the *Engle* case awarded $37,500 (subsequently reduced by the court to $24,835) of compensatory damages against Liggett and two other defendants and found Liggett 50% responsible for the damages. As of September 30, 2009, interest on the award was more than $13,000. It is possible that additional cases could be decided unfavorably. There are approximately 3,300 *Engle* progeny cases, in state and federal courts in Florida, where either Liggett (and other cigarette manufacturers) or us, or both, were named as defendants. These cases include approximately 8,585 plaintiffs. Approximately 43 cases are currently scheduled for trial, or likely to be scheduled for trial, in 2009 and 2010. To date, eight *Engle* progeny cases have gone to trial resulting in six plaintiff verdicts and two defense verdicts. In one of these cases, judgment was entered against Liggett for $156. Liggett may enter into discussions in an attempt to settle particular cases if it believes it is appropriate to do so. Management 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. An unfavorable outcome of a pending smoking and health case could encourage the commencement of additional similar litigation. In recent years, there have been a number of adverse regulatory, political and other developments concerning cigarette smoking and the tobacco industry. These developments

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generally receive widespread media attention. Neither we nor Liggett are able to evaluate the effect of these developing matters on pending litigation or the possible commencement of additional litigation or regulation. See Note 8 to our condensed consolidated financial statements and Legislation and Regulation below for a description of legislation, regulation and litigation.

Except in the case of one individual claim, management is unable to make a reasonable estimate of the amount or range of loss that could result from an unfavorable outcome of the cases pending against Liggett or the costs of defending such cases. It is possible that our condensed consolidated financial position, results of operations or cash flows could be materially adversely affected by an unfavorable outcome in any such tobacco-related litigation.

Vector. Our scheduled maturities in 2009 declined to $17,921 as of September 30, 2009 from $137,063 as of December 31, 2008 due to extinguishments and exchanges of debt. On May 11, 2009, we issued in a private placement the 6.75% Note due 2014 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. On June 30, 2009, we issued $106,940 of our 6.75% Exchange Notes due 2014 in exchange for $99,944 aggregate principal amount of the 5% Notes due 2011, valued at 107% principal amount.

In September 2009, we sold at 94% of face value an additional $85,000 principal amount of our 11% Senior Secured Notes due 2015. We received net proceeds from the offering of approximately $79,900.

We believe that we will continue to meet our liquidity requirements over the next 12 months. Our corporate expenditures (exclusive of our cigarette operations) and other potential liquidity requirements over the next 12 months include:

cash interest expense of approximately $63,650,

dividends on our outstanding common shares (currently at an annual rate of approximately $115,000), and

other corporate expenses and taxes, including a tax payment of approximately $25,000 in connection with the Philip Morris brands transaction.

We believe that our cigarette operations are positive cash flow generating units and will continue to be able to sustain their operations without any significant liquidity concerns.

In order to meet the above liquidity requirements as well as other anticipated liquidity needs in the normal course of business, we had cash and cash equivalents of approximately $237,400, investment securities available for sale of approximately $62,100, long-term investments with an estimated value of approximately $70,000 and availability under Liggett s credit facility of approximately $20,300 at September 30, 2009. Management currently anticipates that these amounts, as well as expected cash flows from our operations, proceeds from public and/or private debt and equity financing, management fees and other payments from subsidiaries should be sufficient to meet our liquidity needs over the next 12 months. We may acquire or seek to acquire additional operating businesses through merger, purchase of assets, stock acquisition or other means, or to make other investments, which may limit our liquidity otherwise available.

As described above under Recent Developments , during the second quarter of 2009, we issued the $50,000 principal amount of 6.75% Note and $106,940 principal amount of 6.75% Exchange Notes. These new notes were issued for $38,225 of cash and $110,949 principal amount of our 5% Notes previously issued in 2004 and 2005. The issuance of the new notes enhanced our liquidity and financial position, as the new notes have an extended maturity and a lower cash interest cost than the 5% Notes.

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The remaining $915 principal amount of 5% Notes mature on November 15, 2011; however, the remaining 5% Notes could become due in November 2009 as a result of an option by the holders to require us to repurchase some or the entire remaining principal amount of the 5% Notes on November 15, 2009.

In addition, during the third quarter of 2009, we issued an additional $85,000 principal amount of our 11% Senior Secured Notes due 2015 at 94% of face value.

On a quarterly basis, we evaluate our investments to determine whether an impairment has occurred. If so, we also make a determination if such impairment is considered temporary or other-than-temporary. We believe 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 our original expected holding period of the investment.

We or our subsidiaries file U.S. federal income tax returns and returns with various state and local jurisdictions. Our condensed consolidated balance sheets include deferred income tax assets and liabilities, which represent temporary differences in the application of accounting rules established by generally accepted accounting principles and income tax laws. As of September 30, 2009, our deferred income tax liabilities exceeded our deferred income tax assets by $23,285. Our current deferred income tax liabilities decreased by approximately $75,304 during the nine months ended September 30, 2009 primarily as a result of tax payments of approximately $75,500 made or expected to be made in 2009 in connection with the Philip Morris brands transaction. These tax payments resulted from our settlement with the Internal Revenue Service in July 2006, which required us to recognize taxable income of approximately $192,000 from the Philip Morris brand transaction by March 1, 2009.

Market Risk

We are exposed to market risks principally from fluctuations in interest rates, foreign currency exchange rates and equity prices. We seek to minimize these risks through our regular operating and financing activities and our long-term investment strategy. Our market risk management procedures cover all market risk sensitive financial instruments.

As of September 30, 2009, approximately $30,600 of our outstanding debt at face value had variable interest rates determined by various interest rate indices, which increases the risk of fluctuating interest rates. Our exposure to market risk includes interest rate fluctuations in connection with our variable rate borrowings, which could adversely affect our cash flows. As of September 30, 2009, we had no interest rate caps or swaps. Based on a hypothetical 100 basis point increase or decrease in interest rates (1%), our annual interest expense could increase or decrease by approximately $177.

In addition, as of September 30, 2009, approximately $73,611 ($267,852 principal amount) of outstanding debt had a variable interest rate determined by the amount of the dividends on our common stock. The difference between the stated value of the debt and its carrying value is due principally to certain embedded derivatives, which were separately valued and recorded upon issuance.

We have 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 yield of our 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 our future dividend

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payments 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 items, including current and future dividends and the volatility of Vector s stock price. The range of estimated fair market values of our embedded derivatives was between $140,058 and $145,750. We recorded the fair market value of our embedded derivatives at the midpoint of the inputs at $142,850 as of September 30, 2009. The estimated fair market value of our embedded derivatives could change significantly based on future market conditions.

Changes to the estimated fair value of these embedded derivatives are reflected quarterly within our statements of operations as Changes 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 and changes in the closing stock price at the end of each quarterly period. Based on a hypothetical 100 basis point increase or decrease in interest rates (1%), our annual Changes in fair value of derivatives embedded within convertible debt could increase or decrease by approximately $5,496 with approximately $526 resulting from the 6.75% Note, due 2014, $944 resulting from the 6.75% Exchange Notes, due 2014, $4,024 resulting from the embedded derivative associated with our 3.875% variable interest senior convertible debentures due 2026, and the remaining $2 resulting from the embedded derivative associated with our 5% variable interest senior convertible notes due 2011. An increase in our quarterly dividend rate by $0.10 per share would increase interest expense by approximately $6,500 per year.

We held investment securities available for sale totaling $62,094 at September 30, 2009, which includes 13,891,205 shares of Ladenburg Thalmann Financial Services Inc. carried at $10,002.

In May, June, and July 2009, we purchased 5,333,526 common shares of Strategic Hotels & Resorts, Inc. for approximately $7,137, excluding commissions. The shares were carried at $13,814 as of September 30, 2009. On July 20, 2009, we reported that we beneficially owned approximately 7.1% of the stock of Strategic Hotels.

See Note 3 to our condensed consolidated financial statements. Adverse market conditions could have a significant effect on the value of these investments.

We and New Valley also hold long-term investments in various investment partnerships. These investments are illiquid, and their ultimate realization is subject to the performance of the underlying entities.

New Accounting Pronouncements

Refer to Note 1. *Summary of Significant Accounting Policies* to our financial statements for further information on *New Accounting Pronouncements.*

Legislation and Regulation

Reports with respect to the alleged harmful physical effects of cigarette smoking have been publicized for many years and, in the opinion of Liggett s management, have had and may continue to have an adverse effect on cigarette sales. Since 1964, the Surgeon General of the United States and the Secretary of Health and Human Services have released a number of reports which state that cigarette smoking is a causative factor with respect to a variety of health hazards, including cancer, heart disease and lung disease, and have recommended various government actions to reduce the incidence of smoking. In 1997, Liggett publicly acknowledged that, as the Surgeon General and respected medical researchers have found, smoking causes health problems, including lung cancer, heart and vascular disease, and emphysema.

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On June 22, 2009, the President signed into law the Family Smoking Prevention and Tobacco Control Act (H.R. 1256). The law grants the Food and Drug Administration (FDA) broad authority over the manufacture, sale, marketing and packaging of tobacco products, although the FDA is prohibited from issuing regulations banning all cigarettes or all smokeless tobacco products, or requiring the reduction of nicotine yields of a tobacco product to zero. 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 the FDA to develop graphic warnings for cigarette packages, and grants the FDA authority to require new warnings;

requires practically all tobacco product advertising to eliminate color and imagery and instead consist solely of black text on white background;

imposes new restrictions on the sale and distribution of tobacco products;

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 the 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 the 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 the FDA to disclose certain constituent information to the public;

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

requires manufacturers to submit to the FDA certain information regarding the health, toxicological, behavioral or physiologic effects of tobacco products;

prohibits use of tobacco containing a pesticide chemical residue at a level greater than allowed under federal law;

requires the FDA to establish good manufacturing practices to be followed at tobacco manufacturing facilities;

requires tobacco product manufacturers (and certain other entities) to register with the FDA;

authorizes the 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 reduction or elimination of other constituents;

imposes (and allows the FDA to impose) various recordkeeping and reporting requirements on tobacco product manufacturers; and

grants the FDA the regulatory authority to impose broad additional restrictions.

The law also requires establishment, within the FDA s new Center for Tobacco Products, of a Tobacco Products Scientific Advisory Committee to provide advice, information and recommendations with respect to the safety, dependence or health issues related to tobacco products, including:

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a recommendation on modified risk applications;

a recommendation on the effects of tobacco product nicotine yield alteration and whether there is a threshold level below which nicotine yields do not produce dependence;

a report on the public health impact of the use of menthol in cigarettes; and

a report on the public health impact of dissolvable tobacco products.

The law imposes user fees on certain tobacco product manufacturers in order to fund tobacco related FDA activities. User fees will be allocated among tobacco product classes according to a formula set out in the legislation, and then among manufacturers and importers within each class based on market share. Based on the current market shares of Liggett and Vector Tobacco, we estimate the FDA user fees on those two companies combined to be approximately $2,000 for 2009.

The law also imposes significant new restrictions on the advertising and promotion of tobacco products. For example, the law requires the FDA to finalize certain portions of regulations previously adopted by the FDA in 1996 (which were struck down by the Supreme Court in 2000 as beyond the FDA s authority). These regulations will significantly limit the ability of manufacturers, distributors and retailers to advertise and promote tobacco products, by, for example, restricting the use of color and graphics in advertising, limiting the use of outdoor advertising, and restricting the sale and distribution of non-tobacco items and services, gifts, and sponsorship of events. The law also requires the FDA to issue future regulations regarding the promotion and marketing of tobacco products sold through non-face-to-face transactions.

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 the FDA under the new tobacco law. Costs, however, could be substantial and could have a material adverse effect on the companies financial condition, results of operations, and cash flows. In addition, 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 its competitive position.

Liggett and Vector Tobacco provide ingredient information annually, as required by law, to the states of Massachusetts, Texas and Minnesota. Several other states are considering ingredient disclosure legislation.

In October 2004, the Fair and Equitable Tobacco Reform Act of 2004 (FETRA) was signed into law. FETRA provides for the elimination of the federal tobacco quota and price support program through an industry funded buyout of tobacco growers and quota holders. Pursuant to the legislation, manufacturers of tobacco products have been assessed $10,140,000 over a ten year period, commencing in 2005, to compensate tobacco growers and quota holders for the elimination of their quota rights. Cigarette manufacturers are currently responsible for 95% of the assessment (subject to adjustment in the future), which is allocated based on relative unit volume of domestic cigarette shipments. Management currently estimates that Liggett s and Vector Tobacco s assessment will be approximately $23,200 for 2009. The relative cost of the legislation to the three largest cigarette manufacturers will likely be less than the cost to smaller manufacturers, including Liggett and Vector Tobacco, because one effect of the legislation is that the three largest manufacturers are no longer obligated to make certain contractual payments, commonly known as Phase II payments, that they agreed in 1999 to make to tobacco-producing states. The ultimate impact of this legislation cannot be determined, but there is a risk that smaller manufacturers, such as Liggett and Vector Tobacco, will be disproportionately affected by the legislation, which could have a material adverse effect on us.

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Cigarettes are subject to substantial and increasing federal, state and local excise taxes. Effective April 1, 2009, the federal cigarette excise tax increased from $0.39 to $1.01 per pack. State excise taxes vary considerably and, when combined with sales taxes, local taxes and the federal excise tax, may exceed $4.00 per pack. In 2009, 15 states have enacted increases in excise taxes and several other states are considering, or have pending, legislation proposing further state excise tax increases. Management believes increases in excise and similar taxes have had, and will continue to have, an adverse effect on sales of cigarettes.

Over the last several years a majority of states have enacted virtually identical legislation requiring cigarettes to meet a laboratory test standard for reduced ignition propensity. Cigarettes that meet this standard are referred to as fire standards compliant or FSC, and are sometimes commonly called self-extinguishing. Effective January 1, 2009, substantially all of the cigarettes that Liggett and Vector Tobacco manufacture are fire standards compliant. Compliance with such legislation could be burdensome and costly and could harm the business of Liggett and Vector Tobacco, particularly if there were to be varying standards from state to state.

In November 2008, the Federal Trade Commission (FTC) rescinded guidance it issued in 1966 that generally permitted statements concerning cigarette tar and nicotine yields if they were based on the Cambridge Filter Method, sometimes called the FTC method. In its rescission notice, the FTC also indicated that advertisers should no longer use terms suggesting the FTC s endorsement or approval of any specific test method, including terms such as per FTC Method or other phrases that state or imply FTC endorsement or approval of the Cambridge Filter Method or other machine-based methods for measuring cigarette tar or nicotine yields. Also in its rescission notice, the FTC indicated that cigarette descriptors such as light and ultra light have not been defined by the FTC, nor has the FTC provided any guidance or authorization for their use. The FTC indicated that to the extent descriptors are used in a manner that convey an overall impression that is false, misleading, or unsubstantiated, such use could be actionable. The FTC further indicated that companies must ensure that any continued use of descriptors does not convey an erroneous or unsubstantiated message that a particular cigarette presents a reduced risk of harm or is otherwise likely to mislead consumers. In response to the FTC s action, we have removed all reference to tar and nicotine testing from our point-of-sale advertising. In addition, the new tobacco law imposes a ban scheduled to take effect next year on the use of light , mild , low or similar descriptors on tobacco product labels and in labeling or advertising. To the extent descriptors are no longer used to market or promote our cigarettes, this may have a material adverse effect on us.

A wide variety of federal, state and local laws limit the advertising, sale and use of cigarettes, and these laws have proliferated in recent years. For example, many local laws prohibit smoking in restaurants and other public places, and many employers have initiated programs restricting or eliminating smoking in the workplace. There are various other legislative efforts pending at the federal, state or local level which seek to, among other things, eliminate smoking in public places, curtail affirmative defenses of tobacco companies in product liability litigation, and further restrict the sale, marketing and advertising of cigarettes and other tobacco products. This trend has had, and is likely to continue to have, an adverse effect on us. It is not possible to predict what, if any, additional legislation, regulation or other governmental action will be enacted or implemented, or to predict what the impact of the new FDA tobacco law will be on these pending legislative efforts.

In addition to the foregoing, there have been a number of other restrictive regulatory actions, adverse legislative and political decisions and other unfavorable developments concerning cigarette smoking and the tobacco industry. These developments may negatively affect the perception of potential triers of fact with respect to the tobacco industry, possibly to the detriment of certain pending litigation, and may prompt the commencement of additional similar litigation or legislation.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

In addition to historical information, this report contains forward-looking statements within the meaning of the federal securities law. Forward-looking statements include information relating to our intent, belief or current expectations, primarily with respect to, but not limited to:

economic outlook,

capital expenditures,

cost reduction,

new legislation,

cash flows,

operating performance,

litigation,

impairment charges and cost savings associated with restructurings of our tobacco operations, and

related industry developments (including trends affecting our business, financial condition and results of operations).

We identify forward-looking statements in this report by using words or phrases such as anticipate , believe , estimate , expect , intend , may be , objective , plan , seek , predict , project and will be and similar wo their negatives.

The forward-looking information involves important risks and uncertainties that could cause our actual results, performance or achievements to differ materially from our anticipated results, performance or achievements expressed or implied by the forward-looking statements. Factors that could cause actual results to differ materially from those suggested by the forward-looking statements include, without limitation, the following:

general economic and market conditions and any changes therein, due to acts of war and terrorism or otherwise,

impact of current crises in capital and credit markets, including any continued worsening,

governmental regulations and policies,

effects of industry competition,

impact of business combinations, including acquisitions and divestitures, both internally for us and externally in the tobacco industry,

impact of restructurings on our tobacco business and our ability to achieve any increases in profitability estimated to occur as a result of these restructurings,

impact of new legislation on our competitors payment obligations, results of operations and product costs, i.e. the impact of recent federal legislation eliminating the federal tobacco quota system,

impact of substantial increases in federal, state and local excise taxes,

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uncertainty related to litigation and potential additional payment obligations for us under the Master Settlement Agreement and other settlement agreements with the states, and

risks inherent in our new product development initiatives.

Further information on risks and uncertainties specific to our business include the risk factors discussed above in Management s Discussion and Analysis of Financial Condition and Results of Operations and under Item 1A, Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Securities and Exchange Commission.

Although we believe the expectations reflected in these forward-looking statements are based on reasonable assumptions, there is a risk that these expectations will not be attained and that any deviations will be material. The forward-looking statements speak only as of the date they are made.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information under the caption Management s Discussion and Analysis of Financial Condition and Results of Operations Market Risk is incorporated herein by reference.

ITEM 4. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we have evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report, and, based on their evaluation, our principal executive officer and principal financial officer have concluded that these controls and procedures are effective.

There were no changes in our internal control over financial reporting during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II
OTHER INFORMATION

Item 1. Legal Proceedings

Reference is made to Note 8., incorporated herein by reference, to our condensed consolidated financial statements included elsewhere in this report which contains a general description of certain legal proceedings to which our company, VGR Holding, Liggett, Vector Tobacco, New Valley or their subsidiaries are a party and certain related matters. Reference is also made to Exhibit 99.1 for additional information regarding the pending smoking-related material legal proceedings to which Liggett or us is a party. A copy of Exhibit 99.1 will be furnished without charge upon written request to us at our principal executive offices, 100 S.E. Second St., Miami, Florida 33131, Attn. Investor Relations.

Item 1A. Risk Factors

Except as set forth below, there are no material changes from the risk factors set forth in Item 1A, Risk Factors, of our Annual Report on 10-K for the year ended December 31, 2008. Please refer to that section for disclosures regarding the risks and uncertainties related to our business. The risk factors in the Annual Report on Form 10-K entitled Litigation will continue to harm the tobacco industry , Individual tobacco-related cases have increased as a result of the Florida Supreme Court s ruling in Engle and Liggett may have additional payment obligations under the Master Settlement Agreement and its other settlement agreements with the states are revised to reflect the updated information concerning the number and status of cases and other matters discussed under Note 8 to our condensed consolidated financial statements and in Management s Discussion and Analysis of Financial Condition Recent Developments Tobacco Settlement Agreements , Recent Developments in Legislation, Regulation and Tobacco-Related Litigation , and Legislation and Regulation.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Except for approximately 3,326,623 shares of our common stock issued as a stock dividend on September 29, 2009 and as discussed in our filing on Form 8-K dated September 1, 2009 related to an additional $85,000,000 principal amount of our 11% Senior Secured Notes, no securities of ours which were not registered under a private offering of the Securities Act of 1933 have been issued or sold by us during the three months ended September 30, 2009.

Our purchases of our common stock during the three months ended September 30, 2009 were as follows:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
July 1 to July 31, 2009		$		
August 1 to August 31, 2009				
September 1 to September 30, 2009	2,120,479(1)	15.43		
Total	2,120,479	$ 15.43		

(1) Delivery of shares to us in payment of exercise price in connection with exercise of an employee stock option for 3,218,998 shares on September 23, 2009. The shares were subsequently cancelled.

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Item 6. Exhibits

4.1 Second Supplemental Indenture, dated as of September 1, 2009, among Vector Group Ltd., the subsidiary guarantors named therein and U.S. Bank National Association, as Trustee (incorporated by reference to Exhibit 4.1 of Vector s Form 8-K dated September 1, 2009).

4.2 Registration Rights Agreement, dated as of September 1, 2009, between Vector Group Ltd., the subsidiary guarantors named therein and Jefferies & Company, Inc. (incorporated by reference to Exhibit 4.2 of Vector s Form 8-K dated September 1, 2009).

31.1 Certification of Chief Executive Officer, Pursuant to Exchange Act Rule 13a-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer, Pursuant to Exchange Act Rule 13a-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer, Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer, Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

99.1 Material Legal Proceedings

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SIGNATURE

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

VECTOR GROUP LTD.
(Registrant)

By: /s/ J. Bryant Kirkland III
J. Bryant Kirkland III
Vice President, Treasurer and Chief Financial Officer

Date: November 9, 2009