



Vector Group Ltd. (VGR)

Updated June 3rd, 2019 by Prakash Kolli

Key Metrics

Current Price:	\$9	5 Year CAGR Estimate:	10.2%	Volatility Percentile:	59.9%
Fair Value Price:	\$11	5 Year Growth Estimate:	3.0%	Momentum Percentile:	4.7%
% Fair Value:	83%	5 Year Valuation Multiple Estimate:	3.8%	Growth Percentile:	13.1%
Dividend Yield:	3.4% ²	5 Year Price Target	\$13	Valuation Percentile:	66.6%
Dividend Risk Score:	F	Retirement Suitability Score:	C	Total Return Percentile:	97.2%

Overview & Current Events

Vector Group Ltd. is a holding company that is an unusual combination of a cigarette company and real estate investment firm. The company owns and controls two tobacco companies that are Liggett Group, LLC and Vector Tobacco, Inc., and also New Valley LLC, which is a real estate investment business. The Tobacco segment primarily sells discount cigarettes and brands include Eagle 20's, Pyramid, Grand Prix, Liggett Select, and Eve. The Real Estate segment owns Douglas Elliman Realty. It operates one of the largest real estate brokerages in New York City but also has operations in South Florida, Beverley Hills, Aspen and Connecticut. Vector Group has a market capitalization of ~\$1.3B. Vector Group reported earnings for Q1 2019 on May 7th, 2019. The company missed both revenue earnings estimates. The stock market responded negatively after the disappointing report and the stock has trended down since then trading near 10-year lows. Net revenues decreased to \$420.9M from \$429.0M on a year-over-year basis. Operating income also decreased to \$42.6M in Q 2019 from \$48.1M in Q1 2018. On a GAAP basis, diluted earnings per share was \$0.08 compared to \$0.04 in Q1 2018. The higher EPS was driven by lower cost of sales and lower equity losses in real estate ventures.

The Tobacco segment had revenues \$256.8M compared to \$267.1M in comparable quarters. This decline was driven by a 7.1% decline in unit sales volume. The Tobacco segment had conventional cigarette (wholesale) shipments of approximately 2.08B units compared to 2.24B units for Q1 2018. The Real Estate segment had revenues of \$164.2M an increase from \$161.9M on a year-over-year basis. The Real Estate segment reported a net loss of (\$9.1M). The Douglas Elliman brokerage closed sales of \$5.8B, a slowdown from \$6.1B in the prior year.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$0.32	\$0.48	\$0.36	\$0.26	\$0.93	\$0.29	\$0.42	\$0.50	\$0.56	\$0.37	\$0.38	\$0.44
DPS	\$0.98	\$1.04	\$1.10	\$1.15	\$1.21	\$1.27	\$1.33	\$1.40	\$1.47	\$1.54	\$1.60	\$0.40¹
Shares	N/A	111	112	120	124	139	143	141	141	141	144	159

Vector Group has consistently grown revenue the past decade. But earnings per share has been tremendously volatile, as its operating margins have fluctuated, interest expense has moved steadily higher, and its real estate business has seen some impairment charges against it. We are maintaining our forecast of 3% EPS growth on average out to 2024.

Vector Group pays both a regular cash dividend and a stock dividend annually. The cash dividend is a constant \$1.60 per share. The company also pays a 5% stock dividend. This leads to a greater dividend expense for the company on a cash basis as there are more shares to pay the dividend on. A small investor can keep the stock dividend or alternatively sell it and in effect increase the yield to 21.9%. *Note that the DPS in the table above are adjusted for the stock dividend.*

Net operating cash has not covered the dividend in recent years. The company has needed to borrow and use debt to pay the dividend. The company had \$447.3M in cash and investments at end of Q1 2019. Vector Group pays about \$240M in dividends annually so the company should be able to continue paying the full dividend in 2019. ¹However, we are modeling a dividend cut to \$0.40 per share in 2020 and out to 2024. This is approximately 50% of free cash flow.

²Our dividend cut estimate is reflected in the dividend yield key metric above and, in the tables, below.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	29.8	23.1	33.8	46.8	13.2	57.6	45.6	38.5	35.2	45.1	24.9	30.0
Avg. Yld.	11.1%	9.4%	9.0%	9.4%	9.8%	7.7%	6.9%	7.3%	7.4%	9.2%	16.9%	3.0% ²

Vector Group's price-to-earnings ratio has been volatile due to the fluctuations in EPS. Notably, the stock price has trended down since early 2018 and is trading at ~\$9 per share. Based on a P/E ratio of 30.0 and our expected 2019 earnings, our fair value estimate is \$11. Our 5-year price target is \$13 suggesting that there is limited upside here. We are forecasting that the yield will come down from 16.9% to 3.4% as we are modeling a dividend cut in 2020.

Safety, Quality, Competitive Advantage, & Recession Resiliency

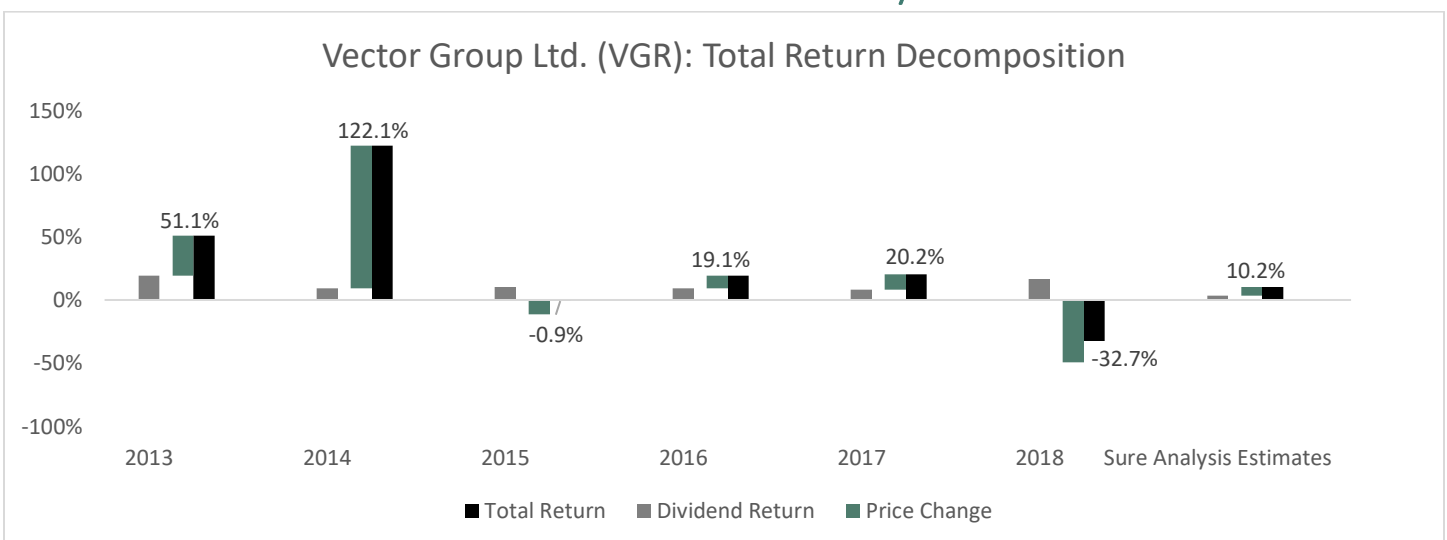
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	306%	217%	306%	442%	130%	438%	317%	280%	263%	416%	420%	91% ²

Vector Group's main advantage is the tobacco business, which tends to have stable revenue and cash flows. We do not believe that the real estate business has a competitive advantage. Operating margins have declined since peaking in 2016 due to headwinds in the Real Estate segment. But of greater concern is that long-term debt has increased over time to pay the dividend and fund operations. Long-term debt was roughly \$541M at end of 2013 and was \$1,387.9M at the end Q1 2019. The company has been able to refinance debt. But Vector Group carries \$850M of 6.125% Senior Secured Notes due in 2025 and \$325M of 10.5% Senior Notes due in 2026 that have restrictive covenants for paying the dividend. The 10.5% notes were issued at the end of 2018 to pay off 7.5% Variable Interest Convertible Notes in cash since the stock was trading below the conversion price. The company also has \$202M of 5.5% Variable Interest Convertible Notes due in 2020 that will likely need to be paid in cash unless the stock price recovers.

Final Thoughts & Recommendation

At present we are forecasting 10.2% annualized returns over the next five years comprising mostly of 3.0% EPS growth, 3.4% yield² and 3.8% from P/E multiple expansion. Despite the current high yield of 16.9%, the potential for a dividend cut is high here due to debt with restrictive covenants, high payout ratio and lack of coverage from operating cash flow. This combined with the high dividend risk score prevents us from recommending this stock. We rate this stock a sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	801	1063	1133	1096	1080	1591	1657	1691	1807	1870
Gross Profit	224	218	240	263	313	494	547	594	579	578
Gross Margin	28.0%	20.5%	21.2%	24.0%	29.0%	31.1%	33.0%	35.1%	32.1%	30.9%
SG&A Exp.	85	91	97	108	114	279	320	339	337	356
D&A Exp.	10	11	11	11	13	24	26	22	19	19
Operating Profit	139	127	143	155	199	215	227	255	242	222
Operating Margin	17.4%	12.0%	12.6%	14.1%	18.5%	13.5%	13.7%	15.1%	13.4%	11.9%
Net Profit	25	54	75	31	37	37	59	71	85	58
Net Margin	3.1%	5.1%	6.6%	2.8%	3.5%	2.3%	3.6%	4.2%	4.7%	3.1%
Free Cash Flow	2	44	24	73	39	84	134	71	112	164
Income Tax	4	31	48	23	24	33	41	49	-2	22

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	736	950	928	1087	1264	1423	1281	1404	1328	1550
Cash & Equivalents	209	300	241	406	234	326	240	394	301	585
Accounts Receivable	8	2	25	11	12	23	24	19	29	34
Inventories	98	107	109	100	93	90	87	90	90	91
Goodwill & Int. Ass.	108	108	108	108	275	270	264	262	268	267
Total Liabilities	740	996	1017	1166	1286	1444	1403	1657	1660	2097
Accounts Payable	4	9	10	6		11	20	11	19	13
Long-Term Debt	357	558	544	624	692	913	865	1172	1228	1643
Shareholder's Equity	-5	-46	-89	-79	-95	-100	-206	-332	-414	-548
D/E Ratio	-76.2	-12.07	-6.11	-7.87	-7.29	-9.16	-4.20	-3.53	-2.97	-3.00

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	3.4%	6.4%	8.0%	3.0%	3.2%	2.7%	4.4%	5.3%	6.2%	4.0%
Return on Equity	171.5%	-212%	-111%	-36.4%	-42.8%	-37.8%	-38.7%	-26.4%	-22.7%	-12.1%
ROIC	7.2%	12.5%	15.5%	6.1%	6.1%	4.7%	7.2%	8.6%	9.3%	5.8%
Shares Out.	N/A	111	112	120	124	139	143	141	141	141
Revenue/Share	7.43	9.64	10.21	9.65	9.22	12.71	11.57	12.34	12.97	13.41
FCF/Share	0.02	0.40	0.22	0.64	0.33	0.67	0.93	0.52	0.80	1.18

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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