



Vector Group Ltd. (VGR)

Updated September 9th, 2019 by Prakash Kolli

Key Metrics

Current Price:	\$13	5 Year CAGR Estimate:	3.6%	Volatility Percentile:	74.5%
Fair Value Price:	\$11	5 Year Growth Estimate:	3.0%	Momentum Percentile:	46.0%
% Fair Value:	112%	5 Year Valuation Multiple Estimate:	-2.2%	Growth Percentile:	16.7%
Dividend Yield:	12.6%	5 Year Price Target	\$13	Valuation Percentile:	47.0%
Dividend Risk Score:	F	Retirement Suitability Score:	C	Total Return Percentile:	41.5%

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. Vector Group also owns New Valley LLC, which is a real estate investment business. The Tobacco segment primarily sells discount cigarette brands including 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 current market capitalization of ~\$1.77B.

Vector Group reported Q2 2019 results on August 7, 2019. Net revenues increased to \$538.3M compared to \$481.5M and diluted GAAP EPS increased to \$0.27 compared to \$0.12 on a year-over-year basis. On an adjusted basis, diluted EPS increased to \$0.29 in the quarter from \$0.19 in the prior year. The Tobacco segment revenues increased to \$294.8M from \$274.8M. Wholesale shipments increased to 2.38 billion from 2.30 billion in comparable periods. On the other hand, retail shipments declined (3.4%) but this was less than the overall industry's retailed shipment decline of (6.1%). Vector's market share increased to 4.2% from 4.1% in the prior year. The Real Estate segment revenue increased to \$243.9M from \$206.7M on a year-over-year basis driven by more closings and the acquisition of the remaining interest of Douglas Elliman Realty. The brokerage closed \$8.9B in sales compared to \$7.5B 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
DPS¹	\$0.98	\$1.04	\$1.10	\$1.15	\$1.21	\$1.27	\$1.33	\$1.40	\$1.47	\$1.54	\$1.60	\$0.40
Shares²	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 the company's 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 annual 3% EPS growth on average out to 2024.

Vector Group pays a regular cash dividend of \$1.60 per share and a 5% stock dividend annually. 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 over 17%.

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 \$458.9M in cash and investments at end of Q2 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.

¹ Adjusted for annual stock dividend of 5%.

² Share count in millions.

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	33.5	30.0
Avg. Yld.	11.1%	9.4%	9.0%	9.4%	9.8%	7.7%	6.9%	7.3%	7.4%	9.2%	12.6%	3.0% ³

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 but has recently recovered. 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 12.9% to 3.4% as we are modeling a dividend cut in 2020.

Safety, Quality, Competitive Advantage, & Recession Resiliency

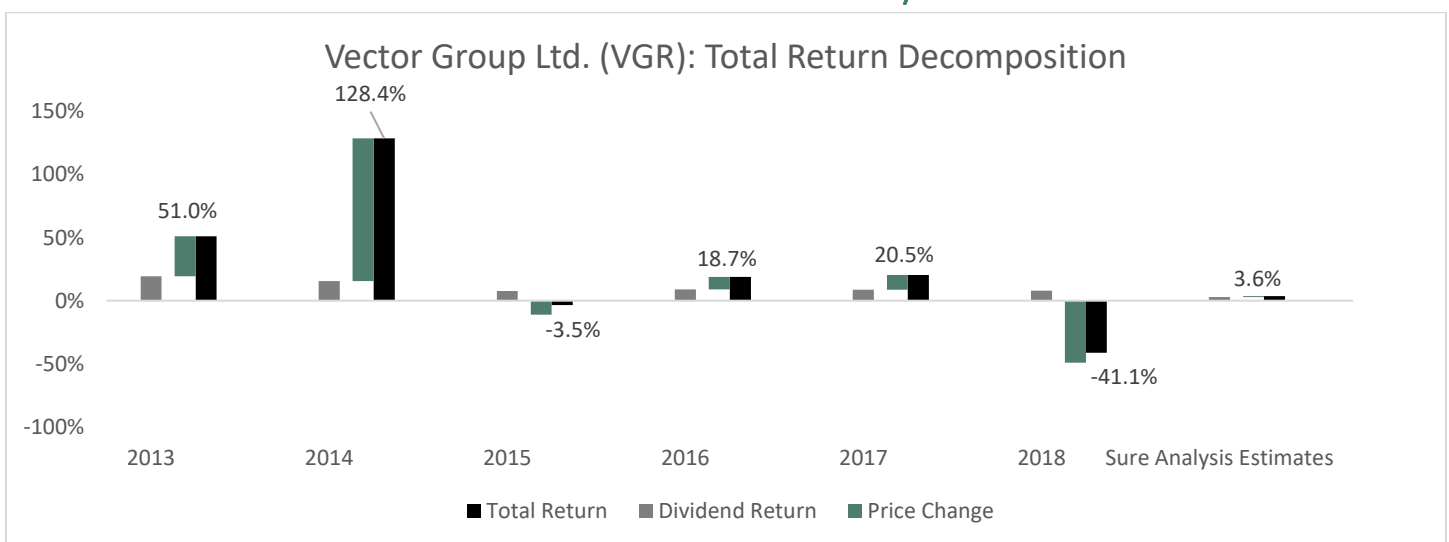
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	306%	217%	306%	442%	130%	438%	317%	280%	263%	416%	420%	91% ³

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 \$1,180.2M at the end Q2 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. The company also has \$213M 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 3.6% annualized returns over the next five years. Despite the current high yield of 12.6%, the potential for a dividend cut is high due to debt with restrictive covenants, high payout ratio and insufficient operating cash flow. Hence, 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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