

Vector Group Ltd. (VGR)

Updated August 17th, 2020 by Prakash Kolli

Key Metrics

Current Price:	\$10	5 Year CAGR Estimate:	6.3%	Market Cap:	\$1.6B
Fair Value Price:	\$8	5 Year Growth Estimate:	3.0%	Ex-Dividend Date:	06/18/20
% Fair Value:	121%	5 Year Valuation Multiple Estimate:	-3.8%	Dividend Payment Date:	06/29/20
Dividend Yield:	8.1%	5 Year Price Target	\$10	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Last Dividend Increase:	0.0%

Overview & Current Events

Vector Group Ltd. is a holding company that is an unusual combination of a cigarette company and real estate firm. The company owns and controls two tobacco companies: 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, which is one of the largest real estate brokerages in New York City and also has operations in South Florida, Beverley Hills, Aspen and Connecticut. The company had revenue of \$1,904M in 2019.

Vector Group reported Q2 2020 results on August 5, 2020. Companywide net revenues declined to \$445.8M compared to \$538.4M and diluted GAAP earnings per share increased to \$0.25 compared to \$0.14 on a year-over-year basis. Tobacco segment revenues increased to \$312.5M from \$243.9M. Wholesale shipments increased to 2.41 billion from 2.38 billion in comparable periods. Retail shipments increased 0.2% versus the overall industry's retail shipment decline of (2.2%). Vector's market share increased to 4.3% from 4.2% in the prior year.

Real Estate segment revenue fell to \$133.3M from \$243.9M on a year-over-year basis driven by lower closings. For the quarter the Real Estate reported a net loss of (\$66.8M) compared to net income of \$6.2M in the prior year.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$0.48	\$0.36	\$0.26	\$0.93	\$0.29	\$0.42	\$0.50	\$0.56	\$0.35	\$0.63	\$0.41	\$0.48
DPS¹	\$1.04	\$1.10	\$1.15	\$1.21	\$1.27	\$1.33	\$1.40	\$1.47	\$1.54	\$1.56	\$0.80	\$0.80
Shares²	111	112	120	124	139	143	141	141	141	148	148	148

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 now expecting a decline in earnings in 2020 due to expected weakness in the real estate segment caused by COVID-19. We anticipate annual 3% earnings per share growth on average after that out to 2025 assuming low single-digit growth for both tobacco and real estate segments.

Vector Group had previously paid a regular cash dividend of \$1.60 per share and a 5% stock dividend annually through 2019. This provided excellent returns to many investors over time. But as we noted in earlier reports, earnings and net operating cash have not covered the dividend in recent years. The company needed to borrow and use debt to pay the dividend. The greater share count from the stock dividend, increase in total debt at higher interest rates, and restrictive covenants on the debt eventually limited the company's ability to pay the dividend. The regular dividend was cut for 2020 and is now \$0.80 per share and the stock dividend was suspended as well. Notably, the new cash dividend of \$0.80 is still not covered by earnings or cash flow. But the company has a reasonable cash position and has recently retired the 5.5% Variable Interest Convertible Notes due in 2020 so no long-term debt is due until 2025.

¹ Adjusted for annual stock dividend of 5% through 2019.

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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	23.1	33.8	46.8	13.2	57.6	45.6	38.5	35.2	45.1	21.3	24.2	20.0
Avg. Yld.	9.4%	9.0%	9.4%	9.8%	7.7%	6.9%	7.3%	7.4%	9.2%	11.9%	8.1%	8.4%

Vector Group's stock price has declined since our last report. That said, the stock is still trading above our fair value estimate. Due to the change in dividend policy and high debt, we have adjusted our fair value multiple for the long haul down to 20.0. Our fair value estimate is now \$8. Our 5-year price target is now \$10.

Safety, Quality, Competitive Advantage, & Recession Resiliency

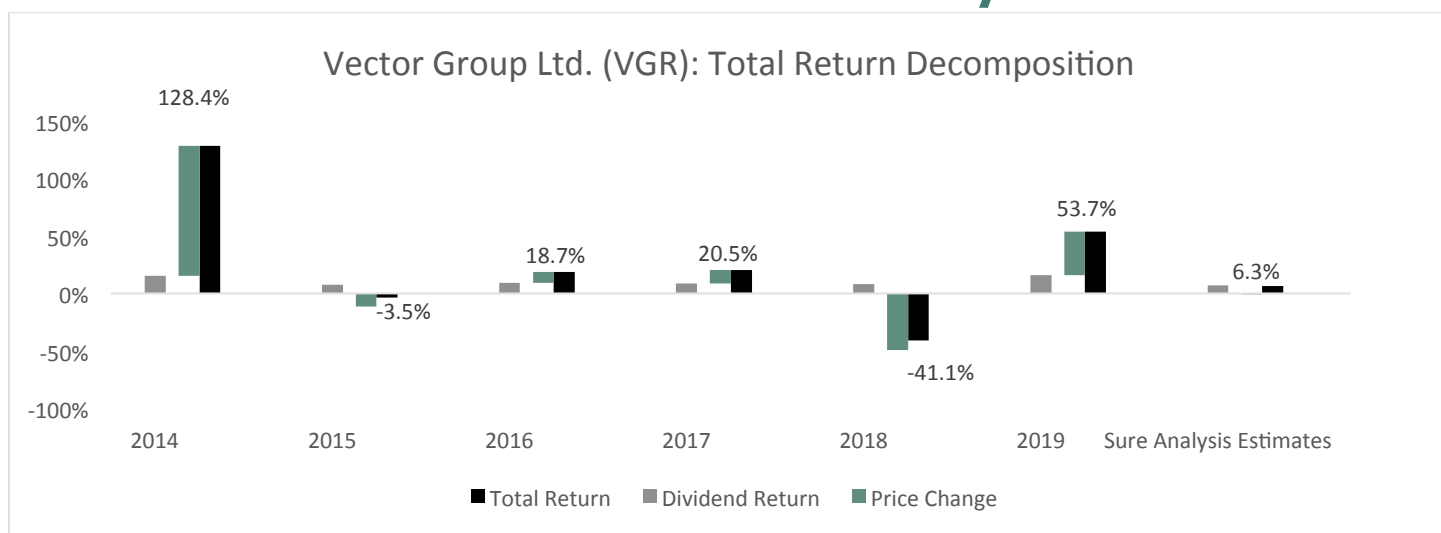
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	217%	306%	442%	130%	438%	317%	280%	263%	416%	248%	195%	168%

Vector Group's main competitive advantage is the tobacco business, which tends to have stable revenue and cash flows. The company's tobacco business has been slowly gaining market share each year. 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. Short-term debt was \$8.9M and long-term debt was \$1,398.2M offset by \$629M in cash, equivalents, and marketable securities at the end of Q2 2020. The company has been able to refinance debt but at high rates. Vector Group carries \$850M of 6.125% Senior Secured Notes due in 2025 and \$551.8M of 10.5% Senior Notes due in 2026 that have restrictive covenants for paying the dividend.

Final Thoughts & Recommendation

At present we are forecasting 6.3% total annualized returns over the next five years. We remain wary of Vector due to the cut to the regular cash dividend, no stock dividend, and high debt. There is still potential for another dividend cut due to debt with restrictive covenants, high payout ratio, and insufficient operating cash flow. We anticipate that 2020 will be a challenging year for Vector Group's Real Estate segment since it focuses on NYC. The high yield may be tempting to some investors, but we do not recommend this stock and rate it a sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	1063	1133	1096	1080	1591	1657	1691	1807	1870	1904
Gross Profit	218	240	263	313	494	547	594	579	578	602
Gross Margin	20.5%	21.2%	24.0%	29.0%	31.1%	33.0%	35.1%	32.1%	30.9%	31.6%
SG&A Exp.	91	97	108	114	279	320	339	337	356	370
D&A Exp.	11	11	11	13	24	26	22	19	19	18
Operating Profit	127	143	155	199	215	227	255	242	222	232
Operating Margin	12.0%	12.6%	14.1%	18.5%	13.5%	13.7%	15.1%	13.4%	11.9%	12.2%
Net Profit	54	75	31	37	37	59	71	85	58	101
Net Margin	5.1%	6.6%	2.8%	3.5%	2.3%	3.6%	4.2%	4.7%	3.1%	5.3%
Free Cash Flow	44	24	73	39	84	134	71	112	164	111
Income Tax	31	48	23	24	33	41	49	-2	22	33

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	950	928	1087	1264	1423	1281	1404	1328	1550	1505
Cash & Equivalents	300	241	406	234	326	240	394	301	585	371
Accounts Receivable	2	25	11	12	23	24	19	29	34	37
Inventories	107	109	100	93	90	87	90	90	91	99
Goodwill & Int. Ass.	108	108	108	275	270	264	262	268	267	266
Total Liabilities	996	1017	1166	1286	1444	1403	1657	1660	2097	2190
Accounts Payable	9	10	6		11	20	11	19	13	10
Long-Term Debt	558	544	624	692	913	865	1172	1228	1643	1606
Shareholder's Equity	-46	-89	-79	-95	-100	-206	-332	-414	-548	-685
D/E Ratio	-12.1	-6.11	-7.87	-7.29	-9.16	-4.20	-3.53	-2.97	-3.00	-2.34

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	6.4%	8.0%	3.0%	3.2%	2.7%	4.4%	5.3%	6.2%	4.0%	6.6%
Return on Equity	-212%	-111%	-36.4%	-42.8%	-37.8%	-38.7%	-26.4%	-22.7%	-12.1%	
ROIC	12.5%	15.5%	6.1%	6.1%	4.7%	7.2%	8.6%	9.3%	5.8%	10.0%
Shares Out.	111	112	120	124	139	143	141	141	141	148
Revenue/Share	9.64	10.21	9.65	9.22	12.71	11.57	12.34	12.97	13.41	12.92
FCF/Share	0.40	0.22	0.64	0.33	0.67	0.93	0.52	0.80	1.18	0.76

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

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