



Vector Group Ltd. (VGR)

Updated March 8th, 2021 by Prakash Kolli

Key Metrics

Current Price:	\$14	5 Year CAGR Estimate:	5.7%	Market Cap:	\$2.15B
Fair Value Price:	\$12	5 Year Growth Estimate:	3.0%	Ex-Dividend Date:	03/18/21
% Fair Value:	112%	5 Year Valuation Multiple Estimate:	-2.3%	Dividend Payment Date:	03/30/21
Dividend Yield:	5.7%	5 Year Price Target	\$14	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	D	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 (NYC) and also has operations in the Hamptons, South Florida, Beverley Hills, Aspen and Connecticut. The company had revenue of \$2,002.7M in 2020.

Vector Group reported Q4 2020 and full year results on February 25, 2021. For the quarter, companywide net revenues increased to \$547.8M compared to \$439.6M and diluted GAAP earnings per share increased to \$0.21 compared to \$0.06 on a year-over-year basis. Tobacco segment revenues increased to \$286.1M from \$260.3M. Wholesale shipments rose to 2.12 billion from 2.07 billion in comparable periods. Retail shipments decreased (0.3%) versus the overall industry's retail shipment gain of 0.6%. Vector's market share declined to 4.21% from 4.25% in the prior year.

Real Estate segment revenue rose to \$268.5M from \$179.2M on a year-over-year basis driven by more sales at Douglas Elliman but reported a net loss of (\$5.0M) compared to net loss of (\$24.9M) in the prior year. The Real Estate segment performance has seemingly stabilized in NYC and performed better in the second half of 2020 despite COVID-19.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	\$0.36	\$0.26	\$0.93	\$0.29	\$0.42	\$0.50	\$0.56	\$0.35	\$0.63	\$0.60	\$0.62	\$0.72
DPS¹	\$1.10	\$1.15	\$1.21	\$1.27	\$1.33	\$1.40	\$1.47	\$1.54	\$1.56	\$0.80	\$0.80	\$0.80
Shares²	112	120	124	139	143	141	141	141	148	148	148	148

Vector Group has consistently grown revenue the past decade. But earnings per share have 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. The company performed better than expected in 2020 due to rising cigarette sales and an improved real estate market in NYC resulting from low interest rates. We anticipate annual 3% earnings per share growth on average out to 2026 assuming low single-digit growth for both 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 current 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	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	33.8	46.8	13.2	57.6	45.6	38.5	35.2	45.1	21.3	19.4	22.5	20.0
Avg. Yld.	9.0%	9.4%	9.8%	7.7%	6.9%	7.3%	7.4%	9.2%	11.9%	6.9%	5.7%	5.6%

Vector Group's stock price is up since our last report on the strength of higher revenue in both segments. We expect earnings per share of \$0.62 in 2021. But the stock is still trading above our fair value multiple for the long haul of 20X. Our fair value estimate is now \$12. Our 5-year price target is now \$14.

Safety, Quality, Competitive Advantage, & Recession Resiliency

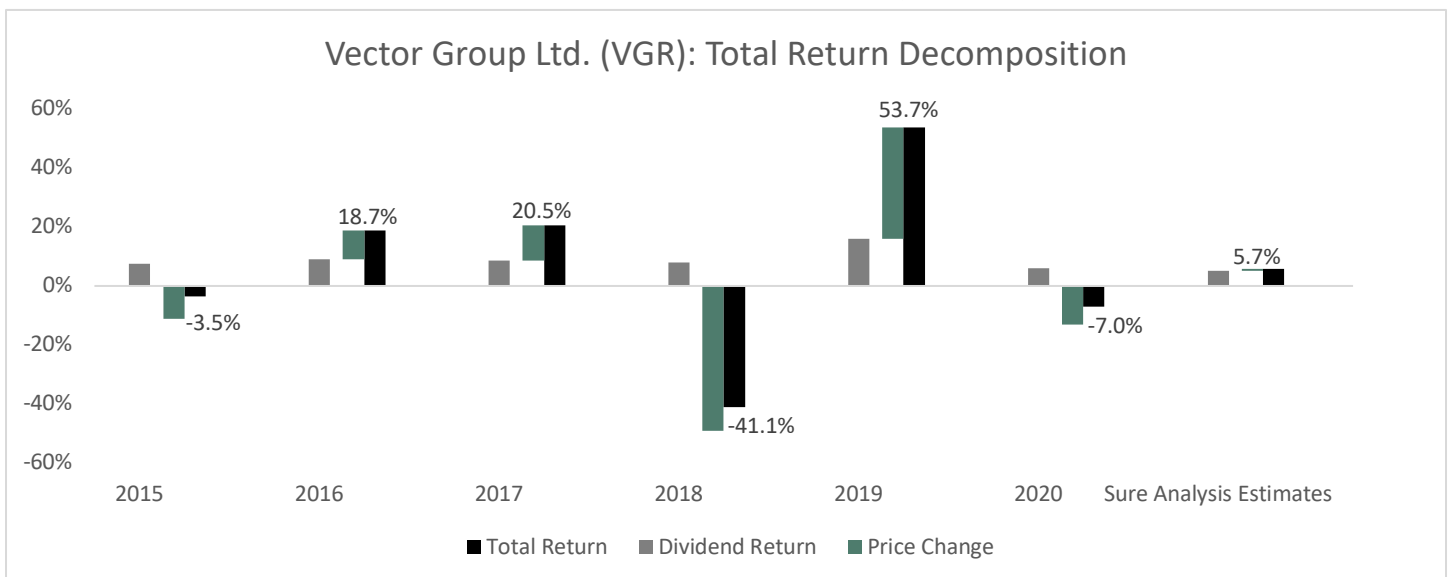
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	306%	442%	130%	438%	317%	280%	263%	440%	248%	133%	129%	111%

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 gained market share each year in the past due to the cost advantage of its discount brands. 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 \$12.6M and long-term debt was \$1,393.7M offset by \$488.4M in cash, equivalents, and marketable securities at the end of 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 \$551.9M of 10.5% Senior Notes due in 2026 that have restrictive covenants for paying the dividend.

Final Thoughts & Recommendation

At present we are forecasting 5.7% total annualized returns over the next five years. We remain negative about Vector due to the cut in the regular cash dividend, suspended stock dividend, and high debt. The company's business segments recovered in the second half of 2020 as cigarette sales rose and NYC's real estate market recovered. The high yield may be alluring, but the dividend may be cut again due to debt with restrictive covenants, payout ratio over 100%, and insufficient cash flow coverage. We do not recommend this stock and rate it a sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	1133	1096	1080	1591	1657	1691	1807	1870	1904	2003
Gross Profit	240	263	313	494	547	594	579	578	602	636
Gross Margin	21.2%	24.0%	29.0%	31.1%	33.0%	35.1%	32.1%	30.9%	31.6%	31.7%
SG&A Exp.	97	108	114	279	320	339	337	356	370	330
D&A Exp.	11	11	13	24	26	22	19	19	18	18
Operating Profit	143	155	199	215	227	255	242	222	232	306
Operating Margin	12.6%	14.1%	18.5%	13.5%	13.7%	15.1%	13.4%	11.9%	12.2%	15.3%
Net Profit	75	31	37	37	59	71	85	58	101	93
Net Margin	6.6%	2.8%	3.5%	2.3%	3.6%	4.2%	4.7%	3.1%	5.3%	4.6%
Free Cash Flow	24	73	39	84	134	71	112	164	111	248
Income Tax	48	23	24	33	41	49	-2	22	33	42

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	928	1087	1264	1423	1281	1404	1328	1550	1505	1343
Cash & Equivalents	241	406	234	326	240	394	301	585	371	353
Accounts Receivable	25	11	12	23	24	19	29	34	37	41
Inventories	109	100	93	90	87	90	90	91	99	98
Goodwill & Int. Ass.	108	108	275	270	264	262	268	267	266	208
Total Liabilities	1017	1166	1286	1444	1403	1657	1660	2097	2190	2003
Accounts Payable	10	6		11	20	11	19	13	10	13
Long-Term Debt	544	624	692	913	865	1172	1228	1643	1606	1406
Shareholder's Equity	-89	-79	-95	-100	-206	-332	-414	-548	-685	-660
D/E Ratio	-6.11	-7.87	-7.29	-9.16	-4.20	-3.53	-2.97	-3.00	-2.34	-2.13

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	8.0%	3.0%	3.2%	2.7%	4.4%	5.3%	6.2%	4.0%	6.6%	6.5%
Return on Equity	-111%	-36.4%	-42.8%	-37.8%	-38.7%	-26.4%	-22.7%	-12.1%		
ROIC	15.5%	6.1%	6.1%	4.7%	7.2%	8.6%	9.3%	5.8%	10.0%	11.1%
Shares Out.	112	120	124	139	143	141	141	141	148	148
Revenue/Share	10.21	9.65	9.22	12.71	11.57	12.34	12.97	13.41	12.92	13.33
FCF/Share	0.22	0.64	0.33	0.67	0.93	0.52	0.80	1.18	0.76	1.65

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

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