



Vector Group Ltd. (VGR)

Updated November 25th, 2022 by Prakash Kolli

Key Metrics

| | | | | | |
|-----------------------------|------|--|------|----------------------------------|----------|
| Current Price: | \$11 | 5 Year CAGR Estimate: | 9.2% | Market Cap: | \$1.69B |
| Fair Value Price: | \$11 | 5 Year Growth Estimate: | 3.0% | Ex-Dividend Date: | 12/09/22 |
| % Fair Value: | 98% | 5 Year Valuation Multiple Estimate: | 0.4% | Dividend Payment Date: | 12/20/22 |
| Dividend Yield: | 7.4% | 5 Year Price Target | \$13 | Years Of Dividend Growth: | 0 |
| Dividend Risk Score: | F | Retirement Suitability Score: | C | Rating: | Hold |

Overview & Current Events

Vector Group Ltd. is a holding company that is a 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 Montego, Eagle 20's, Pyramid, Grand Prix, Liggett Select, and Eve. Vector Group spun off Douglas Elliman Realty, the 6th largest real estate brokerage in the US, in 2021. Around 8% of the share are owned by management and directors. The company had revenue of \$1,220.7M in 2021.

Vector Group reported Q3 2022 results on November 1st, 2022. Companywide net revenue rose 26.6% to \$378.0M compared to \$297.9M and diluted GAAP earnings per share decreased to \$0.25 compared to \$0.31 on a year-over-year basis mostly on the discontinued real estate operations. But the firm still owns commercial real estate properties.

Wholesale shipments rose 30.1% to 2.75 billion from 2.11 billion in comparable periods compared to a (-10.7%) decline for the industry. Vector's wholesale market share increased to 5.7% from 4.2% in the prior year. Retail shipments increased 22.78% versus the overall industry's retail shipment decline of (-8.5%). Vector's retail market share increased to 5.4% from 4.2% in the prior year. Vector's revenue and market share is benefitting from expanded distribution of its low-price Montego brand, but this investment is affecting overall profitability.

Growth on a Per-Share Basis

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2027 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| EPS¹ | \$0.26 | \$0.93 | \$0.29 | \$0.42 | \$0.50 | \$0.56 | \$0.35 | \$0.63 | \$0.60 | \$1.12 | \$0.92 | \$1.07 |
| DPS² | \$1.15 | \$1.21 | \$1.27 | \$1.33 | \$1.40 | \$1.47 | \$1.54 | \$1.56 | \$0.80 | \$0.80 | \$0.80 | \$0.80 |
| Shares³ | 120 | 131 | 146 | 151 | 148 | 148 | 148 | 148 | 153 | 154 | 154 | 154 |

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 impairment charges against it. After the NYC real estate market improved in 2021, Vector spun off the Douglas Elliman Realty business into a separate company. After 2022, we anticipate annual 3% earnings per share growth on average out to 2027 assuming low single-digit growth for cigarette revenue on higher prices and volumes.

Vector Group had previously paid a regular cash dividend of \$1.60 per share and a 5% stock dividend annually through 2019. However, as we noted in earlier reports, earnings and net operating cash did not cover the dividend in recent years. The company needed to 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. Dividend coverage has improved recently due to higher earnings, reasonable cash position, and retirement of the 5.5% Variable Interest Convertible Notes due in 2020. No long-term debt is due until 2026.

¹ VGR spun off Douglas Elliman in 2021, which is treated as discontinued operations from 2021.

² Adjusted for annual stock dividend of 5% through 2019.

³ 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 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | Now | 2027 |
|-----------|------|------|------|------|------|------|------|-------|------|------|-------------|-------------|
| Avg. P/E | 46.8 | 13.2 | 57.6 | 45.6 | 38.5 | 35.2 | 45.1 | 17.2 | 12.0 | 15.0 | 11.8 | 12.0 |
| Avg. Yld. | 9.4% | 9.8% | 7.7% | 6.9% | 7.3% | 7.4% | 9.2% | 14.2% | 7.3% | 5.7% | 7.4% | 6.6% |

Vector Group's stock price is down again since our last report. Our earnings per share estimate is down to \$0.92 in 2022, matching consensus. Our fair value multiple for the long haul is now 12X, accounting for recent challenges and the spinoff of Douglas Elliman. Our fair value estimate is now \$11. Our 5-year price target is now \$13.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2027 |
|--------|------|------|------|------|------|------|------|------|------|------|------------|------------|
| Payout | 442% | 130% | 438% | 317% | 280% | 263% | 440% | 248% | 133% | 71% | 87% | 75% |

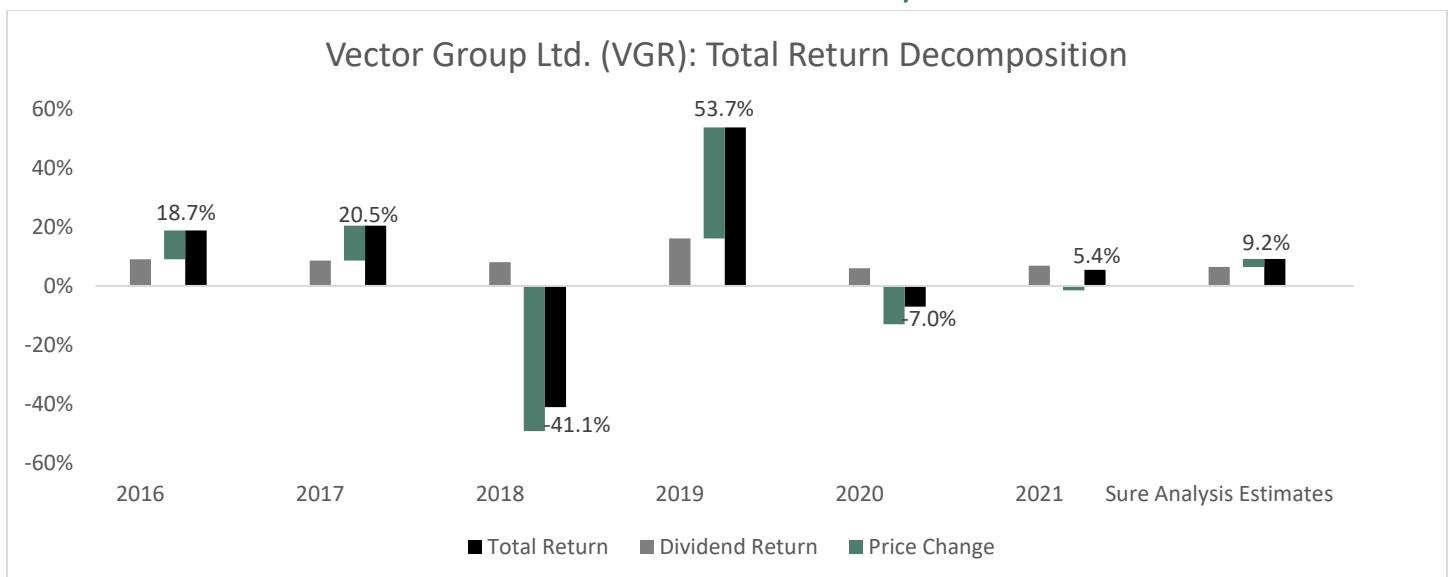
Vector Group's main competitive advantage is the tobacco business, which tends to have stable cash flows. The company focuses on tobacco outlets and discount stores for its value brands. However, e-cigarettes represent a threat and cigarette sales are in a secular decline. The New Valley business does not have a competitive advantage.

Of greater concern is that long-term debt has increased over time to pay the dividend and fund operations. Short-term and current long-term debt was \$51M and long-term debt was \$1,389.2M offset by \$500.8M in cash, equivalents, and marketable securities at the end of Q3 2022. The company has been able to refinance debt but at high rates. Vector Group carries \$875M of 5.75% Senior Secured Notes due in 2029 and \$539.8M of 10.5% Senior Notes due in 2026 that have restrictive covenants for paying the dividend.

Final Thoughts & Recommendation

At present we are forecasting 9.2% total annualized return over the next five years from a dividend yield of 7.4%, 3.0% EPS growth, and 0.4% P/E multiple expansion. Vector's operational performance is improving as it focuses on cigarettes and inflation moves consumers to lower priced brands. However, despite this, and balance sheet improvements, we remain negative for the long-term about Vector due to the cut in the regular cash dividend, suspended stock dividend, high debt, and secular decline of cigarette volumes. We still do not recommend this stock but upped our rating to a hold.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenue | 1096 | 1080 | 1591 | 1657 | 1691 | 1807 | 1870 | 1904 | 2003 | 1221 |
| Gross Profit | 263 | 313 | 494 | 547 | 594 | 579 | 578 | 602 | 636 | 451 |
| Gross Margin | 24.0% | 29.0% | 31.1% | 33.0% | 35.1% | 32.1% | 30.9% | 31.6% | 31.7% | 36.9% |
| SG&A Exp. | 108 | 114 | 279 | 320 | 339 | 337 | 356 | 370 | 330 | 131 |
| D&A Exp. | 11 | 13 | 24 | 26 | 22 | 19 | 19 | 18 | 18 | 16 |
| Operating Profit | 155 | 199 | 215 | 227 | 255 | 242 | 222 | 232 | 306 | 320 |
| Operating Margin | 14.1% | 18.5% | 13.5% | 13.7% | 15.1% | 13.4% | 11.9% | 12.2% | 15.3% | 26.2% |
| Net Profit | 31 | 37 | 37 | 59 | 71 | 85 | 58 | 101 | 93 | 219 |
| Net Margin | 2.8% | 3.5% | 2.3% | 3.6% | 4.2% | 4.7% | 3.1% | 5.3% | 4.6% | 17.9% |
| Free Cash Flow | 73 | 39 | 84 | 134 | 71 | 112 | 164 | 111 | 248 | 242 |
| Income Tax | 23 | 24 | 33 | 41 | 49 | -2 | 22 | 33 | 42 | 63 |

Balance Sheet Metrics

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Total Assets | 1087 | 1264 | 1423 | 1281 | 1404 | 1328 | 1550 | 1505 | 1343 | 871 |
| Cash & Equivalents | 406 | 234 | 326 | 240 | 394 | 301 | 585 | 371 | 353 | 193 |
| Accounts Receivable | 11 | 12 | 23 | 24 | 19 | 29 | 34 | 37 | 41 | 16 |
| Inventories | 100 | 93 | 90 | 87 | 90 | 90 | 91 | 99 | 98 | 95 |
| Goodwill & Int. Ass. | 108 | 275 | 270 | 264 | 262 | 268 | 267 | 266 | 208 | 108 |
| Total Liabilities | 1166 | 1286 | 1444 | 1403 | 1657 | 1660 | 2097 | 2190 | 2003 | 1713 |
| Accounts Payable | 6 | | 11 | 20 | 11 | 19 | 13 | 10 | 13 | 9 |
| Long-Term Debt | 624 | 692 | 913 | 865 | 1172 | 1228 | 1643 | 1606 | 1406 | 1399 |
| Shareholder's Equity | -79 | -95 | -100 | -206 | -332 | -414 | -548 | -685 | -660 | -842 |
| D/E Ratio | -7.87 | -7.29 | -9.16 | -4.20 | -3.53 | -2.97 | -3.00 | -2.34 | -2.13 | -1.67 |

Profitability & Per Share Metrics

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|-------------------------|--------|--------|--------|--------|--------|--------|--------|-------|-------|-------|
| Return on Assets | 3.0% | 3.2% | 2.7% | 4.4% | 5.3% | 6.2% | 4.0% | 6.6% | 6.5% | 19.8% |
| Return on Equity | -36.4% | -42.8% | -37.8% | -38.7% | -26.4% | -22.7% | -12.1% | | | |
| ROIC | 6.1% | 6.1% | 4.7% | 7.2% | 8.6% | 9.3% | 5.8% | 10% | 11.1% | 34.3% |
| Shares Out. | 120 | 124 | 139 | 143 | 141 | 141 | 141 | 148 | 148 | 152 |
| Revenue/Share | 9.65 | 9.22 | 12.71 | 11.57 | 12.34 | 12.97 | 13.41 | 12.92 | 13.33 | 8.00 |
| FCF/Share | 0.64 | 0.33 | 0.67 | 0.93 | 0.52 | 0.80 | 1.18 | 0.76 | 1.65 | 1.59 |

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

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