

VECTOR GROUP LTD
 Form 10-K
 February 24, 2012
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SECURITIES AND EXCHANGE COMMISSION
 Washington, D.C. 20549

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
 SECURITIES EXCHANGE ACT OF 1934
 For The Fiscal Year Ended December 31, 2011

VECTOR GROUP LTD.
 (Exact name of registrant as specified in its charter)

Delaware	1-5759	65-0949535
(State or other jurisdiction of incorporation incorporation or organization)	Commission File Number	(I.R.S. Employer Identification No.)
100 S.E. Second Street, Miami, Florida	33131	
(Address of principal executive offices)	(Zip Code)	
(305) 579-8000		
(Registrant's telephone number, including area code)		

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value \$.10 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. R Yes No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. R Yes No

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). R Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statement incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer R Accelerated filer Non-accelerated filer Smaller reporting company

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(Do not check if a smaller reporting company)

Indicate by check mark whether the Registrant is a shell company as defined in Rule 12b-2 of the Exchange Act. Yes No

The aggregate market value of the common stock held by non-affiliates of Vector Group Ltd. as of June 30, 2011 was approximately \$734 million.

At February 24, 2012, Vector Group Ltd. had 79,445,087 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE:

Part III (Items 10, 11, 12, 13 and 14) from the definitive Proxy Statement for the 2012 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission no later than 120 days after the end of the Registrant's fiscal year covered by this report.

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PART I

ITEM 1. BUSINESS

Overview

Vector Group Ltd., a Delaware corporation, is a holding company and is principally engaged in: the manufacture and sale of cigarettes in the United States through our Liggett Group LLC (“Liggett”) and Vector Tobacco Inc. (“Vector Tobacco”) subsidiaries, and the real estate business through our New Valley LLC subsidiary, which is seeking to acquire additional operating companies and real estate properties. New Valley owns 50% of Douglas Elliman Realty, LLC, which operates the largest residential brokerage company in the New York metropolitan area.

Financial information relating to our business segments can be found in Note 17 to our consolidated financial statements. Our significant business segments for the year ended December 31, 2011 were Tobacco and Real Estate. The Tobacco segment consists of the manufacture and sale of cigarettes. The Real Estate segment includes the Company’s investments in consolidated and non-consolidated real estate businesses.

Strategy

Our strategy is to maximize stockholder value by increasing the profitability of our subsidiaries in the following ways:

Liggett and Vector Tobacco

• Capitalize upon our tobacco subsidiaries’ cost advantage in the U.S. cigarette market due to the favorable treatment that they receive under the Master Settlement Agreement,

• Focus marketing and selling efforts on the discount segment, continue to build volume and margin in core discount brands (PYRAMID, GRAND PRIX, LIGGETT SELECT and EVE) and utilize core brand equity to selectively build distribution,

• Continue product development to provide the best quality products relative to other discount products in the marketplace,

• Increase efficiency by developing and adopting an organizational structure to maximize profit potential,

• Selectively expand the portfolio of private and control label partner brands utilizing a pricing strategy that offers long-term list price stability for customers,

• Identify, develop and launch relevant new cigarette brands and other tobacco products to the market in the future, and

• Pursue strategic acquisitions of smaller tobacco manufacturers.

New Valley

• Continue to grow Douglas Elliman Realty operations by utilizing its strong brand name recognition and pursuing strategic and financial opportunities,

• Continue to leverage our expertise as direct investors by actively pursuing real estate investments in the United States and abroad which we believe will generate above-market returns,

• Acquire operating companies through mergers, asset purchases, stock acquisitions or other means, and

• Invest our excess funds opportunistically in situations that we believe can maximize stockholder value.

Tobacco Operations

General. Liggett is the operating successor to Liggett & Myers Tobacco Company, which was founded in 1873. In April 2002, we acquired The Medallion Company, Inc. (“Medallion”), a discount cigarette manufacturer selling product in the deep discount category, primarily under the USA brand name. Vector Tobacco merged into Medallion which then changed its name to “Vector Tobacco Inc.” In this report, certain references to “Liggett” refer to our tobacco operations, including the business of Liggett and Vector Tobacco, unless otherwise specified.

For the year ended December 31, 2011, Liggett was the fourth-largest manufacturer of cigarettes in the United States in terms of unit sales. Liggett’s manufacturing facilities are located in Mebane, North Carolina where it manufactures most of Vector Tobacco’s cigarettes pursuant to a contract manufacturing agreement. At the present time, Liggett and Vector Tobacco have no foreign operations.

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Our tobacco subsidiaries manufacture and sell cigarettes in the United States. According to data from Management Science Associates, Inc., Liggett's domestic shipments of approximately 11.0 billion cigarettes during 2011 accounted for 3.8% of the total cigarettes shipped in the United States during such year. Liggett's market share increased 0.3% in 2011 from 3.5% in 2010. Market share in 2009 was 2.7%. Historically, Liggett produced premium cigarettes as well as discount cigarettes (which include among others, control label, private label, branded discount and generic cigarettes). Premium cigarettes are generally marketed under well-recognized brand names at higher retail prices to adult smokers with a strong preference for branded products, whereas discount cigarettes are marketed at lower retail prices to adult smokers who are more cost conscious. In recent years, the discounting of premium cigarettes has become far more significant in the marketplace. This has led to some brands that were traditionally considered premium brands becoming more appropriately categorized as branded discount, following list price reductions. Liggett's EVE brand falls into that category. All of Liggett's unit sales volume in 2011, 2010 and 2009 was in the discount segment, which Liggett's management believes has been the primary growth segment in the industry for more than a decade.

Liggett produces cigarettes in approximately 118 combinations of length, style and packaging. Liggett's current brand portfolio includes:

- **PYRAMID** — the industry's first deep discount product with a brand identity relaunched in the second quarter of 2009,
- **GRAND PRIX** — re-launched as a national brand in 2005,
- **LIGGETT SELECT** — a leading brand in the deep discount category,
- **EVE** — a leading brand of 120 millimeter cigarettes in the branded discount category, and
- **USA** and various Partner Brands and private label brands.

In 1999, Liggett introduced LIGGETT SELECT, one of the leading brands in the deep discount category. LIGGETT SELECT represented 8.7% in 2011, 13.0% in 2010 and 21.5% in 2009 of Liggett's unit volume. In September 2005, Liggett repositioned GRAND PRIX to distributors and retailers nationwide. GRAND PRIX represented 12.7% in 2011, 18.5% in 2010 and 27.9% in 2009 of Liggett's unit volume. In April 2009, Liggett repositioned PYRAMID as a box-only brand with a new low price to specifically compete with brands which are priced at the lowest level of the deep discount segment. PYRAMID is now the largest seller in Liggett's family of brands with 56.4% of Liggett's unit volume in 2011, 42.6% in 2010 and 14.6% in 2009. According to Management Science Associates, Liggett held a share of approximately 12.8% of the overall discount market segment for 2011 compared to 11.9% for 2010 and 9.2% for 2009.

Liggett Vector Brands LLC ("LVB"), which coordinates our tobacco subsidiaries' sales and marketing efforts, along with certain support functions, has an agreement with Circle K Stores, Inc., which operates more than 3,300 convenience stores in the United States under the Circle K and Mac's names, to supply MONTEGO, a deep discount brand, exclusively for the Circle K and Mac's stores. The MONTEGO brand was the first to be offered under LVB's "Partner Brands" program which offers customers quality product with long-term price stability. LVB also has an agreement with Sunoco Inc., which operates approximately 675 Sunoco APlus branded convenience stores in the United States, to manufacture SILVER EAGLE. SILVER EAGLE, a deep discount brand, is exclusive to Sunoco and was the second brand to be offered under LVB's "Partner Brands" program. Liggett also manufactures BRONSON cigarettes as part of a multi-year "Partner Brands" agreement with QuikTrip, a convenience store chain with more than 580 stores headquartered in Tulsa, Oklahoma.

Under the Master Settlement Agreement ("MSA") reached in November 1998 with 46 states and various territories, the three largest cigarette manufacturers must make settlement payments to the states and territories based on how many cigarettes they sell annually. Liggett, however, is not required to make any payments unless its market share exceeds approximately 1.65% of the U.S. cigarette market. Additionally, Vector Tobacco has no payment obligation unless its market share exceeds approximately 0.28% of the U.S. cigarette market. We believe our tobacco subsidiaries have a sustainable cost advantage over their competitors as a result of the settlement.

Liggett's and Vector Tobacco's payments under the MSA are based on each respective company's incremental market share above the minimum threshold applicable to each respective company. Thus, if Liggett's total market share is 3%, its MSA payment is based on 1.35%, which is the difference between Liggett's total market share of 3% and its approximate applicable grandfathered share of 1.65%. We anticipate that both Liggett's and Vector Tobacco's payment

exemptions will be fully utilized in the foreseeable future.

The source of industry data in this report is Management Science Associates, Inc., an independent third-party database management organization that collects wholesale shipment data from various cigarette manufacturers and distributors and provides analysis of market share, unit sales volume and premium versus discount mix for individual companies and the industry as a whole. Management Science Associates' information relating to unit sales volume and market share of certain of the smaller, primarily deep discount, cigarette manufacturers is based on estimates developed by Management Science Associates.

Business Strategy. Liggett's business strategy is to capitalize upon its cost advantage in the United States cigarette market resulting from the favorable treatment our tobacco subsidiaries receive under settlement agreements with the states and the MSA.

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Liggett's long-term business strategy is to continue to focus its marketing and selling efforts on the discount segment of the market, to continue to build volume and margin in its core discount brands (PYRAMID, GRAND PRIX, LIGGETT SELECT and EVE) and to utilize its core brand equity to selectively build distribution. Liggett intends to continue its product development to provide the best quality products relative to other discount products in the market place. Liggett will continue to seek increases in efficiency by developing and adapting its organizational structure to maximize profit potential. Liggett intends to expand the portfolio of its private and control label and "Partner Brands" utilizing a pricing strategy that offers long-term list price stability for customers. In addition, Liggett may bring niche-driven brands to the market in the future.

Sales, Marketing and Distribution. Liggett's products are distributed from a central distribution center in Mebane, North Carolina to 16 public warehouses located throughout the United States. These warehouses serve as local distribution centers for Liggett's customers. Liggett's products are transported from the central distribution center to the public warehouses by third-party trucking companies to meet pre-existing contractual obligations to its customers. Liggett's customers are primarily candy and tobacco distributors, the military and large grocery, drug and convenience store chains. One customer accounted for 17%, 17% and 18% of Liggett's revenues in 2011, 2010 and 2009. Concentrations of credit risk with respect to trade receivables are generally limited due to the large number of customers, located primarily throughout the United States, comprising Liggett's customer base. Liggett's largest single customer represented approximately 52% and 31% of net accounts receivable at December 31, 2011 and 2010, respectively. Ongoing credit evaluations of customers' financial condition are performed and, generally, no security is required. Liggett maintains reserves for potential credit losses and such losses, in the aggregate, have generally not exceeded management's expectations.

Trademarks. All of the major trademarks used by Liggett are federally registered or are in the process of being registered in the United States and other markets. Trademark registrations typically have a duration of ten years and can be renewed at Liggett's option prior to their expiration date.

In view of the significance of cigarette brand awareness among consumers, management believes that the protection afforded by these trademarks is material to the conduct of its business. Liggett owns all of its domestic trademarks except for the JADE trademark, which is licensed on a long-term exclusive basis from a third-party for use in connection with cigarettes. These trademarks are pledged as collateral for certain of our senior secured debt.

Manufacturing. Liggett purchases and maintains leaf tobacco inventory to support its cigarette manufacturing requirements. Liggett believes that there is a sufficient supply of tobacco within the worldwide tobacco market to satisfy its current production requirements. Liggett stores its leaf tobacco inventory in warehouses in North Carolina and Virginia. There are several different types of tobacco, including flue-cured leaf, burley leaf, Maryland leaf, oriental leaf, cut stems and reconstituted sheet. Leaf components of American-style cigarettes are generally the flue-cured and burley tobaccos. While premium and discount brands use many of the same tobacco products, input ratios of tobacco products may vary between premium and discount products. Foreign flue-cured and burley tobaccos, some of which are used in the manufacture of Liggett's cigarettes, have historically been 30% to 35% less expensive than comparable domestic tobaccos. However, in recent years, domestic and foreign tobacco prices have begun to equalize. Liggett normally purchases all of its tobacco requirements from domestic and foreign leaf tobacco dealers, much of it under long-term purchase commitments. As of December 31, 2011, the majority of Liggett's commitments were for the purchase of foreign tobacco.

Liggett's cigarette manufacturing facility was designed for the execution of short production runs in a cost-effective manner, which enables Liggett to manufacture and market a wide variety of cigarette brand styles. Liggett produces cigarettes in approximately 118 different brand styles as well as private labels for other companies, typically retail or wholesale distributors who supply supermarkets and convenience stores.

Liggett's facility produced approximately 11.0 billion cigarettes in 2011, but maintains the capacity to produce approximately 18.3 billion cigarettes per year. Vector Tobacco has contracted with Liggett to produce most of its cigarettes at Liggett's manufacturing facility in Mebane.

Quality Control and Research. Expenditures by Liggett for quality control, research and development activities were \$1.012 million in 2011, \$1.058 million in 2010 and \$933,000 in 2009. Vector Tobacco had been engaged in research relating to reduced risk cigarette products. Expenditures by Vector Tobacco for research and development activities

were \$140,000 in 2011, \$524,000 in 2010 and \$1.6 million in 2009.

Competition. Liggett's competition is divided into two segments. The first segment is made up of the three largest manufacturers of cigarettes in the United States: Philip Morris USA Inc., Reynolds American Inc. and Lorillard Tobacco Company. These three manufacturers, while primarily premium cigarette based companies, also produce and sell discount cigarettes.

The second segment of competition is comprised of a group of smaller manufacturers and importers, most of which sell deep discount cigarettes. Our largest competitor in this segment is Commonwealth Brands, Inc., which was acquired by Imperial Tobacco in 2007.

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Historically, there have been substantial barriers to entry into the cigarette business, including extensive distribution organizations, large capital outlays for sophisticated production equipment, substantial inventory investment, costly promotional spending, regulated advertising and, for premium brands, strong brand loyalty. However, in recent years, a number of smaller manufacturers have been able to overcome these competitive barriers due to excess production capacity in the industry and the cost advantage for certain manufacturers and importers resulting from the MSA. Many smaller manufacturers and importers that are not parties to the MSA have been impacted in recent years by the state statutes enacted pursuant to the MSA and have begun to see a decrease in volume after years of growth. Liggett's management believes, while these companies still have significant market share through competitive discounting in this segment, they are losing their cost advantage as their payment obligations under these statutes increase.

In the cigarette business, Liggett competes on a dual front. The three major manufacturers compete among themselves for premium brand market share based on advertising and promotional activities, and trade rebates and incentives and compete with Liggett and others for discount market share, on the basis of brand loyalty. These three competitors have substantially greater financial resources than Liggett, and most of their brands have greater sales and consumer recognition than Liggett's products. Liggett's discount brands must also compete in the marketplace with the smaller manufacturers' and importers' deep discount brands.

According to Management Science Associates' data, the unit sales of Philip Morris, Reynolds American and Lorillard accounted in the aggregate for approximately 84.7% of the domestic cigarette market in 2011. Liggett's domestic shipments of approximately 11.0 billion cigarettes during 2011 accounted for 3.8% of the approximately 293 billion cigarettes shipped in the United States, compared to 10.7 billion cigarettes in 2010 (3.5%) and 8.6 billion cigarettes in 2009 (2.7%).

Industry-wide shipments of cigarettes in the United States have been declining for a number of years, with Management Science Associates' data indicating that domestic industry-wide shipments decreased by approximately 3.5% (approximately 10.7 billion units) in 2011. Liggett's management believes that industry-wide shipments of cigarettes in the United States will continue to decline as a result of numerous factors. These factors include health considerations, diminishing social acceptance of smoking, and a wide variety of federal, state and local laws limiting smoking in restaurants, bars and other public places, as well as increases in federal and state excise taxes and settlement-related expenses which have contributed to higher cigarette prices in recent years.

Historically, because of their dominant market share, Philip Morris and RJR Tobacco (which is now part of Reynolds American), the two largest cigarette manufacturers, have been able to determine cigarette prices for the various pricing tiers within the industry. Market pressures have historically caused the other cigarette manufacturers to bring their prices in line with the levels established by these two major manufacturers. Off-list price discounting and similar promotional activity by manufacturers, however, has substantially affected the average price differential at retail, which can be significantly less than the manufacturers' list price gap. Recent discounting by manufacturers has been far greater than historical levels, and the actual price gap between premium and deep-discount cigarettes has changed accordingly. This has led to shifts in price segment performance depending upon the actual price gaps of products at retail.

Philip Morris and Reynolds American dominate the domestic cigarette market with a combined market share of approximately 71% at December 31, 2011. This concentration of United States market share makes it more difficult for Liggett to compete for shelf space in retail outlets and could impact price competition in the market, either of which could have a material adverse affect on its sales volume, operating income and cash flows.

Legislation, Regulation and Litigation

In the United States, tobacco products are subject to substantial and increasing legislation, regulation and taxation, which has a negative effect on revenue and profitability. In June 2009, legislation was passed providing for regulation of the tobacco industry by the United States Food and Drug Administration. See Item 7. "Management Discussion and Analysis of Financial Condition and Results of Operations — Legislation and Regulation".

The cigarette industry continues to be challenged on numerous fronts. The industry is facing increased pressure from anti-smoking groups and continued smoking and health litigation, including class action litigation and health care cost

recovery actions brought by governmental entities and other third parties, the effects of which, at this time, we are unable to evaluate. As of December 31, 2011, there were approximately 5,800 individual suits (including Engle progeny cases), six purported class actions or actions where class certification has been sought and one health care cost recovery action pending in the United States in which Liggett and/or Vector were named defendants. See Item 3. "Legal Proceedings" and Note 12 to our consolidated financial statements, which contain a description of litigation. It is possible that our consolidated financial position, results of operations or cash flows could be materially adversely affected by an unfavorable outcome in any tobacco-related litigation or as a result of additional federal or state regulation relating

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to the manufacture, sale, distribution, advertising or labeling of tobacco products.

Liggett's management believes that it is in compliance in all material respects with the laws regulating cigarette manufacturers.

The Master Settlement Agreement and Other State Settlement Agreements

In March 1996, March 1997 and March 1998, Liggett entered into settlements of tobacco-related litigation with 46 states and territories. The settlements released Liggett from all tobacco-related claims within those states and territories, including claims for health care cost reimbursement and claims concerning sales of cigarettes to minors. In November 1998, Philip Morris, Brown & Williamson, R.J. Reynolds and Lorillard (the "Original Participating Manufacturers" or "OPMs") and Liggett (together with any other tobacco product manufacturer that becomes a signatory, the "Subsequent Participating Manufacturers" or "SPMs"), (the OPMs and SPMs are hereinafter referred to jointly as the "Participating Manufacturers") entered into the MSA with 46 states, the District of Columbia, Puerto Rico, Guam, the United States Virgin Islands, American Samoa and the Northern Mariana Islands (collectively, the "Settling States") to settle the asserted and unasserted health care cost recovery and certain other claims of those Settling States. The MSA received final judicial approval in each Settling State.

In the Settling States, the MSA released Liggett and other participating tobacco product manufacturers from: all claims of the Settling States and their respective political subdivisions and other recipients of state health care funds, relating to: (i) past conduct arising out of the use, sale, distribution, manufacture, development, advertising and marketing of tobacco products; (ii) the health effects of, the exposure to, or research, statements or warnings about, tobacco products; and

all monetary claims of the Settling States and their respective subdivisions and other recipients of state health care funds, relating to future conduct arising out of the use of or exposure to, tobacco products that have been manufactured in the ordinary course of business.

The MSA restricts tobacco product advertising and marketing within the Settling States and otherwise restricts the activities of Participating Manufacturers. Among other things, the MSA prohibits the targeting of youth in the advertising, promotion or marketing of tobacco products; bans the use of cartoon characters in all tobacco advertising and promotion; limits each Participating Manufacturer to one tobacco brand name sponsorship during any 12-month period; bans all outdoor advertising, with certain limited exceptions; prohibits payments for tobacco product placement in various media; bans gift offers based on the purchase of tobacco products without sufficient proof that the intended recipient is an adult; prohibits Participating Manufacturers from licensing third parties to advertise tobacco brand names in any manner prohibited under the MSA; and prohibits Participating Manufacturers from using as a tobacco product brand name any nationally recognized non-tobacco brand or trade name or the names of sports teams, entertainment groups or individual celebrities.

The MSA also requires Participating Manufacturers to affirm corporate principles to comply with the MSA and to reduce underage usage of tobacco products and imposes restrictions on lobbying activities conducted on behalf of Participating Manufacturers.

Liggett has no payment obligations under the MSA except to the extent its market share exceeds a market share exemption of approximately 1.65% of total cigarettes sold in the United States. Vector Tobacco has no payment obligations except to the extent its market share exceeds a market share exemption of approximately 0.28% of total cigarettes sold in the United States. For years ended December 31, 2011, 2010 and 2009, Liggett and Vector Tobacco's domestic shipments accounted for approximately 3.8%, 3.5% and 2.7%, respectively, of the total cigarettes sold in the United States. If Liggett's or Vector Tobacco's market share exceeds their respective market share exemption in a given year, then on April 15 of the following year, Liggett and/or Vector Tobacco, as the case may be, must pay on each excess unit an amount equal (on a per-unit basis) to that due from the OPMs for that year. On December 31, 2011, Liggett and Vector Tobacco paid \$101.5 million of their estimated \$152.7 million 2011 MSA payment obligations. Under the payment provisions of the MSA, the Participating Manufacturers are required to pay a base amount of \$9.0 billion in 2011 and each year thereafter (subject to applicable adjustments, offsets and reductions). These annual payments are allocated based on unit volume of domestic cigarette shipments. The payment obligations under the MSA are the several, and not joint, obligations of each Participating Manufacturer and are not the responsibility of any parent or affiliate of a Participating Manufacturer.

Liggett may have additional payment obligations under the MSA and its other settlement agreements with the states. See Item 1A. "Risk Factors" and Note 12 to our consolidated financial statements.

New Valley LLC

New Valley LLC, a Delaware limited liability company, is engaged in the real estate business and is seeking to acquire

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additional real estate properties and operating companies. New Valley owns a 50% interest in Douglas Elliman Realty, LLC, which operates the largest residential brokerage company in the New York City metropolitan area. New Valley also holds an investment in a 450-acre approved master planned community in Palm Springs, California (“Escena”), holds investment interests in various real estate projects in Manhattan, New York, southern California and Milan, Italy through both debt and equity investments.

Business Strategy

The business strategy of New Valley is to continue to operate its real estate business, to acquire additional real estate properties and to acquire operating companies through merger, purchase of assets, stock acquisition or other means, or to acquire control of operating companies through one of such means. New Valley may also seek from time to time to dispose of such businesses and properties when favorable market conditions exist. New Valley’s cash and investments are available for general corporate purposes, including for acquisition purposes.

Douglas Elliman Realty, LLC

During 2000 and 2001, New Valley acquired for approximately \$1.7 million a 37.2% ownership interest in B&H Associates of NY, which currently conducts business as Prudential Douglas Elliman Real Estate and was formerly known as Prudential Long Island Realty, a residential real estate brokerage company on Long Island, and a minority interest in an affiliated mortgage company, Preferred Empire Mortgage Company. In December 2002, New Valley and the other owners of Prudential Douglas Elliman Real Estate contributed their interests in Prudential Douglas Elliman Real Estate to Douglas Elliman Realty, LLC, formerly known as Montauk Battery Realty, LLC, a newly formed entity. New Valley acquired a 50% interest in Douglas Elliman Realty as a result of an additional investment of approximately \$1.4 million by New Valley and the redemption by Prudential Douglas Elliman Real Estate of various ownership interests. As part of the transaction, Prudential Douglas Elliman Real Estate renewed its franchise agreement with The Prudential Real Estate Affiliates, Inc. for an additional ten-year term. In October 2004, upon receipt of required regulatory approvals, the former owners of Douglas Elliman Realty contributed to Douglas Elliman Realty their interests in the related mortgage company.

In March 2003, Douglas Elliman Realty purchased the New York City-based residential brokerage firm, Douglas Elliman, LLC, formerly known as Insignia Douglas Elliman, and an affiliated property management company, for \$71.25 million. With that acquisition, the combination of Prudential Douglas Elliman Real Estate with Douglas Elliman created the largest residential brokerage company in the New York metropolitan area. Upon closing of the acquisition, Douglas Elliman entered into a ten-year franchise agreement with The Prudential Real Estate Affiliates, Inc. New Valley invested an additional \$9.5 million in subordinated debt and equity of Douglas Elliman Realty to help fund the acquisition. The balance of the subordinated debt was repaid in 2010. As part of the acquisition, Douglas Elliman Realty acquired Douglas Elliman’s affiliate, Residential Management Group LLC, which conducts business as Douglas Elliman Property Management and is the New York metropolitan area’s largest manager of rental, co-op and condominium housing.

We account for our interest in Douglas Elliman Realty under the equity method. We recorded income of \$16.6 million in 2011, \$22.3 million in 2010, and \$11.4 million in 2009 associated with Douglas Elliman Realty. Equity income from Douglas Elliman Realty includes interest earned by New Valley on the subordinated debt, purchase accounting adjustments and management fees.

Douglas Elliman Realty was negatively impacted in recent years by the downturn in the residential real estate market. The residential real estate market is cyclical and is affected by changes in the general economic conditions that are beyond the control of Douglas Elliman Realty. The U.S. residential real estate market, including some of the markets in the New York metropolitan area where Douglas Elliman operates, has experienced a significant downturn due to various factors including downward pressure on housing prices, credit constraints inhibiting new buyers and an exceptionally large inventory of unsold homes at the same time that sales volumes are decreasing. In 2008 and 2009, the New York metropolitan area market was further impacted by the significant downturn in the financial services industry. The depth and length of the current downturn in the real estate industry has proved exceedingly difficult to predict. We cannot predict whether the downturn will worsen or when the market and related economic forces will return the U.S. residential real estate industry to a growth period.

Real Estate Brokerage Business. Douglas Elliman Realty is engaged in the real estate brokerage business through its two subsidiaries which conduct business as Prudential Douglas Elliman Real Estate. The two brokerage companies have 62 offices with approximately 3,975 real estate agents in the metropolitan New York area. The companies achieved combined sales of approximately \$11.1 billion of real estate in 2011, approximately \$11.5 billion of real estate in 2010 and approximately \$8.6 billion of real estate in 2009. Douglas Elliman Realty was ranked as the fourth-largest residential brokerage company in the United States in 2010 based on closed sales volume by the Real Trends broker survey. Douglas Elliman Realty had revenues of \$346.3 million in 2011, \$348.1 million in 2010, and \$283.9 million in 2009.

The New York City brokerage operation was founded in 1911 by Douglas Elliman and has grown to be one of Manhattan's leading residential brokers by specializing in the highest end of the sales and rental marketplaces. It has 18 New York City offices,

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with approximately 2,125 real estate agents, and had sales volume of approximately \$7.7 billion of real estate in 2011, approximately \$7.8 billion of real estate in 2010, and approximately \$5.3 billion of real estate in 2009.

The Long Island brokerage operation, formerly known as Prudential Long Island Realty, is headquartered in Huntington, New York and is the largest residential brokerage company on Long Island with 44 offices and approximately 1,850 real estate agents. During 2011, the Long Island brokerage operation closed approximately 6,163 transactions, representing sales volume of approximately \$3.4 billion of real estate. This compared to approximately 6,500 transactions, representing sales volume of approximately \$3.6 billion of real estate in 2010, and approximately 6,200 transactions closed in 2009, representing approximately \$3.3 billion of real estate. Prudential Douglas Elliman Real Estate serves approximately 250 communities from Manhattan to Montauk.

In December 2010, Douglas Elliman Realty acquired substantially all of the assets of Prudential Holmes & Kennedy, a small regional residential real estate brokerage company which operated for more than 40 years in Northern Westchester County, a suburban area north of New York City. The acquisition included six offices located in the towns of Chappaqua, Armonk, Bedford, Sommers, Pleasantville and Katonah, with approximately 150 real estate agents. Douglas Elliman Realty's franchise agreement with Prudential Real Estate Affiliates was amended to include these offices as additional locations. The results from operations of Prudential Holmes & Kennedy are included in the Long Island brokerage operation.

Prudential Douglas Elliman Real Estate acts as a broker in residential real estate transactions. In performing these services, the company has historically represented the seller, either as the listing broker, or as a co-broker in the sale. In acting as a broker for the seller, their services include assisting the seller in pricing the property and preparing it for sale, advertising the property, showing the property to prospective buyers, and assisting the seller in negotiating the terms of the sale and in closing the transaction. In exchange for these services, the seller pays to the company a commission, which is generally a fixed percentage of the sales price. In a co-brokered arrangement, the listing broker typically splits its commission with the other co-broker involved in the transaction. The company also offers buyer brokerage services. When acting as a broker for the buyer, its services include assisting the buyer in locating properties that meet the buyer's personal and financial specifications, showing the buyer properties, and assisting the buyer in negotiating the terms of the purchase and closing the transaction. In exchange for these services a commission is paid to the company which also is generally a fixed percentage of the purchase price and is usually, based upon a co-brokerage agreement with the listing broker, deducted from, and payable out of, the commission payable to the listing broker. With the consent of a buyer and seller, subject to certain conditions, the company may, in certain circumstances, act as a selling broker and as a buying broker in the same transaction. The company's sales and marketing services are provided by licensed real estate sales persons or associate brokers who have entered into independent contractor agreements with the company. The company recognizes revenue and commission expenses upon the consummation of the real estate sale.

Prudential Douglas Elliman Real Estate also offers relocation services to employers, which provide a variety of specialized services primarily concerned with facilitating the resettlement of transferred employees. These services include sales and marketing of transferees' existing homes for their corporate employer, assistance in finding new homes, moving services, educational and school placement counseling, customized videos, property marketing assistance, rental assistance, area tours, international relocation, group move services, marketing and management of foreclosed properties, career counseling, spouse/partner employment assistance, and financial services. Clients can select these programs and services on a fee basis according to their needs.

As part of the brokerage company's franchise agreement with Prudential, it has an agreement with Prudential Relocation Services, Inc. to provide relocation services to the Prudential network. The company anticipates that participation in the Prudential network will continue to provide new relocation opportunities with firms on a national level.

In 2009, Douglas Elliman Realty, through a subsidiary, entered into a joint venture with Wells Fargo Ventures, LLC to create DE Capital Mortgage LLC to carry on the business of residential mortgage lending, as a mortgage broker. Wells Fargo Ventures is the nation's leading alliance lender, maintaining long-standing relationships with top real estate companies, builders and financial services institutions across the United States. DE Capital Mortgage replaced the business of Preferred Empire Mortgage Company, which was a mortgage broker, wholly-owned by Douglas

Elliman Realty.

DE Capital primarily originates loans for purchases of properties located on Long Island, New York City and Westchester. Approximately one-half of these loans are for home sales transactions in which Prudential Douglas Elliman Real Estate acts as a broker. The term "origination" refers generally to the process of arranging mortgage financing for the purchase of property directly to the purchaser or for refinancing an existing mortgage. DE Capital's revenues are generated from loan origination fees, which are generally a percentage of the original principal amount of the loan and are commonly referred to as "points", and application and other fees paid by the borrowers. DE Capital recognizes mortgage origination revenues and costs when the mortgage loan is consummated. As a mortgage broker, DE Capital funds and sells mortgage loans through Wells Fargo, its joint venture partner.

Marketing. As members of The Prudential Real Estate Affiliates, Inc., Prudential Douglas Elliman Real Estate offers real estate sales and marketing and relocation services, which are marketed by a multimedia program. This program includes direct mail, newspaper, internet, catalog, radio and television advertising and is conducted throughout Manhattan and Long Island. In

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addition, the integrated nature of the real estate brokerage companies services is designed to produce a flow of customers between their real estate sales and marketing business and their mortgage business.

Competition. The real estate brokerage business is highly competitive. However, Prudential Douglas Elliman Real Estate believes that its ability to offer their customers a range of inter-related services and its level of residential real estate sales and marketing help position them to meet the competition and improve their market share.

In the brokerage company's traditional business of residential real estate sales and marketing, it competes with multi-office independent real estate organizations and, to some extent, with franchise real estate organizations, such as Century-21, ERA, RE/MAX and Coldwell Banker. The company believes that its major competitors in 2012 will also increasingly include multi-office real estate organizations, such as GMAC Home Services, NRT LLC (whose affiliates include the New York City-based Corcoran Group) and other privately owned companies. Residential brokerage firms compete for sales and marketing business primarily on the basis of services offered, reputation, personal contacts, and, recently to a greater degree, price.

The company's relocation business is fully integrated with its residential real estate sales and marketing business. Accordingly, its major competitors are many of the same real estate organizations previously noted. Competition in the relocation business is likewise based primarily on level of service, reputation, personal contact and, recently to a greater degree, price.

In its mortgage loan origination business, DE Capital competes with other mortgage originators. These include mortgage brokers, mortgage bankers, state and national banks, and thrift institutions.

Government Regulation. Several facets of real estate brokerage businesses are subject to government regulation. For example, their real estate sales and marketing divisions are licensed as real estate brokers in the states in which they conduct their real estate brokerage businesses. In addition, their real estate sales associates must be licensed as real estate brokers or salespersons in the states in which they do business. Future expansion of the real estate brokerage operations of Prudential Douglas Elliman Real Estate into new geographic markets may subject it to similar licensing requirements in other states.

A number of states and localities have adopted laws and regulations imposing environmental controls, disclosure rules, zoning and other land use restrictions, which can materially impact the marketability of certain real estate. However, Prudential Douglas Elliman Real Estate does not believe that compliance with environmental, zoning and land use laws and regulations has had, or will have, a materially adverse effect on its financial condition or operations. In DE Capital's mortgage business, mortgage loan origination and funding activities are subject to the Equal Credit Opportunity Act, the Federal Truth-in-Lending Act, the Real Estate Settlement Procedures Act, and the regulations promulgated thereunder which prohibit discrimination and require the disclosure of certain information to borrowers concerning credit and settlement costs. As an affiliate of Wells Fargo Ventures, a wholly-owned subsidiary of Wells Fargo Bank, N.A., DE Capital is not subject to regulation by state banking departments, but rather by the Federal Office of Currency Control.

Prudential Douglas Elliman Real Estate is not aware of any material licensing or other government regulatory requirements governing its relocation business, except to the extent that such business also involves the rendering of real estate brokerage services, the licensing and regulation of which are described above.

Franchises and Trade Names. In December 2002, Prudential Long Island Realty renewed for an additional ten-year term its franchise agreement with The Prudential Real Estate Affiliates, Inc. and has an exclusive franchise, subject to various exceptions and to meeting annual revenue thresholds, in New York for the counties of Nassau and Suffolk on Long Island. In addition, in June 2004, Prudential Long Island Realty was granted an exclusive franchise, subject to various exceptions and to meeting annual revenue thresholds, with respect to the boroughs of Brooklyn and Queens. In March 2003, Douglas Elliman entered into a ten-year franchise agreement with The Prudential Real Estate Affiliates, Inc. and has an exclusive franchise, subject to various exceptions and to meeting annual revenue thresholds, for Manhattan.

The "Douglas Elliman" trade name is a registered trademark in the United States. The name has been synonymous with the most exacting standards of excellence in the real estate industry since Douglas Elliman's formation in 1911. Other trademarks used extensively in Douglas Elliman's business, which are owned by Douglas Elliman Realty and registered in the United States, include "We are New York", "Bringing People and Places Together", "If You Clicked Here

You'd Be Home Now" and "Picture Yourself in the Perfect Home".

The "Prudential" name and the tagline "From Manhattan to Montauk" are used extensively in the Prudential Douglas Elliman Real Estate business. In addition, Prudential Douglas Elliman Real Estate continues to use the trade names of certain companies that it has acquired.

Residential Property Management Business. Douglas Elliman Realty is also engaged in the management of cooperatives, condominiums and apartments through its subsidiary, Residential Management Group, LLC, which conducts business as Douglas Elliman Property Management and is the leading manager of apartments, cooperatives and condominiums in the New York metropolitan area according to a survey in the September 2009 issue of The Real Deal. Residential Management Group provides full service third-party fee management for approximately 350 properties, representing approximately 47,000 units in New York

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City, Nassau County, Northern New Jersey and Westchester County. In January 2010, Residential Management Group acquired the assets of Bellmarc Property Management, a company which managed approximately 50 buildings in Manhattan with approximately 5,000 units. Residential Management Group is seeking to continue to expand its property management business in the greater metropolitan New York area in 2012. Among the notable properties currently managed are the Dakota, Museum Tower, Worldwide Plaza, London Terrace, West Village Houses, Manhattan House, CitySpire Condominium and The Sovereign buildings in New York City. Residential Management Group employs approximately 260 people, of whom approximately 190 work at Residential Management Group's headquarters and the remainder at remote offices in the New York metropolitan area.

New Valley Realty Division

Escena. In March 2008, a subsidiary of New Valley purchased a loan collateralized by a substantial portion of a 450-acre approved master planned community in Palm Springs, California known as "Escena." The loan, which was in foreclosure, was purchased for its \$20 million face value plus accrued interest and other costs of approximately \$1.45 million. The collateral consisted of 867 residential lots with site and public infrastructure and an 18-hole golf course with a substantially completed clubhouse, and a seven-acre site approved for a 450-room hotel.

In April 2009, New Valley's subsidiary entered into a settlement agreement with a guarantor of the loan, which required the guarantor to satisfy its obligations under a completion guaranty by completing improvements to the project in settlement, among other things, of its payment guarantees. The construction of these improvements to the project is substantially complete.

In April 2009, New Valley completed the foreclosure process and took title to the property. The property is classified as "Investment in Escena, net" and was carried in our consolidated balance sheet at \$13.3 million as of December 31, 2011.

Aberdeen Townhomes LLC. In June 2008, a subsidiary of New Valley purchased a preferred equity interest in Aberdeen Townhomes LLC ("Aberdeen") for \$10 million. Aberdeen acquired five townhome residences located in Manhattan, New York, which it sold. Each of the townhomes has been sold and the project is concluded. We recorded an impairment loss of \$3.5 million in each of 2008 and 2009. We recorded a gain of \$1.1 million, which was reflected as a reduction of operating, selling, general and administrative expenses, in 2010. We recorded a gain of \$3.8 million in 2011.

New Valley Oaktree Chelsea Eleven, LLC. In September 2008, a subsidiary of New Valley purchased for \$12 million a 40% interest in New Valley Oaktree Chelsea Eleven, LLC, which lent \$29 million and contributed \$1 million in capital to Chelsea Eleven LLC, which is developing a condominium project in Manhattan, New York. The development consists of 54 luxury residential units and one commercial unit. On July 1, 2010, Chelsea Eleven LLC borrowed \$47.1 million to retire Chelsea Eleven LLC's then outstanding mezzanine debt (approximately \$37.2 million) and for other working capital purposes. This loan has been paid in full. As of December 31, 2011, all units had been sold except for a penthouse unit, a utility unit and a third unit, which is under contract and closed in February 2012.

New Valley's investment in New Valley Oaktree is being accounted for under the equity method and was carried at approximately \$6.3 million on our consolidated balance sheet at December 31, 2011 as a component of "Investments in non-consolidated real estate businesses." We received net distributions of \$7.6 million and \$1.0 million from New Valley Oaktree Chelsea Eleven LLC for the years ended December 31, 2011 and 2010, respectively. Our maximum exposure to loss as a result of New Valley's investment in New Valley Oaktree Chelsea Eleven, LLC is \$6.3 million.

Fifty Third-Five Building LLC. In September 2010, New Valley, through its NV 955 LLC subsidiary, contributed \$2.5 million to a joint venture, Fifty Third-Five Building LLC ("JV"), of which it owns 50%. The JV was formed for the purposes of acquiring a defaulted real estate loan, collateralized by real estate located in New York City. In October 2010, New Valley contributed an additional \$15.5 million to the JV and the JV acquired the defaulted loan for approximately \$35.5 million. Foreclosure proceedings on the defaulted real estate loan are pending. The JV is a variable interest entity; however, New Valley is not the primary beneficiary. Our maximum exposure to loss as a result of its investment in the JV is \$18.0 million. This investment is being accounted for under the equity method of accounting.

Sesto Holdings S.r.l. In October 2010, New Valley, through its NV Milan LLC subsidiary, acquired a 7.2% interest in Sesto Holdings S.r.l. for \$5.0 million. Sesto holds a 42% interest in an entity that has purchased approximately 322 acres in Milan, Italy. Sesto intends to develop the land as a multi-parcel, multi-building mixed use urban regeneration project. Sesto is a variable interest entity; however, New Valley is not the primary beneficiary. Our maximum exposure to loss as a result of New Valley's investment in Sesto is \$5.0 million. New Valley accounts for Sesto under the equity method of accounting.

Lofts 21 LLC. In February 2011, New Valley invested \$900,000 for an approximate 12% interest in Lofts 21 LLC. Lofts 21 LLC acquired an existing property in Manhattan, NY, which is scheduled to be developed into condominiums. Lofts 21 LLC is a variable interest entity; however, New Valley is not the primary beneficiary. Our maximum exposure to loss as a result of this investment is \$900,000. New Valley accounts for Lofts 21 LLC under the equity method of accounting.

1107 Broadway. During 2011, New Valley invested \$5.5 million for an approximate indirect 5% interest in MS/WG 1107 Broadway Holdings LLC. In September 2011, MS/WG 1107 Broadway Holdings LLC acquired the 1107 Broadway property in

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Manhattan, NY. The joint venture plans to develop the property, which was formerly part of the International Toy Center, into luxury residential condominiums with ground floor retail space. MS/WG 1107 Broadway Holdings LLC is a variable interest entity; however, New Valley is not the primary beneficiary. Our maximum exposure to loss on this investment is \$5.5 million. New Valley accounts for MS/WG 1107 Broadway Holdings LLC under the equity method of accounting.

Hotel Taiwana. In October 2011, New Valley invested \$2.7 million for an approximate 17.39% interest in Hill Street Partners LLP ("Hill"). Hill purchased a 37% interest in Hill Street SEP ("Hotel Taiwana") which owns a hotel located in St. Barts, French West Indies. The hotel consists of 30 suites, six pools, a restaurant, lounge and gym. The purpose of the investment is to renovate and the sell the hotel in its entirety or as hotel-condos. The investment is a variable interest entity; however, New Valley is not the primary beneficiary. Our maximum exposure to loss as a result of New Valley's investment in Hotel Taiwana is \$2.7 million. New Valley accounts for Hotel Taiwana under the equity method of accounting.

NV SOCAL LLC. On October 28, 2011, a newly-formed joint venture, between affiliates of New Valley and Winthrop Realty Trust, entered into an agreement with Wells Fargo Bank to acquire a \$117.9 million C-Note (the "C-Note") for a purchase price of \$96.7 million. The C-Note is the most junior tranche of a \$796.0 million first mortgage loan originated in July 2007 which is collateralized by a 31 property portfolio of office properties situated throughout southern California, consisting of approximately 4.5 million square feet. The C-Note bears interest at a rate per annum of LIBOR plus 310 basis points, requires payments of interest only prior to maturity and matures on August 9, 2012. On November 3, 2011, New Valley invested \$25.0 million for an approximate 26% interest in the joint venture. The investment is a variable interest entity; however, New Valley is not the primary beneficiary. Our maximum exposure to loss as a result of New Valley's investment in NV SOCAL LLC is \$25.1 million. New Valley accounts for this investment under the equity method of accounting.

HFZ East 68th Street. In December 2011, New Valley invested \$7.0 million for an approximate 18% interest in a condominium conversion project. The building is a 12-story, 105,000 square foot residential rental building located in Manhattan, NY. The investment is a variable interest entity; however, New Valley is not the primary beneficiary. Our maximum exposure to loss as a result of its investment in HFZ East 68th Street is \$7.0 million. New Valley accounts for this investment under the equity method of accounting.

Former Broker-Dealer Operations

New Valley owned, as of December 31, 2011, 13,891,205 common shares of Ladenburg Thalmann Financial Services Inc. (NYSE Amex: LTS), which represents approximately 8% of the LTS shares. LTS is the parent of New Valley's former subsidiary, Ladenburg Thalmann & Co. Inc., which has been a member of the New York Stock Exchange since 1879. LTS is registered under the Securities Act of 1934 and files periodic reports and other information with the SEC.

Three of our directors, Howard M. Lorber, Henry C. Beinstein and Jeffrey S. Podell, also serve as directors of LTS. Mr. Lorber also serves as Vice Chairman of LTS. Richard J. Lampen, who along with Mr. Lorber is an executive officer of ours, also serves as a director of LTS and has served as the President and Chief Executive Officer of LTS since September 2006. In September 2006, we entered into an agreement with LTS where we agreed to make available the services of Mr. Lampen as well as other financial, accounting and tax services. LTS paid us \$600,000 for 2011, 2010 and 2009, respectively, related to the agreement and will pay us at a rate of \$750,000 per year in 2012. These amounts are recorded as a reduction to our operating, selling, administrative and general expenses. LTS paid compensation of \$500,000, \$200,000 and \$0 for 2011, 2010 and 2009, respectively, to each of Mr. Lorber and Mr. Lampen in connection with their services. See Note 14 to our consolidated financial statements.

In November 2011, we were part of a consortium, which included Dr. Phillip Frost, who is the beneficial owner of approximately 18.5% of our common stock, and Mr. Lampen, that agreed to provide a loan to LTS. The five-year note was approximately \$160.7 million, bears an interest rate of 11% per annum, paid a 0.50% funding fee and issued 10,713,333 warrants to purchase LTS shares at \$1.68 per share to the consortium. LTS has the ability to pay 4% of the 11% interest owed on the note by payment-in-kind in the first two years of the note. LTS is required to repay 10% of the note by December 31, 2014, 10% by December 31, 2015 and the remaining 80% by November 4, 2016. We lent LTS \$15 million and received 1,000,000 warrants.

Other Investments

Castle Brands. In October 2008, we acquired for \$4 million an approximate 11% interest in Castle Brands Inc. (NYSE Amex: ROX), a publicly traded developer and importer of premium branded spirits. Mr. Lampen is serving as the President, Chief Executive Officer and a director of Castle. In October 2008, we entered into an agreement with Castle where we agreed to make available the services of Mr. Lampen as well as other financial, accounting and tax services. We recognized management fees of \$100,000 in each of 2011, 2010 and 2009, under the agreement and Castle has agreed to pay us \$100,000 per year in 2012. In December 2009, we were part of a consortium, which included Dr. Frost and Mr. Lampen, that agreed to provide a line of credit to Castle. The three-year line was for a maximum amount of \$2.5 million, bore interest at a rate of 11% per annum on amounts borrowed, paid a 1% annual commitment fee and was collateralized by Castle's receivables and inventory. Our commitment under the line was \$900,000; all of which was outstanding under the credit line as of December 31, 2010. The amount was repaid on

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October 14, 2011. In December 2010, we were part of a consortium, which included Dr. Frost and Mr. Lampen, that lent \$1.0 million to Castle. We lent \$200,000 of this amount in and received a note bearing interest at a rate of 11% per annum. During 2011, \$217,000 of principal and outstanding interest associated with this note was exchanged for shares of Castle's convertible preferred stock and warrants.

Long-Term Investments. As of December 31, 2011, long-term investments consisted primarily of investments in investment partnerships of approximately \$22.2 million. In the future, we may invest in other investments including limited partnerships, real estate investments, equity securities, debt securities and certificates of deposit depending on risk factors and potential rates of return.

Employees

At December 31, 2011, we had 559 employees, of which approximately 302 were employed at Liggett's Mebane facility and approximately 237 were employed in sales and administrative functions at LVB. Approximately 42% of our employees are hourly employees, who are represented by unions. We have not experienced any significant work stoppages since 1977, and we believe that relations with our employees and their unions are satisfactory.

Available Information

Our website address is www.vectorgrouppltd.com. We make available free of charge on the Investor Relations section of our website (<http://vectorgrouppltd.com/invest.asp>) our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with the Securities and Exchange Commission. We also make available through our website other reports filed with the SEC under the Exchange Act, including our proxy statements and reports filed by officers and directors under Section 16(a) of that Act. Copies of our Code of Business Conduct and Ethics, Corporate Governance Guidelines, Audit Committee charter, Compensation Committee charter and Corporate Governance and Nominating Committee charter have been posted on the Investor Relations section of our website and are also available in print to any shareholder who requests it. We do not intend for information contained in our website to be part of this Annual Report on Form 10-K.

ITEM 1A. RISK FACTORS

Our business faces many risks. We have described below the known material risks that we and our subsidiaries face. There may be additional risks that we do not yet know of or that we do not currently perceive to be significant that may also impact our business or the business of our subsidiaries. Each of the risks and uncertainties described below could lead to events or circumstances that have a material adverse effect on the business, results of operations, cash flows, financial condition or equity of us or one or more of our subsidiaries, which in turn could negatively affect the value of our common stock. You should carefully consider and evaluate all of the information included in this report and any subsequent reports that we may file with the Securities and Exchange Commission or make available to the public before investing in any securities issued by us.

We have significant liquidity commitments

During 2012, we have certain liquidity commitments that could require the use of our existing cash resources. As of December 31, 2011, our corporate expenditures (exclusive of Liggett, Vector Tobacco and New Valley) and other potential liquidity requirements over the next 12 months included the following:

- cash interest expense of approximately \$76.2 million,
- we may be required to purchase \$99 million of our 3.875% Variable Interest Senior Convertible Debentures due 2026 on June 15, 2012,
- dividends on our outstanding common shares (currently at an annual rate of approximately \$131.0 million), and
- other corporate expenses and taxes.

In order to meet the above liquidity requirements as well as other liquidity needs in the normal course of business, we will be required to use cash flows from operations and existing cash and cash equivalents. Should these resources be insufficient to meet the upcoming liquidity needs, we may also be required to liquidate investment securities available for sale and other long-term investments, or, if available, draw on Liggett's credit facility. While there are actions we can take to reduce our liquidity needs, there can be no assurance that such measures can be achieved.

We and our subsidiaries have a substantial amount of indebtedness.

We and our subsidiaries have significant indebtedness and debt service obligations. At December 31, 2011, we and our

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subsidiaries had total outstanding indebtedness (including the embedded derivative liabilities related to our convertible notes) of \$720.5 million. We may be required to purchase \$99 million of our 3.875% Variable Interest Senior Convertible Debentures due 2026 on June 15, 2012. Approximately \$157.5 million of our 6.75% convertible notes mature in 2014 and \$415 million of our 11% senior secured notes matures in 2015. In addition, subject to the terms of any future agreements, we and our subsidiaries will be able to incur additional indebtedness in the future. There is a risk that we will not be able to generate sufficient funds to repay our debt. If we cannot service our fixed charges, it would have a material adverse effect on our business and results of operations.

We are a holding company and depend on cash payments from our subsidiaries, which are subject to contractual and other restrictions, in order to service our debt and to pay dividends on our common stock.

We are a holding company and have no operations of our own. We hold our interests in our various businesses through our wholly-owned subsidiaries, VGR Holding LLC and New Valley. In addition to our own cash resources, our ability to pay interest on our debt and to pay dividends on our common stock depends on the ability of VGR Holding and New Valley to make cash available to us. VGR Holding's ability to pay dividends to us depends primarily on the ability of Liggett, its wholly-owned subsidiary, to generate cash and make it available to VGR Holding. Liggett's revolving credit agreement with Wells Fargo Bank, N.A. contains a restricted payments test that limits the ability of Liggett to pay cash dividends to VGR Holding. The ability of Liggett to meet the restricted payments test may be affected by factors beyond its control, including Wells Fargo's unilateral discretion, if acting in good faith, to modify elements of such test.

Our receipt of cash payments, as dividends or otherwise, from our subsidiaries is an important source of our liquidity and capital resources. If we do not have sufficient cash resources of our own and do not receive payments from our subsidiaries in an amount sufficient to repay our debts and to pay dividends on our common stock, we must obtain additional funds from other sources. There is a risk that we will not be able to obtain additional funds at all or on terms acceptable to us. Our inability to service these obligations and to continue to pay dividends on our common stock would significantly harm us and the value of our common stock.

Our 11% senior secured notes contain restrictive covenants that limit our operating flexibility.

The indenture governing our 11% senior secured notes due 2015 contains covenants that, among other things, restrict our ability to take specific actions, even if we believe them to be in our best interest, including restrictions on our ability to:

- incur or guarantee additional indebtedness or issue preferred stock;
- pay dividends or distributions on, or redeem or repurchase, capital stock;
- create liens with respect to our assets;
- make investments, loans or advances;
- prepay subordinated indebtedness;
- enter into transactions with affiliates; and
- merge, consolidate, reorganize or sell our assets.

In addition, Liggett's revolving credit agreement requires us to meet specified financial ratios. These covenants may restrict our ability to expand or fully pursue our business strategies. Our ability to comply with these and other provisions of the indenture governing the senior secured notes and the Liggett revolving credit agreement may be affected by changes in our operating and financial performance, changes in general business and economic conditions, adverse regulatory developments or other events beyond our control. The breach of any of these covenants, including those contained in the indenture governing the senior secured notes and the Liggett's credit agreement, could result in a default under our indebtedness, which could cause those and other obligations to become due and payable. If any of our indebtedness is accelerated, we may not be able to repay it.

The indenture governing the senior secured notes contain restrictive covenants, which, among other things, restrict our ability to pay certain dividends or make other restricted payments or enter into transactions with affiliates if our Consolidated EBITDA, as defined in the indenture, is less than \$50 million for the four quarters prior to such transaction. Our Consolidated EBITDA for the four quarters ended December 31, 2011 exceeded \$50 million. Changes in respect of the debt ratings of our notes may materially and adversely affect the availability, the cost and the terms and conditions of our debt.

Both we and our 11% Senior Secured Notes have been publicly rated by Moody's Investors Service, Inc., or Moody's, and Standard & Poor's Rating Services, or S&P, independent rating agencies. In addition, future debt instruments may be publicly rated. These debt ratings may affect our ability to raise debt. Any future downgrading of the notes or our other debt by Moody's and S&P may affect the cost and terms and conditions of our financings and could adversely affect the value and trading of the

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notes.

Liggett faces intense competition in the domestic tobacco industry.

Liggett is considerably smaller and has fewer resources than its major competitors, and, as a result, has a more limited ability to respond to market developments. Management Science Associates' data indicate that the three largest cigarette manufacturers controlled approximately 84.7% of the United States cigarette market during 2011. Philip Morris is the largest manufacturer in the market, and its profits are derived principally from its sale of premium cigarettes. Philip Morris had approximately 61.2% of the premium segment and 46.1% of the total domestic market during 2011. During 2011, all of Liggett's sales were in the discount segment, and its share of the total domestic cigarette market was 3.8%. Philip Morris and RJR Tobacco (which is now part of Reynolds American), the two largest cigarette manufacturers, have historically, because of their dominant market share, been able to determine cigarette prices for the various pricing tiers within the industry.

Philip Morris and Reynolds American dominate the domestic cigarette market and had a combined market share of approximately 71.0% at December 31, 2011. This concentration of United States market share could make it more difficult for Liggett and Vector Tobacco to compete for shelf space in retail outlets and could impact price competition in the market, either of which could have a material adverse affect on their sales volume, operating income and cash flows, which in turn could negatively affect the value of our common stock.

Liggett's business is highly dependent on the discount cigarette segment.

Liggett depends more on sales in the discount cigarette segment of the market, relative to the full-price premium segment, than its major competitors. Since 2004, all of Liggett's unit volume was generated in the discount segment. The discount segment is highly competitive, with consumers having less brand loyalty and placing greater emphasis on price. While the three major manufacturers all compete with Liggett in the discount segment of the market, the strongest competition for market share has recently come from a group of smaller manufacturers and importers, most of which sell low quality, deep discount cigarettes. While Liggett's share of the discount market was 12.8% in 2011, 11.9% in 2010 and 9.2% in 2009, Management Science Associates' data indicate that the discount market share of these other smaller manufacturers and importers was approximately 34.1% in 2011, 38.5% in 2010, and 39.4% in 2009. If pricing in the discount market continues to be impacted by these smaller manufacturers and importers, margins in Liggett's only current market segment could be negatively affected, which in turn could negatively affect the value of our common stock.

Liggett's market share is susceptible to decline.

For a number of years prior to 2000, Liggett suffered a substantial decline in market share. Liggett's market share increased during each of the years between 2000 and 2011 (except for 2008, which was unchanged). This earlier market share erosion resulted in part from Liggett's highly leveraged capital structure that existed until December 1998 and its limited ability to match other competitors' wholesale and retail trade programs, obtain retail shelf space for its products and advertise its brands. These declines also resulted from adverse developments in the tobacco industry, intense competition and changes in consumer preferences which have continued up to the current time. According to Management Science Associates' data, Liggett's overall domestic market share during 2011 was 3.8% compared to 3.5% during 2010, and 2.7% during 2009. Liggett's share of the discount segment was 12.8% during 2011, up from 11.9% during 2010 and 9.2% during 2009. If Liggett's market share were to decline again, Liggett's sales volume, operating income and cash flows could be materially adversely affected, which in turn could negatively affect the value of our common stock.

The domestic cigarette industry has experienced declining unit sales in recent periods.

Industry-wide shipments of cigarettes in the United States have been declining for a number of years, with Management Science Associates' data indicating that domestic industry-wide shipments decreased by approximately 3.5% in 2011 as compared to 2010, and by approximately 3.8% in 2010 as compared to 2009. We believe that industry-wide shipments of cigarettes in the United States will continue to decline as a result of numerous factors. These factors include health considerations, diminishing social acceptance of smoking, and a wide variety of federal, state and local laws limiting smoking in restaurants, bars and other public places, as well as increases in federal and state excise taxes and settlement-related expenses which have contributed to high cigarette price levels in recent years. If this decline in industry-wide shipments continues and Liggett is unable to capture market share from its

competitors, or if the industry as a whole is unable to offset the decline in unit sales with price increases, Liggett's sales volume, operating income and cash flows could be materially adversely affected, which in turn could negatively affect the value of our common stock.

Our tobacco operations are subject to substantial and increasing legislation, regulation and taxation, which has a negative effect on revenue and profitability.

Tobacco products are subject to substantial federal and state excise taxes in the United States. On February 4, 2009, President

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Obama signed an increase of \$0.617 in the federal excise tax per pack of cigarettes, for a total of \$1.01 per pack of cigarettes, and significant tax increases on other tobacco products, to fund expansion of the State Children's Health Insurance Program, referred to as the SCHIP. These tax increases came into effect on April 1, 2009. The increases in federal excise tax under the SCHIP are substantial, and, as a result, Liggett's sales volume and profitability has been and may continue to be adversely impacted. In addition, the SCHIP created certain tax differentials between certain types of tobacco products. This has caused a dramatic increase in the sale of pipe tobacco as a substitute for roll-your-own, which has directly impacted sales of cigarettes.

In addition to federal and state excise taxes, certain city and county governments also impose substantial excise taxes on tobacco products sold. Increased excise taxes are likely to result in declines in overall sales volume and shifts by consumers to less expensive brands.

A wide variety of federal, state and local laws limiting the advertising, sale and use of cigarettes have proliferated in recent years. For example, many local laws prohibit smoking in restaurants and other public places. Private businesses also have adopted regulations that prohibit or restrict, or are intended to discourage, smoking. Such laws and regulations also are likely to result in a decline in the overall sales volume of cigarettes.

Furthermore, Liggett and Vector Tobacco also provide ingredient information annually, as required by law, to the states of Massachusetts, Texas and Minnesota. Several other states are considering ingredient disclosure legislation. Over the years, various state and local governments have continued to regulate tobacco products, including smokeless tobacco products. These regulations relate to, among other things, the imposition of significantly higher taxes, increases in the minimum age to purchase tobacco products, sampling and advertising bans or restrictions, ingredient and constituent disclosure requirements and significant tobacco control media campaigns. Additional state and local legislative and regulatory actions will likely be considered in the future, including, among other things, restrictions on the use of flavorings.

In addition to the foregoing, there have been a number of other restrictive regulatory actions from various federal administrative bodies, including the United States Environmental Protection Agency and the Food and Drug Administration ("FDA"). There have also been adverse legislative and political decisions and other unfavorable developments concerning cigarette smoking and the tobacco industry. Recently, legislation was passed by Congress providing for regulation of cigarettes by the FDA. These developments generally receive widespread media attention. Additionally, a majority of states have passed legislation providing for reduced ignition propensity standards for cigarettes. These developments may negatively affect the perception of potential triers of fact with respect to the tobacco industry, possibly to the detriment of certain pending litigation, and may prompt the commencement of additional similar litigation or legislation. We are not able to evaluate the effect of these developing matters on pending litigation or the possible commencement of additional litigation, but our consolidated financial position, results of operations or cash flows could be materially adversely affected.

Additional federal or state regulation relating to the manufacture, sale, distribution, advertising, labeling, or information disclosure of tobacco products could further reduce sales, increase costs and have a material adverse effect on our business.

The newly enacted Family Smoking Prevention and Tobacco Control Act may adversely affect our sales and operating profit.

On June 22, 2009, the President signed into law the "Family Smoking Prevention and Tobacco Control Act" (Public Law 111-31). The law grants the FDA broad authority over the manufacture, sale, marketing and packaging of tobacco products, although FDA is prohibited from issuing regulations banning all cigarettes or all smokeless tobacco products, or requiring the reduction of nicotine yields of a tobacco product to zero. Among other measures, the law (under various deadlines):

- increases the number of health warnings required on cigarette and smokeless tobacco products, increases the size of warnings on packaging and in advertising, requires FDA to develop graphic warnings for cigarette packages, and grants FDA authority to require new warnings;

- requires practically all tobacco product advertising to eliminate color and imagery and instead consist solely of black text on white background;

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imposes new restrictions on the sale and distribution of tobacco products, including significant new restrictions on tobacco product advertising and promotion, as well as the use of brand and trade names;

bans the use of “light,” “mild,” “low” or similar descriptors on tobacco products;

bans the use of “characterizing flavors” in cigarettes other than tobacco or menthol;

gives FDA the authority to impose tobacco product standards that are appropriate for the protection of the public health (by, for example, requiring reduction or elimination of the use of particular constituents or components, requiring product testing, or addressing other aspects of tobacco product construction, constituents, properties or labeling);

requires manufacturers to obtain FDA review and authorization for the marketing of certain new or modified tobacco

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products;

• requires pre-market approval by FDA for tobacco products represented (through labels, labeling, advertising, or other means) as presenting a lower risk of harm or tobacco-related disease;

• requires manufacturers to report ingredients and harmful constituents and requires FDA to disclose certain constituent information to the public;

• mandates that manufacturers test and report on ingredients and constituents identified by FDA as requiring such testing to protect the public health, and allows FDA to require the disclosure of testing results to the public;

• requires manufacturers to submit to FDA certain information regarding the health, toxicological, behavioral or physiological effects of tobacco products;

• prohibits use of tobacco containing a pesticide chemical residue at a level greater than allowed under federal law;

• requires FDA to establish “good manufacturing practices” to be followed at tobacco manufacturing facilities;

• requires tobacco product manufacturers (and certain other entities) to register with FDA;

• authorizes FDA to require the reduction of nicotine (although it may not require the reduction of nicotine yields of a tobacco product to zero) and the potential reduction or elimination of other constituents, including menthol;

• imposes (and allows FDA to impose) various recordkeeping and reporting requirements on tobacco product manufacturers; and

• grants FDA the regulatory authority to impose broad additional restrictions.

The law also required establishment, within FDA’s new Center for Tobacco Products, of a Tobacco Products Scientific Advisory Committee (“TPSAC”) to provide advice, information and recommendations with respect to the safety, dependence or health issues related to tobacco products, including:

• a recommendation on modified risk applications;

• a recommendation on the effects of tobacco product nicotine yield alteration and whether there is a threshold level below which nicotine yields do not produce dependence;

• a report on the public health impact of the use of menthol in cigarettes; and

• a report on the public health impact of dissolvable tobacco products.

The TPSAC completed its review of the use of menthol in cigarettes and issued a report with recommendations to FDA in March 2011. The report states that “removal of menthol cigarettes from the marketplace would benefit public health in the United States,” but does not expressly recommend that FDA ban menthol cigarettes. FDA is considering the report and recommendations of the TPSAC and will make a determination about what future regulatory action(s), if any, it believes are warranted. A decision by FDA to ban menthol in tobacco products could have a material adverse effect on us.

The law imposes user fees on certain tobacco product manufacturers in order to fund tobacco-related FDA activities. User fees will be allocated among tobacco product classes according to a formula set out in the legislation, and then among manufacturers and importers within each class based on market share. The FDA user fees for Liggett and Vector Tobacco for 2011 were \$16.7 million and we estimate that they will be significantly higher in the future.

The law also imposes significant new restrictions on the advertising and promotion of tobacco products. For example, as required under the law, FDA has finalized certain portions of regulations previously adopted by FDA in 1996 (which were struck down by the Supreme Court in 2000 as beyond FDA’s authority). Subject to limitations imposed by a federal injunction (discussed below), these regulations took effect on June 22, 2010. As written, these regulations significantly limit the ability of manufacturers, distributors and retailers to advertise and promote tobacco products, by, for example, restricting the use of color and graphics in advertising, limiting the use of outdoor advertising, restricting the sale and distribution of non-tobacco items and services, gifts, and sponsorship of events, and imposing restrictions on the use for cigarette or smokeless tobacco products of trade or brand names that are used for non-tobacco products.

In August 2009, several cigarette manufacturers filed a federal lawsuit against FDA challenging the constitutionality of a number of the restrictions imposed by these regulations, including the ban on color and graphics, limits on the right to make truthful statements regarding modified risk tobacco products, restrictions on the placement of outdoor advertising, and a ban on the distribution of product samples. In January 2010, a federal judge ruled that the regulations’ ban on the use of color and graphics in certain tobacco product advertising was unconstitutional and

prohibited FDA from enforcing that ban. The judge, however, let stand numerous other advertising and promotion restrictions. In March 2010, both parties appealed this decision. In May 2010, FDA issued a guidance document indicating that it intends to exercise its enforcement discretion and not commence enforcement

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actions based upon these provisions during the pendency of the litigation. We cannot predict the future course or outcome of this lawsuit.

In April 2010, a number of cigarette manufacturers filed a federal lawsuit against FDA challenging the restrictions on trade or brand names based upon First Amendment and other grounds. In May 2010, FDA issued a guidance document indicating that FDA is aware of concerns regarding the trade and brand name restrictions and is considering what changes, if any, would be appropriate to address those concerns. FDA also indicated that while the agency is considering those issues, it intends to exercise its enforcement discretion and not commence trade or brand name enforcement actions for the duration of its consideration where: (1) The trade or brand name of the cigarettes or smokeless tobacco product was registered, or the product was marketed, in the United States on or before June 22, 2009; or (2) The first marketing or registration in the United States of the tobacco product occurs before the first marketing or registration in the United States of the non-tobacco product bearing the same name; provided, however, that the tobacco and non-tobacco product are not owned, manufactured, or distributed by the same, related, or affiliated entities (including as a licensee). The lawsuit was subsequently stayed, at the request of the parties, while FDA is in the process of evaluating these concerns. We cannot predict the future course or outcome of FDA's deliberations or this litigation.

On June 22, 2011, FDA issued a final rule that modifies the required warnings that appear on cigarette packages and in cigarette advertisements. The rule was to become effective on September 22, 2012, and required each cigarette package and advertisement to bear one of nine new textual warning statements accompanied by graphic images. The warnings must appear on at least the top 50% of the front and rear panels of cigarette packages and occupy at least 20% of cigarette advertisements. In August 2011, a number of cigarette manufacturers, including Liggett, filed a federal lawsuit against FDA challenging the constitutionality of these new graphic warning labels on First Amendment and other grounds. The manufacturers sought a preliminary injunction staying implementation of the warning requirement, and other related labeling requirements, pending the court's ruling on the merits of the challenge. In November 2011, the District Court granted the industry's motion for a preliminary injunction, enjoining implementation of the proposed rules for graphic labels on cigarette packaging and advertising until 15 months after the District Court issues a final ruling in the case. FDA appealed the ruling. We cannot predict the ultimate outcome of this litigation or whether or how the inclusion of the new warnings, if ultimately required, will impact product sales or whether it will have a material adverse effect on us.

FDA law requires premarket review of "new tobacco products." A "new tobacco product" is one that was not commercially marketed in the U.S. before February 15, 2007 or that was modified after that date. In general, before a company may commercially market a "new tobacco product," it must either (a) submit an application and obtain an order from FDA permitting the product to be marketed; or (b) submit a report and receive an FDA order finding the product to be "substantially equivalent" to a "predicate" tobacco product that was commercially marketed in the U.S. prior to February 15, 2007. A "substantially equivalent" tobacco product is one that has the "same characteristics" as the predicate or one that has "different characteristics" but does not raise "different questions of public health." Manufacturers of products first introduced after February 15, 2007 and before March 22, 2011 who submitted a substantial equivalence report to FDA prior to March 23, 2011 may continue to market the tobacco product unless FDA issues an order that the product is not substantially equivalent. Failure to submit the report before March 23, 2011, or FDA's conclusion that such a "new tobacco product" is not substantially equivalent, will cause the product to be deemed misbranded and/or adulterated. After March 22, 2011, a "new tobacco product" may not be marketed without an FDA substantial equivalence determination. Prior to the deadline, Liggett and Vector Tobacco submitted substantial equivalence reports to FDA for numerous products. It is possible that FDA could determine some, or all, of these products are not "substantially equivalent" to a preexisting tobacco product. Such a determination could prevent us from marketing these products in the United States and could have a material adverse effect on us.

On July 5, 2011, FDA issued a final rule to establish the process and criteria for requesting an exemption from substantial equivalence requirements. We cannot predict how FDA will interpret and apply these requirements, or whether FDA will deem our products to be substantially equivalent to already marketed tobacco products.

Separately, the law also requires FDA to issue future regulations regarding the promotion and marketing of tobacco products sold through non-face-to-face transactions. FDA has been acting to implement the law and will continue to

implement various provisions over time. Liggett and Vector Tobacco have been monitoring FDA tobacco initiatives and have made various regulatory submissions to FDA in order to comply with new requirements. It is likely that the new tobacco law could result in a decrease in cigarette sales in the United States, including sales of Liggett's and Vector Tobacco's brands. Total compliance and related costs are not possible to predict and depend substantially on the future requirements imposed by FDA under the new tobacco law. Costs, however, could be substantial and could have a material adverse effect on the companies' financial condition, results of operations, and cash flows. In addition, FDA has a number of investigatory and enforcement tools available to it. We are aware, for example, that FDA has already requested company-specific information from competitors. FDA has also initiated a program to award contracts to states to assist with compliance and enforcement activities. Failure to comply with the new tobacco law and with FDA regulatory requirements could result in significant

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financial penalties and could have a material adverse effect on the business, financial condition and results of operation of both Liggett and Vector Tobacco. At present, we are not able to predict whether the new tobacco law will impact Liggett and Vector Tobacco to a greater degree than other companies in the industry, thus affecting its competitive position.

Litigation will continue to harm the tobacco industry.

Liggett could be subjected to substantial liabilities and bonding requirements from litigation relating to cigarette products. Adverse litigation outcomes could have a negative impact on the Company's ability to operate due to their impact on cash flows. We and our Liggett subsidiary, as well as the entire cigarette industry, continue to be challenged on numerous fronts, particularly with respect to the Engle progeny cases in Florida (described below). New cases continue to be commenced against Liggett and other cigarette manufacturers. As of December 31, 2011, there were approximately 5,800 individual suits, including the Engle progeny cases, six purported class actions and one health care cost recovery action pending in the United States in which Liggett and/or us were named defendants. It is likely that similar legal actions, proceedings and claims will continue to be filed against Liggett. Punitive damages, often in amounts ranging into the billions of dollars, are specifically pled in certain cases, in addition to compensatory and other damages. It is possible that there could be adverse developments in pending cases including the certification of additional class actions. An unfavorable outcome or settlement of pending tobacco-related litigation could encourage the commencement of additional litigation. In addition, an unfavorable outcome in any tobacco-related litigation could have a material adverse effect on our consolidated financial position, results of operations or cash flows. Liggett could face difficulties in obtaining a bond to stay execution of a judgment pending appeal.

A civil lawsuit was filed by the United States federal government seeking disgorgement of approximately \$289 billion from various cigarette manufacturers, including Liggett. In August 2006, the trial court entered a Final Judgment and Remedial Order against each of the cigarette manufacturing defendants, except Liggett. The Final Judgment, among other things, ordered the following relief against the non-Liggett defendants: (i) defendants are enjoined from committing any act of racketeering concerning the manufacturing, marketing, promotion, health consequences or sale of cigarettes in the United States; (ii) defendants are enjoined from making any material false, misleading, or deceptive statement or representation concerning cigarettes that persuades people to purchase cigarettes; and (iii) defendants are permanently enjoined from utilizing "lights", "low tar", "ultra lights", "mild" or "natural" descriptors, or conveying any other express or implied health messages in connection with the marketing or sale of cigarettes as of January 1, 2007. No monetary damages were awarded other than the government's costs. To the extent that the Final Judgment leads to a decline in industry-wide shipments of cigarettes in the United States or otherwise imposes regulations which adversely affect the industry, Liggett's sales volume, operating income and cash flows could be materially adversely affected, which in turn could negatively affect the value of our common stock.

Liggett Only Cases. There are currently seven cases pending where Liggett is the only tobacco company defendant. Cases where Liggett is the only defendant could increase substantially as a result of the Engle progeny cases. In February 2009, in *Ferlanti v. Liggett Group*, a Florida state court jury awarded compensatory damages to plaintiff and an \$816,000 judgment was entered by the court. That judgment was affirmed on appeal and was satisfied by Liggett in March 2011. In September 2010, the court awarded plaintiff legal fees of \$996,000. Plaintiff appealed the amount of the attorneys' fee award. Liggett previously accrued \$2.0 million for the *Ferlanti* case. In *Welch v. R.J. Reynolds* and *Katz v. R.J. Reynolds*, both Engle progeny cases, no trial dates have been set. There has been no recent activity in *Hausrath v. Philip Morris*, a case pending in New York state court, where two individuals are suing. The other three individual actions, in which Liggett is the only tobacco company defendant, are dormant.

As new cases are commenced, the costs associated with defending these cases and the risks relating to the inherent unpredictability of litigation continue to increase.

Individual tobacco-related cases have increased as a result of the Florida Supreme Court's ruling in *Engle*.

In May 2003, a Florida intermediate appellate court overturned a \$790 million punitive damages award against Liggett and decertified the *Engle v. R. J. Reynolds Tobacco Co.* smoking and health class action. In July 2006, the Florida Supreme Court affirmed in part and reversed in part the May 2003 intermediate appellate court decision. Among other things, the Florida Supreme Court affirmed the decision decertifying the class on a prospective basis and the order vacating the punitive damages award, but preserved several of the trial court's Phase I findings (including that:

(i) smoking causes lung cancer, among other diseases; (ii) nicotine in cigarettes is addictive; (iii) defendants placed cigarettes on the market that were defective and unreasonably dangerous; (iv) the defendants concealed material information; (v) all defendants sold or supplied cigarettes that were defective; and (vi) all defendants were negligent) and allowed plaintiffs to proceed to trial on individual liability issues (using the above findings) and compensatory and punitive damage issues, provided they commence their individual lawsuits within one year of the date the court's decision became final on January 11, 2007, the date of the court's mandate. In December 2006, the Florida Supreme Court added the finding that defendants sold or supplied cigarettes that, at the time of sale or supply, did not conform to the representations made by defendants.

In June 2002, the jury in a Florida state court action entitled *Lukacs v. R.J. Reynolds Tobacco Company*, awarded \$37.5 million in compensatory damages, jointly and severally, in a case involving Liggett and two other cigarette manufacturers, which amount

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was subsequently reduced by the Court. The jury found Liggett 50% responsible for the damages incurred by the plaintiff. The Lukacs case was the first case to be tried as an individual Engle class member suit following entry of final judgment by the Engle trial court. In November 2008, the court entered final judgment in the amount of \$24.835 million (for which Liggett was 50% responsible), plus interest from June 2002. After the appellate court affirmed the decision, Liggett paid its share of the award including interest and attorney's fees (\$14.361 million). Pursuant to the Florida Supreme Court's July 2006 ruling in Engle, former class members had one year from January 11, 2007 to file individual lawsuits. In addition, some individuals who filed suit prior to January 11, 2007, and who claim they meet the conditions in Engle, are attempting to avail themselves of the Engle ruling. Lawsuits by individuals requesting the benefit of the Engle ruling, whether filed before or after the January 11, 2007 mandate, are referred to as the "Engle progeny cases". As of December 31, 2011, there were 5,755 Engle progeny cases pending where Vector, Liggett, and other cigarette manufacturers were named as defendants. These cases include approximately 7,950 plaintiffs. As of December 31, 2011, there were 52 Engle progeny cases currently scheduled for trial in 2012. Through January 31, 2012, six adverse verdicts have been entered against Liggett in Engle progeny cases. These verdicts are on appeal although appellate efforts, to date, have not been successful.

It is possible that additional cases could be decided unfavorably and that there could be further adverse developments in the Engle case. Liggett may enter into discussions in an attempt to settle particular cases if it believes it is appropriate to do so. We cannot predict the cash requirements related to any future settlements and judgments, including cash required to bond any appeals, and there is a risk that those requirements will not be able to be met. Liggett may be adversely affected by the 2004 legislation to eliminate the federal tobacco quota system. In October 2004, federal legislation was enacted which eliminated the federal tobacco quota system and price support system through an industry funded buyout of tobacco growers and quota holders. Pursuant to the legislation, manufacturers of tobacco products will be assessed \$10.14 billion over a ten-year period to compensate tobacco growers and quota holders for the elimination of their quota rights. Cigarette manufacturers are currently responsible for 92% of the assessment (subject to adjustment in the future), which will be allocated based on relative unit volume of domestic cigarette shipments. Liggett's and Vector Tobacco's assessment was \$32.4 million in 2011, \$31.2 million in 2010 and \$22.9 million in 2009. The relative cost of the legislation to each of the three largest cigarette manufacturers will likely be less than the cost to smaller manufacturers, including Liggett and Vector Tobacco, because one effect of the legislation is that the three largest manufacturers will no longer be obligated to make certain contractual payments, commonly known as Phase II payments, they agreed in 1999 to make to tobacco-producing states. The ultimate impact of this legislation cannot be determined, but there is a risk that smaller manufacturers, such as Liggett and Vector Tobacco, will be disproportionately affected by the legislation, which could have a material adverse effect on us.

Excise tax increases adversely affect cigarette sales.

Cigarettes are subject to substantial and increasing federal, state and local excise taxes. In February 2009, Federal legislation to reauthorize the SCHIP, which includes funding provisions that increase the federal cigarette excise tax from \$0.39 to \$1.01 per pack, was enacted, effective April 1, 2009. State excise taxes vary considerably and, when combined with sales taxes, local taxes and the federal excise tax, may exceed \$4.00 per pack. Various states and other jurisdictions are considering, or have pending, legislation proposing further state excise tax increases. Management believes increases in excise and similar taxes have had, and will continue to have, an adverse effect on sales of cigarettes.

Liggett may have additional payment obligations under the Master Settlement Agreement.

NPM Adjustment. In March 2006, an economic consulting firm selected pursuant to the MSA determined that the MSA was a "significant factor contributing to" the loss of market share of Participating Manufacturers for 2003. This is known as the "NPM Adjustment." The economic consulting firm subsequently rendered the same decision with respect to 2004 and 2005. In March 2009, a different economic consulting firm made the same determination for 2006. As a result, the manufacturers are entitled to potential NPM Adjustments to their 2003, 2004, 2005 and 2006 MSA payments. The Participating Manufacturers are also entitled to potential NPM Adjustments to their 2007, 2008 and 2009 payments pursuant to an agreement entered into in June 2009 between the OPMs and the settling states under which the OPMs agreed to make certain payments for the benefit of the settling states, in exchange for which the

settling states stipulated that the MSA was a “significant factor contributing to” the loss of market share of Participating Manufacturers in 2007, 2008 and 2009. A settling state that has diligently enforced its qualifying escrow statute in the year in question may be able to avoid application of the NPM Adjustment to the payments made by the manufacturers for the benefit of that state or territory.

For 2003 - 2011 Liggett and Vector Tobacco, as applicable, disputed that they owe the Settling States the NPM Adjustments as calculated by the Independent Auditor. As permitted by the MSA, Liggett and Vector Tobacco withheld payment associated with these NPM Adjustment amounts. For 2003, Liggett and Vector Tobacco paid the NPM adjustment amount of \$9.3 million to the Settling States although both companies continue to dispute this amount is owed. The total amount withheld (or paid into a disputed payment account) by Liggett and Vector Tobacco for 2004 - 2011 was \$46.9 million. At December 31, 2011 included

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in “Other assets” on our consolidated balance sheet was a non-current receivable of \$6.5 million relating to the \$9.3 million payment. Arbitration of the 2003 NPM Adjustment is pending. Liggett is currently engaged in an arbitration with the states over the NPM Adjustment.

The following amounts have not been expensed by the Company as they relate to Liggett and Vector Tobacco’s NPM Adjustment claims for 2003 through 2009: \$6.5 million for 2003, \$3.8 million for 2004 and \$800,000 for 2005.

Gross v. Net Calculations. In October 2004, the Independent Auditor notified Liggett and all other Participating Manufacturers that their payment obligations under the MSA, dating from the agreement’s execution in late 1998, had been recalculated using “net” unit amounts, rather than “gross” unit amounts (which had been used since 1999).

Liggett, along with certain other Participating Manufacturers, objected to this retroactive change and disputed the change in methodology. Liggett contends that the retroactive change from using “gross” to “net” unit amounts is impermissible for several reasons, including:

- use of “net” unit amounts is not required by the MSA (as reflected by, among other things, the use of “gross” unit amounts through 2005);

- such a change is not authorized without the consent of affected parties to the MSA;

- the MSA provides for four-year time limitation periods for revisiting calculations and determinations, which precludes recalculating Liggett’s 1997 Market Share (and thus, Liggett’s market share exemption); and

- Liggett and others have relied upon the calculations based on “gross” unit amounts since 1998.

The change in the method of calculation could, among other things, result in at least approximately \$10.2 million, plus interest, of additional MSA payments for prior years by Liggett, because the proposed change from “gross” to “net” units would serve to lower Liggett’s market share exemption under the MSA. The Company currently estimates that future annual MSA payments would be a least \$2.5 million higher if the method of calculation is changed. Liggett is currently engaged in an arbitration with the states over the "gross" versus "net" calculation.

No amounts have been expensed or accrued in the accompanying consolidated financial statements for any potential liability relating to the “gross” versus “net” dispute.

Liggett may have additional payment obligations under its state settlements.

In 2004, the Attorneys General for each of Florida, Mississippi and Texas advised Liggett that they believed that Liggett had failed to make all required payments under the respective settlement agreements with these states for the period 1998 through 2003 and that additional payments may be due for 2004 and subsequent years. Liggett believes these allegations are without merit, based, among other things, on the language of the most favored nation provisions of the settlement agreements and no amounts have been accrued in our consolidated financial statements for any additional amounts that may be payable by Liggett under the settlement agreements with Mississippi and Texas.

Liggett settled the dispute with Florida in 2010 and agreed to, among other things, pay Florida \$1.2 million plus \$250,000 per year for the next 21 years. The payment in years 12-21 will be subject to an inflation adjustment. In February 2012, Mississippi provided Liggett with a 60-day notice that the state intended to pursue its remedies if Liggett did not cure its alleged defaults. There can be no assurance that Liggett will prevail in the remaining matters and that Liggett will not be required to make additional material payments, which payments could materially adversely affect our consolidated financial position, results of operations or cash flows and the value of our common stock.

New Valley is subject to risks relating to the industries in which it operates.

Risks of real estate ventures. New Valley has a number of real estate-related investments, including Douglas Elliman Realty (50% interest), New Valley Oaktree Chelsea Eleven LLC (40% interest) and Fifty Third-Five Building LLC (50% interest), Sesto Holdings S.r.L (7.2% interest), 1107 Broadway (5% interest), NV SOCAL LLC (26% interest) and HFZ East 68th Street (18% interest), where other partners hold significant interests. New Valley must seek approval from these other parties for important actions regarding these joint ventures. Since the other parties’ interests may differ from those of New Valley, a deadlock could arise that might impair the ability of the ventures to function. Such a deadlock could significantly harm the ventures.

The volatility in the capital and credit markets has increased in recent years. Because the volatility in capital and credit markets may create additional risks in the upcoming months and possibly years, the Company will continue to perform additional assessments to determine the impact, if any, on the Company’s consolidated financial statements.

Thus, future impairment charges may occur.

New Valley may pursue a variety of real estate development projects. Development projects are subject to special risks including potential increase in costs, changes in market demand, inability to meet deadlines which may delay the timely completion of projects, reliance on contractors who may be unable to perform and the need to obtain various governmental and third party

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consents.

Risks relating to the residential brokerage business. Through New Valley's investment in Douglas Elliman Realty, we are subject to the risks and uncertainties endemic to the residential brokerage business. Douglas Elliman Realty's two subsidiaries, which conduct business as Prudential Douglas Elliman Real Estate, operate as franchisees of The Prudential Real Estate Affiliates, Inc. Prudential Douglas Elliman Real Estate operates each of its offices under its franchiser's brand name, and the franchiser has significant rights over the use of the franchised service marks and the conduct of the two brokerage companies' business. The franchise agreements require the companies to:

- coordinate with the franchiser on significant matters relating to their operations, including the opening and closing of offices;
- make substantial royalty payments to the franchiser and contribute significant amounts to national advertising funds maintained by the franchiser;
- indemnify the franchiser against losses arising out of the operations of their business under the franchise agreements; and
- maintain standards and comply with guidelines relating to their operations which are applicable to all franchisees of the franchiser's real estate franchise system.

The franchiser has the right to terminate Prudential Douglas Elliman Real Estate's franchises, upon the occurrence of certain events, including a bankruptcy or insolvency event, a change in control, a transfer of rights under the franchise agreement and a failure to promptly pay amounts due under the franchise agreements. A termination of Prudential Douglas Elliman Real Estate's franchise agreements could adversely affect our investment in Douglas Elliman Realty. The franchise agreements grant Prudential Douglas Elliman Real Estate exclusive franchises in New York for the counties of Nassau and Suffolk on Long Island and for Manhattan, Brooklyn and Queens, subject to various exceptions and to meeting specified annual revenue thresholds. If the company fails to achieve these levels of revenues for two consecutive years or otherwise materially breach the franchise agreements, the franchiser would have the right to terminate its exclusivity rights. A loss of these rights could have a material adverse on Douglas Elliman Realty.

Real estate ventures and mortgage receivables have been negatively impacted by the current downturn in the residential real estate market. The U.S. residential real estate market, including the New York metropolitan area where Douglas Elliman Realty operates, is cyclical and is affected by changes in the general economic conditions that are beyond the control of Douglas Elliman Realty. The U.S. residential real estate market is currently in a significant downturn due to various factors including downward pressure on housing prices, credit constraints inhibiting new buyers and an exceptionally large inventory of unsold homes at the same time that sales volumes are decreasing. The depth and length of the current downturn in the real estate industry has proved exceedingly difficult to predict. We cannot predict whether the downturn will worsen or when the market and related economic forces will return the U.S. residential real estate industry to a growth period.

Any of the following could have a material adverse effect on our real estate ventures by causing a general decline in the number of home sales and/or prices, which in turn, could adversely affect their revenues and profitability:

- periods of economic slowdown or recession;
- rising interest rates;
- the general availability of mortgage financing, including:
- the impact of the recent contraction in the subprime and mortgage markets generally; and
- the effect of more stringent lending standards for home mortgages;
- adverse changes in economic and general business conditions in the New York metropolitan area;
- a decrease in the affordability of homes;
- declining demand for real estate;
- a negative perception of the market for residential real estate;
- commission pressure from brokers who discount their commissions;
- acts of God, such as hurricanes, earthquakes and other natural disasters, or acts or threats of war or terrorism; and/or
- an increase in the cost of homeowners insurance.

The three major real estate ventures' current operations are located in the New York metropolitan area. Local and regional economic and general business conditions in this market could differ materially from prevailing conditions in other parts of the country. Among other things, the New York metropolitan area residential real estate market has been impacted by the significant

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downturn in the financial services industry. A continued downturn in the residential real estate market or economic conditions in that region could have a material adverse effect on these investments.

Potential new investments we may make are unidentified and may not succeed.

We currently hold a significant amount of marketable securities and cash not committed to any specific investments. This subjects a security holder to increased risk and uncertainty because a security holder will not be able to evaluate how this cash will be invested and the economic merits of particular investments. There may be substantial delay in locating suitable investment opportunities. In addition, we may lack relevant management experience in the areas in which we may invest. There is a risk that we will fail in targeting, consummating or effectively integrating or managing any of these investments.

We depend on our key personnel.

We depend on the efforts of our executive officers and other key personnel. While we believe that we could find replacements for these key personnel, the loss of their services could have a significant adverse effect on our operations.

We are exposed to risks from legislation requiring companies to evaluate their internal control over financial reporting.

Section 404 of the Sarbanes-Oxley Act of 2002 requires our management to assess, and our independent registered certified public accounting firm to attest to, the effectiveness of our internal control structure and procedures for financial reporting. We completed an evaluation of the effectiveness of our internal control over financial reporting for the fiscal year ended December 31, 2010, and we have an ongoing program to perform the system and process evaluation and testing necessary to continue to comply with these requirements. We expect to continue to incur expense and to devote management resources to Section 404 compliance. In the event that our chief executive officer, chief financial officer or independent registered certified public accounting firm determines that our internal control over financial reporting is not effective as defined under Section 404, investor perceptions and our reputation may be adversely affected and the market price of our stock could decline.

The price of our common stock may fluctuate significantly.

The trading price of our common stock has ranged between \$14.64 and \$18.36 per share over the past 52 weeks. We expect that the market price of our common stock will continue to fluctuate.

The market price of our common stock may fluctuate in response to numerous factors, many of which are beyond our control. These factors include the following:

- actual or anticipated fluctuations in our operating results;
- changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;
- the operating and stock performance of our competitors;
- announcements by us or our competitors of new products or services or significant contract, acquisitions, strategic partnerships, joint ventures or capital commitments;
- the initiation or outcome of litigation;
- changes in interest rates;
- general economic, market and political conditions;
- additions or departures of key personnel; and
- future sales of our equity or convertible securities.

We cannot predict the extent, if any, to which future sales of shares of common stock or the availability of shares of common stock for future sale, may depress the trading price of our common stock.

In addition, the stock market in recent years has experienced extreme price and trading volume fluctuations that often have been unrelated or disproportionate to the operating performance of individual companies. These broad market fluctuations may adversely affect the price of our common stock, regardless of our operating performance.

Furthermore, stockholders may initiate securities class action lawsuits if the market price of our stock drops significantly, which may cause us to incur substantial costs and could divert the time and attention of our management. These factors, among others, could significantly depress the price of our common stock.

We have many potentially dilutive securities outstanding.

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At December 31, 2011, we had outstanding options granted to employees to purchase approximately 2,581,452 shares of our common stock, with a weighted-average exercise price of \$11.70 per share, of which options for 373,199 shares were exercisable at December 31, 2011. We also have outstanding convertible notes and debentures maturing in November 2014 and June 2026, which are currently convertible into 17,314,438 shares of our common stock. The issuance of these shares will cause dilution which may adversely affect the market price of our common stock. The availability for sale of significant quantities of our common stock could adversely affect the prevailing market price of the stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our principal executive offices are located in Miami, Florida. We lease 13,849 square feet of office space from an unaffiliated company in an office building in Miami, which we share with various of our subsidiaries. The lease expires in November 2014.

We lease approximately 18,000 square feet of office space in New York, New York under leases that expire in 2013. Approximately 9,000 square feet of such space has been subleased to unaffiliated third parties for the balance of the term of the lease. New Valley's operating properties are discussed above under the description of New Valley's business.

Liggett's tobacco manufacturing facilities, and several of the distribution and storage facilities, are currently located in or near Mebane, North Carolina. Various of such facilities are owned and others are leased. As of December 31, 2011, the principal properties owned or leased by Liggett are as follows:

Type	Location	Owned or Leased	Approximate Total Square Footage
Storage Facilities	Danville, VA	Owned	578,000
Office and Manufacturing Complex	Mebane, NC	Owned	240,000
Warehouse	Mebane, NC	Owned	60,000
Warehouse	Mebane, NC	Leased	125,000
Warehouse	Mebane, NC	Leased	22,000

LVB leases approximately 20,000 square feet of office space in Morrisville, North Carolina. The lease expires in January 2013.

Liggett's management believes that its property, plant and equipment are well maintained and in good condition and that its existing facilities are sufficient to accommodate a substantial increase in production.

ITEM 3. LEGAL PROCEEDINGS

Liggett and other United States cigarette manufacturers have been named as defendants in numerous, direct, third-party and class actions predicated on the theory that they should be liable for damages from adverse health effects alleged to have been caused by cigarette smoking or by exposure to secondary smoke from cigarettes. Reference is made to Note 12 to our consolidated financial statements, which contains a general description of certain legal proceedings to which the Company, Liggett or their subsidiaries are a party and certain related matters. Reference is also made to Exhibit 99.1, Material Legal Proceedings, incorporated herein, for additional information regarding the pending tobacco-related legal proceedings to which we or Liggett are parties. A copy of Exhibit 99.1 will be furnished without charge upon written request to us at our principal executive offices, 100 S.E. Second Street, Miami, Florida 33131, Attn: Investor Relations.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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PART II

ITEM MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND
5. ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is listed and traded on the New York Stock Exchange under the symbol "VGR". The following table sets forth, for the periods indicated, high and low sale prices for a share of its common stock on the NYSE, as reported by the NYSE, and quarterly cash dividends declared on shares of common stock:

Year	High	Low	Cash Dividends
2011:			
Fourth Quarter	\$18.20	\$16.53	\$0.40
Third Quarter	18.36	15.48	\$0.38
Second Quarter	18.34	16.47	\$0.38
First Quarter	16.91	14.64	\$0.38
2010:			
Fourth Quarter	\$18.16	\$15.25	\$0.38
Third Quarter	18.87	15.03	0.36
Second Quarter	15.73	12.59	0.36
First Quarter	14.43	12.29	0.36

At February 15, 2012, there were approximately 1,959 holders of record of our common stock.

The declaration of future cash dividends is within the discretion of our Board of Directors and is subject to a variety of contingencies such as market conditions, earnings and our financial condition as well as the availability of cash.

Liggett's revolving credit agreement currently permits Liggett to pay dividends to VGR Holding only if Liggett's borrowing availability exceeds \$5 million for the 30 days prior to payment of the dividend, and so long as no event of default has occurred under the agreement, including Liggett's compliance with the covenants in the credit facility, including maintaining minimum levels of EBITDA (as defined) if its borrowing availability is less than \$20 million and not exceeding maximum levels of capital expenditures (as defined).

Our 11% Senior Secured Notes due 2015 prohibit our payment of cash dividends or distributions on our common stock if at the time of such payment our Consolidated EBITDA (as defined) for the most recently completed four full fiscal quarters is less than \$50 million. Our Consolidated EBITDA for the four quarters ended December 31, 2011 exceeded \$50 million.

We paid 5% stock dividends on September 29, 2011, September 29, 2010, and September 29, 2009 to the holders of our common stock. All information presented in this report is adjusted for the stock dividends.

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Performance Graph

The following graph compares the total annual return of our Common Stock, the S&P 500 Index, the S&P MidCap 400 Index and the NYSE Arca Tobacco Index, formerly known as the AMEX Tobacco Index, for the five years ended December 31, 2011. The graph assumes that \$100 was invested on December 31, 2006 in the Common Stock and each of the indices, and that all cash dividends and distributions were reinvested.

	12/06	12/07	12/08	12/09	12/10	12/11
Vector Group Ltd.	100	128	100	121	172	203
S&P 500	100	105	67	84	97	99
S&P MidCap	100	108	69	95	120	118
NYSE Arca Tobacco	100	110	88	124	147	172

Unregistered Sales of Equity Securities and Use of Proceeds

Except for approximately 3,782,308 shares of our common stock issued as a stock dividend on September 29, 2011, no securities of ours which were not registered under the Securities Act of 1933 were issued or sold by us during the twelve months ended December 31, 2011.

Issuer Purchases of Equity Securities

No other securities of ours which were not registered under the Securities Act of 1933 were purchased by us during the three months ended December 31, 2011.

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EXECUTIVE OFFICERS OF THE REGISTRANT

The table below, together with the accompanying text, presents certain information regarding all our current executive officers as of February 24, 2012. Each of the executive officers serves until the election and qualification of such individual's successor or until such individual's death, resignation or removal by the Board of Directors.

Name	Age	Position	Year Individual Became an Executive Officer
Howard M. Lorber	63	President and Chief Executive Officer	2001
Richard J. Lampen	58	Executive Vice President	1996
J. Bryant Kirkland III	46	Vice President, Chief Financial Officer and Treasurer	2006
Marc N. Bell	51	Vice President, General Counsel and Secretary	1998
Ronald J. Bernstein	58	President and Chief Executive Officer of Liggett	2000

Howard M. Lorber has been our President and Chief Executive Officer since January 2006. He served as our President and Chief Operating Officer from January 2001 to December 2005 and has served as a director of ours since January 2001. From November 1994 to December 2005, Mr. Lorber served as President and Chief Operating Officer of New Valley, where he also served as a director. Mr. Lorber was Chairman of the Board of Hallman & Lorber Assoc., Inc., consultants and actuaries of qualified pension and profit sharing plans, and various of its affiliates from 1975 to December 2004 and has been a consultant to these entities since January 2005; Chairman of the Board of Directors since 1987 and Chief Executive Officer from November 1993 to December 2006 of Nathan's Famous, Inc., a chain of fast food restaurants; a director of United Capital Corp., a real estate investment and diversified manufacturing company, since May 1991; Chairman of the Board of Ladenburg Thalmann Financial Services from May 2001 to July 2006 and Vice Chairman since July 2006 and was a Director of Borders Group Inc. from May 2010 until January 2012. He is also a trustee of Long Island University.

Richard J. Lampen has served as our Executive Vice President since July 1996. From October 1995 to December 2005, Mr. Lampen served as the Executive Vice President and General Counsel of New Valley, where he also served as a director. Since September 2006, he has served as President and Chief Executive Officer of Ladenburg Thalmann Financial Services. From November 1998 to November 2011, he served as President and Chief Executive Officer of CDSI Holdings Inc., an affiliate of New Valley, which is now known as SG Blocks Inc. Since October 2008, Mr. Lampen has served as President and Chief Executive Officer of Castle Brands Inc., a publicly traded developer and importer of premium branded spirits in which we held an approximate 11% equity interest at December 31, 2011. From May 1992 to September 1995, Mr. Lampen was a partner at Steel Hector & Davis, a law firm located in Miami, Florida. From January 1991 to April 1992, Mr. Lampen was a Managing Director at Salomon Brothers Inc, an investment bank, and was an employee at Salomon Brothers Inc from 1986 to April 1992. Mr. Lampen is a director of Castle, SG Blocks Inc. and Ladenburg Thalmann Financial Services.

J. Bryant Kirkland III has been our Vice President, Chief Financial Officer and Treasurer since April 2006. Mr. Kirkland has served as a Vice President of ours since January 2001 and served as New Valley's Vice President and Chief Financial Officer from January 1998 to December 2005. He has served since July 1992 in various financial capacities with us, Liggett and New Valley. Mr. Kirkland served as Vice President, Treasurer and Chief Financial Officer of SG Blocks Inc. from January 1998 to November 2011 and as a director of SG Blocks Inc. since November 1998.

Marc N. Bell has been our General Counsel and Secretary since May 1994 and our Vice President since January 1998 and the Senior Vice President and General Counsel of Vector Tobacco since April 2002. From November 1994 to December 2005, Mr. Bell served as Associate General Counsel and Secretary of New Valley and from February 1998 to December 2005, as a Vice President of New Valley. Mr. Bell previously served as Liggett's General Counsel and currently serves as an officer, director or manager for many of Vector's or New Valley's subsidiaries. Prior to May

1994, Mr. Bell was with the law firm of Zuckerman Spaeder LLP in Miami, Florida and from June 1991 to May 1993, with the law firm of Fischbein Badillo Wagner Harding in New York, New York.

Ronald J. Bernstein has served as President and Chief Executive Officer of Liggett since September 1, 2000 and of Liggett Vector Brands since March 2002 and has been a director of ours since March 2004. From July 1996 to December 1999, Mr. Bernstein served as General Director and, from December 1999 to September 2000, as Chairman of Liggett-Ducat, our former Russian tobacco business sold in 2000. Prior to that time, Mr. Bernstein served in various positions with Liggett commencing in 1991, including Executive Vice President and Chief Financial Officer.

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ITEM 6. SELECTED FINANCIAL DATA

	Year Ended December 31,				
	2011	2010	2009	2008	2007
	(dollars in thousands, except per share amounts)				
Statement of Operations Data:					
Revenues(1)	\$1,133,380	\$1,063,289	\$801,494	\$565,186	\$555,430
Net income	75,020	54,084	24,806	60,504	73,803
Per basic common share(2):					
Net income applicable to common shares	\$0.93	\$0.68	\$0.31	\$0.77	\$0.95
Per diluted common share(2):					
Net income applicable to common shares	\$0.93	\$0.67	\$0.31	\$0.69	\$0.93
Cash distributions declared per common share(2)	\$1.54	\$1.47	\$1.40	\$1.33	\$1.27
Balance Sheet Data:					
Current assets	\$509,741	\$526,763	\$389,208	\$355,283	\$395,626
Total assets	927,768	949,595	735,542	717,712	785,289
Current liabilities	315,198	226,872	149,008	296,159	109,337
Notes payable, embedded derivatives, long-term debt and other obligations, less current portion	542,371	647,064	487,936	287,546	378,760
Non-current employee benefits, deferred income taxes and other long-term liabilities	159,229	121,893	103,280	100,402	196,340
Stockholders' (deficiency) equity	(89,030)	(46,234)	(4,682)	33,605	100,852

Revenues include federal excise taxes of \$552,965, \$538,328, \$377,771, \$168,170 and \$176,269, respectively.

(1) Effective April 1, 2009, federal excises taxes increased from \$0.39 per pack of cigarettes to \$1.01 per pack of cigarettes.

(2) Per share computations include the impact of 5% stock dividends on September 29, 2011, September 29, 2010, September 29, 2009, September 29, 2008 and September 28, 2007.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Dollars in Thousands, Except Per Share Amounts)

Overview

We are a holding company and are engaged principally in:

- the manufacture and sale of cigarettes in the United States through our Liggett Group LLC and Vector Tobacco Inc. subsidiaries, and

- the real estate business through our New Valley LLC subsidiary, which is seeking to acquire additional operating companies and real estate properties. New Valley owns 50% of Douglas Elliman Realty, LLC, which operates the largest residential brokerage company in the New York metropolitan area.

All of our tobacco operation's unit sales volume in 2011, 2010 and 2009 was in the discount segment, which management believes has been the primary growth segment in the industry for over a decade. The significant discounting of premium cigarettes in recent years has led to brands, such as EVE, that were traditionally considered premium brands to become more appropriately categorized as discount, following list price reductions.

Our tobacco subsidiaries' cigarettes are produced in approximately 118 combinations of length, style and packaging. Liggett's current brand portfolio includes:

- **PYRAMID** — the industry's first deep discount product with a brand identity re-launched in the second quarter of 2009, and

- **GRAND PRIX** — re-launched as a national brand in 2005,

- **LIGGETT SELECT** — a leading brand in the deep discount category,

- **EVE** — a leading brand of 120 millimeter cigarettes in the branded discount category, and

- **USA** and various Partner Brands and private label brands.

In 1999, Liggett introduced LIGGETT SELECT, one of the leading brands in the deep discount category. LIGGETT SELECT's represented 8.7% in 2011, 13.0% in 2010 and 21.5% in 2009 of Liggett's unit volume. In September 2005, Liggett repositioned GRAND PRIX to distributors and retailers nationwide. GRAND PRIX represented 12.7% in 2011, 18.5% in 2010 and 27.9% in 2009 of Liggett's unit volume. In April 2009, Liggett repositioned PYRAMID as a box-only brand with a new low price to specifically compete with brands which are priced at the lowest level of the deep discount segment. PYRAMID is now the largest seller in Liggett's family of brands with 56.4% of Liggett's unit volume in 2011, 42.6% in 2010 and 14.6% in 2009. According to Management Science Associates, Liggett held a share of approximately 12.8% of the overall discount market segment for 2011 compared to 11.9% for 2010 and 9.2% for 2009.

Under the Master Settlement Agreement ("MSA") reached in November 1998 with 46 states and various territories, the three largest cigarette manufacturers must make settlement payments to the states and territories based on how many cigarettes they sell annually. Liggett, however, is not required to make any payments unless its market share exceeds approximately 1.65% of the U.S. cigarette market. Additionally, Vector Tobacco has no payment obligation unless its market share exceeds approximately 0.28% of the U.S. market. Liggett's and Vector Tobacco's payments under the MSA are based on each company's incremental market share above the minimum threshold applicable to such company. We believe that our tobacco subsidiaries have gained a sustainable cost advantage over their competitors as a result of the settlement.

The discount segment is a challenging marketplace, with consumers having less brand loyalty and placing greater emphasis on price. Liggett's competition is now divided into two segments. The first segment is made up of the three largest manufacturers of cigarettes in the United States, Philip Morris USA Inc., Reynolds America Inc., and Lorillard Tobacco Company. The three largest manufacturers, while primarily premium cigarette based companies, also produce and sell discount cigarettes. The second segment of competition is comprised of a group of smaller manufacturers and importers, most of which sell deep discount cigarettes. Our largest competitor in this segment is Commonwealth Brands, Inc. (a wholly owned subsidiary of Imperial Tobacco PLC).

Recent Developments

Senior Secured Notes. We have outstanding \$415,000 principal amount of our 11% Senior Secured Notes due 2015 (the "Senior Secured Notes"). The Senior Secured Notes were sold in August 2007 (\$165,000), September 2009 (\$85,000), April 2010 (\$75,000) and December 2010 (\$90,000) in private offerings to qualified institutional investors in accordance with Rule 144A of the Securities Act of 1933.

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In May 2008 and June 2010, we completed offers to exchange the Senior Secured Notes then outstanding for an equal amount of newly issued 11% Senior Secured Notes due 2015. The new Senior Secured Notes have substantially the same terms as the original Notes, except that the new Senior Secured Notes have been registered under the Securities Act. In May 2011, we completed an exchange offer to exchange the Senior Secured Notes issued in December 2010 for an equal amount of newly issued 11% Senior Secured Notes due 2015. The new Senior Secured Notes have substantially the same terms as the original Notes, except that the new Senior Secured Notes have been registered under the Securities Act.

5% Variable Interest Senior Convertible Notes Due November 2011. Between November 2004 and April 2005, we sold \$111,864 principal amount of our 5% Variable Interest Senior Convertible Notes due November 15, 2011 (the “5% Notes”). In May 2009, the holder of \$11,005 principal amount of the 5% Notes exchanged its 5% Notes for \$11,775 principal amount of our 6.75% Variable Interest Senior Convertible Note due 2014 (the “6.75% Note”) as discussed below. In June 2009, certain holders of \$99,944 principal amount of the 5% Notes exchanged their 5% Notes for \$106,940 principal amount of our 6.75% Variable Interest Senior Convertible Exchange Notes due 2014 (the “6.75% Exchange Notes”). In November 2009, we retired \$360 of the remaining \$915 principal amount of the 5% Notes for cash and exchanged approximately \$555 of the remaining 5% Notes for \$593 principal amount of the 6.75% Exchange Notes. As of December 31, 2009, no 5% Notes remained outstanding after these exchanges. We recorded a loss of \$18,573 associated with the extinguishment of the 5% Notes for the year ended December 31, 2009.

6.75% Variable Interest Senior Convertible Note due 2014. On May 11, 2009, we issued in a private placement the 6.75% Note in the principal amount of \$50,000. The purchase price was paid in cash (\$38,225) and by tendering \$11,005 principal amount of the 5% Notes, valued at 107% of principal amount. The note pays interest (“Total Interest”) on a quarterly basis at a rate of 3.75% per annum plus additional interest, which is based on the amount of cash dividends paid during the prior three-month period ending on the record date for such interest payment multiplied by the total number of shares of its common stock into which the debt will be convertible on such record date. Notwithstanding the foregoing, however, the interest payable on each interest payment date shall be the higher of (i) the Total Interest or (ii) 6.75% per annum. The note is convertible into our common stock at the holder’s option. As of December 31, 2011, the conversion price of \$12.99 per share (approximately 76.9697 shares of common stock per \$1,000 principal amount of the note) is subject to adjustment for various events, including the issuance of stock dividends. The note matures on November 15, 2014. We will redeem on May 11, 2014 and at the end of each interest accrual period thereafter an additional amount, if any, of the note necessary to prevent the note from being treated as an “Applicable High Yield Discount Obligation” under the Internal Revenue Code. If a fundamental change (as defined in the note) occurs, we will be required to offer to repurchase the note at 100% of its principal amount, plus accrued interest.

The purchaser of this 6.75% Note is an entity affiliated with Dr. Phillip Frost, who reported, after the consummation of the sale, beneficial ownership of approximately 11.7% of our common stock. In November 2011, Dr. Frost reported that entities affiliated with him had beneficial ownership of 18.5% of our common stock following the purchase of additional shares in a privately-negotiated transaction from an existing stockholder.

6.75% Variable Interest Senior Convertible Exchange Notes due 2014. On June 15, 2009, we entered into agreements with certain holders of the 5% Notes to exchange their 5% notes for our 6.75% Exchange Notes. On June 30, 2009, we accepted for exchange \$99,944 principal amount of the 5% Notes for \$106,940 principal amount of our 6.75% Exchange Notes. In November, 2009, we exchanged approximately \$555 of the remaining 5% Notes for \$593 principal amount of our 6.75% Variable Interest Senior Convertible Exchange Notes due 2014.

We issued the 6.75% Exchange Notes to the holders in reliance on the exemption from the registration requirements of the Securities Act of 1933 afforded by Section 3(a)(9) thereof. The notes pay interest (“Total Interest”) on a quarterly basis beginning August 15, 2009 at a rate of 3.75% per annum plus additional interest, which is based on the amount of cash dividends paid during the prior three-month period ending on the record date for such interest payment multiplied by the total number of shares of its common stock into which the debt will be convertible on such record date. Notwithstanding the foregoing, however, the interest payable on each interest payment date shall be the higher of (i) the Total Interest or (ii) 6.75% per annum. The notes are convertible into our common stock at the holder’s option.

As of December 31, 2011, the conversion price of \$14.74 per share (approximately 67.8442 shares of common stock per \$1,000 principal amount of notes) is subject to adjustment for various events, including the issuance of stock dividends. The notes will mature on November 15, 2014. We will redeem on June 30, 2014 and at the end of each interest accrual period thereafter an additional amount, if any, of the notes necessary to prevent the notes from being treated as an “Applicable High Yield Discount Obligation” under the Internal Revenue Code. If a fundamental change (as defined in the indenture) occurs, we will be required to offer to repurchase the notes at 100% of their principal amount, plus accrued interest and, under certain circumstances, a “make whole” payment.

Enacted and proposed excise tax increases. On April 1, 2009, the federal cigarette excise tax was increased from \$3.90 per carton (\$0.39 per pack) to \$10.07 per carton (\$1.01 per pack). State excise taxes vary considerably and, when combined with sales taxes, local taxes and the federal excise tax, may exceed \$4.00 per pack. Various states and other jurisdictions are considering, or have pending, legislation proposing further state excise tax increases.

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Real Estate Activities. New Valley accounts for its 50% interest in Douglas Elliman Realty LLC and its 40% interest in New Valley Oaktree Chelsea Eleven LLC on the equity method. Douglas Elliman Realty operates the largest residential brokerage company in the New York metropolitan area.

Escena. In March 2008, a subsidiary of New Valley purchased a loan collateralized by a substantial portion of a 450-acre approved master planned community in Palm Springs, California known as “Escena.” The loan, which was in foreclosure, was purchased for its \$20,000 face value plus accrued interest and other costs of \$1,445. The collateral consists of 867 residential lots with site and public infrastructure, an 18-hole golf course, a substantially completed clubhouse, and a seven-acre site approved for a 450-room hotel.

We recorded an operating loss of \$503, \$631 and \$886 for the years ended December 31, 2011, 2010 and 2009, respectively, from Escena.

New Valley Oaktree Chelsea Eleven, LLC. As of February 15, 2012, 52 of the 54 units in the Chelsea Eleven LLC real estate development had been sold.

As of December 31, 2011, Chelsea Eleven LLC had approximately \$17,628 of total assets and \$1,345 of total liabilities, excluding amounts owed to New Valley Oaktree Chelsea Eleven LLC. Chelsea Eleven LLC retired its construction loan during the second quarter of 2010 from the proceeds of the sales of units. In addition, on July 1, 2010, Chelsea Eleven LLC borrowed \$47,100 to retire Chelsea Eleven LLC’s then outstanding mezzanine debt (approximately \$37,200) and for other working capital purposes. The loan was repaid in 2011.

As of December 31, 2011, we received net distributions of \$7,638 and \$1,042 from New Valley Oaktree Chelsea Eleven LLC for the years ended December 31, 2011 and 2010, respectively. We recorded equity income of \$3,000, \$900 and \$1,500 for the years ended December 31, 2011, 2010 and 2009, respectively, related to New Valley Chelsea. Our maximum exposure to loss as a result of its investment in Chelsea is \$6,320.

Aberdeen Townhomes LLC. In June 2008, a subsidiary of New Valley purchased a preferred equity interest in Aberdeen Townhomes LLC for \$10,000. Aberdeen acquired five townhome residences located in Manhattan, New York, which it is in the process of rehabilitating and selling. Each of the townhomes has been sold and this project is concluded. We recorded an impairment loss of \$3,500 in each of 2008 and 2009. We recorded gains of \$3,843 in 2011, which was reflected as Gain on Townhomes, and in 2010 we recognized a gain of \$760 primarily resulting from the acquisition of mortgage loans and operating income of \$352. These amounts were reflected as a reduction of operating, selling, administrative and general.

Fifty Third-Five Building LLC. In September 2010, New Valley, through its NV 955 LLC subsidiary, contributed \$2,500 to a joint venture, Fifty Third-Five Building LLC (“JV”), of which it owns 50%. The JV was formed for the purposes of acquiring a defaulted real estate loan, collateralized by real estate located in New York City. In October 2010, New Valley contributed an additional \$15,500 to the JV and the JV acquired the defaulted loan for approximately \$35,500. The previous lender had commenced proceedings seeking to foreclose its mortgage. Upon acquisition of the loan, the JV succeeded to the rights of the previous lender in the litigation. In April 2011, the court granted the JV’s motion for summary judgment, dismissing certain substantive defenses raised by the borrower and the other named parties. Thereafter, the borrower challenged the validity of the assignment from the previous lender to the JV. In February 2012, the court affirmed the validity of the assignment and its decision to grant summary judgment. The JV is a variable interest entity; however, we are not the primary beneficiary. Our maximum exposure to loss as a result of its investment in the JV is \$18,000. This investment is being accounted for under the equity method.

Sesto Holdings S.r.l. In October 2010, New Valley, through its NV Milan LLC subsidiary, acquired a 7.2% interest in Sesto Holdings S.r.l. for approximately \$5,000. Sesto holds a 42% interest in an entity that has purchased approximately 322 acres in Milan, Italy. Sesto intends to develop the land as a multi-parcel, multi-building mixed use urban regeneration project. Sesto is a variable interest entity; however, we are not the primary beneficiary. Our maximum exposure to loss as a result of New Valley’s investment in Sesto is \$5,037. New Valley accounts for Sesto under the equity method of accounting.

Loft 21 LLC. In February 2011, New Valley invested \$900 for an approximate 12% interest in Lofts 21 LLC. Lofts 21 LLC acquired an existing property in Manhattan, NY, which is scheduled to be developed into condominiums. Lofts 21 LLC is a variable interest entity; however, New Valley is not the primary beneficiary. Our maximum

exposure to loss as a result of New Valley's investment is \$900. New Valley accounts for Lofts 21 LLC under the equity method of accounting.

1107 Broadway. During 2011, New Valley invested \$5,489 for an approximate indirect 5% interest in MS/WG 1107 Broadway Holdings LLC. In September 2011, MS/WG 1107 Broadway Holdings LLC acquired the 1107 Broadway property in Manhattan, NY. The joint venture plans to develop the property, which was formerly part of the International Toy Center, into luxury residential condominiums with ground floor retail space. MS/WG 1107 Broadway Holdings LLC is a variable interest entity; however, New Valley is not the primary beneficiary. Our maximum exposure on New Valley's investment in MS/WG 1107

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Broadway Holdings LLC is \$5,489. New Valley accounts for MS/WG 1107 Broadway Holdings LLC under the equity method of accounting.

Hotel Taiwana. In October 2011, New Valley invested \$2,658 for an approximate 17.39% interest in Hill Street Partners LLP ("Hill"). Hill purchased a 37% interest in Hill Street SEP ("Hotel Taiwana") which owns a hotel located in St. Barts, French West Indies. The hotel consists of 30 suites, 6 pools, a restaurant, lounge and gym. The purpose of the investment is to renovate and the sell the hotel in its entirety or as hotel-condos. The investment is a variable interest entity; however, we are not the primary beneficiary. Our maximum exposure to loss as a result of New Valley's investment in Hotel Taiwana is \$2,658. New Valley accounts for Hotel Taiwana under the equity method of accounting.

NV SOCAL LLC. In October 2011, a newly-formed joint venture, between affiliates of New Valley and Winthrop Realty Trust, entered into an agreement with Wells Fargo Bank to acquire a \$117,900 C-Note (the "C-Note") for a purchase price of \$96,700. The C-Note is the most junior tranche of a \$796,000 first mortgage loan originated in July 2007 which is collateralized by a 31-property portfolio of office properties situated throughout southern California, consisting of approximately 4.5 million square feet. The C-Note bears interest at a rate per annum of LIBOR plus 310 basis points, requires payments of interest only prior to maturity and matures on August 9, 2012. On November 3, 2011, New Valley invested \$25,000 for an approximate 26% interest in the joint venture. The investment is a variable interest entity; however, New Valley is not the primary beneficiary. Our maximum exposure to loss as a result of New Valley's investment in NV SOCAL LLC is \$25,095. New Valley accounts for NV SOCAL LLC under the equity method of accounting. New Valley recorded equity income of \$95 for the year ended December 31, 2011.

HFZ East 68th Street. In December 2011, New Valley invested \$7,000 for an approximate 18% interest in a condominium conversion project. The building is a 12-story, 105,000 square foot residential rental building located on 68th Street between Fifth Avenue and Madison Avenue in Manhattan, NY. The investment is a variable interest entity; however, New Valley is not the primary beneficiary. Our maximum exposure to loss as a result of New Valley's investment in HFZ East 68th Street is \$7,000. New Valley accounts for this investment under the equity method of accounting.

Gains or Losses on Long-term Investments. Two of our long-term investments were liquidated in January 2011 and April 2011, respectively. We received distributions of \$66,190 for the year ended December 31, 2011 primarily from the liquidation of the two long-term investments. We recognized a gain of \$25,832 for the year ended December 31, 2011.

Recent Developments in Tobacco-Related Litigation

The cigarette industry continues to be challenged on numerous fronts. New cases continue to be commenced against Liggett and other cigarette manufacturers. Liggett could be subjected to substantial liabilities and bonding requirements from litigation relating to cigarette products. Adverse litigation outcomes could have a negative impact on our ability to operate due to their impact on cash flows. We and our Liggett subsidiary, as well as the entire cigarette industry, continue to be challenged on numerous fronts, particularly with respect to the Engle progeny cases in Florida. New cases continue to be commenced against Liggett and other cigarette manufacturers. It is likely that similar legal actions, proceedings and claims will continue to be filed against Liggett. Punitive damages, often in amounts ranging into the billions of dollars, are specifically pled in certain cases, in addition to compensatory and other damages. It is possible that there could be adverse developments in pending cases including the certification of additional class actions. An unfavorable outcome or settlement of pending tobacco-related litigation could encourage the commencement of additional litigation. In addition, an unfavorable outcome in any tobacco-related litigation could have a material adverse effect on our consolidated financial position, results of operations or cash flows. Liggett could face difficulties in obtaining a bond to stay execution of a judgment pending appeal.

As of December 31, 2011, there were approximately 5,755 Engle progeny cases, 33 individual suits, six purported class actions and one healthcare cost recovery action pending in the United States in which Liggett or us, or both, were named as a defendant. To date, adverse verdicts have been entered against Liggett in six Engle progeny cases. As of December 31, 2011, 52 alleged Engle progeny cases, where Liggett is currently named as a defendant, were scheduled for trial in 2012.

Liggett Only Cases. There are currently seven cases pending where Liggett is the only tobacco company defendant. Cases where Liggett is the only defendant could increase substantially as a result of the Engle progeny cases. In February 2009, in *Ferlanti v. Liggett Group*, a Florida state court jury awarded compensatory damages to plaintiff and an \$816 judgment was entered by the court. That judgment was affirmed on appeal and was satisfied by Liggett in March 2011. In September 2010, the court awarded plaintiff legal fees of \$996. Plaintiff is appealing the amount of the attorneys' fee award. Liggett previously accrued \$2,000 for the *Ferlanti* case. In *Welch v. R.J. Reynolds and Katz v. R.J. Reynolds*, both Engle progeny cases, no trial dates have been set. There has been no recent activity in *Hausrath v. Philip Morris*, a case pending in New York state court, where two individuals are suing. The other three individual actions, in which Liggett is the only tobacco company defendant, are dormant.

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Engle Progeny Cases. In 2000, a jury in *Engle v. R.J. Reynolds Tobacco Co.* rendered a \$145,000,000 punitive damages verdict in favor of a “Florida Class” against certain cigarette manufacturers, including Liggett. Pursuant to the Florida Supreme Court’s July 2006 ruling in *Engle*, which decertified the class on a prospective basis, and affirmed the appellate court’s reversal of the punitive damages award, former class members had one year from January 11, 2007 in which to file individual lawsuits. In addition, some individuals who filed suit prior to January 11, 2007, and who claim they meet the conditions in *Engle*, are attempting to avail themselves of the *Engle* ruling. Lawsuits by individuals requesting the benefit of the *Engle* ruling, whether filed before or after the January 11, 2007 deadline, are referred to as the “*Engle* progeny cases.” Liggett and us have been named in 5,755 *Engle* progeny cases in both federal (2,755 cases) and state (3,000 cases) courts in Florida. Other cigarette manufacturers have also been named as defendants in these cases, although as a case proceeds, one or more defendants may ultimately be dismissed from the action. These cases include approximately 7,950 plaintiffs. The number of state court *Engle* progeny cases may increase as multi-plaintiff cases continue to be severed into individual cases. The total number of plaintiffs may also increase as a result of attempts by existing plaintiffs to add additional parties.

Critical Accounting Policies

General. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses. Significant estimates subject to material changes in the near term include impairment charges, inventory valuation, deferred tax assets, allowance for doubtful accounts, promotional accruals, sales returns and allowances, actuarial assumptions of pension plans, the estimated fair value of embedded derivative liabilities, settlement accruals, long-term investments and impairments, accounting for investments in equity securities, and litigation and defense costs. Actual results could differ from those estimates.

Revenue Recognition. Revenues from sales of cigarettes are recognized upon the shipment of finished goods when title and risk of loss have passed to the customer, there is persuasive evidence of an arrangement, the sale price is determinable and collectibility is reasonably assured. We provide an allowance for expected sales returns, net of any related inventory cost recoveries. In accordance with authoritative guidance on how taxes collected from customers and remitted to governmental authorities should be presented in the income statement (that is, gross versus net presentation)”, our accounting policy is to include federal excise taxes in revenues and cost of goods sold. Such revenues and cost of sales totaled \$552,965, \$538,328, and \$377,771