VECTOR GROUP LTD
Form 10-Q
November 10, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For The Quarterly Period Ended September 30, 2008

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

Delaware	**1-5759**	**65-0949535**
(State or other jurisdiction incorporation or organization)	Commission File Number	(I.R.S. Employer Identification No.)

100 S.E. Second Street
Miami, Florida 33131
305/579-8000
(Address, including zip code and telephone number, including area code, of the principal executive offices)

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. x Yes o No

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

x Large accelerated filer	o Accelerated filer
o Non-accelerated filer	o Smaller reporting company

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

At November 10, 2008, Vector Group Ltd. had 66,014,070 shares of common stock outstanding.

VECTOR GROUP LTD.
FORM 10-Q
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PART I. FINANCIAL INFORMATION

ITEM 1. VECTOR GROUP LTD. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED):

VECTOR GROUP LTD. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

	September 30, 2008	December 31, 2007
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 206,509	$ 238,117
Investment securities available for sale	46,151	45,875
Accounts receivable trade	7,398	3,113
Inventories	92,044	86,825
Deferred income taxes	13,439	18,336
Other current assets	5,128	3,360
Total current assets	370,669	395,626
Property, plant and equipment, net	52,318	54,432
Mortgage receivable, net	17,704	
Long-term investments accounted for at cost	70,019	72,971
Long-term investment accounted for under the equity method		10,495
Investments in non-consolidated real estate businesses	57,858	35,731
Restricted assets	7,928	8,766
Deferred income taxes	30,958	26,637
Intangible asset	107,511	107,511
Prepaid pension costs	45,148	42,084
Other assets	29,582	31,036
Total assets	$ 789,695	$ 785,289
LIABILITIES AND STOCKHOLDERS EQUITY:		
Current liabilities:		
Current portion of notes payable and long-term debt	$ 9,432	$ 20,618
Accounts payable	4,459	6,980
Accrued promotional expenses	10,629	9,210
Income taxes payable, net	14,384	2,363
Accrued excise and payroll taxes payable, net	276	5,327
Settlement accruals	38,211	10,041
Deferred income taxes	95,593	24,019
Accrued interest	4,987	9,475
Other current liabilities	19,106	21,304

Total current liabilities	197,077	109,337
Notes payable, long-term debt and other obligations, less current portion	281,434	277,178
Fair value of derivatives embedded within convertible debt	93,745	101,582
Non-current employee benefits	44,743	40,933
Deferred income taxes	66,879	141,904
Other liabilities	16,785	13,503
Total liabilities	700,663	684,437
Commitments and contingencies		
Stockholders equity:		
Preferred stock, par value $1.00 per share, 10,000,000 shares authorized		
Common stock, par value $0.10 per share, 150,000,000 shares authorized, 69,107,320 and 63,307,020 shares issued and 66,014,070 and and 60,361,068 shares outstanding	6,601	6,036
Additional paid-in capital	80,081	89,494
Retained earnings		
Accumulated other comprehensive income	15,207	18,179
Less: 3,093,250 and 2,945,952 shares of common stock in treasury, at cost	(12,857)	(12,857)
Total stockholders equity	89,032	100,852
Total liabilities and stockholders equity	$ 789,695	$ 785,289

The accompanying notes are an integral part of the condensed consolidated financial statements.

VECTOR GROUP LTD. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Revenues*	$ 145,601	$ 136,053	$ 420,766	$ 410,296
Expenses:				
Cost of goods sold*	84,999	80,182	251,036	252,089
Operating, selling, administrative and general expenses	23,067	22,164	69,809	69,597
Operating income	37,535	33,707	99,921	88,610
Other income (expenses):				
Interest and dividend income	1,094	2,445	4,440	5,862
Interest expense	(15,515)	(12,113)	(46,025)	(30,767)
Change in fair value of derivatives embedded within convertible debt	522	(6,331)	7,837	(4,215)
Provision for loss on investments	(7,000)	(58)	(7,000)	(1,216)
Gain from exchange of LTS notes				8,121
Equity income from non-consolidated real estate businesses	5,202	6,589	22,706	15,926
Income from lawsuit settlement				20,000
Other, net	(1)	(6)	(578)	(42)
Income before provision for income taxes	21,837	24,233	81,301	102,279
Income tax expense	7,010	9,169	33,042	42,707
Net income	$ 14,827	$ 15,064	$ 48,259	$ 59,572
Per basic common share:				
Net income applicable to common shares	$ 0.22	$ 0.22	$ 0.72	$ 0.89
Per diluted common share:				
Net income applicable to common shares	$ 0.21	$ 0.22	$ 0.70	$ 0.87
Cash distributions and dividends declared per share	$ 0.38	$ 0.36	$ 1.14	$ 1.09

* Revenues and Cost of goods sold include excise taxes of $43,327, $43,025, $127,050 and $132,305, respectively.

The accompanying notes are an integral part
of the condensed consolidated financial statements.

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VECTOR GROUP LTD. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
(Dollars in Thousands, Except Share Amounts)
Unaudited

	Common Stock		Additional		Accumulated Other		
	Shares	Amount	Paid-In Capital	Retained Earnings	Comprehensive Income	Treasury Stock	Total
Balance, December 31, 2007	60,361,068	$ 6,036	$ 89,494	$	$ 18,179	$ (12,857)	$ 100,852
Net income				48,259			48,259
Pension-related minimum liability adjustments, net of taxes					586		586
Forward contract adjustments, net of taxes					26		26
Unrealized loss on long-term investments accounted for under the equity method, net of taxes					(399)		(399)
Unrealized loss on investment securities, net of taxes					(3,185)		(3,185)
Total other comprehensive income							(2,972)
Total comprehensive income							45,287
Distributions and dividends on common stock			(30,148)	(47,945)			(78,093)
Effect of stock dividend	3,142,760	314		(314)			
Exercise of options, net of 1,375,895 shares delivered to pay exercise price	2,510,242	251	(164)				87
Excess tax benefit of options exercised			18,304				18,304
			2,595				2,595

Amortization of deferred compensation							
Balance, September 30, 2008	66,014,070	$ 6,601	$ 80,081	$	$ 15,207	$ (12,857)	$ 89,032

The accompanying notes are an integral part
of the condensed consolidated financial statements.

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VECTOR GROUP LTD. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Net cash provided by operating activities	$ 70,435	$ 91,199
Cash flows from investing activities:		
Purchase of investment securities	(5,682)	(6,048)
Proceeds from sale or liquidation of long-term investments	8,334	50
Purchase of long-term investments	(51)	(35,091)
Purchase of mortgage receivable	(21,704)	
Distributions from non-consolidated real estate businesses	17,628	1,000
Investments in non-consolidated real estate businesses	(22,000)	(750)
Increases in cash surrender value of life insurance policies	(766)	(690)
Decrease (increase) in non-current restricted assets	838	(310)
Proceeds from sale of fixed assets	403	789
Capital expenditures	(5,426)	(4,211)
Net cash used in investing activities	(28,426)	(45,261)
Cash flows from financing activities:		
Proceeds from debt issuance	2,830	174,576
Repayments of debt	(4,666)	(39,718)
Deferred financing charges	(137)	(9,888)
Borrowings under revolver	386,499	389,383
Repayments on revolver	(397,892)	(401,231)
Dividends and distributions on common stock	(78,581)	(75,258)
Excess tax benefit of options exercised	18,304	1,928
Proceeds from exercise of options	26	4,857
Net cash (used in) provided by financing activities	(73,617)	44,649
Net (decrease) increase in cash and cash equivalents	(31,608)	90,587
Cash and cash equivalents, beginning of period	238,117	146,769
Cash and cash equivalents, end of period	$ 206,509	$ 237,356

The accompanying notes are an integral part
of the condensed consolidated financial statements.

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VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation:

The condensed consolidated financial statements of Vector Group Ltd. (the Company or Vector) include the accounts of VGR Holding LLC (VGR Holding), Liggett Group LLC (Liggett), Vector Tobacco Inc. (Vector Tobacco), Liggett Vector Brands Inc. (Liggett Vector Brands), New Valley LLC (New Valley) and other less significant subsidiaries. All significant intercompany balances and transactions have been eliminated.

Liggett is engaged in the manufacture and sale of cigarettes in the United States. Vector Tobacco is engaged in the development and marketing of low nicotine and nicotine-free cigarette products and the development of reduced risk cigarette products. New Valley is engaged in the real estate business and is seeking to acquire additional operating companies and real estate properties.

The interim condensed consolidated financial statements of the Company are unaudited and, in the opinion of management, reflect all adjustments necessary (which are normal and recurring) to state fairly the Company s consolidated financial position, results of operations and cash flows. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2007 filed with the Securities and Exchange Commission. The consolidated results of operations for interim periods should not be regarded as necessarily indicative of the results that may be expected for the entire year.

(b) Distributions and Dividends on Common Stock:

The Company records distributions on its common stock as dividends in its condensed consolidated statement of stockholders equity to the extent of retained earnings. Any amounts exceeding retained earnings are recorded as a reduction to additional paid-in capital.

(c) Earnings Per Share (EPS):

Information concerning the Company s common stock has been adjusted to give retroactive effect to the 5% stock dividend paid to Company stockholders on September 29, 2008 and September 28, 2007. The dividends were recorded at par value of $314 and $287 since the Company did not have retained earnings at September 30, 2008 and 2007, respectively. In connection with the 5% stock dividend, the Company increased the number of outstanding stock options by 5% and reduced the exercise prices accordingly. All per share amounts have been presented as if the stock dividends had occurred on January 1, 2007.

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VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

The Company has stock option awards which provide for common stock dividends at the same rate as paid on the common stock with respect to the shares underlying the unexercised portion of the options. As a result, in its calculation of basic EPS for the three and nine months ended September 30, 2008 and 2007, the Company has adjusted its net income for the effect of its participating securities as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Net income	$ 14,827	$ 15,064	$ 48,259	$ 59,572
Income attributable to participating securities	(675)	(979)	(2,228)	(3,895)
Net income available to common stockholders	$ 14,152	$ 14,085	$ 46,031	$ 55,677

Basic EPS is computed by dividing net income available to common stockholders by the weighted-average number of shares outstanding, which includes vested restricted stock.

Diluted EPS includes the dilutive effect of stock options, unvested restricted stock grants and convertible securities. Diluted EPS is computed by dividing net income available to common stockholders by the diluted weighted-average number of shares outstanding, which includes dilutive non-vested restricted stock grants, stock options and convertible securities.

Basic and diluted EPS were calculated using the following shares for the three and nine months ended September 30, 2008 and 2007:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Weighted-average shares for basic EPS	65,643,892	62,631,805	64,043,271	62,472,190
Plus incremental shares related to dilutive stock options and non-vested restricted stock	1,246,278	1,923,574	1,396,407	1,619,616
Weighted-average shares for fully diluted EPS	66,890,170	64,555,379	65,439,678	64,091,806

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
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The following stock options, non-vested restricted stock and shares issuable upon the conversion of convertible debt were outstanding during the three and nine months ended September 30, 2008 and 2007 but were not included in the computation of diluted EPS because the exercise prices of the options and the per share expense associated with the restricted stock were greater than the average market price of the common shares during the respective periods, and the impact of common shares issuable under the convertible debt were anti-dilutive to EPS.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Number of stock options	514,735	171,247	514,735	228,954
Weighted-average exercise price	$ 19.22	$ 26.41	$ 19.22	$ 24.26
Weighted-average shares of non-vested restricted stock	81,080		225,784	
Weighted-average expense per share	$ 17.62	N /A	$ 17.15	N /A
Weighted-average number of shares issuable upon conversion of debt	12,932,556	12,932,556	12,932,556	12,932,556
Weighted-average conversion price	$ 17.16	$ 17.16	$ 17.16	$ 17.16

The $18,304 excess tax benefit of options exercised was derived primarily from stock options exercised during the second quarter of 2008.

(d) Comprehensive Income:

Other comprehensive income is a component of stockholders equity and includes such items as the unrealized gains and losses on investment securities available for sale, forward foreign contracts and minimum pension liability adjustments. The Company s comprehensive income for the three and nine months ended September 30, 2008 was $19,843 and $45,287, respectively. The Company s comprehensive income for the three and nine months ended September 30, 2007 was $13,119 and $70,510, respectively.

(e) Fair Value of Derivatives Embedded within Convertible Debt:

The Company has estimated the fair market value of the embedded derivatives based principally on the results of a valuation model. The estimated fair value of the derivatives embedded within the convertible debt is based principally on the present value of future dividend payments expected to be received by the convertible debt holders over the term of the debt. The discount rate applied to the future cash flows is estimated based on a spread in the yield of the Company s debt when compared to risk-free securities with the same duration; thus, a readily determinable fair market value of the embedded derivatives is not available. The valuation model assumes future dividend payments by the Company and utilizes interest rates and credit spreads for secured to unsecured debt, unsecured to subordinated debt and subordinated debt to preferred stock to determine the fair value of the derivatives embedded within the convertible debt. The valuation also considers other items, including current and future dividends and the volatility of Vector s stock price. The range of estimated fair market values of the Company s embedded derivatives was between $93,200 and $94,900. The Company recorded the fair market value of its embedded derivatives at the midpoint of the inputs at $93,745 as of September 30, 2008. The estimated fair market value of the Company s embedded derivatives could change significantly based on future market conditions. (See Note 6.)

(f) Capital and Credit Market Crisis

As the capital and credit market crisis has worsened, the Company has performed additional assessments to determine the impact, if any, of recent market developments, on the Company s consolidated condensed financial statements. The Company s additional assessments have included a review of access to liquidity in the capital and credit markets, counterparty creditworthiness, value of the Company s investments (including long-term investments, mortgage receivable and employee benefit plans) and macroeconomic conditions. The recent unprecedented volatility in capital and credit markets may create additional risks in the upcoming months and possibly years and the Company will continue to perform additional assessments to determine the impact, if any, on the Company s condensed consolidated financial statements. Thus, future impairment charges may occur.

On a quarterly basis, the Company evaluates its investments to determine whether an impairment has occurred. If so, the Company also makes a determination of whether such impairment is considered temporary or other-than-temporary. The Company believes that the assessment of temporary or other-than-temporary impairment is facts and circumstances driven. However, among the matters that are considered in making such a determination are the period of time the investment has remained below its cost or carrying value, the likelihood of recovery given the reason for the decrease in market value and the Company s original expected holding period of the investment.

(g) Contingencies:

The Company records Liggett s product liability legal expenses and other litigation costs as operating, selling, general and administrative expenses as those costs are incurred. As discussed in Note 8, legal proceedings covering a wide range of matters are pending or threatened in various jurisdictions against Liggett.

Management is unable to make a reasonable estimate with respect to the amount or range of loss that could result from an unfavorable outcome of pending tobacco-related litigation or the costs of defending such cases, and the Company has not provided any amounts in its consolidated financial statements for unfavorable outcomes, if any. Litigation is subject to many uncertainties, and it is possible that the Company s consolidated financial position, results of operations or cash flows could be materially adversely affected by an unfavorable outcome in any such tobacco-related litigation.

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VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

(h) New Accounting Pronouncements:

Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS No. 157) for financial assets and financial liabilities. SFAS No. 157 does not require any new fair value measurements but provides a definition of fair value, establishes a framework for measuring fair value and expands disclosure about fair value measurements. The Company will adopt SFAS No. 157 for nonfinancial assets and nonfinancial liabilities on January 1, 2009. The adoption of SFAS No. 157 on financial assets and financial liabilities did not have a material impact on our consolidated results of operations, financial position or cash flows. The Company is currently assessing the impact of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities on its consolidated results of operations, financial position or cash flows.

In February 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities . SFAS No. 159 permits entities to elect to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company has not elected to use the fair value option.

In December 2007, the FASB issued SFAS No. 141(R), a revised version of SFAS No. 141, Business Combinations . The revision is intended to simplify existing guidance and converge rulemaking under U.S. Generally Accepted Accounting Principles (GAAP) with international accounting rules. This statement applies prospectively to business combinations where the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. An entity may not apply it before that date. The new standard also converges financial reporting under U.S. GAAP with international accounting rules. The Company is currently assessing the impact, if any, of SFAS No. 141(R) on its consolidated financial statements, which will depend on future transactions.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities-an amendment of FASB Statement No. 133 . SFAS No. 161 seeks qualitative disclosures about the objectives and strategies for using derivatives, quantitative data about the fair value of and gains and losses on derivative contracts, and details of credit-risk-related contingent features in hedged positions. SFAS No. 161 also seeks enhanced disclosure around derivative instruments in financial statements, accounting under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities , and how hedges affect an entity s financial position, financial performance and cash flows. SFAS No. 161 is effective for the Company as of January 1, 2009 and the Company does not expect the adoption of SFAS No. 161 to have a material impact on its consolidated results of operations, financial position or cash flows.

On May 9, 2008, the FASB issued FASB Staff Position No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement) (FSP No. APB 14-1). The Company is currently assessing the impact of FSP No. APB 14-1 on its consolidated financial statements.

On June 16, 2008, the FASB issued FASB Staff Position No. EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities, which states that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share under the two-class method. The guidance is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. The Company is currently assessing the impact of FSP No. EITF 03-6-1 on its consolidated financial statements.

In October 2008, the FASB issued FSP SFAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active, which addresses the application of SFAS 157 for illiquid financial instruments. FSP SFAS 157-3 clarifies that approaches to determining fair value other than the market approach may be appropriate when the market for a financial asset is not active.

2. RESTRUCTURING

The only remaining component of the 2006 Vector Research restructuring at September 30, 2008 and December 31, 2007 was employee severance and benefits of $14 and $70, respectively. Approximately $0 and $56 was utilized during the three and nine months ended September 30, 2008, respectively.

The only remaining component of the 2004 Liggett Vector Brands restructuring at September 30, 2008 and December 31, 2007 was contract termination and exit costs and the balance was $520 and $598 at September 30, 2008 and December 31, 2007, respectively. Approximately $44 and $78 was utilized during the three and nine months ended September 30, 2008, respectively.

VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

3. INVESTMENT SECURITIES AVAILABLE FOR SALE

Investment securities classified as available for sale are carried at fair value, with net unrealized gains or losses included as a component of stockholders equity, net of income taxes. The components of investment securities available for sale at September 30, 2008 are as follows:

	Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Marketable equity securities	$ 27,229	$ 19,836	$ (914)	$ 46,151

Investment securities available for sale as of September 30, 2008 and December 31, 2007 include the Company s 13,888,889 shares of Ladenburg Thalmann Financial Services Inc. (LTS) common stock, which were carried at $25,000 and $29,444, respectively. Investment securities available for sale as of September 30, 2008 and December 31, 2007 also include 5,057,110 and 2,257,110 shares, respectively, of Opko Health Inc. (Opko) common stock, which were carried at $8,850 and $6,433, respectively. In March 2008, the Company acquired 2,800,000 shares of Opko in a private placement. These shares have not been registered for resale but are expected to be freely tradable within one year. In 2008, the Company acquired 2,259,796 shares of Cardo Medical, Inc. for $500. The shares were carried at $3,842 as of September 30, 2008. These shares have not been registered for resale but are expected to be freely tradable within one year.

4. INVENTORIES

Inventories consist of:

	September 30, 2008	December 31, 2007
Leaf tobacco	$ 47,959	$ 41,502
Other raw materials	4,615	4,847
Work-in-process	268	710
Finished goods	47,794	45,331
Inventories at current cost	100,636	92,390
LIFO adjustments	(8,592)	(5,565)
	$ 92,044	$ 86,825

The Company has a leaf inventory management program whereby, among other things, it is committed to purchase certain quantities of leaf tobacco. The purchase commitments are for quantities not in excess of anticipated requirements and are at prices, including carrying costs, established at the commitment date. At September 30, 2008, Liggett had leaf tobacco purchase commitments of approximately $9,901. There were no leaf tobacco purchase commitments at Vector Tobacco at that date. During 2007, the Company entered into a single source supply agreement for fire safe cigarette paper through 2012.

The Company capitalizes the incremental prepaid cost of the Master Settlement Agreement in ending inventory. For the nine months ended September 30, 2008, the Company s MSA expense was reduced by approximately $1,300 as a result of a change in estimate to the MSA assessment for 2007.

LIFO inventories represent approximately 95% of total inventories at September 30, 2008 and December 31, 2007.

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VECTOR GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in Thousands, Except Per Share Amounts)
Unaudited

5. LONG-TERM INVESTMENTS

Long-term investments consist of investments in the following:

	September 30, 2008		December 31, 2007	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Investment partnerships accounted for at cost	$ 70,019	$ 72,489	$ 72,971	$ 89,007
Investments accounted for on the equity method	$	$	$ 10,495	$ 10,495

The principal business of these investment partnerships is investing in investment securities and real estate. The estimated fair value of the investment partnerships was provided by the partnerships based on the indicated market values of the underlying assets or investment portfolio. The investments in these investment partnerships are illiquid and the ultimate realization of these investments is subject to the performance of the underlying partnership and its management by the general partners.

In April 2008, the Company elected to withdraw its investment in Jefferies Buckeye Fund, LLC (Buckeye Fund), a privately managed investment partnership, of which Jefferies Asset Management, LLC is the portfolio manager. The Company recorded a loss of $567 during the first quarter of 2008 associated with the Buckeye Fund s performance, which has been included as Other expense on the Company s condensed consolidated statement of operations. The Company received proceeds of $8,328 in May 2008 and anticipates receiving an additional $925 of proceeds in the fourth quarter of 2008, which has been included in Other current assets on the Company s condensed consolidated balance sheet.

The Company recorded a loss of $3,000 during the third quarter of 2008 due to the performance of two of its long-term investments. The Company determined that an other-than-temporary impairment had occurred during the third quarter of 2008 as a result of its quarterly evaluation of long-term investments. If it is determined that an other-than-temporary decline in fair value exists in long-term investments, the Company records an impairment charge with respect to such investment in its consolidated statements of operations. During the three and nine months ended September 30, 2008, one of the Company s long-term investments was impaired due to a portion of its underlying assets being held in an account with the European subsidiary of Lehman Brothers Holdings Inc. while another of the Company s long-term investments was impaired as a result of the fund s performance in 2008.

The long-term investments are carried on the condensed consolidated balance sheet at cost. The fair value determination disclosed above would be classified as Level 3 under the SFAS 157 hierarchy disclosed in Note 11 if such assets were recorded on the condensed consolidated balance sheet at fair value. The fair values were determined based on unobservable inputs and were based on company assumptions, and information obtained from the partnerships based on the indicated market values of the underlying assets of the investment portfolio.

The changes in the fair value of these investments as of September 30, 2008 were as follows:

	Investment Partnerships Accounted for at	Investment Partnerships Accounted for on

	Cost	the Equity Method
Balance as of January 1, 2008	$ 89,007	$ 10,495
Unrealized loss on long-term investments	(2,034)	(675)
Realized loss on long-term investments		(567)
Balance as of March 31, 2008	86,973	9,253
Contributions (distributions)	47	(8,328)
Unrealized loss on long-term investments	(3,767)	
Realized gain on long-term investments	14	
Receivable classified as Other currents assets		(925)
Balance as of June 30, 2008	83,267	
Contributions (distributions)		
Unrealized loss on long-term investments	(7,778)	
Realized loss on long-term investments	(3,000)	
Balance as of September 30, 2008	$ 72,489	$

VECTOR GROUP LTD.
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Because the capital and credit market crisis has continued to worsen, the Company will continue to perform additional assessments to determine the impact, if any, on the Company s condensed consolidated financial statements. Thus, future impairment charges may occur.

In the future, the Company may invest in other investments, including limited partnerships, real estate investments, equity securities, debt securities, derivatives and certificates of deposit, depending on risk factors and potential rates of return.

6. NOTES PAYABLE, LONG-TERM DEBT AND OTHER OBLIGATIONS

Notes payable, long-term debt and other obligations consist of:

	September 30, 2008	December 31, 2007
Vector:		
11% Senior Secured Notes due 2015	$ 165,000	$ 165,000
3.875% Variable Interest Senior Convertible Debentures due 2026, net of unamortized discount of $84,066 and $84,299*	25,934	25,701
5% Variable Interest Senior Convertible Notes due 2011, net of unamortized net discount of $41,961 and $48,027*	69,903	63,837
Liggett:		
Revolving credit facility	3,389	14,782
Term loan under credit facility	7,422	7,822
Equipment loans	9,416	9,660
V.T. Aviation:		
Note payable	5,583	6,470
VGR Aviation:		
Note payable	4,130	4,370
Other	89	154
Total notes payable, long-term debt and other obligations	290,866	297,796
Less:		
Current maturities	(9,432)	(20,618)
Amount due after one year	$ 281,434	$ 277,178

* The fair value of the derivatives

embedded within the 3.875% Variable Interest Senior Convertible Debentures ($64,986 at September 30, 2008 and $67,911 at December 31, 2007) and the 5% Variable Interest Senior Convertible Notes ($28,759 at September 30, 2008 and $33,671 at December 31, 2007) is separately classified as a derivative liability in the condensed consolidated balance sheets.

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11% Senior Secured Notes due 2015 Vector:

In August 2007, the Company sold $165,000 of its 11% Senior Secured Notes due 2015 (the Senior Secured Notes) in a private offering to qualified institutional investors in accordance with Rule 144A of the Securities Act of 1933. On May 28, 2008, the Company completed an offer to exchange the Senior Secured Notes 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.

Variable Interest Senior Convertible Debt Vector:

Vector has issued two series of variable interest senior convertible debt. Both series of debt pay interest on a quarterly basis at a stated rate plus an additional amount of interest on each payment date. The additional amount 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 would be convertible on such record date.

A summary of non-cash interest expense associated with the amortization of the debt discount created by the embedded derivative liability associated with the Company s variable interest senior convertible debt for the three and nine months ended September 30, 2008 and 2007 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
3.875% convertible debentures	$ 89	$ 70	$ 269	$ (98)
5% convertible notes	1,423	1,033	3,904	2,681
Interest expense associated with embedded derivatives	$ 1,512	$ 1,103	$ 4,173	$ 2,583

A summary of non-cash changes in fair value of derivatives embedded within convertible debt is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
3.875% convertible debentures	$ 43	$ (5,313)	$ 2,925	$ (5,419)
5% convertible notes	479	(1,018)	4,912	1,204
Loss (gain) on changes in fair value of derivatives embedded within convertible debt	$ 522	$ (6,331)	$ 7,837	$ (4,215)

The following table reconciles the fair value of derivatives embedded within convertible debt at September 30, 2008.

	3.875% Convertible Debentures	5% Convertible Notes	Total
Balance at December 31, 2007	$ 67,911	$ 33,671	$ 101,582
Loss (gain) from changes in fair value of embedded derivatives	3,250	(806)	2,444
Balance at March 31, 2008	71,161	32,865	104,026
Gain from changes in fair value of embedded derivatives	(6,132)	(3,627)	(9,759)
Balance at June 30, 2008	65,029	29,238	94,267
Gain from changes in fair value of embedded derivatives	(43)	(479)	(522)
Balance at September 30, 2008	$ 64,986	$ 28,759	$ 93,745

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Beneficial Conversion Feature on Variable Interest Senior Convertible Debt:

A summary of non-cash interest expense associated with the amortization of the debt discount created by the beneficial conversion feature on the Company s variable interest senior convertible debt for the three and nine months ended September 30, 2008 and 2007 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Amortization of beneficial conversion feature:				
3.875% convertible debentures	$ (17)	$ (17)	$ (36)	$ (197)
5% convertible notes	789	572	2,162	1,465
Interest expense associated with beneficial conversion feature	$ 772	$ 555	$ 2,126	$ 1,268

Unamortized Debt Discount:

The following table reconciles unamortized debt discount at September 30, 2008:

	3.875% Convertible Debentures	5% Convertible Notes	Total
Balance at December 31, 2007	$ 84,299	$ 48,027	$ 132,326
Amortization of embedded derivatives	(269)	(3,904)	(4,173)
Amortization of beneficial conversion feature	36	(2,162)	(2,126)
Balance at September 30, 2008	$ 84,066	$ 41,961	$ 126,027

Revolving Credit Facility Liggett:

Liggett has a $50,000 credit facility with Wachovia Bank, N.A. under which $3,389 was outstanding at September 30, 2008. Availability as determined under the facility was approximately $23,112 based on eligible collateral at September 30, 2008.

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7. EMPLOYEE BENEFIT PLANS

Defined Benefit and Postretirement Plans:

Net periodic benefit cost for the Company s pension and other postretirement benefit plans for the three and nine months ended September 30, 2008 and 2007 consists of the following:

	Pension Benefits			
	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Service cost benefits earned during the period	$ 1,035	$ 1,062	$ 3,105	$ 3,186
Interest cost on projected benefit obligation	2,381	2,281	7,143	6,843
Expected return on plan assets	(3,036)	(3,183)	(9,108)	(9,549)
Amortization of prior service cost	350	351	1,050	1,053
Amortization of net loss	25	176	75	528
Net expense	$ 755	$ 687	$ 2,265	$ 2,061

	Other Postretirement Benefits			
	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Service cost benefits earned during the period	$ 4	$ 4	$ 12	$ 12
Interest cost on projected benefit obligation	148	148	444	444
Amortization of net loss	(45)	(26)	(135)	(78)
Net expense	$ 107	$ 126	$ 321	$ 378

The Company did not make contributions to its pension benefits plans for the three and nine months ended September 30, 2008 and does not anticipate making any contributions to such plans in 2008. The Company anticipates paying approximately $750 in other postretirement benefits in 2008.

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8. CONTINGENCIES

Tobacco-Related Litigation:

Overview

Since 1954, Liggett and other United States cigarette manufacturers have been named as defendants in numerous direct, third-party and purported class actions predicated on the theory that cigarette manufacturers should be liable for damages alleged to have been caused by cigarette smoking or by exposure to secondary smoke from cigarettes. New cases continue to be commenced against Liggett and other cigarette manufacturers. The cases generally fall into the following categories: (i) smoking and health cases alleging personal injury brought on behalf of individual plaintiffs (Individual Actions); (ii) smoking and health cases primarily alleging personal injury or seeking court-supervised programs for ongoing medical monitoring and purporting to be brought on behalf of a class of individual plaintiffs (Class Actions); (iii) health care cost recovery actions brought by various foreign and domestic governmental entities (Governmental Actions); and (iv) health care cost recovery actions brought by third-party payors including insurance companies, union health and welfare trust funds, asbestos manufacturers and others (Third-Party Payor Actions). 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. The future financial impact of the risks and expenses of litigation and the effects of the tobacco litigation settlements discussed below are not quantifiable at this time. Liggett incurred legal expenses and other litigation related costs totaling approximately $1,737 and $1,648, for the three months ended September 30, 2008 and 2007, respectively, and $4,806 and $5,886 for the nine months ended September 30, 2008 and 2007, respectively.

Individual Actions

As of September 30, 2008, there were 36 individual cases pending against Liggett and/or the Company, where one or more individual plaintiffs allege injury resulting from cigarette smoking, addiction to cigarette smoking or exposure to secondary smoke and seek compensatory and, in some cases, punitive damages. In addition, there were approximately 2,240 *Engle* progeny cases (defined below) pending, in state and federal courts in Florida, and approximately 100 individual cases pending in West Virginia state court as part of a consolidated action. The following table lists the number of individual cases by state that are pending against Liggett (excluding *Engle* progeny cases and the cases consolidated in West Virginia) or its affiliates as of September 30, 2008:

State	Number of Cases
Florida	11
New York	11
Louisiana	5
Mississippi	2
West Virginia	2
District of Columbia	1
Maryland	1
Missouri	1
Ohio	1
Pennsylvania	1

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Liggett Only Cases. There are currently five cases pending where Liggett is the only tobacco company defendant. In April 2004, in *Davis v. Liggett Group,* a Florida state court jury awarded compensatory damages of $540 against Liggett. In addition, plaintiff s counsel was awarded legal fees of $752. Liggett appealed both the verdict and the legal fee award. In October 2007, the compensatory award was affirmed by the Fourth District Court of Appeal, but the court certified certain issues to the Florida Supreme Court. Oral argument was held on November 6, 2008. The parties await a decision. In March 2008, the Fourth District Court of Appeal reversed and remanded the legal fee award for further proceedings in the trial court. No amounts have been expensed for this matter. In *Ferlanti v. Liggett Group*, an *Engle* progeny case, a trial is scheduled for February 2009. This case was originally filed by plaintiff in 2003 as an individual case. Trial commenced in 2008 and, after three days, the court declared a mistrial. Since that time, plaintiff amended her complaint to assert her status as a decertified *Engle* class member. The *Engle* progeny cases are discussed below. The other three individual actions, where Liggett is the only tobacco company defendant, are dormant.

The plaintiffs allegations of liability in those cases in which individuals seek recovery for injuries allegedly caused by cigarette smoking are based on various theories of recovery, including negligence, gross negligence, breach of special duty, strict liability, fraud, concealment, misrepresentation, design defect, failure to warn, breach of express and implied warranties, conspiracy, aiding and abetting, concert of action, unjust enrichment, common law public nuisance, property damage, invasion of privacy, mental anguish, emotional distress, disability, shock, indemnity and violations of deceptive trade practice laws, the federal Racketeer Influenced and Corrupt Organizations Act (RICO), state RICO statutes and antitrust statutes. In many of these cases, in addition to compensatory damages, plaintiffs also seek other forms of relief including treble/multiple damages, medical monitoring, disgorgement of profits and punitive damages. Although alleged damages often are not determinable from a complaint, and the law governing the pleading and calculation of damages varies from state to state and jurisdiction to jurisdiction, compensatory and punitive damages have been specifically pleaded in a number of cases, sometimes in amounts ranging into the hundreds of millions and even billions of dollars.

Defenses raised by defendants in individual cases include lack of proximate cause, assumption of the risk, comparative fault and/or contributory negligence, lack of design defect, statute of limitations, equitable defenses such as unclean hands and lack of benefit, failure to state a claim and federal preemption.

In addition to the award against Liggett in *Davis* (discussed above), jury awards have been returned against other cigarette manufacturers in recent years. The awards in these individual actions, often in excess of millions of dollars, are for both compensatory and punitive damages. There are several significant jury awards against other cigarette manufacturers which are currently on appeal.

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 mandate, are referred to as the *Engle* progeny cases. Liggett and/or the Company have been named in approximately 2,240 *Engle* progeny cases in both state and federal courts in Florida. Other cigarette manufacturers have also been named as defendants in most of these cases. These cases include approximately 9,570 plaintiffs, although duplicate cases were filed in federal and state court on behalf of approximately 660 plaintiffs. Although the total number of *Engle* plaintiffs will not increase, the number of cases will likely increase as the court may require multi-plaintiff cases to be severed into individual cases. For further information on the *Engle* case, see Class Actions *Engle* Case, below.

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Class Actions

As of September 30, 2008, there were eight actions pending for which either a class has been certified or plaintiffs are seeking class certification, where Liggett is a named defendant, including two alleged price fixing cases. Other cigarette manufacturers are also named in these actions. Many of these actions purport to constitute statewide class actions and were filed after May 1996 when the Fifth Circuit Court of Appeals, in *Castano v. American Tobacco Co.*, *Inc.*, reversed a federal district court s certification of a purported nationwide class action on behalf of persons who were allegedly addicted to tobacco products.

Engle Case. In May 1994, *Engle* was filed against Liggett and others in Miami-Dade County, Florida. The class consisted of all Florida residents who, by November 21, 1996, have suffered, presently suffer or have died from diseases and medical conditions caused by their addiction to cigarette smoking. In July 1999, after the conclusion of Phase I of the trial, the jury returned a verdict against Liggett and other cigarette manufacturers on certain issues determined by the trial court to be common to the causes of action of the plaintiff class. The jury made several findings adverse to the defendants including that defendants conduct rose to a level that would permit a potential award or entitlement to punitive damages. Phase II of the trial was a causation and damages trial for three of the class plaintiffs and a punitive damages trial on a class-wide basis, before the same jury that returned the verdict in Phase I. In April 2000, the jury awarded compensatory damages of $12,704 to the three class plaintiffs, to be reduced in proportion to the respective plaintiff s fault. In July 2000, the jury awarded approximately $145,000,000 in punitive damages, including $790,000 against Liggett.

In May 2003, Florida s Third District Court of Appeal reversed the trial court s final judgment and remanded the case with instructions to decertify the class. The judgment in favor of one of the three class plaintiffs, in the amount of $5,831, was overturned as time barred and the court found that Liggett was not liable to the other two class plaintiffs.

In July 2006, the Florida Supreme Court affirmed the decision vacating the punitive damages award and held that the class should be decertified prospectively, 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 former class members 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 from 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. As a result of the decision, approximately 9,570 former *Engle* class members have commenced suit against Liggett and/or the Company as well as other cigarette manufacturers.

In June 2002, the jury in a Florida state court action entitled *Lukacs v. R.J. Reynolds Tobacco Co.,* awarded $37,500 in compensatory damages in a case involving Liggett and two other cigarette manufacturers, which amount 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* progeny suit following entry of final judgment by the *Engle* trial court. In August 2008, the court entered judgment in the amount of $24,835 (for which Liggett is 50% responsible), plus interest from June 2002 which, as of September 30, 2008, was approximately $13,200. Liggett intends to appeal the award and may be required to post a bond. In addition, plaintiff filed a motion seeking an award of attorneys fees from Liggett based on plaintiff s prior proposal for settlement. In

October 2008, plaintiff withdrew her request for punitive damages.

Other Class Actions. Classes remain certified against Liggett in Kansas (*Smith*) and New Mexico (*Romero*). *Smith v. Philip Morris* and *Romero v. Philip Morris* are actions in which plaintiffs allege that cigarette manufacturers conspired to fix cigarette prices in violation of antitrust laws. Class certification was granted in *Smith* in November 2001. Discovery is ongoing. Class certification was granted in *Romero* in April 2003 and was affirmed by the New Mexico Supreme Court in February 2005. In June 2006, the trial court granted defendants motion for summary judgment. Plaintiffs appealed to the New Mexico Court of Appeals. The parties completed briefing in August 2007 and await a decision. In West Virginia, a jury verdict in a purported medical monitoring class action was entered in favor of all tobacco company defendants other than Liggett (Liggett was previously severed from the trial). There has been no further activity in this case.

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Class action suits have been filed in a number of states against cigarette manufacturers, alleging, among other things, that the use of the terms light and ultra light constitutes unfair and deceptive trade practices, among other things. One such suit, *Schwab v. Philip Morris,* pending in federal court in New York since 2004, sought to create a nationwide class of light cigarette smokers. In September 2006, the United States District Court for the Eastern District of New York certified the class. In April 2008, the United States Court of Appeals for the Second Circuit decertified the class. The case was returned to the trial court for further proceedings. There has been no further activity.

In November 1997, in *Young v. American Tobacco Co.,* a purported personal injury class action was commenced on behalf of plaintiff and all similarly situated residents in Louisiana who, though not themselves cigarette smokers, alleged to have been exposed to secondhand smoke from cigarettes which were manufactured by the defendants, and who suffered injury as a result of that exposure. The plaintiffs seek to recover an unspecified amount of compensatory and punitive damages. In October 2004, the trial court stayed this case pending the outcome of the appeal in *Scott v. American Tobacco Co.,* (See description below).

In June 1998, in *Cleary v. Philip Morris,* a putative class action was brought in Illinois state court on behalf of persons who were allegedly injured by (i) the defendants purported conspiracy pursuant to which defendants allegedly concealed material facts regarding the addictive nature of nicotine; (ii) the defendants alleged acts of targeting their advertising and marketing to minors; and (iii) the defendants claimed breach of the public s right to defendants compliance with laws prohibiting the distribution of cigarettes to minors. The plaintiffs request that the defendants be required to disgorge all profits unjustly received through their sale of cigarettes to plaintiffs and the class, which in no event will be greater than $75 per class member, inclusive of punitive damages, interest and costs. In July 2006, the plaintiffs filed a motion for class certification. A class certification hearing occurred in September 2007 and the parties are awaiting a decision. Merits discovery is stayed pending a ruling by the court. A status conference is scheduled in October 2009.

In April 2001, in *Brown v. American Tobacco Co.,* a California state court granted in part plaintiffs motion for class certification and certified a class comprised of adult residents of California who smoked at least one of defendants cigarettes during the applicable time period and who were exposed to defendants marketing and advertising activities in California. In March 2005, the court granted defendants motion to decertify the class based on a recent change in California law. In October 2006, the plaintiffs filed a petition for review with the California Supreme Court, which was granted in November 2006. Oral argument has not yet been scheduled.

Although not technically a class action, in *In Re: Tobacco Litigation (Personal Injury Cases)*, a West Virginia State court consolidated approximately 750 individual smoker actions that were pending prior to 2001 for trial of certain common issues. In January 2002, the court severed Liggett from the trial of the consolidated action. The consolidation was affirmed on appeal by the West Virginia Supreme Court. In February 2008, the United States Supreme Court denied the defendants petition for writ of certiorari asking the Court to review the trial plan. It is estimated that Liggett could be a defendant in approximately 100 of the cases. In February 2008, the court granted defendants motion to stay all proceedings pending United States Supreme Court review in *Altria Group Inc. v. Good*, where the Court will determine whether certain state law claims are preempted by federal law. Oral argument was held in that case in October 2008 and the parties await a decision.

Class certification motions are pending in a number of other cases and a number of orders denying class certification are on appeal. In addition to the cases described above, numerous class actions remain certified against other cigarette manufacturers, including *Scott.* In that case, a Louisiana jury returned a $591,000 verdict (subsequently reduced by the court to $263,500 plus interest from June 2004) against other cigarette manufacturers to fund medical monitoring or smoking cessation programs for members of the class. The verdict is on appeal.

Governmental Actions

As of September 30, 2008, there were two Governmental Actions pending against Liggett, only one of which is active. The claims asserted in health care cost recovery actions vary. In these cases, the governmental entities typically assert equitable claims that the tobacco industry was unjustly enriched by their payment of health care costs allegedly attributable to smoking and seek reimbursement of those costs. Other claims made by some but not all plaintiffs include the equitable claim of indemnity, common law claims of negligence, strict liability, breach of express and implied warranty, breach of special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under state and federal statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under RICO.

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In December 1998, in *City of St. Louis v. American Tobacco Company*, a case pending in Missouri state court, the City of St. Louis and approximately 50 hospitals brought suit against Liggett and other cigarette manufacturers seeking recovery of costs expended by the hospitals on behalf of patients who suffer, or have suffered, from illnesses allegedly resulting from the use of cigarettes. In June 2005, the court granted defendants motion for summary judgment as to claims for damages which accrued prior to November 16, 1993. The claims for damages which accrued after November 16, 1993 are pending. Discovery is ongoing. On September 3, 2008, the court heard argument on motions for summary judgment filed by the parties. A decision is pending. Recently, several plaintiffs dismissed their cases, with prejudice. Trial is scheduled to commence in January 2010.

DOJ Case. In September 1999, the United States government commenced litigation against Liggett and other cigarette manufacturers in the United States District Court for the District of Columbia. The action sought to recover an unspecified amount of health care costs paid for and furnished, and to be paid for and furnished, by the federal government for lung cancer, heart disease, emphysema and other smoking-related illnesses allegedly caused by the fraudulent and tortious conduct of defendants, to restrain defendants and co-conspirators from engaging in alleged fraud and other allegedly unlawful conduct in the future, and to compel defendants to disgorge the proceeds of their unlawful conduct. The action asserted claims under three federal statutes, the Medical Care Recovery Act (MCRA), the Medicare Secondary Payer provisions of the Social Security Act (MSP) and RICO. In September 2000, the court dismissed the government s claims based on MCRA and MSP.

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 that the non-Liggett defendants are enjoined from: (i) committing any act of racketeering concerning the manufacturing, marketing, promotion, health consequences or sale of cigarettes in the United States; (ii) making any material false, misleading, or deceptive statement or representation concerning cigarettes that persuades people to purchase cigarettes; and (iii) utilizing lights , low tar , ultra lights , mild , or natural descriptors, or conveying any other express or implie health messages in connection with the marketing or sale of cigarettes, domestically and internationally.

Although this case has been concluded as to Liggett, it is unclear what impact, if any, the Final Judgment will have on the cigarette industry as a whole. All parties, other than Liggett, appealed the decision and, on October 14, 2008, oral argument was heard by the United States Court of Appeals for the District of Columbia. A decision is pending. 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.

Third-Party Payor Actions

As of September 30, 2008, there were two Third-Party Payor Actions pending against Liggett. Other cigarette manufacturers are also named. The Third-Party Payor Actions typically have been commenced by insurance companies, union health and welfare trust funds, asbestos manufacturers and others. In Third-Party Payor Actions, plaintiffs seek damages for: funding of corrective public education campaigns relating to issues of smoking and health; funding for clinical smoking cessation programs; disgorgement of profits from sales of cigarettes; restitution; treble damages; and attorneys fees. Although no specific amounts are provided, it is understood that requested damages against cigarette manufacturers in these cases might be in the billions of dollars.

Several federal circuit courts of appeals and state appellate courts have ruled that Third-Party Payors did not have standing to bring lawsuits against cigarette manufacturers, relying primarily on grounds that plaintiffs claims were too remote. The United States Supreme Court has refused to consider plaintiffs appeals from the cases decided by five federal circuit courts of appeals.

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In June 2005, the Jerusalem District Court in Israel added Liggett as a defendant in an action commenced in 1998 by the largest private insurer in that country, General Health Services, against the major United States cigarette manufacturers. The plaintiff seeks to recover the past and future value of the total expenditures for health care services provided to residents of Israel resulting from tobacco related diseases, court ordered interest for past expenditures from the date of filing the statement of claim, increased and/or punitive and/or exemplary damages and costs. The court ruled that, although Liggett had not sold product in Israel since at least 1978, it might still have liability for cigarettes sold prior to that time. Motions filed by the defendants are pending before the Israel Supreme Court seeking appeal from a lower court s decision granting leave to plaintiff for foreign service of process.

In May 2008, in *National Committee to Preserve Social Security and Medicare v. Philip Morris USA,* a case pending in the United States District Court for the Eastern District of New York, plaintiffs commenced an action to recover twice the amount paid by Medicare for the health care services provided to Medicare beneficiaries to treat diseases allegedly attributable to smoking the defendants cigarettes from May 21, 2002 to the present, for which treatment the defendants allegedly were required to make payment under MSP. Defendants motion to dismiss and Plaintiffs motion for partial summary judgment were filed in July 2008. A decision is pending.

Upcoming Trials

There are currently 41 individual actions in Florida, that may be set for trial in 2009, where Liggett and/or Vector, and other cigarette manufacturers are named as defendants. These cases are all *Engle* progeny cases. There is one *Engle* progeny case scheduled for trial in February 2009 where Liggett is the only defendant. In addition, a trial has been scheduled for January 19, 2009 in a non-*Engle* individual action in Florida and for October 19, 2009 in an individual action in Missouri where Liggett and other cigarette manufacturers are named as defendants. Trial dates are subject to change.

MSA and Other State Settlement Agreements

In March 1996, March 1997 and March 1998, Liggett entered into settlements of smoking-related litigation with 45 states and territories. The settlements released Liggett from all smoking-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 Master Settlement Agreement (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 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.

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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. In addition, the MSA provides for the appointment of an independent auditor to calculate and determine the amount of payments owed pursuant to the MSA.

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 under the MSA, except to the extent its market share exceeds a market share exemption of approximately 0.28% of total cigarettes sold in the United States. According to data from Management Science Associates, Inc., domestic shipments by Liggett and Vector Tobacco accounted for approximately 2.2%, 2.4% and 2.5% of the total cigarettes shipped in the United States in 2005, 2006 and 2007, respectively. 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, would pay on each excess unit an amount equal (on a per-unit basis) to that due by the OPMs for that year. In April 2006 and 2007, Liggett and Vector Tobacco paid $10,637 and $38,743 for their 2005 and 2006 MSA obligations, respectively and, in April 2008, paid $35,995 for their 2007 MSA obligations, having prepaid $34,500 in 2007.

Under the payment provisions of the MSA, the Participating Manufacturers are required to pay a base annual amount of $9,000,000 in 2008 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.

Certain MSA Disputes

In 2005, the independent auditor under the MSA calculated that Liggett owed $28,668 for its 2004 sales. In April 2005, Liggett paid $11,678 and disputed the balance, as permitted by the MSA. Liggett subsequently paid $9,304 of the disputed amount, although Liggett continues to dispute that this amount is owed. This $9,304 relates to an adjustment to its 2003 payment obligation claimed by Liggett for the market share loss to non-participating manufacturers, which is known as the NPM Adjustment. At September 30, 2008, included in Other assets on the Company s consolidated balance sheet, was a noncurrent receivable of $6,513 relating to such amount. The remaining balance in dispute of $7,686 is comprised of $5,318 claimed for a 2004 NPM Adjustment and $2,368 relating to the independent auditor s retroactive change from gross to net units in calculating MSA payments, which Liggett contends is improper, as discussed below. From their April 2006 payment, Liggett and Vector Tobacco withheld approximately $1,600 claimed for the 2005 NPM Adjustment and $2,612 relating to the retroactive change from gross to net units. Liggett and Vector Tobacco withheld approximately $4,200 from their April 2007 payments related to the 2006 NPM Adjustment and approximately $3,000 relating to the retroactive change from gross to net units. From its April 2008 payment, Liggett withheld approximately $4,000 for the 2007 NPM Adjustment and approximately $3,300 relating to the retroactive change from gross to net units. Vector Tobacco paid approximately $200 into the disputed payments account for the 2007 NPM Adjustment.

The following amounts have not been expensed in the accompanying condensed consolidated financial statements as they relate to Liggett s and Vector Tobacco s claim for an NPM adjustment: $6,513 for 2003, $3,789 for 2004 and $800 for 2005.

NPM Adjustment. In March 2006, an economic consulting firm selected pursuant to the MSA rendered its final and non-appealable decision that the MSA was a significant factor contributing to the loss of market share of Participating Manufacturers for 2003. The economic consulting firm rendered the same decision with respect to 2004 and 2005. As a result, the manufacturers are entitled to potential NPM Adjustments to their 2003, 2004 and 2005 MSA payments. 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.

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Since April 2006, notwithstanding provisions in the MSA requiring arbitration, litigation has been commenced in 49 Settling States over the issue of whether the application of the NPM Adjustment for 2003 is to be determined through litigation or arbitration. These actions relate to the potential NPM Adjustment for 2003, which the independent auditor under the MSA previously determined to be as much as $1,200,000 for all Participating Manufacturers. To date, all 48 courts that have decided the issue have ruled that the 2003 NPM Adjustment dispute is arbitrable and 42 of those decisions are final. It is not possible to estimate a date by which arbitration of the dispute will commence or how many states will ultimately participate. There can be no assurance that Liggett or Vector Tobacco will receive any adjustment as a result of these proceedings.

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). The change in the method of calculation could, among other things, require additional MSA payments by Liggett of approximately $18,300 for 2001 through 2007, require an additional payment of approximately $3,300 for 2008 and require additional amounts in future periods because the proposed change from gross to net units would serve to lower Liggett s market share exemption under the MSA.

Liggett has objected to this retroactive change and has disputed the change in methodology. Liggett contends that the retroactive change from using gross unit amounts 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.

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

QUEST 3. Vector Tobacco does not make MSA payments on sales of its QUEST 3 product as Vector Tobacco believes that QUEST 3 does not fall within the definition of a cigarette under the MSA. There can be no assurance that Vector Tobacco s assessment is correct and that additional payments under the MSA for QUEST 3 will not be owed.

Litigation Challenging the MSA. In litigation pending in federal court in New York, certain importers of cigarettes allege that the MSA and certain related New York statutes violate federal antitrust and constitutional law. The district court granted defendants motion to dismiss the complaint for failure to state a claim. On appeal, the United States Court of Appeals for the Second Circuit held that if all of the allegations of the complaint were assumed to be true, plaintiffs had stated a claim for relief on antitrust grounds. On remand to the district court, in September 2004, the court denied plaintiffs motion to preliminarily enjoin the MSA and certain related New York statutes, but the court issued a preliminary injunction against an amendment to the allocable share provision of the New York escrow statute. The parties cross-motions for summary judgment are pending. Additionally, in another proceeding pending in New York federal court, plaintiffs seek to enjoin the statutes enacted by New York and other states in connection with the MSA on the grounds that the statutes violate the Commerce Clause of the United States Constitution and federal antitrust laws. In September 2005, the United States Court of Appeals for the Second Circuit held that if all of the allegations of the complaint were assumed to be true, plaintiffs had stated a claim for relief and that the New York federal court had jurisdiction over the other defendant states. In October 2006, the United States Supreme Court denied the petition of the attorneys general for writ of certiorari. Similar challenges to the MSA and MSA-related state statutes are pending in Kentucky, Arkansas, Kansas, Louisiana, Tennessee and Oklahoma. Liggett and the other cigarette manufacturers are not defendants in these cases.

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On October 28, 2008, Vibo Corporation, Inc., d/b/a General Tobacco commenced litigation in the United States District Court for the Western District of Kentucky against each of the Settling States and certain Participating Manufacturers. The plaintiff alleges, among other things, that the market share exemptions (i.e.: Grandfathered Share) provided to certain SPMs under the MSA, including Liggett and Vector Tobacco, violate federal antitrust and constitutional law. The plaintiff seeks, among other things, treble damages against each Participating Manufacturer.

Litigation challenging the validity of the MSA, including claims that the MSA violates antitrust laws, to date, has not been successful.

Other State Settlements. The MSA replaces Liggett s prior settlements with all states and territories except for Florida, Mississippi, Texas and Minnesota. Each of these four states, prior to the effective date of the MSA, negotiated and executed settlement agreements with each of the other major tobacco companies, separate from those settlements reached previously with Liggett. Liggett s agreements with these states remain in full force and effect, and Liggett made various payments to these states during 1996, 1997 and 1998 under the agreements. These states settlement agreements with Liggett contained most favored nation provisions which could reduce Liggett s payment obligations based on subsequent settlements or resolutions by those states with certain other tobacco companies. Beginning in 1999, Liggett determined that, based on each of these four states settlements with United States Tobacco Company, Liggett s payment obligations to those states had been eliminated. With respect to all non-economic obligations under the previous settlements, Liggett believes it is entitled to the most favorable provisions as between the MSA and each state s respective settlement with the other major tobacco companies. Therefore, Liggett s non-economic obligations to all states and territories are now defined by the MSA. In 2003, in order to resolve any potential issues with Minnesota as to Liggett s ongoing economic settlement obligations, Liggett negotiated a $100 a year payment to Minnesota, to be paid any year cigarettes manufactured by Liggett are sold in that state.

In 2004, the Attorneys General for 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. In 2004, Florida and Mississippi proposed settlements to Liggett in the total amount of approximately $20,000 for the period 1998 though 2003. Subsequent discussions did not result in a resolution of the issues. Liggett believes the states allegations are without merit, based, among other things, on the language of the most favored nation provisions of the settlement agreements.

Except for $2,500 accrued at September 30, 2008, in connection with the foregoing matters, no other amounts have been accrued in the accompanying condensed consolidated financial statements for any additional amounts that may be payable by Liggett under the settlement agreements with Florida, Mississippi and Texas. There can be no assurance that Liggett will resolve these matters or that Liggett will not be required to make additional material payments, which payments could adversely affect the Company s consolidated financial position, results of operations or cash flows.

Management is not able to predict the outcome of the litigation pending or threatened against Liggett. Litigation is subject to many uncertainties. For example, in June 2002, the jury in the *Lukacs* case, an individual case brought under the third phase of the *Engle* case, awarded $37,500 (subsequently reduced by the court to $24,835) of compensatory damages against Liggett and two other defendants and found Liggett 50% responsible for the damages. In August 2008, the court entered judgment in favor of the plaintiff, including interest from June 2002 which, as of September 30, 2008, was approximately $13,200. In April 2004, a jury in an individual action in a Florida state court awarded compensatory damages of $540 against Liggett and legal fees of $752. The legal fee award was reversed on appeal and remanded to the trial court for further proceedings. It is possible that additional cases could be decided unfavorably against Liggett. As a result of the *Engle* decision, approximately 9,570 former *Engle* class members commenced suit against Liggett and/or the Company and other cigarette manufacturers. Liggett may enter into discussions in an attempt to settle particular cases if it believes it is appropriate to do so.

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Management cannot predict the cash requirements related to any future defense costs, settlements or judgments, including cash required to bond any appeals, and there is a risk that those requirements will not be able to be met. An unfavorable outcome of a pending smoking and health case could encourage the commencement of additional similar litigation, or could lead to multiple adverse decisions in the *Engle* progeny cases. Management is unable to make a reasonable estimate with respect to the amount or range of loss that could result from an unfavorable outcome of the cases pending against Liggett or the costs of defending such cases and as a result has not provided any amounts in its condensed consolidated financial statements for unfavorable outcomes. The complaints filed in these cases rarely detail alleged damages. Typically, the claims set forth in an individual s complaint against the tobacco industry seek money damages in an amount to be determined by a jury, plus punitive damages and costs.

The tobacco industry is subject to a wide range of laws and regulations regarding the marketing, sale, taxation and use of tobacco products imposed by local, state and federal governments. There have been a number of restrictive regulatory actions, adverse legislative and political decisions and other unfavorable developments concerning cigarette smoking and the tobacco industry. 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.

It is possible that the Company s consolidated financial position, results of operations or cash flows could be materially adversely affected by an unfavorable outcome in any of the smoking-related litigation.

Liggett s and Vector Tobacco s management are unaware of any material environmental conditions affecting their existing facilities. Liggett s and Vector Tobacco s management believe that current operations are conducted in material compliance with all environmental laws and regulations and other laws and regulations governing cigarette manufacturers. Compliance with federal, state and local provisions regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, has not had a material effect on the capital expenditures, results of operations or competitive position of Liggett or Vector Tobacco.

Other Matters:

In February 2004, Liggett Vector Brands and another cigarette manufacturer entered into a five year agreement with a subsidiary of the American Wholesale Marketers Association to support a program to permit certain tobacco distributors to secure, on reasonable terms, tax stamp bonds required by state and local governments for the distribution of cigarettes. This agreement was recently extended through 2014. Under the agreement, Liggett Vector Brands has agreed to pay a portion of losses, if any, incurred by the surety under the bond program, with a maximum loss exposure of $500 for Liggett Vector Brands. To secure its potential obligations under the agreement, Liggett Vector Brands has delivered to the subsidiary of the association a $100 letter of credit and agreed to fund up to an additional $400. Liggett Vector Brands has incurred no losses to date under this agreement, and the Company believes the fair value of Liggett Vector Brands obligation under the agreement was immaterial at September 30, 2008.

There may be several other proceedings, lawsuits and claims pending against the Company and certain of its consolidated subsidiaries unrelated to tobacco or tobacco product liability. Management is of the opinion that the liabilities, if any, ultimately resulting from such other proceedings, lawsuits and claims should not materially affect the Company s financial position, results of operations or cash flows.

9. INCOME TAXES

Vector s income tax rates for the three and nine months ended September 30, 2008 and 2007 do not bear a customary relationship to statutory income tax rates as a result of the impact of nondeductible expenses, state income taxes and interest and penalties accrued on unrecognized tax benefits offset by the impact of the domestic production activities deduction.

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The Company s provision for income taxes in interim periods is based on an estimated annual effective income tax rate derived, in part, from estimated annual pre-tax results from ordinary operations in accordance with FIN 18, Accounting for Income Taxes in Interim Periods an interpretation of APB Opinion No. 28. In 2008, the Company did not include the gain on the income of the Company s investment in the St. Regis Hotel, a $2,600 reversal of previously unrecognized tax benefits due to the expiration of the Statute of Limitations, and the provision for losses on long-term investments and mortgage receivable in the computation of the effective annual income tax rate from estimated pre-tax results from ordinary operations. In 2007, the Company did not include the benefit from the settlement of a state income tax assessment, the income from the lawsuit settlement with the United States government, the gain from the exchange of the LTS notes and the $2,200 reversal of previously unrecognized deferred tax benefits in the computation of the effective annual income tax rate for 2007 from estimated pre-tax results from ordinary operations. These items reduced the Company s income tax provision by approximately $2,700 and $3,800 for the nine months ended September 30, 2008 and 2007, respectively, and the Company s provision for income taxes by approximately $2,750 and $2,200 for the three months ended September 30, 2008 and 2007, respectively due to differences in the Company s marginal tax rate of approximately 41% and its anticipated effective annual income tax rate from ordinary operations of approximately 44%.

The Company s current deferred income tax liabilities increased by approximately $75,500 in 2008 as a result of the reclassification of a deferred tax liability from non-current to current liabilities. This reclassification resulted from the Company s settlement with the Internal Revenue Service in July 2006, which required the Company to recognize taxable income of approximately $192,000 from the Philip Morris brand transaction by March 1, 2009.

10. NEW VALLEY

Investments in non-consolidated real estate businesses. The components of Investments in non-consolidated real estate businesses were as follows as of September 30, 2008 and December 31, 2007:

	September 30, 2008	December 31, 2007
Douglas Elliman Realty LLC	$ 35,383	$ 31,893
16th and K Holdings LLC		3,838
Koa Investors LLC		
Aberdeen Townhomes LLC	10,475	
New Valley Oaktree Chelsea Eleven LLC	12,000	
Investments in non-consolidated real estate businesses	$ 57,858	$ 35,731

Residential Brokerage Business. New Valley recorded income of $4,727 and $6,621 for the three months ended September 30, 2008 and 2007, respectively, and income of $10,249 and $17,763 for the nine months ended September 30, 2008 and 2007, respectively, associated with Douglas Elliman Realty. New Valley s income includes 50% of Douglas Elliman s net income, as well as interest income earned by New Valley on a subordinated loan to Douglas Elliman Realty, increases to income resulting from amortization of negative goodwill which resulted from purchase accounting, and management fees. New Valley received cash distributions from Douglas Elliman Realty LLC of $3,200 and $322 for the three months ended September 30, 2008 and 2007, respectively, and $5,757 and $5,170 for the nine months ended September 30, 2008 and 2007, respectively.

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Summarized financial information for Douglas Elliman Realty for the three and nine months ended September 30, 2008 and 2007 and as of September 30, 2008 and December 31, 2007 is presented below.

	September 30, 2008	December 31, 2007
Cash	$ 24,954	$ 26,916
Other current assets	9,124	9,462
Property, plant and equipment, net	16,734	18,394
Trademarks	21,663	21,663
Goodwill	38,321	38,294
Other intangible assets, net	1,387	1,928
Other non-current assets	922	850
Notes payable current	592	581
Current portion of notes payable to member Prudential Real Estate Financial Services Of America, Inc.	4,729	4,373
Current portion of notes payable to member New Valley	4,729	625
Other current liabilities	24,518	26,579
Notes payable long term	803	2,402
Notes payable to member Prudential Real Estate Financial Services of America, Inc.	3,043	15,115
Notes payable to member New Valley	3,043	8,583
Other long-term liabilities	7,479	6,599
Members equity	64,169	52,650

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Revenues	$ 99,259	$ 110,139	$ 281,515	$ 313,434
Costs and expenses	88,564	95,249	256,803	272,314
Depreciation expense	1,373	1,476	4,080	4,528
Amortization expense	74	111	223	285
Interest expense, net	800	966	2,465	3,424
Income tax expense	76	57	422	247
Net income	$ 8,372	$ 12,280	$ 17,522	$ 32,636

16th and K Holdings LLC. In 2007, 16th and K Holdings LLC entered into certain agreements to sell 90% of the St. Regis Hotel. The sale closed in March 2008. In addition to retaining a 3% interest, net of incentives, in the St. Regis Hotel, New Valley received $15,822 in March 2008 and received an additional $584 associated with the sale of the hotel in October 2008. The Company anticipates receiving an additional $3,400 in various installments between 2009 and 2012. The Company recorded the $15,822 as an investing activity in the condensed consolidated statement of cash flows. New Valley recorded equity losses of $0 and $32 for the three months ended September 30, 2008 and 2007, respectively, and $3,796 and $134 for the nine months ended September 30, 2008 and 2007, respectively, associated with 16th and K Holdings LLC. For the nine months ended September 30, 2008, New Valley also recorded equity income of $15,779 in connection with the gain from the sale of the St. Regis because the amount received from 16th and K Holdings exceeded the Company s basis in the investment and the Company has no legal obligation to make additional investments to 16th and K Holdings.

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Hawaiian Hotel. KOA Investors LLC owns the Sheraton Keauhou Bay Resort & Spa in Kailua-Kona, Hawaii. New Valley and certain members in KOA Investors have chosen not to fund discretionary capital calls in 2008 and KOA Investors was not able to meet its financial obligations in the third quarter of 2008. KOA has been informed by its Lender that it is in default on its $82,000 loan. The Company has carried its investment in KOA at $0 throughout 2008.

Aberdeen Townhomes LLC. In June 2008, a subsidiary of New Valley purchased a preferred equity interest in Aberdeen Townhomes LLC (Aberdeen) for $10,000. Aberdeen acquired five town home residences located in Manhattan, New York which it is in the process of rehabilitating and selling. In the event that Aberdeen makes distributions of cash, New Valley is entitled to a priority preferred return of 15% per annum until it has recovered its invested capital. New Valley is entitled to 25% of subsequent cash distributions of profits until it has achieved an annual 18% internal rate of return (IRR). New Valley is then entitled to 20% of subsequent cash distributions of profits until it has achieved an annual 23% IRR. After New Valley has achieved an annual 23% IRR, it is then entitled to 10% of any remaining cash distributions of profits. Aberdeen is a variable interest entity; however, the Company is not the primary beneficiary. The Company s maximum exposure to loss as a result of its investment in Aberdeen is $10,000. This investment is being accounted for under the cost method. New Valley recorded income of $475 related to the priority return of 15% per annum for the three and nine months ended September 30, 2008

New Valley Oaktree Chelsea Eleven, LLC. In September 2008, a subsidiary of New Valley LLC purchased a 40% interest in New Valley Oaktree Chelsea Eleven, LLC (New Valley Oaktree). New Valley Oaktree lent $29,000 and contributed $1,000 in capital to Chelsea Eleven LLC (Chelsea), which is developing a condominium project in Manhattan, New York. The development consists of 72 luxury residential units and one commercial unit. Approximately 75% of the units have been pre-sold and approximately $35,000 in deposits held in escrow. The loan from New Valley Oaktree loan is subordinate to a $110,000 construction loan and a $24,000 mezzanine loan plus accrued interest. The loan from New Valley Oaktree to Chelsea bears interest at 60.25% per annum, compounded monthly, with $3,750 being held in an interest reserve.

New Valley Chelsea is a variable interest entity; however, the Company is not the primary beneficiary. The Company s maximum exposure to loss as a result of its investment in Chelsea is $12,000. This investment is being accounted for under the equity method.

Mortgage receivable. In March 2008, a subsidiary of New Valley purchased a loan secured by a substantial portion of a 450-acre approved master planned community in Palm Springs, California known as Escena. The loan, which is currently in foreclosure, was purchased for its $20,000 face value plus accrued interest and other costs of $1,445. The loan is being accounted for under the cost recovery method and the cost includes the purchase price and additional capitalized acquisition costs of $259.

The borrowers are Escena-PSC, LLC and Palm Springs Classic, LLC, a joint venture of Lennar Homes of California, Inc. and Empire Land, LLC. Empire Land recently filed a Chapter 11 bankruptcy petition. Lennar Homes is an affiliate of Lennar Corporation. The loan collateral consists of 867 residential lots with site and public infrastructure, an 18-hole Nicklaus Design golf course, a substantially completed clubhouse, and a seven-acre site approved for a 450-room hotel.

In October 2007, the as is value of the land was appraised in excess of the outstanding value of the loan. The Company recently obtained an updated appraisal that valued the property at substantially less than the outstanding loan balance. The reduction in value was attributed to the overall real estate market conditions in California. Among other things, Lennar Corporation has a payment guaranty of up to 50% of the outstanding loan and accrued interest as well as a guaranty to complete the development of the property. In order to calculate the fair market value of the investment, the Company utilized the most recent as is appraised value of the collateral and estimated the value of Lennar Corporation s completion and payment guaranties, less estimated costs to enforce the guaranties and dispose of the property. The Company applied a discount rate of 25% and a default rate of approximately 5.4% to the Guarantor s debt in valuing the guaranties. The Company believes that both rates approximated market conditions at September 30, 2008. Based on these estimates, the Company has determined that the fair market value was less than the carrying amount of the mortgage receivable at September 30, 2008 by approximately $4,000. This determination was made because real estate values in Palm Springs declined significantly in the third quarter. Accordingly, a reserve was established for the decline in value and a charge of $4,000 was recorded for the three and nine months ended September 30, 2008 as a component of Provision for loss on investments in the Company s Condensed Consolidated Statement of Operations. The Company carried the loan on its condensed consolidated balance sheet at its net basis of $17,704 as of September 30, 2008. Litigation is ongoing to enforce the Company s rights under the loan documents.

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Real Estate Market Conditions. Because the real estate, capital and credit markets have continued to worsen, the Company will continue to perform additional assessments to determine the impact of the markets, if any, on the Company s condensed consolidated financial statements. Thus, future impairment charges may occur.

NASA Settlement. In 1994, New Valley commenced an action against the United States government seeking damages for breach of a launch services agreement covering the launch of one of the Westar satellites owned by New Valley s former Western Union satellite business. In March 2007, the parties entered into a Stipulation for Entry of Judgment to settle New Valley s claims and, pursuant to the settlement, $20,000 was paid in May 2007. In the first quarter of 2007, the Company recognized a pre-tax gain of $19,590, which consisted of other non-operating income of $20,000 and $410 of selling, general and administrative expenses, in connection with the settlement.

11. INVESTMENTS AND FAIR VALUE MEASUREMENTS

On January 1, 2008, the Company adopted SFAS No. 157, Fair Value Measurements , for financial assets and financial liabilities. SFAS No. 157 does not require any new fair value measurements but rather introduces a framework for measuring fair value and expands required disclosure about fair value measurements of assets and liabilities.

SFAS No. 157 discusses valuation techniques, such as the market approach (comparable market prices), the income approach (present value of future income or cash flow), and the cost approach (cost to replace the service capacity of an asset or replacement cost). The statement clarifies that fair value is an exit price, representing amounts that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

SFAS No. 157 utilizes a three-tier fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

Level 1	Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.
Level 2	Inputs other than quoted prices that are observable for the assets or liability, either directory or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.
Level 3	Unobservable inputs in which there is little market data, which requires the reporting entity to develop their own assumptions

This hierarchy requires the use of observable market data, when available, and to minimize the use of unobservable inputs when determining fair value.

The Company s population of recurring financial assets and liabilities subject to fair value measurements and the necessary disclosures are as follows:

Fair Value Measurements as of September 30, 2008

Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money market funds	$ 197,629	$ 197,629	$	$
Investment securities available for sale	46,151	37,331	8,820	
Total	$ 243,780	$ 234,960	$ 8,820	$
Liabilities:				
Fair value of derivatives embedded within convertible debt	$ 93,745	$	$	$ 93,745