VECTOR GROUP LTD
Form S-3
May 19, 2005

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As filed with the Securities and Exchange Commission on May 19, 2005
Registration No. 333-

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM S-3

REGISTRATION STATEMENT
Under
The Securities Act of 1933

VECTOR GROUP LTD.

(Exact name of Registrant as specified in its charter)

Delaware	**65-0949535**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

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

Richard J. Lampen
Executive Vice President
Vector Group Ltd.
100 S.E. Second Street
Miami, Florida 33131
(305) 579-8000
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:
Mark J. Mihanovic, Esq.
McDermott Will & Emery LLP
2049 Century Park East, 34th Floor
Los Angeles, California 90067
(310) 277-4110

Approximate date of commencement of proposed sale to the public: From time to time after the effective date of this Registration Statement.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box.o

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box.þ

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.o

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box.o

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CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	**Amount to be Registered**	**Proposed Maximum Offering Price Per Security**	**Aggregate Offering Price**	**Amount of Registration Fee**
$30,000,000 5% Variable Interest Senior Convertible Notes due November 15, 2011	$ 30,000,000(1)	100% (2)	$ 30,000,000(1)	$ 3,531
Common Stock, $.10 par value	1,546,392(3)			(4)

(1) Represents the aggregate principal amount of the notes issued by the Registrant.

(2) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(c) under the Securities Act of 1933 and exclusive of accrued interest and distributions, if any.

(3) Represents 1,546,392 shares of common stock issuable upon conversion of the notes at the conversion price of $19.40 per share of common stock. Pursuant to Rule 416 under the Securities Act, such number of shares of common stock registered hereby shall include an indeterminate number of shares of common stock that may be issued in connection with a stock split, stock dividend, recapitalization or similar event.

(4) Pursuant to Rule 457(i), no additional filing fee is payable with respect to the shares of common stock issuable upon conversion of the notes because no additional consideration will be received in connection with the exercise of the conversion privilege.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

Subject to Completion, Dated May 19, 2005

$30,000,000

[VECTOR LOGO]

VECTOR GROUP LTD.

The information in this prospectus is not complete and may be changed. The holders may not sell these securities until the registration statement relating to these securities that has been filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

5% Variable Interest Senior Convertible Notes due November 15, 2011
and the common stock issuable upon conversion of the notes

This prospectus relates to the resale of up to 1,546,392 of our shares of common stock by certain selling securityholders. The shares that may be resold pursuant to this prospectus include 1,546,392 shares of common stock issuable upon conversion of $30,000,000 aggregate principal amount of our convertible notes (the notes).

We issued the notes offered by this prospectus in a private placement in April 2005. This prospectus will be used by selling securityholders to resell their notes and the common stock issuable upon conversion of their notes. We will not receive any proceeds from this offering.

The notes are convertible by securityholders prior to maturity (unless previously redeemed or repurchased pursuant to their terms) into common stock at a conversion rate of 51.5464 shares per each $1,000 principal amount of notes, subject to adjustment if certain events occur. This is equivalent to an initial conversion price of $19.40 per share. We will pay interest on the notes on each February 15, May 15, August 15, and November 15 of each year the notes are outstanding, beginning on May 15, 2005. The notes accrue interest at a rate of 5% per year, with an additional amount of interest payable on the notes on each interest payment date based on the amount of cash dividends actually paid by us per share on our common stock during the prior three-month period ending on the record date for such interest payment multiplied by the number of shares of our common stock into which the notes are convertible on such record date (together, the Total Interest). Notwithstanding the foregoing, however, during the period prior to and including November 15, 2006, the interest payable on each interest payment date shall be the higher of (i) the Total Interest and (ii) 6 3/4% per year.

The notes will mature on November 15, 2011, unless earlier converted, redeemed or repurchased. We must redeem 12.5% of the total aggregate principal amount of the notes outstanding on November 15, 2009. In addition to such redemption amount, we will also redeem on November 15, 2009 and on each interest accrual period thereafter an additional amount, if any, of the notes necessary to prevent the notes from being treated as an Applicable High Yield Discount Obligation under the Internal Revenue Code. The holders of the notes will have the option on November 15, 2009 to require us to repurchase some or all of their remaining notes. The redemption price for such redemptions will equal 100% of the principal amount of the notes plus accrued and unpaid interest thereafter, if any. The notes are our senior unsecured obligations and rank on a parity in right of payment with all of our existing and future senior unsecured indebtedness to the extent described herein. The notes will effectively rank junior to any future secured indebtedness we may incur and junior to liabilities of our subsidiaries.

In the event of a fundamental change, as described in this prospectus, the holders of the notes may require us to repurchase any notes held by them. In addition to the repurchase price, we will pay the make-whole premium described in this prospectus to holders of notes who require us to repurchase their notes in connection with such repurchase event.

Our common stock is traded on the New York Stock Exchange under the symbol VGR . On ____________, 2005, the closing price of our common stock on the New York Stock Exchange was $_______ per share.

The securities offered by this prospectus involve a high degree of risk. See Risk Factors beginning on page 12.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

This prospectus is dated _________ __, 2005

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WHERE YOU CAN FIND MORE INFORMATION

We are subject to the informational reporting requirements of the Securities Exchange Act of 1934, as amended (the Exchange Act), and file reports, proxy statements and other information with the Securities and Exchange Commission (SEC). You can inspect and copy all of this information at the Public Reference Room maintained by the SEC at its principal office at 450 Fifth Street, N.W., Judiciary Plaza, Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains a web site that contains reports, proxy statements and other information regarding issuers, like us, that file electronically with the SEC. The address of this web site is: http://www.sec.gov.

We have filed with the SEC a registration statement on Form S-3 under the Securities Act of 1933 with respect to the notes and common stock offered by this prospectus. This prospectus does not contain all of the information set forth in the registration statement. We have omitted parts of the registration statement as permitted by the rules and regulations of the SEC. Statements contained in or incorporated by reference into this prospectus as to the contents of any contract or other document are not necessarily complete. You should refer to a copy of each contract or document filed as an exhibit to the registration statement or incorporated by reference into this prospectus for complete information. Copies of the registration statement, including exhibits and information incorporated by reference into this prospectus, may be inspected without charge at the SEC s public reference facility or website.

INCORPORATION BY REFERENCE

The SEC allows us to incorporate by reference into this prospectus information we have filed with the SEC. This means that we can disclose important information by referring you to those documents containing the other information. The information incorporated by reference is considered to be a part of this prospectus. Information that we file later with the SEC will automatically update and supercede this information. We incorporate by reference the documents listed below and any filings made by us with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of this prospectus and before the termination of this offering:

Our Annual Report on Form 10-K for the fiscal year ended December 31, 2004, filed with the SEC on March 25, 2004, as amended on March 31, 2005;

Our Quarterly Report on Form 10-Q for the quarter ended March 31, 2005, filed with the SEC on May 10, 2005; and

Our Current Reports on Form 8-K, filed with the SEC on April 1, 2005, April 14, 2005, and May 10, 2005.

Any statement contained in a document incorporated or deemed to be incorporated by reference herein shall be deemed to be modified or superceded for purposes of this prospectus to the extent that a statement contained herein or in any other document subsequently filed which is also incorporated by reference herein modifies or supercedes such statement. Any such statement so modified or superceded shall not be deemed, except as so modified, to constitute a part of this prospectus.

You can obtain any of the documents incorporated by reference through us or the SEC. Documents incorporated by reference are available from us without charge. You may obtain documents incorporated by reference in this prospectus by sending a request in writing to the following address or by telephone:

Vector Group Ltd.
Attention: Investor Relations
100 S.E. Second Street, 32nd Floor

Miami, Florida 33131
(305) 579-8000

You should rely only on the information provided or incorporated by reference in this prospectus or a prospectus supplement or amendment. We have not authorized anyone else to provide you with different

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information. We are not making an offer of these securities in any jurisdiction where the offer is not permitted. You should not assume the information in this prospectus or a prospectus supplement or amendment is accurate as of any date other than the date on the front of the documents.

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PROSPECTUS SUMMARY

This summary highlights some information from this prospectus. Because it is a summary, it does not contain all of the information that you should consider before investing. You should read the entire prospectus carefully, including the Risk Factors section and the financial statements and the notes to those statements incorporated by reference into this prospectus. As used in this prospectus, the terms Vector , we , our and us and similar terms refer to Vector Group Ltd. and all of our consolidated subsidiaries, including VGR Holding Inc., Liggett Group Inc., Vector Tobacco Inc., Liggett Vector Brands Inc. and New Valley Corporation, except with respect to the section entitled Description of Notes and where it is clear that these terms mean only Vector Group Ltd.

Vector Group

We are a holding company for a number of businesses. We are engaged principally in:

- the manufacture and sale of cigarettes in the United States through our subsidiary Liggett Group Inc., and

- the development and marketing of the low nicotine and nicotine-free QUEST cigarette products and the development of reduced risk cigarette products through our subsidiary Vector Tobacco Inc.

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

We are controlled by Bennett S. LeBow, our Chairman and the Chairman of New Valley, who beneficially owns approximately 33.8% of our common stock.

Liggett

Liggett is the successor to the Liggett & Myers Tobacco Company, which was founded in 1873. Liggett, which is currently the fifth largest manufacturer of cigarettes in the United States in terms of unit sales, shipped approximately 9 billion cigarettes during 2004. Liggett believes, based on published industry sources, that this accounted for 2.3% of the total cigarettes shipped in the United States during 2004.

Liggett s cigarettes are produced in approximately 220 combinations of length, style and packaging. Liggett s current brand portfolio includes:

- LIGGETT SELECT the second largest brand in the deep discount category,

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

- JADE a free-standing deep discount menthol brand,

- PYRAMID the industry s first deep discount product with a brand identity, and

- USA and various control and private label brands.

Liggett has a history of introducing innovative products to improve its competitive position in the discount cigarette segment, which Liggett s management believes has been the primary growth segment for the industry for over a decade. In 1980, Liggett was the first major domestic cigarette manufacturer to successfully introduce discount cigarettes as an alternative to premium priced cigarettes. In 1989, Liggett established a new price point within the discount market segment by introducing PYRAMID, a branded discount product which, at that time, sold for less than most other discount cigarettes. In 1999, Liggett introduced LIGGETT SELECT, one of the fastest growing brands in the deep discount category. LIGGETT SELECT is now the largest seller in Liggett s family of brands, comprising 55.8% of Liggett s unit volume in 2004, 50.9% in 2003 and 42.1% in 2002. These product introductions allowed Liggett to increase its market share through greater penetration of the discount segment. Liggett believes, based on published industry sources, that Liggett s discount cigarette shipments represented 7.4% of this market segment for 2004.

In April 2002, we acquired the stock of The Medallion Company, Inc. for a total purchase price of $110 million. Medallion, a discount cigarette manufacturer, is a participating manufacturer under the Master Settlement Agreement (described below). Medallion has no payment obligations under the Master Settlement Agreement unless its market share exceeds approximately 0.28% of total cigarettes sold in the United States (which amounted to approximately 1.1 billion units in 2004). Following the purchase of the Medallion stock, Vector Tobacco merged into Medallion and Medallion changed its name to Vector Tobacco Inc. For purposes of this prospectus, references to the Liggett segment encompass the manufacture and sale of conventional cigarettes and include the former operations of Medallion (which operations are held for legal purposes as part of Vector Tobacco).

Liggett has also taken a unique approach to the litigation proceedings against U.S. cigarette manufacturers concerning the harmful effects of cigarette consumption. Beginning in 1996, Liggett settled, independently of its four major competitors, the tobacco litigation brought by various state attorneys general against it and the other major cigarette manufacturers.

Liggett believes that it has gained a sustainable cost advantage over its competitors through these settlement initiatives. Under the Master Settlement Agreement reached in November 1998 with 46 state attorneys general, the three largest cigarette manufacturers must make settlement payments to the 46 states based on how many cigarettes are sold annually. Liggett, however, is not required to make any payments unless its market share exceeds approximately 1.65% of the U.S. cigarette market. Additionally, Vector Tobacco, the legal successor by merger to Medallion, likewise has no payment obligation unless its market share exceeds approximately 0.28% of the U.S. cigarette market.

Vector Tobacco

Vector Tobacco is engaged in the development and marketing of the low nicotine and nicotine-free QUEST cigarette products and the development of reduced risk cigarette products.

QUEST. In January 2003, Vector Tobacco introduced QUEST, its brand of low nicotine and nicotine-free cigarette products. The product is currently available in eight states, and sales of cigarettes in those eight states account for approximately 30% of all cigarette sales in the United States. QUEST is designed for adult smokers who are interested in reducing their levels of nicotine intake and is available in both menthol and nonmenthol styles. Each style offers three different packagings, with decreasing amounts of nicotine QUEST 1, 2 and 3. QUEST 1, the low nicotine variety, contains 0.6 milligrams of nicotine. QUEST 2, the extra-low nicotine variety, contains 0.3 milligrams of nicotine. QUEST 3, the nicotine-free variety, contains only trace levels of nicotine no more than 0.05 milligrams of nicotine per cigarette. QUEST cigarettes utilize a proprietary process that enables the production of nicotine-free tobacco that tastes and smokes like tobacco in conventional cigarettes. All six QUEST varieties are sold in box style packs and are priced comparably to other premium brands. We continue to support the brand by point-of-purchase awareness campaigns and other store-related promotions.

The premium segment of the tobacco industry is currently experiencing intense competitive activity, with increased discounting of premium brands at all levels of retail. Given these marketplace conditions, and the results that we have seen to date with QUEST, we determined during the second quarter of 2004 to postpone indefinitely the national launch of QUEST. Vector Tobacco continues to explore potential opportunities to expand the market for the brand on a more limited basis. Any determination as to future expansion of the market presence of the QUEST brand will be based on the ongoing and projected demand for the product, market conditions in the premium segment and the prevailing regulatory environment, including any restrictions on the advertising of the product.

In October 2003, we announced that Jed E. Rose, Ph.D., Director of Duke University Medical Center s Nicotine Research Program and co-inventor of the nicotine patch, had conducted a study at Duke University

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Medical Center to provide preliminary evaluation of the use of the QUEST technology as a smoking cessation aid. In the preliminary study on QUEST, 33% of QUEST 3 smokers were able to achieve four-week continuous abstinence, a standard threshold for smoking cessation. We believe these results show promise for the QUEST technology as a smoking cessation aid. We have received guidance from the Food and Drug Administration as to the additional clinical research and regulatory filings necessary to market QUEST as a smoking cessation product. We believe that obtaining the Food and Drug Administration s approval to market QUEST as a smoking cessation product will be an important factor in the long-term commercial success of the QUEST brand. No assurance can be given that such approval can be obtained or as to the timing of any such approval if received.

OMNI. In November 2001, Vector Tobacco launched nationwide its OMNI brand, which was the first reduced carcinogen cigarette that smokes, tastes and burns like other premium cigarettes. In comparison to comparable styles of the leading U.S. cigarette brand, OMNI cigarettes produced significantly lower levels of many of the recognized carcinogens and toxins that the medical community has identified as major contributors to lung cancer and other diseases in smokers. Acceptance of OMNI was limited, and the product is not currently being distributed. Vector Tobacco was unable to achieve the anticipated breadth of distribution and sales of the OMNI product due in part to the lack of success of its advertising and marketing efforts in differentiating OMNI from other conventional cigarettes with consumers through the reduced carcinogen message. Over the next several years, our in-house research program, together with third-party collaborators, plans to conduct appropriate studies relating OMNI s reduction of carcinogens to reduced risk in smokers and, based on these studies, we will review the marketing and positioning of the OMNI brand in order to formulate a strategy for its long-term success.

New Valley

We currently own 55.1% of New Valley (NASDAQ: NVAL), which is engaged in the following businesses:

- 50% ownership of Douglas Elliman Realty, LLC, and

- New Valley Realty Division

Douglas Elliman Realty. New Valley owns 50% of Douglas Elliman Realty, LLC, which operates the largest residential brokerage company in the New York metropolitan area through its two subsidiaries, Douglas Elliman, LLC and Prudential Douglas Elliman Real Estate. Together, the two brokerage companies have 54 offices with more than 2,800 real estate brokers in the metropolitan New York area. The companies achieved combined sales of approximately $10.0 billion of real estate for the year ended December 31, 2004. In 2004, Douglas Elliman Realty was ranked as the seventh largest residential brokerage company in the United States based on closed sales volume by the Real Trends broker survey.

Douglas Elliman, LLC was founded in 1911 and has grown to be one of Manhattan s leading residential brokers by specializing in the highest end of the sales and rental marketplaces. It has 12 offices in New York City, more than 1,100 real estate brokers and sales volume of approximately $5.9 billion of real estate for the year ended December 31, 2004.

Prudential Douglas Elliman Real Estate is headquartered in Huntington, New York and is the largest residential brokerage company on Long Island with 42 offices and more than 1,700 real estate agents. During 2004, Prudential Douglas Elliman Real Estate closed approximately 7,975 transactions, representing sales volume of approximately $4.2 billion of real estate. Prudential Douglas Elliman Real Estate serves approximately 250 communities from Manhattan to Montauk.

New Valley Realty Division. Through its Realty Division, New Valley is engaged in the real estate business and owns a 50% interest in the Sheraton Keauhou Bay Resort & Spa in Kailua-Kona, Hawaii, which reopened in the fourth quarter of 2004 after a major renovation. In February 2005, New Valley sold its two office buildings in Princeton, New Jersey for $71.5 million. New Valley also seeks to acquire additional operating companies and real estate properties.

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Strategy

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

Liggett

- Capitalize upon Liggett s cost advantage in the U.S. cigarette market due to the favorable treatment that it receives under settlement agreements with the state attorney generals and the Master Settlement Agreement,
- Focus marketing efforts on the discount segment, continue to build volume and margin in core discount brands (LIGGETT SELECT and EVE) and utilize core brand equity to selectively build distribution,
- Continue product development to provide the best quality products relative to other discount products in the marketplace,
- Increase efficiency by developing and adopting an organizational structure to maximize profit potential,
- Expand the portfolio of private and control label partner brands utilizing a pricing strategy that offers long-term list price stability for customers,
- Bring niche-driven brands to the market in the future, and
- Pursue strategic acquisitions of smaller tobacco manufacturers.

Vector Tobacco

- Take a measured approach to expanding the market presence of the QUEST brand,
- Continue to pursue the QUEST technology as a smoking cessation aid, and
- Continue to conduct appropriate studies relating OMNI s reduction of carcinogens to reduced risk in smokers and review the marketing and positioning of the OMNI brand in order to formulate a strategy for its long-term success.

New Valley

- Continue to grow Douglas Elliman operations by utilizing its strong brand name recognition and pursuing strategic and financial opportunities,
- Continue to leverage our expertise as direct investors by actively pursuing real estate investments in the United States and abroad which we believe will generate above-market returns,
- Acquire operating companies through mergers, asset purchases, stock acquisitions or other means, and
- Invest New Valley s excess funds opportunistically in situations that we believe can maximize shareholder value.

We were incorporated in the State of Delaware on September 7, 1999. The mailing address of our principal executive offices is 100 S.E. Second Street, Miami, Florida 33131. Our telephone number at that address is

(305) 579-8000. Our website address is www.vectorgroupltd.com. Our website and the information contained in our website are not incorporated into this prospectus or the registration statement of which it forms a part.

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THE OFFERING

The following is a brief summary of some of the terms of the notes offered for resale in this prospectus. For a more complete description of the terms of the notes, see the Description of Notes section in this prospectus.

Issuer	Vector Group Ltd.
Securities Offered	$30,000,000 in principal amount of 5% Variable Interest Senior Convertible Notes due 2011. This prospectus also relates to the offering of shares of our common stock issuable upon conversion of the notes.
Maturity	November 15, 2011
Interest	Annual Rate: 5%, with an additional amount of interest payable on each interest payment date based on the amount of cash dividends per share paid by us on our common stock during the prior three-month period ending on the record date for such interest payment multiplied by the total number of shares of our common stock into which the notes are convertible on such record date (together, the Total Interest). Notwithstanding the foregoing, however, during the period prior to and including November 15, 2006, the interest payable on each interest payment date shall be the higher of (i) the Total Interest and (ii) 6.75% per year. Payment Frequency: Every quarter on February 15, May 15, August 15 and November 15 First Payment: May 15, 2005
Conversion Rights	The notes are convertible, at the holders option at any time following the date of issuance until the maturity date, unless previously redeemed or repurchased as described below, into our common stock at an initial conversion price of $19.40 per share of common stock, subject to adjustment for various events. The initial conversion ratio is 51.5464 shares of common stock per $1,000 principal amount of notes.
Mandatory Redemption	We must redeem 12.5% of the total aggregate principal amount of the notes outstanding on November 15, 2009. We will also redeem on November 15, 2009 and on each interest accrual period thereafter an additional amount, if any, of the notes necessary to prevent the notes from being treated as an Applicable High Yield Discount Obligation under the Internal Revenue Code. The holders of the notes will have the option on November 15, 2009 to require us to repurchase some or all of their remaining notes. The redemption price for such redemptions will equal 100% of the principal amount of the notes plus accrued and unpaid interest, if any.
Repurchase at Option of the Holders Upon a Fundamental Change	If a fundamental change (as defined in Description of Notes Repurchase of Notes at the Option of the Holders Upon a Fundamental Change) occurs, subject to certain conditions and restrictions, we will be required to repurchase the notes, at the option of the holders thereof, at 100% of their principal amount, plus accrued and unpaid interest, if any, plus, under certain circumstances, the make-whole premium described in this prospectus to holders of notes who require us to repurchase their notes in connection with such fundamental change.

Ranking	The notes are our senior unsecured obligations and rank on a parity in right

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	of payment with all of our existing and future senior unsecured indebtedness. The notes will effectively rank junior to any future secured indebtedness we may incur and junior to liabilities of our subsidiaries. As of March 31, 2005, these notes would have been effectively junior to approximately $58.9 million of indebtedness of our subsidiaries.
Use of Proceeds	We will not receive any of the proceeds from the sale by any selling securityholders of the notes or the underlying common stock offered by this prospectus.
Events of Default	The following are events of default under the indenture for the notes: we fail to deliver within 30 days the required number of shares of common stock upon conversion, we fail for 30 days to reserve shares of common stock issuable upon conversion, we fail to pay interest or registration default payments when due and that failure continues for 5 days, we fail to pay the principal and any premium on the notes when due, we fail to perform any other covenant in the indenture or the notes and that failure continues for 60 days after notice to us by the trustee or the holders of a least 25% in the aggregate principal amount of the outstanding notes, subject to certain exceptions, we fail to pay when due the principal of any indebtedness for money borrowed by us or any of our subsidiaries in excess of $10.0 million if the indebtedness is not discharged and such failure continues for 30 days or more, or, if such indebtedness has been accelerated and such acceleration is not annulled, within 30 days after written notice to us by the trustee or the holders of at least 25% in the aggregate principal amount of the outstanding notes, final unsatisfied judgments not covered by insurance aggregating in excess of $10.0 million, at any one time, are rendered against us or any significant subsidiary and not stayed, bonded or discharged within 60 days, and certain events of bankruptcy, insolvency or reorganization with respect to us or any of our significant subsidiaries specified in the indenture. See Description of Notes Events of Default and Remedies.
Registration Rights	This prospectus is part of a registration statement filed pursuant to a registration rights agreement we entered into with the initial purchaser listed therein. If we fail to comply with certain of our obligations under the registration rights agreement, we will pay liquidated damages on the notes. See Description of the Notes Registration Rights.
Trading Market	The notes issued in the initial private placement are eligible for trading in the PORTAL system. However, notes sold using this prospectus will no longer be eligible for trading in the PORTAL system. We do not intend to list the notes on any securities exchange or

	automated quotation system. Our common stock trades on the New York Stock Exchange under the symbol VGR .
Certain United States Federal Income Tax Consequences	We and each holder of the notes agree in the indenture, for United States federal income tax purposes, to treat the notes as contingent payment debt instruments and to be bound by our application of the U.S. Treasury regulations that govern contingent payment debt instruments, including our determination that the rate at which interest will be deemed to accrue for

	United States federal income tax purposes will be 10.74% compounded quarter-annually, which is the rate comparable to the rate at which we would borrow on a non-contingent, non-convertible borrowing with terms and conditions otherwise comparable to the notes. Accordingly, each holder will be required to accrue interest on a constant yield to maturity basis at that rate (subject to certain adjustments), with the result that a U.S. holder (as defined below under Certain United States Federal Income Tax Consequences) may recognize taxable income significantly in excess of cash received while the notes are outstanding. In addition, a U.S. holder will recognize ordinary income upon a sale, exchange, conversion, redemption or repurchase of the note at a gain. In computing such gain, the amount realized by a U.S. holder will include, in the case of a conversion, the amount of cash and the fair market value of shares received. However, the proper United States federal income tax treatment of a holder of a note is uncertain in various respects. If the agreed upon treatment was successfully challenged by the Internal Revenue Service, it might be determined that, among other differences, a holder should have accrued interest income at a lower rate, should not have recognized income or gain upon the conversion, and should not have recognized ordinary income upon a taxable disposition of its notes. See Certain United States Federal Income Tax Consequences.
	We intend to take the position that payments of contingent interest to non-U.S. holders will not be exempt from the 30% U.S. withholding tax and, therefore, we intend to withhold on such payments of contingent interest at a rate of 30% unless such holder is eligible for a reduced rate or an exemption under an applicable U.S. income tax treaty or such interest is effectively connected with the holder s conduct of a U.S. trade or business. Payments of noncontingent interest and cash or common stock delivered upon the conversion, redemption, or retirement of a note will generally not be subject to such withholding if certain conditions are satisfied by the holder, as explained in detail below under Certain United States Federal Income Tax Consequences.
	HOLDERS ARE URGED TO CONSULT THEIR TAX ADVISORS REGARDING THE TAX TREATMENT OF THE NOTES AND WHETHER A PURCHASE OF THE NOTES IS ADVISABLE IN LIGHT OF THE TAX TREATMENT OF THE NOTES AND THE INVESTOR S PARTICULAR TAX SITUATION.
Risk Factors	Investment in the notes and the underlying common stock involves a high degree of risk. Therefore, you should carefully consider all information in this prospectus and in particular the matters set forth in the Risk Factors section beginning on page 12.

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RISK FACTORS

Before you invest in our securities, you should be aware that we are subject to various risks, including the ones listed below, the occurrence of any of which could materially adversely affect our business, financial condition and results of operations. You should carefully consider these risk factors, as well as the other information included or incorporated by reference in this prospectus, in evaluating an investment in our securities. Although the risks identified below represent those we believe are the most significant risks at the present time, additional risks of which we are currently unaware or that we currently deem immaterial could also materially impair our business operations.

Risks Relating to our Business

We and our subsidiaries have a substantial amount of indebtedness.

We and our subsidiaries have significant indebtedness and debt service obligations. At March 31, 2005, we and our subsidiaries had total outstanding indebtedness (including embedded derivative liability and beneficial conversion feature related to convertible notes) of $273.6 million. In addition, subject to the terms of any future agreements, we and our subsidiaries will be able to incur additional indebtedness in the future. There is a risk that we will not be able to generate sufficient funds to repay our debt. If we cannot service our fixed charges, it would have a material adverse effect on our business and results of operations.

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

We are a holding company and have no operations of our own. We hold our interests in our various businesses through our wholly-owned subsidiary, VGR Holding Inc. In addition to our own cash resources, our ability to pay interest on our convertible notes and to pay dividends on our common stock depends on the ability of VGR Holding to make cash available to us. VGR Holding s ability to pay dividends to us depends primarily on the ability of Liggett, its wholly-owned subsidiary, and New Valley, in which we indirectly hold an approximately 55.1% interest, to generate cash and make it available to VGR Holding. Liggett s revolving credit agreement permits Liggett to pay cash dividends to VGR Holding only if Liggett s borrowing availability exceeds $5 million for the 30 days prior to payment of the dividend and immediately after giving effect to the dividend, and so long as no event of default has occurred under the agreement, including Liggett s compliance with the covenants in the credit facility, including an adjusted net worth and working capital requirement.

As the controlling stockholder of New Valley, we must deal fairly with New Valley, which may limit our ability to enter into transactions with New Valley that result in the receipt of cash from New Valley and to influence New Valley s dividend policy. In addition, since we indirectly own only approximately 55.1% of the common shares of New Valley, a significant portion of any cash and other assets distributed by New Valley will be received by persons other than us and our subsidiaries.

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

Our liquidity could be adversely affected if taxing authorities prevail in their assertion that we incurred a tax obligation in 1998 and 1999 in connection with the Philip Morris brand transaction.

In connection with the 1998 and 1999 transaction with Philip Morris Incorporated, in which a subsidiary of Liggett contributed three of its premium cigarette brands to Trademarks LLC, a newly-formed limited liability company, we recognized in 1999 a pre-tax gain of $294.1 million in our consolidated financial statements and established a deferred tax liability of $103.1 million relating to the gain. In such transaction, Philip Morris acquired an option to purchase the remaining interest in Trademarks for a 90-day period commencing in December 2008, and we have an option to require Philip Morris to purchase the remaining interest for a 90-day period commencing in March 2010. Upon exercise of the options during either of the 90-day periods commencing in December 2008 or in March 2010, we will be required to pay tax in the amount of the deferred tax liability, which will be offset by the benefit of any deferred tax assets, including any net operating losses, available to us at that time. In connection with an examination of our 1998 and 1999 federal income tax returns, the Internal Revenue Service issued to us in September 2003 a notice of proposed adjustment. The notice asserts that, for tax reporting purposes, the entire gain should have been recognized in 1998 and in 1999 in the additional amounts of $150 million and $129.9 million, respectively, rather than upon the exercise of the options during either of the 90-day periods commencing in December 2008 or in March 2010. If the Internal Revenue Service were to ultimately prevail with the proposed adjustment, it would result in the potential acceleration of tax payments of approximately $123 million, including interest, net of tax benefits, through March 31, 2005. These amounts have been previously recognized in our consolidated financial statements as tax liabilities. In addition, we have filed a protest with the Appeals Division of the Internal Revenue Service. Although no payment is due with respect to these matters during the appeal process, interest is accruing on the disputed amounts.

There is a risk that the taxing authorities will ultimately prevail in their assertion that we incurred a tax obligation prior to the exercise dates of these options and we will be required to make such tax payments prior to 2009 or 2010. If that were to occur and any necessary financing were not available to us, our liquidity could be materially adversely affected, which in turn would materially adversely affect our ability to meet payment obligations under the notes and the value of our common stock.

Liggett faces intense competition in the domestic tobacco industry.

Liggett is considerably smaller and has fewer resources than its major competitors and, as a result, has a more limited ability to respond to market developments. Management Science Associates data indicate that the three largest cigarette manufacturers controlled approximately 83.2% of the United States cigarette market during 2004. Philip Morris is the largest and most profitable manufacturer in the market, and its profits are derived principally from its sale of premium cigarettes. Philip Morris had approximately 62.3% of the premium segment and 47.5% of the total domestic market during 2004. During 2004, all of Liggett s sales were in the discount segment, and its share of the total domestic cigarette market was 2.3%. Philip Morris and RJR Tobacco (which is now part of Reynolds American), the two largest cigarette manufacturers, have historically, because of their dominant market share, been able to determine cigarette prices for the various pricing tiers within the industry. The other cigarette manufacturers historically have brought their prices into line with the levels established by these two major manufacturers.

In July 2004, RJR Tobacco and Brown & Williamson, the second and third largest cigarette manufacturers, completed the combination of their United States tobacco businesses to create Reynolds American Inc. This transaction will further consolidate the dominance of the domestic cigarette market by Philip Morris and the newly created Reynolds American, who will have a combined market share of approximately 76%. This concentration of United States market share could make it more difficult for Liggett and Vector Tobacco to compete for shelf space in retail outlets and could impact price competition in the market, either of which could have a material adverse affect on their sales volume, operating income and cash flows, which would harm us and the value of the notes and our common stock.

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

Liggett depends more on sales in the discount cigarette segment of the market, relative to the full-price premium segment, than its major competitors. All of Liggett s unit volume in 2004, and approximately 94.6% of Liggett s unit sales in 2003, were generated in the discount segment, The discount segment is highly competitive, with consumers having less brand loyalty and placing greater emphasis on price. While the three major manufacturers all compete with Liggett in the discount segment of the market, the strongest competition for market share has recently come from a group of small manufacturers and importers, most of which sell low quality, deep discount cigarettes. While Liggett s share of the discount market increased to 7.4% in 2004 from 7.3% in 2003 and 6.7% in 2002, Management Science Associates data indicate that the discount market share of these other smaller manufacturers and importers increased to 39% in 2004 from 37.8% in 2003 and 33.5% in 2002 due to their increased competitive discounting. If pricing in the discount market continues to be impacted by these smaller manufacturers and importers, margins in Liggett s only current market segment could be negatively affected, which in turn could negatively affect the value of the notes and our common stock.

Liggett s market share is susceptible to decline.

In years prior to 2000, Liggett suffered a substantial decline in unit sales and associated market share. Liggett s unit sales and market share increased during each of 2000, 2001 and 2002, and its market share increased in 2003 while its unit sales declined. During 2004, Liggett s unit sales and market share declined compared to the prior year. This earlier market share erosion resulted in part from Liggett s highly leveraged capital structure that existed until December 1998 and its limited ability to match other competitors wholesale and retail trade programs, obtain retail shelf space for its products and advertise its brands. The decline in recent years also resulted from adverse developments in the tobacco industry, intense competition and changes in consumer preferences. According to Management Science Associates data, Liggett s overall domestic market share during 2004 was 2.3% compared to 2.4% during 2003 and 2002. Liggett s share of the premium segment was 0.2% in 2003 and 0.3% in 2002, and its share of the discount segment during 2004 was 7.4%, up from 7.3% in 2003 and 6.7% in 2002. If Liggett s market share continues to decline, Liggett s sales volume, operating income and cash flows could be materially adversely affected, which in turn could negatively affect the value of the notes and our common stock.

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

Industry-wide shipments of cigarettes in the United States have been generally declining for a number of years, with published industry sources estimating that domestic industry-wide shipments decreased by approximately 1.7% during 2004. According to Management Science Associates data, domestic industry-wide shipments decreased by 4.1% in 2003 compared to 2002. Liggett s management believes that industry-wide shipments of cigarettes in the United States will generally continue to decline as a result of numerous factors. These factors include health considerations, diminishing social acceptance of smoking, and a wide variety of federal, state and local laws limiting smoking in restaurants, bars and other public places, as well as federal and state excise tax increases and settlement-related expenses which have contributed to high cigarette price levels in recent years. If this decline in industry-wide shipments continues and Liggett is unable to capture market share from its competitors, or if the industry as a whole is unable to offset the decline in unit sales with price increases, Liggett s sales volume, operating income and cash flows could be materially adversely affected, which in turn could negatively affect the value of the notes and our common stock.

Litigation and regulation will continue to harm the tobacco industry.

The cigarette industry continues to be challenged on numerous fronts. New cases continue to be commenced against Liggett and other cigarette manufacturers. As of March 31, 2005, there were approximately 340 individual suits, 16 purported class actions and 16 governmental and other third-party payor health care reimbursement actions pending in the United States in which Liggett was a named defendant. A civil lawsuit has been filed by the United States federal government seeking disgorgement of approximately $289 billion from various cigarette manufacturers, including Liggett. A federal appellate court ruled in February 2005 that disgorgement is not an available remedy in the case. In April 2005, the appellate court denied the government s request that the disgorgement ruling be reconsidered by the full court. The government may appeal to the United States Supreme Court. Trial of the case began in September 2004 and is proceeding. In addition to these cases, in 2000, an action against cigarette manufacturers involving approximately 1,000 named individual plaintiffs was consolidated before a single West Virginia state court. Liggett is a defendant in most of the cases pending in West Virginia. In January 2002, the court severed Liggett from the trial of the consolidated action. Two purported class actions have been certified in state court in Kansas and New

Mexico against the cigarette manufacturers for alleged antitrust violations. 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.

There are six individual actions where Liggett is the only defendant, with trial in one of these cases currently scheduled for May 2005 and trial in another scheduled for October 2005. In April 2004, in one of these cases, a jury in a Florida state court action awarded compensatory damages of $0.5 million against Liggett. In addition, plaintiff s counsel was awarded legal fees of $0.8 million. Liggett has appealed the verdict. In February 2005, in another of these cases, a Florida state court jury returned a verdict in favor of Liggett. The plaintiff s post-trial motion seeking a new trial is pending. In March 2005, in another case in Florida state court in which Liggett is the only defendant, the court granted Liggett s motion for summary judgment disposing of the case in its entirety. The plaintiff has appealed.

In May 2003, a Florida intermediate appellate court overturned a $790 million punitive damages award against Liggett and decertified the *Engle* smoking and health class action. In May 2004, the Florida Supreme Court agreed to review the case. Oral argument was held in November 2004. If the intermediate appellate court s ruling is not upheld on further appeal, it will have a material adverse effect on us. In November 2000, Liggett filed the $3.45 million bond required under the bonding statute enacted in 2000 by the Florida legislature which limits the size of any bond required, pending appeal, to stay execution of a punitive damages verdict. In May 2001, Liggett reached an agreement with the class in the *Engle* case, which provided assurance to Liggett that the stay of execution, in effect under the Florida bonding statute, would not be lifted or limited at any point until completion of all appeals, including to the United States Supreme Court. As required by the agreement, Liggett paid $6.27 million into an escrow account to be held for the benefit of the *Engle* class, and released, along with Liggett s existing $3.45 million statutory bond, to the court for the benefit of the class upon completion of the appeals process, regardless of the outcome of the appeal. In June 2002, the jury in an individual case brought under the third phase of the *Engle* case awarded $37.5 million (subsequently reduced by the court to $25.1 million) of compensatory damages against Liggett and two other defendants and found Liggett 50% responsible for the damages. The verdict, which is subject to the outcome of the *Engle* appeal, has been overturned as a result of the appellate court s ruling discussed above. It is possible that additional cases could be decided unfavorably and that there could be further adverse developments in the *Engle* case. Liggett may enter into discussions in an attempt to settle particular cases if it believes it is appropriate to do so. We cannot predict the cash requirements related to any future settlements and judgments, including cash required to bond any appeals, and there is a risk that those requirements will not be able to be met.

In recent years, there have been a number of restrictive regulatory actions from various federal administrative bodies, including the United States Environmental Protection Agency and the Food and Drug Administration. There have also been adverse political decisions and other unfavorable developments concerning cigarette smoking and the tobacco industry, including the commencement and certification of class actions and the commencement of third-party payor actions. These developments generally receive widespread media attention. We are not able to evaluate the effect of these developing matters on pending litigation or the possible commencement of additional litigation, but our consolidated financial position, results of operations or cash flows could be materially adversely affected by an unfavorable outcome in any smoking-related litigation, which in turn could negatively affect the value of our common stock.

Liggett may have additional payment obligations under the Master Settlement Agreement and its other settlement agreements with the states.

Liggett has recently been notified that all Participating Manufacturers payment obligations under the Master Settlement Agreement, dating from the agreement s execution in late 1998, have been recalculated utilizing net unit amounts, rather than gross unit amounts (which have been utilized since 1999). The change in the method of calculation could, among other things, require additional payments by Liggett under the Master Settlement Agreement of approximately $2 million per year for the period 2001 through 2004, or a total of approximately $8 million, and require Liggett to pay an additional amount of approximately $2 million per year in 2005 and in future periods by lowering Liggett s market share exemption under the Master Settlement Agreement. Liggett contends that the retroactive change from utilizing gross unit amounts to net unit amounts is impermissible and has objected to the change. Liggett intends to challenge it by way of arbitration or court proceeding if it is ultimately implemented.

On March 30, 2005, the Independent Auditor under the Master Settlement Agreement calculated $28.7 million in Master Settlement Agreement payments for Liggett s 2004 sales. On April 15, 2005, Liggett paid $11.7 million of this amount and, in accordance with its rights under the Master Settlement Agreement, disputed the balance of $17 million. Of the disputed amount, Liggett paid $9.3 million into the disputed payments account under the Master Settlement Agreement and withheld from payment $7.7 million.

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By letter dated April 28, 2005, the settling states under the Master Settlement Agreement provided Liggett with a 30-day notice under the Master Settlement Agreement which stated, among other things, that one or more of the settling states may initiate proceedings against Liggett under Sections IX(i) and XI(d) of the Master Settlement Agreement and the June 2003 settlement agreement between Liggett and the settling states. The settling states contend that Liggett had no right under the Master Settlement Agreement or the June 2003 settlement agreement to pay into the disputed payments account any amount claimed as an adjustment for market share loss for non-participating manufacturers for 2003, although they acknowledge that Liggett has the right to dispute such amounts. The settling states sent similar letters to several other Subsequent Participating Manufacturers that paid into the disputed payments account.

In 2004, the Attorneys General for each of Florida, Mississippi and Texas advised Liggett that they believed that Liggett has failed to make all required payments under the settlement agreements with these three states for the period 1998 through 2003 and that additional payments may be due for 2004 and subsequent years. Liggett believes these allegations are without merit, based, among other things, on the language of the most-favored nations provisions of the settlement agreements. In December 2004, the State of Florida offered to settle all amounts allegedly owed by Liggett for the period through 2003 for the sum of $13.5 million. In November 2004, the State of Mississippi offered to settle all amounts allegedly owed by Liggett for the period through 2003 for the sum of $6.5 million. In March 2005, the State of Florida reaffirmed its December 2004 offer to settle and provided Liggett with a 60 day notice to cure the alleged defaults. In April 2005, the State of Mississippi reaffirmed its November 2004 offer to settle and provided Liggett with a 60 day notice to cure the alleged defaults.

No amounts have been accrued in our financial statements for any additional amounts that may be payable by Liggett under the Master Settlement Agreement, due to the recalculation of the Participating Manufacturers payment obligations, or under the settlement agreements with these three states. There can be no assurance that Liggett will prevail and that Liggett will not be required to make additional material payments under the Master Settlement and the settlement agreements with these three states, which payments could materially adversely affect our consolidated financial position, results of operations or cash flows and the value of our common stock.

Liggett has significant sales to a single customer.

During 2004, 13.8% of Liggett s total revenues and 13.4% of our consolidated revenues were generated by sales to Liggett s largest customer. Liggett s contract with this customer currently extends through June 30, 2005. If this customer discontinues its relationship with Liggett or experiences financial difficulties, Liggett s results of operations could be materially adversely affected.

Liggett may be adversely affected by recent legislation to eliminate the federal tobacco quota system.

In October 2004, federal legislation was enacted which will eliminate the federal tobacco quota system and price support system. Pursuant to the legislation, manufacturers of tobacco products will be assessed $10.1 billion over a ten year period to compensate tobacco growers and quota holders for the elimination of their quota rights. Cigarette manufacturers will initially be responsible for 96.3% of the assessment (subject to adjustment in the future), which will be allocated based on relative unit volume of domestic cigarette shipments. We currently estimate that Liggett s assessment will be approximately $23 million for the first year of the program which began January 1, 2005. The cost of the legislation to the three largest cigarette manufacturers will likely be less than the cost to smaller manufacturers, including Liggett and Vector Tobacco, because one effect of the legislation is that the three largest manufacturers will no longer be obligated to make certain contractual payments, commonly known as Phase II payments, they agreed in 1999 to make to tobacco-producing states. The ultimate impact of this legislation cannot be determined, but there is a risk that smaller manufacturers, such as Liggett and Vector Tobacco, will be disproportionately affected by the legislation, which could have a material adverse effect on us.

Excise tax increases adversely affect cigarette sales.

Cigarettes are subject to substantial and increasing federal, state and local excise taxes. The federal excise tax on cigarettes is currently $0.39 per pack. State and local sales and excise taxes vary considerably and, when combined with the current federal excise tax, may currently exceed $4.00 per pack. In 2004, 10 states enacted increases in excise taxes, and two states have enacted increases in 2005. Congress has considered significant

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increases in the federal excise tax or other payments from tobacco manufacturers, and various states and other jurisdictions have currently under consideration or pending legislation proposing further state excise tax increases. We believe that increases in excise and similar taxes have had an adverse impact on sales of cigarettes. Further substantial federal or state excise tax increases could accelerate the trend away from smoking and could have a material adverse effect on Liggett s sales and profitability, which in turn could negatively affect the value of our common stock.

Vector Tobacco is subject to risks inherent in new product development initiatives.

We have made, and plan to continue to make, significant investments in Vector Tobacco s development projects in the tobacco industry. Vector Tobacco is in the business of developing and marketing the low nicotine and nicotine-free QUEST cigarette products and developing reduced risk cigarette products. These initiatives are subject to high levels of risk, uncertainties and contingencies, including the challenges inherent in new product development. There is a risk that continued investments in Vector Tobacco will harm our results of operations, liquidity or cash flow.

The substantial risks facing Vector Tobacco include:

Risks of market acceptance of new products. In November 2001, Vector Tobacco launched nationwide its reduced carcinogen OMNI cigarettes. During 2002, acceptance of OMNI in the marketplace was limited, with revenues of only approximately $5.1 million on sales of 70.7 million units. During 2003, OMNI sales activity was minimal as Vector Tobacco has not been actively marketing the OMNI product, and the product is not currently in distribution. Vector Tobacco was unable to achieve the anticipated breadth of distribution and sales of the OMNI product due, in part, to the lack of success of its advertising and marketing efforts in differentiating OMNI from other conventional cigarettes with consumers through the reduced carcinogen message. Over the next several years, our in-house research program, together with third-party collaborators, plans to conduct appropriate studies relating OMNI s reduction of carcinogens to reduced risk in smokers and, based on these studies, we will review the marketing and positioning of the OMNI brand in order to formulate a strategy for its long-term success. OMNI has not been a commercially successful product to date, and there is a risk that we will be unable to take action to significantly increase the level of OMNI sales in the future.

Vector Tobacco introduced its low nicotine and nicotine-free QUEST cigarettes in an initial seven-state market in January 2003 and in Arizona in January 2004. During the second quarter of 2004, based on an analysis of the market data obtained since the introduction of the QUEST product, we determined to postpone indefinitely the national launch of QUEST. A national launch of the QUEST brands would require the expenditure of substantial additional sums for advertising and sales promotion, with no assurance of consumer acceptance. Low nicotine and nicotine-free cigarettes may not ultimately be accepted by adult smokers and also may not prove to be commercially successful products. Adult smokers may decide not to purchase cigarettes made with low nicotine and nicotine-free tobaccos due to taste or other preferences, or due to the use of genetically modified tobacco or other product modifications.

Recoverability of costs of inventory. At December 31, 2004, approximately $1.6 million of our inventory was associated with Vector Tobacco s QUEST product. We estimate an inventory reserve for excess quantities and obsolete items, taking into account future demand and market conditions. During the second quarter of 2004, we recognized a non-cash charge of $37 million to adjust the carrying value of excess leaf tobacco inventory for the QUEST product, based on estimates of future demand and market conditions. If actual demand or market conditions in the future are less favorable than those estimated, additional inventory write-downs may be required.

Third party allegations that Vector Tobacco products are unlawful or bear deceptive or unsubstantiated product claims. Vector Tobacco is engaged in the development and marketing of low nicotine and nicotine-free cigarettes and the development of reduced risk cigarette products. With respect to OMNI, which is not currently being distributed by

Vector Tobacco, reductions in carcinogens have not yet been proven to result in a safer cigarette. Like other cigarettes, the OMNI and QUEST products also produce tar, carbon monoxide, other harmful by-products, and, in the case of OMNI, increased levels of nitric oxide and formaldehyde. There are currently no specific governmental standards or parameters for these products and product claims. There is a risk that federal or state regulators may object to Vector Tobacco s reduced carcinogen and low nicotine and nicotine-free cigarette products as unlawful or allege they bear deceptive or unsubstantiated product claims, and seek the removal of the products from the marketplace, or significant changes to advertising. Various concerns regarding Vector Tobacco s

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advertising practices have been expressed to Vector Tobacco by certain state attorneys general. Vector Tobacco has engaged in discussions in an effort to resolve these concerns and Vector Tobacco has recently agreed to suspend all print advertising for its QUEST brand while discussions are pending. If Vector Tobacco is unable to advertise its QUEST brand, it could have a material adverse effect on sales of QUEST. Allegations by federal or state regulators, public health organizations and other tobacco manufacturers that Vector Tobacco s products are unlawful, or that its public statements or advertising contain misleading or unsubstantiated health claims or product comparisons, may result in litigation or governmental proceedings. Vector Tobacco s defense against such claims could require it to incur substantial expense and to divert significant efforts of its scientific and marketing personnel. An adverse determination in a judicial proceeding or by a regulatory agency could have a material and adverse impact on Vector Tobacco s business, operating results and prospects.

Potential extensive government regulation. Vector Tobacco s business may become subject to extensive additional domestic and international government regulation. Various proposals have been made for federal, state and international legislation to regulate cigarette manufacturers generally, and reduced constituent cigarettes specifically. It is possible that laws and regulations may be adopted covering matters such as the manufacture, sale, distribution and labeling of tobacco products as well as any health claims associated with reduced carcinogen and low nicotine and nicotine-free cigarette products and the use of genetically modified tobacco. A system of regulation by agencies such as the Food and Drug Administration, the Federal Trade Commission and the United States Department of Agriculture may be established. In addition, a group of public health organizations submitted a petition to the Food and Drug Administration, alleging that the marketing of the OMNI product is subject to regulation by the FDA under existing law. Vector Tobacco has filed a response in opposition to the petition. The FTC has expressed interest in the regulation of tobacco products made by tobacco manufacturers, including Vector Tobacco, which bear reduced carcinogen claims. The outcome of any of the foregoing cannot be predicted, but any of the foregoing could have a material adverse impact on Vector Tobacco s business, operating results and prospects.

Necessity of obtaining Food and Drug Administration approval to market QUEST as a smoking cessation product. In October 2003, we announced that Jed E. Rose, Ph.D., Director of Duke University Medical Center s Nicotine Research Program and co-inventor of the nicotine patch, had conducted a study at Duke University Medical Center to provide preliminary evaluation of the use of the QUEST technology as a smoking cessation aid. We have received guidance from the Food and Drug Administration as to the additional clinical research and regulatory filings necessary to market QUEST as a smoking cessation product. We believe that obtaining the Food and Drug Administration s approval to market QUEST as a smoking cessation product will be an important factor in the long-term commercial success of the QUEST brand. No assurance can be given that such approval can be obtained or as to the timing of any such approval if received.

Competition from other cigarette manufacturers with greater resources. Vector Tobacco s competitors generally have substantially greater resources than Vector Tobacco has, including financial, marketing and personnel resources. Other major tobacco companies have stated that they are working on reduced risk cigarette products and have made publicly available at this time only limited additional information concerning their activities. Philip Morris has announced it is developing products that potentially reduce smokers exposure to harmful compounds in cigarette smoke. RJR Tobacco has stated that in 2003 it began a phased expansion into a select number of retail chain outlets of a cigarette product that primarily heats rather than burns tobacco, which it claims reduces the toxicity of its smoke. In 2002, Brown & Williamson Tobacco Corporation announced it was test marketing a new cigarette with reduced levels of many toxins which it may introduce on a national basis. There is a substantial likelihood that other major tobacco companies will continue to introduce new products that are designed to compete directly with Vector Tobacco s reduced carcinogen and low nicotine and nicotine-free products.

Potential disputes concerning intellectual property. Vector Tobacco s ability to commercially exploit its proprietary technology for its reduced carcinogen and low nicotine and nicotine-free products depends in large part on its ability to obtain and defend issued patents, to obtain further patent protection for its existing technology in the United States and other jurisdictions, and to operate without infringing on the patents and proprietary rights of others both in the United States and abroad. Additionally, it must be able to obtain appropriate licenses to patents or proprietary rights held by third parties if infringement would otherwise occur, both in the United States and in foreign countries.

Intellectual property rights, including Vector Tobacco s patents (owned or licensed), involve complex legal and factual issues. Any conflicts resulting from third party patent applications and granted patents could significantly limit Vector Tobacco s ability to obtain meaningful patent protection or to commercialize its technology. If necessary patents currently exist or are issued to other companies that contain competitive or conflicting claims, Vector Tobacco may be required to obtain licenses to use these patents or to develop or obtain alternative technology. Licensing agreements, if required, may not be available on acceptable terms or at all. If licenses are not obtained, Vector Tobacco could be delayed in, or prevented from, pursuing the further development or marketing of its new cigarette products. Any alternative technology, if feasible, could take several years to develop.

Litigation which could result in substantial cost also may be necessary to enforce any patents to which Vector Tobacco has rights, or to determine the scope, validity and unenforceability of other parties proprietary rights which may affect Vector Tobacco s rights. Vector Tobacco also may have to participate in interference proceedings declared by the U.S. Patent and Trademark Office to determine the priority of an invention or in opposition proceedings in foreign counties or jurisdictions, which could result in substantial costs. There is a risk that its licensed patents would be held invalid by a court or administrative body or that an alleged infringer would not be found to be infringing. The mere uncertainty resulting from the institution and continuation of any technology-related litigation or any interference or opposition proceedings could have a material and adverse effect on Vector Tobacco s business, operating results and prospects.

Vector Tobacco may also rely on unpatented trade secrets and know-how to maintain its competitive position, which it seeks to protect, in part, by confidentiality agreements with employees, consultants, suppliers and others. There is a risk that these agreements will be