

Turning Point Brands, Inc.  
Form 10-K  
March 07, 2019  
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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-K**

**(Mark One)**

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

**Commission file number: 001-37763**

**TURNING POINT BRANDS, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**20-0709285**

(I.R.S. Employer Identification No.)

**5201 Interchange Way, Louisville, KY**

(Address of principal executive offices)

**40229**

(Zip Code)

**(502) 778-4421**

(Registrant's telephone number, including area code)

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

Title of each class

Common Stock, \$0.01 par value

Name of each exchange on which registered

New York Stock Exchange

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

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

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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 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. Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company   
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act

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

As of June 30, 2018, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was approximately \$257 million based on the closing sale price of the common stock as reported on the New York Stock Exchange.

At February 25, 2019, there were 19,556,869 shares outstanding of the registrant's voting common stock, par value \$0.01 per share.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive proxy statement for use in connection with its annual meeting of stockholders to be held on May 1, 2019, expected to be filed with the Securities and Exchange Commission on or about March 20, 2019, are incorporated by reference into Part III hereof.

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### **Cautionary Note Regarding Forward-Looking Statements**

This annual report on Form 10-K contains forward-looking statements within the meaning of the federal securities laws. Forward-looking statements may generally be identified by the use of words such as anticipate, believe, expect, intend, plan and will or, in each case, their negative, or other variations or comparable terminology. These forward-looking statements include all matters that are not historical facts. By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future. As a result, actual events may differ materially from those expressed in or suggested by the forward-looking statements. Any forward-looking statement made by TPB in this annual report on Form 10-K speaks only as of the date hereof. New risks and uncertainties come up from time to time, and it is impossible for TPB to predict these events or how they may affect it. TPB has no obligation, and does not intend, to update any forward-looking statements after the date hereof, except as required by federal securities laws. Factors that could cause these differences include, but are not limited to:

- declining sales of tobacco products, and expected continuing decline of sales, in the tobacco industry overall;
- our dependence on a small number of third-party suppliers and producers;
- the possibility that we will be unable to identify or contract with new suppliers or producers in the event of a supply or product disruption;
- the possibility that our licenses to use certain brands or trademarks will be terminated, challenged or restricted;
- failure to maintain consumer brand recognition and loyalty of our customers;
- substantial and increasing U.S. regulation;
- regulation of our products by the FDA, which has broad regulatory powers;
- our products are subject to developing and unpredictable regulation;
- our products contain nicotine which is considered to be a highly addictive substance;
- uncertainty related to the regulation and taxation of our NewGen products;
- possible significant increases in federal, state and local municipal tobacco- and vapor-related taxes;
- possible increasing international control and regulation;
- our reliance on relationships with several large retailers and national chains for distribution of our products;
- our amount of indebtedness;
- the terms of our credit facilities, which may restrict our current and future operations;
- intense competition and our ability to compete effectively;
- uncertainty and continued evolution of markets containing our NewGen products;
- significant product liability litigation;
- the scientific community's lack of information regarding the long-term health effects of electronic cigarettes, vaporizer and e-liquid use;
- requirement to maintain compliance with master settlement agreement escrow account;
- competition from illicit sources;
- our reliance on information technology;
- security and privacy breaches;
- contamination of our tobacco supply or products;
- infringement on our intellectual property;
- third-party claims that we infringe on their intellectual property;

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- failure to manage our growth;
- failure to successfully integrate our acquisitions or otherwise be unable to benefit from pursuing acquisitions;
- fluctuations in our results;
- exchange rate fluctuations;
- adverse U.S. and global economic conditions;
- sensitivity of end-customers to increased sales taxes and economic conditions;
- failure to comply with certain regulations;
- departure of key management personnel or our inability to attract and retain talent;
- imposition of significant tariffs on imports into the U.S.;
- reduced disclosure requirements applicable to emerging growth companies may make our common stock less attractive to investors, potentially decreasing our stock price;
- failure to maintain our status as an emerging growth company before the five-year maximum time period a company may retain such status;
- our principal stockholders will be able to exert significant influence over matters submitted to our stockholders and may take certain actions to prevent takeovers;
- our certificate of incorporation and bylaws, as well as Delaware law and certain regulations, could discourage or prohibit acquisition bids or merger proposals, which may adversely affect the market price of our common stock;
- our certificate of incorporation limits the ownership of our common stock by individuals and entities that are Restricted Investors. These restrictions may affect the liquidity of our common stock and may result in Restricted Investors being required to sell or redeem their shares at a loss or relinquish their voting, dividend and distribution rights;
- future sales of our common stock in the public market could reduce our stock price, and any additional capital raised by us through the sale of equity or convertible securities may dilute your ownership in us;
- we may issue preferred stock whose terms could adversely affect the voting power or value of our common stock; and
- our status as a controlled company could make our common stock less attractive to some investors or otherwise harm our stock price.

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PART I

**Item 1. Business**

**Turning Point Brands, Inc., Overview**

Turning Point Brands, Inc. (the Company, we, our, or us) is a leading, independent provider of Other Tobacco Products (OTP) in the U.S. We estimate the OTP industry generated approximately \$11 billion of manufacturer revenue in 2017. In contrast to manufactured cigarettes, which have been experiencing declining volumes for decades based on data published by the Alcohol and Tobacco Tax and Trade Bureau (TTB), the OTP industry is demonstrating increased consumer appeal with low to mid-single digit consumer unit growth as reported by Management Science Associates, Inc. (MSAi), a third-party analytics and information company. We were the largest competitor in terms of total OTP consumer units sold during 2018. We sell a wide range of products across the OTP spectrum; however, we do not sell cigarettes. Our portfolio of brands includes some of the most widely recognized names in the OTP industry, such as *Zig-Zag*<sup>®</sup>, *Beech-Nut*<sup>®</sup>, *Stoker* *s*<sup>®</sup>, *Trophy*<sup>®</sup>, *VaporBeast*<sup>®</sup>, *Vapor Shark*<sup>®</sup>, and *VaporFi*<sup>®</sup>. We currently ship to approximately 800 distributors with an additional 100 secondary, indirect wholesalers in the U.S. that carry and sell our products. We operate in three segments: (i) Smokeless products, (ii) Smoking products, and (iii) NewGen products.

We have a portfolio of widely recognized brands with significant customer loyalty. We have an experienced management team that possesses long-standing industry relationships and a deep understanding of the OTP industry. We have identified additional opportunities to grow sales, including the launch of new products and expanding our distribution and salesforce. We also believe there are meaningful opportunities to grow through acquisitions and joint ventures across all product categories. As of December 31, 2018, our products are available in approximately 185,000 U.S. retail locations which, with the addition of retail stores in Canada, brings our total North American retail presence to an estimated 210,000 points of distribution. Our sales team targets widespread distribution to all traditional retail channels, including convenience stores, where over 60% of all OTP volume is currently sold, according to MSAi.

***Smokeless Segment***

Our Smokeless segment includes both loose leaf chewing tobacco and moist snuff tobacco (MST). Our Smokeless focus brand is *Stoker* *s* in both chewing tobacco and MST. *Stoker* *s*<sup>®</sup> chewing tobacco has grown considerable share over the last several years and is presently the #1 discount brand and the second largest brand in the industry, with approximately a 19% market share. Our status in the chew market is further strengthened by *Beech-Nut*<sup>®</sup>, the #3 premium brand and #7 overall, as well as *Trophy*<sup>®</sup>, *Durango*<sup>®</sup>, and the five Wind River Brands we acquired in November 2016. Collectively, the company is the #2 marketer of chewing tobacco with approximately 28% market share. Our chewing tobacco operations are facilitated through our long-standing relationship with Swedish Match, the manufacturer of our loose leaf chewing tobaccos.<sup>1</sup>

In MST, *Stoker* *s* remains among the fastest growing brands and holds a 7.4% share in the stores with distribution and a 3.5% share of the total U.S. MST market. *Stoker* *s* pioneered the large 12 oz. tub packaging format and is manufactured using a proprietary process that we think results in a superior product. In late 2015, we extended the *Stoker* *s*<sup>®</sup> MST franchise to include traditional 1.2 oz. cans to broaden retail availability. Our proprietary manufacturing process is conducted at our Dresden, Tennessee, plant and packaged in both our Dresden, Tennessee, and Louisville, Kentucky facilities.<sup>1</sup>

***Smoking Segment***

Our Smoking segment principally includes cigarette papers and Make-Your-Own ( MYO ) cigar wraps. The iconic strength of the *Zig-Zag*<sup>®</sup> brand drives our leadership position in both the cigarette papers and MYO cigar wrap markets. In cigarette papers, *Zig-Zag*<sup>®</sup> is the #1 premium cigarette paper in the U.S. with approximately 30% total market share. Management estimates also indicate that *Zig-Zag*<sup>®</sup> is the #1 brand in the promising Canadian market. Cigarette paper operations are aided by our sourcing relationships with Bolloré.<sup>1</sup>

In MYO cigar wraps, the *Zig-Zag*<sup>®</sup> brand commands about three-quarters of the market and continues to innovate in novel ways, including our recent introduction of *Zig-Zag*<sup>®</sup> 'Rillo sized wraps which are similar in size to cigarillos, the most popular and fastest growing type of machine-made cigars. MYO cigar wraps operations are facilitated by our long-standing commercial relationship with the patent holder, Durfort.<sup>1</sup>

### ***NewGen Segment***

Our NewGen segment includes our acquisitions of Smoke Free Technologies, d/b/a VaporBeast ( VaporBeast ), The Hand Media and its subsidiaries, d/b/a Vapor Shark (collectively, Vapor Shark ), Vapor Supply, and

<sup>1</sup> Brand rankings and market share percentages obtained from MSAi as of December 31, 2018.

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International Vapor Group and its subsidiaries (collectively, IVG) which have solidified our status as a major player within the NewGen segment. VaporBeast is a leading distributor of liquid and device vapor products servicing the non-traditional retail channel. Vapor Shark is a leading distributor and manufacturer of premium vaping e-liquids with distribution through non-traditional retail as well as Vapor Shark branded retail locations. Vapor Supply operates high-volume vapor outlets in the Oklahoma market in addition to a B2B wholesale vapor business. IVG operates a strong B2C eCommerce business with direct sales to consumers nationwide and abroad through the Direct-Vapor and VaporFi brands and runs a wholesale vaping business under the Direct-Vapor mark. Our acquisition of VaporBeast, Vapor Shark, Vapor Supply, and IVG accelerated our entry into the non-traditional retail outlets for vaporizers, e-liquids, and accessories. We believe our NewGen business will expand further as consumers continue to move from combustible cigarettes to vaping. We believe we are well-positioned to act as a consolidator in the NewGen space in anticipation of increased regulation and will continue to explore potential acquisitions. Refer to Note 3 of our Notes to Consolidated Financial Statements for further details regarding these acquisitions.

In November 2018, we announced a minority position (19.99%) in Canadian American Standard Hemp (CASH). CASH is headquartered in Warwick, Rhode Island, and manufactures cannabidiol isolate (CBD) developed through highly efficient and proprietary processes. On January 15, 2019, we announced the formation of Nu-X Ventures dedicated to the development, production and sale of alternative products including CBD and proprietary vapor products. Nu-X management is working collaboratively with CASH to bring proprietary CBD products to market. Both Nu-X CBD and proprietary vapor products will leverage the TPB national salesforce and the wholesale distribution prowess of VaporBeast and the B2C selling power at IVG to distribute novel new products across our full platform of opportunity.

### ***IPO***

In our May 2016 initial public offering (the IPO), we sold 6,210,000 shares of our voting common stock at a public offering price per share of \$10.00. We raised a total of approximately \$62.1 million in gross proceeds from the IPO which amounted to \$58.2 million in net proceeds after deducting underwriting commissions and other associated costs.

### **Competitive Strengths**

We believe our competitive strengths include the following:

#### ***Large, Leading Brands with Significant Scale***

We have built a portfolio of leading brands with significant scale that are well recognized by consumers, retailers, and wholesalers. Our *Stoker's*<sup>®</sup> and *Zig-Zag*<sup>®</sup> brands are each well established and date back 79 and 119 years, respectively. The NewGen segment has been built primarily through the 2016 acquisition of VaporBeast and the 2018 acquisition of IVG, leading sellers of e-liquids, devices, and accessories.

- *Stoker's*<sup>®</sup> is the #2 loose leaf chewing tobacco brand and among the fastest growing MST brands in the industry. We manufacture *Stoker's*<sup>®</sup> MST using only 100% American Leaf, utilizing a proprietary process to produce what we believe is a superior product.
- *Zig-Zag*<sup>®</sup> is the #1 cigarette paper brand in terms of retail dollar sales in the U.S., as measured by Nielsen Convenience, with significant distribution in Canada. *Zig-Zag*<sup>®</sup> is also the #1 MYO cigar wrap brand in the U.S., as measured by MSAi.
- VaporBeast is a leading distributor of liquid vapor products to the non-traditional retail channel. Revenue growth at VaporBeast has been delivered through a more effective selling process, which generated increased order sizes and the frequency of customer orders.



- IVG is a leading B2C marketer of proprietary and third party liquid vapor products.

We believe the *Stokers*<sup>®</sup> brand is seen as an innovator in both the loose leaf chewing tobacco and moist snuff markets. *Zig-Zag*<sup>®</sup> is an iconic brand and has strong, enduring brand recognition among a wide audience of consumers. VaporBeast is a powerful distribution engine that allows us to further penetrate the vaporizer and e-liquids markets via non-traditional retail outlets. Most recently, the 2018 acquisition of IVG moves TPB directly into the highly attractive, high margin B2C segment via the flagship *VaporFi*<sup>®</sup> brand.

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### ***Successful Track Record of New Product Launches and Category Expansions***

We have successfully launched new products and entered new product categories by leveraging the strength of our brands. We methodically target markets which we believe have significant growth potential. We have been successful in entering new product categories by extending existing products and brands in addition to introducing new products:

We leveraged the proud legacy and value of the *Stoker's*<sup>®</sup> brand to introduce a 12 oz. MST tub, a product whose size was not offered by any other market participant at the time of introduction. *Stoker's*<sup>®</sup> MST has been among the fastest growing moist snuff brands in the industry in terms of pounds sold. While

- competitors have introduced larger format tub packaging, the early entry and differentiation of the *Stoker's*<sup>®</sup> product have firmly established us as the market leader with over 50% of the Tub market. In third quarter 2015, we introduced *Stoker's*<sup>®</sup> MST in 1.2 oz. cans to further expand retail penetration, particularly in convenience stores.

In 2009, we extended the *Zig-Zag*<sup>®</sup> tobacco brand into the MYO cigar wraps market and captured a 50% market share within the first two years. We are now the market share leader for MYO cigar wraps with

- approximately a 75% share. We believe our success was driven by the *Zig-Zag*<sup>®</sup> tobacco branding, which we feel is widely understood by consumers to represent a favorable, customizable experience ideally suited to MYO products.

VaporBeast quickly established itself as a leading marketer and distributor of liquid vapor products to the non-traditional retail universe. With its national footprint, VaporBeast is leveraging its regional consumer preference insights to further accelerate sales advances.

- The IVG acquisition, and specifically the VaporFi B2C marketing engine, offers us the opportunity to leverage the marketing competencies and processes to sell novel new proprietary products across multiple channels and platforms.

We strategically target product categories that we believe demonstrate significant growth potential and for which the value of our brands is likely to have a meaningful impact. We believe that our track record and existing portfolio of brands provide growth advantages as we continue to evaluate opportunities to extend our product lines and expand into new categories.

### ***Extensive Distribution Network and Data Driven Sales Organization***

We have taken important steps to enhance our selling and distribution network and consumer marketing capabilities while keeping our capital expense requirements relatively low. We service our traditional tobacco and vapor customer bases with an experienced sales and marketing organization of approximately 174 professionals who possess in-depth knowledge of the tobacco and vapor industries. We extensively use data supported by leading technology to enable our salesforce to analyze changing trends and effectively identify evolving consumer preferences at the store level. We subscribe to a sales tracking system provided by MSAi that measures all OTP product shipments by all market participants, on a weekly basis, from approximately 900 wholesalers to over 250,000 traditional retail stores in the U.S. This system enables us to understand share and volume trends across multiple categories at the individual store level, allowing us to allocate field salesforce coverage to the highest opportunity stores, thereby enhancing the value of new store placements and sales activity. Within our *Stoker's* product categories, we have seen a positive correlation between the frequency of store calls by our salesforce and our retail market share. As the initial sales effort is critical to the success of a product launch, we believe our experienced salesforce, expansive distribution network, and leading market analytics put us in a strong position to swiftly execute new product launches in response to evolving consumer and market preferences.

### ***Long-standing, Strong Relationships with an Established Set of Producers***

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As part of our asset-light operating model we built long-standing and extensive relationships with leading, high-quality producers. In 2018, our three most important suppliers were:

- Swedish Match, which manufactures our loose leaf chewing tobacco;
- Bolloré, which provides us with exclusive access to the *Zig-Zag*<sup>®</sup> cigarette paper and accessories brand for the U.S. and Canada; and
- Durfort, from which we source our MYO cigar wraps.

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By outsourcing the production of products that represent more than 80% of our net sales to a select group of suppliers with whom we have strong relationships, we are able to maintain low overhead costs and minimal capital expenditures, which together drive our margins.

### ***Experienced Management Team***

With an average of approximately 25 years of consumer products experience, including an average of 23 years in the tobacco industry, our senior management team has enabled us to grow and diversify our business while improving operational efficiency. Members of management have previous experience at other leading tobacco companies, including Altria Group, Inc. (formerly Philip Morris); Liggett & Myers Tobacco Company (now Liggett Group, a subsidiary of Vector Group Ltd); Swedish Match; and American Brands, Inc. Given the professional experience of the senior management team we are able to analyze risks and opportunities from a variety of perspectives. Our senior leadership has embraced a collaborative culture in which the combined experience, analytical rigor, and creativity are leveraged to assess opportunities and deliver products that satisfy consumers' demands.

### **Growth Strategies**

We are focused on building sustainable margin streams, expanding the availability of our products, developing new products through innovation, and enhancing overall operating efficiencies with the goal of improving margins and cash flow. We adopted the following strategies to drive growth in our business and build stockholder value:

#### ***Grow Share of Existing Product Lines, Domestically and Internationally***

We intend to remain a consumer centric organization with an innovative view and understanding of the OTP market. We believe there are meaningful opportunities for growth within the OTP market and in the emerging alternatives market which includes cannabidiol isolate ( CBD ). We expect to continue to identify unmet consumer needs and provide quality products that we believe will result in genuine consumer satisfaction and foster the growth of revenue. We maintain a robust product pipeline and plan to strategically introduce new products in attractive, growing OTP segments, both domestically and internationally. For example, in addition to our successful launch of *Stoker s*<sup>®</sup> smaller 1.2 oz. MST cans, we believe there are opportunities for new products in the MST pouch and MYO cigar wrap markets. Products currently in our pipeline include *Zig-Zag*<sup>®</sup> Natural Leaf Wraps and *Zig-Zag*<sup>®</sup> Unbleached Paper and *Zig-Zag*<sup>®</sup> Cones in the Smoking products segment and *Primal*<sup>®</sup> Hemp Wraps/Cones, small form factor vaping devices and pods as well as CBD products in the NewGen products segment. We believe we have successfully built strong, powerful brands possessing significant potential.

In 2018, less than 5% of our revenues were generated outside of the U.S. Having established a strong infrastructure and negotiated relationships across multiple segments and products, we are pursuing an international growth strategy to broaden sales and strengthen margins. We believe international sales represent a meaningful growth opportunity. Our goals include expanding our presence in the worldwide OTP industry on a targeted basis. For example, we are selling our *Stoker s*<sup>®</sup> MST products in South America, and *Primal*<sup>®</sup> herbal wraps and cones internationally. We intend to pursue a dual path of introducing our own products and brands as well as partnering with other industry leaders to improve market access and profitability in efforts to support our international expansion.

#### ***Expand into Adjacent Categories through Innovation and New Partnerships***

We continually evaluate opportunities to expand into adjacent product categories by leveraging our current portfolio or through new partnerships. In 2009, we leveraged the *Zig-Zag*<sup>®</sup> tobacco brand and introduced *Zig-Zag*<sup>®</sup> MYO cigar wraps with favorable results. We now command the #1 market share position for that segment. We are currently expanding our *Zig-Zag*<sup>®</sup> MYO cigar wraps through the expansion of the *Zig-Zag*<sup>®</sup> 'Rillo' size cigar wraps which are

similar in size to machine-made cigarillos, the most popular and rapidly growing cigar type. Additionally, we leveraged the big value equity in Stokers to launch a highly-differentiated and proprietary MST product that remains among the fastest growing brands in the category. We have identified a number of new adjacencies and we intend to leverage our existing brands and partnerships to continue the process of commercializing winning products that satisfy consumer needs.

***Continue to Grow a Strong NewGen Platform***

The OTP category is continually evolving as consumers actively seek out new products and product forms. Given this market demand, we have developed a NewGen product platform which we believe will serve new and

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evolving consumer demands across multiple product categories. Core products within our existing NewGen segment include electronic cigarette ( e-cigarette ) and vapor products, including e-liquids, and herbal smoking products which contain no tobacco or nicotine.

Moving forward, we have identified additional opportunities in both CBD and vapor which we intend to take to market under our newly established subsidiary, Nu-X Ventures. Through our partnership with CASH and the keen insights we have attained in the vapor space over the last several years, we intend to fully leverage the total TPB infrastructure to place novel Nu-X products at retail and online via our B2C expertise.

Based upon our continuing success in the vapor channel, we remain optimistic that the liquid vapor segment will continue to present opportunities for additional growth as it allows each customer to customize his or her experience by being able to choose both flavor and nicotine level. Although the liquid vapor segment is still developing, we believe that it is already becoming highly disruptive to the combustible cigarette industry, particularly in traditional retail where sales have rapidly expanded over each of the last two years. While traditional retail has experienced significant liquid vapor sales increases, we believe a significant portion of current liquid vapor revenues are earned outside of the traditional retail environment through online sales or in non-traditional retail outlets.

We believe the categories within our NewGen segment are poised to be the key industry growth drivers in the future, and we are well-positioned to capitalize on this growth. We intend to continue to pursue growth of our NewGen product platform by offering unique and innovative products to address evolving consumer demands.

### ***Strategically Pursue Acquisitions***

We believe there are meaningful acquisition opportunities in the fragmented OTP space. We regularly evaluate acquisition opportunities across the OTP landscape. In evaluating acquisition opportunities, our focus is on identifying acquisitions that strengthen our current distribution platform and product offerings or enable category expansion in areas with high potential growth.

Substantially all of our 2018 U.S. gross profit was derived from sales of products currently regulated by the U.S. Food and Drug Administration ( FDA ) Center for Tobacco Products. We have significant experience in complying with the FDA regulatory regime with a compliance infrastructure composed of legal and scientific professionals. We believe many smaller OTP manufacturers currently lack this infrastructure, which we believe is necessary to comply with the broad scope of FDA regulations. We believe our regulatory compliance infrastructure, combined with our skilled management and strong distribution platform, position us to act as a consolidator within the OTP industry.

We have a strong track record of enhancing our OTP business with strategic and accretive acquisitions. For example, our acquisition of the North American *Zig-Zag*<sup>®</sup> cigarette papers distribution rights in 1997 has made us the #1 premium cigarette paper brand in the U.S. in terms of retail dollar sales, as measured by Nielsen. Perhaps more importantly, we own the *Zig-Zag*<sup>®</sup> tobacco trademark in the U.S. and have leveraged this asset effectively with approximately 50% of our total 2018 *Zig-Zag* branded net sales under our own *Zig-Zag*<sup>®</sup> marks rather than those we license from Bolloré. In 2003, we acquired the *Stoker* <sup>®</sup> brand. We have since built the brand to a strong #2 position in the chewing tobacco industry while successfully leveraging the brand's value through our MST expansion where it remains among the fastest growing MST brands in the industry. More recently, we have completed five acquisitions since our IPO to acquire (i) smokeless tobacco brands from Wind River, (ii) VaporBeast, (iii) Vapor Shark, (iv) Vapor Supply, and (v) IVG. Additionally, our strategic minority interest in CASH gives us access to a pipeline of novel new CBD products that we believe will be a dynamic force in the industry.

### **Maintain Lean, Low-Cost Operating Model**

We have a lean, asset-light manufacturing and sourcing model which requires low capital expenditures and utilizes outsourced supplier relationships. We believe our asset-light model provides marketplace flexibility and allows us to achieve favorable margins. Our market analytics allow us to efficiently and effectively address evolving consumer and market demands. Our supplier relationships allow us to increase the breadth of our product offerings and quickly enter new OTP markets as management is able to focus on brand building and innovation. We intend to continue to optimize our asset-light operating model as we grow in order to maintain a low cost of operations and healthy margins. In 2018, approximately 85% of our net sales were derived from outsourced production operations. Our capital expenditures have ranged between \$1.3 million and \$3.2 million per year over the previous 5 years. We do not intend to outsource our MST production as a result of our proprietary manufacturing processes which are substantively different than those of our competitors.

TABLE OF CONTENTS**Raw Materials, Product Supply, and Inventory Management**

We source our products through a series of longstanding, highly-valued relationships which allow us to conduct our business on an asset-light, distribution-focused basis.

The components of inventories at December 31, 2018 and 2017, were as follows (in thousands):

	<b>December 31, 2018</b>	<b>December 31, 2017</b>
Raw materials and work in process	\$ 2,722	\$ 2,545
Leaf tobacco	34,977	30,308
Finished goods - Smokeless products	6,321	5,834
Finished goods - Smoking products	14,666	14,110
Finished goods - NewGen products	37,194	14,532
Other	738	1,290
	96,618	68,619
LIFO reserve	(5,381 )	(5,323 )
	\$ 91,237	\$ 63,296

***Smokeless Products***

Our loose leaf chewing and moist snuff tobaccos are produced from air-cured and fire-cured leaf tobacco, respectively. We utilize recognized suppliers that generally maintain 12- to 24-month supplies of our various types of tobacco at their facilities. We do not believe we are dependent on any single country or supplier source for tobacco. We generally maintain up to a two-month supply of finished, loose leaf chewing tobacco and moist snuff. This supply is maintained at our Louisville, Kentucky, facility and in two regional public warehouses to facilitate distribution.

We also utilize a variety of suppliers for the sourcing of additives used in our smokeless products and for the supply of our packaging materials. Thus, we believe we are not dependent on a single supplier for these products. There are no current U.S. federal regulations that restrict tobacco flavor additives in smokeless products. The additives that we use are food-grade, generally accepted ingredients.

All of our loose leaf chewing tobacco production is fulfilled through our agreement with Swedish Match. See the Distribution and Supply Agreements section for our discussion of the Swedish Match Manufacturing Agreement. All of our moist snuff products are manufactured at our facility in Dresden, Tennessee. Packaging occurs at the Dresden, Tennessee, location in addition to the facility in Louisville, Kentucky.

***Smoking Products***

Pursuant to our distribution agreements with Bolloré (discussed in more detail, below, under the heading Distribution and Supply Agreements ), we are required to purchase from Bolloré all cigarette papers, cigarette tubes, and cigarette injecting machines that we sell, subject to Bolloré fulfilling its obligations under these distribution agreements. If Bolloré is unable or unwilling to perform its obligations or ceases its cigarette paper manufacturing operations, in each case, as set forth in the Distribution Agreements, we may seek third-party suppliers and continue the use of the Zig-Zag® trademark to market these products. To ensure we have a steady supply of premium cigarette paper products, as well as cigarette tubes and injectors, Bolloré is required to maintain, at its expense, a two-month supply of inventory in a bonded, public warehouse in the U.S.



We obtain our MYO cigar wraps from the patent holder under our agreement with Durfort in the Dominican Republic. We also obtain our Zig-Zag branded cigar products from the Dominican Republic. We obtain our pipe tobaccos from domestic sources. We generally purchase these tobaccos through multiple sources; thus, we believe we are not dependent on a single supplier. We package these products at our Louisville, Kentucky, facility.

***NewGen Products***

We have sourcing relationships that are capable of providing liquid vapor products for other companies' brands and for producing our own branded product lines in the category. Our acquisitions of VaporBeast, Vapor Shark, Vapor Supply, and IVG have (i) accelerated our entry into the non-traditional retail channel, where we believe a significant portion of liquid vapor products are sold; (ii) provided enhanced distribution of products; and (iii) established

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best-in-class distribution and B2C platforms combining eCommerce selling skills with a national, retail salesforce. We believe the VaporBeast B2B competency coupled with the IVG B2C selling strengths and our national retail salesforce is a genuine competitive advantage and one that we intend to leverage on behalf of Nu-X CBD and vapor products. Furthermore, we have established a sourcing group in Asia to ensure timely and cost-effective access to marketplace winners and new product launches, while also maximizing margin through thoughtful logistics strategies.

### **Distribution and Supply Agreements**

#### ***Bolloré Distribution and License Agreements***

We are party to two long-term distribution and license agreements with Bolloré with respect to sales of cigarette papers, cigarette tubes, and cigarette injector machines—one with respect to distribution in the U.S. and one with respect to distribution in Canada (collectively, the *Distribution Agreements* ). Under the *Distribution Agreements*, Bolloré granted us the exclusive right to purchase products bearing the *Zig-Zag*<sup>®</sup> brand name from Bolloré for resale in the U.S. and Canada. We have the sole right to determine pricing and other terms upon which we may resell any products purchased from Bolloré, including the right to determine the ultimate distributors of such products within these countries. Furthermore, on March 19, 2013, we entered into an additional License and Distribution Agreement with Bolloré (the *Bolloré License Agreement* ), which permits us the exclusive use of the *Zig-Zag* brand name in the U.S. for e-cigarettes and any related accessories, including vaporizers and e-liquids. The *Bolloré License Agreement* terminates upon termination of the *Distribution Agreements*.

Each of the *Distribution Agreements* were entered into on November 30, 1992, by a predecessor in interest for an initial twenty-year term. The *Distribution Agreements* automatically renewed in November 2012 for a second twenty-year term and will automatically renew for successive twenty-year terms unless terminated in accordance with the provisions of such agreement. The *Distribution Agreements* provide that, in order to assure each of the parties receives commercially reasonable profits in light of inflationary trends and currency fluctuation factors, 120 days prior to December 31, 2004, and each fifth-year anniversary from such date thereafter, the parties are required to enter into good faith negotiations to agree on an index and currency adjustment formula to replace the index and formula currently in effect. If the parties are unable to agree, the dispute is to be submitted to binding arbitration. Pursuant to the *Distribution Agreements*, if at any time the price received by Bolloré fails to cover its costs, Bolloré may give us notice of this deficiency, and the parties must promptly negotiate in good faith to adjust prices. If the parties cannot agree on new prices, we may purchase products from an alternative supplier reasonably acceptable to Bolloré until the next price adjustment period (subject to certain price-matching rights available to Bolloré and other terms and conditions). Further, Bolloré sources its needs for our orders from an affiliate of one of our competitors. See *Risk Factors—We depend on a small number of key third-party suppliers and producers for our products* for further details.

Pursuant to the *Distribution Agreements*, export duties, insurance, and shipping costs are the responsibility of Bolloré. Import duties and taxes in the U.S. and Canada are our responsibility. Under the *Distribution Agreements*, we must purchase cigarette papers, cigarette tubes, and cigarette injector machines from Bolloré, subject to Bolloré fulfilling its obligations under these agreements. Bolloré is required to provide us with the quantities of the products that we order consistent with specific order-to-delivery timelines detailed in the agreement. The *Distribution Agreements* provide us with certain safeguards to ensure that we will be able to secure a steady supply of product, including (i) granting us the right to seek third-party suppliers with continued use of the *Zig-Zag*<sup>®</sup> trademark if Bolloré is unable to perform its obligations or ceases its cigarette paper manufacturing operation, in each case as set forth in the *Distribution Agreements*, and (ii) maintaining a two-month supply of safety stock inventory of the premium papers, tubes, and injector machines in the U.S. at Bolloré's expense.

Under the *Distribution Agreements*, we have agreed that for a period of five years after the termination of the agreements we will not engage, directly or indirectly, in the manufacturing, selling, distributing, marketing, or

otherwise promoting, in the U.S. and Canada, of cigarette paper or cigarette paper booklets of a competitor without Bolloré's consent, except for certain de minimis acquisitions of debt or equity securities of such a competitor and certain activities with respect to an alternative supplier used by us as permitted under the Distribution Agreements.

Each of the Distribution Agreements permits Bolloré to terminate such agreement (i) if certain minimum purchases (which, in the case of both Distribution Agreements, have been significantly exceeded in recent years) of cigarette paper booklets have not been made by us for resale in the jurisdiction covered by such agreement within a calendar year, (ii) if we assign such agreement without the consent of Bolloré, (iii) upon a change of control without

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the consent of Bolloré, (iv) upon certain acquisitions of our equity securities by one of our competitors or certain investments by our significant stockholders in one of our competitors, (v) upon certain material breaches, including our agreement not to promote, directly or indirectly, cigarette paper or cigarette paper booklets of a competitor, or (vi) upon our bankruptcy, insolvency, liquidation, or other similar event. Additionally, the Canada Distribution Agreement is terminable by either us or Bolloré upon the termination of the U.S. Distribution Agreement.

### ***Swedish Match Manufacturing Agreement***

On September 4, 2008, we entered into a manufacturing and distribution agreement with Swedish Match whereby Swedish Match became the exclusive manufacturer of our loose leaf chewing tobacco. Under the agreement, production of our loose leaf chewing tobacco products was completely transitioned to Swedish Match's plant located in Owensboro, Kentucky, on September 18, 2009. We source all of the tobacco Swedish Match uses to manufacture our products along with certain proprietary flavorings and retain all marketing, design, formula, and trademark rights over our loose leaf products. We also have the right to approve all product modifications and are solely responsible for decisions related to package design and branding of the loose leaf tobacco produced for us. Responsibilities related to process control, manufacturing activities, and inventory management with respect to our loose leaf products are allocated between us and Swedish Match as specified in the agreement. We also have rights to monitor production and quality control processes on an ongoing basis.

The agreement had an initial ten-year term and will automatically be renewed for five successive ten-year terms unless either party provides at least 180 days' notice prior to a renewal term of its intent to terminate the agreement, or unless otherwise terminated by mutual agreement of the parties in accordance with the provisions of the agreement. If a notice of non-renewal is delivered, the contract will expire two years after the date on which the agreement would have otherwise been renewed. The terms allow the agreement to be assumed by a buyer, terminated for uncured material breach, or terminated by us subject to a buyout. We also hold a right of first refusal to acquire the manufacturing plant as well as Swedish Match's chewing tobacco unit. The agreement was automatically renewed for the first of five 10-year renewal periods on September 4, 2018.

### **Production and Quality Control**

We primarily outsource our manufacturing and production processes and focus on packaging, marketing, and distribution. We currently manufacture approximately 15% of our products as measured by net sales. Our in-house manufacturing operations are limited to (i) the manufacturing of our moist snuff products, which occurs at our facility in Dresden, Tennessee; (ii) the packaging of our moist snuff products at our facilities in Dresden, Tennessee, and Louisville, Kentucky; (iii) the manufacturing of e-liquids at our Louisville, Kentucky, facility; and (iv) the processing and packaging of our pipe tobacco products, which is completed at our manufacturing facility in Louisville, Kentucky. Our MST products are processed in-house, rather than outsourced, as a result of our proprietary manufacturing processes which are substantively different than those of our competitors.

We use proprietary production processes and techniques, including strict quality controls. Our quality control group routinely tests the quality of the tobacco, flavorings, application of flavorings, premium cigarette papers, tubes and injectors, cigars, MYO cigar wraps, liquid vapor products, and packaging materials. We utilize sophisticated quality controls to test and closely monitor the quality of our products. The high quality of our tobacco products is largely the result of using high-grade tobacco leaf and food-grade flavorings and, on an ongoing basis, analyzing the tobacco cut, flavorings, and moisture content together with strict specifications for sourced products.

Given the importance of contract manufacturing to our business, our quality control group ensures that established, written procedures and standards are adhered to by each of our contract manufacturers. Responsibilities related to process control, manufacturing activities, quality control, and inventory management with respect to our loose leaf are

allocated between us and Swedish Match under the manufacturing agreement.

### **Sales and Marketing**

We have grown the size and capacity of our salesforce and intend to continue strengthening the organization to advance our ability to deepen and broaden the retail availability of our products and brands.

As of December 31, 2018, we had a nationwide tobacco and vapor sales and marketing organization of approximately 174 professionals. Our tobacco-related sales and marketing group focuses on priority markets and sales channels and seeks to operate with a high level of efficiency. In 2018, our tobacco-related sales and marketing efforts enabled our products to reach an estimated 210,000 retail doors in North America and over 800 direct wholesale customers with an additional 100 secondary, indirect wholesalers in the U.S.

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Our tobacco sales efforts are focused on wholesale distributors and retail merchants in the independent and chain convenience store, tobacco outlet, food store, mass merchandising, drug store, and non-traditional retail channels. Our NewGen sales efforts are focused on alternative channels and winning new stores, increasing store share of requirements and growing the B2C engine to capture a greater share of online sales direct to the consumer. We have expanded, and intend to continue to expand, the sales of our products into previously underdeveloped geographic markets and retail channels. In 2018, we derived more than 95% of our net sales from sales in the U.S., with the remainder primarily from sales in Canada.

We subscribe to a sales tracking system from MSAi that records all traditional OTP product shipments (ours as well as those of our competitors) from approximately 900 wholesalers to over 250,000 traditional retail stores in the U.S. This system enables us to understand individual product share and volume trends across multiple categories down to the individual retail store level, allowing us to allocate field salesforce coverage to the highest opportunity stores. Additionally, the ability to select from a range of parameters and to achieve this level of granularity means we can analyze marketplace trends in a timely manner and swiftly evolve our business planning to meet market opportunities.

We employ marketing activities to grow awareness, trial, and sales including selective trade advertising to expand wholesale availability, point-of-sale advertising and merchandising and permanent and temporary displays to improve consumer visibility, and social media. We comply with all regulations relating to the marketing of tobacco products, such as directing marketing efforts to adult consumers, and are committed to full legal compliance in the sales and marketing of our products. To date, we have neither relied upon, nor conducted, any substantial advertising in the consumer media for our products.

In the years ended December 31, 2018, 2017, and 2016, we did not have any customer that accounted for 10% or more of our net sales. Our customers use an open purchase order system to buy our products and are not obligated to do so pursuant to ongoing contractual obligations. We perform periodic credit evaluations of our customers and generally do not require collateral on trade receivables. Historically, we have not experienced material credit losses. Sales to customers within our NewGen segment are generally prepaid.

### **Competition**

Many of our competitors are better capitalized than we are and have greater resources, financial and otherwise. We believe our ability to effectively compete and strong market positions in our principal product lines are due to the high recognition of our brand names, the perceived quality of each of our products, and the efforts of our sales, marketing, and distribution teams. We compete against big tobacco, including Altria Group, Inc. (formerly Philip Morris); British American Tobacco p.l.c. (formerly Reynolds); Swedish Match; Swisher International; and manufacturers including U.K. based Imperial Brands, PLC, across our segments. Big tobacco has substantial resources and a customer base that has historically demonstrated loyalty to their brands.

Competition in the OTP market is based upon not only brand quality and positioning but also on price, packaging, promotion, and retail availability and visibility. Given the decreasing prevalence of cigarette consumption, the big tobacco companies continue to demonstrate an increased interest and participation in a number of OTP markets.

### ***Smokeless Products***

Our three principal competitors in the loose leaf chewing tobacco market are Swedish Match, the American Snuff Company, LLC (a unit of British American Tobacco p.l.c.), and Swisher International Group, Inc. We believe moist snuff products are used interchangeably with loose leaf products by many consumers. In the moist snuff category, we face the same competitors with the addition of U.S. Smokeless Tobacco Company (a division of Altria Group, Inc.).

***Smoking Products***

Our principle competitors for premium cigarette paper sales are Republic Tobacco, L.P. and HBI International. Our two major competitors for MYO cigar wraps are New Image Global, Inc., and Blunt Wrap USA.

***NewGen Products***

In the NewGen products segment, aside from the established operations of Juul Labs, our competitors are varied as the market is relatively new and highly fragmented. Our direct competitors sell products that are substantially similar to our products through the same channels in which we sell our liquid vapor products. We compete with these

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direct competitors for sales through wholesalers and retailers including, but not limited to, vapor stores, national chain stores, tobacco shops, and convenience stores and in the online direct to consumer environment. Through our acquisitions we now also compete directly with other non-traditional distributors and retailers.

### **Patents, Trademarks, and Trade Secrets**

We have numerous registered trademarks relating to our products, including: *Beech-Nut*<sup>®</sup>, *Trophy*<sup>®</sup>, *Havana Blossom*<sup>®</sup>, *Durango*<sup>®</sup>, *Stoker* *s*<sup>®</sup>, *Tequila Sunrise*<sup>®</sup>, *Fred s Choice*<sup>®</sup>, *Old Hillside*<sup>®</sup>, *Our Pride*<sup>®</sup>, *Red Cap*<sup>®</sup>, *Tennessee Chew*<sup>®</sup>, *Big Mountain*<sup>®</sup>, *Springfield Standard*<sup>®</sup>, *Snake River*<sup>®</sup>, *VaporBeast*<sup>®</sup>, *Vapor Shark*<sup>®</sup>, *DirectVapor*<sup>®</sup>, *VaporFi*<sup>®</sup>, and *SouthBeachSmoke*<sup>®</sup>. The registered trademarks, which are significant to our business, expire periodically and are renewable for additional 10-year terms upon expiration. Flavor and blend formula trade secrets relating to our tobacco products, which are key assets of our businesses, are maintained under strict secrecy. The *Zig-Zag*<sup>®</sup> trade name and trademark for premium cigarette papers and related products are owned by Bolloré and have been exclusively licensed to us in the U.S. and Canada. The *Zig-Zag*<sup>®</sup> trade name and trademark for e-cigarette and vaporizers are also owned by Bolloré and have been exclusively licensed to us in the U.S. We own the *Zig-Zag*<sup>®</sup> trademark with respect to its use in connection with products made with tobacco including, without limitation, cigarettes, cigars, and MYO cigar wraps in the U.S.

### **Research and Development and Quality Assurance**

We have a research and development and quality assurance function that tests raw materials and finished products in order to maintain a high level of product quality and consistency. Research and development largely bases its new product development efforts on our high-tech data systems. We spent approximately \$2.5 million, \$2.3 million, and \$2.0 million dollars on research and development and quality control efforts for the years ended December 31, 2018, 2017, and 2016, respectively.

### **Employees**

As of February 25, 2019, we employed 520 full-time employees. None of our employees are represented by unions. We believe we have a positive relationship with our employees.

### **Internet Address and Company SEC Filings**

Our primary Internet address is [www.turningpointbrands.com](http://www.turningpointbrands.com). On the investor relations portion of our website, [www.turningpointbrands.com/investor-relations](http://www.turningpointbrands.com/investor-relations), we provide a link to our electronic filings with the U.S. Securities and Exchange Commission (the "SEC"), including our annual report on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K, and any amendments to these reports. We make all such filings available free of charge as soon as reasonably practicable after filing. The information found on our website is not part of this or any other report we file with or furnish to the SEC.



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### **Item 1A. Risk Factors**

#### **Risks related to our business and industry include the following:**

##### ***Sales of tobacco products are generally expected to continue to decline.***

As a result of restrictions on advertising and promotions, increases in regulation and excise taxes, health concerns, a decline in the social acceptability of tobacco and tobacco-related products, increased pressure from anti-tobacco groups, and other factors, the overall U.S. market for tobacco products has generally been declining in terms of volume of sales and is expected to continue to decline. The general climate of declining sales of tobacco products is principally driven by the long-standing declines in cigarettes. OTP, on the other hand, as measured by MSAi, have been generating modest volume gains. For instance, while loose leaf chewing tobacco products have declined for over a decade, MST, a much larger Smokeless segment, has been growing in the low single digits over the same period. Additionally, cigarillo cigars and MYO cigar wraps have each demonstrated MSAi volume gains in recent years. Our tobacco products comprised approximately 61% of our total 2018 net sales and, while some of our sales volume declines have been offset by higher prices or by increased sales in other product categories, there can be no assurance that these price increases or increased sales can be sustained, especially in an environment of increased regulation and taxation and changes in consumer spending habits.

##### ***We depend on a small number of key third-party suppliers and producers for our products.***

Our operations are largely dependent on a small number of key suppliers and producers to supply or manufacture our products pursuant to long-term contracts. In 2018, our three most important suppliers and producers were: (i) Swedish Match, which produces all of our loose leaf chewing tobacco in the U.S., (ii) Bolloré, which provides us with exclusive access to the Zig-Zag® cigarette paper and related accessories in the U.S. and Canada, and (iii) Durfort, from which we source our MYO cigar wraps.

All of our loose leaf tobacco products are manufactured for us by Swedish Match pursuant to a ten-year renewable agreement, which we entered into in 2008. The agreement will automatically be renewed for five successive ten-year terms unless either party provides at least 180 days notice prior to a renewal term of its intent to terminate the agreement or unless otherwise terminated in accordance with the provisions of the agreement. If a notice of non-renewal is delivered, the contract will expire two years after the date on which the agreement would have otherwise been renewed. Under this agreement, we retain the rights to all marketing, distribution and trademarks over the loose leaf brands that we own or license. The agreement renewed for an additional ten-year term in 2018. We share responsibilities with Swedish Match related to process control, manufacturing activities, quality control, and inventory management with respect to our loose leaf products. We rely on the performance by Swedish Match of its obligations under the agreement for the production of our loose leaf tobacco products. Any significant disruption in Swedish Match's manufacturing capabilities or our relationship with Swedish Match, a deterioration in Swedish Match's financial condition, or an industry-wide change in business practices with respect to loose leaf tobacco products could have a material adverse effect on our business, results of operations, and financial condition.

All of our Zig-Zag® premium cigarette papers, cigarette tubes, and injectors are sourced from Bolloré, pursuant to a renewable 20-year exclusive agreement. This agreement was most recently renewed in 2012. In addition, under the terms of the agreement with Bolloré, we renegotiate pricing terms every five years. Further, Bolloré sources its needs for certain of our orders from an affiliate of one of our competitors.

We source our MYO cigar wraps through the patent holder, Durfort, pursuant to an agreement entered into in October 2008. The agreement extends until expiration of the patents or cancellation of the agreement by either party. We rely on Durfort to produce and package our MYO cigar wraps to our specifications. Any significant disruption in our

relationship with Durfort, a deterioration in Durfort's financial condition, an industry-wide change in business practices relating to MYO cigar wraps, or our ability to source the MYO cigar wraps from them could have a material adverse effect on our business, results of operations, and financial condition.

Pursuant to agreements with certain suppliers, we have agreed to store tobacco inventory purchased on our behalf and generally maintain a 12- to 24-month supply of our various tobacco products at their facilities. We cannot guarantee our supply of these products will be adequate to meet the demands of our customers. Further, a major fire, violent weather conditions, or other disasters that affect us or any of our key suppliers or producers, including Bolloré, Swedish Match, or Durfort, as well as those of our other suppliers and vendors, could have a material adverse effect on our operations. Although we have insurance coverage for some of these events, a prolonged interruption in our operations, as well as those of our producers, suppliers, or vendors, could have a material adverse effect on our

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business, results of operations, and financial condition. In addition, we do not know whether we will be able to renew any or all of our agreements on a timely basis, on terms satisfactory to us, or at all.

Any disruptions in our relationships with Bolloré, Swedish Match, or Durfort, a failure to renew any of our agreements, an inability or unwillingness by any supplier to produce sufficient quantities of our products in a timely manner or finding a new supplier would have a significant impact on our ability to continue distributing the same volume and quality of products and maintain our market share, even during a temporary disruption, which could have a material adverse effect on our business, results of operations and financial condition.

### ***We may be unable to identify or contract with new suppliers or producers in the event of a disruption to our supply.***

In order to continue selling our products in the event of a disruption to our supply, we would have to identify new suppliers or producers that would be required to satisfy significant regulatory requirements. Only a limited number of suppliers or producers may have the ability to produce our products at the volumes we need, and it could be costly or time-consuming to locate and approve such alternative sources. Moreover, it may be difficult or costly to find suppliers to produce small volumes of our new products in the event we are looking only to supplement current supply as suppliers may impose minimum order requirements. In addition, we may be unable to negotiate pricing or other terms with our existing or new suppliers as favorable as those we currently enjoy. Even if we were able to successfully identify new suppliers and contract with them on favorable terms, these new suppliers would also be subject to stringent regulatory approval procedures that could result in prolonged disruptions to our sourcing and distribution processes.

Furthermore, there is no guarantee that a new third-party supplier could accurately replicate the production process and taste profile of our existing products. We cannot guarantee that a failure to adequately replace our existing suppliers would not have a material adverse effect on our business, results of operations, and financial condition.

### ***Our licenses to use certain brands and trademarks may be terminated or not renewed.***

We are reliant upon brand recognition in the OTP markets in which we compete as the OTP industry is characterized by a high degree of brand loyalty and a reluctance to switch to new or unrecognizable brands on the part of consumers. Some of the brands and trademarks under which our products are sold are licensed to us for a fixed period of time in respect of specified markets, such as our distribution and license agreement with Bolloré for use of the Zig-Zag® name and associated trademarks in connection with certain of our cigarette papers and related products.

We have two licensing agreements with Bolloré, the first of which governs licensing and the use of the Zig-Zag® name with respect to cigarette papers, cigarette tubes, and cigarette injector machines, and the second of which governs licensing and the use of the Zig-Zag® name with respect to e-cigarettes, vaporizers, and e-liquids. In 2018, we generated \$112 million in net sales of Zig-Zag® products, of which approximately \$56 million was generated from products sold through our license agreement with Bolloré. In the event the licensing agreements with Bolloré are not renewed, the terms of the agreements bind us under a five-year non-compete clause, under which we cannot engage in direct or indirect manufacturing, selling, distributing, marketing, or otherwise promoting of cigarette papers of a competitor without Bolloré's consent, except in limited instances. We do not know whether we will renew these agreements on a timely basis, on terms satisfactory to us, or at all. As a result of these restrictions, if our agreements with Bolloré are terminated, we may not be able to access the markets with recognizable brands that would be positioned to compete in these segments.

In the event that the licenses to use the brands and trademarks in our portfolio are terminated or are not renewed after the end of the term, there is no guarantee we will be able to find a suitable replacement, or if a replacement is found, that it will be on favorable terms. Any loss in our brand-name appeal to our existing customers as a result of the lapse

or termination of our licenses could have a material adverse effect on our business, results of operations, and financial condition.

*We may not be successful in maintaining the consumer brand recognition and loyalty of our products.*

We compete in a market that relies on innovation and the ability to react to evolving consumer preferences. The tobacco industry in general, and the OTP industry in particular, are subject to changing consumer trends, demands, and preferences. Therefore, products once favored may over time become disfavored by consumers or no longer

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perceived as the best option. Consumers in the OTP market have demonstrated a high degree of brand loyalty, but producers must continue to adapt their products in order to maintain their status among these customers as the market evolves. The Zig-Zag® brand has strong brand recognition among smokers, and our continued success depends in part on our ability to continue to differentiate the brand names that we own or license and maintain similarly high levels of recognition with target consumers. Trends within the OTP industry change often. Our failure to anticipate, identify, or react to changes in these trends could, among other things, lead to reduced demand for our products. Factors that may affect consumer perception of our products include health trends and attention to health concerns associated with tobacco, price-sensitivity in the presence of competitors' products or substitute products, and trends in favor of new NewGen products that are currently being researched and produced by participants in our industry. For example, in recent years, we have witnessed a shift in consumer purchases from chewing tobacco to moist snuff due to its increased affordability. Along with our biggest competitors in the chewing tobacco market, which also produce moist snuff, we have been able to shift priorities and adapt to this change. A failure to react to similar trends in the future could enable our competitors to grow or establish their brands' market shares in these categories before we have a chance to respond.

Consumer perceptions of the overall health of tobacco-based products is likely to continue to shift, and our success depends, in part, on our ability to anticipate these shifting tastes and the rapidity with which the markets in which we compete will evolve in response to these changes on a timely and affordable basis. If we are unable to respond effectively and efficiently to changing consumer preferences, the demand for our products may decline, which could have a material adverse effect on our business, results of operations, and financial condition.

Regulations may be enacted in the future, particularly in light of increasing restrictions on the form and content of marketing of tobacco products, that would make it more difficult to appeal to our consumers or to leverage existing recognition of the brands that we own or license. Furthermore, even if we are able to continue to distinguish our products, there can be no assurance that the sales, marketing, and distribution efforts of our competitors will not be successful in persuading consumers of our products to switch to their products. Many of our competitors have greater access to resources than we do, which better positions them to conduct market research in relation to branding strategies or costly marketing campaigns. Any loss of consumer brand loyalty to our products or reduction of our ability to effectively brand our products in a recognizable way will have a material effect on our ability to continue to sell our products and maintain our market share, which could have a material adverse effect on our business, results of operations, and financial condition.

### ***We are subject to substantial and increasing regulation.***

The tobacco industry has been under public scrutiny for over 50 years. Industry critics include special interest groups, the U.S. Surgeon General, and many legislators and regulators at the state and federal levels. A wide variety of federal, state, and local laws limit the advertising, sale, and use of tobacco, and these laws have proliferated in recent years. Together with changing public attitudes towards tobacco consumption, the constant expansion of regulations has been a major cause of the overall decline in the consumption of tobacco products since the early 1970s. These regulations relate to, among other things, the importation of tobacco products and shipping throughout the U.S. market, increases in the minimum age to purchase tobacco products, imposition of taxes, sampling and advertising bans or restrictions, flavor bans or restrictions, ingredient and constituent disclosure requirements, and media campaigns and restrictions on where smokers can smoke. Additional restrictions may be legislatively imposed or agreed to in the future. These limitations may make it difficult for us to maintain the value of any brand.

Moreover, the current trend is toward increasing regulation of the tobacco industry, which is likely to differ between the various U.S. states and Canadian provinces in which we currently conduct the majority of our business. Extensive and inconsistent regulation by multiple states and at different governmental levels could prove to be particularly disruptive to our business as we may be unable to accommodate such regulations in a cost-effective manner that

allows us to continue to compete in an economically viable way. Regulations are often introduced without the tobacco industry's input and have been a significant reason behind reduced industry sales volumes and increased illicit trade.

In 1986, federal legislation was enacted regulating smokeless tobacco products (including dry and moist snuff and chewing tobacco) by, among other things, requiring health warnings on smokeless tobacco packages and prohibiting the advertising of smokeless tobacco products on media subject to the jurisdiction of the Federal Communications Commission ( FCC ). Since 1986, other proposals have been made at the federal, state, and local levels for additional regulation of tobacco products. It is likely that additional proposals will be made in the coming

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years. For example, the Prevent All Cigarette Trafficking Act prohibits the use of the U.S. Postal Service to mail most tobacco products and amends the Jenkins Act, which established cigarette sales reporting requirements for state excise tax collection, to require individuals and businesses that make interstate sales of cigarettes or smokeless tobacco comply with state tax laws. See —There is uncertainty related to the federal regulation of NewGen products, cigars and pipe tobacco products for further details. Additional federal or state regulation relating to the manufacture, sale, distribution, advertising, labeling, mandatory ingredients disclosure and nicotine yield information disclosure of tobacco products could reduce sales, increase costs, and have a material adverse effect on our business, results of operations, and financial condition.

On June 22, 2009, the Family Smoking Prevention and Tobacco Control Act (the Tobacco Control Act) authorized the FDA for regulatory authority over tobacco products. The Act also amended the Federal Cigarette Labeling and Advertising Act, which governs how cigarettes can be advertised and marketed, as well as the Comprehensive Smokeless Tobacco Health Education Act (CSTHEA), which governs how smokeless tobacco can be advertised and marketed. In addition to the FDA and FCC, we are subject to regulation by numerous other federal agencies, including the Federal Trade Commission (FTC), the Department of Justice (DOJ), the Alcohol and Tobacco Tax and Trade Bureau (TTB), the U.S. Environmental Protection Agency (EPA), the U.S. Department of Agriculture (USDA), the Consumer Product Safety Commission (CPSC), the U.S. Customs and Border Protection (CBP) and the U.S. Center for Disease Control and Prevention's (CDC) Office on Smoking and Health. There have also been adverse legislative and political decisions and other unfavorable developments concerning cigarette smoking and the tobacco industry, which have received widespread public attention. FDA has, and other governmental entities have, expressed concerns about the use of flavors in tobacco products and an interest in significant regulation of such use, up to and including de facto bans in certain products. There can be no assurance as to the ultimate content, timing or effect of any regulation of tobacco products by governmental bodies, nor can there be any assurance that potential corresponding declines in demand resulting from negative media attention would not have a material adverse effect on our business, results of operations and financial condition.

### ***Some of our products are subject to developing and unpredictable regulation.***

Some of our NewGen products marketed through our Nu-X subsidiary and similar third-party products sold through our NewGen distribution vehicles may be subject to uncertain federal, state and local regulations concerning hemp, CBD and other non-tobacco consumable products. Enforcement initiatives by those authorities are therefore unpredictable and impossible to anticipate. We anticipate that all levels of government are likely to seek in some way to regulate these products, but the type, timing, and impact of such regulations remains uncertain. Accordingly, we cannot give any assurance that such actions would not have a material adverse effect on this emerging business.

### ***Our products are regulated by the FDA, which has broad regulatory powers.***

Substantially all of our 2018 U.S. net sales are derived from the sale of products that are currently regulated by the FDA. The Tobacco Control Act grants the FDA broad regulatory authority over the design, manufacture, sale, marketing and packaging of tobacco products. Among the regulatory powers conferred to the FDA under the Tobacco Control Act is the authority to impose tobacco product standards that are appropriate for the protection of the public health, require manufacturers to obtain FDA review and authorization for the marketing of certain new or modified tobacco products and impose various additional restrictions. Such restrictions may include requiring reduction or elimination of the use of particular constituents or components, requiring product testing, or addressing other aspects of tobacco product construction, constituents, properties or labeling.

Specifically, the Tobacco Control Act (i) increases the number of health warnings required on cigarette and smokeless tobacco products, increases the size of warnings on packaging and in advertising, requires the FDA to develop graphic warnings for cigarette packages, and grants the FDA authority to require new warnings, (ii) imposes restrictions on the

sale and distribution of tobacco products, including significant restrictions on tobacco product advertising and promotion as well as the use of brand and trade names, (iii) bans the use of light, mild, low or similar descriptors on tobacco products, (iv) bans the use of characterizing flavors in cigarettes other than tobacco or menthol, (v) requires manufacturers to report ingredients and harmful constituents and requires the FDA to disclose certain constituent information to the public, (vi) authorizes the FDA to require the reduction of nicotine and the potential reduction or elimination of other constituents or additives, including menthol, (vii) establishes potentially expensive and time-consuming pre-market and substantial equivalence review pathways for tobacco

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products that are considered new, (viii) gives FDA broad authority to deny product applications thereby preventing the sale or distribution of the product subject to the application (and requiring such product to be removed from the market, if applicable), and (ix) requires tobacco product manufacturers (and certain other entities) to register with the FDA.

The FDA charges user fees based on the USDA unit calculations pro-rated to the annualized FDA congressionally allocated budget. These fees only apply to certain products currently regulated by the FDA, which include our smokeless and smoking products (other than cigarette paper products), but we may in the future be required to pay such fees on more of our products, and we cannot accurately predict which additional products may be subject to such fees or the magnitude of such fees, which could become significant.

Although the FDA is prohibited from issuing regulations banning all cigarettes, all smokeless tobacco products, all little cigars, all cigars other than little cigars, all pipe tobacco, or all roll-your-own tobacco, or requiring the reduction of nicotine yields of a tobacco product to zero, it is likely that its regulations in accordance with the Tobacco Control Act could result in a decrease in cigarette and smokeless tobacco sales in the U.S. We believe that such regulation could adversely affect our ability to compete against our larger competitors, who may be able to more quickly and cost-effectively comply with these new rules and regulations. Our ability to gain efficient market clearance for new tobacco products, or even to keep existing products on the market, could also be affected by FDA rules and regulations. Some of our currently marketed products that are subject to FDA regulation will require marketing authorizations from the FDA for us to continue marketing them (e.g., pre-market or substantial equivalence marketing authorizations, as applicable to the product), which we cannot guarantee we will be able to obtain. In addition, failure to comply with new or existing tobacco laws under which the FDA imposes regulatory requirements could result in significant financial penalties and government investigations of us. To the extent we are unable to respond to, or comply with, new FDA regulations it could have a material adverse effect on our business, results of operations and financial condition.

### ***Many of our products contain nicotine, which is considered to be a highly addictive substance.***

Many of our products contain nicotine, a chemical that is considered to be highly addictive. The Tobacco Control Act empowers the FDA to regulate the amount of nicotine found in tobacco products, but not to require the reduction of nicotine yields of a tobacco product to zero. Any FDA regulation, whether of nicotine levels or other product attributes, may require us to reformulate, recall and/or discontinue certain of the products we may sell from time to time, which may have a material adverse effect on our ability to market our products and have a material adverse effect on our business, results of operations and financial condition.

### ***There is uncertainty related to the federal regulation of NewGen products, cigars and pipe tobacco products. Increased regulatory compliance burdens could have a material adverse impact on our NewGen business development efforts.***

Since their introduction, there has been significant uncertainty regarding whether, how and when tobacco regulations would apply to NewGen products, such as electronic cigarettes or other vaporizer products. Based on a decision in December 2010 by the U.S. Court of Appeals for the D.C. Circuit (the *Sottera* decision), the FDA is permitted to regulate electronic cigarettes containing tobacco-derived nicotine as tobacco products under the Tobacco Control Act.

Effective August 8, 2016, FDA's regulatory authority under the Tobacco Control Act was extended to all remaining tobacco products, including: (i) certain NewGen products (such as electronic cigarettes, vaporizers and e-liquids) and their components or parts (such as tanks, coils and batteries); (ii) cigars and their components or parts (such as cigar tobacco); (iii) pipe tobacco; (iv) hookah products; or (v) any other tobacco product newly deemed by FDA. These deeming regulations apply to all products made or derived from tobacco intended for human consumption, but

excluding accessories of tobacco products (such as lighters).

The deeming regulations require us to (i) register with the FDA and report product and ingredient listings; (ii) market newly deemed products only after FDA review and approval; (iii) only make direct and implied claims of reduced risk if the FDA approves after finding that scientific evidence supports the claim and that marketing the product will benefit public health as a whole; (iv) refrain from distributing free samples; (v) implement minimum age and identification restrictions to prevent sales to individuals under age 18; (vi) develop an approved warning plan and include prescribed health warnings on packaging and advertisements; and (vii) refrain from selling the products in vending machines, unless the machine is located in a facility that never admits youth. Newly-deemed tobacco

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products are also subject to the other requirements of the Tobacco Control Act, such as that they not be adulterated or misbranded. The FDA could in the future promulgate good manufacturing practice regulations for these and our other products, which could have a material adverse impact on our ability and the cost to manufacture our products.

Marketing authorizations will be necessary in order for us to continue our distribution of NewGen and cigar and pipe tobacco products. Compliance dates vary depending upon type of application submitted, but all newly-deemed products will require an application no later than August 8, 2021, for combustible products (e.g. cigar and pipe) and August 8, 2022, for non-combustible products (e.g. vapor products) with the exception of our grandfathered products (products in commerce as of February 15, 2007) which are already authorized, unless FDA grants extensions to these compliance periods. We intend to timely file for the appropriate authorizations to allow us to sell our products in the U.S. We have no assurances that the outcome of such processes will result in our products receiving marketing authorizations from the FDA. We also have certain previously-regulated tobacco products which FDA removed from review but remain subject to provisional substantial equivalence filings made on March 22, 2011; however, FDA has the discretion to reinitiate review of these products. If the FDA establishes regulatory processes that we are unable or unwilling to comply with, our business, results of operations, financial condition and prospects could be adversely affected.

The anticipated costs of complying with future FDA regulations will be dependent on the rules issued by the FDA, the timing and clarity of any new rules or guidance documents accompanying these rules, the reliability and simplicity (or complexity) of the electronic systems utilized by FDA for information and reports to be submitted, and the details required by FDA for such information and reports with respect to each regulated product (which have yet to be issued by FDA). Failure to comply with existing or new FDA regulatory requirements could result in significant financial penalties and could have a material adverse effect on our business, results of operations, financial condition and ability to market and sell our products. Compliance and related costs could be substantial and could significantly increase the costs of operating in our NewGen and cigar and pipe tobacco product markets.

In addition, failure to comply with the Tobacco Control Act and with FDA regulatory requirements could result in litigation, criminal convictions or significant financial penalties and could impair our ability to market and sell our electronic and vaporizer products. At present, we are not able to predict whether the Tobacco Control Act will impact our products to a greater degree than competitors in the industry, thus affecting our competitive position.

Furthermore, neither the Prevent All Cigarette Trafficking Act nor the Federal Cigarette Labeling and Advertising Act currently apply to NewGen products. There may, in the future, also be increased regulation of additives in tobacco products and internet sales of NewGen products. The application of either or both of these federal laws, and of any new laws or regulations which may be adopted in the future, to NewGen products or such additives could result in additional expenses and require us to change our advertising and labeling, and methods of marketing and distribution of our products, any of which could have a material adverse effect on our business, results of operations and financial condition.

***Significant increases in state and local regulation of our NewGen products have been proposed or enacted and are likely to continue to be proposed or enacted in numerous jurisdictions.***

There has been increasing activity on the state and local levels with respect to scrutiny of NewGen products. State and local governmental bodies across the U.S. have indicated NewGen products may become subject to new laws and regulations at the state and local levels. Further, some states and cities, have enacted regulations that require obtaining a tobacco retail license in order to sell electronic cigarettes and vaporizer products. If one or more states from which we generate or anticipate generating significant sales of NewGen products bring actions to prevent us from selling our NewGen products unless we obtain certain licenses, approvals or permits, and if we are not able to obtain the necessary licenses, approvals or permits for financial reasons or otherwise and/or any such license, approval or permit

is determined to be overly burdensome to us, then we may be required to cease sales and distribution of our products to those states, which could have a material adverse effect on our business, results of operations and financial condition.

Certain states and cities have already restricted the use of electronic cigarettes and vaporizer products in smoke-free venues, imposed excise taxes, or limited sales of flavored NewGen products. Additional city, state or federal regulators, municipalities, local governments and private industry may enact additional rules and regulations restricting electronic cigarettes and vaporizer products. Because of these restrictions, our customers may reduce or otherwise cease using our NewGen products, which could have a material adverse effect on our business, results of operations and financial condition.

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***Increases in tobacco-related taxes have been proposed or enacted and are likely to continue to be proposed or enacted in numerous jurisdictions.***

Tobacco products, premium cigarette papers and tubes have long been subject to substantial federal, state and local excise taxes. Such taxes have frequently been increased or proposed to be increased, in some cases significantly, to fund various legislative initiatives or further disincentivize tobacco usage. Since 1986, smokeless products have been subject to federal excise tax. Smokeless products are taxed by weight (in pounds or fractional parts thereof) manufactured or imported.

Since the State Children's Health Insurance Program ( S-CHIP ) reauthorization in early 2009, which utilizes, among other things, taxes on tobacco products to fund health insurance coverage for children, the federal excise tax increases adopted have been substantial and have materially reduced sales in the roll your own ( RYO )/MYO cigarette smoking products market, and also caused volume declines in other markets. Although the RYO/MYO cigarette smoking tobacco and related products market had been one of the fastest growing markets in the tobacco industry in the five years prior to 2009, the reauthorization of S-CHIP increased the federal excise tax on RYO tobacco from \$1.10 to \$24.78 per pound, and materially reduced the MYO cigarette smoking tobacco market in the U.S. There have not been any increases announced since 2009, but we cannot guarantee that we will not be subject to further increases, nor whether any such increases will affect prices in a way that further deters consumers from purchasing our products and/or affects our net revenues in a way that renders us unable to compete effectively.

In addition to federal excise taxes, every state and certain city and county governments have imposed substantial excise taxes on sales of tobacco products, and many have raised or proposed to raise excise taxes in recent years. Approximately one-half of the states tax MST on a weight-based versus ad valorem system of taxation. Additional states may consider adopting such revised tax structures as well. Tax increases, depending on their parameters, may result in consumers switching between tobacco products or depress overall tobacco consumption, which is likely to result in declines in overall sales volumes.

Any future enactment of increases in federal or state excise taxes on our tobacco products or rulings that certain of our products should be categorized differently for excise tax purposes could adversely affect demand for our products and may result in consumers switching between tobacco products or a depression in overall tobacco consumption, which would have a material adverse effect on our business, results of operations and financial condition.

***If our NewGen products become subject to increased taxes it could adversely affect our business.***

Presently the federal government and most states do not tax the sale of NewGen products like the sale of conventional cigarettes or other tobacco products, all of which generally have high tax rates and have faced significant increases in the amount of taxes collected on their sales. In recent years, however, state and local governments have taken actions to move towards imposing excise taxes on NewGen products. As of December 31, 2018, California, Delaware, the District of Columbia, Kansas, Louisiana, Minnesota, New Jersey, North Carolina, Pennsylvania, West Virginia and certain localities impose excise taxes on electronic cigarettes and/or liquid vapor. Other jurisdictions are contemplating similar legislation and other restrictions on electronic cigarettes. Should federal, state and local governments and or other taxing authorities begin or continue to impose excise taxes similar to those levied against conventional cigarettes and tobacco products on NewGen products, it may have a material adverse effect on the demand for these products, as consumers may be unwilling to pay the increased costs, which in turn could have a material adverse effect on our business, results of operations and financial condition.

***We may be subject to increasing international control and regulation.***

The World Health Organization's Framework Convention on Tobacco Control ( FCTC ) is the first international public health treaty that establishes a global agenda to reduce initiation of tobacco use and regulate tobacco in an effort to encourage tobacco cessation. Over 170 governments worldwide have ratified the FCTC. The FCTC has led to increased efforts to reduce the supply and demand of tobacco products and to encourage governments to further regulate the tobacco industry. The tobacco industry expects significant regulatory developments to take place over the next few years, driven principally by the FCTC. Regulatory initiatives that have been proposed, introduced or enacted include:

- the levying of substantial and increasing tax and duty charges;
- restrictions or bans on advertising, marketing and sponsorship;

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- the display of larger health warnings, graphic health warnings and other labeling requirements;
- restrictions on packaging design, including the use of colors and generic packaging;
- restrictions or bans on the display of tobacco product packaging at the point of sale, and restrictions or bans on cigarette vending machines;
- requirements regarding testing, disclosure and performance standards for tar, nicotine, carbon monoxide and other smoke constituents levels;
- requirements regarding testing, disclosure and use of tobacco product ingredients;
- increased restrictions on smoking in public and work places and, in some instances, in private places and outdoors;
- elimination of duty free allowances for travelers; and
- encouraging litigation against tobacco companies.

If the U.S. becomes a signatory to the FCTC and/or national laws are enacted in the U.S. that reflect the major elements of the FCTC, our business, results of operations and financial condition could be materially and adversely affected. If NewGen products become subject to one or more of the significant regulatory initiatives proposed under the FCTC, our NewGen products segment may also be materially adversely affected.

As part of our strategy, we have begun strategic international expansions, such as introducing our moist snuff tobacco products in South America and cigar products in Canada. This and other future expansions may subject us to additional or increasing international regulation, either by the countries that are the object of the strategic expansion or through international regulatory regimes, such as the FCTC, to which those countries may be signatories.

Canada and some Canadian provinces have restricted or are contemplating restrictions on the sales and marketing of electronic cigarettes. Furthermore, some Canadian provinces have limited the use of electronic cigarettes and vaporizer products in public places. These measures, and any future measures taken to limit the marketing, sale and use of NewGen products may have a material adverse effect on our business, results of operations and financial condition.

To the extent our existing or future products become subject to international regulatory regimes that we are unable to comply with or fail to comply with, they may have a material adverse effect on our business, results of operations and financial condition.

***Our distribution efforts rely in part on our ability to leverage relationships with large retailers and national chains.***

Our distribution efforts rely in part on our ability to leverage relationships with large retailers and national chains to sell and promote our products, which is dependent upon the strength of the brand names that we own or license and our salesforce effectiveness. In order to maintain these relationships, we must continue to supply products that will bring steady business to these retailers and national chains. We may not be able to sustain these relationships or establish other relationships with such entities, which could have a material adverse effect on our ability to execute our branding strategies, our ability to access the end-user markets with our products or our ability to maintain our relationships with the producers of our products. For example, if we are unable to meet benchmarking provisions in contracts or if we are unable to maintain and leverage our retail relationships on a scale sufficient to make us an attractive distributor, it would have a material adverse effect on our ability to source products, and on our business, results of operations and financial condition. In addition, there are factors beyond our control that may prevent us from leveraging existing relationships, such as industry consolidation. If we are unable to develop and sustain relationships with large retailers and national chains, or are unable to leverage those relationships due to factors such as a decline in the role of brick-and-mortar retailers in the North American economy, our capacity to maintain and grow brand and product recognition and increase sales volume will be significantly undermined. In such an event, we may ultimately be forced to pursue and rely on local and more fragmented sales channels, which will have a material adverse effect on our business, results of operations and financial condition.





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### ***We have a substantial amount of indebtedness that could affect our financial condition.***

As of February 25, 2019, we had \$212.0 million outstanding under our credit facility with the ability to borrow an additional \$30.7 million under our revolving credit facility. If we cannot generate sufficient cash flow from operations to service our debt, we may need to further refinance our debt, dispose of assets or issue equity to obtain necessary funds. We do not know whether we will be able to do any of this on a timely basis or on terms satisfactory to us or at all.

Our substantial amount of indebtedness could limit our ability to:

- obtain necessary additional financing for working capital, capital expenditures or other purposes in the future;
- plan for, or react to, changes in our business and the industries in which we operate;
- make future acquisitions or pursue other business opportunities;
- react in an extended economic downturn; and
- pay dividends.

***The terms of the agreement governing our indebtedness may restrict our current and future operations, which would adversely affect our ability to respond to changes in our business and to manage our operations.***

Our 2018 Credit Facility contains, and any future indebtedness of ours would likely contain, a number of restrictive covenants that impose significant operating and financial restrictions on us, including restrictions on our ability to, among other things:

- incur additional debt;
- pay dividends and make other restricted payments;
- create liens;
- make investments and acquisitions;
- engage in sales of assets and subsidiary stock;
- enter into sale-leaseback transactions;
- enter into transactions with affiliates;
- transfer all or substantially all of our assets or enter into merger or consolidation transactions; and
- enter into certain hedging agreements.

Our 2018 Credit Facility requires, us to maintain certain financial ratios. As of December 31, 2018, we were in compliance with the financial and restrictive covenants of the 2018 Credit Facility. However, a failure by us to comply with the covenants or financial ratios in our debt instruments could result in an event of default under the applicable facility, which could adversely affect our ability to respond to changes in our business and manage our operations. In the event of any default under our 2018 Credit Facility, the lenders under our debt instruments could elect to declare all amounts outstanding under such instruments to be due and payable and require us to apply all of our available cash to repay these amounts. If the indebtedness under our 2018 Credit Facility were to be accelerated, which would cause an event of default and a cross-acceleration of our obligations under our other debt instruments, there can be no assurance that our assets would be sufficient to repay this indebtedness in full, which could have a material adverse effect on our business, results of operations, and financial condition.

### ***We face intense competition and may fail to compete effectively.***

We are subject to significant competition across our segments, and compete against companies in all segments that have access to significant resources in terms of technology, relationships with suppliers and distributors and access to cash flow and financial markets. The OTP industry is characterized by brand recognition and loyalty, with product quality, price, marketing and packaging constituting the primary methods of competition. Substantial marketing

support, merchandising display, competitive pricing and other financial incentives generally are required to introduce a new brand or to improve or maintain a brand's market position. Our principal competitors are big

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tobacco, Altria Group, Inc. (formerly Phillip Morris) and British American Tobacco p.l.c. (formerly Reynolds) as well as Swedish Match, Swisher International and manufacturers of electronic cigarettes, including U.K.-based Imperial Brands PLC. These competitors are significantly larger than us and aggressively seek to limit the distribution or sale of other companies' products, both at the wholesale and retail levels. For example, certain competitors have entered into agreements limiting retail-merchandising displays of other companies' products or imposing minimum prices for OTP products, thereby limiting their competitors' ability to offer discounted products. In addition, the tobacco industry is experiencing a trend toward industry consolidation, most recently evidenced by the December 2018 investment in Juul Labs by Altria, the July 2017 acquisition of Reynolds American, Inc., by British American Tobacco p.l.c., and the June 2015 acquisition of Lorillard, Inc., by Reynolds American, Inc. Industry consolidation could result in a more competitive environment if our competitors are able to increase their combined resources, enhance their access to national distribution networks, or become acquired by established companies with greater resources than ours. Any inability to compete due to our smaller scale as the industry continues to consolidate and be dominated by big tobacco could have a material adverse effect on our business, results of operations and financial condition.

The competitive environment and our competitive position is also significantly influenced by economic conditions, the state of consumer confidence, competitors' introduction of low-priced products or innovative products, higher taxes, higher absolute prices and larger gaps between price categories and product regulation that diminishes the consumer's ability to differentiate tobacco products. Due to the impact of these factors, as well as higher state and local excise taxes and the market share of deep discount brands, the tobacco industry has become increasingly price competitive. As we seek to adapt to the price competitive environment, our competitors that are better capitalized may be able to sustain price discounts for long periods of time by spreading the loss across their expansive portfolios, with which we are not positioned to compete.

Big tobacco has also established its presence in the NewGen products market. There can be no assurance that our products will be able to compete successfully against these companies or any of our other competitors, some of which have far greater resources, capital, experience, market penetration, sales and distribution channels than us. In addition, there are currently no U.S. restrictions on advertising electronic cigarettes and vaporizer products and competitors, including big tobacco, may have more resources than us for advertising expenses, which could have a material adverse effect on our ability to build and maintain market share, and thus have a material adverse effect on our business, results of operations and financial condition.

### ***The market for NewGen products is subject to a great deal of uncertainty and is still evolving.***

Vaporizer products and electronic cigarettes, having recently been introduced to market, are at an early stage of development, and represent core components of a market that is evolving rapidly and is characterized by a number of market participants. Rapid growth in the use of, and interest in, vaporizer products and electronic cigarettes is recent, and may not continue on a lasting basis. The demand and market acceptance for these products is subject to a high level of uncertainty. Therefore, we are subject to all of the business risks associated with a new enterprise in an evolving market. Continued evolution, uncertainty and the resulting increased risk of failure of our new and existing product offerings in this market could have a material adverse effect on our ability to build and maintain market share and on our business, results of operations and financial condition. Further, there can be no assurance that we will be able to continue to effectively compete in the NewGen products marketplace.

### ***We are subject to significant product liability litigation.***

The tobacco industry has experienced, and continues to experience, significant product liability litigation. Most tobacco liability lawsuits have been brought against manufacturers and sellers of cigarettes by individual plaintiffs, often participating on a class-action basis, for injuries allegedly caused by cigarette smoking or by exposure to cigarette smoke. However, several lawsuits have also been brought against us and other manufacturers and sellers of

smokeless products for injuries to health allegedly caused by use of smokeless products. There are several such suits pending against us with limited activity. In addition to the risks to our business, results of operations and financial condition resulting from adverse results in any such action, ongoing litigation may divert management's attention and resources, which could have an impact on our business and operations. We cannot predict with certainty the outcome of these claims and there can be no assurance that we will not sustain losses in connection with such lawsuits and that such losses will not have a material adverse effect on our business, results of operations and financial condition.

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In addition to current and potential future claims related to our smoking and smokeless products, we are subject to several lawsuits alleging personal injuries resulting from malfunctioning vaporizer devices and may be subject to claims in the future relating to our other NewGen products. We are still evaluating these claims and the potential defenses to them. As a result of their relative novelty, electronic cigarette and vaporizer product manufacturers and sellers have only recently become subject to litigation. We may see increasing litigation over NewGen products or the regulation of our products, as the regulatory regimes surrounding these products develop. For a description of current material litigation to which we or our subsidiaries are a party, see Item 3. Legal Proceedings.

As a result, we may face substantial costs due to increased product liability litigation relating to new regulations or other potential defects associated with NewGen products we ship, which could have a material adverse effect on our business, results of operations and financial condition.

***The scientific community has not yet studied extensively the long-term health effects of electronic cigarette, vaporizer or e-liquids products use.***

Electronic cigarettes, vaporizers and related products were recently developed and therefore the scientific community has not had a sufficient period of time to study the long-term health effects of their use. Currently, there is no way of knowing whether these products are safe for their intended use. If the scientific community were to determine conclusively that use of any or all of these products poses long-term health risks, market demand for these products and their use could materially decline. Such a determination could also lead to litigation and significant regulation. Loss of demand for our product, product liability claims and increased regulation stemming from unfavorable scientific studies on these products could have a material adverse effect on our business, results of operations and financial condition.

***We are required to maintain cash amounts within an escrow account in order to be compliant with a settlement agreement between us and certain U.S. states and territories.***

In November 1998, the major U.S. cigarette manufacturers entered into the Master Settlement Agreement ( MSA ) and the Smokeless Tobacco Master Settlement Agreement ( STMSA ) with 46 U.S. states and certain U.S. territories and possessions. Pursuant to the MSA and subsequent states' statutes, a cigarette manufacturer (which is defined to also include a manufacturer of RYO/MYO cigarette tobacco) has the option of either becoming a signatory to the MSA, or, as we have elected, operating as a non-participating manufacturer ( NPM ) by funding and maintaining an escrow account, with sub-accounts on behalf of each settling state. These NPM escrow accounts are governed by states' escrow and complementary statutes that are generally monitored by the Office of the State Attorney General. The statutes require NPM companies to deposit, on an annual basis, into qualified banks' escrow funds based on the number of cigarettes or cigarette equivalents, which is measured by pounds of RYO/MYO tobacco sold. NPM companies are, within specified limits, entitled to direct the investment of the escrowed funds and withdraw any interest or appreciation, but cannot withdraw the principal for twenty-five years from the year of each annual deposit, except to withdraw funds deposited pursuant to an individual state's escrow statute to pay a final judgment to that state's plaintiffs in the event of such a final judgment. The investment vehicles available to us are specified in the state escrow agreements and are limited to low-risk government securities.

Various states have enacted or proposed complementary legislation intended to curb the activity of certain manufacturers and importers of cigarettes or MYO tobacco that are selling into MSA states without signing the MSA or who have failed to properly establish and fund a qualifying escrow account. We believe we have been fully compliant with all applicable laws, regulations, and statutes, although compliance-related issues may, from time to time, be disruptive to our business, any of which could have a material adverse effect on our business, results of operations, and financial condition.

Pursuant to the NPM escrow account statutes, in order to be compliant with the NPM escrow requirements, we are required to deposit such funds for each calendar year into a qualifying escrow account by April 15 of the following year with each year's deposit being released from escrow after 25 years. During 2018 we deposited less than \$0.1 million relating to 2017 sales. We discontinued our MYO tobacco line in the third quarter of 2017. As of December 31, 2018, we had made deposits of approximately \$32.1 million. Thus, pending a change in MSA legislation, we have no remaining product lines covered by the MSA and will not be required to make future escrow deposits.

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Although no such legislation has been proposed or enacted, future changes to the MSA, such as legislation that extends the MSA to products to which it does not currently apply or legislation that limits the ability of companies to receive unused escrow funds after 25 years, may have a material adverse effect on our business, results of operations and financial condition. Despite the amounts maintained and funded to the escrow account, compliance with the funding requirements for the escrow account does not necessarily prevent future federal and/or state regulations with respect to the OTP industry from having a material adverse effect on our business, results of operations and financial condition.

***Competition from illicit sources may have an adverse effect on our overall sales volume, restricting the ability to increase selling prices and damaging brand equity.***

Illicit trade and tobacco trafficking in the form of counterfeit products, smuggled genuine products and locally manufactured products on which applicable taxes are evaded, represent a significant and growing threat to the legitimate tobacco industry. Factors such as increasing tax regimes, regulatory restrictions, and compliance requirements are encouraging more consumers to switch to illegal, cheaper tobacco products and providing greater rewards for smugglers. Illicit trade can have an adverse effect on our overall sales volume, restrict the ability to increase selling prices, damage brand equity and may lead to commoditization of our products.

Although we combat counterfeiting of our products by engaging in certain tactics, such as requiring all sales force personnel to randomly collect our products from retailers in order to be tested by our quality control team, maintaining a quality control group that is responsible for identifying counterfeit products and using a private investigation firm to help perform surveillance of retailers we suspect are selling counterfeit products, no assurance can be given that we will be able to detect or stop sales of all counterfeit products. In addition, we have in the past and will continue to bring suits against retailers and distributors that sell certain counterfeit products. While we have been successful in securing financial recoveries from and helping to obtain criminal convictions of counterfeiters in the past, no assurance can be given that we will be successful in any such suits or that such suits will be successful in stopping other retailers or distributors from selling counterfeit products. Even if we are successful, such suits could consume a significant amount of management's time and could also result in significant expenses to the company. Any failure to track and prevent counterfeiting of our products could have a material adverse on our ability to maintain or effectively compete for the products we distribute under our brand names, which would have a material adverse effect on our business, results of operations and financial condition.

***Reliance on information technology means a significant disruption could affect our communications and operations.***

We increasingly rely on information technology systems for our internal communications, controls, reporting and relations with customers and suppliers and information technology is becoming a significantly important tool for our sales staff. Our marketing and distribution strategy is dependent upon our ability to closely monitor consumer and market trends on a highly specified level, for which we are reliant on our highly sophisticated data tracking systems, which are susceptible to disruption or failure. In addition, our reliance on information technology exposes us to cyber-security risks, which could have a material adverse effect on our ability to compete. Security and privacy breaches may expose us to liability and cause us to lose customers, or may disrupt our relationships and ongoing transactions with other entities with whom we contract throughout our supply chain. The failure of our information systems to function as intended, or the penetration by outside parties intent on disrupting business processes, could result in significant costs, loss of revenue, assets or personal or other sensitive data and reputational harm.

***Security and privacy breaches may expose us to liability and cause us to lose customers.***

Federal and state laws require us to safeguard our wholesalers and retailers financial information, including credit information. Although we have established security procedures to protect against identity theft and the theft of our customers and distributors financial information, our security and testing measures may not prevent security breaches and breaches of privacy may occur and could harm our business. Typically, we rely on encryption and authentication technology licensed from third parties to enhance transmission security of confidential information in relation to financial and other sensitive information that we have on file. Advances in computer capabilities, new discoveries in the field of cryptography, inadequate facility security or other developments may result in a compromise or breach of the technology used by us to protect customer data. Any compromise of our security could harm our reputation or financial condition and, therefore, our business. In addition, a party who is able to circumvent our security measures or exploit inadequacies in our security measures, could, among other effects, misappropriate



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proprietary information, cause interruptions in our operations or expose customers and other entities with which we interact to computer viruses or other disruptions. Actual or perceived vulnerabilities may lead to claims against us. To the extent the measures we have taken prove to be insufficient or inadequate, we may become subject to litigation or administrative sanctions, which could result in significant fines, penalties or damages and harm to our reputation.

### ***Contamination of, or damage to, our products could adversely impact sales volume, market share and profitability.***

Our market position may be affected through the contamination of our tobacco supply or products during the manufacturing process or at different points in the entire supply chain. We keep significant amounts of inventory of our products in warehouses and it is possible that this inventory could become contaminated prior to arrival at our premises or during the storage period. If contamination of our inventory or packaged products occurs, whether as a result of a failure in quality control by us or by one of our suppliers, we may incur significant costs in replacing the inventory and recalling products. We may be unable to meet customer demand and may lose customers who purchase alternative brands or products. In addition, consumers may lose confidence in the affected product.

Under the terms of our contracts, we impose requirements on our suppliers to maintain quality and comply with product specifications and requirements, and on our third-party co-manufacturer to comply with all federal, state and local laws. These third-party suppliers, however, may not continue to produce products that are consistent with our standards or that are in compliance with applicable laws, and we cannot guarantee that we will be able to identify instances in which our third-party suppliers fail to comply with our standards or applicable laws. A loss of sales volume from a contamination event may occur, and such a loss may affect our ability to supply our current customers and to recapture their business in the event they are forced to switch products or brands, even if on a temporary basis. We may also be subject to legal action as a result of a contamination, which could result in negative publicity and affect our sales. During this time, our competitors may benefit from an increased market share that could be difficult and costly to regain. Such a contamination event could have a material adverse effect on our business, results of operations and financial condition.

### ***Our intellectual property may be infringed.***

We currently rely on trademark and other intellectual property rights to establish and protect the brand names and logos we own or license. Third parties have in the past infringed, and may in the future infringe, on these trademarks and our other intellectual property rights. Our ability to maintain and further build brand recognition is dependent on the continued and exclusive use of these trademarks, service marks and other proprietary intellectual property, including the names and logos we own or license. Despite our attempts to ensure these intellectual property rights are protected, third parties may take actions that could materially and adversely affect our rights or the value of this intellectual property. Any litigation concerning our intellectual property rights, whether successful or unsuccessful, could result in substantial costs to us and diversions of our resources. Expenses related to protecting our intellectual property rights, the loss or compromise of any of these rights or the loss of revenues as a result of infringement could have a material adverse effect on our business, results of operations and financial condition, and may prevent the brands we own or license from growing or maintaining market share.

### ***Third parties may claim that we infringe their intellectual property and trademark rights.***

Competitors in the tobacco products and NewGen markets may claim that we infringe their proprietary rights. Such claims, whether or not meritorious, may result in the expenditure of significant financial and managerial resources, injunctions against us or the payment of damages. Further, our vapor distribution businesses distribute third party product brands with those suppliers' branding and imagery. If that branding or imagery is alleged by other parties to infringe or otherwise violate intellectual property rights, we could be drawn into such litigation.

***We may fail to manage our growth.***

We have expanded over our history and intend to grow in the future. We acquired the *Stoker's*<sup>®</sup> brand in 2003, and have continued to develop it through the introduction of new products, such as moist snuff. Our acquisition of the VaporBeast<sup>®</sup> brand in 2016 accelerated our entry into non-traditional retail channels. More recently, our September 2018 acquisition of IVG adds a top vapor B2C platform which enhances our marketing and selling of proprietary and third party vapor products to adult consumers. We have also focused on growing our relationships with our key suppliers through expansion into new product lines such as MYO cigar wraps, which are sourced from

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Durfort. However, any future growth will place additional demands on our resources, and we cannot be sure we will be able to manage our growth effectively. If we are unable to manage our growth while maintaining the quality of our products and profit margins, or if new systems that we implement to assist in managing our growth do not produce the expected benefits, our business, financial position, results of operations and cash flows could be adversely affected. We may not be able to support, financially or otherwise, future growth, or hire, train, motivate and manage the required personnel. Our failure to manage growth effectively could also limit our ability to achieve our goals as they relate to streamlined sales, marketing and distribution operations and the ability to achieve certain financial metrics.

***We may fail to successfully integrate our acquisitions or otherwise be unable to benefit from pursuing acquisitions.***

We believe there are meaningful opportunities to grow through acquisitions and joint ventures across all OTP product categories and we expect to continue a strategy of selectively identifying and acquiring businesses with complementary products. We may be unable to identify, negotiate, and complete suitable acquisition opportunities on reasonable terms. There can be no assurance that any business acquired by us will be successfully integrated with our operations or prove to be profitable to us. We may incur future liabilities related to acquisitions. Should any of the following problems, or others, occur as a result of our acquisition strategy, the impact could be material:

- difficulties integrating personnel from acquired entities and other corporate cultures into our business;
- difficulties integrating information systems;
- the potential loss of key employees of acquired companies;
- the assumption of liabilities and exposure to undisclosed or unknown liabilities of acquired companies; or
- the diversion of management attention from existing operations.

***We are subject to fluctuations in our results that make it difficult to track trends and develop strategies in the short-term.***

In response to competitor actions and pricing pressures, we have engaged in significant use of promotional and sales incentives. We regularly review the results of our promotional spending activities and adjust our promotional spending programs in an effort to maintain our competitive position. Accordingly, unit sales volume and sales promotion costs in any period are not necessarily indicative of sales and costs that may be realized in subsequent periods. Additionally, promotional activity significantly increases net sales in the month in which it is initiated and net sales are adversely impacted in the month after a promotion. Accordingly, based upon the timing of our marketing and promotional initiatives, we have and may continue to experience significant variability in our results, which could affect our ability to formulate strategies that allow us to maintain our market presence across volatile periods. If our fluctuations obscure our ability to track important trends in our key markets, it may have a material adverse effect on our business, results of operations and financial condition.

***We are subject to the risks of exchange rate fluctuations.***

Currency movements and suppliers' price increases relating to premium cigarette papers and cigarette tubes are the primary factors affecting our cost of sales. These products are purchased from Bolloré and we make payments in euros. Thus, we bear certain foreign exchange rate risk for certain of our inventory purchases. In addition, as part of our strategy, we have begun strategic international expansions. As a result, we may be more sensitive to the risks of exchange rate fluctuations. To manage this risk, we sometimes utilize short-term forward currency contracts to purchase euros for our inventory purchases. We have a foreign exchange currency policy which governs our hedging of risk. While we engage in hedging transactions from time to time, no assurance can be made that we will be successful in eliminating currency exchange risks or that changes in currency rates will not have a material adverse effect on our business, results of operations and financial condition.

***Adverse U.S. and global economic conditions could negatively impact our business, prospects, results of operations, financial condition or cash flows.***

Our business and operations are sensitive to global economic conditions. These conditions include interest rates, energy costs, inflation, recession, fluctuations in debt and equity capital markets and the general condition of the U.S. and world economy. A material decline in the economic conditions affecting consumers, which cause a reduction in

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disposable income for the average consumer, may change consumption patterns, and may result in a reduction in spending on OTP or a switch to cheaper products or products obtained through illicit channels. Electronic cigarettes, vaporizer and e-liquid products are relatively new to market and may be regarded by users as a novelty item and expendable. As such, demand for our NewGen products may be particularly sensitive to economic conditions such as inflation, recession, high energy costs, unemployment, changes in interest rates and money supply, changes in the political environment and other factors beyond our control, any combination of which could result in a material adverse effect on our business, results of operations and financial condition.

***Our supply to our wholesalers and retailers is dependent on the demands of their customers who are sensitive to increased sales taxes and economic conditions affecting their disposable income.***

Consumer purchases of tobacco products are historically affected by economic conditions, such as changes in employment, salary and wage levels, the availability of consumer credit, inflation, interest rates, fuel prices, sales taxes, and the level of consumer confidence in prevailing and future economic conditions. Discretionary consumer purchases, such as of OTP, may decline during recessionary periods or at other times when disposable income is lower and taxes may be higher.

In addition, states such as New York, Hawaii, Rhode Island, Georgia and North Carolina have begun collecting taxes on internet sales where companies have used independent contractors in those states to solicit sales from residents of those states. These taxes apply to our online sales of NewGen products into those states, and may result in reduced demand from the independent wholesalers who may not be able to absorb the increased taxes or successfully pass them onto the end-user without experiencing reduced demand. Further, as a result of *South Dakota v. Wayfair*, states are now able to impose sales tax on internet purchases made from out-of-state sellers, even if the seller does not have a physical presence in the taxing state. Consequently, additional states are likely to seek to impose sales tax on our online sales. The requirement to collect, track and remit taxes may require us to increase our prices, which may affect demand for our products or conversely reduce our net profit margin, which could have a material adverse effect on our business, results of operations and financial condition.

***Our failure to comply with certain environmental, health and safety regulations could adversely affect our business.***

The storage, distribution and transportation of some of the products that we sell are subject to a variety of federal and state environmental regulations. In addition, our manufacturing facilities are similarly subject to federal, state and local environmental laws. We are also subject to operational, health and safety laws and regulations. Our failure to comply with these laws and regulations could cause a disruption in our business, an inability to maintain our manufacturing resources, and additional and potentially significant remedial costs and damages, fines, sanctions or other legal consequences that could have a material adverse effect on our business, results of operations and financial condition.

***The departure of key management personnel and the failure to attract and retain talent could adversely affect our operations.***

Our success depends upon the continued contributions of our senior management. Our ability to implement our strategy of attracting and retaining the best talent may be impaired by the decreasing social acceptance of OTP usage. The OTP industry competes for talent with the consumer products industry and other companies that enjoy greater societal acceptance. As a result, we may be unable to attract and retain the best talent, which could have a material adverse effect on our business, results of operations and financial condition.

***Imposition of significant tariffs on imports into the U.S., could have a material and adverse effect on our business.***

We are required to purchase all our cigarette papers, cigarette tubes and cigarette injector machines from Bolloré in France. Additionally, a substantial portion of our NewGen products are sourced from China. In 2018, President Trump and his administration imposed significant additional tariffs on certain goods imported from outside the U.S. and could impose additional tariffs in the future. These additional tariffs apply to a significant portion of our NewGen products and may result in increased prices for our customers. These increased prices may reduce demand where customers are unable to absorb the increased prices or successfully pass them onto the end-user. If the U.S. were to impose additional tariffs on goods we import, it is likely to make it more costly for us to import goods from other countries. As a result, our business, financial condition and results of operations could be materially adversely affected.

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***The reduced disclosure requirements applicable to emerging growth companies may make our common stock less attractive to investors, potentially decreasing our stock price.***

We are an emerging growth company as defined under the federal securities laws. For as long as we continue to be an emerging growth company, we may take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not Emerging Growth Companies. Investors may find our common stock less attractive because we may rely on these exemptions, which include but are not limited to, not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act ( Section 404 ), reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and shareholder approval of any golden parachute payments not previously approved. In addition, Section 107 of the JOBS Act ( Section 107 ) provides that an Emerging Growth Company can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. We have elected to opt out of the extended transition period for complying with the revised accounting standards.

If investors find our common stock less attractive as a result of exemptions and reduced disclosure requirements, there may be a less active trading market for our common stock and our stock price may be more volatile or decrease.

***We may lose our status as an emerging growth company before the five-year maximum time period a company may retain such status.***

We have elected to rely on certain exemptions and reduced disclosure requirements applicable to emerging growth companies and expect to continue to do so. However, we may choose to opt out of such reduced disclosure requirements and provide disclosure required for companies that do not qualify as emerging growth companies. In addition, we chose to opt out of the provision of the JOBS Act that permits us to take advantage of an extended transition period to comply with new or revised accounting standards applicable to public companies. Section 107 provides that our decision to opt out of the extended transition period for complying with new or revised accounting standards would be irrevocable.

Furthermore, although we are able to remain an emerging growth company for up to five years, we may lose such status at an earlier time if (i) our annual gross revenues exceed \$1 billion, (ii) we become a large accelerated filer as defined in Rule 12b-2 under the Exchange Act, which would occur if the market value of our common stock that is held by non-affiliates exceeds \$700 million as of the last business day of our most recently completed second fiscal quarter, or (iii) we issued more than \$1 billion in non-convertible debt during the preceding three-year period.

When we lose our emerging growth company status, whether due to an election, the end of the five-year period, or one of the circumstances listed in the preceding paragraph, the emerging growth company exemptions will cease to apply and we expect we will incur additional expenses and devote increased management effort toward ensuring compliance with the non-emerging growth company requirements. We cannot predict or estimate the amount of additional costs we may incur as a result of the change in our status or the timing of such costs, though such costs may be substantial.

***Our principal stockholders are able to exert significant influence over matters submitted to our stockholders and may take certain actions to prevent takeovers.***

Standard Diversified Inc. ( SDI ), which is controlled by funds managed by Standard General L.P. (together with the funds it manages, Standard General ), is a significant stockholder. SDI owns approximately 50.3% of our stock and Standard General directly owns approximately 3.4% of our common stock. The existence of these and other significant stockholders may have the effect of deterring hostile takeovers, delaying or preventing changes in control or changes in management, or limiting the ability of our other stockholders to approve transactions that they may

deem to be in the best interests of our company. In addition, our significant stockholders will be able to exert significant influence over the decision, if any, to authorize additional capital stock, which, if issued, could have a significant dilutive effect on holders of common stock.

Our certificate of incorporation provides that the doctrine of corporate opportunity will not apply against SDI and Standard General in a manner that would prohibit them from investing in competing businesses or doing business with our customers. To the extent they invest in such other businesses, SDI and Standard General may have differing interests than our other stockholders. In addition, SDI and Standard General are permitted to engage in business activities or invest in or acquire businesses which may compete with or do business with any competitors of ours.



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Furthermore, Standard General is in the business of managing investment funds and therefore may pursue acquisition opportunities that may be complementary to our business and, as a result, such acquisition opportunities may not be available to us.

***Our certificate of incorporation and bylaws, as well as Delaware law and certain regulations, could discourage or prohibit acquisition bids or merger proposals, which may adversely affect the market price of our common stock.***

Our certificate of incorporation authorizes our board of directors to issue preferred stock without stockholder approval. If our board of directors elects to issue preferred stock, it could be more difficult for a third party to acquire us. In addition, some provisions of our certificate of incorporation, bylaws and applicable law could make it more difficult for a third party to acquire control of us, even if the change of control would be beneficial to our stockholders, including:

- limitations on the removal of directors;
- limitations on the ability of our stockholders to call special meetings;
- limitations on stockholder action by written consent;
- establishing advance notice provisions for stockholder proposals and nominations for elections to the board of directors to be acted upon at meetings of stockholders; and
- limitations on the ability of our stockholders to fill vacant directorships or amend the number of directors constituting our board of directors.

***Our certificate of incorporation limits the ownership of our common stock by individuals and entities that are Restricted Investors. These restrictions may affect the liquidity of our common stock and may result in Restricted Investors being required to sell or redeem their shares at a loss or relinquish their voting, dividend and distribution rights.***

For so long as we or one of our subsidiaries is party to any of the Bolloré distribution agreements, our certificate of incorporation will limit the ownership of our common stock by any Restricted Investor to 14.9% of our outstanding common stock and shares convertible or exchangeable therefor (including our non-voting common stock) (the Permitted Percentage). A Restricted Investor is defined as: (i) any entity that directly or indirectly manufactures, sells, markets, distributes or otherwise promotes cigarette paper booklets, filter tubes, injector machines or filter tips in the United States, the District of Columbia, the territories, possessions and military bases of the United States and the Dominion of Canada (a Bolloré Competitor), (ii) any entity that owns more than a 20% equity interest in any Bolloré Competitor, or (iii) any person who serves as a director or officer of, or any entity that has the right to appoint an officer or director of, any Bolloré Competitor or of any Entity that owns more than a 20% equity interest in any Bolloré Competitor (each, a Restricted Investor). Our certificate of incorporation further provides that any issuance or transfer of shares to a Restricted Investor in excess of the Permitted Percentage will be ineffective as against us and that neither we nor our transfer agent will register the issuance or transfer of shares or be required to recognize the transferee or owner as a holder of our common stock for any purpose except to exercise our remedies described below. Any shares in excess of the Permitted Percentage in the hands of a Restricted Investor will not have any voting or dividend rights and are subject to redemption by us in our discretion. The liquidity or market value of the shares of our common stock may be adversely impacted by such transfer restrictions.

As a result of the above provisions, a proposed transferee of our common stock that is a Restricted Investor may not receive any return on its investment in shares it purchases or owns, as the case may be, and it may sustain a loss. We are entitled to redeem all or any portion of such shares acquired by a Restricted Investor in excess of the Permitted Percentage ( Excess Shares ) at a redemption price based on a fair market value formula that is set forth in our certificate of incorporation, which may be paid in any form, including cash or promissory notes, at our discretion. Excess Shares not yet redeemed will not be accorded any voting, dividend or distribution rights while they constitute Excess Shares. As a result of these provisions, a stockholder who is a Restricted Investor may be required to sell its

shares of our common stock at an undesirable time or price and may not receive any return on its investment in such shares. However, we may not be able to redeem Excess Shares for cash because our operations may not have generated sufficient excess cash flow to fund the redemption and we may incur additional indebtedness to fund all or a portion of such redemption, in which case our financial condition may be materially weakened.

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Our certificate of incorporation permits us to require that owners of any shares of our common stock provide certification of their status as a Restricted Investor. In the event that a person does not submit such documentation, our certificate of incorporation provides us with certain remedies, including the suspension of the payment of dividends and distributions with respect to shares held by such person and deposit of any such dividends and distributions into an escrow account. As a result of non-compliance with these provisions, an owner of the shares of our common stock may lose significant rights associated with those shares.

Although our certificate of incorporation contains the above provisions intended to assure compliance with the restrictions on ownership of our common stock by Restricted Investors, we may not be successful in monitoring or enforcing the provisions. A failure to enforce or otherwise maintain compliance could lead Bollore to exercise its termination rights under the agreements, which would have a material and adverse effect on the Company's financial position and its results of operations.

In addition to the risks described above, the foregoing restrictions could delay, defer or prevent a transaction or change in control that might involve a premium price for our common stock or that might otherwise be in the best interest of our stockholders.

***Future sales of our common stock in the public market could reduce our stock price, and any additional capital raised by us through the sale of equity or convertible securities may dilute our stockholders.***

We may sell additional shares of common stock in subsequent public offerings. We may also issue additional shares of common stock or convertible securities.

We cannot predict the size of future issuances of our common stock or securities convertible into common stock or the effect, if any, that future issuances and sales of shares of our common stock will have on the market price of our common stock. Sales of substantial amounts of our common stock (including shares issued in connection with an acquisition), or the perception that such sales could occur, may adversely affect prevailing market prices of our common stock.

***We may issue preferred stock whose terms could adversely affect the voting power or value of our common stock.***

Our certificate of incorporation authorizes us to issue, without the approval of our stockholders, one or more classes or series of preferred stock having such designations, preferences, limitations and relative rights, including preferences over our common stock respecting dividends and distributions, as our board of directors may determine. The terms of one or more classes or series of preferred stock could adversely impact the voting power or value of our common stock. For example, we might grant holders of preferred stock the right to elect some number of our directors in all events or on the happening of specified events or the right to veto specified transactions. Similarly, the repurchase or redemption rights or liquidation preferences we might assign to holders of preferred stock could affect the residual value of the common stock.

***Our status as a controlled company could make our common stock less attractive to some investors or otherwise harm our stock price.***

Because we qualify as a controlled company under the corporate governance rules for NYSE-listed companies we are not required to have, and could elect in the future not to have, a majority of our board of directors be independent, a compensation committee, or an independent nominating function. Accordingly, should the interests of our controlling stockholder differ from those of other stockholders, the other stockholders may not have the same protections afforded to stockholders of companies subject to all of the corporate governance rules for NYSE-listed companies. Our status as a controlled company could make our common stock less attractive to some investors or otherwise harm our stock

price.

**Item 1B. Unresolved Staff Comments**

None

**Item 2. Properties**

As of December 31, 2018, we operated manufacturing, distribution, retail, office, and warehouse space in the U.S. with a total floor area of approximately 410,000 square feet, all of which is leased with the exception of our Dresden, Tennessee, manufacturing facility which we purchased in 2016. To provide a cost-efficient supply of

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products to our customers, we maintain centralized management of internal manufacturing and nationwide distribution facilities. Our three manufacturing and distribution facilities are located in Louisville, Kentucky, Dresden, Tennessee, and Miami, Florida. We believe our facilities are generally adequate for our current and anticipated future use.

The following table describes our principal properties as of December 31, 2018:

<b>Location</b>	<b>Principal Use</b>	<b>Segments that use the Property(ies)</b>	<b>Square Feet</b>	<b>Owned or Leased</b>
Darien, CT	Administrative office	All segments	1,950	Leased
Louisville, KY	Corporate offices, manufacturing, R&D, warehousing, and distribution	All segments	248,800	Leased
Carlsbad, CA	Administrative office	NewGen	10,491	Leased
Dresden, TN	Manufacturing and administration	Smokeless	76,600	Owned
Miami, FL	Administrative offices, manufacturing, and warehousing	NewGen	40,662	Leased
Various cities in Florida	Sixteen retail stores	NewGen	16,974	Leased
Various cities in Oklahoma	Seven retail stores	NewGen	14,660	Leased

### **Item 3. Legal Proceedings**

We are a party from time to time to various proceedings in the ordinary course of business. For a description of the Master Settlement Agreement, to which we are a party, see Financial Statements and Supplementary Data - Note 2 Summary of Significant Accounting Policies: Risk and Uncertainties. Other than the proceedings mentioned below, there is no material litigation, arbitration or governmental proceeding currently pending against us or any of our officers or directors in their capacity as such, and we and our officers and directors have not been subject to any such proceeding.

Other major tobacco companies are defendants in product liability claims. The Company has been a defendant in a number of smokeless tobacco product liability cases in the past. All of those cases have been dismissed with prejudice and the Company has no tobacco product liability cases against it. The Company is subject to several lawsuits alleging personal injuries resulting from allegedly malfunctioning vaporizer devices and batteries and may be subject to claims in the future relating to other NewGen products. The Company is still evaluating these claims and the potential defenses to them. For example, the Company did not design or manufacture the products at issue; rather, the Company was merely the distributor. Nonetheless, there can be no assurance that the Company will prevail in these cases, and they could have a material adverse effect on the financial position, results of operations, or cash flows of the Company. See Risk Factors—We are subject to significant product liability litigation.

The Company is engaged in discussions and mediation with VMR and Juul, which acquired VMR in 2018. Pursuant to a Distribution and Supply Agreement ( VMR Agreement ), VMR was providing the Company with V2 e-cigarettes for exclusive distribution in bricks-and-mortar stores in the United States. Under the terms of the VMR Agreement, in

the event of termination following a change in control, the acquirer is required to make a payment to the Company under a formula designed to provide the Company with a fair share of the value created by the Company's performance under the VMR Agreement. Thus, the impact on our financial position, results of operations, or cash flows are uncertain as of December 31, 2018.

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**Item 4. Mine Safety Disclosures**

Not applicable.

**Executive Officers of the Registrant**

Listed below are the executive officers of the Company. Our executive officers are appointed by, and serve at the discretion of, our board of directors. There are no family relationships between any of the executive officers, and there is no arrangement or understanding between any executive officer and any other person pursuant to which the executive officer was selected.

*Lawrence S. Wexler*, age 65, has served as our President and CEO since June 2009 and as President and Chief Operating Officer of NATC, our primary operating subsidiary since June 2006. Prior to June 2006, Mr. Wexler had been the Chief Operating Officer of NATC since June 2005, and prior to that, the President and Chief Operating Officer of one of our other subsidiaries since December 2003. Mr. Wexler was a consultant to a number of emerging marketing, communication, and financial companies, advising them on financial, marketing and strategic matters, at times in an operating role, from 1998 to 2003. From 1977 to 1998, he was employed by Philip Morris, USA in various positions in the Sales, Marketing, and Finance Departments. As Group Director, Discount Brands, his group introduced the Basic and Alpine brands. He served as Senior Vice President of Marketing from 1992 to 1993 and Senior Vice President Finance, Planning, and Information Services from 1993 until his departure in 1998. Mr. Wexler holds a bachelor of science in administrative science from Yale and a master of business administration from Stanford.

*Robert Lavan*, age 36, joined us as Chief Financial Officer in March 2018 and served as a consultant for us since January 2018. Prior to joining the company, Mr. Lavan was the Chief Financial Officer of General Wireless Operations from January 2017 to January 2018, where he was responsible for revamping the company's financial reporting systems and building a robust distribution platform that linked multiple eCommerce sites and Amazon. From 2014 until Mr. Lavan's appointment as Chief Financial Officer of General Wireless Operations, Mr. Lavan served as an analyst for Standard General LP, a New York-based investment firm that is the majority shareholder of Standard Diversified Inc. (SDI), TPB's majority shareholder. Before that, Mr. Lavan worked at SAC Capital and J. Goldman & Co. LP in various analyst and portfolio manager roles covering a wide range of industries. He began his career at The Blackstone Group. Mr. Lavan holds a bachelor of science in engineering from the University of Pennsylvania.

*James W. Dobbins*, age 59, has been our Senior Vice President, General Counsel, and Secretary since June 1999 and has served in various roles in our legal department since joining us in June 1999. Prior to joining us, Mr. Dobbins was in private practice in North Carolina and held various positions in the legal department of Liggett Group, Inc., a major cigarette manufacturer, including, at the time he left that company, Vice President, General Counsel, and Secretary. Mr. Dobbins has also practiced as an outside litigation attorney with Webster & Sheffield, a New York law firm, representing a variety of clients including Liggett Group, Inc. Prior to joining Webster & Sheffield, he served as a law clerk to the Honorable J. Daniel Mahoney, U.S. Circuit Judge for the Second Circuit Court of Appeals. Mr. Dobbins holds a bachelor of arts in mathematics and political science from Drew University and a J.D. from Fordham University School of Law.

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PART II

**Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

**Market Information**

The principal stock exchange on which Turning Point Brands, Inc.’s common stock (par value \$0.01 per share) is listed is the New York Stock Exchange under the symbol TPB. At February 25, 2019, there were 219 holders of record of Turning Point Brands, Inc.’s common stock.

**Dividends.** On November 9, 2017, our Board of Directors approved the initiation of a cash dividend to shareholders. The initial quarterly dividend of \$0.04 per common share was paid on December 15, 2017 to shareholders of record at the close of business on November 27, 2017. The most recent dividend of \$0.045 per common share was paid on January 11, 2019, to shareholders of record at the close of business on December 21, 2018.

**Performance graph.** The graph below compares the cumulative total shareholder return of Turning Point Brands, Inc.’s common stock since our initial public offering on May 11, 2016, with the Russell 3000 Index and the S&P Small Cap 600 Consumer Staples Index. The information presented assumes an initial investment of \$100 on May 11, 2016, and that all dividends were reinvested. The cumulative returns shown represent the value that these investments would have had on December 31, 2018.

**Issuer purchases of equity securities.** No shares of common stock were purchased during 2018.



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The following selected financial data should be read in conjunction with Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and consolidated financial statements and notes thereto contained in Item 8. Financial Statements and Supplementary Data of this report. A reconciliation of non-GAAP measures to the most directly comparable GAAP financial measure is presented following the Selected Financial Data.

(dollars in thousands)

	<b>Year Ended December 31,</b>					
	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>
<b>Consolidated Statement of Operations Data:</b>						
Net sales	\$ 332,683	\$ 285,777	\$ 206,228	\$ 197,256	\$ 200,329	\$ 193,304
Cost of sales	190,124	160,807	105,683	100,775	106,986	103,043
Gross profit	142,559	124,970	100,545	96,481	93,343	90,261
Selling, general and administrative expenses	94,075	75,290	56,626	51,758	45,241	46,849
Operating income	48,484	49,680	43,919	44,723	48,102	43,412
Interest expense	15,086	16,904	26,739	34,457	34,330	44,094
Interest income	(267 )	(15 )	(118 )	(173 )	(19 )	—
Investment income	(424 )	(438 )	(768 )	—	—	—
Loss on extinguishment of debt	2,384	6,116	2,824	—	42,780	441
Net periodic benefit expense, excluding service cost	131	180	334	212	46	—
Income (loss) before income taxes	31,574	26,933	14,908	10,227	(29,035 )	(1,123 )
Income tax expense (benefit)	6,285	7,280	(12,005 )	1,078	370	486
Consolidated net income (loss)	25,289	19,653	26,913	9,149	(29,405 )	\$ (1,609 )
Net loss attributable to non-controlling interest	—	(556 )	—	\$ —	\$ —	\$ —
Net income (loss) attributable to Turning Point Brands, Inc.	\$ 25,289	\$ 20,209	\$ 26,913	\$ 9,149	\$ (29,405 )	\$ (1,609 )

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Basic income (loss)  
per common share:

Net income (loss) attributable to Turning Point Brands, Inc.	\$	1.31	\$	1.06	\$	1.63	\$	1.27	\$	(4.07 )	\$	(0.22 )
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Diluted income  
(loss) per common  
share:

Net income (loss) attributable to Turning Point Brands, Inc.	\$	1.28	\$	1.04	\$	1.49	\$	1.10	\$	(4.07 )	\$	(0.22 )
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Weighted average  
common shares  
outstanding:

Basic	19,355,607	18,989,177	16,470,352	7,198,081	7,223,378	7,288,993
Diluted	19,827,562	19,513,008	18,015,545	8,354,387	7,223,378	7,288,993

**Other Financial  
Information:**

Net cash provided by operating activities	\$	13,090	\$	29,690	\$	9,128	\$	24,430	\$	6,025	\$	3,026
Net cash used in investing activities		(24,669 )		(1,116 )		(55,888 )		(2,030 )		(1,314 )		(723 )
Net cash provided by (used in) financing activities		9,930		(28,016 )		15,734		(26,032 )		(31,623 )		10,641
Capital expenditures		(2,267 )		(2,021 )		(3,207 )		(1,602 )		(1,314 )		(729 )
Depreciation and amortization		3,111		2,328		1,285		1,059		933		932
EBITDA <sup>(1)</sup>		51,888		52,822		45,638		45,570		48,989		43,903
Adjusted EBITDA <sup>(1)</sup>		64,610		60,024		52,449		50,604		48,792		49,609
Leverage Ratio <sup>(2)</sup>		3.4x		3.3x		4.1x		5.7x		6.1x		5.2x

**Balance Sheet  
Data:**

Cash	\$	3,306	\$	2,607	\$	2,865	\$	4,835	\$	8,467	\$	35,379
Working capital		48,088		41,263		37,289		42,815		42,738		68,499
Total assets		339,377		282,277		285,020		242,463		242,568		287,049
Notes payable and		220,715		202,040		218,225		292,440		304,916		294,007

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long-term debt						
Total liabilities	256,754	228,953	250,962	324,075	334,140	350,484
Total stockholders' equity (deficit)	82,623	53,324	34,058	(81,612 )	(91,572 )	(63,434 )

To supplement our financial information presented in accordance with generally accepted accounting principles in the United States, or U.S. GAAP, we use non-U.S. GAAP financial measures including EBITDA and Adjusted (1) EBITDA. We define EBITDA as net income before interest expense, loss on extinguishment of debt, income taxes, depreciation, and amortization. We define Adjusted EBITDA as net income before interest expense, loss on extinguishment of debt, income taxes, depreciation, amortization, other non-cash items, and other

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items that we do not consider ordinary course in our evaluation of ongoing, operating performance. We present EBITDA and Adjusted EBITDA in this Form 10-K because they are key metrics used by management and our board of directors to assess our financial performance and are also used by management to assess performance for the purposes of our executive compensation programs. EBITDA and Adjusted EBITDA are also frequently used by analysts, investors and other interested parties to evaluate companies in our industry. We believe that EBITDA and Adjusted EBITDA are appropriate measures of operating performance because they eliminate the impact of expenses that do not relate to business performance. EBITDA and Adjusted EBITDA have limitations as analytical tools, and you should not consider them in isolation, or as a substitute for analysis of our results as reported under GAAP. Some of these limitations are:

- (i) They do not reflect our cash expenditures, or future requirements for capital expenditures or contractual commitments;
  - (ii) They do not reflect changes in, or cash requirements for, our working capital needs;
  - (iii) They do not reflect our significant interest expense, or the cash requirements necessary to service interest or principal payments on our debt; and
  - (iv) Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized often will have to be replaced in the future, and EBITDA and Adjusted EBITDA do not reflect any cash requirements for such replacements.
- (2) Leverage Ratio - We calculate our Leverage Ratio by dividing Notes payable and long-term debt, less Cash, by Adjusted EBITDA.

<i>(in thousands)</i>	<b>Years ended December 31,</b>				
	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
Net income attributable to Turning Point Brands, Inc.	\$ 25,289	\$ 20,209	\$ 26,913	\$ 9,149	\$ (29,405 )
Add:					
Interest expense	15,086	16,904	26,739	34,457	34,330
Interest income	(267 )	(15 )	(118 )	(173 )	(19 )
Loss on extinguishment of debt	2,384	6,116	2,824	—	42,780
Income tax expense	6,285	7,280	(12,005 )	1,078	370
Depreciation expense	2,105	1,626	1,227	1,059	933
Amortization expense	1,006	702	58	—	—
EBITDA	\$ 51,888	\$ 52,822	\$ 45,638	\$ 45,570	\$ 48,989
Components of Adjusted EBITDA					
LIFO adjustment <sup>(a)</sup>	58	1,123	889	(56 )	(798 )
Pension/postretirement expense <sup>(b)</sup>	237	284	437	341	16
Stock options, restricted stock, and incentives expense <sup>(c)</sup>	1,410	668	180	234	585
Foreign exchange hedging <sup>(d)</sup>	71	(90 )	125	(35 )	—
Product line rationalizations <sup>(e)</sup>	3,224	563	—	—	—
Strategic initiatives <sup>(f)</sup>	4,482	2,133	1,587	2,259	—
New product launch costs <sup>(g)</sup>	1,835	2,414	2,678	1,915	—
Organizational development <sup>(h)</sup>	778	—	—	—	—
Warehouse reorganization <sup>(i)</sup>	627	—	—	376	—
Bonus <sup>(j)</sup>	—	107	—	—	—

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IPO related compensation costs <sup>(k)</sup>	—	—	915	—	—
Adjusted EBITDA	\$ 64,610	\$ 60,024	\$ 52,449	\$ 50,604	\$ 48,792

(a) Represents expense related to an inventory valuation allowance for last-in, first-out ( LIFO ) reporting.

(b) Represents our non-cash pension/postretirement expense.

(c) Represents non-cash stock options, restricted stock and incentives expense.

(d) Represents non-cash gain and loss stemming from our foreign exchange hedging activities.

(e) Represents costs associated with discontinued products related to product line rationalization.

(f) Represents the fees incurred for strategic initiatives and acquisitions, as well as \$1.5 million of earnout for IVG management in 2018.

(g) Represents product launch costs of our new product lines.

(h) Represents costs associated with executive departures.

(i) Represents costs associated with inventory rationalization from warehouse consolidation.

(j) Represents bonuses associated with the December 2017 Tax Cuts and Jobs Act.

(k) Represents non-recurring compensation expenses incurred coincident with the May 2016 IPO.

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### **Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations**

*You should read the following discussion of the historical financial condition and results of operations in conjunction with our historical condensed consolidated financial statements and accompanying notes, which are included elsewhere in this Annual Report on Form 10-K. In addition, this discussion includes forward-looking statements subject to risks and uncertainties that may result in actual results differing from statements we make. See Cautionary Note Regarding Forward-Looking Statements. Factors that could cause actual results to differ include those risks and uncertainties discussed in Risk Factors.*

*The following discussion relates to the audited financial statements of Turning Point Brands, Inc., included elsewhere in this Annual Report on Form 10-K. In this discussion, unless the context requires otherwise, references to our Company we, our, or us refer to Turning Point Brands, Inc., and its consolidated subsidiaries. References to TPB refer to Turning Point Brands, Inc., without any of its subsidiaries. We were incorporated in 2004 under the name North Atlantic Holding Company, Inc. On November 4, 2015, we changed our name to Turning Point Brands, Inc. Many of the amounts and percentages in this discussion have been rounded for convenience of presentation.*

### **Organizational Structure**

We, Turning Point Brands, Inc., are a holding company which owns North Atlantic Trading Company, Inc. ( NATC ), and its subsidiaries National Tobacco Company, L.P. ( NTC ), National Tobacco Finance, LLC ( NTFLLC ), North Atlantic Operating Company, Inc. ( NAOC ), North Atlantic Cigarette Company, Inc. ( NACC ), and RBJ Sales, Inc. ( RBJ ); and Turning Point Brands, LLC ( TPLLC ) and its subsidiaries Intrepid Brands, LLC ( Intrepid ), Vapor Beast, LLC ( VaporBeast, f/k/a Smoke Free Technologies, Inc.), Vapor Shark, LLC, and its subsidiaries (collectively, Vapor Shark, f/k/a The Hand Media), Vapor Acquisitions Company, LLC ( Vapor Supply ), Vapor Finance, LLC ( VFIN ), and International Vapor Group, LLC and its subsidiaries (collectively, IVG ). On January 15, 2019, we announced the formation of Nu-X Ventures, LLC ( Nu-X ), a subsidiary of TPLLC.

### **Overview**

We are a leading independent provider of Other Tobacco Products ( OTP ) in the U.S. We sell a wide range of products across the OTP spectrum including moist snuff tobacco ( MST ), loose leaf chewing tobacco, premium cigarette papers, make-your-own ( MYO ) cigar wraps, cigars, and liquid vapor products; but, we do not sell cigarettes. We estimate the OTP industry generated approximately \$11 billion in manufacturer revenue in 2017. In contrast to manufactured cigarettes, which have been experiencing declining volumes for decades based on data published by the Alcohol and Tobacco Tax and Trade Bureau ( TTB ), the OTP industry is demonstrating increased consumer appeal with low to mid-single digit consumer unit growth as reported by Management Science Associates, Inc. ( MSAi ), a third-party analytics and informatics company. Under the leadership of a senior management team with an average of 23 years of experience in the tobacco industry, we have grown and diversified our business through new product launches, category expansions, and acquisitions while concurrently improving operational efficiency.

### *Products*

We operate in three segments: Smokeless products, Smoking products and NewGen products. In our Smokeless products segment we (i) manufacture and market moist snuff and (ii) contract for and market loose leaf chewing tobacco products. In our Smoking products segment, we (i) market and distribute cigarette papers, tubes, and related products; (ii) market and distribute finished cigars and MYO cigar wraps; and (iii) process, package, market, and distribute traditional pipe tobaccos. In our NewGen products segment, we (i) market and distribute e-cigarettes, e-liquids, vaporizers, and certain other products without tobacco and/or nicotine; (ii) distribute a wide assortment of vaping related products to non-traditional retail via VaporBeast, Vapor Shark, Vapor Supply, and IVG; and (iii)

distribute a wide assortment of vaping related products to individual consumers via Vapor Shark, Vapor World, and VaporFi branded retail outlets in addition to online platforms. Refer to the 'Recent Developments' section below for details regarding the Vapor Supply and IVG acquisitions.

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Our portfolio of brands includes some of the most widely recognized names in the OTP industry, such as *Stoker's*<sup>®</sup> in the Smokeless segment, *Zig-Zag*<sup>®</sup> in the Smoking segment, and *VaporBeast*<sup>®</sup> and *VaporFi*<sup>®</sup> in the NewGen segment. The following table sets forth the market share and category rank of our core products and demonstrates their industry positions:

<b>Brand</b>	<b>Product</b>	<b>TPB Segment</b>	<b>Market Share<sup>(1)</sup></b>	<b>Category Rank<sup>(1)</sup></b>
<i>Stoker's</i> <sup>®</sup>	Chewing Tobacco	Smokeless Products	19.2%	#1 discount, #2 overall
<i>Stoker's</i> <sup>®</sup>	Moist Snuff	Smokeless Products	3.5%	#4 discount, #6 overall
<i>Zig-Zag</i> <sup>®</sup>	Cigarette Papers	Smoking Products	32.1%	#1 premium
<i>Zig-Zag</i> <sup>®</sup>	MYO Cigar Wraps	Smoking Products	78.5%	#1 overall

(1) Market share and category rank data for all products are derived from MSAi data as of 12/31/18.

*Operations*

As of December 31, 2018, our products are available in approximately 185,000 U.S. retail locations which, with the addition of retail stores in Canada, brings our total North American retail presence to an estimated 210,000 points of distribution. We subscribe to a sales tracking system from MSAi that records all OTP product shipments (ours as well as those of our competitors) from approximately 900 wholesalers to over 250,000 traditional retail stores in the U.S. This system enables us to understand individual product share and volume trends across multiple categories down to the individual retail store level, allowing us to allocate field salesforce coverage to the highest opportunity stores. Our sales and marketing group of approximately 174 professionals utilizes the MSAi system to efficiently target markets and sales channels with the highest sales potential.

Our core tobacco business (Smokeless and Smoking segments) primarily generates revenues from the sale of our products to wholesale distributors who, in turn, resell the products to retail operations. Our acquisition of VaporBeast in the fourth quarter of 2016 expanded our revenue streams as we began selling directly to non-traditional retail outlets. Our acquisitions of Vapor Shark in the second quarter of 2017 and Vapor Supply in the second quarter of 2018 further expanded our selling network by allowing us to directly reach ultimate consumers through Vapor Shark and Vapor World branded retail outlets, respectively. Our acquisition of IVG in the third quarter of 2018 enhanced our business-to-consumer revenue stream with the addition of Vapor-Fi branded retail outlets accompanying a robust online platform headlined by VaporFi.com and DirectVapor.com. Our net sales, which include federal excise taxes, consist of gross sales net of cash discounts, returns, and selling and marketing allowances.

We rely on long-standing relationships with high-quality, established manufacturers to provide the majority of our produced products. Approximately 85% of our production, as measured by net sales, is outsourced to suppliers. The remaining production consists of our moist snuff tobacco operations located in Dresden, Tennessee, and Louisville, Kentucky; the packaging of our pipe tobacco in Louisville, Kentucky; and the proprietary e-liquids operations located in Louisville, Kentucky, and Miami, Florida. Our principal operating expenses include the cost of raw materials used to manufacture the limited number of our products which we produce in-house; the cost of finished products, which are generally purchased goods; federal excise taxes; legal expenses; and compensation expenses, including benefits and costs of salaried personnel. Our other principal expenses include interest expense and other expenses.

**Key Factors Affecting Our Results of Operations**

We consider the following to be the key factors affecting our results of operations:

- Our ability to further penetrate markets with our existing products;
- Our ability to introduce new products and product lines that complement our core business;



- Decreasing interest in tobacco products among consumers;
- Price sensitivity in our end-markets;
- Marketing and promotional initiatives, which cause variability in our results;
- General economic conditions, including consumer access to disposable income;

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- Cost and increasing regulation of promotional and advertising activities;
- Cost of complying with regulation, including newly passed deeming regulations ;
- Counterfeit and other illegal products in our end-markets;
- Currency fluctuations;
- Our ability to identify attractive acquisition opportunities in OTP; and
- Our ability to integrate acquisitions.

### **Recent Developments**

#### *VMR*

On October 2, 2018, VMR Products LLC ( VMR ), the supplier of V2 e-cigarettes to TPB under a long-term exclusive agreement for retail brick and mortar distribution and sales, was purchased by Juul Labs for a reported \$75 million. Our contract anticipated such an event and affords an acquirer of VMR the right to terminate the contract, subject to certain terms and conditions including product buyback requirements and a termination payment based on the purchase price. On November 6, 2018, we received a letter from VMR, now owned by Juul Labs, stating that it would no longer accept orders and that we are permitted to continue to sell-through any V2 inventory. Our net sales of V2 products were approximately \$7.8 million for the year ended December 31, 2018. We have sufficient inventory on hand to satisfy sales through the first quarter of 2019. Refer to Note 17 of Notes to Consolidated Financial Statements for potential mediation involving VMR.

On May 18, 2018, we entered into an arrangement with VMR which manufactures and distributes vapor products whereby VMR received a \$6.5 million loan with a maturity date of May 18, 2019. The note was secured by the VMR's assets and accrued interest at an annual rate of 15% with quarterly interest payments due beginning in August 2018. In September 2018, VMR repaid the full outstanding balance of the loan in addition to a \$1.0 million early termination fee which was recorded as a reduction to selling, general, and administrative expenses. As a condition to the loan, VMR agreed to issue us warrants to purchase 7.5% of the ownership interest of VMR. In connection with the loan repayments we received \$1.0 million, net of expenses, for compensation of the warrants which was recorded as a reduction to selling, general, and administrative expenses.

#### *IVG*

In September 2018, we acquired IVG for total consideration of \$23.8 million satisfied through \$14.5 million paid in cash, 153,079 shares of common stock with a fair value of \$5.3 million, and a \$4.0 million note payable to IVG's former owners ( IVG Note ) which matures 18 months from the acquisition date. All principal and accrued and unpaid interest under the IVG Note is subject to indemnification obligations of the sellers pursuant to the International Vapor Group Stock Purchase Agreement dated as of September 5, 2018. The arrangement includes an additional \$4.5 million of earnouts with both performance-based and service-based conditions payable to former IVG owners who became employees of the Company as a result of the acquisition. The portion of earnout payments a recipient will receive will be calculated by reference to certain performance metrics not to exceed a two-year period as specified within the acquisition agreement. The Company recorded earnout expense of \$1.5 million within the consolidated statement of income for the year ended December 31, 2018, based on the probability of achieving the performance conditions.

IVG markets and sells a broad array of proprietary and third-party vapor products directly to adult consumers through an online platform under brand names such as VaporFi, South Beach Smoke, and Direct-Vapor. IVG operates company-owned stores under the VaporFi brand and also operates as a franchisor to franchisee-owned stores. The acquisition of IVG adds a significant business-to-consumer distribution platform to the Company's NewGen portfolio. Refer to Note 3 of Notes to Consolidated Financial Statements for more details regarding the IVG acquisition.

#### *Vapor Supply*

On April 30, 2018, we purchased the assets of Vapor Supply LLC, vaporsupply.com, and some of its affiliates including the Ecig.com domain through our subsidiary Vapor Acquisitions Company, LLC, for total consideration of \$4.8 million paid in cash. Vapor Supply is a business-to-business e-commerce distribution platform servicing

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independent retail vape shops. Additionally, Vapor Supply manufactures and markets proprietary e-liquids under the DripCo brand and operates company-owned stores. Refer to Note 3 of Notes to Consolidated Financial Statements for more details regarding the Vapor Supply acquisition.

### *Investments*

In November 2018, we paid \$2.0 million to acquire a minority ownership position (19.99%) in Canadian American Standard Hemp ( CASH ). CASH is headquartered in Warwick, Rhode Island, and manufactures cannabidiol isolate ( CBD ) developed through highly efficient and proprietary processes. The investment in CASH positions us to participate in the market for hemp-derived products.

In December 2018, we acquired a minority interest in General Wireless Operations, Inc. (d/b/a RadioShack; RadioShack ) from an affiliate of Standard General LP for \$0.4 million. Standard General LP has a controlling interest in us and qualifies as a related party. We will work together with RadioShack on product development and sourcing teams in China. Furthermore, we purchased \$1.1 million of finished goods inventory from Radio Shack during 2018, none of which was outstanding at December 31, 2018.

Both investments are presented as assets within the other assets line of the December 31, 2018, Consolidated Balance Sheet. We do not exercise significant influence over either investment and have elected to measure the investments at cost less impairment. The investments will be adjusted for any changes resulting from observable price changes in orderly transactions for identical or similar investments of the issuer.

### **Critical Accounting Policies and Uses of Estimates**

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States. When more than one accounting principle, or the method of its application, is generally accepted, we select the principle or method that is appropriate in the specific circumstances. Application of these accounting principles requires us to make estimates about the future resolution of existing uncertainties. Actual results could differ from these estimates. We evaluate our estimates, including those related to revenue recognition, collectability of accounts receivable, inventory valuation and obsolescence, goodwill, intangibles, pension and post-retirement obligations, income taxes, litigation, and contingencies on an ongoing basis. We base these estimates on our historical experience and other assumptions we believe are appropriate under the circumstances. In preparing these consolidated financial statements, we have made our best estimates and judgments of the amounts and disclosures included in the consolidated financial statements.

### *Revenue Recognition*

We adopted Accounting Standards Update ( ASU ) 2014-09, Revenue from Contracts with Customers (Topic 606), which supersedes nearly all existing revenue recognition guidance under U.S. GAAP, on January 1, 2018. We recognize revenues, net of sales incentives and sales returns, including shipping and handling charges billed to customers, upon delivery of goods to the customer—at which time our performance obligation is satisfied—at an amount that we expect to be entitled to in exchange for those goods in accordance with the five-step analysis outlined in Topic 606: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations, and (v) recognize revenue when (or as) performance obligations are satisfied.

A further requirement of ASU 2014-09 is for entities to disaggregate revenue recognized from contracts with customers into categories that depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors. Our management views business performance through segments that closely resemble

the performance of major product lines. Thus, the primary, and most useful, disaggregation of our contract revenue for decision making purposes is the disaggregation by segment which can be found in Note 19 of Notes to Consolidated Financial Statements. An additional disaggregation of contract revenue by sales channel can be found within Note 19 as well.

*Interest Rate Swaps*

We enter into interest rate swap contracts to manage interest rate risk and reduce the volatility of future cash flows. We account for interest rate swap contracts under the provisions of ASC 815, Derivatives and Hedging. Swap contracts that qualify as hedges are adjusted to their fair value through other comprehensive income as determined

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by market prices on the measurement date, except any hedge ineffectiveness which is recognized currently in income. Gains and losses on these swap contracts are transferred from other comprehensive income into net income upon settlement of the derivative position or at maturity of the interest rate swap contract. Changes in fair value of any contracts that do not qualify for hedge accounting or are not designated as hedges are recognized currently in income.

### *Derivative Instruments*

We use foreign currency forward contracts to hedge a portion of our exposure to changes in foreign currency exchange rates from time to time. We account for our forward contracts under the provisions of ASC 815, Derivatives and Hedging. Under our policy, as amended, we may hedge up to 100% of our anticipated purchases of inventory in the denominated invoice currency over a forward period not to exceed twelve months. We may also, from time to time, hedge up to ninety percent of our non-inventory purchases in the denominated invoice currency. Forward contracts that qualify as hedges are adjusted to their fair value through other comprehensive income as determined by market prices on the measurement date except any hedge ineffectiveness which is recognized currently in income. Gains and losses on these contracts are transferred from other comprehensive income into net income as the related inventories are received. Changes in fair value of any contracts that do not qualify for hedge accounting or are not designated as hedges are recognized in income currently.

### *Goodwill and Other Intangible Assets*

We follow the provisions of ASC 350, Intangibles – Goodwill and Other in accounting for our goodwill and other intangible assets. Goodwill and indefinite-lived intangible assets are reviewed for impairment annually on December 31, or more frequently if certain indicators are present, in accordance with ASC 350-20-35 and ASC 350-30-35, respectively. If the carrying value of the goodwill or indefinite-life intangible asset exceeds its fair value, determined using the discounted cash flows method and the relief-from-royalty method, respectively, the goodwill or intangible asset is considered impaired. The carrying value of the goodwill or indefinite-life intangible asset would then be reduced to fair value. For goodwill, the determination of a reporting unit's fair value involves, among other things, our market capitalization and application of the income approach, which includes developing forecasts of future cash flows and determining an appropriate discount rate.

Based on our annual goodwill impairment testing, the estimated fair values of each of our reporting units were substantially in excess of the respective carrying values at December 31, 2018. We had no such impairment of goodwill or other intangible assets during the year ended December 31, 2018. Refer to Note 9 of Notes to Consolidated Financial Statements for further details regarding our goodwill and other intangible assets as of December 31, 2018.

### *Fair Value*

GAAP establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1) and the lowest priority to unobservable inputs (level 3). The three levels of the fair value hierarchy under GAAP are described below:

- Level 1 – Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets at the measurement date.
- Level 2 – Inputs to the valuation methodology include: quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; inputs other than quoted prices that are observable for the asset or liability; and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

- Level 3 – Unobservable inputs that reflect management’s best estimate of what market participants would use in pricing the asset or liability at the measurement date.

*Retirement Plans.*

We follow the provisions of ASC 715, Compensation – Retirement Benefits in accounting for our retirement plans, which requires an employer to (i) recognize in its statement of financial position the funded status of a benefit plan, measured as the difference between the fair value of plan assets and benefit obligations; (ii) recognize, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost; and (iii) measure defined benefit plan assets and obligations as of the date of the employer’s statement of financial position.

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### *Income Taxes.*

We account for income taxes under ASC 740. We record the effects of income taxes under the liability method in which deferred income tax assets and liabilities are recognized based on the difference between the financial and tax basis of assets and liabilities using the enacted tax rates in effect for the years in which the differences are expected to reverse. We assess our ability to realize future benefits of deferred tax assets by determining if they meet the more likely than not criteria in ASC 740, Income Taxes. If we determine that future benefits do not meet the more likely than not criteria, a valuation allowance is recorded.

### *Stock-Based Compensation.*

We measure stock compensation costs related to our stock options on the fair value based method under the provisions of ASC 718, Compensation – Stock Compensation, which requires compensation cost for stock options to be recognized based on the fair value of stock options granted. We determined the fair value of these awards using the Black-Scholes option pricing model.

### *Accounts Receivable.*

Accounts receivable are recognized at their net realizable value. All accounts receivable are trade-related and are recorded at the invoiced amount and do not bear interest. We maintain allowances for doubtful accounts receivable for estimated uncollectible invoices resulting from the customer's inability to pay, which may result in write-offs. We recorded an allowance for doubtful accounts of less than \$0.1 million at December 31, 2018 and 2017, respectively.

### *Inventories.*

Inventories are stated at the lower of cost or market. Cost was determined using the LIFO method for approximately 49.1% of the inventories as of December 31, 2018. Leaf tobacco is presented in current assets in accordance with standard industry practice, notwithstanding the fact that such tobaccos are carried longer than one year for the purpose of curing. We recorded an inventory valuation allowance of \$2.5 million and \$0.5 million at December 31, 2018 and 2017, respectively.

## **Jumpstart Our Business Startups Act of 2012**

We chose to opt out of the provision of the JOBS Act that permits us, as an emerging growth company, to take advantage of an extended transition period to comply with new or revised accounting standards applicable to public companies. As a result, we will comply with new or revised accounting standards as required for public companies. Our decision to opt out of the extended transition period provided in the JOBS Act is irrevocable.



TABLE OF CONTENTS**Results of Operations***Summary*

The table and discussion set forth below relates to our consolidated results of operations for the years ended December 31 (in thousands):

	<b>For the year ended December 31,</b>				
	<b>2018</b>	<b>2017</b>	<b>% Change</b>	<b>2016</b>	<b>% Change</b>
<b>Consolidated Results of Operations Data:</b>					
Net sales					
Smokeless products	\$ 90,031	\$ 84,560	6.5 %	\$ 77,913	8.5 %
Smoking products	111,507	109,956	1.4 %	111,005	(0.9 )%
NewGen products	131,145	91,261	43.7 %	17,310	427.2 %
Total net sales	332,683	285,777	16.4 %	206,228	38.6 %
Cost of sales	190,124	160,807	18.2 %	105,683	52.2 %
Gross profit					
Smokeless products	46,490	42,703	8.9 %	38,823	10.0 %
Smoking products	57,043	57,146	(0.2 )%	57,595	(0.8 )%
NewGen products	39,026	25,121	55.4 %	4,127	508.7 %
Total gross profit	142,559	124,970	14.1 %	100,545	24.3 %
Selling, general, and administrative expenses	94,075	75,290	25.0 %	56,626	33.0 %
Operating income	48,484	49,680	(2.4 )%	43,919	13.1 %
Interest expense	15,086	16,904	(10.8 )%	26,739	(36.8 )%
Interest income	(267 )	(15 )	NM	(118 )	(87.3 )%
Investment income	(424 )	(438 )	(3.2 )%	(768 )	(43.0 )%
Loss on extinguishment of debt	2,384	6,116	(61.0 )%	2,824	116.6 %
Net periodic benefit expense, excluding service cost	131	180	(27.2 )%	334	(46.1 )%
Income before income taxes	31,574	26,933	17.2 %	14,908	80.7 %
Income tax expense (benefit)	6,285	7,280	(13.7 )%	(12,005 )	(160.6 )%
Consolidated net income	25,289	19,653	28.7 %	26,913	(27.0 )%
Net loss attributable to non-controlling interest	—	(556 )	NM	—	NM
Net income attributable to Turning Point Brands, Inc.	\$ 25,289	\$ 20,209	25.1 %	\$ 26,913	(24.9 )%
<i>Comparison of Year Ended December 31, 2018, to Year Ended December 31, 2017</i>					

**Net Sales.** For the year ended December 31, 2018, overall net sales increased to \$332.7 million from \$285.8 million for the year ended December 31, 2017, an increase of \$46.9 million or 16.4%. The increase in net sales was primarily driven by continued VaporBeast momentum and the acquisitions of Vapor Supply and IVG.

For the year ended December 31, 2018, net sales in the Smokeless products segment increased to \$90.0 million from \$84.6 million for the year ended December 31, 2017, an increase of \$5.5 million or 6.5%. For the year ended December 31, 2018, Smokeless products volume increased 2.6% and price/mix increased 3.9%. The increase in net sales was primarily driven by the continuing growth of *Stoker s*<sup>®</sup> MST partially offset by declines in chewing tobacco attributable to increased competition, our promotional timing, and a continuing segment shift to lower price products.

For the year ended December 31, 2018, net sales in the Smoking products segment increased to \$111.5 million from \$110.0 million for the year ended December 31, 2017, an increase of \$1.6 million or 1.4%. For the year ended December 31, 2018, Smoking products volumes decreased 0.7%, while price/mix decreased 0.7%. The increase in net sales is primarily due to volume growth for our *Zig-Zag*<sup>®</sup> branded papers and cigar wraps offset by our strategic decision to de-emphasize the low margin cigar products business and line rationalization of our MYO tobacco products. Cigar product sales declined by \$3.0 million to \$5.5 million in the year ended December 31, 2018.

For the year ended December 31, 2018, net sales in the NewGen products segment increased to \$131.1million from \$91.3 million for the year ended December 31, 2017, an increase of \$39.9 million or 43.7%. The increase in net sales was primarily driven by continued VaporBeast momentum along with the acquisitions of Vapor Supply and IVG.

**Gross Profit.** For the year ended December 31, 2018, overall gross profit increased to \$142.6 million from \$125.0 million for the year ended December 31, 2017, an increase of \$17.6 million or 14.1%, primarily due to growth

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in the NewGen segment. Consolidated gross profit for the year ended December 31, 2018, included \$0.1 million of unfavorable LIFO adjustments, \$1.0 million of introductory launch costs, \$2.4 million of product line rationalizations, and \$0.5 million of warehouse reorganization costs compared to \$1.1 million, \$0.7 million, \$0.4 million, and less than \$0.1 million, respectively, in the year ended December 31, 2017. Gross profit as a percentage of net sales weakened to 42.9% for the year ended December 31, 2018, from 43.7% for the year ended December 31, 2017, primarily due to the majority of the sales growth coming from the NewGen segment, which has lower margins.

For the year ended December 31, 2018, gross profit in the Smokeless products segment increased to \$46.5 million from \$42.7 million for the year ended December 31, 2017, an increase of \$3.8 million or 8.9%. Smokeless gross profit for the year ended December 31, 2018, included \$0.1 million of unfavorable LIFO adjustments, \$0.2 million of introductory launch costs and \$0.1 million of line rationalization expenses compared to \$0.7 million, \$0.7 million, and less than \$0.1 million, respectively, for the year ended December 31, 2017. Gross profit as a percentage of net sales increased to 51.6% of net sales for the year ended December 31, 2018, from 50.5% of net sales for the year ended December 31, 2017.

For the year ended December 31, 2018, gross profit in the Smoking products segment decreased to \$57.0 million from \$57.1 million for the year ended December 31, 2017, a decrease of \$0.1 million or 0.2%. Smoking gross profit for the year ended December 31, 2018, included less than \$0.1 million of unfavorable LIFO adjustments, \$0.6 million of introductory launch costs and \$1.3 million of line rationalization expenses compared to \$0.4 million, \$0, and \$0.2 million, respectively, for the year ended December 31, 2017. Gross profit as a percentage of net sales decreased to 51.2% of net sales for the year ended December 31, 2018, from 52.0% of net sales for the year ended December 31, 2017. The decrease in gross profit as a percentage of net sales is primarily due to introductory launch costs and line rationalization expenses on discontinued products.

For the year ended December 31, 2018, gross profit in the NewGen products segment increased to \$39.0 million from \$25.1 million for the year ended December 31, 2017, an increase of \$13.9 million or 55.4%. NewGen gross profit for the year ended December 31, 2018, included \$0.3 million of introductory launch costs, \$1.0 million of line rationalization expenses, and \$0.5 million of warehouse reorganization expenses compared to less than \$0.1 million, \$0.2 million, and \$0, respectively, for the year ended December 31, 2017. Additionally, the Company paid \$2.8 million for newly imposed tariffs on goods from outside the United States in 2018, \$1.1 million of which was included in cost of goods sold for the year ended December 31, 2018. Gross profit as a percentage of net sales increased to 29.8% of net sales for the year ended December 31, 2018, from 27.5% of net sales for the year ended December 31, 2017, primarily due to acquisition activity which has resulted in business-to-consumer sales, which generally have higher margins, becoming a larger share of the NewGen segment.

**Selling, General and Administrative Expenses.** For the year ended December 31, 2018, selling, general and administrative expenses increased to \$94.1 million from \$75.3 million for the year ended December 31, 2017, an increase of \$18.8 million or 25.0%. Selling, general, and administrative expenses for the year ended December 31, 2018, include \$10.5 million of expenses relating to the inclusion of our 2018 acquisitions IVG and Vapor Supply, \$4.0 million of transaction costs (primarily relating to IVG and Vapor Supply), \$0.5 million of expenses associated with strategic initiatives, \$0.9 million of introductory launch costs, \$0.8 million of organizational development expenses, \$0.9 million of line rationalization expenses, \$0.1 million of warehouse reconfiguration expenses, and a \$2.0 million net reduction to selling, general, and administrative expenses related to the VMR Loan. Selling, general, and administrative expenses for the year ended December 31, 2017, include \$0.9 million of expenses associated with strategic initiatives, \$1.7 million of launch costs, \$1.2 million of transaction costs, and \$0.1 million of line rationalization expenses. Other items leading to the increase in selling, general, and administrative expenses in the year ended December 31, 2018, when compared to the year ended December 31, 2017, include higher legal and litigation expenses associated with our anti-counterfeiting initiative and variable logistics costs associated with increased sales at VaporBeast partially offset by a receivable reserve reversal and prepayment penalty, both of which

are associated with the loan issued to a supplier in the second quarter of 2018 that was repaid during the third quarter of 2018.

**Interest Expense.** For the year ended December 31, 2018, interest expense decreased to \$15.1 million from \$16.9 million for the year ended December 31, 2017, primarily as a result of lower interest rates from our March 2018 refinancing of our credit facility.

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**Income Tax Expense (Benefit).** The Company's income tax expense of \$6.3 million, or 19.9% of income before income taxes, for the year ended December 31, 2018, is lower than the expected annual effective tax rate as a result of discrete tax benefits of \$5.4 million from the exercise of stock options during the year. The Company's income tax expense of \$7.3 million, or 27% of income before income taxes, for the year ended December 31, 2017, is lower than the expected annual effective tax rate as a result of discrete tax benefits of \$4.2 million from the exercise of stock options during the year.

**Investment Income.** For the year ended December 31, 2018 and 2017, investment income relating to investments of the MSA escrow deposits was \$0.4 million and \$0.4 million, respectively.

**Loss on Extinguishment of Debt.** For the year ended December 31, 2018, loss on extinguishment of debt was \$2.4 million as the result of refinancing our credit facility in the first quarter of 2018. For the year ended December 31, 2017, loss on extinguishment of debt was \$6.1 million as the result of refinancing our credit facility in the first quarter of 2017.

**Consolidated Net Income.** Due to the factors described above, net income for the year ended December 31, 2018 and 2017, was \$25.3 million and \$19.7 million, respectively.

**Net Loss Attributable to Non-Controlling Interest.** Net loss attributable to non-controlling interest of \$0.6 million for the year ended December 31, 2017, is related to Vapor Shark, which was accounted for as a VIE during the second quarter of 2017.

**Net Income Attributable to Turning Point Brands, Inc.** Due to the factors described above, net income for the year ended December 31, 2018 and 2017, was \$25.3 million and \$20.2 million, respectively.

*Comparison of Year Ended December 31, 2017, to Year Ended December 31, 2016*

**Net Sales.** For the year ended December 31, 2017, overall net sales increased to \$285.8 million from \$206.2 million for the year ended December 31, 2016, an increase of \$79.5 million or 38.6%. For the year ended December 31, 2017, volumes increased 34.2% and price/mix increased 4.4%. This increase was substantially due to an increase in NewGen products sales as a result of the acquisitions of VaporBeast and Vapor Shark.

For the year ended December 31, 2017, net sales in the Smokeless products segment increased to \$84.6 million from \$77.9 million for the year ended December 31, 2016, an increase of \$6.6 million or 8.5%. For the year, volume increased 3.4% and price/mix increased 5.1%. Net sales growth was primarily driven by *Stoker's*<sup>®</sup> MST.

For the year ended December 31, 2017, net sales in the Smoking products segment decreased to \$110.0 million from \$111.0 million for the year ended December 31, 2016, a decrease of \$1.0 million or 0.9%. For the year ended December 31, 2017, Smoking products volumes decreased 3.7%, while price/mix increased 2.8%. The decline in net sales is primarily due to reduced investment in the cigar product line to allow for those resources to be used for other product lines with higher margins.

For the year ended December 31, 2017, net sales in the NewGen products segment increased to \$91.3 million from \$17.3 million for the year ended December 31, 2016, an increase of \$74.0 million or 427.2%. For the year ended December 31, 2017, NewGen products volumes increased 415.8%, while price/mix increased 11.4%. Net sales growth was primarily driven by the acquisitions of VaporBeast and Vapor Shark.

**Gross Profit.** For the year ended December 31, 2017, overall gross profit increased to \$125.0 million from \$100.5 million for the year ended December 31, 2016, an increase of \$24.4 million or 24.3%, primarily due to acquisition of

VaporBeast. Consolidated gross profit for the year ended December 31, 2017, included \$1.1 million of unfavorable LIFO adjustments, \$0.7 million of introductory launch costs, and \$0.4 million of line rationalization expenses compared to \$0.9 million, \$1.3 million, and \$0, respectively, for the year ended December 31, 2016. Gross profit as a percentage of net sales weakened to 43.7% for the year ended December 31, 2017, from 48.8% for the year ended December 31, 2016, as a result of the mix impact of VaporBeast's inherently lower distribution margins.

For the year ended December 31, 2017, gross profit in the Smokeless products segment increased to \$42.7 million from \$38.8 million for the year ended December 31, 2016, an increase of \$3.9 million or 10.0%. Smokeless gross profit for the year ended December 31, 2017, included \$0.7 million of unfavorable LIFO adjustments and \$0.7 million of introductory launch costs compared to \$1.0 million and \$1.1 million, respectively, for the year ended December 31, 2016. Gross profit as a percentage of net sales increased to 50.5% of net sales for the year ended December 31, 2017, from 49.8% of net sales for the year ended December 31, 2016. The increase in

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gross profit as a percentage of net sales is due to us being able to take price increases and the further expansion of *Stoker s*<sup>®</sup> MST sales, leveraging our Smokeless fixed costs across a higher sales volume.

For the year ended December 31, 2017, gross profit in the Smoking products segment decreased to \$57.1 million from \$57.6 million for the year ended December 31, 2016, a decrease of \$0.4 million or 0.8%. Smoking gross profit for the year ended December 31, 2017, included \$0.4 million of unfavorable LIFO adjustments and \$0.2 million of line rationalization expenses compared to \$0.1 million of favorable LIFO adjustments for the year ended December 31, 2016. Gross profit as a percentage of net sales increased to 52.0% of net sales for the year ended December 31, 2017, from 51.9% of net sales for the year ended December 31, 2016.

For the year ended December 31, 2017, gross profit in the NewGen products segment increased to \$25.1 million from \$4.1 million for the year ended December 31, 2016, an increase of \$21.0 million or 508.7%. NewGen gross profit for the year ended December 31, 2017, included less than \$0.1 of introductory launch costs and \$0.2 million of line rationalization expenses compared to \$0.2 million and \$0, respectively, for the year ended December 31, 2016. Gross profit as a percentage of net sales increased to 27.5% of net sales for the year ended December 31, 2017, from 23.8% of net sales for the year ended December 31, 2016, primarily as a result of the change in product mix in the segment and our continued focus on margin expansion in the NewGen segment.

**Selling, General and Administrative Expenses.** For the year ended December 31, 2017, selling, general and administrative expenses increased to \$75.3 million from \$56.6 million for the year ended December 31, 2016, an increase of \$18.7 million or 33.0%, due primarily to the inclusion of a full year of VaporBeast expenses in 2017 compared to one month of expenses in 2016 and the inclusion of Vapor Shark expenses in 2017. Selling, general, and administrative expenses for the year ended December 31, 2017, included \$0.9 million of expenses associated with strategic initiatives, \$1.7 million of introductory launch costs, \$1.2 million of transaction costs, and \$0.1 million of line rationalization expenses compared to \$0.5 million, \$1.4 million, \$1.1 million, and \$0, respectively, for the year ended December 31, 2016. Selling, general, and administrative expenses for the year ended December 31, 2016, also included \$0.9 million of IPO-related compensation costs.

**Interest Expense.** For the year ended December 31, 2017, interest expense decreased to \$16.9 million from \$26.6 million for the year ended December 31, 2016, primarily as a result of lower interest rates from our 2017 debt refinancing.

**Income Tax Expense (Benefit).** The Company's income tax expense of \$7.3 million, or 27% of income before income taxes, for the year ended December 31, 2017, is lower than the expected annual effective tax rate as a result of discrete tax benefits of \$4.2 million from the exercise of stock options during the year. The Company's income tax expense for the year ended December 31, 2016, does not bear the normal relationship to income before income taxes primarily due to releasing the valuation allowance on our deferred taxes as we determined that it is more-likely than not that we will realize our deferred tax assets which consist primarily of a federal net operating loss ( NOL ) carryforward.

**Investment Income.** For the year ended December 31, 2017 and 2016, investment income relating to investments of the MSA escrow deposits was \$0.4 million and \$0.8 million, respectively.

**Loss on Extinguishment of Debt.** For the year ended December 31, 2017, loss on extinguishment of debt was \$6.1 million as the result of refinancing our credit facility in the first quarter of 2017. For the year ended December 31, 2016, loss on extinguishment of debt was \$2.8 million as the result of retiring certain debt with proceeds from our IPO.

**Consolidated Net Income.** Due to the factors described above, net income for the year ended December 31, 2017 and 2016, was \$19.7 million and \$26.9 million, respectively.

**Net Loss Attributable to Non-Controlling Interest.** Net loss attributable to non-controlling interest of \$0.6 million for the year ended December 31, 2017, is related to Vapor Shark, which was accounted for as a VIE during the second quarter of 2017.

**Net Income Attributable to Turning Point Brands, Inc.** Due to the factors described above, net income for the year ended December 31, 2017 and 2016, was \$20.2 million and \$26.9 million, respectively.



TABLE OF CONTENTS**Liquidity and Capital Reserves**

Our principal uses for cash are working capital, debt service, and capital expenditures. We believe our cash flows from operations and borrowing availability under our 2018 Revolving Credit Facility (as defined herein) are adequate to satisfy our operating cash requirements for the foreseeable future.

Our working capital, which we define as current assets less current liabilities, increased \$6.8 million to \$48.1 million at December 31, 2018, compared with \$41.3 million at December 31, 2017. The increase in working capital is primarily due to inventory increases resulting from the Vapor Supply asset purchase and the IVG acquisition, in addition to pre-tariff inventory buys within our existing operations.

<i>(in thousands)</i>	As of	
	December 31, 2018	December 31, 2017
Current assets	\$ 111,854	\$ 79,493
Current liabilities	63,766	38,230
Working capital	\$ 48,088	\$ 41,263

During the year ended December 31, 2018, we invested \$2.3 million in capital expenditures. We had unrestricted cash on hand of \$3.3 million and \$2.6 million as of December 31, 2018 and 2017, respectively. We had restricted assets of \$30.6 million and \$30.8 million as of December 31, 2018 and 2017, respectively. Restricted assets consist of escrow deposits under the MSA. On the 25<sup>th</sup> anniversary of each annual deposit, we are entitled to receive reimbursement of the principal amount of escrow remaining for that year. See [Master Settlement Agreement](#) below for details.

*Cash Flows from Operating Activities*

For the year ended December 31, 2018, net cash provided by operating activities decreased to \$13.1 million from \$29.7 million for the year ended December 31, 2017, a decrease of \$16.6 million or 56%, primarily due to inventory increases from pre-tariff inventory buys within our existing operations.

For the year ended December 31, 2017, net cash provided by operating activities increased to \$29.7 million from \$9.1 million for the year ended December 31, 2016, an increase of \$20.6 million or 225.3%, principally due to an increase in pre-tax income of \$12.0 million as we did not pay federal income taxes in 2017 and 2016 in addition to interest paid on the PIK Toggle Notes in 2016, which did not recur.

*Cash Flows from Investing Activities*

For the year ended December 31, 2018, net cash used in investing activities increased to \$24.7 million from \$1.9 million for the year ended December 31, 2017, an increase of \$23.6 million or 2110%, primarily due to the Vapor Supply and IVG acquisitions.

For the year ended December 31, 2017, net cash used in investing activities decreased to \$1.9 million from \$26.8 million for the year ended December 31, 2016, a decrease of \$24.9 million or 92.8%, principally due to the 2016 acquisitions of VaporBeast, certain brands from Wind River, and the land and building in Dresden, Tennessee.

*Cash Flows from Financing Activities*

For the year ended December 31, 2018, net cash provided by financing activities was \$9.9 million compared to net cash used in financing activities of \$28.0 million for the year ended December 31, 2017, an increase of \$37.9 million,

primarily due to borrowings against our 2018 Revolving Credit Facility to fund our investing activities.

For the year ended December 31, 2017, net cash used by financing activities was \$28.0 million compared with net cash provided by financing activities of \$15.7 million for the year ended December 31, 2016, a decrease of \$43.8 million or 278.1%, principally due to proceeds from the issuance of stock from our IPO in May 2016 and refinancing costs associated with the 2017 Credit Facility in 2017.

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Notes payable and long-term debt consisted of the following at December 31, 2018 and 2017, in order of preference:

	<b>December 31, 2018</b>	<b>December 31, 2017</b>
2018 Revolving Credit Facility	\$ 26,000	\$ —
2018 First Lien Term Loan	154,000	—
2018 Second Lien Term Loan	40,000	—
Note payable - IVG	4,000	—
2017 Revolving Credit Facility	—	8,000
2017 First Lien First Out Term Loan	—	105,875
2017 First Lien Second Out Term Loan	—	34,738
2017 Second Lien Term Loan	—	55,000
Note payable - VaporBeast	—	2,000
Total notes payable and long-term debt	224,000	205,613
Less deferred finance charges	(3,285 )	(3,573 )
Less revolving credit facility	(26,000 )	(8,000 )
Less current maturities	(8,000 )	(7,850 )
	<b>\$ 186,715</b>	<b>\$ 186,190</b>

*2018 Credit Facility*

On March 7, 2018, the Company entered into a \$250 million credit facility consisting of a \$160 million 2018 First Lien Term Loan with Fifth Third Bank, as administrative agent, and other lenders, and a \$50 million 2018 Revolving Credit Facility (collectively, the 2018 First Lien Credit Facility ) in addition to a \$40 million 2018 Second Lien Term Loan (together with the 2018 First Lien Credit Facility, the 2018 Credit Facility ) with Prospect Capital Corporation, as administrative agent, and other lenders. The 2018 Credit Facility retained the \$40 million accordion feature of the 2017 Credit Facility. Proceeds from the 2018 Credit Facility were used to repay, in full, the 2017 Credit Facility. The Company incurred a loss on extinguishment of debt of \$2.4 million in the first quarter of 2018 as a result of the refinancing.

The 2018 Credit Facility contains customary events of default including payment defaults, breaches of representations and warranties, covenant defaults, cross-defaults to certain other material indebtedness in excess of specified amounts, certain events of bankruptcy and insolvency, certain ERISA events, judgments in excess of specified amounts, and change in control defaults. The 2018 Credit Facility also contains certain negative covenants customary for facilities of these types including covenants that, subject to exceptions described in the 2018 Credit Facility, restrict the ability of the Company and its subsidiary guarantors: (i) to pledge assets, (ii) to incur additional indebtedness, (iii) to pay dividends, (iv) to make distributions, (v) to sell assets, and (vi) to make investments. Refer to Note 21 of Notes to Consolidated Financial Statements for further information regarding dividend restrictions.

**2018 First Lien Credit Facility:** The 2018 First Lien Term Loan and the 2018 Revolving Credit Facility bear interest at LIBOR plus a spread of 2.75% to 3.50% based on the Company's senior leverage ratio. The 2018 First Lien Term Loan has quarterly required payments of \$2.0 million beginning June 30, 2018, increasing to \$3.0 million on June 30, 2020, and increasing to \$4.0 million on June 30, 2022. The 2018 First Lien Credit Facility has a maturity date of March 7, 2023. The 2018 First Lien Term Loan is secured by a first priority lien on substantially all of the assets of

the borrowers and the guarantors thereunder, including a pledge of the Company's capital stock, other than certain excluded assets (the Collateral). The 2018 First Lien Credit Facility contains certain financial covenants including maximum senior leverage ratio of 3.50x with step-downs to 3.00x, a maximum total leverage ratio of 4.50x with step-downs to 4.00x, and a minimum fixed charge coverage ratio of 1.20x. The weighted average interest rate of the 2018 First Lien Term Loan was 5.77% at December 31, 2018. The weighted average interest rate of the 2018 Revolving Credit Facility was 5.79% at December 31, 2018. At December 31, 2018, the Company had \$26.0 million of borrowings outstanding under the 2018 Revolving Credit Facility. The \$24.0 million unused portion of the 2018 Revolving Credit Facility is reduced by \$1.3 million letters of credit with Fifth Third Bank, resulting in \$22.7 million of availability under the 2018 Revolving Credit Facility at December 31, 2018.

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**2018 Second Lien Credit Facility:** The 2018 Second Lien Credit Facility bears interest at a rate of LIBOR plus 7.00% and has a maturity date of March 7, 2024. The 2018 Second Lien Term Loan is secured by a second priority interest in the Collateral and is guaranteed by the same entities as the 2018 First Lien Term Loan. The 2018 Second Lien Credit Facility contains certain financial covenants including a maximum senior leverage ratio of 3.75x with step-downs to 3.50x, a maximum total leverage ratio of 4.75x with step-downs to 4.50x, and a minimum fixed charge coverage ratio of 1.10x. The weighted average interest rate of the 2018 Second Lien Term Loan was 9.46% at December 31, 2018.

*Note Payable – IVG*

In September 2018, the Company issued a note payable to IVG's former shareholders ( *IVG Note* ). The IVG Note is \$4.0 million principal with 6.0% interest compounding annually and matures on March 5, 2020. The IVG Note is subject to customary defaults including defaults for nonpayment, nonperformance, any material breach under the purchase agreement, and bankruptcy or insolvency.

*2017 Credit Facility*

On February 17, 2017, the Company and NATC, entered into a \$250 million secured credit facility comprised of (i) a First Lien Credit Facility with Fifth Third Bank, as administrative agent, and other lenders (the *2017 First Lien Credit Facility* ) and (ii) a Second Lien Credit Facility with Prospect Capital Corporation, as administrative agent, and other lenders (the *2017 Second Lien Credit Facility*, and together with the 2017 First Lien Credit Facility, the *2017 Credit Facility* ). The Company used the proceeds of the 2017 Credit Facility to repay, in full, the Company's prior credit facilities and to pay related fees and expenses. As a result of this transaction, the Company incurred a loss on extinguishment of debt of \$6.1 million during the first quarter of 2017. Refer to Note 12 of Notes to Consolidated Financial Statements for a more complete description of our debt instruments including the 2017 Credit Facility.

*Note Payable – VaporBeast*

On November 30, 2016, the Company issued a note payable to VaporBeast's former shareholders ( *VaporBeast Note* ). The VaporBeast Note was \$2.0 million principal with 6% interest compounded monthly and matured on May 30, 2018, at which time it was paid in full.

**Distribution Agreements**

For a description of our material distribution agreements, see *Business—Distribution and Supply Agreements*.

TABLE OF CONTENTS**Master Settlement Agreement**

On November 23, 1998, the major U.S. cigarette manufacturers, Philip Morris USA, Inc., Brown & Williamson Tobacco Corporation, Lorillard Tobacco Company and R.J. Reynolds Tobacco Company, entered into the MSA with attorneys general representing states that agreed to settle certain recovery actions (the Settling States). In order to be in compliance with the MSA and subsequent states' statutes, we were required to fund an escrow account with each of the Settling States based on the number of cigarettes or cigarette equivalents (which is measured by pounds of MYO cigarette smoking tobacco) sold in such state. Funding of the escrow deposit by us in 2018 was less than \$0.1 million in respect of sales of smoking products in 2017. We estimate the total deposits relating to 2018 sales will be less than \$0.1 million. Under current MSA legislation, we will not be required to make escrow deposits after making deposits for 2017 sales as our last remaining product line subject to MSA legislation, MYO cigarette smoking tobacco, was discontinued in the third quarter of 2017. Each year's deposit will be released from escrow after 25 years. We are scheduled to begin receiving payments as our escrow deposits are released from escrow beginning in 2024.

The following table summarizes our escrow deposit balances (in thousands) by sales year as of:

Sales Year	Deposits as of December 31,	
	2018	2017
1999	\$ 211	\$ 211
2000	1,017	1,017
2001	1,673	1,673
2002	2,271	2,271
2003	4,249	4,249
2004	3,714	3,714
2005	4,552	4,552
2006	3,847	3,847
2007	4,167	4,167
2008	3,364	3,364
2009	1,619	1,626
2010	406	406
2011	193	193
2012	199	199
2013	173	173
2014	143	143
2015	101	101
2016	91	81
2017	83	70
Total	\$ 32,073	\$ 32,057

**Off-balance Sheet Arrangements**

During 2018 we executed various forward contracts, none of which met hedge accounting requirements, for the purchase of €14.5 million with maturity dates ranging from March 2018 to January 2019. During 2017, we executed no forward contracts. During 2016, we executed various forward contracts, none of which met hedge accounting, for the purchase of €5.6 million with maturity dates from January 26, 2017, to July 17, 2017. At December 31, 2018 and 2017,

we had forward contracts for the purchase of €1.5 million and €0 million, respectively. The Company had swap contracts for a total notional amount of \$70 million at December 31, 2018. The fair values of the swap contracts are based upon quoted market prices and resulted in a liability of \$0.9 million as of December 31, 2018.

TABLE OF CONTENTS**Contractual Obligations**

The following table summarizes our contractual obligations at December 31, 2018 (in thousands):

	<b>Payments due by period</b>				
	<b>Total</b>	<b>Less than 1 year</b>	<b>1-3 years</b>	<b>4-5 years</b>	<b>More than 5 years</b>
Long-term debt obligations, including interest	\$ 273,509	\$ 20,494	\$ 71,906	\$ 140,415	\$ 40,694
Operating lease obligations	4,689	1,938	2,616	135	—
Purchase obligations	36,983	36,983	—	—	—
	\$ 315,181	\$ 59,415	\$ 74,522	\$ 140,550	\$ 40,694

The total lease expense included in the consolidated statements of income for the years ended December 31, 2018, 2017, and 2016, was \$3.6 million, \$2.6 million, and \$1.8 million, respectively.

**Inflation**

We believe that any effect of inflation at current levels will be minimal. Historically, we have been able to increase prices at a rate equal to or greater than that of inflation and believe that we will continue to be able to do so for the foreseeable future. In addition, we have been able to maintain a relatively stable variable cost structure for our products due, in part, to our successful procurement with regard to our tobacco products and, in part, to our existing contractual agreement for the purchase of our premium cigarette papers.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk****Foreign Currency Sensitivity**

Our inventory purchases from Bolloré are denominated in euros. Accordingly, we have exposure to potentially adverse movements in the euro exchange rate. In addition, Bolloré provides a contractual hedge against catastrophic currency fluctuation in our agreement. We do not use derivative financial instruments for speculative trading purposes, nor do we hedge our foreign currency exposure in a manner that offsets the effects of changes in foreign exchange rates.

We regularly review our foreign currency risk and hedging programs and may as part of that review determine at any time to change our hedging policy. During 2018 we executed various forward contracts, none of which met hedge accounting requirements, for the purchase of €14.5 million with maturity dates ranging from March 2018 to January 2019. At December 31, 2018, we had forward contracts for the purchase of €1.5 million. A 10% change in the euro to U.S. dollars exchange rate would change pre-tax income by approximately \$1.8 million per year.

**Credit Risk**

At December 31, 2018 and 2017, we had bank deposits, including MSA escrows, in excess of federally insured limits of approximately \$4.4 million and \$5.0 million, respectively. The Company has chosen to invest a portion of the MSA escrows in U.S. Government securities including Treasury Notes and Treasury Bonds.

We sell our products to distributors, retail establishments, and individual consumers (via online sales from 2016 acquisition VaporBeast, 2017 acquisition Vapor Shark, and 2018 acquisitions Vapor Supply and IVG) throughout the U.S. and also have sales of Zig-Zag® premium cigarette papers in Canada. In 2018, 2017, and 2016, we had no



customers that accounted for more than 10% of our net sales. We perform periodic credit evaluations of our customers and generally do not require collateral on trade receivables. Historically, we have not experienced significant losses due to customer credit issues.

### **Interest Rate Sensitivity**

We have exposure to interest rate volatility principally relating to interest rate changes applicable to loans under our 2018 Credit Facility. As of December 31, 2018, all of our debt with the exception of the IVG Note Payable bears interest at variable rates. However, the Company had swap contracts for a total notional amount of \$70 million at December 31, 2018. The fair values of the swap contracts are based upon quoted market prices and resulted in a liability of \$0.9 million as of December 31, 2018. We believe that the effect, if any, of reasonably possible near-term changes in interest rates on our consolidated financial position, results of operations or cash flows would not be significant. A 1% change in the interest rate would change pre-tax income by approximately \$1.5 million per year.

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**Item 8. Financial Statements and Supplementary Data**

TURNING POINT BRANDS, INC.

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**Report of Independent Registered Public Accounting Firm**

To the Stockholders and the Board of Directors of Turning Point Brands, Inc.

**Opinion on the Financial Statements**

We have audited the accompanying consolidated balance sheets of Turning Point Brands, Inc. and its subsidiaries (the Company) as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, changes in stockholders' equity (deficit) and cash flows for each of the three years in the period ended December 31, 2018, and the related notes to the consolidated financial statements (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

**Basis for Opinion**

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ RSM US LLP

We have served as the Company's auditor since 2006.

Greensboro, North Carolina  
March 6, 2019

TABLE OF CONTENTS**Turning Point Brands, Inc. and Subsidiaries****Consolidated Balance Sheets***December 31, 2018 and 2017**(dollars in thousands except share data)*

	<b>December 31, 2018</b>	<b>December 31, 2017</b>
<b><i>ASSETS</i></b>		
Current assets:		
Cash	\$ 3,306	\$ 2,607
Accounts receivable, net of allowances of \$42 in 2018 and \$17 in 2017	2,617	3,248
Inventories	91,237	63,296
Other current assets	14,694	10,342
Total current assets	111,854	79,493
Property, plant, and equipment, net	10,589	8,859
Deferred income taxes	—	450
Deferred financing costs, net	870	630
Goodwill	145,939	134,620
Other intangible assets, net	35,339	26,436
Master Settlement Agreement (MSA) escrow deposits	30,550	30,826
Other assets	4,236	963
Total assets	\$ 339,377	\$ 282,277
<b><i>LIABILITIES AND STOCKHOLDERS' EQUITY</i></b>		
Current liabilities:		
Accounts payable	\$ 6,841	\$ 3,686
Accrued liabilities	22,925	18,694
Current portion of long-term debt	8,000	7,850
Revolving credit facility	26,000	8,000
Total current liabilities	63,766	38,230
Notes payable and long-term debt	186,715	186,190
Deferred income taxes	2,291	—
Postretirement benefits	3,096	3,962
Other long-term liabilities	886	571
Total liabilities	256,754	228,953
Commitments and contingencies		
Stockholders' equity:		
Preferred stock; \$0.01 par value; authorized shares 40,000,000; issued and outstanding shares -0-	—	—

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Common stock, voting, \$0.01 par value; authorized shares, 190,000,000; issued and outstanding shares - 19,553,857 at December 31, 2018, and 19,210,633 at December 31, 2017	196	192
Common stock, nonvoting, \$0.01 par value; authorized shares, 10,000,000; issued and outstanding shares -0-	—	—
Additional paid-in capital	110,466	103,640
Accumulated other comprehensive loss	(2,536 )	(2,973 )
Accumulated deficit	(25,503 )	(47,535 )
Total stockholders' equity	82,623	53,324
Total liabilities and stockholders' equity	\$ 339,377	\$ 282,277

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

TABLE OF CONTENTS**Turning Point Brands, Inc. and Subsidiaries****Consolidated Statements of Income***for the years ended December 31, 2018, 2017, and 2016**(dollars in thousands except share data)*

	<b>For the year ended December 31,</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
Net sales	\$ 332,683	\$ 285,777	\$ 206,228
Cost of sales	190,124	160,807	105,683
Gross profit	142,559	124,970	100,545
Selling, general, and administrative expenses	94,075	75,290	56,626
Operating income	48,484	49,680	43,919
Interest expense	15,086	16,904	26,739
Interest income	(267 )	(15 )	(118 )
Investment income	(424 )	(438 )	(768 )
Loss on extinguishment of debt	2,384	6,116	2,824
Net periodic benefit expense, excluding service cost	131	180	334
Income before income taxes	31,574	26,933	14,908
Income tax expense (benefit)	6,285	7,280	(12,005 )
Consolidated net income	25,289	19,653	26,913
Net loss attributable to non-controlling interest	—	(556 )	—
Net income attributable to Turning Point Brands, Inc.	\$ 25,289	\$ 20,209	\$ 26,913
Basic income per common share:			
Net income attributable to Turning Point Brands, Inc.	\$ 1.31	\$ 1.06	\$ 1.63
Diluted income per common share:			
Net income attributable to Turning Point Brands, Inc.	\$ 1.28	\$ 1.04	\$ 1.49
Weighted average common shares outstanding:			
Basic	19,355,607		