

Turning Point Brands, Inc.  
Form 10-Q  
May 01, 2019

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2019

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 20-0709285  
(State or other jurisdiction of Incorporation or organization) (I.R.S. Employer Identification No.)

5201 Interchange Way, Louisville, KY 40229  
(Address of principal executive offices) (Zip Code)

(502) 778-4421  
(Registrant's telephone number, including area code)

Former name, former address and former fiscal year, if changed since last report: not applicable

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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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

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Non-accelerated filer (Do not check if a smaller reporting company) 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

At April 22, 2019, there were 19,589,410 shares outstanding of the registrant's voting common stock, par value \$0.01 per share.

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Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q 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 Turning Point Brands, Inc. (“TPB”), in this Quarterly Report on Form 10-Q 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;
- some of our products are subject to developing and unpredictable regulations;
- the scientific community’s lack of information regarding the long-term health effects of electronic cigarette, 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;
- 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;

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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—FINANCIAL INFORMATION

Item 1. Financial Statements

Turning Point Brands, Inc.  
 Consolidated Balance Sheets  
 (dollars in thousands except share data)

|   | (unaudited)<br>March 31,<br>2019 | December 31,<br>2018 |
|---|----------------------------------|----------------------|
| <b>ASSETS</b>   |                                  |                      |
| Current assets:   |                                  |                      |
| Cash  | \$ 1,741                         | \$ 3,306             |
| Accounts receivable, net of allowances of \$47 in 2019 and \$42 in 2018   | 4,343                            | 2,617                |
| Inventories   | 90,871                           | 91,237               |
| Other current assets  | 11,666                           | 14,694               |
| Total current assets  | 108,621                          | 111,854              |
| Property, plant, and equipment, net   | 10,942                           | 10,589               |
| Right of use assets   | 10,951                           | -                    |
| Deferred financing costs, net   | 818                              | 870                  |
| Goodwill  | 145,961                          | 145,939              |
| Other intangible assets, net  | 34,979                           | 35,339               |
| Master Settlement Agreement (MSA) escrow deposits   | 31,045                           | 30,550               |
| Other assets  | 4,225                            | 4,236                |
| Total assets  | \$ 347,542                       | \$ 339,377           |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                                  |                      |
| Current liabilities:  |                                  |                      |
| Accounts payable  | \$ 15,070                        | \$ 6,841             |
| Accrued liabilities   | 20,419                           | 22,925               |
| Current portion of long-term debt   | 12,000                           | 8,000                |
| Revolving credit facility   | 14,000                           | 26,000               |
| Total current liabilities   | 61,489                           | 63,766               |
| Notes payable and long-term debt  | 180,900                          | 186,715              |
| Deferred income taxes   | 2,172                            | 2,291                |
| Postretirement benefits   | 3,092                            | 3,096                |
| Lease liabilities   | 9,504                            | -                    |
| Other long-term liabilities   | 1,544                            | 886                  |
| Total liabilities   | 258,701                          | 256,754              |
| Commitments and contingencies   |                                  |                      |
| Stockholders' equity:   |                                  |                      |
| Preferred stock; \$0.01 par value; authorized shares 40,000,000; issued and outstanding shares -0-  | -                                | -                    |
| Common stock, voting, \$0.01 par value; authorized shares, 190,000,000; issued and outstanding shares - 19,576,398 at March 31, 2019, and 19,553,857 at December 31, 2018 | 196                              | 196                  |
| Common stock, nonvoting, \$0.01 par value; authorized shares, 10,000,000; issued and outstanding shares -0-   | -                                | -                    |

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|  |            |   |            |   |
|--|------------|---|------------|---|
| Additional paid-in capital                 | 111,089    |   | 110,466    |   |
| Accumulated other comprehensive loss       | (2,614     | ) | (2,536     | ) |
| Accumulated deficit                        | (19,830    | ) | (25,503    | ) |
| Total stockholders' equity                 | 88,841     |   | 82,623     |   |
| Total liabilities and stockholders' equity | \$ 347,542 |   | \$ 339,377 |   |

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

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Turning Point Brands, Inc.  
 Consolidated Statements of Income  
 (dollars in thousands except share data)  
 (unaudited)

|   | Three Months Ended |            |   |
|---|--------------------|------------|---|
|   | March 31,          |            |   |
|   | 2019               | 2018       |   |
| Net sales   | \$91,628           | \$73,942   |   |
| Cost of sales                                       | 51,164             | 42,133     |   |
| Gross profit  | 40,464             | 31,809     |   |
| Selling, general, and administrative expenses       | 28,429             | 22,068     |   |
| Operating income                                    | 12,035             | 9,741      |   |
| Interest expense, net                               | 3,856              | 3,654      |   |
| Investment income                                   | (144               | ) (95      | ) |
| Loss on extinguishment of debt                      | -                  | 2,384      |   |
| Net periodic benefit income, excluding service cost | (11                | ) (43      | ) |
| Income before income taxes                          | 8,334              | 3,841      |   |
| Income tax expense                                  | 1,774              | 809        |   |
| Consolidated net income                             | \$6,560            | \$3,032    |   |
| Basic income per common share:                      |                    |            |   |
| Consolidated net income                             | \$0.34             | \$0.16     |   |
| Diluted income per common share:                    |                    |            |   |
| Consolidated net income                             | \$0.33             | \$0.15     |   |
| Weighted average common shares outstanding:         |                    |            |   |
| Basic   | 19,559,596         | 19,221,892 |   |
| Diluted   | 20,045,964         | 19,762,194 |   |

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

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Turning Point Brands, Inc.

Consolidated Statements of Comprehensive Income

(dollars in thousands)

(unaudited)

|   | Three Months Ended |          |
|---|--------------------|----------|
|   | March 31,          |          |
|   | 2019               | 2018     |
| Consolidated net income   | \$ 6,560           | \$ 3,032 |
| Other comprehensive loss, net of tax  |                    |          |
| Amortization of unrealized pension and postretirement gain (loss), net of tax of \$1 in 2019 and \$10 in 2018 | (4 )               | 30       |
| Unrealized gain (loss) on investments, net of tax of \$93 in 2019 and \$135 in 2018                           | 402                | (384 )   |
| Unrealized loss on interest rate swaps, net of tax of \$182 in 2019 and \$185 in 2018                         | (476 )             | (526 )   |
|   | (78 )              | (880 )   |
| Consolidated comprehensive income   | \$ 6,482           | \$ 2,152 |

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

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Turning Point Brands, Inc.  
 Consolidated Statements of Cash Flows  
 (dollars in thousands)  
 (unaudited)

|   | Three Months ended March 31, |            |
|---|------------------------------|------------|
|   | 2019                         | 2018       |
| Cash flows from operating activities:   |                              |            |
| Consolidated net income   | \$ 6,560                     | \$ 3,032   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                              |            |
| Loss on extinguishment of debt  | -                            | 2,384      |
| Loss on disposal of property, plant, and equipment                                | 23                           | -          |
| Depreciation expense  | 531                          | 560        |
| Amortization of other intangible assets   | 359                          | 176        |
| Amortization of deferred financing costs  | 237                          | 238        |
| Deferred income taxes   | (29)                         | ) 793      |
| Stock compensation expense  | 466                          | 197        |
| Changes in operating assets and liabilities:                                      |                              |            |
| Accounts receivable   | (1,726)                      | ) 965      |
| Inventories   | 366                          | 5,237      |
| Other current assets  | 2,984                        | (2,051)    |
| Other assets  | (427)                        | ) (23)     |
| Accounts payable  | 8,229                        | 2,955      |
| Accrued postretirement liabilities  | (9)                          | ) (14)     |
| Accrued liabilities and other   | (3,539)                      | ) (6,029)  |
| Net cash provided by operating activities   | \$ 14,025                    | \$ 8,420   |
| Cash flows from investing activities:   |                              |            |
| Capital expenditures  | \$ (886)                     | ) \$ (363) |
| Restricted cash, MSA escrow deposits  | 1,702                        | (530)      |
| Net cash provided by (used in) investing activities                               | \$ 816                       | \$ (893)   |

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Turning Point Brands, Inc.

Consolidated Statements of Cash Flows (Cont.)

(dollars in thousands)

(unaudited)

|   | Three Months ended March 31, |             |
|---|------------------------------|-------------|
|   | 2019                         | 2018        |
| Cash flows from financing activities:                           |                              |             |
| Proceeds from 2018 first lien term loan                         | \$ -                         | \$ 160,000  |
| Payments of 2018 first lien term loan                           | (2,000 )                     | -           |
| Proceeds from 2018 second lien term loan                        | -                            | 40,000      |
| Payments of 2018 revolving credit facility                      | (12,000 )                    | -           |
| Payment of dividends  | (880 )                       | -           |
| Payments of 2017 first lien term loan                           | -                            | (140,613 )  |
| Payments of 2017 second lien term loan                          | -                            | (55,000 )   |
| Proceeds from (payments of) 2017 revolving credit facility, net | -                            | (8,000 )    |
| Payments of financing costs                                     | -                            | (3,279 )    |
| Exercise of options   | 187                          | 20          |
| Redemption of options   | (12 )                        | -           |
| Net cash used in financing activities                           | \$ (14,705 )                 | \$ (6,872 ) |
| Net increase in cash  | \$ 136                       | \$ 655      |
| Cash, beginning of period:                                      |                              |             |
| Unrestricted  | 3,306                        | 2,607       |
| Restricted  | 2,361                        | 4,709       |
| Total cash at beginning of period                               | \$ 5,667                     | \$ 7,316    |
| Cash, end of period:  |                              |             |
| Unrestricted  | \$ 1,741                     | \$ 3,792    |
| Restricted  | 4,062                        | 4,179       |
| Total cash at end of period                                     | \$ 5,803                     | \$ 7,971    |
| Supplemental schedule of noncash financing activities:          |                              |             |
| Accrued expenses incurred for financing costs                   | \$ -                         | \$ 154      |
| Dividends declared not paid                                     | \$ 887                       | \$ -        |

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

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Turning Point Brands, Inc.

Consolidated Statements of Changes in Stockholders' Equity (Deficit)

(dollars in thousands except share data)

(unaudited)

|   | Voting<br>Shares | Common<br>Stock,<br>Voting | Common<br>Stock,<br>Non-Voting | Additional<br>Paid-In<br>Capital | Accumulated<br>Other<br>Comprehensive<br>Loss | Accumulated<br>Deficit | Accumulated<br>Total |
|---|------------------|----------------------------|--------------------------------|----------------------------------|---|------------------------|----------------------|
| Beginning balance January 1,<br>2019  | 19,553,857       | \$ 196                     | \$ -                           | \$ 110,466                       | \$ (2,536 )                                   | \$ (25,503 )           | \$ 82,623            |
| Unrecognized pension and<br>postretirement cost adjustment,<br>net of tax of \$1  | -                | -                          | -                              | -                                | (4 )  | -                      | (4 )                 |
| Unrealized gain on MSA<br>investments, net of tax of \$93                         | -                | -                          | -                              | -                                | 402   | -                      | 402                  |
| Unrealized loss on other<br>investments, net of tax of \$0                        | -                | -                          | -                              | -                                | -   | -                      | -                    |
| Unrealized loss on interest rate<br>swaps, net of tax of \$182                    | -                | -                          | -                              | -                                | (476 )  | -                      | (476 )               |
| Stock compensation expense  | -                | -                          | -                              | 449                              | -   | -                      | 449                  |
| Restricted stock forfeitures  | (47 )            | -                          | -                              | (1 )                             | -   | -                      | (1 )                 |
| Exercise of options   | 22,588           | -                          | -                              | 187                              | -   | -                      | 187                  |
| Redemption of options   | -                | -                          | -                              | (12 )                            | -   | -                      | (12 )                |
| Dividends   | -                | -                          | -                              | -                                | -   | (887 )                 | (887 )               |
| Net income  | -                | -                          | -                              | -                                | -   | 6,560                  | 6,560                |
| Ending balance March 31, 2019   | 19,576,398       | \$ 196                     | \$ -                           | \$ 111,089                       | \$ (2,614 )                                   | \$ (19,830 )           | \$ 88,841            |
| Beginning balance January 1,<br>2018  | 19,210,633       | \$ 192                     | \$ -                           | \$ 103,640                       | \$ (2,973 )                                   | \$ (47,535 )           | \$ 53,324            |
| Unrecognized pension and<br>postretirement cost adjustment                        | -                | -                          | -                              | -                                | 30  | -                      | 30                   |
| Unrealized loss on MSA<br>investments, net of tax of \$133                        | -                | -                          | -                              | -                                | (379 )  | -                      | (379 )               |
| Unrealized loss on other<br>investments, net of tax of \$2                        | -                | -                          | -                              | -                                | (5 )  | -                      | (5 )                 |
| Unrealized loss on interest rate<br>swaps, net of tax of \$185                    | -                | -                          | -                              | -                                | (526 )  | -                      | (526 )               |
| Stock compensation expense  | -                | -                          | -                              | 177                              | -   | -                      | 177                  |
| Restricted stock forfeitures  | (517 )           | -                          | -                              | (4 )                             | -   | -                      | (4 )                 |
| Exercise of options   | 12,501           | -                          | -                              | 20                               | -   | -                      | 20                   |
| Dividends   | -                | -                          | -                              | -                                | -   | (777 )                 | (777 )               |
| Reclassification of tax effects from<br>accumulated other comprehensive<br>income | -                | -                          | -                              | -                                | 24  | (24 )                  | -                    |
| Net income  | -                | -                          | -                              | -                                | -   | 3,032                  | 3,032                |
| Ending balance March 31, 2018   | 19,222,617       | \$ 192                     | \$ -                           | \$ 103,833                       | \$ (3,829 )                                   | \$ (45,304 )           | \$ 54,892            |

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



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Turning Point Brands, Inc.

Notes to Consolidated Financial Statements

(dollars in thousands, except where designated and per share data)

Note 1. Organizations and Basis of Presentation

Organizations

Turning Point Brands, Inc. (the “Company”), is a holding company which owns North Atlantic Trading Company, Inc. (“NATC”), and its subsidiaries and Turning Point Brands, LLC (“TPLL”) and its subsidiaries. Except where the context indicates otherwise, references to the Company include the Company; 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 TPLL 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”), International Vapor Group, LLC and its subsidiaries (collectively, “IVG”), and Nu-X Ventures LLC (“Nu-X”).

Basis of Presentation

The accompanying interim, consolidated financial statements have been prepared in accordance with the accounting practices described in the Company’s audited, consolidated financial statements as of and for the year ended December 31, 2018, and are unaudited. In the opinion of management, the unaudited, interim, consolidated financial statements included herein contain all adjustments necessary to present fairly the financial position, results of operations, and cash flows of the Company for the periods indicated. Such adjustments, other than nonrecurring adjustments separately disclosed, are of a normal and recurring nature. The operating results for interim periods are not necessarily indicative of results to be expected for a full year or future interim periods. The unaudited, interim, consolidated financial statements should be read in conjunction with the Company’s audited, consolidated financial statements and accompanying notes as of and for the year ended December 31, 2018. The accompanying interim, consolidated financial statements are presented in accordance with the rules and regulations of the Securities and Exchange Commission and, accordingly, do not include all the disclosures required by generally accepted accounting principles in the United States (“GAAP”) with respect to annual financial statements.

Note 2. Summary of Significant Accounting Policies

Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly-owned. All significant intercompany transactions have been eliminated.

Revenue Recognition

The Company recognizes revenues, net of sales incentives and sales returns, including shipping and handling charges billed to customers, upon delivery of goods to the customer at an amount that the Company expects to be entitled to in exchange for those goods in accordance with the five-step analysis outlined in Revenue from Contracts with Customers (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.

Topic 606 requires 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. Company management views business performance through segments that closely resemble the performance of major product lines. Thus, the primary and most useful disaggregation of the Company's contract revenue for decision making purposes is the disaggregation by segment which can be found in Note 17 of Notes to Consolidated Financial Statements. An additional disaggregation of contract revenue by sales channel can be found within Note 17 as well.



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### Shipping Costs

The Company records shipping costs incurred as a component of selling, general, and administrative expenses. Shipping costs incurred were approximately \$4.3 million and \$3.2 million for the three months ending March 31, 2019 and 2018, respectively.

### 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.

### Derivative Instruments

**Foreign Currency Forward Contracts:** The Company enters into foreign currency forward contracts to hedge a portion of its exposure to changes in foreign currency exchange rates on inventory purchase commitments. The Company accounts for its forward contracts under the provisions of ASC 815, Derivatives and Hedging. Under the Company's policy, the Company may hedge up to 100% of its anticipated purchases of inventory in the denominated invoice currency over a forward period not to exceed twelve months. The Company may also, from time to time, hedge up to ninety percent of its 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 forward 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 currently in income.

**Interest Rate Swap Agreements:** The Company enters into interest rate swap contracts to manage interest rate risk and reduce the volatility of future cash flows. The Company accounts for its 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 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.

### Risks and Uncertainties

Manufacturers and sellers of tobacco products are subject to regulation at the federal, state, and local levels. Such regulations include, among others, labeling requirements, limitations on advertising, and prohibition of sales to minors. The tobacco industry is likely to continue to be heavily regulated. There can be no assurance as to the ultimate content, timing, or effect of any regulation of tobacco products by any federal, state, or local legislative or regulatory body, nor can there be any assurance that any such legislation or regulation would not have a material adverse effect on the Company's financial position, results of operations, or cash flows.

The tobacco industry has experienced, and is experiencing, significant product liability litigation. Most tobacco liability lawsuits have been brought against manufacturers and sellers of cigarettes for injuries allegedly caused by smoking or exposure to smoke. However, several lawsuits have been brought against manufacturers and sellers of smokeless products for injuries to health allegedly caused by use of smokeless products. Typically, such claims assert that use of smokeless products is addictive and causes oral cancer. Additionally, several lawsuits have been brought against manufacturers and distributors of NewGen products due to malfunctioning devices. There can be no assurance the Company will not sustain losses in connection with such lawsuits and that such losses will not have a material adverse effect on the Company's financial position, results of operations, or cash flows.

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Master Settlement Agreement (MSA): Pursuant to the Master Settlement Agreement (the “MSA”) entered into in November 1998 by most states (represented by their attorneys general acting through the National Association of Attorneys General) and subsequent states’ statutes, a “cigarette manufacturer” (which is defined to include a manufacturer of make-your-own (“MYO”) cigarette tobacco) has the option of either becoming a signatory to the MSA or opening, funding, and maintaining an escrow account to have funds available for certain potential tobacco-related liabilities with sub-accounts on behalf of each settling state. Such companies are entitled to direct the investment of the escrowed funds and withdraw any 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 judgement to that state’s plaintiffs in the event of such a final judgement against the company. The Company chose to open and fund an escrow account as its method of compliance. It is the Company’s policy to record amounts on deposit in the escrow account for prior years as a non-current asset. Each year’s annual obligation is required to be deposited in the escrow account by April 15 of the following year. In addition to the annual deposit, many states have elected to require quarterly deposits for the previous quarter’s sales. As of March 31, 2019, the Company had on deposit approximately \$32.1 million, the fair value of which was approximately \$31.0 million. At December 31, 2018, the Company had on deposit approximately \$32.1 million, the fair value of which was approximately \$30.6 million. Effective in the third quarter of 2017, the Company no longer sells any product covered under the MSA. Thus, absent a change in legislation, the Company will no longer be required to make deposits to the MSA escrow account.

The Company has chosen to invest a portion of the MSA escrow deposits in U.S. Government securities including TIPS, Treasury Notes, and Treasury Bonds. These investments are classified as available-for-sale and carried at fair value. Realized losses are prohibited under the MSA; any investment in an unrealized loss position will be held until the value is recovered, or until maturity. The following shows the fair value of the MSA escrow account:

|   | As of March 31, 2019 |                        |                         |                      | As of December 31, 2018 |                        |                         |                      |
|---|----------------------|------------------------|-------------------------|----------------------|-------------------------|------------------------|-------------------------|----------------------|
|   | Cost                 | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value | Cost                    | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Cash and cash equivalents   | \$4,062              | \$ -                   | \$ -                    | \$4,062              | \$2,361                 | \$ -                   | \$ -                    | \$2,361              |
| U.S. Governmental agency obligations (unrealized gain position < 12 months) | 500                  | 2                      | -                       | 502                  | 1,193                   | 9                      | -                       | 1,202                |
| U.S. Governmental agency obligations (unrealized loss position < 12 months) | -                    | -                      | -                       | -                    | 1,000                   | -                      | (3 )                    | 997                  |
| U.S. Governmental agency obligations (unrealized loss position > 12 months) | 27,511               | -                      | (1,030 )                | 26,481               | 27,519                  | -                      | (1,529 )                | 25,990               |
|   | \$32,073             | \$ 2                   | \$(1,030 )              | \$31,045             | \$32,073                | \$ 9                   | \$(1,532 )              | \$30,550             |

Fair value for the U.S. Governmental agency obligations are Level 2. The following shows the maturities of the U.S. Governmental agency obligations:

|                        | As of March 31, 2019 | December 31, 2018 |
|------------------------|----------------------|-------------------|
| Less than one year     | \$1,499              | \$ 1,499          |
| One to five years      | 14,091               | 13,591            |
| Five to ten years      | 9,453                | 11,152            |
| Greater than ten years | 2,968                | 3,470             |

Total U.S. Governmental agency obligations \$28,011 \$ 29,712

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The following shows the amount of deposits by sales year for the MSA escrow account:

|            | Deposits as of |                   |
|------------|----------------|-------------------|
|            | March          |                   |
| Sales Year | 31, 2019       | December 31, 2018 |
| 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          | 1,619             |
| 2010       | 406            | 406               |
| 2011       | 193            | 193               |
| 2012       | 199            | 199               |
| 2013       | 173            | 173               |
| 2014       | 143            | 143               |
| 2015       | 101            | 101               |
| 2016       | 91             | 91                |
| 2017       | 83             | 83                |
| Total      | \$32,073       | \$ 32,073         |

Food and Drug Administration (“FDA”): On June 22, 2009, the Family Smoking Prevention and Tobacco Control Act (“FSPTCA”) authorized the FDA to immediately regulate the manufacturing, sale, and marketing of four categories of tobacco products – cigarettes, cigarette tobacco, roll-your-own tobacco, and smokeless tobacco. On August 8, 2016, the FDA deeming regulation became effective. The deeming regulation gave the FDA the authority to additionally regulate cigars, pipe tobacco, electronic cigarettes (“e-cigarettes”), vaporizers, and e-liquids as “deemed” tobacco products under the FSPTCA.

The FDA assesses tobacco product user fees on six classes of regulated tobacco products and computes user fees using a methodology similar to the methodology used by the U.S Department of Agriculture to compute the Tobacco Transition Payment Program (“TTPP,” also known as the “Tobacco Buyout”) assessment. First, the total, annual, congressionally established user fee assessment is allocated among the various classes of tobacco products using the federal excise tax weighted market share of tobacco products subject to regulation. Then, the assessment for each class of tobacco products is divided among individual manufacturers and importers.

Prior to October 1, 2016, these FDA user fees applied only to those products then regulated by the FDA. Effective October 1, 2016, the FDA began additionally applying FDA user fees to newly “deemed” tobacco products subject to FDA user fees as described above, i.e., cigars and pipe tobacco.

On July 28, 2017, the FDA announced a new direction in regulating tobacco products, including the newly “deemed” markets such as cigars and vapor products. The FDA stated it intends to begin several new rulemaking processes, some of which will outline foundational rules governing the premarket application process for the deemed products,

including Substantial Equivalence Applications and Premarket Tobacco Applications. Compliance and related costs could be significant and could increase the costs of operating in our NewGen segment. The original filing deadlines for newly “deemed” products on the market as of August 8, 2016, have been postponed until August 8, 2021, for “combustible” products (e.g., cigar and pipe) and August 8, 2022, for “non-combustible” products (e.g., vapor products). The FDA is currently considering changes to this policy. No other significant filing deadlines have been altered at this time. The FDA also acknowledged a “continuum of risk” among tobacco products (i.e., certain tobacco products pose a greater risk to individual and public health than others), that it intends to seek public comment on the role flavors play in attracting youth and the role flavors may play in helping some smokers switch to potentially less harmful forms of nicotine delivery, and that it would be increasing its focus on the regulation of cigarette products. FDA has since published a number of Advanced Notices of Proposed Rulemaking (“ANPRM”) on these subjects.

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## Recent Accounting Pronouncements Adopted

Effective January 1, 2019, the Company adopted Accounting Standards Update (“ASU”) No. 2016-02, “Leases.” This ASU requires substantially all leases be recorded on the balance sheet as right of use assets and lease obligations. The Company adopted the ASU using a retrospective adoption method at January 1, 2019, as outlined in ASU No. 2018-11, “Leases - Targeted Improvements.” Under this method of adoption, there is no impact to the comparative consolidated statement of income and consolidated balance sheet. The Company determined that there was no cumulative-effect adjustment to beginning retained earnings on the consolidated balance sheet. The Company will continue to report periods prior to January 1, 2019 in its financial statements under prior guidance as outlined in Accounting Standards Codification Topic 840, “Leases”. In addition, the Company elected the package of practical expedients permitted under the transition guidance within the new standard, which among other things, allowed carry forward of historical lease classifications. Adoption of this standard did not materially impact the Company’s income before income taxes and had no impact on the statement of cash flows. See Note 11, “Leases” for further details.

## Note 3. Acquisitions

## IVG

In September 2018, the Company acquired 100% of the equity interest of 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. Such amounts will be considered compensation and not a component of the IVG purchase price. 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 approximately \$0.4 million within the consolidated statement of income for the three months ended March 31, 2019, 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. As of March 31, 2019, the Company had not completed the accounting for the acquisition. The following purchase price and goodwill are based on the excess of the acquisition price over the estimated fair value of the tangible and intangible assets acquired and are based on management’s preliminary estimates.

|   |          |
|---|----------|
| Total consideration transferred           | \$24,292 |
| Adjustments to consideration transferred: |          |
| Cash acquired, net of debt assumed        | (221 )   |
| Working capital                           | (245 )   |
| Adjusted consideration transferred        | 23,826   |
| Assets acquired:                          |          |
| Working capital (primarily inventory)     | 3,331    |
| Fixed assets                              | 1,274    |
| Intangible assets                         | 7,880    |
| Net assets acquired                       | 12,485   |

|          |          |
|----------|----------|
| Goodwill | \$11,341 |
|----------|----------|

The goodwill of \$11.3 million consists of the synergies and scale expected from combining the operations and is currently deductible for tax purposes.

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## Vapor Supply

On April 30, 2018, the Company purchased the assets of Vapor Supply LLC, vaporsupply.com, and some of its affiliates including the Ecig.com domain through its subsidiary Vapor Acquisitions Company, LLC, for total consideration of \$4.8 million paid in cash to strengthen its presence within the NewGen segment. Vapor Supply is a business-to-business e-commerce distribution platform servicing independent retail vape shops. Additionally, Vapor Supply manufactures and markets proprietary e-liquids under the DripCo brand and operates company-owned stores. As of March 31, 2019, the Company had not completed the accounting for the acquisition of these assets. The following fair value for working capital (primarily inventory), fixed assets, and trade name are based on management's preliminary estimates:

|                                 | Fair Value |
|---------------------------------|------------|
| Working capital                 | \$ 2,500   |
| Fixed assets                    | 272        |
| Trade name                      | 2,028      |
| Total consideration transferred | \$ 4,800   |

## Note 4. Derivative Instruments

## Foreign Currency

The Company's policy is to manage the risks associated with foreign exchange rate movements. The policy allows hedging up to 100% of its anticipated purchases of inventory over a forward period that will not exceed 12 rolling and consecutive months. The Company may, from time to time, hedge currency for non-inventory purchases, e.g., production equipment, not to exceed 90% of the purchase price. The Company did not execute any forward contracts during the three months ended March 31, 2019. During 2018 the Company executed various forward contracts, none of which met hedge accounting requirements, for the purchase of €14.5 million. At March 31, 2019, and December 31, 2018, the Company had forward contracts for the purchase of €0.0 million and €1.5 million, respectively.

## Interest Rate Swaps

The Company's policy is to manage interest rate risk by reducing the volatility of future cash flows associated with debt instruments bearing interest at variable rates. In March 2018, the Company executed various interest rate swap agreements for a notional amount of \$70 million with an expiration of December 2022. The swap agreements fix LIBOR at 2.755%. The swap agreements met the hedge accounting requirements; thus, any change in fair value is recorded to other comprehensive income. The Company uses the Shortcut Method to account for the swap agreements. The Shortcut Method assumes the hedge to be perfectly effective; thus, there is no ineffectiveness to be recorded in earnings. The swap agreements' fair values at March 31, 2019, and December 31, 2018, resulted in a liability of \$1.5 million and \$0.9 million, respectively, included in other long-term liabilities.

## Note 5. Fair Value of Financial Instruments

The estimated fair value amounts have been determined by the Company using the methods and assumptions described below. However, considerable judgment is required to interpret market data to develop estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

## Cash and Cash Equivalents

Cash and cash equivalents are, by definition, short-term. Thus, the carrying amount is a reasonable estimate of fair value.

Accounts Receivable

The fair value of accounts receivable approximates their carrying value due to their short-term nature.

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2018 Revolving Credit Facility

The fair value of the 2018 Revolving Credit Facility approximates its carrying value as the interest rate fluctuates with changes in market rates.

Note Payable – IVG

The fair value of the IVG Note approximates its carrying value of \$4.0 million due to the recency of the note’s issuance, relative to the end of the quarter, March 31, 2019.

Long-Term Debt

As the Company’s long-term debt bears interest at variable rates that fluctuate with market rates, the carrying values of the long-term debt instruments approximate their respective fair values. As of March 31, 2019, the fair values of the 2018 First Lien Term Loan and the 2018 Second Lien Term Loan approximated \$152.0 million and \$40.0 million, respectively. As of December 31, 2018, the fair values of the 2018 First Lien Term Loan and the 2018 Second Lien Term Loan approximated \$154.0 million and \$40.0 million, respectively. See Note 10 of Notes to Consolidated Financial Statements for information regarding our credit facilities.

Foreign Exchange

The Company did not have any open forward contracts at March 31, 2019. The Company had forward contracts for the purchase of €1.5 million as of December 31, 2018. The fair values of the foreign exchange contracts are based upon quoted market prices and resulted in a gain of approximately \$0.1 million for the three months ended March 31, 2019. As there were no open contracts as of March 31, 2019, there is no resulting balance sheet position related to the fair value.

Interest Rate Swaps

The Company had swap contracts for a total notional amount of \$70 million at March 31, 2019 and December 31, 2018. The fair values of the swap contracts are based upon quoted market prices and resulted in a liability of \$1.5 million and \$0.9 million as of March 31, 2019 and December 31, 2018, respectively.

Note 6. Inventories

The components of inventories are as follows:

|                                     | March 31,<br>2019 | December 31,<br>2018 |
|-------------------------------------|-------------------|----------------------|
| Raw materials and work in process   | \$ 3,967          | \$ 2,722             |
| Leaf tobacco                        | 35,929            | 34,977               |
| Finished goods - Smokeless products | 6,540             | 6,321                |
| Finished goods - Smoking products   | 15,079            | 14,666               |
| Finished goods - NewGen products    | 33,810            | 37,194               |
| Other                               | 903               | 738                  |
|                                     | 96,228            | 96,618               |
| LIFO reserve                        | (5,357 )          | (5,381 )             |
|                                     | \$ 90,871         | \$ 91,237            |

The inventory valuation allowance was \$1.5 million and \$2.5 million as of March 31, 2019, and December 31, 2018, respectively.

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## Note 7. Property, Plant, and Equipment

Property, plant, and equipment consisted of the following:

|                            | March 31,<br>2019 | December 31,<br>2018 |
|----------------------------|-------------------|----------------------|
| Land                       | \$ 22             | \$ 22                |
| Buildings and improvements | 2,320             | 2,320                |
| Leasehold improvements     | 2,101             | 2,101                |
| Machinery and equipment    | 14,214            | 13,292               |
| Furniture and fixtures     | 5,003             | 5,045                |
|                            | 23,660            | 22,780               |
| Accumulated depreciation   | (12,718)          | (12,191)             |
|                            | \$ 10,942         | \$ 10,589            |

## Note 8. Other Current Assets

Other current assets consisted of the following:

|                    | March 31,<br>2019 | December 31,<br>2018 |
|--------------------|-------------------|----------------------|
| Inventory deposits | \$ 7,134          | \$ 9,739             |
| Other              | 4,532             | 4,955                |
|                    | \$ 11,666         | \$ 14,694            |

## Note 9. Accrued Liabilities

Accrued liabilities consisted of the following:

|                                   | March 31,<br>2019 | December 31,<br>2018 |
|-----------------------------------|-------------------|----------------------|
| Accrued payroll and related items | \$ 3,093          | \$ 6,063             |
| Customer returns and allowances   | 3,082             | 3,634                |
| Taxes payable                     | 3,758             | 2,138                |
| Lease liabilities                 | 1,700             | -                    |
| Other                             | 8,786             | 11,090               |
|                                   | \$ 20,419         | \$ 22,925            |

## Note 10. Notes Payable and Long-Term Debt

Notes payable and long-term debt consisted of the following in order of preference:

|  | March 31,<br>2019 | December 31,<br>2018 |
|--|-------------------|----------------------|
| 2018 First Lien Term Loan              | \$ 152,000        | \$ 154,000           |
| 2018 Second Lien Term Loan             | 40,000            | 40,000               |
| Note payable - IVG                     | 4,000             | 4,000                |
| Total notes payable and long-term debt | 196,000           | 198,000              |
| Less deferred finance charges          | (3,100)           | (3,285)              |
| Less current maturities                | (12,000)          | (8,000)              |

\$ 180,900      \$ 186,715

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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 contains a \$40 million accordion feature. 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 18 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 5.75% at March 31, 2019. The weighted average interest rate of the 2018 Revolving Credit Facility was 6.61% at March 31, 2019. At March 31, 2019, the Company had \$14.0 million of borrowings outstanding under the 2018 Revolving Credit Facility. The \$36.0 million unused portion of the 2018 Revolving Credit Facility is reduced by a \$1.3 million letter of credit with Fifth Third Bank, resulting in \$34.7 million of availability under the 2018 Revolving Credit Facility at March 31, 2019.

**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 9.48% at March 31, 2019.

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. 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.

Note 11. Leases

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As of January 1, 2019, the Company adopted ASU 2016-02, Leases (Topic 842). The main impact to the financial statements is the recognition of lease liabilities and right of use assets. The Company's leases consist primarily of leased property for manufacturing warehouse, head offices and retail space as well as vehicle leases. In general, the Company does not recognize any renewal periods within the lease terms as there are not significant barriers to ending the lease at the initial term. Lease and non-lease components are accounted for as a single lease component.

Leases with an initial term of 12 months or less are not recorded on the balance sheet. Lease expense for these leases is recognized on a straight-line basis over the lease term.



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The components of lease expense consisted of the following:

| Three months ended                  | March 31,<br>2019 |
|-------------------------------------|-------------------|
| Operating lease cost                |                   |
| Cost of sales                       | \$ 192            |
| Selling, general and administrative | 555               |
| Variable lease cost (1)             | 245               |
| Short-term lease cost               | 54                |
| Sublease income                     | (30 )             |
| Total operating lease cost          | \$ 1,016          |

(1) Variable lease expense includes elements of a contract that do not represent a good or service but for which the lessee is responsible for paying.

|                               | March 31,<br>2019 |
|-------------------------------|-------------------|
| Assets:                       |                   |
| Right of use assets           | \$ 10,951         |
| Total leased assets           | \$ 10,951         |
| Liabilities:                  |                   |
| Current lease liabilities (2) | \$ 1,700          |
| Long-term lease liabilities   | 9,504             |
| Total Lease Liabilities       | \$ 11,204         |

(2) Reported within accrued liabilities on the balance sheet

|  | As of March 31, 2019 |   |
|--|----------------------|---|
| Weighted-average remaining lease term - operating leases | 9.0 years            |   |
| Weighted-average discount rate - operating leases        | 6.49                 | % |

Nearly all the lease contracts for the Company do not provide a readily determinable implicit rate. For these contracts, the Company estimated the incremental borrowing rate based on information available upon adoption of ASU 2016-02.

As of March 31, 2019, maturities of lease liabilities consisted of the following:

|                                    | March 31,<br>2019 |
|------------------------------------|-------------------|
| Remaining nine months of 2019      | \$ 1,736          |
| 2020                               | 2,167             |
| 2021                               | 1,788             |
| 2022                               | 1,144             |
| 2023                               | 973               |
| Years thereafter                   | 7,245             |
| Total lease payments               | \$ 15,053         |
| Less: Imputed interest             | 3,849             |
| Present value of lease liabilities | \$ 11,204         |



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## Note 12. Income Taxes

In December 2017, the U.S. Congress passed the Tax Cuts and Jobs Act of 2017 ("TCJA") which the President signed in the same month. The TCJA reduced the corporate income tax rate to 21%, effective January 1, 2018. Other significant changes accompanying the corporate income tax rate reduction include eliminating the corporate alternative minimum tax, limiting the interest expense deduction to 30% of adjusted taxable income, and limiting net operating losses to 80% of taxable income for losses arising in tax years beginning after 2017. The TCJA required the Company to remeasure its deferred tax assets and liabilities at the newly enacted tax rate in December 2017, the period of enactment.

The Company's effective income tax rate for the three months ended March 31, 2019, was 21.3% which includes a discrete tax deduction of \$0.9 million for the three months ended March 31, 2019, relating to stock option exercises. The Company's effective income tax rate for the three months ended March 31, 2018, was 21% which includes a discrete tax deduction of \$0.3 million for the three months ended March 31, 2018, relating to stock option exercises.

The Company follows the provisions of ASC 740-10-25, which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by taxing authorities. The amount recognized is measured as the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. The Company has determined that the Company did not have any uncertain tax positions requiring recognition under the provisions of ASC 740-10-25. The Company's policy is to recognize interest and penalties accrued on uncertain tax positions, if any, as part of interest expense. The Company files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. In general, the Company is no longer subject to U.S. federal and state tax examinations for years prior to 2014.

## Note 13. Pension and Postretirement Benefit Plans

The Company has a defined benefit pension plan. Benefits for hourly employees were based on a stated benefit per year of service, reduced by amounts earned in a previous plan. Benefits for salaried employees were based on years of service and the employees' final compensation. The defined benefit pension plan is frozen. The Company's policy is to make the minimum amount of contributions that can be deducted for federal income taxes. The Company expects to make no contributions to the pension plan in 2019. In the second quarter of 2018, the Company made mutually agreed upon lump-sum payments to certain individuals covered by the defined benefit pension plan which resulted in a curtailment loss of approximately \$0.3 million during the second quarter of 2018.

The Company sponsored a defined benefit postretirement plan that covered hourly employees. This plan provides medical and dental benefits. This plan is contributory with retiree contributions adjusted annually. The Company's policy is to make contributions equal to benefits paid during the year. The Company expects to contribute approximately \$0.2 million to its postretirement plan in 2019 for the payment of benefits.

The following table provides the components of net periodic pension and postretirement benefit costs and total costs for the plans:

|                                | Three Months Ended March 31, |        |                         |      |
|--------------------------------|------------------------------|--------|-------------------------|------|
|                                | Pension Benefits             |        | Postretirement Benefits |      |
|                                | 2019                         | 2018   | 2019                    | 2018 |
| Service cost                   | \$ 26                        | \$ 26  | \$ -                    | \$ - |
| Interest cost                  | 130                          | 142    | 25                      | 29   |
| Expected return on plan assets | (161 )                       | (254 ) | -                       | -    |

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|                                    |       |          |          |       |
|------------------------------------|-------|----------|----------|-------|
| Amortization of (gains) losses     | 37    | 60       | (42 )    | (20 ) |
| Net periodic benefit (income) cost | \$ 32 | \$ (26 ) | \$ (17 ) | \$ 9  |

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## Note 14. Share Incentive Plans

On April 28, 2016, the Board of Directors of the Company adopted the Turning Point Brands, Inc., 2015 Equity Incentive Plan (the “2015 Plan”), pursuant to which awards may be granted to employees, non-employee directors, and consultants. In addition, the 2015 Plan provides for the granting of nonqualified stock options to employees of the Company or any subsidiary of the Company. Pursuant to the 2015 Plan, 1,400,000 shares of the Company’s voting common stock are reserved for issuance as awards to employees, non-employee directors, and consultants as compensation for past or future services or the attainment of certain performance goals. The 2015 Plan is scheduled to terminate on April 27, 2026. The 2015 Plan is administered by a committee (the “Committee”) of the Company’s Board of Directors. The Committee determines the vesting criteria for the awards, with such criteria to be specified in the award agreement. As of March 31, 2019, net of forfeitures, there were 18,059 shares of restricted stock, 272,776 performance-based restricted stock units, and 447,728 options granted under the 2015 Plan. There are 661,437 shares available for grant under the 2015 Plan.

On February 8, 2006, the Board of Directors of the Company adopted the 2006 Equity Incentive Plan (the “2006 Plan”) of North Atlantic Holding Company, Inc., pursuant to which awards may be granted to employees. The 2006 Plan provides for the granting of nonqualified stock options and restricted stock awards to employees. Upon the adoption of the Company’s 2015 Equity Incentive Plan in connection with its IPO, the Company determined no additional grants would be made under the 2006 Plan. However, all awards issued under the 2006 Plan that have not been previously terminated or forfeited remain outstanding and continue unaffected.

There are no shares available for grant under the 2006 Plan. Stock option activity for the 2006 and 2015 Plans is summarized below:

|                                | Stock<br>Option<br>Shares | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Grant Date<br>Fair Value |
|--------------------------------|---------------------------|--|---|
| Outstanding, December 31, 2017 | 763,672                   | 5.73                                     | 2.36  |
| Granted                        | 124,100                   | 21.27                                    | 6.33  |
| Exercised                      | (209,943 )                | 3.97                                     | 1.47  |
| Forfeited                      | (18,255 )                 | 13.46                                    | 3.90  |
| Outstanding, December 31, 2018 | 659,574                   | \$ 9.00                                  | \$ 3.34   |
| Granted                        | 155,780                   | 47.58                                    | 15.63   |
| Exercised                      | (22,892 )                 | 8.16                                     | 3.08  |
| Forfeited                      | (912 )                    | 44.69                                    | 14.64   |
| Outstanding, March 31, 2019    | 791,550                   | \$ 16.58                                 | \$ 5.75   |

Under the 2006 and 2015 Plans, the total intrinsic value of options exercised during the three months ended March 31, 2019 and 2018, was \$0.8 million, and \$0.3 million, respectively.

At March 31, 2019, under the 2006 Plan, the outstanding stock options’ exercise price for 405,296 options is \$3.83 per share, all of which are exercisable. The weighted average of the remaining lives of the outstanding stock options with an exercise price of \$3.83 is approximately 4.17 years. The Company estimates the expected life of these stock options is ten years from the date of grant. For the \$3.83 per share options, the weighted average fair value of options was determined using the Black-Scholes model assuming a ten-year life from grant date, a current share price and exercise price of \$3.83, a risk-free interest rate of 3.57%, volatility of 40%, and no assumed dividend yield. Based on

these assumptions, the fair value of these options is approximately \$2.17 per share option granted.

At March 31, 2019, under the 2015 Plan, the risk-free interest rate is based on the U.S. Treasury rate for the expected life at the time of grant. The expected volatility is based on the average long-term historical volatilities of peer companies. We intend to continue to consistently use the same group of publicly traded peer companies to determine expected volatility until sufficient information regarding volatility of our share price becomes available or until the selected companies are no longer suitable for this purpose. Due to our limited trading history, we are using the simplified method presented by SEC Staff Accounting Bulletin No. 107 to calculate expected holding periods, which represent the periods of time for which options granted are expected to be outstanding. We will continue to use this method until we have sufficient historical exercise experience to give us confidence in the reliability of our calculations. The fair values of these options were determined using the Black-Scholes option pricing model.

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The following table outlines the assumptions based on the number of options granted under the 2015 Plan.

|                                       | February 10,<br>2017 | May 17,<br>2017 | March 7,<br>2018 | March 13,<br>2018 | March 20,<br>2019 |
|---------------------------------------|----------------------|-----------------|------------------|-------------------|-------------------|
| Number of options granted             | 40,000               | 93,819          | 98,100           | 26,000            | 155,780           |
| Options outstanding at March 31, 2019 | 30,700               | 79,874          | 94,730           | 26,000            | 154,950           |
| Number exercisable at March 31, 2019  | 19,150               | 53,511          | 33,746           | 17,420            | -                 |
| Exercise price                        | \$ 13.00             | \$ 15.41        | \$ 21.21         | \$ 21.49          | \$ 47.58          |
| Remaining lives                       | 7.87                 | 8.13            | 8.94             | 8.96              | 9.98              |
| Risk free interest rate               | 1.89                 | % 1.76          | % 2.65           | % 2.62            | % 2.34            |
| Expected volatility                   | 27.44                | % 26.92         | % 28.76          | % 28.76           | % 30.95           |
| Expected life                         | 6.000                | 6.000           | 6.000            | 5.495             | 6.000             |
| Dividend yield                        | -                    | -               | 0.83             | % 0.82            | % 0.42            |
| Fair value at grant date              | \$ 3.98              | \$ 4.60         | \$ 6.37          | \$ 6.18           | \$ 15.63          |

The Company has recorded compensation expense related to the options based on the provisions of ASC 718 under which the fixed portion of such expense is determined as the fair value of the options on the date of grant and amortized over the vesting period. The Company recorded compensation expense related to the options of approximately \$0.2 million and \$0.1 million for the three months ended March 31, 2019 and 2018. Total unrecognized compensation expense related to options at March 31, 2019, is \$2.5 million, which will be expensed over 2.62 years.

## Performance-Based Restricted Stock Units (“PRsUs”)

PRsUs are restricted stock units subject to both performance-based and service-based vesting conditions. The number of common stock shares a recipient will receive upon vesting of a PRsU will be calculated by reference to certain performance metrics related to the Company’s performance over a five-year period. PRsUs will vest on the measurement date, which is no more than 65 days after the performance period (provided the applicable service and performance conditions are satisfied). On March 7, 2018, the Company’s Board of Directors granted 96,000 PRsUs to employees of the Company. On March 20, 2019, the Company’s Board of Directors granted an additional 92,500 PRsUs to employees of the Company. The fair values of the PRsUs granted on March 7, 2018, and March 20, 2019, are \$21.21 and \$47.58, respectively, the Company’s stock price on the date of grant. As of March 31, 2019, there are 267,900 PRsUs outstanding, all of which are unvested. On March 20, 2019, the Company’s Board of Directors granted 4,876 PRsUs with a one-year performance period. The fair value of these awards is \$47.58. The Company recorded compensation expense related to the PRsUs of approximately \$0.2 million and \$0.1 million in the consolidated statements of income for the three months ended March 31, 2019 and 2018, based on the probability of achieving the performance condition. Total unrecognized compensation expense related to these awards at March 31, 2019, is \$6.7 million which will be expensed over the service periods based on the probability of achieving the performance condition.

## Note 15. Contingencies

Other major tobacco companies are defendants in product liability claims. In a number of these cases, the amounts of punitive and compensatory damages sought are significant and could have a material adverse effect on our business and results of operations. The Company is a defendant in certain cases which have been dormant for many years, which cases have now been dismissed with prejudice.

The Company is subject to several lawsuits alleging personal injuries resulting from malfunctioning vaporizer devices 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.



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## Note 16. Income Per Share

The following is a reconciliation of the numerators and denominators of the basic and diluted EPS computations of net income:

|                                | Three Months Ended March 31, |            |           |         |            |           |
|--------------------------------|------------------------------|------------|-----------|---------|------------|-----------|
|                                | 2019                         |            | 2018      |         |            |           |
|                                | Income                       | Shares     | Per Share | Income  | Shares     | Per Share |
| Consolidated net income        | \$6,560                      |            |           | \$3,032 |            |           |
| Basic EPS:                     |                              |            |           |         |            |           |
| Weighted average               |                              | 19,559,596 | \$0.34    |         | 19,221,892 | \$0.16    |
| Diluted EPS:                   |                              |            |           |         |            |           |
| Effect of dilutive securities: |                              |            |           |         |            |           |
| Stock options                  |                              | 486,368    |           |         | 540,302    |           |
|                                |                              | 20,045,964 | \$0.33    |         | 19,762,194 | \$0.15    |

## Note 17. Segment Information

In accordance with ASC 280, Segment Reporting, the Company has three reportable segments: Smokeless products, Smoking products, and NewGen products. The Smokeless products segment (i) manufactures and markets moist snuff and (ii) contracts for and markets chewing tobacco products. The Smoking products segment (i) markets and distributes cigarette papers, tubes, and related products; (ii) markets and distributes finished cigars and MYO cigar wraps; and (iii) processes, packages, markets, and distributes traditional pipe tobaccos. The NewGen products segment (i) markets and distributes e-cigarettes, e-liquids, vaporizers, and certain other products without tobacco and/or nicotine; (ii) distributes a wide assortment of vaping and CBD related products to non-traditional retail outlets via VaporBeast, Vapor Shark, Vapor Supply, and IVG; and (iii) distributes a wide assortment of vaping and CBD related products to individual consumers via Vapor Shark, Vapor World, and VaporFi branded retail outlets in addition to online platforms. Smokeless and Smoking products are distributed primarily through wholesale distributors in the United States while NewGen products are distributed primarily through e-commerce to non-traditional retail outlets in the United States. The Other segment includes the costs and assets of the Company not assigned to one of the three reportable segments such as intercompany transfers, deferred taxes, deferred financing fees, and investments in subsidiaries.

The accounting policies of these segments are the same as those of the Company. Corporate costs are not directly charged to the three reportable segments in the ordinary course of operations. The Company evaluates the performance of its segments and allocates resources to them based on operating income. In 2018, corporate costs were allocated to the segments based on net sales. Management believes this allocation does not reflect the operations of the business. Prior periods have been adjusted to conform to the current year presentation.

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The tables below present financial information about reported segments:

|   | Three Months Ended<br>March 31, |           |
|---|---------------------------------|-----------|
|   | 2019                            | 2018      |
| Net sales   |                                 |           |
| Smokeless products                                  | \$ 22,544                       | \$ 20,747 |
| Smoking products                                    | 25,519                          | 26,996    |
| NewGen products                                     | 43,565                          | 26,199    |
|   | \$ 91,628                       | \$ 73,942 |
| Gross profit  |                                 |           |
| Smokeless products                                  | \$ 12,073                       | \$ 10,993 |
| Smoking products                                    | 13,484                          | 13,164    |
| NewGen products                                     | 14,907                          | 7,652     |
|   | \$ 40,464                       | \$ 31,809 |
| Operating income (loss)                             |                                 |           |
| Smokeless products                                  | \$ 7,487                        | \$ 6,805  |
| Smoking products                                    | 9,946                           | 9,544     |
| NewGen products                                     | 2,838                           | 1,010     |
| Corporate unallocated <sup>(1)</sup>                | (8,236 )                        | (7,618 )  |
|   | \$ 12,035                       | \$ 9,741  |
| Interest expense, net                               | 3,856                           | 3,654     |
| Investment Income                                   | (144 )                          | (95 )     |
| Loss on extinguishment of debt                      | -                               | 2,384     |
| Net periodic benefit income, excluding service cost | (11 )                           | (43 )     |
| Income before income taxes                          | \$ 8,334                        | \$ 3,841  |
| Capital expenditures                                |                                 |           |
| Smokeless products                                  | \$ 577                          | \$ 349    |
| Smoking products                                    | -                               | -         |
| NewGen products                                     | 309                             | 14        |
|   | \$ 886                          | \$ 363    |
| Depreciation and amortization                       |                                 |           |
| Smokeless products                                  | \$ 357                          | \$ 339    |
| Smoking products                                    | -                               | -         |
| NewGen products                                     | 533                             | 396       |
|   | \$ 890                          | \$ 735    |

(1) Includes corporate costs that are not allocated to any of the three reportable segments.

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|                                      | March 31,<br>2019 | December 31,<br>2018 |
|--------------------------------------|-------------------|----------------------|
| Assets                               |                   |                      |
| Smokeless products                   | \$ 108,762        | \$ 99,441            |
| Smoking products                     | 143,108           | 142,520              |
| NewGen products                      | 93,990            | 95,397               |
| Corporate unallocated <sup>(1)</sup> | 1,682             | 2,019                |
|                                      | \$ 347,542        | \$ 339,377           |

(1) Includes assets not assigned to the three reportable segments. All goodwill has been allocated to the reportable segments.

## Revenue Disaggregation—Sales Channel

Revenues of the Smokeless and Smoking segments are primarily comprised of sales made to wholesalers while NewGen sales are made to wholesalers, retailers, and ultimate end-customers. NewGen net sales are broken out by sales channel below.

|                | NewGen Segment<br>Three Months Ended<br>March 31, |           |
|----------------|---|-----------|
|                | 2019  | 2018      |
| Wholesalers    | \$ 2,197  | \$ 2,330  |
| Retail outlets | 28,645  | 20,884    |
| End-customers  | 12,673  | 2,935     |
| Other          | 50  | 50        |
|                | \$ 43,565   | \$ 26,199 |

## Net Sales—Domestic vs. Foreign

The following table shows a breakdown of consolidated net sales between domestic and foreign customers.

|          | Three Months Ended<br>March 31, |           |
|----------|---------------------------------|-----------|
|          | 2019                            | 2018      |
| Domestic | \$ 88,769                       | \$ 70,858 |
| Foreign  | 2,859                           | 3,084     |
| Total    | \$ 91,628                       | \$ 73,942 |

## Note 18. Dividends

On November 9, 2017, the Company's 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 April 12, 2019, to shareholders of record at the close of business on March 22, 2019.

Dividends are classified as restricted payments within the 2018 Credit Facility. The Company is generally permitted to make restricted payments provided that, at the time of payment, or as a result of payment, the Company is not in default on its debt covenants. Additional restrictions limit the aggregate amount of restricted, quarterly dividends

during a fiscal year to the aggregate amount of mandatory and voluntary principal payments made on the priority term loans during the fiscal year.

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Note 19. Subsequent Events

The company engaged in discussions and mediation with VMR Products LLC (“VMR”), which was acquired in 2018. Pursuant to a Distribution and Supply agreement (“VMR Agreement”), VMR was providing the Company with V2 e-cigarettes for the 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 was 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. The discussions have been completed and the Company received \$6.7 million in April 2019 to settle the issue. Net of legal costs and reserves for anticipated future returns associated with the discontinuance, the Company expects to record a \$5.5 million gain in the second quarter.

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Item 2. 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 consolidated financial statements and accompanying notes, which are included elsewhere in this Quarterly Report on Form 10-Q. 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 unaudited financial statements of Turning Point Brands, Inc., included elsewhere in this Quarterly Report on Form 10-Q. 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”), International Vapor Group, LLC and its subsidiaries (collectively, “IVG”), and Nu-X Ventures, LLC (“Nu-X”).

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, liquid vapor products, and tobacco vaporizer products; however, we do not sell cigarettes. We estimate the OTP industry generated approximately \$11 billion in manufacturer revenue in 2018. 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 and CBD related products to non-traditional retail via VaporBeast, Vapor Shark, Vapor Supply, and IVG; and (iii) distribute a wide assortment of vaping and CBD related products to individual consumers via Vapor Shark, Vapor

World, and VaporFi branded retail outlets in addition to online platforms. Our portfolio of brands includes some of the most widely recognized names in the OTP industry such as Stoker'® in the Smokeless segment, Zig-Zag® in the Smoking segment, and VaporBeast® and VaporFi® in the NewGen segment.

#### Operations

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.

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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 some 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;
- 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

We engaged in discussions and mediation with VMR Products LLC (“VMR”), which was acquired in 2018. Pursuant to a Distribution and Supply agreement (“VMR Agreement”), VMR was providing us with V2 e-cigarettes for the 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 was required to make a payment to us under a formula designed to provide us with a fair share of the value created by our performance under the VMR Agreement. The discussions have been completed and we received \$6.7 million in April 2019 to settle the issue. Net of legal costs and reserves for anticipated future returns associated with the discontinuance, we expect to record a \$5.5 million gain in the second quarter.

## Critical Accounting Policies and Uses of Estimates

There have been no material changes to our critical accounting policies and estimates from the information provided in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in our 2018 Annual Report on Form 10-K.

## Recent Accounting Pronouncements

Refer to Note 2 of Notes to Consolidated Financial Statements included in this Quarterly Report for a description of recently issued accounting pronouncements, including those recently adopted.





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## Results of Operations

Comparison of the Three Months Ended March 31, 2019, to the Three Months Ended March 31, 2018

The table and discussion set forth below displays our consolidated results of operations (in thousands):

|   | Three Months Ended March 31, |           |          |   |
|---|------------------------------|-----------|----------|---|
|   | 2019                         | 2018      | % Change |   |
| Consolidated Results of Operations Data:            |                              |           |          |   |
| Net sales   |                              |           |          |   |
| Smokeless products                                  | \$ 22,544                    | \$ 20,747 | 8.7      | % |
| Smoking products                                    | 25,519                       | 26,996    | -5.5     | % |
| NewGen products                                     | 43,565                       | 26,199    | 66.3     | % |
| Total net sales                                     | 91,628                       | 73,942    | 23.9     | % |
| Cost of sales                                       | 51,164                       | 42,133    | 21.4     | % |
| Gross profit  |                              |           |          |   |
| Smokeless products                                  | 12,073                       | 10,993    | 9.8      | % |
| Smoking products                                    | 13,484                       | 13,164    | 2.4      | % |
| NewGen products                                     | 14,907                       | 7,652     | 94.8     | % |
| Total gross profit                                  | 40,464                       | 31,809    | 27.2     | % |
| Selling, general, and administrative expenses       | 28,429                       | 22,068    | 28.8     | % |
| Operating income                                    | 12,035                       | 9,741     | 23.5     | % |
| Interest expense, net                               | 3,856                        | 3,654     | 5.5      | % |
| Investment Income                                   | (144 )                       | (95 )     | 51.6     | % |
| Loss on extinguishment of debt                      | -                            | 2,384     | -100.0   | % |
| Net periodic benefit income, excluding service cost | (11 )                        | (43 )     | -74.4    | % |
| Income before income taxes                          | 8,334                        | 3,841     | 117.0    | % |
| Income tax expense                                  | 1,774                        | 809       | 119.3    | % |
| Consolidated net income                             | \$ 6,560                     | \$ 3,032  | 116.4    | % |

Net Sales: For the three months ended March 31, 2019, consolidated net sales increased to \$91.6 million from \$73.9 million for the three months ended March 31, 2018, an increase of \$17.7 million or 23.9%. The increase in net sales was primarily driven by volume growth in NewGen which includes the addition of three months of IVG and Vapor Supply sales in 2019.

For the three months ended March 31, 2019, net sales in the Smokeless products segment increased to \$22.5 million from \$20.7 million for the three months ended March 31, 2018, an increase of \$1.8 million or 8.7%. For the three months ended March 31, 2019, volume increased 4.8% and price/mix increased 3.9%. The increase in net sales was primarily driven by the continuing double-digit volume growth of Stoker<sup>®</sup> MST partially offset by declining sales in chewing tobacco, largely attributable to long-term segment erosion, and a continuing shift to lower price products.

For the three months ended March 31, 2019, net sales in the Smoking products segment decreased to \$25.5 million from \$27.0 million for the three months ended March 31, 2018, a decrease of \$1.5 million or 5.5%. For the three months ended March 31, 2019, volume decreased 8.4% and price/mix increased 2.9%. The net sales decline is attributable to delayed Canadian paper orders as a result of the packaging regulations and declining sales in the low-margin cigars business.

For the three months ended March 31, 2019, net sales in the NewGen products segment increased to \$43.6 million from \$26.2 million for the three months ended March 31, 2018, an increase of \$17.4 million or 66.3%. The increase in

net sales was primarily driven by continued VaporBeast momentum, and three months of IVG and Vapor Supply net sales.

**Gross Profit:** For the three months ended March 31, 2019, consolidated gross profit increased to \$40.5 million from \$31.8 million for the three months ended March 31, 2018, an increase of \$8.7 million or 27.2%. Gross profit as a percentage of revenue increased to 44.2% for the three months ended March 31, 2019, from 43.0% for the three months ended March 31, 2018.

For the three months ended March 31, 2019, gross profit in the Smokeless products segment increased to \$12.1 million from \$11.0 million for the three months ended March 31, 2018, an increase of \$1.1 million or 9.8%. Gross profit as a percentage of net sales increased to 53.6% of net sales for the three months ended March 31, 2019, from 53.0% of net sales for the three months ended March 31, 2018, primarily as a result of product mix.

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For the three months ended March 31, 2019, gross profit in the Smoking products segment increased to \$13.5 million from \$13.2 million for the three months ended March 31, 2018, an increase of \$0.3 million or 2.4%. Gross profit as a percentage of net sales increased to 52.8% of net sales for the three months ended March 31, 2019, from 48.8% of net sales for the three months ended March 31, 2018, as a result of a continued decline in the low margin cigar business. For the three months ended March 31, 2019 cigar sales were \$1.1 million compared to \$1.6 million for the three months ended March 31, 2018.

For the three months ended March 31, 2019, gross profit in the NewGen products segment increased to \$14.9 million from \$7.7 million for the three months ended March 31, 2018, an increase of \$7.3 million or 94.8%. Gross profit as a percentage of net sales increased to 34.2% of net sales for the three months ended March 31, 2019, from 29.2% of net sales for the three months ended March 31, 2018, primarily as a result of the addition of IVG, a business-to-consumer operation which generally has higher margins.

**Selling, General, and Administrative Expenses:** For the three months ended March 31, 2019, selling, general, and administrative expenses increased to \$28.4 million from \$22.1 million for the three months ended March 31, 2018, an increase of \$6.4 million or 28.8%. Selling, general and administrative expenses included \$5.9 million of expense relating to the inclusion of Vapor Supply and IVG, \$0.9 million of transaction costs including an earnout for IVG management, \$0.5 million of severance related expenses for organizational changes, \$0.5 million of duplicative warehouse expenses associated with consolidating VaporBeast operations into the Louisville facility and \$0.4 million of new product launch costs for Nu-X products.

**Interest Expense, net:** For the three months ended March 31, 2019, interest expense increased to \$3.9 million from \$3.7 million for the three months ended March 31, 2018, as a result of higher outstanding balance on our revolver and higher interest rates.

**Investment Income:** Investment income relating to investment of the MSA escrow deposits was approximately \$0.1 million for the three months ended March 31, 2019 and 2018.

**Loss on extinguishment of debt:** For the three months ended March 31, 2019, we had no loss on extinguishment of debt. For the three months ended March 31, 2018, loss on extinguishment of debt was \$2.4 million as the result of refinancing our credit facility during the period.

**Income Tax Expense:** Our income tax expense of \$1.8 million was 21.3% of income before income taxes for the three months ended March 31, 2019 compared to 21.1% for the three months ended March 31, 2018.

**Consolidated Net Income:** Due to the factors described above, consolidated net income for the three months ended March 31, 2019 and 2018, was \$6.6 million and \$3.0 million, respectively.

### EBITDA and Adjusted EBITDA

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 EBITDA. We believe Adjusted EBITDA provides useful information to management and investors regarding certain financial and business trends relating to our financial condition and results of operations. Adjusted EBITDA is used by management to compare our performance to that of prior periods for trend analyses and planning purposes and is presented to our Board of Directors. 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 operating performance. In addition, our credit agreements contain financial covenants which use Adjusted EBITDA calculations.

We define “EBITDA” as net income before interest expense, loss on extinguishment of debt, provision for income taxes, depreciation, and amortization. We define “Adjusted EBITDA” as net income before interest expense, loss on extinguishment of debt, provision for income taxes, depreciation, amortization, other non-cash items, and other items we do not consider ordinary course in our evaluation of ongoing operating performance.

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Non-U.S. GAAP measures should not be considered a substitute for, or superior to, financial measures calculated in accordance with U.S. GAAP. Adjusted EBITDA excludes significant expenses required to be recorded in our financial statements by U.S. GAAP and is subject to inherent limitations. Other companies in our industry may calculate this non-U.S. GAAP measure differently than we do or may not calculate it at all, limiting its usefulness as a comparative measure. The tables below provide reconciliations between net income and Adjusted EBITDA.

|   | Three Months Ended |           |
|---|--------------------|-----------|
|   | March 31,          |           |
|   | 2019               | 2018      |
| Consolidated net income                                     | \$ 6,560           | \$ 3,032  |
| Add:  |                    |           |
| Interest expense, net                                       | 3,856              | 3,654     |
| Loss on extinguishment of debt                              | -                  | 2,384     |
| Income tax expense  | 1,774              | 809       |
| Depreciation expense  | 531                | 560       |
| Amortization expense  | 359                | 175       |
| EBITDA  | \$ 13,080          | \$ 10,614 |
| Components of Adjusted EBITDA                               |                    |           |
| LIFO adjustment (a)   | (24 )              | (57 )     |
| Pension/postretirement expense (income) (b)                 | 16                 | (17 )     |
| Stock options, restricted stock, and incentives expense (c) | 715                | 197       |
| Foreign exchange hedging (d)                                | (71 )              | 46        |
| Transactional expenses and strategic initiatives (e)        | 910                | 599       |
| New product launch costs (f)                                | 442                | 682       |
| Product line rationalizations (g)                           | -                  | 1,008     |
| Warehouse reorganization (h)                                | 508                | -         |
| Severance charges and organizational development (i)        | 496                | 636       |
| Adjusted EBITDA   | \$ 16,072          | \$ 13,708 |

- (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 the fees incurred for transaction expenses and strategic initiatives.  
(f) Represents product launch costs of our new product lines.  
(g) Represents costs associated with discontinued products related to product line rationalization.  
(h) Represents costs associated with consolidating warehouses.  
(i) Represents costs associated with departmental restructuring, including severance.

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 are adequate to satisfy our operating cash requirements for the foreseeable future.

Our working capital, which we define as current assets less current liabilities, decreased \$1.0 million to \$47.1 million at March 31, 2019, compared with \$48.1 million at December 31, 2018. The decrease in working capital is primarily due to the IVG Note Payable becoming current.



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|                     | As of      |              |
|---------------------|------------|--------------|
|                     | March      |              |
| (in thousands)      | 31,        | December 31, |
|                     | 2019       | 2018         |
| Current assets      | \$ 108,621 | \$ 111,854   |
| Current liabilities | 61,489     | 63,766       |
| Working capital     | \$ 47,132  | \$ 48,088    |

## Cash Flows from Operating Activities

For the three months ended March 31, 2019, net cash provided by operating activities was \$14.0 million compared to net cash provided by operating activities of \$8.4 million for the three months ended March 31, 2018, an increase of \$5.6 million, primarily due to changes in working capital accounts.

## Cash Flows from Investing Activities

For the three months ended March 31, 2019, net cash provided by investing activities was \$0.8 million compared to net cash used in investing activities of \$0.9 million for the three months ended March 31, 2018, an increase of \$1.7 million, primarily due to MSA funds shifting from investments to cash.

## Cash Flows from Financing Activities

For the three months ended March 31, 2019, net cash used in financing activities was \$14.7 million compared to net cash used in financing activities of \$6.9 million for the three months ended March 31, 2018, an increase of \$7.8 million, primarily due to payments on our 2018 Revolving Credit Facility, as well as the payment of financing costs in 2018, which did not occur in 2019.

## 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 April 12, 2019, to shareholders of record at the close of business on March 22, 2019.

## Long-Term Debt

As of March 31, 2019, we were in compliance with the financial and restrictive covenants of the 2018 Credit Facility. The following table provides outstanding balances of our debt instruments.

|  | March 31, | December 31, |
|--|-----------|--------------|
|  | 2019      | 2018         |
| 2018 Revolving Credit Facility         | \$ 14,000 | \$ 26,000    |
| 2018 First Lien Term Loan              | 152,000   | 154,000      |
| 2018 Second Lien Term Loan             | 40,000    | 40,000       |
| Note payable - IVG                     | 4,000     | 4,000        |
| Total notes payable and long-term debt | 210,000   | 224,000      |
| Less deferred finance charges          | (3,100 )  | (3,285 )     |
| Less revolving credit facility         | (14,000 ) | (26,000 )    |



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|                         |            |   |            |   |
|-------------------------|------------|---|------------|---|
| Less current maturities | (12,000    | ) | (8,000     | ) |
|                         | \$ 180,900 |   | \$ 186,715 |   |

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2018 Credit Facility

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 our ability: (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 18 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 our 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 our 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 5.75% at March 31, 2019. The weighted average interest rate of the 2018 Revolving Credit Facility was 6.61% at March 31, 2019. At March 31, 2019, we had \$14.0 million of borrowings outstanding under the 2018 Revolving Credit Facility. The \$36.0 million unused portion of the 2018 Revolving Credit Facility is reduced by a \$1.3 million letter of credit with Fifth Third Bank, resulting in \$34.7 million of availability under the 2018 Revolving Credit Facility at March 31, 2019.

**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 9.48% at March 31, 2019.

Note Payable – IVG

In September 2018, we 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. 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.

Off-balance Sheet Arrangements

During the first quarter of 2019 we did not execute any forward contracts. During 2018 the Company 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 March 31, 2019, and December 31, 2018, we had forward contracts for the purchase of €0.0 million and €1.5 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.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

Foreign Currency Sensitivity

Although we engaged in hedging inventory purchases during the three months ended March 31, 2019, there have been no material changes in our exposure to exchange rate fluctuation risk, as reported within our 2018 Annual Report on Form 10-K, during the period. Please refer to our ‘Quantitative and Qualitative Disclosures about Market Risk’ included in our 2018 Annual Report on Form 10-K filed with the SEC.

Credit Risk

There have been no material changes in our exposure to credit risk, as reported within our 2018 Annual Report on Form 10-K, during the three months ended March 31, 2019. Please refer to our ‘Quantitative and Qualitative Disclosures about Market Risk’ included in our 2018 Annual Report on Form 10-K filed with the SEC.

Interest Rate Sensitivity

Our March 2018 refinancing resulted in all of our long-term debt instruments having variable interest rates that fluctuate with market rates. To reduce the volatility of future cash flows, we entered into interest rate swap agreements with lenders under the 2018 Credit Facility in March 2018. At March 31, 2019, \$70 million of our outstanding long-term debt carrying variable rates is covered by the interest rate swap agreements and, thus, effectively bears interest at a fixed rate. We believe 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% increase in the interest rate would change pre-tax income by approximately \$1.4 million per year. Refer to Note 4 of Notes to Consolidated Financial Statements located at Part I, Item 1, for additional information regarding the interest rate swaps.

Item 4. Controls and Procedures

We have carried out an evaluation under the supervision, and with the participation of, our management including our Chief Executive Officer (“CEO”), Chief Financial Officer (“CFO”), and Chief Accounting Officer (“CAO”), of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act of 1934, as amended (the “Act”)) as of March 31, 2019. Based upon the evaluation, our CEO, CFO, and CAO concluded our disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed by us in the reports we file or submit under the Act is: (i) recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms and (ii) accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosures.

There have been no changes in the Company’s internal control over financial reporting during the most recent fiscal quarter which have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

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PART II—OTHER INFORMATION

Item 1. 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 “Notes to Consolidated Financial Statements - 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. In a number of these cases, the amounts of punitive and compensatory damages sought are significant and could have a material adverse effect on our business and results of operations. The Company is a defendant in certain cases which have been dormant for many years, which cases have now been dismissed with prejudice. The Company is 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. 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, we were merely the distributor. Nonetheless, there can be no assurance that we will prevail in these cases, and they could have a material adverse effect on our business and results of operations. Because of their relative novelty, electronic cigarette and vaporizer product manufacturers and sellers have only recently become subject to litigation.

We engaged in discussions and mediation with VMR, which was acquired in 2018. Pursuant to a Distribution and Supply agreement (“VMR Agreement”), VMR was providing us with V2 e-cigarettes for the 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 was required to make a payment to us under a formula designed to provide us with a fair share of the value created by our performance under the VMR Agreement. The discussions have been completed and we received \$6.7 million in April 2019 to settle the issue. Net of legal costs and reserves for anticipated future returns associated with the discontinuance, we expect to record a \$5.5 million gain in the second quarter.

See ‘Risk Factors—We may become subject to significant product liability litigation’ within our 2018 Annual Report on Form 10-K for additional details.

Item 1A. Risk Factors

In addition to the other information set forth in this report, carefully consider the factors discussed in the ‘Risk Factors’ section contained in our 2018 Annual Report on Form 10-K. There have been no material changes to the Risk Factors set forth in the 2018 Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

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Item 6. Exhibits

Exhibit  
No. Description

31.1 Rule 13a-14(a)/15d-14(a) Certification of Lawrence S. Wexler.\*

31.2 Rule 13a-14(a)/15d-14(a) Certification of Robert Lavan.\*

31.3 Rule 13a-14(a)/15d-14(a) Certification of Brian Wigginton.\*

32.1 Section 1350 Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.\*

101 XBRL (eXtensible Business Reporting Language). The following materials from Turning Point Brands, Inc.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2019, filed on May 1, 2019, formatted in XBRL: (i) consolidated balance sheets, (ii) consolidated statements of income, (iii) consolidated statements of comprehensive income, (iv) consolidated statements of cash flows, and (v) the notes to consolidated financial statements.\*

\* Filed or furnished herewith

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Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TURNING POINT  
BRANDS, INC.

By: /s/ Lawrence S. Wexler  
Name: Lawrence S. Wexler  
Title: President and Chief  
Executive Officer

By: /s/ Robert Lavan  
Name: Robert Lavan  
Title: Chief Financial  
Officer

By: /s/ Brian Wigginton  
Name: Brian Wigginton  
Title: Chief Accounting  
Officer

Date: May 1, 2019