Turning Point Brands, Inc.
Form 10-K
March 08, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K
(Mark One)

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

For the fiscal year ended December 31, 2017

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

Title of each class	Name of each exchange on which registered
Common Stock, $0.01 par value	New York Stock Exchange

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

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

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

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

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

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

Large accelerated filer		Accelerated filer
Non-accelerated filer	(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

As of June 30, 2017, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was approximately $119 million based on the closing sale price of the common stock as reported on the New York Stock Exchange.

At March 1, 2018, there were 19,222,804 shares outstanding of the registrant's voting common stock, par value $0.01 per share.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for use in connection with its annual meeting of stockholders to be held on May 8, 2018, expected to be filed with the Securities and Exchange Commission on or about March 29, 2018, are incorporated by reference into Part III hereof.

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Cautionary Note Regarding Forward-Looking Statements

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

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

- failure to maintain our status as an emerging growth company before the five-year maximum time period a company may retain such status;
- our principal stockholders will be able to exert significant influence over matters submitted to our stockholders and may take certain actions to prevent takeovers;
- our certificate of incorporation and bylaws, as well as Delaware law and certain regulations, could discourage or prohibit acquisition bids or merger proposals, which may adversely affect the market price of our common stock;
- our certificate of incorporation limits the ownership of our common stock by individuals and entities that are Restricted Investors. These restrictions may affect the liquidity of our common stock and may result in Restricted Investors being required to sell or redeem their shares at a loss or relinquish their voting, dividend and distribution rights;
- future sales of our common stock in the public market could reduce our stock price, and any additional capital raised by us through the sale of equity or convertible securities may dilute your ownership in us;
- we may issue preferred stock whose terms could adversely affect the voting power or value of our common stock; and
- our status as a “controlled company” could make our common stock less attractive to some investors or otherwise harm our stock price.

PART I

Item 1. Business

Turning Point Brands, Inc., Overview

Turning Point Brands, Inc. (the "Company," "we," "our," or "us") is a leading, independent provider of Other Tobacco Products ("OTP") in the U.S. We estimate the OTP industry generated approximately $11 billion of manufacturer revenue in 2017. In contrast to manufactured cigarettes, which have been experiencing declining volumes for decades based on data published by the Alcohol and Tobacco Tax and Trade Bureau ("TTB"), the OTP industry is demonstrating increased consumer appeal with low to mid-single digit consumer unit growth as reported by Management Science Associates, Inc. ("MSAi"), a third-party analytics and information company. We were the 6th largest competitor in terms of total OTP consumer units sold during 2017. We sell a wide range of products across the OTP spectrum; however, we do not sell cigarettes. Our portfolio of brands includes some of the most widely recognized names in the OTP industry, such as Zig-Zag®, Beech-Nut®, Stoker's®, Trophy®, VaporBeast®, and Vapor Shark®. We currently ship to approximately 800 distributors with an additional 100 secondary, indirect wholesalers in the U.S. that carry and sell our products. We operate in three segments: (i) Smokeless products, (ii) Smoking products, and (iii) NewGen products. Information regarding net sales, operating income, and assets attributable to each of our segments is included within Note 20 of our Notes to Consolidated Financial Statements, which are incorporated herein by reference.

We have a portfolio of widely recognized brands with significant customer loyalty. We have an experienced management team that possesses long-standing industry relationships and a deep understanding of the OTP industry. We have identified additional opportunities to grow sales, including the launch of new products and expanding our distribution and salesforce. We also believe there are meaningful opportunities to grow through acquisitions and joint ventures across all product categories. As of December 31, 2017, our products are available in approximately 170,000 U.S. retail locations which, with the addition of retail stores in Canada, brings our total North American retail presence to an estimated 200,000 points of distribution. Our sales team targets widespread distribution to all traditional retail channels, including convenience stores, where over 60% of all OTP volume is currently sold, according to MSAi.

Smokeless Segment

Our Smokeless segment includes both loose leaf chewing tobacco and moist snuff tobacco ("MST"). Our Smokeless focus brand is Stoker's in both chewing tobacco and MST. Stoker's® chewing tobacco has grown considerably over the last several years and is presently the #1 discount brand and the second largest brand in the industry, with approximately 18% market share. Our status in the chew market is further strengthened by Beech-Nut®, the #3 premium brand and #6 overall, as well as Trophy®, Durango®, and the five Wind River Brands we acquired in November 2016. Refer to Note 4 of Notes to Consolidated Financial Statements for further details regarding this acquisition. Collectively, the company is the #2 marketer of chewing tobacco with approximately 28% market share. Our chewing tobacco operations are facilitated through our long-standing relationship with Swedish Match, the manufacturer of our loose leaf chewing tobaccos.[1]

In MST, Stoker's remains among the fastest growing brands and holds a 6.7% share in the stores with distribution and a 2.9% share of the total U.S. MST market. Stoker's pioneered the large 12 oz. tub packaging format and is manufactured using a proprietary process that we think results in a superior product. In late 2015, we extended the Stoker's® MST franchise to include traditional 1.2 oz. cans to broaden retail availability. Our proprietary manufacturing process is conducted at our Dresden, Tennessee, plant and packaged in both our Dresden, Tennessee, and Louisville, Kentucky facilities.[1]

Smoking Segment

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

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

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[1] Brand rankings and market share percentages obtained from MSAi as of December 31, 2017.

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NewGen Segment

Our NewGen segment includes our recent acquisitions of Smoke Free Technologies, d/b/a VaporBeast ("VaporBeast"), and The Hand Media and its subsidiaries, d/b/a Vapor Shark (collectively, "Vapor Shark"), which have solidified our status as a major player within the segment, in addition to V2 branded products. Refer to Note 4 of our Notes to Consolidated Financial Statements for further details regarding these acquisitions. VaporBeast is a leading distributor of liquid vapor products servicing the non-traditional retail channel. Vapor Shark is a leading distributor and manufacturer of premium vaping e-liquids with nationwide distribution through non-traditional retail as well as Vapor Shark branded retail locations. Our acquisition of VaporBeast, and subsequent acquisition of Vapor Shark, accelerated our entry into the non-traditional retail outlets for vaporizers, e-liquids, and accessories, which we estimate sell greater than 50% of all liquid vapor volume. We believe our NewGen business will expand further as consumers continue to move from combustible cigarettes to vaping. We believe we are well-positioned to act as a consolidator in the NewGen space in anticipation of increased regulation and will continue to explore potential acquisitions.

IPO

In our May 2016 initial public offering (the "IPO"), we sold 6,210,000 shares of our voting common stock at a public offering price per share of $10.00. We raised a total of approximately $62.1 million in gross proceeds from the IPO which amounted to $58.2 million in net proceeds after deducting underwriting commissions and other associated costs. We used the proceeds from the IPO, together with cash on hand, to pay fees and expenses related to the IPO; repurchase outstanding warrants and options issued by our subsidiary Intrepid Brands, LLC ("Intrepid"); repay approximately $34 million of our floating rate PIK Toggle Notes due 2021; and repay approximately $20 million in borrowings outstanding under our second lien credit facility.

Competitive Strengths

We believe our competitive strengths include the following:

Large, Leading Brands with Significant Scale

We have built a portfolio of leading brands with significant scale that are well recognized by consumers, retailers, and wholesalers. Our Stoker's® and Zig-Zag® brands are each well established and date back 78 and 118 years, respectively. Though the NewGen segment is relatively new within the OTP industry, our 2016 acquisition of VaporBeast added a leading seller of e-liquids, devices, and accessories. In 2017, Stoker's®, Zig-Zag®, and VaporBeast® together generated approximately $261 million of gross sales, or 84% of our consolidated gross sales. Specifically:

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

We believe the Stoker's® brand is seen as an innovator in both the loose leaf chewing tobacco and moist snuff markets. Zig-Zag® is an iconic brand and has strong, enduring brand recognition among a wide audience of consumers. VaporBeast is a powerful distribution engine that allows us to further penetrate the vaporizer and e-liquids markets via non-traditional retail outlets.

Successful Track Record of New Product Launches and Category Expansions

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

- We leveraged the proud legacy and value of the Stoker's® brand to introduce a 12 oz. MST tub, a product whose size was not offered by any other market participant at the time of introduction. Stoker's® MST has been among the fastest growing moist snuff brands in the industry in terms of pounds sold. While competitors have introduced larger format tub packaging, the early entry and differentiation of the Stoker's® product have firmly established us as the market leader with over 50% of the Tub market. In third quarter 2015, we introduced Stoker's® MST in 1.2 oz. cans to further expand retail penetration, particularly in convenience stores.

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- In 2009, we extended the Zig-Zag® tobacco brand into the MYO cigar wraps market and captured a 50% market share within the first two years. We are now the market share leader for MYO cigar wraps with a 76% share. We believe our success was driven by the Zig-Zag® tobacco branding, which we feel is widely understood by consumers to represent a favorable, customizable experience ideally suited to MYO products.
- VaporBeast quickly established itself as a leading marketer and distributor of liquid vapor products to the non-traditional retail universe. With its national footprint, VaporBeast is leveraging its regional consumer preference insights to further accelerate sales advances.

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

Extensive Distribution Network and Data Driven Sales Organization

We have taken important steps to enhance our selling and distribution network and consumer marketing capabilities while keeping our capital expense requirements relatively low. We service our customer base with an experienced sales and marketing organization of approximately 145 professionals who possess in-depth knowledge of the tobacco industry. We extensively use data supported by leading technology to enable our salesforce to analyze changing trends and effectively identify evolving consumer preferences at the store level. We subscribe to a sales tracking system provided by MSAi that measures all OTP product shipments by all market participants, on a weekly basis, from approximately 900 wholesalers to over 250,000 retail stores in the U.S. This system enables us to understand share and volume trends across multiple categories at the individual store level, allowing us to allocate field salesforce coverage to the highest opportunity stores, thereby enhancing the value of new store placements and sales activity. Within our Stoker's product categories, we have seen a positive correlation between the frequency of store calls by our salesforce and our retail market share. As the initial sales effort is critical to the success of a product launch, we believe our experienced salesforce, expansive distribution network, and leading market analytics put us in a strong position to swiftly execute new product launches in response to evolving consumer and market preferences.

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

As part of our asset-light operating model we built long-standing and extensive relationships with leading, high-quality producers. In 2017, our four most important producers were:

- Swedish Match, which manufactures our loose leaf chewing tobacco;
- Bolloré, which provides us with exclusive access to the Zig-Zag® cigarette paper and accessories brand for the U.S. and Canada;
- Durfort, from which we source our MYO cigar wraps; and
- JJA Distributors ("JJA"), from which we source our Zig-Zag branded cigars.

By outsourcing the production of products that represent approximately 87% of our gross sales to a select group of producers with whom we have strong relationships, we are able to maintain low overhead costs and minimal capital expenditures, which together drive our margins.

Experienced Management Team

With an average of 25 years of consumer products experience, including an average of 22 years in the tobacco industry, our senior management team has enabled us to grow and diversify our business while improving operational efficiency. Members of management have previous experience at other leading tobacco companies, including Altria Group, Inc. (formerly Philip Morris); Liggett & Myers Tobacco Company (now Liggett Group, a subsidiary of Vector

Group ltd); Swedish Match; American Brands, Inc.; and U.S. Smokeless Tobacco Company (a subsidiary of Altria). Notably, Lawrence Wexler, our President and CEO, brings over 20 years of experience from Altria Group, Inc., where he held various leadership positions within the finance, marketing, planning, manufacturing, and sales departments. Given the professional experience of the senior management team we are able to analyze risks and opportunities from a variety of perspectives. Our senior leadership has embraced a collaborative culture in which the combined experience, analytical rigor, and creativity are leveraged to assess opportunities and deliver products that satisfy consumers’ demands.

Growth Strategies

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

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Grow Share of Existing Product Lines, Domestically and Internationally

We intend to remain a consumer centric organization with an innovative view and understanding of the OTP market. We believe there are meaningful opportunities for growth within the OTP market. We expect to continue to identify unmet consumer needs and provide quality products that we believe will result in genuine consumer satisfaction and foster the growth of revenue. We maintain a robust product pipeline and plan to strategically introduce new products in attractive, growing OTP segments, both domestically and internationally. For example, in addition to our successful launch of Stoker's® smaller 1.2 oz. MST cans, we believe there are opportunities for new products in the MST pouch, cigar, and MYO cigar wrap markets. Products currently in our pipeline include Zig-Zag® Natural Leaf Wraps and Zig-Zag® Unbleached/Hemp Paper in the Smoking products segment and Primal® Hemp Wraps/Cones, Premium e-liquids, and Vape-not-Burn ("VnB") devices in the NewGen products segment. We believe we have successfully built strong, powerful brands possessing significant potential.

In 2017, less than 5% of our revenues were generated outside of the U.S. Having established a strong infrastructure and negotiated relationships across multiple segments and products, we are pursuing an international growth strategy to broaden sales and strengthen margins. We believe international sales represent a meaningful growth opportunity. Our goals include expanding our presence in the worldwide OTP industry on a targeted basis. For example, we are selling our Stoker's® MST products in South America, Zig-Zag® cigars in Canada, and Primal® herbal wraps and cones internationally. We intend to pursue a dual path of introducing our own products and brands as well as partnering with other industry leaders to improve market access and profitability in efforts to support our international expansion.

Expand into Adjacent Categories through Innovation and New Partnerships

We continually evaluate opportunities to expand into adjacent product categories by leveraging our current portfolio or through new partnerships. In 2009, we leveraged the Zig-Zag® tobacco brand and introduced Zig-Zag® MYO cigar wraps with favorable results. We now command the #1 market share position for that segment. We are currently expanding our Zig-Zag® MYO cigar wraps through the expansion of the Zig-Zag® 'Rillo™' size cigar wraps which are similar in size to machine-made cigarillos, the most popular and rapidly growing cigar type. Additionally, in 2015, we negotiated the worldwide, exclusive distribution rights to an herbal sheet material that does not contain tobacco or nicotine, affording us the opportunity to sell, on a global basis, an assortment of products that meet new and emerging consumer preferences. These products are sold under our Primal® brand name and are a component of our NewGen product segment. We intend to continue to identify new adjacent categories for which we are able to leverage our existing brands and partnerships.

Continue to Grow a Strong NewGen Platform

The OTP category is continually evolving as consumers actively seek out new products and product forms. Given this market demand, we have developed a NewGen product platform which we believe will serve new and evolving consumer demands across multiple product categories. Core products within our existing NewGen segment include:

- Electronic cigarette ("e-cigarette") and vapor products, including e-liquids,
- Tobacco vaporizers, which heat rather than combust the smoking material (VnB), and
- Herbal smoking products, which contain no tobacco or nicotine.

Among these categories, we believe the emerging liquid vapor segment may present the greatest growth opportunity as it allows each consumer to customize his or her experience by being able to choose both flavor and nicotine level. Although the liquid vapor segment is in its infancy, we believe that, when properly commercialized, it may be highly disruptive to the combustible cigarette industry and emerge as a more significant segment of the OTP market. We believe a majority of current liquid vapor revenues are earned outside of the traditional retail environment through online sales or in non-traditional retail outlets. Our recent acquisitions of VaporBeast and Vapor Shark accelerate our expansion into the non-traditional retail outlets for liquid vapor products.

Outside of the tobacco space, we believe there are meaningful opportunities for herbal smoking products like wraps and cones. To capitalize on these opportunities, we have obtained the exclusive rights to a proprietary and patented herbal sheet process that enables us to meet consumer interest and achieve strong margins. These products are marketed and sold on a worldwide basis under our Primal™ brand as discussed above.

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

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Strategically Pursue Acquisitions

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

Substantially all of our 2017 U.S. gross margin was derived from sales of products currently regulated by the U.S. Food and Drug Administration ("FDA") Center for Tobacco Products. We have significant experience in complying with the FDA regulatory regime with a compliance infrastructure composed of legal and scientific professionals. We believe many smaller OTP manufacturers currently lack this infrastructure, which we believe is necessary to comply with the broad scope of FDA regulations. We believe our regulatory compliance infrastructure, combined with our skilled management and strong distribution platform, position us to act as a consolidator within the OTP industry.

We have a strong track record of enhancing our OTP business with strategic and accretive acquisitions. For example, our acquisition of the North American Zig-Zag® cigarette papers distribution rights in 1997 has made us the #1 premium cigarette paper brand in the U.S. in terms of retail dollar sales, as measured by Nielsen. Perhaps more importantly, we own the Zig-Zag® tobacco trademark in the U.S. and have leveraged this asset effectively with approximately 52% of our total 2017 Zig-Zag branded gross sales under our own Zig-Zag® marks rather than those we license from Bolloré. In 2003, we acquired the Stoker's® brand. We have since built the brand to a strong #2 position in the chewing tobacco industry while successfully leveraging the brand's value through our MST expansion where it remains among the fastest growing MST brands in the industry. More recently, we have completed three acquisitions to acquire the five smokeless tobacco brands from Wind River in addition to VaporBeast and Vapor Shark.

We will continue to evaluate acquisition opportunities as they may arise while exercising care and diligence to ensure we only pursue opportunities believed to afford operational or distribution synergies and add value.

Maintain Lean, Low-Cost Operating Model

We have a lean, asset-light manufacturing and sourcing model which requires low capital expenditures and utilizes outsourced supplier relationships. We believe our asset-light model provides marketplace flexibility and allows us to achieve favorable margins. Our market analytics allow us to efficiently and effectively address evolving consumer and market demands. Our supplier relationships allow us to increase the breadth of our product offerings and quickly enter new OTP markets as management is able to focus on brand building and innovation. We intend to continue to optimize our asset-light operating model as we grow in order to maintain a low cost of operations and healthy margins. In 2017, approximately $268 million of our gross sales, or 87%, were from outsourced production operations. Our capital expenditures have ranged between $0.7 million and $3.2 million per year over the previous 5 years. We do not intend to outsource our MST production as a result of our proprietary manufacturing processes which are substantively different than those of our competitors.

Raw Materials, Product Supply, and Inventory Management

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

The components of inventories at December 31, 2017 and 2016, were as follows (in thousands):

	2017	2016
Raw materials and work in process	$2,545	$2,596
Leaf tobacco	30,308	27,391

Finished goods - smokeless products	5,834	4,789
Finished goods - smoking products	14,110	18,384
Finished goods - electronic/vaporizer products	14,532	11,993
Other	1,290	1,232
	68,619	66,385
LIFO reserve	(5,323)	