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## 22nd Century Group, Inc. (AMEX: XXII)

May 7, 2021

### Buy: Q1 Results

*Q1 revenue was lower and costs higher than expected. Our revenue and EBITDA estimates for the year, however, have increased, based on the expectation of high-margin license revenue in Q4. The major potential catalyst for the shares remains FDA approval of the company's MRTP application.*

Q1 revenue was \$6.8 million, and the EBITDA loss was \$4.4 million. Revenue was lower than the Q4 2020 level of \$7.3 million and lower than our \$7.2 million estimate. Gross margin of 9.5% was better than forecast and an improvement over Q4, but expenses were higher, mainly driven by higher personnel costs. The EBITDA loss of \$4.4 million was greater than our \$3.5 million estimate but an improvement over the \$5.4 million loss in Q4 2020.

Contract manufacturing revenue should remain the main source of revenue this year and next, but we are now including \$2 million of revenue this year from the licensing of technology developed with Anandia. We have also included, in 2022, \$2 million in revenue from the sale of biomass produced from hemp grown with specific levels of CBG and CBD. We have modeled the biomass sale to occur next year, but there is a reasonable chance some or all of the sale occurs this year instead.

Approval of the MRTP is still the mostly likely near-term catalyst, in our view. The company believes the FDA's pursuit of a ban on menthol cigarettes will not have an impact on its MRTP application that includes very-low-nicotine-menthol cigarettes. This is a reasonable assumption, but other possibilities include partial approval of the company's MRTP or further delays. Since the company's MRTP fits into the FDA's strategy of reducing tobacco consumption, we continue to believe approval of the MRTP will occur.

Cash at quarter-end was \$31 million, or 2 years' worth at the current burn rate. We think this is adequate, barely, given the financial resources of Big Tobacco and the tendency of government decisions to take longer than expected.

**Valuation:** Our \$7 price target is the sum of the estimated values of the VLN, non-addictive nicotine and hemp franchises. We attribute about \$3.08/share for the VLN asset. The non-addictive nicotine mandate is valued at \$3.18 per share. The remainder of the price target comprises the investment in the hemp business and its relationship with KeyGene.

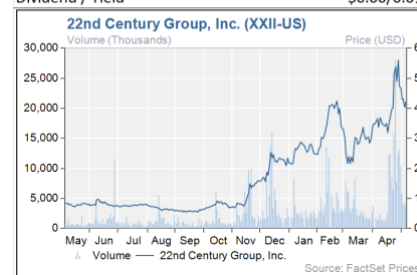
**Risks to Target:** The tobacco industry is highly regulated, and our price target depends on approval of the company's MRTP application and a nicotine mandate, which could be delayed or may not be approved. Our price target assumes the company will find a partner for the VLN business and this could take longer than estimated and/or the partner could demand different terms than assumed. The nicotine mandate may take longer to decide, and the transition period could be longer than estimated. There will likely be other paths attempted by the industry to comply or the industry may opt to focus on other nicotine delivery systems as regulation of the combustible cigarette market increases. This could affect our assumptions on the royalty rate and market share.

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Current Price	\$4.23		
Price Target	\$7.00		
Estimates	F2020A	F2021E	F2022E
Revenues (\$000s)	\$ 28,111	\$ 29,806 E	\$ 32,000
1Q March	\$ 7,058	\$ 6,806 A	\$ 9,500
2Q June	\$ 6,435	\$ 7,000 E	\$ 7,500
3Q September	\$ 7,310	\$ 7,000 E	\$ 7,500
4Q December	\$ 7,308	\$ 9,000 E	\$ 7,500
	F2020A	F2021E	F2022E
EPS (diluted)	\$ (0.14)	\$ (0.12)E	\$ (0.12)
1Q March	\$ (0.03)	\$ (0.03)A	\$ (0.02)
2Q June	\$ (0.04)	\$ (0.03)E	\$ (0.03)
3Q September	\$ (0.03)	\$ (0.03)E	\$ (0.03)
4Q December	\$ (0.05)	\$ (0.02)E	\$ (0.04)
EBITDA (\$Ms)	\$ (16.0)	\$ (15.5)	\$ (15.7)
EV/EBITDA (x)	-38.4x	-39.6x	-39.1x
Stock Data			
52-Week Range	\$0.55	-	\$6.07
Shares Outstanding (mil.)	152.4		
Market Capitalization (mil.)	\$645		
Enterprise Value (mil.)	\$614		
Debt to Capital	1%		
Book Value/Share	\$0.32		
Price/Book	13.3x		
Average Three Months Trading Volume (K)	3,034		
Insider Ownership	2.7%		
Institutional Ownership	24.8%		
Short Interest (mil.)	5.2%		
Dividend / Yield	\$0.00/0.0%		



### Q1 Results.

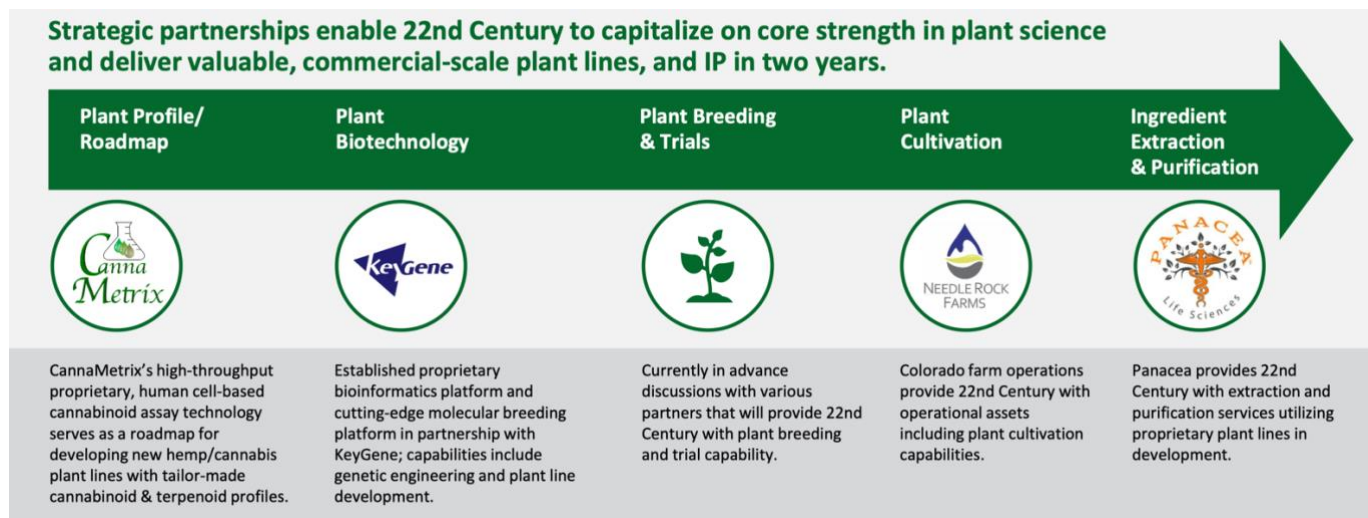
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<b>Q1 21</b>			
<b>(\$ in 000's)</b>	<b>Actual</b>	<b>Estimates</b>	
Revenue	\$ 6,806	\$ 7,250	-6.1%
Cost Of Goods Sold	6,159	6,720	-8.3%
Gross Profit	647	530	22.1%
R&D	701	1,250	-43.9%
G&A	4,829	3,298	46.4%
Depreciation & Amort.	288	349	-17.5%
Opex	5,818	4,897	18.8%
Operating Income	\$ (5,171)	\$ (4,367)	-18.4%
Other	36	0	
Interest Expense	0	0	
Other	112	223	
Warrant Charge	(7)	(18)	
Pretax Income	(5,030)	(4,162)	
Income Tax Expense	0	0	
Net to Common	\$ (5,030)	\$ (4,162)	
Shares (000)	144,258	145,730	
EPS	\$ (0.03)	\$ (0.03)	
D&A	288	348	
Stock Comp	507	492	
EBITDA	\$ (4,376)	\$ (3,527)	

Source: 22<sup>nd</sup> Century Group, Inc. and Dawson James Securities estimates.

### Hemp/Cannabis

The company has made substantial progress building out its hemp/cannabis franchise by targeting the upstream segments of the cannabinoid value chain. Its goal is to deliver commercial-scale plant lines and intellectual property for the life science, consumer product, and pharmaceutical end-use markets. Partnerships with CannaMetrix, KeyGene, and Panacea address creation of plant profiles, seeds with specific genetic characteristics, plant cultivation and extraction. The company is working to consummate agreements with plant breeders to complete the capabilities it believes are necessary to have a full-service suite for the market.



Source: 22<sup>nd</sup> Century Group, Inc.

22<sup>nd</sup> Century's investment and business relationship with Panacea is being restructured, and this will give the company greater control over plant cultivation and extraction and purification technology. 22<sup>nd</sup> Century and Panacea have entered into a non-binding agreement to transfer \$7.2 million of assets from Panacea in exchange for cancellation of a \$7 million convertible note receivable, and removal of any future investment rights and obligations of 22<sup>nd</sup> Century to invest in Panacea. The agreement will also cancel 22<sup>nd</sup> Century's warrant to purchase additional Series B preferred stock of Panacea. The assets received by 22<sup>nd</sup> Century, assuming completion of the agreement under their current terms, include an agricultural facility and various extraction and distillation equipment.

#### Low-nicotine mandate

The third element of our valuation is the value of a low-nicotine mandate. We think it is likely, based on the FDA's long-standing goal of reducing cigarette consumption, that the FDA will reintroduce a low-nicotine mandate, although the timing is uncertain. We believe it is reasonable to assume a new mandate would broadly follow the 2018 ANPRM since none of the studies supporting the efficacy of a low-nicotine mandate have been invalidated and, in our opinion, technical achievability of a mandate has been demonstrated by 22<sup>nd</sup> Century.

The ANPRM was published in March 2018 and the comment period closed in July 2018. An argument can be made that a similar comment period would be allowed if a Notice of Proposed Rulemaking (NPRM) were issued, but since a lot of the ground has already been covered in the ANPRM, it is also reasonable to believe that there would be a shorter comment period. "[A Guide to the Rulemaking Process](#)" has been published in the Federal Register and it indicates comment periods generally range from 30 to 60 days, but more complex rules can have comment periods of 180 days or more. Our guess is a rule of this import would require a three- to four-month comment period, similar to the 2018 ANPRM.

After that, there isn't a required time mentioned in "A Guide to the Rulemaking Process" for a federal agency to consider the comments and issue a final rule, if a final rule is to be issued at all. Based on our knowledge of variety of federal agencies, a normal period to consider the comments and issue a final rule can be three to six months. The more complex the rule, or the more impactful, the longer this period will likely be.

The ANPRM asked about transition times if a mandate were issued, and this could be critical for 22<sup>nd</sup> Century. In our view, a shorter transition period would be more positive for the company since it would allow less time for alternatives to be explored, developed, and deployed by competitors.

#### Outlook

Our revenue, EPS and EBITDA estimates have changed modestly. For this year, we have increased our revenue estimate, with a lesser amount from contract manufacturing and a \$2 million contribution from license revenue resulting in higher margins and improved EPS and EBITDA. Our contract manufacturing revenue for 2022 is unchanged, but we have included \$2 million from the sale of biomass. The impact on EPS and EBITDA is positive, but small.

	2021E		2022E	
	Old	New	Old	New
Revenue (\$M)	\$ 29.0	\$ 29.8	\$ 30.0	\$ 32.0
EPS	\$ (0.12)	\$ (0.12)	\$ (0.12)	\$ (0.12)
EBITDA (\$M)	\$ (16.2)	\$ (15.5)	\$ (16.3)	\$ (15.7)

Source: Dawson James Securities estimates.

**Price Target.** Our \$7 price target is the sum of the estimated values of the VLN, non-addictive nicotine and hemp franchises. We attribute about \$3.08/share for the VLN asset. The non-addictive nicotine mandate is valued at \$3.18 per share. The remainder of the price target comprises the investment in the hemp business and the relationship with KeyGene.

### Risk Analysis

The tobacco industry is highly regulated, and our price target depends on approval of the company's MRTP application and a nicotine mandate, which could be delayed or may not be approved. Our price target assumes the company will find a partner for the VLN business and this could take longer than estimated and/or the partner could demand different terms than assumed. The nicotine mandate may take longer to decide, and the transition period could be longer than estimated. There will likely be other paths attempted by the industry to comply or the industry may opt to focus on other nicotine delivery systems as regulation of the combustible cigarette market increases. This could affect our assumptions on the royalty rate as well as market share.



**Exhibit 1. Income Statement**

(\$ in 000s, except per-share data)

	2018	2019	2020	Q1 21 A	Q2 21 E	Q3 21 E	Q4 21 E	2021 E	2022 E
Revenue	\$ 26,426	\$ 25,833	\$ 28,111	\$ 6,806	\$ 7,000	\$ 7,000	\$ 9,000	\$ 29,806	\$ 32,000
Cost Of Goods Sold	25,527	25,818	26,673	6,159	6,159	6,159	6,159	24,636	26,000
Gross Profit	899	14	1,438	647	841	841	2,841	5,170	6,000
			5.1%	9.5%					
R&D	14,990	8,057	4,128	701	701	701	701	2,804	2,944
G&A	7,658	12,956	14,971	4,829	4,829	4,829	5,418	19,905	20,900
Impairment Charge	0	1,142	176	0	0	0	0	0	0
Sales & marketing	927	0	0	0	0	0	0	0	0
Depreciation & Amort.	1,342	1,425	1,346	288	288	288	288	1,152	1,152
Opex	24,918	23,581	20,621	5,818	5,818	5,818	6,407	23,861	24,996
Operating Income	\$ (24,019)	\$ (23,566)	\$ (19,183)	\$ (5,171)	\$ (4,977)	\$ (4,977)	\$ (3,566)	\$ (18,691)	\$ (18,996)
Other	14,945	(4,002)	(428)	36	36	36	36	144	144
Impairment Charge	49	0	(1,741)	0	0	0	0	0	0
Interest Income	1,069	1,066	1,751	112	309	270	231	923	636
Interest Expense	(11)	(56)	(72)	(7)	(7)	(7)	(7)	(28)	(28)
Pretax Income	(7,967)	(26,559)	(19,673)	(5,030)	(4,639)	(4,678)	(3,306)	(17,652)	(18,245)
Income Tax Expense	0	0	38	0	0	0	0	0	0
Net to Common	\$ (7,967)	\$ (26,559)	\$ (19,711)	\$ (5,030)	\$ (4,639)	\$ (4,678)	\$ (3,306)	\$ (17,652)	\$ (18,245)
Shares (000)	124,299	125,883	138,813	144,258	152,421	152,694	153,194	150,642	154,007
EPS	(\$0.06)	(\$0.21)	(\$0.14)	(\$0.03)	(\$0.03)	(\$0.03)	(\$0.02)	(\$0.12)	(\$0.12)
D&A	1,200	1,425	1,346	288	288	288	288	1,152	1,152
Stock Comp	3,187	3,540	1,654	507	507	507	507	2,028	2,129
Other	0	1,142	176	0	0	0	0	0	0
EBITDA	\$ (19,632)	\$ (17,459)	\$ (16,007)	\$ (4,376)	\$ (4,182)	\$ (4,182)	\$ (2,771)	\$ (15,511)	\$ (15,715)

 Source: 22<sup>nd</sup> Century Group, Inc. and Dawson James Securities estimates

**Exhibit 2. Balance Sheet and Cash Flow Statement**

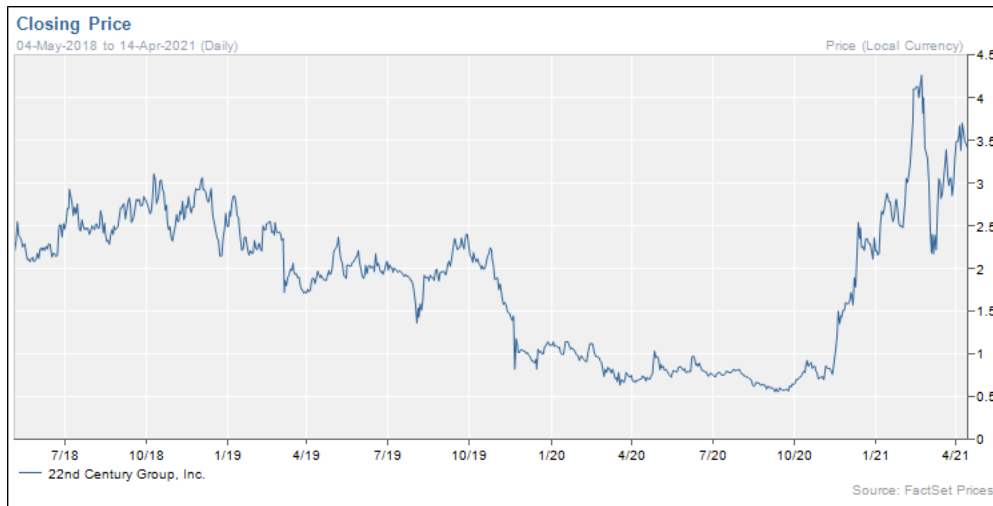
(\$ in 000s)

	2018	2019	2020	2021 E	2022 E
Cash	605	485	1,029	1,272	1,272
Short-Term Investments	55,749	38,477	21,313	19,284	4,121
A/R	871	867	2,159	2,023	2,023
Inventory	3,044	2,266	2,034	2,137	2,137
Prepaid Exp.	928	648	1,806	1,280	1,280
<b>Total Current Assets</b>	<b>\$ 61,198</b>	<b>\$ 42,743</b>	<b>\$ 28,341</b>	<b>\$ 25,996</b>	<b>\$ 10,833</b>
PP&E	3,261	3,120	2,483	2,148	1,696
Operating Lease	0	602	247	182	182
Patent, Trademark, other intangibles	9,752	8,494	8,211	8,035	7,935
Equity Investment	3,092	8,403	6,536	6,643	6,643
Convertible Note Receivable	0	5,589	5,876	5,876	5,876
<b>Total Assets</b>	<b>\$ 77,302</b>	<b>\$ 68,951</b>	<b>\$ 51,694</b>	<b>\$ 48,880</b>	<b>\$ 33,165</b>
Bank Loans and N/P	689	581	539	295	295
Operating Lease	0	220	247	182	182
A/P	2,575	1,998	1,116	1,572	1,572
Accrued Expenses	1,826	2,619	4,830	4,681	4,681
Accrued Severance	0	359	339	274	274
Deferred Income	83	5	272	0	0
<b>Total Current Liabilities</b>	<b>\$ 5,174</b>	<b>\$ 5,780</b>	<b>\$ 7,343</b>	<b>\$ 7,004</b>	<b>\$ 7,004</b>
Long-Term Debt	848	292	0	0	0
Operating Lease	0	382	0	0	0
Accrued Severance	0	446	241	187	187
Shareholders' Equity	71,280	62,051	44,110	41,689	25,974
<b>Total Liabilities And Equity</b>	<b>\$ 77,302</b>	<b>\$ 68,951</b>	<b>\$ 51,694</b>	<b>\$ 48,880</b>	<b>\$ 33,165</b>
	2018	2019	2020	2021 E	2022 E
Net Income	(7,967)	(26,559)	(19,711)	(17,652)	(18,245)
Depreciation & Amort.	1,200	1,425	1,345	1,152	1,152
Stock Comp	3,187	3,540	1,654	2,028	2,129
Other	(14,618)	7,249	2,722	(10)	0
Working Capital	354	(242)	(1,631)	334	0
<b>Operating Cash Flow</b>	<b>\$ (17,844)</b>	<b>\$ (14,587)</b>	<b>\$ (15,621)</b>	<b>\$ (14,148)</b>	<b>\$ (14,963)</b>
Acquisition of Patents and trademarks	(657)	(515)	(468)	(395)	(500)
CapEx	(449)	(527)	(54)	(175)	(100)
Other	16,251	5,595	16,991	(8,415)	0
<b>Investing Activities</b>	<b>\$ 15,145</b>	<b>\$ 4,552</b>	<b>\$ 16,469</b>	<b>\$ (8,985)</b>	<b>\$ (600)</b>
Debt	(800)	(700)	(354)	(246)	0
Equity	445	10,616	50	13,235	400
Other	0	0	0	0	0
<b>Financing Activities</b>	<b>\$ (355)</b>	<b>\$ 9,916</b>	<b>\$ (304)</b>	<b>\$ 12,989</b>	<b>\$ 400</b>
Change in Cash	<b>(\$3,055)</b>	<b>(\$120)</b>	<b>\$ 544</b>	<b>(\$10,144)</b>	<b>(\$15,163)</b>

 Source: 22<sup>nd</sup> Century Group, Inc. and Dawson James Securities estimates

**Important Disclosures:**

**Price Chart:**



**Price target and ratings changes over the past three years:**

Initiated – Buy – April 13, 2021 – Price Target \$7.00  
 Update – Buy – April 15, 2021 – Price Target \$7.00  
 Update – Buy – April 19, 2021 – Price Target \$7.00  
 Update – Buy – May 7, 2021 – Price Target \$7.00

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- 1) **Buy:** The analyst believes the price of the stock will appreciate and produce a total return of at least 20% over the next 12-18 months.
- 2) **Neutral:** The analyst believes the price of the stock is fairly valued for the next 12-18 months.
- 3) **Sell:** The analyst believes the price of the stock will decline by at least 20% over the next 12-18 months and should be sold.

The following chart reflects the range of current research report ratings for all companies, followed by the analysts of the Firm. The chart also reflects the research report ratings relating to those companies for which the Firm has performed investment banking services.

As of: 5-May-21

	<b>Company Coverage</b>		<b>Investment Banking</b>	
<b>Ratings Distribution</b>	<b># of Companies</b>	<b>% of Total</b>	<b># of Companies</b>	<b>% of Totals</b>
Market Outperform (Buy)	23	70%	5	22%
Market Perform (Neutral)	10	30%	0	0%
Market Underperform (Sell)	0	0%	0	0%
<b>Total</b>	<b>33</b>	<b>100%</b>	<b>5</b>	<b>15%</b>

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