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22nd Century Group, Inc. (NASDAQ: XXII)

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Buy: Q1 Report This Week. Menthol Ban, Circle K. Low-Nic Mandate.

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22nd Century is scheduled to release Q1 results on Thursday May 5. We expect revenue and EBITDA to be similar to prior quarters. The drivers of growth remain in place and include launch of VLN, the FDA's ban of menthol-flavored cigarettes and a low-nicotine mandate. We reiterate our Buy recommendation and \$8.50 price target.

We expect Q1 results, to be released on Thursday May 5, to be similar to prior quarters, with revenue mostly generated from contract manufacturing and an EBITDA loss of \$5.7 million. Cash at the end of Q4 2021 was \$48.7 million and at the current burn rate the company has about a two-year runway.

The Circle K pilot launch of the company's low-nicotine cigarette, VLN, has begun in 150 Chicagoland stores and is expected to last 3-6 months. We expect this to be followed by a national rollout to Circle K's 7,000 outlets and additional regional and national retailers next year. We have forecast a modest increase in sales beginning in 2023.

The FDA released a Notice of Proposed Rulemaking (NPRM) that would ban menthol flavor in cigarettes. A 60-day comment period follows after publication of the NPRM in the Federal Register. Comment periods are often extended an additional 45 to 60 days. We expect publication of the final rule at least 6 months after the closing of comments. This would put a final rule in early 2023 at the earliest. The NPRM proposed implementation of the ban one year after publication of final rule. The FDA is considering options to exempt certain products, on a case-by-case basis, from the ban. The FDA has consistently maintained offramps are necessary for consumers as restrictions on the market increases. We believe this would include 22nd Century's VLN, and would place VLN as one of the only menthol options in the market. According to the FTC Cigarette Report for 2020, menthol accounts for 37% of sales in the U.S.

We continue to expect a low-nicotine mandate, and believe this will follow the menthol ban. We believe other nations, such as New Zealand, will also pursue a low-nic mandate and this will be a major value driver for 22nd Century, as it controls the most cost-effective tool to meet this requirement.

Valuation: Our \$8.50 price target is the sum of: An estimated \$4.58/share for the VLN asset, \$3.18/share for the low-nicotine mandate and \$0.74 for the hemp/cannabis franchise.

Risks to Target include, among others: Our price target assumes the company launches VLN pilots in test markets this year and this could take longer than estimated and/or its partner could demand different terms than assumed. Our price target also assumes a nicotine mandate. The nicotine mandate may take longer to decide, and the transition period could be longer than estimated. See the Risks Analysis section for additional risks.

Current Price				\$1.91
Price Target				\$8.50
Estimates	F2021A	F2022E	F2023E	
Revenues (\$000s)	\$ 30,948	\$ 35,260 E	\$ 39,400	
1Q March	\$ 6,806	\$ 8,750 E	\$ 9,520	
2Q June	\$ 8,371	\$ 8,520 E	\$ 9,700	
3Q September	\$ 7,811	\$ 8,870 E	\$ 9,940	
4Q December	\$ 7,960	\$ 9,120 E	\$ 10,240	
	F2021A	F2022E	F2023E	
EPS (diluted)	\$ (0.21)	\$ (0.19)E	\$ (0.19)	
1Q March	\$ (0.03)	\$ (0.04)E	\$ (0.05)	
2Q June	\$ (0.03)	\$ (0.05)E	\$ (0.05)	
3Q September	\$ (0.06)	\$ (0.05)E	\$ (0.05)	
4Q December	\$ (0.09)	\$ (0.05)E	\$ (0.05)	
EBITDA (\$Ms)	\$ (23.2)	\$ (25.2)	\$ (26.3)	
EV/EBITDA (x)	-11.4x	-10.5x	-10.1x	
Stock Data				
52-Week Range	\$1.80	-	\$5.37	
Shares Outstanding (mil.)				162.9
Market Capitalization (mil.)				\$311
Enterprise Value (mil.)				\$265
Debt to Capital				0%
Cash (mil.)				\$48.7
Cash/share				\$0.30
Average Three Months Trading Volume (K)				2,863
Insider Ownership				3.6%
Institutional Ownership				28.2%
Short interest (mil.)				8.9%
Dividend / Yield				\$0.00/0.0%



For this year we assume about \$32 million of contract manufacturing sales, \$3 million from hemp/cannabis and \$360 thousand from VLN. We think there is a wide range of possibilities for VLN this year. The pilot program is designed to evaluate consumer demand, the impact on store sales and traffic and the effectiveness of shelf placement and marketing materials. We expect there will be starts and stops as inputs are changed to evaluate the outputs.

Valuation. Our price target of \$8.50 comprises three components: We attribute about \$4.58/share for the VLN asset. The non-addictive nicotine mandate is valued at \$3.18 per share. The remainder of the price target, or \$0.74 per share, equals about \$112 million and encompasses the company's investment in Exactus, the Anandia licenses and the potential from its relationship with KeyGene. We have assumed a long gestation period for the hemp/cannabis business because it is in the early stages. However, the Aurora announcement and the restructuring of the Panacea/Exactus investment could be catalysts to more rapid development of the market and 22nd Century's monetization efforts.

Risk Analysis

Our price target assumes the company launches VLN pilots in test markets this year, and this could take longer than estimated and/or its launch partner could demand different terms than assumed. Our price target also assumes a nicotine mandate. 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

<i>(\$ in 000's except per-share data)</i>	2019	2020	2021	Q1 22 E	Q2 22 E	Q3 22 E	Q4 22 E	2022 E	2023 E
Revenue	\$ 25,833	\$ 28,111	\$ 30,948	\$ 8,750	\$ 8,520	\$ 8,870	\$ 9,120	\$ 35,260	\$ 39,400
Cost Of Goods Sold	25,818	26,673	28,879	7,895	7,780	7,955	8,080	31,710	34,484
Gross Profit	14	1,438	2,069	855	740	915	1,040	3,550	4,916
	0.1%	5.1%	6.7%	9.8%	8.7%	10.3%	11.4%	10.1%	12.5%
R&D	8,057	4,128	3,274	850	850	850	850	3,400	3,400
G&A	12,956	14,971	25,881	6,820	7,500	7,500	8,000	29,820	32,222
Impairment Charge	1,142	176	78	0	0	0	0	0	0
Depreciation & Amort.	1,425	1,346	1,248	316	316	316	316	1,264	1,264
Opex	23,581	20,621	30,481	7,986	8,666	8,666	9,166	34,484	36,886
Operating Income	\$ (23,566)	\$ (19,183)	\$ (28,412)	\$ (7,131)	\$ (7,926)	\$ (7,751)	\$ (8,126)	\$ (30,934)	\$ (31,970)
Other	(4,002)	(428)	(4,446)	0	0	0	0	0	0
Impairment Charge	0	(1,741)	0	0	0	0	0	0	0
Interest Income	1,066	1,751	321	50	50	50	50	200	200
Interest Expense	(56)	(72)	(58)	(14)	(14)	(14)	(14)	(56)	(56)
Pretax Income	(26,559)	(19,673)	(32,595)	(7,095)	(7,890)	(7,715)	(8,090)	(30,790)	(31,826)
Income Tax Expense	0	38	14	0	0	0	0	0	0
Net to Common	\$ (26,559)	\$ (19,711)	\$ (32,609)	\$ (7,095)	\$ (7,890)	\$ (7,715)	\$ (8,090)	\$ (30,790)	\$ (31,826)
Shares (000)	125,883	138,813	156,208	162,906	163,188	163,688	164,188	163,493	167,313
EPS	(\$0.21)	(\$0.14)	(\$0.21)	(\$0.04)	(\$0.05)	(\$0.05)	(\$0.05)	(\$0.19)	(\$0.19)
D&A	1,425	1,346	1,248	316	316	316	316	1,264	1,264
Stock Comp	3,540	1,654	3,983	1,112	1,112	1,112	1,112	4,448	4,448
Other	1,142	176	0	0	0	0	0	0	0
EBITDA	\$ (17,459)	\$ (16,007)	\$ (23,181)	\$ (5,703)	\$ (6,498)	\$ (6,323)	\$ (6,698)	\$ (25,222)	\$ (26,258)

Source: 22nd Century Group, Inc. and Dawson James Securities estimates

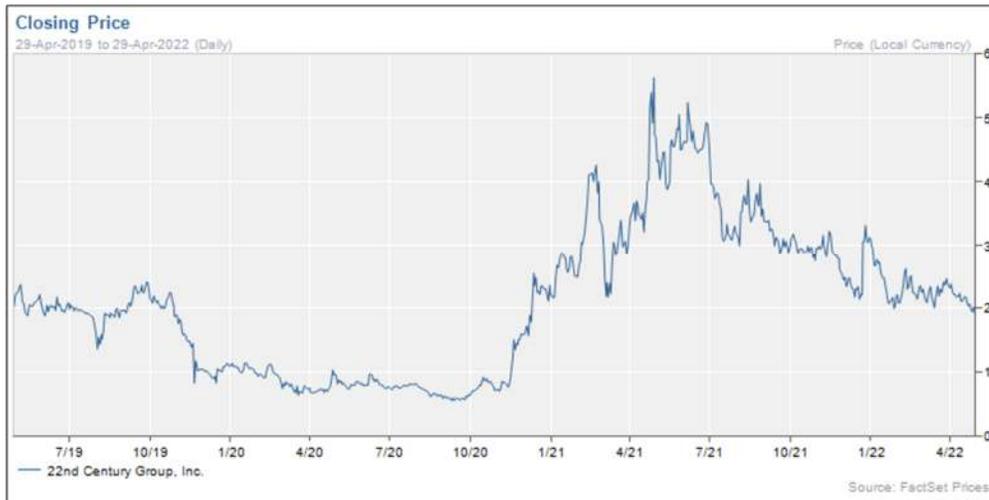
Exhibit 2. Balance Sheet and Cash Flow Statement

(\$ in 000's)	2019	2020	2021	2022 E	2023 E
Cash	485	1,029	1,336	1,336	1,336
Short-Term Investments	38,477	21,313	47,400	20,715	12,387
A/R	867	2,159	585	1,499	2,805
Inventory	2,266	2,034	2,881	3,074	3,381
Prepaid Exp.	648	1,806	2,183	2,183	2,183
Total Current Assets	\$ 42,743	\$ 28,341	\$ 54,385	\$ 28,807	\$ 22,093
PP&E	3,120	2,483	5,841	5,553	5,265
Operating Lease	602	247	1,723	1,723	1,723
Patent, Trademark, other intangibles	8,494	8,211	7,919	7,843	7,767
Equity Investment	8,403	6,536	2,345	2,345	2,345
Convertible Note Receivable	5,589	5,876	3,741	3,741	3,741
Total Assets	\$ 68,951	\$ 51,694	\$ 75,954	\$ 50,012	\$ 42,934
Bank Loans and N/P	581	539	596	596	596
Operating Lease	220	247	308	308	308
A/P	1,998	1,116	2,173	2,173	2,173
Accrued Expenses	2,619	4,830	5,014	5,014	5,014
Accrued Severance	359	339	217	217	217
Deferred Income	5	272	119	119	119
Total Current Liabilities	\$ 5,780	\$ 7,343	\$ 8,427	\$ 8,427	\$ 8,427
Long-Term Debt	292	0	0	0	0
Operating Lease	382	0	1,432	1,432	1,432
Accrued Severance	446	241	21	21	21
Shareholders' Equity	62,051	44,110	66,074	40,132	33,054
Total Liabilities And Equity	\$ 68,951	\$ 51,694	\$ 75,954	\$ 50,012	\$ 42,934
	2019	2020	2021	2022 E	2023 E
Net Income	(26,559)	(19,711)	(32,609)	(30,790)	(31,826)
Depreciation & Amort.	1,425	1,345	1,248	1,264	1,264
Stock Comp	3,540	1,654	3,983	4,448	4,448
Other	7,249	2,722	5,272	0	0
Working Capital	(242)	(1,631)	(733)	(1,107)	(1,614)
Operating Cash Flow	\$ (14,587)	\$ (15,621)	\$ (22,839)	\$ (26,185)	\$ (27,728)
Acquisition of Patents and trademarks	(515)	(468)	(326)	(500)	(500)
CapEx	(527)	(54)	(745)	(400)	(400)
Other	5,595	16,991	(26,658)	0	0
Investing Activities	\$ 4,552	\$ 16,469	\$ (27,729)	\$ (900)	\$ (900)
Debt	(700)	(354)	49	0	0
Equity	10,616	50	50,826	400	20,300
Other	0	0	0	0	0
Financing Activities	\$ 9,916	\$ (304)	\$ 50,875	\$ 400	\$ 20,300
Change in Cash	(\$120)	\$ 544	\$ 307	(\$26,685)	(\$8,328)

 Source: 22nd 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
- Update – Buy – June 1, 2021 – Price Target \$7.00
- Update – Buy – June 11, 2021 – Price Target \$7.00
- Update – Buy – July 2, 2021 – Price Target \$7.00
- Update – Buy – July 23, 2021 – Price Target \$7.00
- Update – Buy – August 6, 2021 – Price Target \$7.00
- Update – Buy – August 31, 2021 – Price Target \$7.00
- Update – Buy – October 18, 2021 – Price Target \$7.00
- Update – Buy – November 5, 2021 – Price Target \$7.00
- Update – Buy – November 22, 2021 – Price Target \$7.00
- Update – Buy – December 9, 2021 – Price Target \$7.00
- Update – Buy – December 23, 2021 – Price Target \$7.00
- Price Target Change – Buy – January 6, 2022 – Price Target changed from \$7.00 to \$8.50
- Update – Buy – January 24, 2022 – Price Target \$8.50
- Update – Buy – February 16, 2022 – Price Target \$8.50
- Update – Buy – February 24, 2022 – Price Target \$8.50
- Update – Buy – March 4, 2022 – Price Target \$8.50
- Update – Buy – May 2, 2022 – Price Target \$8.50

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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.

Current as of 26-Apr-22

	Company Coverage		Investment Banking	
Ratings Distribution	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	32	74%	4	13%
Market Perform (Neutral)	11	26%	0	0%
Market Underperform (Sell)	0	0%	0	0%
Total	43	100%	4	9%

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