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UPDATE REPORT

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

May 6, 2022

Buy: Q1 Review. Early Circle K Results Positive.

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Q1 results were generally in line with our expectations. 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.

Current Price			**$1.81**
Price Target			**$8.50**
Estimates	F2021A	F2022E	F2023E
Revenues ($000s)	$ 30,948	$ 35,555 E	$ 39,400
1Q March	$ 6,806	$ 9,045 A	$ 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)	$ (0.22)E	$ (0.21)
1Q March	$ (0.03)	$ (0.05)A	$ (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)	$ (25.8)	$ (26.0)
EV/EBITDA (x)	-11.3x	-10.1x	-10.0x
Stock Data			
52-Week Range	$1.78	-	$5.25
Shares Outstanding (mil.)			164.5
Market Capitalization (mil.)			$298
Enterprise Value (mil.)			$261
Debt to Capital			0%
Cash (mil.)			$38.6
Cash/share			$0.23
Average Three Months Trading Volume (K)			1,885
Insider Ownership			3.6%
Institutional Ownership			28.2%
Short interest (mil.)			8.8%
Dividend / Yield			$0.00/0.0%

Q1 revenue of $9.0 million exceeded our $8.8 million estimate and the EBITDA loss of $6.5 million was higher than our $5.7 million forecast. Cash at quarter-end was $38.6 million, a 12-18 month runway at recent burn rates.

The company has two weeks of data of the VLN pilot launch at 159 Circle K stores in Chicagoland. The early results are better than the company expected, but not definitive regarding the ultimate consumer acceptance of the product. Marketing has been limited but will increase in the coming weeks and will include direct mail, email, both digital and print advertising, training and incentives for store clerks and in-store promotions. Plans for additional pilots are underway and could begin while the initial Circle K pilot is ongoing. These pilots could be at additional Circle K stores and/or with additional retailers.

Investments in manufacturing capacity to satisfy about 1% of the domestic market are underway and an investment in another VLN crop will take place this year to give the company inventory necessary to satisfy demand for the product as pilots expand and regional and/or national roll-outs begin. Using sales and market share data from Altria, a 1% market share of the domestic combustible cigarette market would result in about $450 million in annual sales.

Recently, the FDA released a Notice of Proposed Rulemaking (NPRM) that would ban menthol flavor in cigarettes. According to the FTC Cigarette Report for 2020, menthol accounts for 37% of sales in the U.S. We expect publication of the final rule in early 2023 at the earliest and 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.

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.

Q1 Results

Q1 sales were $9.0 million, up 32% from the year-ago amount, up 14% from Q4, and were also 3.4% ahead of our estimate. Gross margin was lower than expected and operating expenses were greater than we forecast. This resulted in an EBITDA loss of $6.5 million versus our estimate of a $5.7 million EBITDA loss.

Q1 22			
$ in 000's, except per-share data	Actual	Estimates	Delta
Revenue	$ 9,045	$ 8,750	3.4%
Cost Of Goods Sold	8,585	7,895	8.7%
Gross Profit	460	855	-46.2%
	5.1%	9.8%	
R&D	972	850	
G&A	7,305	6,820	
Depreciation & Amort.	329	316	
Opex	8,606	7,986	7.8%
Operating Income	$ (8,146)	$ (7,131)	-14.2%
Interest and other, net	(772)	36	
Pretax Income	(8,918)	(7,095)	
Income Tax Expense	0	0	
Net to Common	$ (8,918)	$ (7,095)	
Shares (000)	163,157	162,906	
EPS	$ (0.05)	$ (0.04)	
D&A	421	316	
Stock Comp	1,213	1,112	
EBITDA	$ (6,512)	$ (5,703)	-14.2%

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

For this year we assume about $32.2 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.

	2022E		2023E	
	Old	New	Old	New
Revenue ($M)	$ 35.3	$ 35.6	$ 39.4	$ 39.4
EPS	$ (0.19)	$ (0.22)	$ (0.19)	$ (0.21)
EBITDA ($M)	$ (25.2)	$ (25.8)	$ (26.3)	$ (26.0)

Source: Dawson James Securities estimates

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

($ in 000's except per-share data)	2019	2020	2021	Q1 22 A	Q2 22 E	Q3 22 E	Q4 22 E	2022 E	2023 E
Revenue	$ 25,833	$ 28,111	$ 30,948	$ 9,045	$ 8,520	$ 8,870	$ 9,120	$ 35,555	$ 39,400
Cost Of Goods Sold	25,818	26,673	28,879	8,585	7,780	7,955	8,080	32,400	34,484
Gross Profit	14	1,438	2,069	460	740	915	1,040	3,155	4,916
	0.1%	5.1%	6.7%	5.1%	8.7%	10.3%	11.4%	8.9%	12.5%
R&D	8,057	4,128	3,274	972	972	972	972	3,888	3,888
G&A	12,956	14,971	25,881	7,305	7,500	7,500	8,000	30,305	32,222
Impairment Charge	1,142	176	78	0	0	0	0	0	0
Depreciation & Amort.	1,425	1,346	1,248	329	329	329	329	1,316	1,316
Opex	23,581	20,621	30,481	8,606	8,801	8,801	9,301	35,509	37,426
Operating Income	$ (23,566)	$ (19,183)	$ (28,412)	$ (8,146)	$ (8,061)	$ (7,886)	$ (8,261)	$ (32,354)	$ (32,510)
Interest and other, net	(2,992)	(490)	(4,183)	(772)	45	45	45	(637)	180
Pretax Income	(26,559)	(19,673)	(32,595)	(8,918)	(8,016)	(7,841)	(8,216)	(32,991)	(32,330)
Income Tax Expense	0	38	14	0	0	0	0	0	0
Net to Common	$ (26,559)	$ (19,711)	$ (32,609)	$ (8,918)	$ (8,016)	$ (7,841)	$ (8,216)	$ (32,991)	$ (32,330)
Shares (000)	125,883	138,813	156,208	163,157	164,537	164,787	165,287	164,442	165,924
EPS	($0.21)	($0.14)	($0.21)	($0.05)	($0.05)	($0.05)	($0.05)	($0.20)	($0.19)
D&A	1,425	1,346	1,248	421	421	421	421	1,684	1,684
Stock Comp	3,540	1,654	3,983	1,213	1,213	1,213	1,213	4,852	4,852
Other	1,142	176	0	0	0	0	0	0	0
EBITDA	$ (17,459)	$ (16,007)	$ (23,181)	$ (6,512)	$ (6,427)	$ (6,252)	$ (6,627)	$ (25,818)	$ (25,974)

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

Exhibit 2. Balance Sheet and Cash Flow Statement

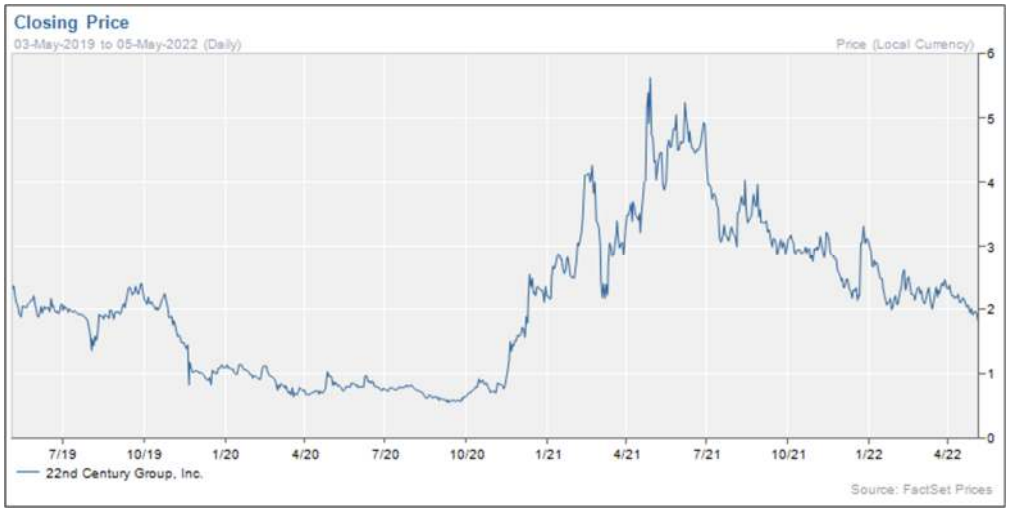
($ in 000's)	2019	2020	2021	2022 E	2023 E
Cash	485	1,029	1,336	1,584	1,584
Short-Term Investments	38,477	21,313	47,400	15,881	7,873
A/R	867	2,159	585	1,499	2,805
Inventory	2,266	2,034	2,881	3,074	3,381
Prepaid Exp.	648	1,806	2,183	1,389	1,389
Total Current Assets	**$ 42,743**	**$ 28,341**	**$ 54,385**	**$ 23,427**	**$ 17,033**
PP&E	3,120	2,483	5,841	5,745	5,473
Operating Lease	602	247	1,723	1,631	1,631
Patent, Trademark, other intangibles	8,494	8,211	7,919	7,550	7,038
Equity Investment	8,403	6,536	2,345	2,211	2,211
Convertible Note Receivable	5,589	5,876	3,741	3,770	3,770
Total Assets	**$ 68,951**	**$ 51,694**	**$ 75,954**	**$ 44,334**	**$ 37,156**
Bank Loans and N/P	581	539	596	0	0
Operating Lease	220	247	308	359	359
A/P	1,998	1,116	2,173	1,512	1,512
Accrued Expenses	2,619	4,830	5,014	2,632	2,632
Accrued excise taxes and fees					
Accrued Severance	359	339	217	187	187
Deferred Income	5	272	119	483	483
Total Current Liabilities	**$ 5,780**	**$ 7,343**	**$ 8,427**	**$ 5,173**	**$ 5,173**
Long-Term Debt	292	0	0	0	0
Operating Lease	382	0	1,432	1,326	1,326
Accrued Severance	446	241	21	0	0
Shareholders' Equity	62,051	44,110	66,074	37,835	30,657
Total Liabilities And Equity	**$ 68,951**	**$ 51,694**	**$ 75,954**	**$ 44,334**	**$ 37,156**

	2019	2020	2021	2022 E	2023 E
Net Income	(26,559)	(19,711)	(32,609)	(32,991)	(32,330)
Depreciation & Amort.	1,425	1,345	1,248	1,684	1,684
Stock Comp	3,540	1,654	3,983	4,852	4,852
Other	7,249	2,722	5,272	936	0
Working Capital	(242)	(1,631)	(733)	(3,189)	(1,614)
Operating Cash Flow	**$ (14,587)**	**$ (15,621)**	**$ (22,839)**	**$ (28,708)**	**$ (27,408)**
Acquisition of Patents and trademarks	(515)	(468)	(326)	(480)	(500)
CapEx	(527)	(54)	(745)	(558)	(400)
Other	5,595	16,991	(26,658)	9,135	0
Investing Activities	**$ 4,552**	**$ 16,469**	**$ (27,729)**	**$ 8,097**	**$ (900)**
Debt	(700)	(354)	49	(596)	0
Equity	10,616	50	50,826	300	20,300
Other	0	0	0	0	0
Financing Activities	**$ 9,916**	**$ (304)**	**$ 50,875**	**$ (296)**	**$ 20,300**
Change in Cash	**($120)**	**$ 544**	**$ 307**	**($20,907)**	**($8,008)**

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
Update – Buy – May 6, 2022 – Price Target $8.50

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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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