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

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Buy: XXII Amasses Resources Necessary for Growth.

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22nd Century now has over \$70 million in cash, and we estimate has eliminated financing risk as it ramps up growth for its VLN introduction and GVB integration. In addition, operational success, we believe, will drive share price gains and result in an additional \$35 million in cash to the company and five-years of runway in the highly conservative scenario that cash burn remains at current levels. We reiterate our Buy recommendation and \$8.50 price target.

22nd Century completed a capital raise of \$35 million, bringing its cash balance to over \$70 million and securing the funding necessary to launch VLN, integrate GVB and amassing the resources necessary to benefit from the FDA's upcoming proposed rule to lower nicotine in cigarettes to non-addictive levels. We believe this raise significantly strengthens the company's ability to compete on multiple fronts and eliminates financing risk for the company.

The company is in the fourth month of a three-to-six month pilot program with Circle K testing the VLN low-nic cigarette in the Chicagoland market. The company indicates results to date have been very positive and is testing specific incentive programs. We believe ultimate success will be based on market share and repeat buying. This is a very large market so garnering even modest market share will be a major accomplishment. We expect geographic expansion with Circle K later this year and additional retailers to be added as well. The company has indicated it is in discussions with multiple retailers and distributors to carry the line.

The integration of GVB continues and we model a meaningful increase in revenues in the second half of this year. GVB generated \$27 million in revenue in 2021 and is expected to post \$48 million in revenue this year with 44% gross margin. We have modeled a significant ramp in revenue from GVB in the second half, and these volume increases driving margin expansion. The addition of GVB provides much greater scale for 22nd Century and with the front-end plant design expertise, will enable GVB to offer customized products to the CBD market. We think this will put GVB in a unique position relative to competitors and we also believe the regulatory environment will tighten and benefit suppliers like GVB which has focused from the beginning on being compliant with FDA regulations.

Cash is required to fund operations until the low-nic mandate becomes operational, which will take a few years. We expect the incumbent tobacco companies will try to delay. The additional capital strengthens XXII's position relative to this delay strategy.

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				\$1.74
Price Target				\$8.50
Estimates	F2021A	F2022E	F2023E	
Revenues (\$000s)	\$ 30,948	\$ 65,555 E	\$ 96,812	
1Q March	\$ 6,806	\$ 9,045 A	\$ 23,040	
2Q June	\$ 8,371	\$ 13,520 E	\$ 23,761	
3Q September	\$ 7,811	\$ 18,870 E	\$ 24,563	
4Q December	\$ 7,960	\$ 24,120 E	\$ 25,448	
	F2021A	F2022E	F2023E	
EPS (diluted)	\$ (0.21)	\$ (0.16)E	\$ (0.11)	
1Q March	\$ (0.03)	\$ (0.05)A	\$ (0.03)	
2Q June	\$ (0.03)	\$ (0.04)E	\$ (0.03)	
3Q September	\$ (0.06)	\$ (0.04)E	\$ (0.03)	
4Q December	\$ (0.09)	\$ (0.02)E	\$ (0.03)	
EBITDA (\$Ms)	\$ (23.2)	\$ (21.9)	\$ (16.5)	
EV/EBITDA (x)	-13.3x	-14.1x	-18.6x	
Stock Data				
52-Week Range	\$1.42	-	\$4.17	
Shares Outstanding (mil.)				214.5
Market Capitalization (mil.)				\$373
Enterprise Value (mil.)				\$308
Debt to Capital				2%
Cash (mil.)				\$71.9
Cash/share				\$0.34
Average Three Months Trading Volume (K)				1,058
Insider Ownership				3.6%
Institutional Ownership				27.3%
Short interest (mil.)				7.0%
Dividend / Yield				\$0.00/0.0%



We estimate the company's annual burn currently between \$20 and \$25 million. We expect this rate to diminish this year as GVB ramps and diminish further in 2023 depending on the scope and success of VLN. But even in the highly unlikely scenario where the current burn rate persists, the company now has a minimum of three years of cash, but realistically at least five years of cash and reasonably more than enough cash to fund growth and reach cash-flow breakeven.

One path for the company to capitalize on the low-nic mandate is the introduction of its VLN (very low nicotine) brand of cigarettes. Tests are underway in Chicago at Circle K and a regional and/or national roll-out with Circle K and other retailers is likely, in our view, in 2023. Each 1% market share of the 50% of smokers who attempt to quit annually equates to almost \$250 million in revenue, and at a 5x sales multiple, similar to the comp group, a valuation of \$1.25 billion, or \$6.25 per share.

At least for now the large tobacco companies are focusing on e-cigarettes as a replacement for their combustible cigarette franchise. The FDA has required pre-market tobacco applications (PMTA) from suppliers of e-cigarettes. The vast majority of the 8 million applications received have been rejected for lack of necessary information or denied after review. The FDA's denial of Juul's application is the most well-known example and indicates how difficult it will be to serve the market. The FDA is also requiring synthetic tobacco suppliers to submit PMTAs, and it seems reasonable to expect a similar winnowing down to a few competitors.

In our view, this is highly bullish for 22nd Century. A low-nic mandate will take a few years to implement, and in the meantime 22nd Century will be all alone in offering a low-nic alternative to the 50% of smokers who try to quit every year. The e-cig off-ramp for combustible cigarettes is moving slowly. To date, only 23 products have been granted marketing orders out of the 8 million applications received. Synthetic nicotine products also face the regulatory hurdles put in place by the FDA.

Our estimates reflect the mid-May acquisition of GVB. Total revenue for GVB this year is expected to be \$48 million, and we have assumed a \$30 million contribution for the partial year it is owned by 22nd Century. For 2023 we have assumed a \$57 million revenue contribution from GVB. Gross margin for GVB has been running at about 44% and we have assumed this is maintained for this year and next. We have assumed the operating income contribution from GVB is modest for this year and next and believe there is room for upside as the business scales.

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 A	Q2 22 E	Q3 22 E	Q4 22 E	2022 E	2023 E
Revenue	\$ 25,833	\$ 28,111	\$ 30,948	\$ 9,045	\$ 13,520	\$ 18,870	\$ 24,120	\$ 65,555	\$ 96,812
Cost Of Goods Sold	25,818	26,673	28,879	8,585	11,640	14,140	15,890	50,255	67,831
Gross Profit	14	1,438	2,069	460	1,880	4,730	8,230	15,300	28,981
	0.1%	5.1%	6.7%	5.1%	13.9%	25.1%	34.1%	23.3%	29.9%
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	8,700	11,000	11,500	38,505	46,863
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	10,001	12,301	12,801	43,709	52,067
Operating Income	\$ (23,566)	\$ (19,183)	\$ (28,412)	\$ (8,146)	\$ (8,121)	\$ (7,571)	\$ (4,571)	\$ (28,409)	\$ (23,086)
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)	(8,076)	(7,526)	(4,526)	(29,046)	(22,906)
Income Tax Expense	0	38	14	0	0	0	0	0	0
Net to Common	\$ (26,559)	\$ (19,711)	\$ (32,609)	\$ (8,918)	\$ (8,076)	\$ (7,526)	\$ (4,526)	\$ (29,046)	\$ (22,906)
Shares (000)	125,883	138,813	156,208	163,157	180,987	205,973	214,760	191,219	215,397
EPS	(\$0.21)	(\$0.14)	(\$0.21)	(\$0.05)	(\$0.04)	(\$0.04)	(\$0.02)	(\$0.15)	(\$0.11)
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)	\$ (6,487)	\$ (5,937)	\$ (2,937)	\$ (21,873)	\$ (16,550)

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

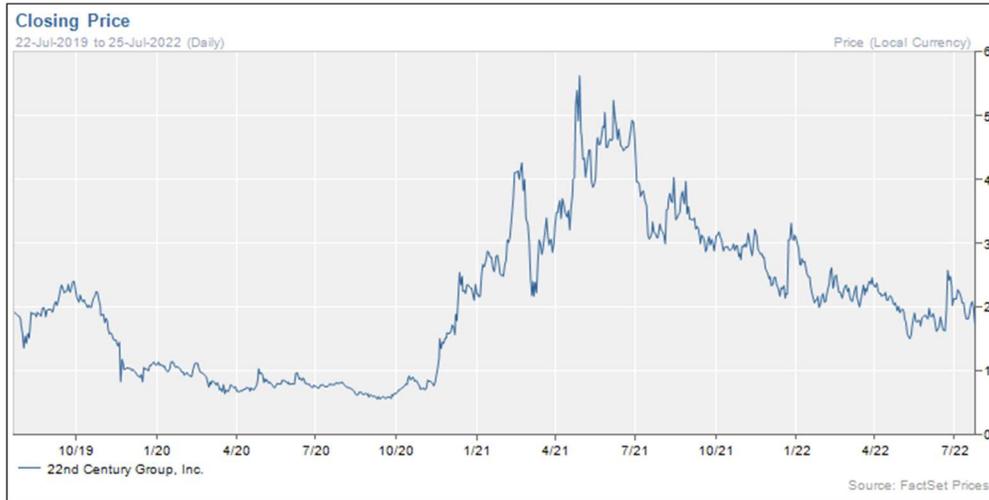
Exhibit 2. Balance Sheet and Cash Flow Statement

(\$ 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	46,339	25,657
A/R	867	2,159	585	3,965	6,972
Inventory	2,266	2,034	2,881	6,045	6,851
Prepaid Exp.	648	1,806	2,183	1,389	1,389
Total Current Assets	\$ 42,743	\$ 28,341	\$ 54,385	\$ 59,322	\$ 42,452
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	50,550	50,038
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	\$ 123,229	\$ 105,575
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	4,500	4,500
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	112,230	94,576
Total Liabilities And Equity	\$ 68,951	\$ 51,694	\$ 75,954	\$ 123,229	\$ 105,575
	2019	2020	2021	2022 E	2023 E
Net Income	(26,559)	(19,711)	(32,609)	(29,046)	(22,906)
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)	(8,626)	(3,813)
Operating Cash Flow	\$ (14,587)	\$ (15,621)	\$ (22,839)	\$ (30,200)	\$ (20,183)
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	33,450	400
Other	0	0	0	0	0
Financing Activities	\$ 9,916	\$ (304)	\$ 50,875	\$ 32,854	\$ 400
Change in Cash	(\$120)	\$ 544	\$ 307	\$ 10,751	(\$20,683)

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
- Update – Buy – May 16, 2022 – Price Target \$8.50
- Update – Buy – June 13, 2022 – Price Target \$8.50
- Update – Buy – June 22, 2022 – Price Target \$8.50
- Update – Buy – July 1, 2022 – Price Target \$8.50
- Update – Buy – July 26, 2022 – Price Target \$8.50

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Current as of 25-Jul-22

	Company Coverage		Investment Banking	
Ratings Distribution	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	30	68%	5	17%
Market Perform (Neutral)	13	30%	0	0%
Market Underperform (Sell)	1	2%	0	0%
Total	44	100%	5	11%

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