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

March 10, 2023

Buy: Q4 Review. Driving to Positive CF in 2024.

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Q4 revenue of \$19.2 million exceeded our \$16.5 million estimate as the company overcame the supply disruption at its Grass Valley facility much more effectively than we modeled. The company sees a path to positive cash flow in both its VLN and hemp/cannabis business by the middle of 2024. We reiterate our Buy recommendation and \$8.50 price target.

Q4 revenue of \$19.2 million exceeded our \$16.5 million estimate. We had assumed the company would have greater difficulty overcoming the supply disruption at its Grass Valley facility and modeled hemp/cannabis revenue of \$6 million. The company reported \$9.3 million from hemp/cannabis and \$10 million from tobacco revenue. The reported tobacco revenue was in line with our estimate.

Gross margin suffered in the quarter for both tobacco and hemp/cannabis. Mix impacted the tobacco business and purchasing product on the merchant market in the hemp/cannabis segment to fill orders hurt that segment. We expect gross margin to improve each quarter over our forecast horizon.

In the tobacco segment, the company is rolling out VLN and intends to be in 18 markets by year-end. This is at least a \$25 billion addressable market, and the company estimates it will achieve cash flow break-even with total annualized revenue of about \$70 million. Margins will increase with scale and the company expects to reach its CF break-even level of sales by mid-2024. We have modeled this to occur in the second half.

The hemp/cannabis business will also have improved gross margin as the year progresses. The Grass Valley fire forced the company to purchase isolate and distillate on the merchant market in order to fill orders, and this resulted in a reseller-like margins in Q4 and we expect an improved, but still subdued, margin in Q1. Margins will improve as the new Prineville facility becomes operational this quarter and ramps through the year. The company is also pursuing CDMO relationships with smaller players in the space that would enable it to grow revenue and margins by supplying these customers with end-to-end manufacturing and distribution services. We have assumed modest growth in this initiative, but there is room for upside.

We have raised our revenue estimate for this year to \$93 million based on higher revenue in both segments. Margins should improve as the year progresses and we have modeled positive cash flow by year-end 2024, a bit later than the company's expectation.

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				\$0.86
Price Target				\$8.50
Estimates	F2022A	F2023E	F2024E	
Revenues (\$M's)	\$ 62.1	\$ 93.3 E	\$ 168.5	
1Q March	\$ 9.0	\$ 19.8 E	\$ 35.0	
2Q June	\$ 14.5	\$ 20.5 E	\$ 41.0	
3Q September	\$ 19.4	\$ 24.0 E	\$ 44.5	
4Q December	\$ 19.2	\$ 29.0 E	\$ 48.0	
	F2022A	F2023E	F2024E	
EPS (diluted)	(\$0.31)	\$ (0.27)E	(\$0.10)	
1Q March	(\$0.05)	\$ (0.07)E	(\$0.04)	
2Q June	(\$0.06)	\$ (0.07)E	(\$0.03)	
3Q September	(\$0.06)	\$ (0.07)E	(\$0.02)	
4Q December	(\$0.12)	\$ (0.05)E	(\$0.01)	
EBITDA (\$Ms)	\$ (39.7)	\$ (45.1)	\$ (12.1)	
EV/EBITDA (x)	-4.5x	-4.0x	-14.9x	
Stock Data				
52-Week Range	\$0.82	-	\$2.70	
Shares Outstanding (mil.)				215.2
Market Capitalization (mil.)				\$185
Enterprise Value (mil.)				\$180
Debt to Capital				22%
Cash (mil.)				\$33.2
Cash/share				\$0.15
Average Three Months Trading Volume (K)				1,406
Insider Ownership				2.6%
Institutional Ownership				19.3%
Short interest (mil.)				8.5%
Dividend / Yield				\$0.00/0.0%



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 for 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>	2020	2021	2022	Q1 23 E	Q2 23 E	Q3 23 E	Q4 23 E	2023 E	2024 E
Revenue	\$ 28,111	\$ 30,948	\$ 62,111	\$ 19,750	\$ 20,500	\$ 24,000	\$ 29,000	\$ 93,250	\$ 168,500
Cost Of Goods Sold	26,673	28,879	60,937	18,775	19,000	21,700	24,450	83,925	124,325
Gross Profit	1,438	2,069	1,174	975	1,500	2,300	4,550	9,325	44,175
	5.1%	6.7%	1.9%	4.9%	7.3%	9.6%	15.7%	10.0%	26.2%
R&D	4,128	3,274	6,561	1,500	1,500	1,500	1,500	6,000	6,400
G&A	14,971	25,881	44,517	14,097	14,097	14,449	14,449	57,093	58,520
Other	176	78	7,202	0	0	0	0	0	0
Depreciation & Amort.	1,346	1,248	0	0	0	0	0	0	0
Opex	20,621	30,481	58,280	15,597	15,597	15,949	15,949	63,093	64,920
Operating Income	\$ (19,183)	\$ (28,412)	\$ (57,106)	\$ (14,622)	\$ (14,097)	\$ (13,649)	\$ (11,399)	\$ (53,768)	\$ (20,745)
Interest and other, net	(490)	(4,183)	(3,129)	(1,029)	(1,322)	(1,322)	(1,322)	(4,994)	(5,286)
Pretax Income	(19,673)	(32,595)	(60,235)	(15,651)	(15,419)	(14,971)	(12,721)	(58,761)	(26,031)
Income Tax Expense	38	14	(434)	0	0	0	0	0	0
Net to Common	\$ (19,711)	\$ (32,609)	\$ (59,801)	\$ (15,651)	\$ (15,419)	\$ (14,971)	\$ (12,721)	\$ (58,761)	\$ (26,031)
Shares (000)	138,813	156,208	192,837	215,471	215,954	216,221	236,237	220,971	270,944
EPS	(\$0.14)	(\$0.21)	(\$0.31)	(\$0.07)	(\$0.07)	(\$0.07)	(\$0.05)	(\$0.27)	(\$0.10)
D&A	1,346	1,248	2,858	866	866	866	866	3,464	3,464
Stock Comp	1,654	3,983	5,489	1,300	1,300	1,300	1,300	5,200	5,200
Other	176	0	9,065	0	0	0	0	0	0
EBITDA	\$ (16,007)	\$ (23,181)	\$ (39,694)	\$ (12,456)	\$ (11,931)	\$ (11,483)	\$ (9,233)	\$ (45,104)	\$ (12,081)

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

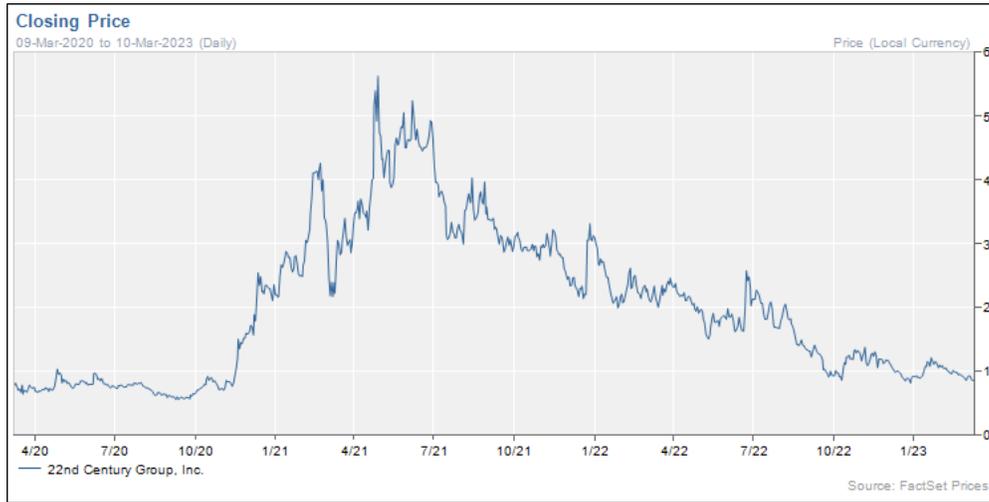
Exhibit 2. Balance Sheet and Cash Flow Statement

(\$ in 000's)	2020	2021	2022	2023 E	2024 E
Cash & ST Investments	22,342	48,736	21,213	11,743	10,347
Restricted Cash	0	0	0	7,500	7,500
A/R	2,159	585	5,641	14,301	23,671
Inventory	2,034	2,881	10,008	12,058	16,570
Insurance Recovery	0	0	5,000	0	0
Prepaid Exp.	1,806	2,183	2,743	2,743	2,743
Total Current Assets	\$ 28,341	\$ 54,385	\$ 44,605	\$ 48,345	\$ 60,831
PP&E	2,483	5,841	13,093	17,533	17,973
Operating Lease	247	1,723	2,675	2,675	2,675
Goodwill	0	0	33,160	33,160	33,160
Patent, Trademark, other intangibles	8,211	7,919	16,853	16,641	16,429
Equity Investment	6,536	2,345	682	682	682
Other Assets	5,876	3,741	3,583	3,583	3,583
Total Assets	\$ 51,694	\$ 75,954	\$ 114,651	\$ 122,619	\$ 135,333
Bank Loans and N/P	539	596	908	908	908
Operating Lease	247	308	681	681	681
A/P	1,116	2,173	4,168	5,133	7,054
Accrued Expenses & Payroll	4,830	5,014	4,627	5,699	7,831
Accrued excise taxes and fees	0	0	1,423	1,423	1,423
Deferred Income	272	119	831	831	831
Accrued Severance	339	217	380	380	380
Total Current Liabilities	\$ 7,343	\$ 8,427	\$ 13,018	\$ 15,055	\$ 19,109
Long-Term Debt	0	0	3,001	23,001	23,001
Operating Lease	0	1,432	2,141	2,141	2,141
Other	241	21	516	516	516
Shareholders' Equity	44,110	66,074	95,975	81,906	90,566
Total Liabilities And Equity	\$ 51,694	\$ 75,954	\$ 114,651	\$ 122,619	\$ 135,333
	2020	2021	2022	2023 E	2024 E
Net Income	(19,711)	(32,609)	(59,801)	(58,761)	(26,031)
Depreciation & Amort.	1,345	1,248	2,858	3,464	3,464
Stock Comp	1,654	3,983	5,489	5,200	5,200
Other	2,722	5,272	11,310	0	0
Working Capital	(1,631)	(733)	(11,570)	(3,673)	(9,828)
Operating Cash Flow	\$ (15,621)	\$ (22,839)	\$ (51,714)	\$ (53,770)	\$ (27,196)
Acquisition of Patents and trademarks	(468)	(326)	(772)	(500)	(500)
CapEx	(54)	(745)	(3,657)	(8,000)	(4,000)
Other	16,991	(26,658)	27,007	0	0
Investing Activities	\$ 16,469	\$ (27,729)	\$ 22,578	\$ (8,500)	\$ (4,500)
Debt	(354)	49	(3,822)	12,500	0
Equity	50	50,826	32,335	40,300	30,300
Other	0	0	2,307	0	0
Financing Activities	\$ (304)	\$ 50,875	\$ 30,820	\$ 52,800	\$ 30,300
Change in Cash	\$ 544	\$ 307	\$ 1,684	(\$9,470)	(\$1,396)

 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
- Update – Buy – August 10, 2022 – Price Target \$8.50
- Update – Buy – September 21, 2022 – Price Target \$8.50
- Update – Buy – October 20, 2022 – Price Target \$8.50
- Update – Buy – October 27, 2022 – Price Target \$8.50
- Update – Buy – November 9, 2022 – Price Target \$8.50
- Update – Buy – November 22, 2022 – Price Target \$8.50
- Update – Buy – February 1, 2023 – Price Target \$8.50
- Update – Buy – March 6, 2023 – Price Target \$8.50

Update – Buy – March 10, 2023 – Price Target \$8.50

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- 2) **Neutral:** The analyst believes the price of the stock is fairly valued for the next 12-18 months.
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Current as of 03-Mar-23

	Company Coverage		Investment Banking	
Ratings Distribution	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	24	69%	1	3%
Market Perform (Neutral)	11	31%	2	6%
Market Underperform (Sell)	0	0%	0	0%
Total	35	100%	3	9%

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