

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

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Buy: Operational Improvement in Challenging Financing Environment.

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We expect significant operational improvement over the coming quarters as the company's VLN business expands into 18 states serving 56% of total cigarette sales and its CBD business expands from CDMO agreements with Cookies, Old Pal. Also, we expect improved mix and margins as distillate and isolate capacity comes on line. However, removal from the Russell 3000 Index and the share price decline has made financing more expensive and increased our estimate of further share issuances. We have adjusted our price target to reflect these factors.

By the end of Q2 22nd Century was distributing its VLN cigarettes in 10 markets addressing about 30% of the U.S. market and expects to operate in 18 markets addressing over 50% of the U.S. market by year end. The company needs to sell about 1.2 million cartons per year, or less than 0.5% of the addressable markets in those states to reach cash flow breakeven. The company is targeting the second half of next year for that event. Results in pilot markets point to a 1% market share potential in a short period of time and growing from there. As the company grows its distribution reach over the coming quarters, cash flow from VLN is expected to increase rapidly.

We expect hemp/cannabis revenue to grow meaningfully over the course of the year from Q1's \$13 million to over \$15 million in Q4 and doubling by the end of 2024. Margins will improve with the resumption of distillate production Q2/Q3 and isolate production in Q4/Q1 24. The company has announced two CDMO agreements with Cookies and Old Pal which it estimates could contribute over \$45 million annually in sales.

The company has guided to revenue this year of \$105 to \$110 million. At the midpoint, this is 73% higher than revenue in 2022 and we estimate sales in 2024 of \$192 million and positive EBITDA in Q3.

While operational trends are positive the shares have suffered by its deletion from the Russell 3000 Index, and subsequent selling caused by that action. This has negatively impacted its financing options, and increased the number of shares it will be required to issue to fund its growth. The elimination from the Russell Index reduces some of the investable audience, which we expect to have a temporary impact on the target multiple the shares can garner. For these reasons, we have lowered our price target to \$1 per share from \$4.50 per share.

Valuation: Our \$1.00 price target is based on a multiple of sales of about 1.25x and the Q4 2024 run rate revenue of \$240 million. The multiple range is consistent with other companies in the space.

Risks to Target: Our price target assumes success in VLN launches this year and this could take longer than estimated, and/or its partner could demand different terms than assumed. We assume significant margin expansion in both the tobacco and hemp segments which will be driven partly by capacity utilization. Our forecasted growth in the company's hemp segment this year could be impacted by price pressures.

Current Price				\$0.38
Price Target				\$1.00
Estimates	F2022A	F2023E	F2024E	
Revenues (\$M's)	\$ 62.1	\$ 103.0 E	\$ 192.5	
1Q March	\$ 9.0	\$ 22.0 A	\$ 35.0	
2Q June	\$ 14.5	\$ 23.0 E	\$ 45.0	
3Q September	\$ 19.4	\$ 26.5 E	\$ 52.5	
4Q December	\$ 19.2	\$ 31.5 E	\$ 60.0	
	F2022A	F2023E	F2024E	
EBITDA (\$M's)	\$ (39.7)	\$ (51.0)E	\$ (4.5)	
1Q March	\$ (6.5)	\$ (14.9)A	\$ (6.3)	
2Q June	\$ (7.1)	\$ (13.2)E	\$ (2.4)	
3Q September	\$ (11.0)	\$ (12.5)E	\$ 0.3	
4Q December	\$ (15.0)	\$ (9.5)E	\$ 4.0	
EBITDA (\$Ms)	\$ (39.7)	\$ (51.0)	\$ (4.5)	
EV/EBITDA (x)	-2.5x	-1.9x	-21.9x	
Stock Data				
52-Week Range	\$0.34	-	\$2.32	
Shares Outstanding (mil.)				237.9
Market Capitalization (mil.)				\$91
Enterprise Value (mil.)				\$99
Debt to Capital				19%
Cash (mil.)				\$23.7
Cash/share				\$0.10
Average Three Months Trading Volume (K)				609
Insider Ownership				3.2%
Institutional Ownership				18.4%
Short interest (mil.)				11.2%
Dividend / Yield				\$0.00/0.0%



Over the past few months, the company has made substantial progress in both segments of its business. The VLN business is expanding with launches in Illinois, Colorado, New Mexico, Utah, Arizona, Florida, Texas and California. The company has agreements with Circle K in the Four Corner States and the largest C-Store operator in the nation (7-11, according to C-Store News) in California, Texas and Florida. The company estimates these eight states sell about 240 million cartons of cigarettes annually, and to achieve cash flow breakeven 22nd Century needs to sell about 1.2 million cartons annually, or a market share of 0.5%. With data showing 1% share is possible, we expect the company to achieve its goal of cash flow breakeven by the middle of next year.

The Hemp/cannabis segment is also expected to post strong growth over the coming quarters with recently signed CDMO+D deals with both Cookies and Old Pal. We estimate these contracts alone can generate over \$45 million annually for the company. We also expect margin improvement with the installation of in-house distillate and isolate capacity. Our margin forecast for the hemp/cannabis segment is below what the company expects, which could lead to upside in our EBITDA estimates as early as Q3 of this year.

The financial environment remains challenging. Elimination from the Russell 3000 Index resulted in a sharp share decline on heavy volume, and while the majority of that selling pressure is likely over, the audience of investors has diminished with removal from the Index. This will place a heavier burden on the company to raise the capital it needs to finance its growth, which is reflected in our share count estimates and price target.

Exhibit 1. Income Statement

<i>(\$ in 000's except per-share data)</i>	2020	2021	2022	Q1 23 A	Q2 23 E	Q3 23 E	Q4 23 E	2023 E	2024 E
Revenue	\$ 28,111	\$ 30,948	\$ 62,111	\$ 21,962	\$ 23,000	\$ 26,500	\$ 31,500	\$ 102,962	\$ 192,500
Cost Of Goods Sold	26,673	28,879	60,937	23,139	22,550	24,920	26,935	97,544	139,750
Gross Profit	1,438	2,069	1,174	(1,177)	450	1,580	4,565	5,418	52,750
	5.1%	6.7%	1.9%	-5.4%	2.0%	6.0%	14.5%	5.3%	27.4%
R&D	4,128	3,274	6,561	1,517	1,517	1,517	1,517	6,068	6,400
G&A	14,971	25,881	44,517	14,231	14,231	14,587	14,587	57,636	59,076
Other	176	78	7,202	898	0	0	0	898	0
Depreciation & Amort.	1,346	1,248	0	0	0	0	0	0	0
Opex	20,621	30,481	58,280	16,646	15,748	16,104	16,104	64,602	65,476
Operating Income	\$ (19,183)	\$ (28,412)	\$ (57,106)	\$ (17,823)	\$ (15,298)	\$ (14,524)	\$ (11,539)	\$ (59,184)	\$ (12,726)
Interest and other, net	(490)	(4,183)	(3,129)	(359)	(659)	(659)	(659)	(2,335)	(2,634)
Pretax Income	(19,673)	(32,595)	(60,235)	(18,182)	(15,957)	(15,182)	(12,197)	(61,518)	(15,360)
Income Tax Expense	38	14	(434)	0	0	0	0	0	0
Net to Common	\$ (19,711)	\$ (32,609)	\$ (59,801)	\$ (18,182)	\$ (15,957)	\$ (15,182)	\$ (12,197)	\$ (61,518)	\$ (15,360)
Shares (000)	138,813	156,208	192,837	215,784	219,781	222,521	242,538	225,156	277,245
EPS	(\$0.14)	(\$0.21)	(\$0.31)	(\$0.08)	(\$0.07)	(\$0.07)	(\$0.05)	(\$0.27)	(\$0.06)
D&A	1,346	1,248	2,858	881	881	881	881	3,524	3,524
Stock Comp	1,654	3,983	5,489	1,175	1,175	1,175	1,175	4,700	4,700
Other	176	0	9,065	0	0	0	0	0	0
EBITDA	\$ (16,007)	\$ (23,181)	\$ (39,694)	\$ (15,767)	\$ (13,242)	\$ (12,468)	\$ (9,483)	\$ (50,960)	\$ (4,502)

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

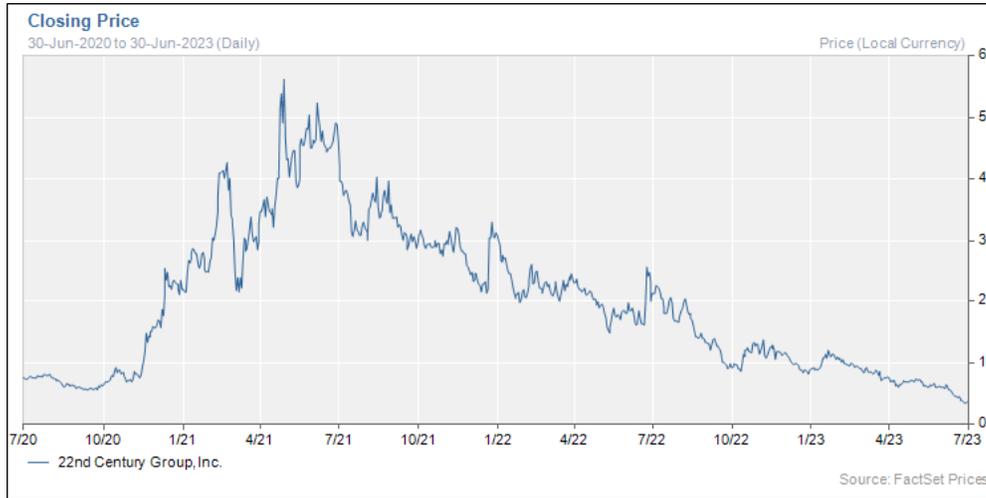
Exhibit 2. Balance Sheet and Cash Flow Statement

(\$ in 000's)	2020	2021	2022	2023 E	2024 E
Cash & ST Investments	22,342	48,736	21,213	8,724	13,820
A/R	2,159	585	5,641	15,534	29,589
Inventory	2,034	2,881	10,008	13,283	20,466
Insurance Recovery	0	0	5,000	0	0
Prepaid Exp.	1,806	2,183	2,743	2,252	2,252
Total Current Assets	\$ 28,341	\$ 54,385	\$ 44,605	\$ 39,794	\$ 66,127
PP&E	2,483	5,841	13,093	18,918	21,046
Operating Lease	247	1,723	2,675	5,309	5,309
Goodwill	0	0	33,160	33,160	33,160
Patent, Trademark, other intangibles	8,211	7,919	16,853	17,521	16,369
Equity Investment	6,536	2,345	682	682	682
Restricted Cash				7,500	7,500
Other Assets	5,876	3,741	3,583	3,642	3,642
Total Assets	\$ 51,694	\$ 75,954	\$ 114,651	\$ 126,526	\$ 153,835
Bank Loans and N/P	539	596	908	314	314
Operating Lease	247	308	681	862	862
A/P	1,116	2,173	4,168	5,357	8,254
Accrued Expenses & Payroll	4,830	5,014	4,627	8,826	13,598
Accrued excise taxes and fees	0	0	1,423	2,330	2,330
Deferred Income	272	119	831	257	257
Accrued Severance	339	217	380	923	923
Total Current Liabilities	\$ 7,343	\$ 8,427	\$ 13,018	\$ 18,869	\$ 26,538
Long-Term Debt	0	0	3,001	16,571	16,571
Operating Lease	0	1,432	2,141	4,602	4,602
Other	241	21	516	4,736	4,736
Shareholders' Equity	44,110	66,074	95,975	81,748	101,388
Total Liabilities And Equity	\$ 51,694	\$ 75,954	\$ 114,651	\$ 126,526	\$ 153,835
	2020	2021	2022	2023 E	2024 E
Net Income	(19,711)	(32,609)	(59,801)	(61,518)	(15,360)
Depreciation & Amort.	1,345	1,248	2,858	3,524	3,524
Stock Comp	1,654	3,983	5,489	4,700	4,700
Other	2,722	5,272	11,310	856	0
Working Capital	(1,631)	(733)	(11,570)	(6,389)	(13,568)
Operating Cash Flow	\$ (15,621)	\$ (22,839)	\$ (51,714)	\$ (58,828)	\$ (20,705)
Acquisition of Patents and trademarks	(468)	(326)	(772)	(491)	(500)
CapEx	(54)	(745)	(3,657)	(7,910)	(4,000)
Other	16,991	(26,658)	27,007	16,749	0
Investing Activities	\$ 16,469	\$ (27,729)	\$ 22,578	\$ 8,348	\$ (4,500)
Debt	(354)	49	(3,822)	12,607	0
Equity	50	50,826	32,335	45,802	30,300
Other	0	0	2,307	0	0
Financing Activities	\$ (304)	\$ 50,875	\$ 30,820	\$ 58,409	\$ 30,300
Change in Cash	\$ 544	\$ 307	\$ 1,684	\$ 7,929	\$ 5,095

 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
 Price Target Change – Buy – May 10, 2023 – Price Target changed from \$8.50 to \$4.50
 Price Target Change – Buy – July 2, 2023 – Price Target changed from \$4.50 to \$1.00

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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.

Current as of 22-Jun-23

	Company Coverage		Investment Banking	
Ratings Distribution	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	26	72%	2	5.50%
Market Perform (Neutral)	10	28%	2	5.50%
Market Underperform (Sell)	0	0%	0	0.00%

Total	36	100%	4	11.00%
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