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

August 15, 2023

Buy: Q2 Review.

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Q2 revenue exceeded our estimates, but gross margin was lower than forecast and opex higher than estimated. EBITDA was lower than expected. The company is targeting \$15 million in annual cost savings, and that combined with gross margin improvement and top-line growth should lead to significant improvement in EBITDA over the coming quarters.

We reiterate our Buy recommendation of 22nd Century as we expect the extremely low valuation to expand as operations improve. Valuation is compelling. The shares trade at 0.4x our 2024 revenue estimate, far below the comp group of hemp/cannabis and tobacco stocks. We expect significant improvement in gross margin as volume in both segments grows, distillate and isolate capacity comes online and VLN sales ramp. Also, a \$15 million annual expense reduction program is underway and is a key component of our positive EBITDA estimate by mid-year 2024.

Q2 revenue of \$23.4 million exceeded our \$23 million estimate but was lower than consensus of \$24 million. Hemp/cannabis revenue of \$15.4 million exceeded our estimate of \$13.5 million but Tobacco revenue of \$8.1 million fell short of our \$9.5 million forecast.

Gross margin in the hemp/cannabis segment remained negative despite an increase in sales, as the lack of distillate and isolate manufacturing capacity forced the company to purchase product on the open market to satisfy customer demand. Distillate capacity comes online this quarter and isolate capacity in Q4, which will drive gross margin higher. Tobacco revenue is still mostly contract manufacturing, with low margins.

VLN sales remain modest but will grow over time as customer education and awareness improves. The company has a large footprint, and a consequence of the expense reduction will be a focus on the higher-volume, densely populated markets. As VLN sales grow, margins will improve, as we expect 50% gross margins at reasonable volumes.

The change in company leadership, the cost reduction program, and the need to expand margins have caused a change in how the company is addressing the VLN market. The company will focus on customer education and awareness in fewer markets in order to more efficiently deploy its capital. This will result in lower revenue than we previously forecast but the size of the available market is unchanged.

Valuation: Our \$7.50 price target (down from \$10) is based on a multiple of sales of about 1.5x our 2024 revenue estimate of \$148 million and assumes a 32 million share count, after the warrant exercise. The multiple range is consistent with other companies in the space, but as margins and cash flow improves, we expect the multiple can increase.

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.

Estimates	F2022A	F2023E	F2024E
Current Price			\$2.29
Price Target			\$7.50
Revenues (\$M's)	\$ 62.1	\$ 85.9 E	\$ 148.5
1Q March	\$ 9.0	\$ 22.0 A	\$ 26.0
2Q June	\$ 14.5	\$ 23.4 A	\$ 32.5
3Q September	\$ 19.4	\$ 19.5 E	\$ 40.0
4Q December	\$ 19.2	\$ 21.0 E	\$ 50.0
	F2022A	F2023E	F2024E
EBITDA (\$M's)	\$ (39.2)	\$ (50.8)E	\$ (2.6)
1Q March	\$ (6.5)	\$ (14.6)A	\$ (4.9)
2Q June	\$ (6.9)	\$ (16.1)A	\$ (2.8)
3Q September	\$ (11.0)	\$ (10.9)E	\$ 0.0
4Q December	\$ (14.8)	\$ (8.0)E	\$ 5.0
EBITDA (\$Ms)	\$ (39.2)	\$ (50.8)	\$ (2.6)
EV/Sales	0.9x	0.7x	0.4x
Stock Data			
52-Week Range	\$2.10	-	\$27.00
Shares Outstanding (mil.)	21.1		
Market Capitalization (mil.)	\$48		
Enterprise Value (mil.)	\$57		
Debt to Capital	24%		
Cash (mil.)	\$17.8		
Cash/share	\$0.85		
Average Three Months Trading Volume (K)	69		
Insider Ownership	2.3%		
Institutional Ownership	9.5%		
Short interest (mil.)	10.1%		
Dividend / Yield	\$0.00/0.0%		



Actual v Estimates

Q2 23			
<i>\$ in 000's, except per-share data</i>	Actual	Estimates	
Revenue	\$ 23,427	\$ 23,000	1.9%
Cost Of Goods Sold	25,772	22,550	14.3%
Gross Profit	(2,345)	450	NM
Gross Margin	-10.0%	2.0%	
SG&A	14,540	14,231	2.2%
R&D	1,793	1,517	18.2%
Other	675	0	
Opex	17,008	15,748	8.0%
Operating Income	\$ (19,353)	\$ (15,298)	-26.5%
Interest and other	(1,140)	(659)	
Pretax Income	(20,493)	(15,957)	
Income Tax Expense	0	0	
Net to Common	\$ (20,493)	\$ (15,957)	
Shares (000)	14,900	15,185	
EPS	\$ (1.38)	\$ (1.05)	
D&A	1,442	881	
Stock Comp	1,486	1,175	
Other	336	0	
EBITDA	\$ (16,089)	\$ (13,242)	-21.5%

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

We have reduced our revenue estimates for this year and next to reflect a more measured pace of acceptance of VLN, the impact of the expense reduction program and the resulting focus on higher-value markets as well as a pullback in hemp/cannabis sales until distillate and isolate capacity comes on-line this quarter and next respectively.

Tobacco stocks trade at EV/Sales multiple of 3x to 5x, and as the company's tobacco sales increase, we believe the multiple can as well. Currently the shares trade at 0.7x 2023 estimated sales and about 40% of 2024 estimated sales.

The depressed multiple of sales, we believe, is a reflection of low gross margin in both the hemp and tobacco segments as well as an uncertain path to positive operational cash flow and the cash needed to get there. We expect gross margin to show noticeable improvement in the coming quarters from both the hemp and tobacco units and the \$15 million annualized cost-cutting program should result in sharply improved cash flow and positive operational cash flow by mid-year 2024.

Exhibit 1. Income Statement

(\$ in 000's except per-share data)	2020	2021	2022	Q1 23 A	Q2 23 A	Q3 23 E	Q4 23 E	2023 E	2024 E
Revenue	\$ 28,111	\$ 30,948	\$ 62,111	\$ 21,962	\$ 23,427	\$ 19,500	\$ 21,000	\$ 85,889	\$ 148,500
Cost Of Goods Sold	26,673	28,879	60,937	23,139	25,772	18,860	19,355	87,126	117,750
Gross Profit	1,438	2,069	1,174	(1,177)	(2,345)	640	1,645	(1,237)	30,750
	5.1%	6.7%	1.9%	-5.4%	-10.0%	3.3%	7.8%	-1.4%	20.7%
SG&A	14,971	25,881	44,517	14,231	14,540	12,665	10,790	52,226	38,637
R&D	4,128	3,274	6,561	1,517	1,793	1,793	1,793	6,896	6,400
Other	176	78	7,202	898	675	0	0	1,573	0
Depreciation & Amort.	1,346	1,248	0	0	0	0	0	0	0
Opex	20,621	30,481	58,280	16,646	17,008	14,458	12,583	60,695	45,037
Operating Income	\$ (19,183)	\$ (28,412)	\$ (57,106)	\$ (17,823)	\$ (19,353)	\$ (13,818)	\$ (10,938)	\$ (61,932)	\$ (14,287)
Interest and other, net	(490)	(4,183)	(3,129)	(359)	(1,140)	(1,080)	(1,080)	(3,659)	(4,320)
Pretax Income	(19,673)	(32,595)	(60,235)	(18,182)	(20,493)	(14,898)	(12,018)	(65,591)	(18,607)
Income Tax Expense	38	14	(434)	0	0	0	0	0	0
Net to Common	\$ (19,711)	\$ (32,609)	\$ (59,801)	\$ (18,182)	\$ (20,493)	\$ (14,898)	\$ (12,018)	\$ (65,591)	\$ (18,607)
Shares (000)	9,254	10,414	12,856	14,386	14,900	18,503	21,079	17,217	30,680
EPS	(\$2.13)	(\$3.13)	(\$4.65)	(\$1.26)	(\$1.38)	(\$0.81)	(\$0.57)	(\$3.81)	(\$0.61)
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D&A	1,346	1,536	3,306	1,175	1,442	1,442	1,442	5,501	5,768
Stock Comp	1,654	3,983	5,489	1,175	1,486	1,486	1,486	5,633	5,944
Other	176	0	9,065	898	336	0	0	0	0
EBITDA	\$ (16,007)	\$ (22,893)	\$ (39,246)	\$ (14,575)	\$ (16,089)	\$ (10,890)	\$ (8,010)	\$ (50,798)	\$ (2,575)

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

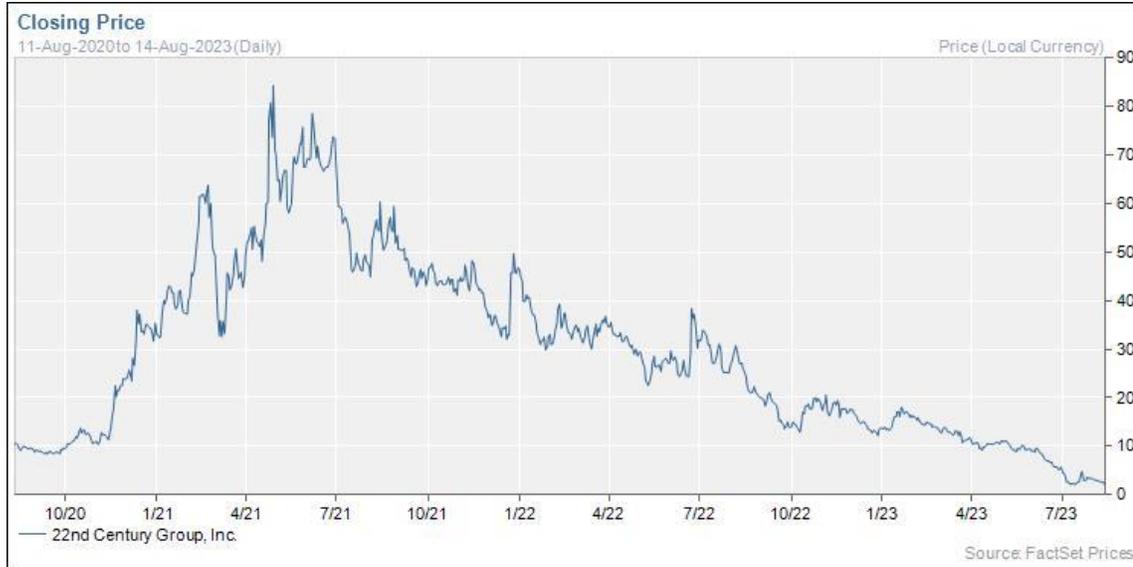
Exhibit 2. Balance Sheet and Cash Flow Statement

(\$ in 000's)	2020	2021	2022	2023 E	2024 E
Cash & ST Investments	22,342	48,736	21,213	2,080	7,801
A/R	2,159	585	5,641	7,831	18,645
Inventory	2,034	2,881	10,008	10,753	20,278
Insurance Recovery	0	0	5,000	0	0
Prepaid Exp.	1,806	2,183	2,743	6,388	6,388
Total Current Assets	\$ 28,341	\$ 54,385	\$ 44,605	\$ 27,052	\$ 53,112
PP&E	2,483	5,841	13,093	14,877	15,829
Operating Lease	247	1,723	2,675	6,955	6,955
Goodwill	0	0	33,160	33,360	33,360
Patent, Trademark, other intangibles	8,211	7,919	16,853	20,334	17,950
Equity Investment	6,536	2,345	682	682	682
Restricted Cash				7,500	7,500
Other Assets	5,876	3,741	3,583	3,681	3,681
Total Assets	\$ 51,694	\$ 75,954	\$ 114,651	\$ 114,441	\$ 139,069
Bank Loans and N/P	539	596	908	1,988	1,988
LTD-Current	0	0	0	1,960	1,960
Operating Lease	247	308	681	1,082	1,082
A/P	1,116	2,173	4,168	4,843	9,133
Accrued Expenses & Payroll	4,830	5,014	4,627	6,960	13,126
Accrued excise taxes and fees	0	0	1,423	2,704	2,704
Deferred Income	272	119	831	214	214
Other	339	217	380	1,438	1,438
Total Current Liabilities	\$ 7,343	\$ 8,427	\$ 13,018	\$ 21,190	\$ 31,645
Notes and loans payable	0	0	0	185	185
Operating Lease	0	1,432	2,141	6,118	6,118
Long-Term Debt	0	0	3,001	15,326	15,326
Other	241	21	516	5,656	5,656
Shareholders' Equity	44,110	66,074	95,975	65,966	80,139
Total Liabilities And Equity	\$ 51,694	\$ 75,954	\$ 114,651	\$ 114,441	\$ 139,069
Net Income	(19,711)	(32,609)	(59,801)	(65,637)	(18,607)
Depreciation & Amort.	1,345	1,536	3,591	5,501	5,768
Stock Comp	1,654	3,983	5,489	5,633	5,944
Other	2,722	4,984	10,577	6,399	0
Working Capital	(1,631)	(733)	(11,570)	(2,731)	(9,883)
Operating Cash Flow	\$ (15,621)	\$ (22,839)	\$ (51,714)	\$ (50,835)	\$ (16,778)
Acquisition of Patents and trademarks	(468)	(326)	(772)	(648)	(500)
CapEx	(54)	(745)	(3,657)	(4,759)	(4,000)
Other	16,991	(26,658)	27,007	22,080	0
Investing Activities	\$ 16,469	\$ (27,729)	\$ 22,578	\$ 16,673	\$ (4,500)
Debt	(354)	49	(3,822)	14,312	0
Equity	50	50,826	32,335	26,410	27,000
Other	0	0	2,307	0	0
Financing Activities	\$ (304)	\$ 50,875	\$ 30,820	\$ 40,722	\$ 27,000
Change in Cash	\$ 544	\$ 307	\$ 1,684	\$ 6,560	\$ 5,722

 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 3, 2023 – Price Target changed from \$4.50 to \$1.00
1-15 Stock split July 5, 2023
Price Target Change – Buy – July 25, 2023 – Price Target changed from \$15.00 to \$10.00
Price Target Change – Buy – August 15, 2023 – Price Target changed from \$10.00 to \$7.50

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- 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.

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Current as of 3-Aug-23

	Company Coverage		Investment Banking	
Ratings Distribution	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	24	69%	3	8.60%
Market Perform (Neutral)	11	31%	3	8.60%
Market Underperform (Sell)	0	0%	0	0.00%
Total	35	100%	6	17.20%

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