INSTITUTIONAL RESEARCH
Emerging Growth
UPDATE REPORT

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

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Buy: Cost Reduction Program Improves Q3 Results.

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Q3 revenue exceeded our forecast and EBITDA was in line and down sharply from Q2. The impact of the company's cost-cutting program is evident and we believe additional actions are necessary. Key for the shares is the ability of the company to monetize the only FDA-approved MRTP combustible cigarette on the market.

Q3 revenue was $17.8 million, higher than our $15.5 million estimates and the EBITDA loss and operating cash flow burn for the quarter were in line with our estimates and down sharply from Q2. For the quarter the EBITDA loss of $11.5 million was down from $16.1 million in Q2 and OPCF was a loss of $12.8 million down from $20 million in Q2. The company's $15 million annualized cost reduction program has had a major impact on cash use, and we believe another round of cuts given the company's balance sheet is necessary.

There were significant charges in the quarter, including a goodwill write-down of $33 million and impairment charges totaling $24 million, mostly relating to the hemp/cannabis segment. Ex the charges, Tobacco opex fell from $3.4 million in Q2 to $2.9 million in Q3, Hemp/cannabis opex dropped from $4.3 million to $3.3 million and corporate overhead declined from $8.5 million to $6.7 million. This is an annualized cost reduction of $13.6 million, nearly to the company's goal of a $15 million annual reduction in costs.

We estimate additional cuts are necessary as well as a strategy with a narrower focus in order to align the company's capabilities with its balance sheet. The company hired advisors to explore the sale of its tobacco business and has received interest in other assets and has declared it is open to a wide range of alternatives. Our estimates for 2024 assumes all business units remain under the company's umbrella, but it is likely either the hemp/cannabis or tobacco business will be sold in order to reduce cash needs.

There are catalysts in the coming months that could help the company's business and the shares. The FDA's rule proposing a menthol ban is in final review and recently picked up additional political support from Senator Kirsten Gillibrand. A key concern of the FDA is offering smokers an offramp when new rules are proposed. 22nd Century's menthol VLN combustible cigarettes might be excluded from the ban, as an offramp, giving the company a unique position in the market. A $4 to $10 million settlement with the company's insurance carrier would also be positive. We also expect a low-nicotine mandate in the future.

Current Price			**$0.45**
Price Target			**$3.33**
Estimates	F2022A	F2023E	F2024E
Revenues ($M's)	$ 62.1	$ 78.7 E	$ 74.5
1Q March	$ 9.0	$ 22.0 A	$ 16.8
2Q June	$ 14.5	$ 23.4 A	$ 18.0
3Q September	$ 19.4	$ 17.8 A	$ 19.3
4Q December	$ 19.2	$ 15.5 E	$ 20.5
	F2022A	F2023E	F2024E
EBITDA ($M's)	$ (39.2)	$ (51.9)E	$ (26.4)
1Q March	$ (6.5)	$ (14.6)A	$ (6.8)
2Q June	$ (6.9)	$ (16.1)A	$ (6.6)
3Q September	$ (11.0)	$ (11.7)A	$ (6.6)
4Q December	$ (14.8)	$ (9.6)E	$ (6.4)
EBITDA ($Ms)	$ (39.2)	$ (51.9)	$ (26.4)
EV/Sales	0.2x	0.1x	0.1x
Stock Data			
52-Week Range	$0.42	-	$21.75
Shares Outstanding (mil.)			30.9
Market Capitalization (mil.)			$14
Enterprise Value (mil.)			$10
Debt to Capital			18%
Cash (mil.)			$22.7
Cash/share			$0.74
Average Three Months Trading Volume (K)			650
Insider Ownership			2.1%
Institutional Ownership			11.1%
Short interest (mil.)			12.1%
Dividend / Yield			$0.00/0.0%

Valuation: Our $3.33 price is based on a multiple of sales of 1.3x our 2024 revenue estimate of $74.5 million and using a share count of 31 million. The target multiple range is consistent with other companies in the space.

Risks to Target: Our price target assumes success in VLN next year and this could take longer than estimated, and/or its partners 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.

Last month the company took actions to improve its balance sheet including a capital raise of nearly $5 million, an agreement with the holder of the senior secured debenture to release $7.5 million of restricted cash to reduce the outstanding principal amount and the near elimination of a put liability for warrants owned by the holder of the senior secured debenture.

As of the end of Q3, the company had $2.8 million in cash and subsequent to quarter end raised $4.9 million. Cash usage has been substantial to build a sales force to launch VLN in multiple markets across the country and maintain market share in the Hemp/cannabis business. The current scope of operations is too large for the financial resources at hand. The company publicly articulated a willingness to shed its tobacco business but given the low cash balance and negative cash from operations, we believe the hemp/cannabis business must also be regarded as for sale as well as NASCO, the tobacco contract manufacturing plant. However, we believe selling NASCO would impact the ability to market VLN due to NASCO's membership in the industry's MSA and ownership of a predicate brand, both of which are necessary to engage in combustible cigarette sales.

Actions have been taken to improve gross margins and cut opex. More is required. Gross margin in the hemp/cannabis business has been pressured by the reselling of product in order to meet the revenue targets in the debenture. With the covenants re-negotiated through the end of this year, gross margin and cash generation can improve on lower revenue. We expect the company to continue to sharpen its gross margin requirement for its tobacco contract manufacturing business. This too could improve gross margins. Despite a recent reduction in our revenue estimate, we have assumed an improvement in gross margin for the reasons cited above.

We believe the company must reduce expenses sharply from current levels, far more than the $15 million annual reduction announced over the summer. Total opex (excluding special charges) in Q3 was $2.9 million for the tobacco business, $3.3 million for the Hemp/Cannabis business and unallocated expenses were $6.7 million. About $1.4 million of these quarterly expenses were non-cash depreciation, amortization and amortization of stock comp. This was before the $15 million annual, $3.75 million quarterly expense reduction program announced over the summer. But given the current cash balance, and the difficulty of raising additional equity capital and the necessity of addressing the debenture due in 2026, we think further cuts, and sharp ones, are required. This will entail difficult choices on which business to fund, and how much, and will probably drive the company's strategy on which business it plans to remain in. Our estimates for 2024 do not include additional expense reduction, but we think this is very likely.

The hemp/cannabis business is growing, and the company has new facilities that should improve margins in the short term. The company indicates its market share has been increasing and prices have been firming. These are all positive factors, but there is still regulatory uncertainty in the business, and barriers to entry are not high, putting into question the sustainability of margins at least until regulatory certainty is established and barriers to entry are created by regulations.

The tobacco business has a unique asset: it has the only FDA-approved combustible cigarette with a modified risk claim. We are not aware of any other combustible product even attempting to make this claim. The other advantage for this business is the FDA's long-standing attempt to reduce the harm from cigarette smoking, and its recognition it must give smokers an off-ramp as it changes the market with menthol bans and a low-nicotine mandate.

One challenge for the tobacco business is building a brand is time-consuming and expensive. That said, the company's success to date in attracting distribution partners is impressive. Unless additional resources become available via asset sales, or license agreements, or warrant exchange, a retrenchment on VLN distribution is likely. Another challenge is that the FDA moves at its own pace, often impacted by public opinion and political factors. The menthol ban is likely the most near-term catalyst, and with a final rule submitted to OMB, action is probably weeks to months away. Senator Gillibrand's recent letter to the Office of Management and Budget, joins eighty national health groups, "including the American Heart Association, the American Medical Association, the American Academy of Pediatrics and the American College of Preventative Medicine," voicing their support for the menthol ban. It would be very positive for the company if its menthol VLN combustible cigarettes were exempted from the ban and given the FDA's recognition of the necessity of giving smokers an offramp, we believe the chances of an exemption are good. The low-nicotine mandate, we believe, is also a priority for the FDA, but its willingness and capacity to move on a menthol ban and a low-nic mandate simultaneously is unknown.

Before its cost-cutting program, the company estimated it could achieve positive cash-flow for its tobacco business at annual VLN volumes of 1.2 million cartons, or $72 million in revenue, at $60 per carton. We believe the company will need to generate close to this amount or demonstrate it is on a path to doing so if it wants to monetize the tobacco business at industry multiples of 3x-5x sales.

Relative to the size of the market, 1.2 million cartons is modest. Annual volumes in the U.S. is almost 900 million cartons and 22nd Century is now addressing about 55% to 60% of the total market. If we assume the cost-cutting program focuses the company on half of where it is currently distributing product, achieving sales of 1.2 million cartons implies a market share of less than 0.5% in the markets it would be actively addressing.

The challenge for the company is how much time, and money, it will take to achieve this market share and exploring strategic options could address one or both of the factors, but we expect it would come at the cost of a lower valuation or reduced participation in future revenue and cash flow.

Should the company exit the tobacco business, the remaining sales, about $45 million in the past twelve months, would come from the CBD business, which is expected to show substantial margin improvement as distillate capacity ramps in the remaining months of this year and isolate capacity comes on line in Q1 of next year. However, multiples of sales in the CBD business are much lower than in the tobacco business, less than 1x versus ~4x, due to the lower margin profile of the business.

Valuation is compelling. The shares trade at 0.1x our 2024 revenue estimate, far below the comp group of hemp/cannabis and tobacco stocks. 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. 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.

Exhibit 1. Income Statement

($ in 000's except per-share data)	**2020**	**2021**	**2022**	**Q1 23 A**	**Q2 23 A**	**Q3 23 A**	**Q4 23 E**	**2023 E**	**2024 E**
Revenue	$ 28,111	$ 30,948	$ 62,111	$ 21,962	$ 23,427	$ 17,811	$ 15,500	$ 78,700	$ 74,500
Cost Of Goods Sold	26,673	28,879	60,937	23,139	25,772	19,777	15,500	84,188	67,350
Gross Profit	1,438	2,069	1,174	(1,177)	(2,345)	(1,966)	0	(5,488)	7,150
	5.1%	6.7%	1.9%	-5.4%	-10.0%	-11.0%	0.0%	-7.0%	9.6%
SG&A	14,971	25,881	44,517	14,231	14,540	11,199	9,324	49,294	32,700
R&D	4,128	3,274	6,561	1,517	1,793	1,613	1,613	6,536	6,400
Other	176	78	7,202	898	675	56,704	0	58,277	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	69,516	10,937	114,107	39,100
Operating Income	$ (19,183)	$ (28,412)	$ (57,106)	$ (17,823)	$ (19,353)	$ (71,482)	$ (10,937)	$ (119,595)	$ (31,950)
Interest and other, net	(490)	(4,183)	(3,129)	(359)	(1,140)	(1,238)	(1,192)	(3,929)	(4,768)
Pretax Income	(19,673)	(32,595)	(60,235)	(18,182)	(20,493)	(72,720)	(12,129)	(123,524)	(36,718)
Income Tax Expense	38	14	(434)	0	0	0	0	0	0
Net loss	$ (19,711)	$ (32,609)	$ (59,801)	$ (18,182)	$ (20,493)	$ (72,720)	$ (12,129)	$ (123,524)	$ (36,718)
Deemed dividend						(564)			
Net to Common						$ (73,284)			
Shares (000)	9,254	10,414	12,856	14,386	14,900	19,887	25,978	18,788	45,229
EPS	($2.13)	($3.13)	($4.65)	($1.26)	($1.38)	($3.68)	($0.47)	($6.57)	($0.81)
D&A	1,346	1,536	3,306	1,175	1,442	810	810	4,237	3,240
Stock Comp	1,654	3,983	5,489	1,175	1,486	576	576	3,813	2,304
Other	176	0	9,065	898	336	58,391	0	59,625	0
EBITDA	$ (16,007)	$ (22,893)	$ (39,246)	$ (14,575)	$ (16,089)	$ (11,705)	$ (9,551)	$ (51,920)	$ (26,406)

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

Exhibit 2. Balance Sheet and Cash Flow Statement

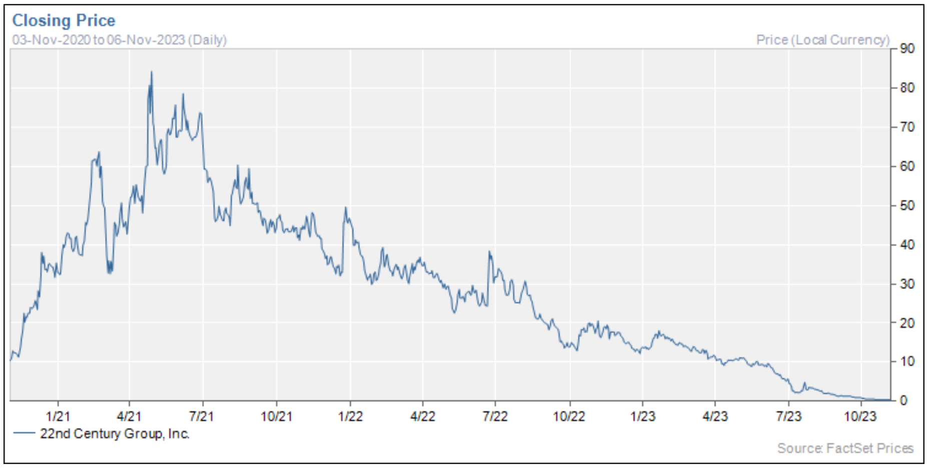
($ in 000's)	2020	2021	2022	2023 E	2024 E
Cash & ST Investments	22,342	48,736	21,213	20,275	19,781
Restricted Cash					
A/R	2,159	585	5,641	5,651	7,473
Inventory	2,034	2,881	10,008	11,273	13,364
Insurance Recovery	0	0	5,000	0	0
Prepaid Exp.	1,806	2,183	2,743	4,818	4,818
Total Current Assets	**$ 28,341**	**$ 54,385**	**$ 44,605**	**$ 42,017**	**$ 45,436**
PP&E	2,483	5,841	13,093	10,225	13,889
Operating Lease	247	1,723	2,675	2,984	2,984
Goodwill	0	0	33,160	0	0
Patent, Trademark, other intangibles	8,211	7,919	16,853	6,299	3,895
Equity Investment	6,536	2,345	682	682	682
Restricted Cash				0	0
Other Assets	5,876	3,741	3,583	3,705	3,705
Total Assets	**$ 51,694**	**$ 75,954**	**$ 114,651**	**$ 65,912**	**$ 70,591**
Bank Loans and N/P	539	596	908	1,441	1,441
LTD-Current	0	0	0	18,165	18,165
Operating Lease	247	308	681	1,097	1,097
A/P	1,116	2,173	4,168	5,490	6,508
Accrued Expenses & Payroll	4,830	5,014	4,627	5,793	6,868
Accrued excise taxes and fees	0	0	1,423	2,693	2,693
Deferred Income	272	119	831	704	704
Other	339	217	380	1,263	1,263
Total Current Liabilities	**$ 7,343**	**$ 8,427**	**$ 13,018**	**$ 36,646**	**$ 38,739**
Notes and loans payable	0	0	0	156	156
Operating Lease	0	1,432	2,141	6,219	6,219
Long-Term Debt	0	0	3,001	7,500	7,500
Other	241	21	516	4,266	4,266
Shareholders' Equity	44,110	66,074	95,975	11,124	13,711
Total Liabilities And Equity	**$ 51,694**	**$ 75,954**	**$ 114,651**	**$ 65,912**	**$ 70,591**

	2020	2021	2022	2023 E	2024 E
Net Income	(19,711)	(32,609)	(59,801)	(123,570)	(36,718)
Depreciation & Amort.	1,345	1,536	3,591	4,237	3,240
Stock Comp	1,654	3,983	5,489	3,813	2,304
Other	2,722	4,984	10,577	72,822	0
Working Capital	(1,631)	(733)	(11,570)	(1,318)	(1,821)
Operating Cash Flow	**$ (15,621)**	**$ (22,839)**	**$ (51,714)**	**$ (44,016)**	**$ (32,994)**
Acquisition of Patents and trademarks	(468)	(326)	(772)	(558)	(500)
CapEx	(54)	(745)	(3,657)	(4,951)	(4,000)
Other	16,991	(26,658)	27,007	21,736	0
Investing Activities	**$ 16,469**	**$ (27,729)**	**$ 22,578**	**$ 16,227**	**$ (4,500)**
Debt	(354)	49	(3,822)	21,236	0
Equity	50	50,826	32,335	31,308	37,000
Other	0	0	2,307	0	0
Financing Activities	**$ (304)**	**$ 50,875**	**$ 30,820**	**$ 52,544**	**$ 37,000**
Change in Cash	**$ 544**	**$ 307**	**$ 1,684**	**$ 24,755**	**($494)**

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
Update – Buy – September 6, 2023 – Price Target $7.50
Price Target Change – Buy – October 24, 2023 – Price Target $3.33
Update – Buy – November 7, 2023 – Price Target $3.33

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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.

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 3-Nov-23

	Company Coverage		Investment Banking	
Ratings Distribution	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	22	64.70%	3	8.80%
Market Perform (Neutral)	12	35.30%	2	5.90%
Market Underperform (Sell)	0	0%	0	0.00%
Total	34	100%	5	14.70%

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