

**22nd Century Group, Inc. (XXII - \$0.92 - Buy)**

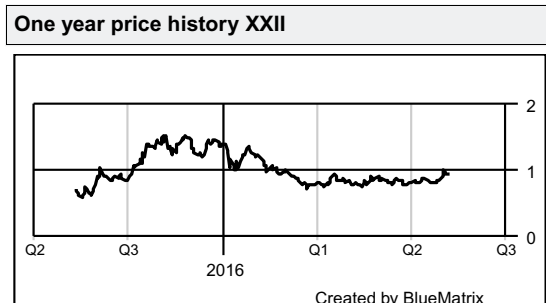
**FLASH NOTE**

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**Sales and trading** 7 a.m. to 7 p.m. ET, (646) 465-9090

**Sales and trading** 7 p.m. to 7 a.m. ET, (646) 465-9063

Stock Data	08/09/16
52 Week Range	(\$0.56 - \$1.75)
Price Target	\$4.50
Market Cap (mil)	\$75.40
Shares out (mil)	82.00



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**Q2 Revenue Exceeds Estimates**

22nd Century reported Q2 results better than we modeled, with revenue of \$2.8 million exceeding our \$2.7 million estimate and a net loss of \$3 million less than our \$3.3 million net loss estimate. The company hosts a conference call today at 4 PM Eastern.

The company's path to value creation remains the same: monetizing its extensive intellectual property which allows it to modulate the level of nicotine in tobacco plants through genetic engineering and plant breeding. There are a number of paths the company is pursuing to monetize this technology.

One of the most promising paths for 22nd Century is the pending application with the FDA for a reduced exposure designation for its Brand A, low-nicotine cigarette. This has now been before the FDA since the beginning of the year and a 12-month evaluation by the agency is expected. However, one must remember that government agencies move at their own pace and delays are common. That said, this application, if successful, would be ground breaking and would highlight the unique and valuable technology 22nd Century possesses and could result in the company licensing its technology to large tobacco companies with wider distribution.

The company is also attempting to develop a low nicotine cigarette brand, MAGIC, and high nicotine brand RED SUN. Sales to date have been modest but 22nd Century continues to make progress in the US and international markets. For instance, shipments to Australia and France are scheduled for September of both RED SUN and MAGIC.

Most of the company's revenues this year have been for contract manufacturing which it is seeking to expand. It continues to target the filtered cigar market which has been roiled by a recent change in FDA regulations. This could result in an opportunity for the company to increase its presence in this space.

The company eliminated the near term financing risk it faced by raising \$5 million in a stock and warrant deal. With the cash on hand, plus \$5 million from the raise, the company estimates it has enough cash to fund operations through May 2017

Recently, in testimony for litigation which is underway, the company stated that its patents are worth more than \$200 million, or greater than \$2.50 per share. We value X-22/Modified risk at \$3 per share and the combined value of the potential BAT royalty stream and commercial products at \$1.50 per share to reflect a modest tempo in the roll-out of commercial products as well as a less steep ramp for the BAT royalties. We have not given any value for the company's 25% ownership of Anandia or its exclusive US rights to four genes required for cannabinoid production in the cannabis plant. Risks to achieving our price target include delays in the FDA process, ability to find partners for X-22, challenges in attracting contract manufacturing

and selling product overseas and possibility of requiring additional capital.

22nd Century Group, Inc.  
Actual v. Estimates

<b>Q2 16</b>					
	Actual		Estimates		
Revenue	\$	2,828	\$	2,700	4.7%
Cost Of Goods Sold		2,969		2,650	12.0%
Gross Profit		(141)		50	NM
R&D		510		600	-15.0%
G&A		1,722		1,847	-6.8%
Sales & marketing		251		703	-64.3%
Depreciation & Amort.		207		205	0.8%
Opex		2,690		3,355	-19.8%
Operating Income	\$	(2,831)	\$	(3,305)	14.3%
Interest Expense		(7)		(8)	
Other		(64)		0	
Warrant Charge		0		0	
Pretax Income		(2,902)		(3,313)	
Income Tax Expense		0		0	
Net before Minority Interest		(2,902)		(3,313)	
Minority Interest					
Net to Common	\$	(2,902)	\$	(3,313)	
Shares		76,024		74,531	
EPS	\$	(0.04)	\$	(0.04)	

**Valuation:**

We value X-22/Modified risk at \$3 per share and the combined value of the potential BAT royalty stream and commercial products at \$1.50 per share to reflect a modest tempo in the roll-out of commercial products as well as a less steep ramp for the BAT royalties.

**Risks to achievement of target price:**

Risks to achieving our price target: The industry is subject to significant regulatory constraints, litigation, societal views on smoking and changing legislation. Any one of these could have a deleterious impact on our assumptions. We assume the company is able to monetize its technology in multiple ways, but these are subject to regulatory risk, funding risk and could take longer and cost more than we expect.

**Company description:**

22nd Century owns or exclusively controls over 200 issued patents, 50 pending patent applications. The company's proprietary technology enables the control of nicotine levels in tobacco plants by controlling the genes responsible for nicotine production in tobacco plants.

## Important Research Disclosures



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Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [BUY]	60	68.97	21	35.00
HOLD [NEUTRAL]	20	22.99	0	0.00
SELL [SELL]	7	8.05	0	0.00
NOT RATED [NR]	0	0.00	0	0.00

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**Neutral:** Returns expected to be in line with sector average over 12 months and indicates total return between negative 10% and 10% over the next 12 months.

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