

22nd Century Group, Inc. (XXII - \$3.31 - Buy)

FLASH NOTE

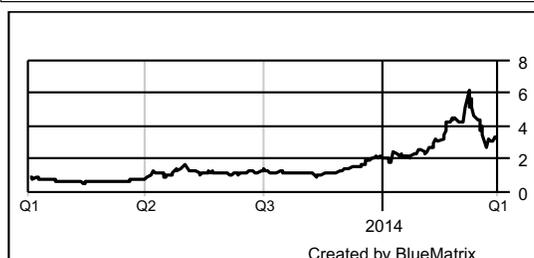
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Sales and trading 7 a.m. to 7 p.m. ET, (646) 465-9090

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

Stock Data	04/02/14
52 Week Range	(\$0.46 - \$6.36)
Price Target	\$9.00
Market Cap (mil)	\$192.81
Shares out (mil)	58.25

One year price history XXII



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XXII Weakness on Warrant Amendment. Recommend Purchase.

Shares of 22nd Century are weak today in part, we believe, due to investor mis-perception of the company's announcement yesterday of a warrant amendment. We view the weakness as a buying opportunity.

Yesterday, 22nd Century Group announced it entered into warrant amendments that for the most part eliminates its derivative warrant liability. This is good news for the shares since it will make the income statement much cleaner and reduce potential confusion on upcoming earnings releases.

The company reduced the strike price on warrants for 756,953 shares by an average of \$0.18 in exchange for removal of the anti-dilution provision. Management eliminated its anti-dilution feature on its 3.1 million warrants for no consideration. Without the anti-dilution provision the derivative liability is eliminated. Prior to this amendment, 6.25 million of the 10.6 million warrants outstanding at December 31, had an exercise price of \$1.96 to \$2.40. Post this transaction that would be reduced to a range of \$1.78 to \$2.22.

In Q1 the Company will take a **non-cash** charge to reflect the value given to warrant holders of a lower strike price but after that the large swings in net income due to changes in the derivative liability should go away. This will make the income statement much cleaner and reduce potential confusion on upcoming earnings releases.

The real key for the shares, in our opinion, is the MSA. When this occurs, and we continue to believe it will occur soon, the company will be able to execute on a number of fronts to drive revenue, cash flow and earnings significantly higher.

Valuation:

We approached valuation from a sum-of-the-parts perspective to arrive at our \$9.00 price target. We discounted the projected BAT license revenue at 10% and in the low case assumed the license terminated in 2028, while in the high case we assumed the license was extended by an additional 15 years.

For the commercial products we assume RED SUN can achieve \$142 million in sales by 2023 and MAGIC \$55 million by the same year. Our EV/Sales valuation ranges are comparable to the 3.6x to 5.2x EV/Sales multiples awarded to Altira, British American Tobacco, Lorillard, Reynolds American and Philip Morris International.

Our modified risk/X-22 valuation of \$2 to \$4 per share is derived in a number of ways. E-cigarette makers, Victory Electronic Cigarettes and Vapor Corp., proxies for modified risk valuations, have enterprise values of \$499 million and \$141 million respectively. This equates to \$2.42 per share using the lower EV as a bogey. X-22 valuation using a modest market share of the smoking cessation market and EV/Sales of 2x to 3x also yields per share valuation to 22nd Century of over \$2 per share. We have heavily discounted these assumptions due to the longer-term nature of development of these lines of business as well as the additional capital required for them.

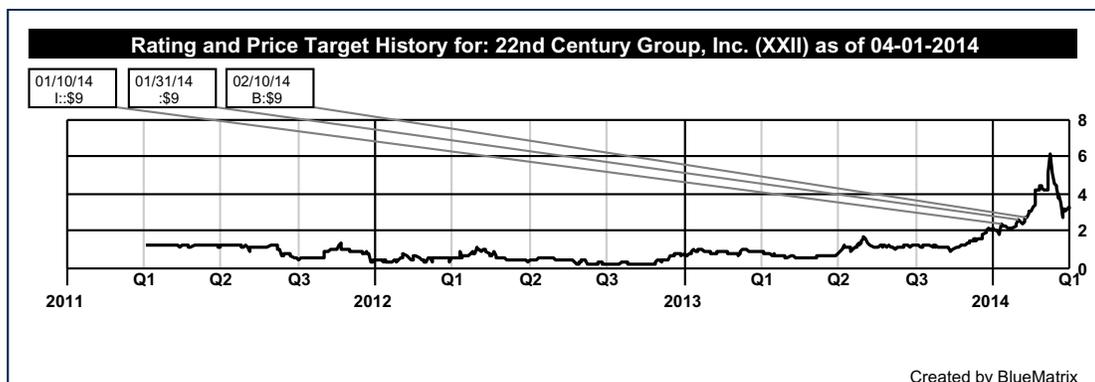
Risks to achievement of target price:

Risks to achieving our price target: NAAG approval of the NASCO purchase is critical and assumed to occur this quarter. Lacking that approval we believe it will be difficult for the company to achieve our domestic RED SUN estimates. We have also assumed the commercial product growth trajectory will be similar to American Spirit, but changes in the industry can hinder 22nd Century from achieving our estimates. We have also assumed the BAT license will change from a research license to a commercial royalty-bearing license, but that too is not assured. 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.

Company description:

22nd Century owns or exclusively controls 113 issued patents and 37 patent applications which gives it exclusive worldwide rights to all uses for certain genes that control nicotine content in tobacco plants. 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. This can be accomplished with or without genetic engineering.

Important Research Disclosures



Distribution of Ratings/IB Services Chardan Capital Markets

Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [BUY]	29	72.50	10	34.48
HOLD [NEUTRAL]	10	25.00	2	20.00
SELL [SELL]	0	0.00	0	0.00
NOT RATED [NR]	1	2.50	0	0.00

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RATINGS

Buy: Expected to materially outperform sector average over 12 months and indicates total return of at least 10% over the next 12 months.

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.

Sell: Returns expected to be materially below sector average over 12 months and indicates total price decline of at least 10% over the next 12 months.

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