

**22nd Century Group, Inc. (XXII - \$2.76 - Buy)**

**FLASH NOTE**

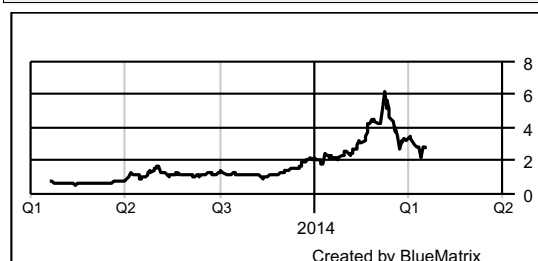
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**Sales and trading** 7 a.m. to 7 p.m. ET, (646) 465-9090

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

Stock Data	04/21/14
52 Week Range	(\$0.46 - \$6.36)
Price Target	\$9.00
Market Cap (mil)	\$160.77
Shares out (mil)	58.25

**One year price history XXII**



For the last note available [click here](#)  
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**XXII files mixed-use shelf, and provides update.**

22nd Century filed a \$45 million mixed-use shelf last Friday, a move that will aid it IF the company finds potential acquisitions, needs capital for modified risk studies, or, as the company states, for "negotiating agreements," which we believe encompasses a wide variety of potential partnerships and/or ventures.

The shares have drifted recently, but we continue to believe the catalysts we identified when we launched coverage of the name are still in place. While the consent of the National Association of Attorneys General has taken longer than we expected, it is common for government approvals to take longer than forecast.

The company continues to move on other fronts. International sales are expected soon, after completion of laboratory testing and labeling requirements. We have modest international sales built into our model for the second half of this year. The company is also pursuing opportunities in Asia.

While we have discounted sharply the potential value of the company's modified risk and smoking cessation initiatives, both of these programs should see some action this year. The company still intends to file two modified risk applications with the FDA this year and is seeking partners for its X-22 smoking cessation product.

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.

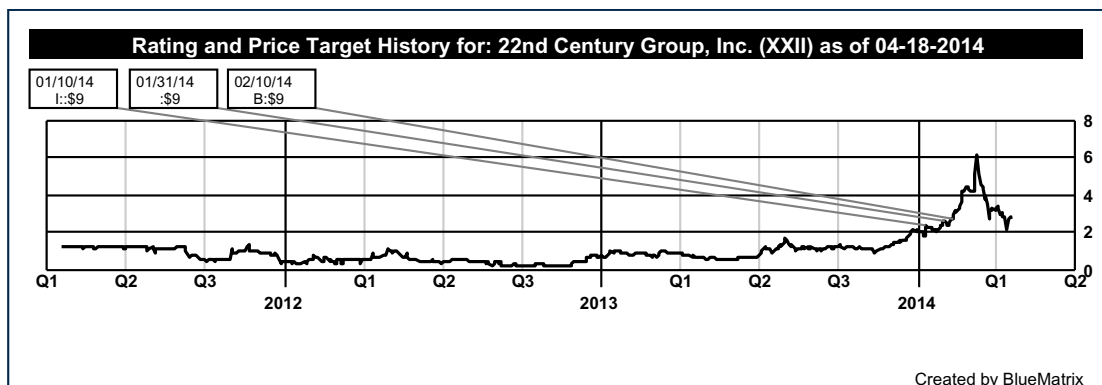
**Risks to achievement of target price:**

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 22<sup>nd</sup> 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:**

22<sup>nd</sup> 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	70.73	10	34.48
HOLD [NEUTRAL]	11	26.83	2	18.18
SELL [SELL]	0	0.00	0	0.00
NOT RATED [NR]	1	2.44	0	0.00

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**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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