

**February 22, 2010**

**CURRENT PRICE:** \$20.27

**RATING:** OUTPERFORM

**PRICE TARGET:** \$21.00

**CURRENT YIELD:** 6.7%

**EPS Estimates - Non-GAAP**

	DEC 09A	DEC 10E
1Q	\$0.28 A	\$0.26
2Q	\$0.49 A	\$0.45
3Q	\$0.42 A	\$0.48
4Q	\$0.35 A	\$0.42
	<b>\$1.54</b>	<b>\$1.61</b>

**Trading Data**

52-WEEK PRICE RANGE: **\$20.64-\$14.50**

SHARES OUTSTANDING: **2,073(M)**

MARKET CAP: **\$42,020(M)**

AVG. DAILY TRADING VOLUME: **13.9(M)**

S&P 500: **1,109**

**Valuation Data**

BOOK VALUE: **\$1.95**

PRICE TO BOOK: **10.3x**

DIVIDEND: **\$1.36**

**Altria Corp (NYSE:MO)**

*4Q Earnings update: Maintain Outperform Rating*

**HIGHLIGHTS**

- 4Q09 operating earnings of \$0.35/share vs \$0.33/share
- Progression on \$1.5 billion cost-cutting program
- EPS growth potential from cost-cutting & future revenue growth
- 6.7% dividend yield
- \$21/share price target

**INVESTMENT THESIS**

Given the current economic recession, and debate over the length of its duration, investors should consider high-yielding dividend equities operating in predictable industries. One such company is Altria Corp (MO-\$20.27), formerly known as Philip Morris, the largest US tobacco company. MO is focused on the US domestic tobacco business and has seen year-over-year revenue growth, on a pro-forma basis. Going forward management intends to grow earnings through revenue/cash flow growth and cost reductions. The tobacco industry has historically been viewed by Wall Street as recession resistant. Given MO's attractive dividend yield of 6.7%, and our price target of \$21/share, these shares are recommended for income/growth investors.

**COMPANY SUMMARY**

Altria Group, headquartered in Richmond VA, is the parent company of Philip Morris USA, US Smokeless Tobacco, John Middleton, Ste. Michelle Estate Wineries, and Philip Morris Capital Corp (PMCC). The company operates five segments: domestic cigarettes, smokeless tobacco products, machine made cigars, wineries, and financial services/real estate. The company has 10,400 employees located throughout the US. Philip Morris USA manufactures and sells cigarettes, and other tobacco products, in the US. This unit's cigarette brands include "Marlboro" (#1 in US market share), "Benson & Hedges", "Parliament", "Basic" and "Virginia Slims". This business gives MO approximately a 49.9% market share of the US cigarette market. Through 12/31/09 Philip Morris USA generated approximately 90% of overall revenues, or \$20.91 billion. During 2009 MO completed its purchase of US Tobacco (Skoal/Copenhagen brands & Ste. Michele Wines) giving MO 54.7% of the smokeless tobacco market share.

*For Important Disclosure information regarding the Firm's rating system, valuation methods and potential conflicts of interest, please refer to the last page of this report.*



# EQUITY RESEARCH

## BUSINESS OVERVIEW

MO is the largest cigarette manufacturer in the US. In 2007 the company purchased the John Middleton Co which sells and manufactures machine-made cigars (Black & Mild)/pipe tobacco and has 30.5% market share. This business generated 2.3% of MO's revenues, or \$520 million during FY09. PMCC owns a portfolio of leveraged/direct finance leases and produced 1.7% of revenues, or \$400 million. The cigarette business produced 90%, or \$20.9 billion, of the company's revenues. MO also owns approximately a 26%-27% economic equity interest, with voting rights, in the SABMiller beer company. Over the past twenty years MO at one time owned, or acquired, Miller Brewing, Nabisco, Kraft, and Jacobs Suchard AG. These businesses were subsequently either sold or spun-off. During the past three years the company spun-off Kraft Foods (KFT-\$26.53) and Philip Morris Intl (PM-\$49.87). MO's 2009 earnings from continuing operations totaled \$5.5 billion with \$5.1 billion (92.8%) from Philip Morris USA, \$176 million (3.2%) from John Middleton, \$199 million (3.6%) from PMCC, and \$21 million (0.4%) from the wine segment.

## RECENT EARNINGS

Altria (MO-\$20.27) reported 4Q09 operating earnings rose 6.1% to \$0.35/sh vs. \$0.33/sh during 4Q08. The increased results came from higher operating company's income (OCI) from cigarettes, cigars, financial services, from contributions by the US Tobacco (UST) acquisition, lower asset impairment/exit costs, and higher earnings from MO's equity investment in SABMiller. These positives were partially offset by higher interest expense/income taxes and higher general corporate expenses. Operating income increased 20.2% to \$1.2 billion. Revenues, on a quarter to quarter basis, rose to 29.2% to \$6.0 billion due to higher Federal Excise Taxes (FET) on tobacco products and the UST acquisition. FY09 operating earnings grew to 4.1% to \$1.54/sh vs. \$1.48/sh during FY08. Adjusted EPS grew 6.1% to \$1.75/share during 2009 and revenues increased 21.7% to \$23.6 billion from \$19.4 billion.

## SEGMENT RESULTS

**Cigarette Business:** Revenues for this unit rose 18.9% to \$5.37 billion, from \$4.5 billion, due mainly to higher pricing on products related to the increase in FET. When factoring out FET revenues declined 4.7% to \$3.54 billion. OCI for this segment grew 2.9% to \$1.15 billion from \$1.12 billion. When factoring out exit/implementation costs adjusted OCI improved 2.8% to \$1.23 billion from \$1.19 billion. 4Q09's cigarette volumes declined 11.4% due to FET, a decline in trade inventories, and changes to PM USA's pricing/promotional strategies with its product brands. Pricing competition caused Marlboro's retail share percent to decline to 41.7 from 42.1 during the quarter. MO focused on maximizing Marlboro's profitability by selective spending promotional money in response to increased spending by its competitors. While overall cigarette volumes declined, margins improved in the cigarette unit.

**Smokeless Products:** MO purchased UST in January of 2009 adding many new smokeless items to its own product lines. Revenues for this segment totaled \$343 million and \$317 million when factoring out FET. Adjusted OCI was \$137 million, when factoring out asset impairment, exit/integration costs, and inventory adjustments. Factoring these back in, OCI was \$79



# EQUITY RESEARCH

million. Adjusted OCI Shipment volumes grew 3.6% while Copenhagen/Skoal combined 4Q09 volumes increased 7.8%, with Copenhagen experiencing a 15.1% increase. On a sequential quarter basis, MO's overall market share for smokeless products increased to 54.7 from 53.8 as Copenhagen's share grew to 24.7 from 23.2, Shoal's declined slightly to 23.4 from 23.6, and Red Seal/Other fell to 6.6 from 7.0.

**Cigars:** Revenues grew 38.1% to \$134 million due to higher pricing caused mainly by FET. Net of excise taxes, revenues rose 6.2% to \$86 million from higher product pricing. OCI for this unit increased 2.8% to \$37 million from lower integration costs and higher pricing which partially offset larger costs for new products and trade programs. Factoring out integration costs of \$2 million, OCI declined 7.1%. Middleton's cigar volumes decreased 2.7% to 303 million units primarily due to reductions in trade inventory caused by moving the product sales to the Altria Sales & Distribution system which reduced wholesale delivery lead times. However, overall retail share of the cigar market increased to 31.1 from 30.0. The Black & Mild brand saw its retail share of machine-made large cigars increase 1.2 points to 30.6 from the introduction of Black & Mild's Wood Tip and Wood Tip Wine products.

**Wine:** Net revenues were \$132 million and OCI was \$21 million reflecting \$9 million in UST acquisition-related/integration costs. Factoring out these costs, adjusted OCI was \$30 million. Overall total wine volumes declined 2.2% during the quarter to 1,917 cases. The Ste. Michelle brand volume increased 4.5%, helping to offset declines in the Columbia Crest (-6.0%) and its other lines (-4.9%). Management attributed the decline to the timing of shipments during year-end 2008.

**Financial Services:** OCI for this segment was \$10 million versus -\$26 million during 4Q08. Last year's quarter experienced increases in loss allowances. The allowance for loan losses at year-end 2009 decreased by \$38 to \$266 million due largely to the write-off of a lease related to Motors Liquidation Company.

## OUR THOUGHTS

MO continues to transition its business model towards improved profitability despite declining cigarette volumes. The company's cost cutting efforts and revenue diversification appears to be delivering benefits as quarterly diluted earnings increased 6.1% to \$0.35/share. 2009's adjusted diluted earnings rose 6.1% to \$1.75/share. MO has achieved approximately \$1 billion of \$1.5 billion in planned cost savings by year-end 2011. While MO appears to be stabilizing cigarette volume declines, 2010-2011's objective is to grow revenues in the smokeless products business. If successful, earnings could offer long-term growth potential during the next 5 years. Additionally, investors should be encouraged by management's announcement to increase the dividend-payout ratio to 80% from 75%. Thus, earnings growth could lead to an increase of future dividends during 2010 and beyond. MO provided 2010 adjusted diluted EPS guidance of \$1.85-\$1.89/share representing a 6%-8% increase from 2009's profit levels. This stock looks attractive trading at 12.4x our 2010 diluted earnings estimate of \$1.61/share and paying a high dividend yield of 6.7%. These shares are recommended for income/growth investors seeking a high dividend yield, in a low interest rate environment. MO is rated OUTPERFORM and our current price target is \$21/share, equating to 13x our 2010 diluted earnings estimate.



## **RISKS**

There is no guarantee MO will improve earnings/cash flow. Declining US cigarette sales volumes may hurt the company's revenues and profits. Litigation risks surround US cigarette manufacturers. Rising interest rates, higher fuel prices, negative rate case decisions, tax issues, or rising operating costs could negatively impact MO's earnings. MO's stock may be adversely impacted by negative equity/credit markets, terrorist attacks, and failure to comply with Sarbanes Oxley guidelines.

Steve Marascia  
Director of Research  
Capitol Securities Management  
804-612-9715  
[smarascia@capitolsecurities.com](mailto:smarascia@capitolsecurities.com)



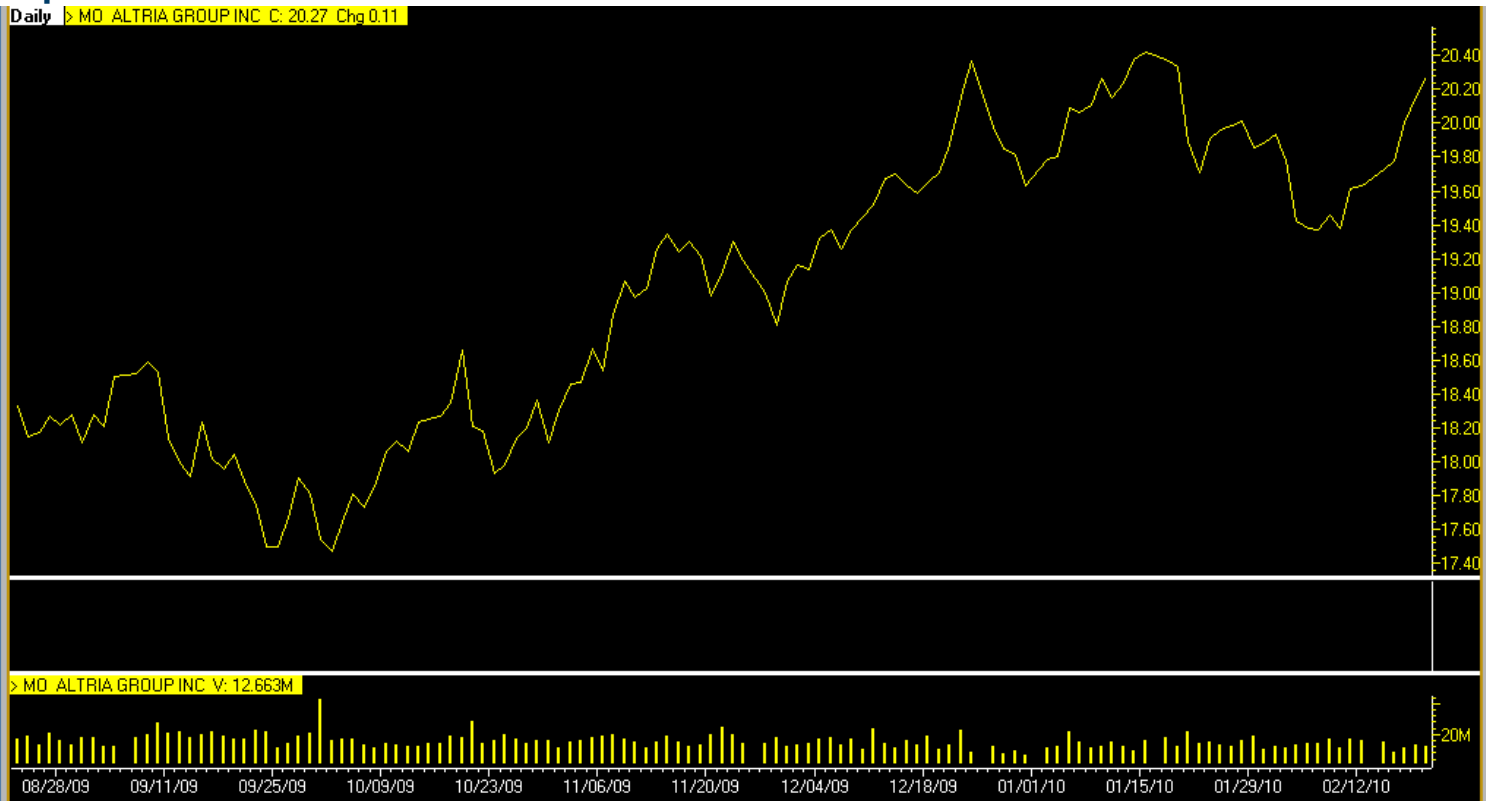
# EQUITY RESEARCH

ALTRIA GROUP, INC.  
(in millions, except per share data)

	1Q09	2Q09	3Q09	4Q09	2009	1Q10e	2Q10e	3Q10e	4Q10e	2010e
Net revenues	\$4,523	\$6,719	\$6,300	\$6,014	\$23,556	\$5,826	\$6,389	6,792	6,329	\$25,336
Cost of sales	1,770	2,138	2,033	2,049	7,990	2,098	2,075	2,064	2,054	8,291
Excise taxes on products	711	2,125	1,982	1,914	6,732	1,806	2,012	2,106	1,961	7,885
Gross profit	2,042	2,456	2,295	2,051	8,844	1,922	2,302	2,622	2,314	9,160
Marketing, administration, & research costs	604	688	628	659	2,579	684	665	674	689	2,712
Exit cost/asset impairment	122	37	79	92	330	36	14	27	23	100
Operating companies income	1,316	1,731	1,578	1,300	5,925	1,202	1,623	1,921	1,602	6,348
Amortization of intangibles	-6	-3	-7	-4	20	-6	-5	-7	-5	-23
General corporate expenses	-53	-50	-35	-66	-204	-63	-61	-69	-68	-261
Acquisition related transaction costs	-60									
Adjustment to 3rd party guarantee accrual										
Corporate exit cost						-24	-35	-43	-43	-155
Operating income	1,191	1,677	1,394	1,200	5,462	1,109	1,522	1,802	1,486	5,919
Interest & other debt expense, net	-336	-287	-279	-283	-1,185	-270	-255	-253	-248	-1,026
Loss on early debt extinguishment										
Earnings from SABMiller equity investment	106	217	-119	175	379	108	124	84	176	492
Earnings before income taxes	961	1,607	1,234	1,075	4,877	947	1,391	1,633	1,414	5,385
Income taxes	372	596	352	349	1,669	374	468	637	551	2,030
Net earnings (continuing ops.)	589	1,011	882	726	3,208	573	923	996	862	3,355
Earnings from discontinued ops.										
Net earnings attributable to noncontrolling interests		-1		-1	-2	-26				-26
Net earnings attributable to Altria	\$589	\$1,010	\$882	\$725	\$3,206	\$547	\$923	\$996	\$882	\$3,329
Earnings per share	\$0.28	\$0.49	\$0.42	\$0.35	\$1.54	\$0.26	\$0.45	\$0.48	\$0.42	\$1.61
Continuing operations earnings per share	\$0.28	\$0.49	\$0.42	\$0.35	\$1.54	\$0.26	\$0.45	\$0.48	\$0.42	\$1.61

## Important Disclosures

Daily > MD ALTRIA GROUP INC C: 20.27 Chg 0.11



Steven Marascia certifies, with respect to the companies or securities that he analyzes, that (1) the views expressed in this report accurately reflect his personal views about all of the subject companies and securities and (2) no part of his compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

Capitol Securities and employees of Capitol Securities may own shares of Altria Corp.

Stock ratings used in this report are defined as follows:

- (1) Outperform – The stock's total return including dividends is expected to exceed the industry or market average by at least 10% over the next twelve months.
- (2) Neutral – The stock's total return including dividends is expected to be in line with the industry or market average of +/- 10% over the next twelve months.
- (3) Underperform – The Stock's total return including dividends is expected to be below the industry or market average by 10% or more over the next twelve months.

The distribution of investment ratings for all companies in our coverage universe are as follows: (1) 75%, (2) 25%, (3) 0%

Capitol Securities does not have investment banking operations.

For regulatory purposes, our ratings of Outperform, Neutral and Underperform most closely correspond to Buy, Hold and Sell, respectively.

## Other Disclosures

This report is not directed to, or intended for distribution to or use by any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would subject Capitol Securities or its affiliates to any registration or licensing requirement within such jurisdiction. The information presented in this report is provided to you for information purposes only and is not to be used or considered as an offer or the solicitation of an offer to sell or buy or subscribe for securities or other financial instruments. Capitol Securities may not have taken any steps to ensure that the securities referred to in this report are suitable for any particular investor. Capitol Securities will not treat recipients of this report as its customers by virtue of their receiving this report. The investments and services contained or referred to in this report may not be suitable for you and it is recommended that you consult an independent investment advisor if you are in doubt about such investments or investment services. Nothing in this report constitutes investment, legal, accounting or tax advice, or a representation that any investment or strategy is suitable or appropriate to your individual circumstances, or otherwise constitutes a personal recommendation to you. Capitol Securities does not advise on the tax consequences of investments and you are advised to contact an independent tax advisor. Information and opinions presented in this report have been obtained or derived from sources believed by Capitol Securities to be reliable, but Capitol Securities makes no representation as to their accuracy or completeness. This report is not to be relied upon in substitution for the exercise of independent judgment. Capitol Securities may have issued, and may in the future issue, other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. Information, opinions and estimates contained in this report reflect a judgment at its original date of publication by Capitol Securities and are subject to change without notice. The price, value of and income from any of the securities mentioned in this report can fall as well as rise.



**For more information on this report, please contact us at 888-612-1484 or write to Capitol Securities, 100 Concourse Boulevard, Suite 101, Glen Allen, Virginia 23059**