

May 18, 2010

CURRENT PRICE: \$21.37
RATING: OUTPERFORM
PRICE TARGET: \$23.00
CURRENT YIELD: 6.6%

EPS Estimates - Non-GAAP

	DEC 09A	DEC 10E
1Q	\$0.28 A	\$0.39
2Q	\$0.49 A	\$0.45e
3Q	\$0.42 A	\$0.48e
4Q	\$0.35 A	\$0.48e
	\$1.54	\$1.80

Trading Data

52-WEEK PRICE RANGE: **\$21.91-\$16.10**
 SHARES OUTSTANDING: **2,077(M)**
 MARKET CAP: **\$44,385(M)**
 AVG. DAILY TRADING VOLUME: **14.7(M)**
 S&P 500: **1,121**

Valuation Data

BOOK VALUE: **\$2.01**
 PRICE TO BOOK: **10.6x**
 DIVIDEND: **\$1.40**

Altria Corp (NYSE:MO)
1Q Earnings update: Maintain Outperform Rating
HIGHLIGHTS

- 1Q10 operating earnings of \$0.39/share vs \$0.28/share
- Progression on \$1.5 billion cost-cutting program
- EPS growth potential from cost-cutting & future revenue growth
- 6.6% dividend yield
- Raising price target to \$23/share from \$21/share

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-\$21.37), 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. Earnings growth may generate dividend increases in the future. Given MO's attractive dividend yield of 6.6%, and our price target of \$23/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-\$21.37) reported 1Q10 reported diluted earnings of \$0.39/share vs \$0.28/share during 1Q09. The 39.3% increase was due to an increase in operating companies' income (OCI) from the cigarette, smokeless product, and wine units in addition to higher contributions from MO's SAB Miller equity investment. Results were also bolstered by 1Q09 transaction costs/financing fees related to the UST acquisition. Reported OCI income grew 7.6% to \$1.23 billion from \$1.14 billion, while adjusted OCI improved 6.7% to \$1.26 billion from \$1.18 billion. These positives were partially offset by lower OCI results from the financial service and cigars unit. 1Q10 adjusted diluted earnings totaled \$0.42/share vs. \$0.39/share during 1Q09. Revenues on a quarter-to-quarter basis, net of excise taxes grew 5.5% to \$3.39 billion from \$3.22 billion. Excise taxes increased to \$1.73 billion from \$680 million due to Federal mandates.

SEGMENT RESULTS

Cigarette Business: Revenues for this unit rose 31.5%, to \$5.1 billion from \$3.9 billion, due to higher pricing from increases in Federal Excise Taxes (FET). Net of FET, cigarette revenues grew 5.5% to \$3.3 billion resulting from higher product pricing. OCI improved 6.7% to \$1.3 billion from \$1.2 billion. When factoring out implementation/exit costs, OCI grew 7.6% to \$1.2 billion from \$1.1 billion from higher product pricing and lower implementation/exit costs, which were partly offset by FDA user fees and lower volume. 1Q10 cigarette volumes declined 0.7% due to shifting inventory dynamics. Following adjustments for trade inventory changes, 1Q10's cigarette shipments fell 11%. Marlboro cigarettes retail share increased to 42.7% from 42.4% due to Marlboro Menthol and the introduction of Marlboro Special Blend products. MO's overall retail cigarette market share declined to 50.2% from 50.9% as Marlboro's gains were offset by a decline in market share of the company's Other Premium brands (4.0% vs 4.6%) and its Discount Brands (3.5% vs 3.9%)



EQUITY RESEARCH

Smokeless Products: MO purchased UST in January 2009 adding many new smokeless items to its own product line. Net of FET, revenues rose 24.1% to \$355 million from \$286 million. Adjusted OCI, when factoring out exit/integration costs and UST acquisition-related costs, increased 49.2% to \$188 million from \$126 million. Factoring these back in, OCI was \$178 million vs (\$2 million) due to lower exit/integration costs and UST acquisition related costs, higher volumes, and cost savings. Compared to last year's quarter, combined smokeless product shipment volumes rose 21.9% to 186.1 million from 152.6 million resulting primarily from product initiatives during 1Q10 and trade inventory changes during 1Q09. When adjusting for new product pipeline volume, trade inventory changes, and other product adjustments MO's smokeless products volume grew 5%. Copenhagen's volume increase 31.3% to 83.8 million from 63.8 million while Skoal's rose 10.1% to 67.7 million from 61.5 million. Red Seal/Other product volumes grew 26.5% to 34.6 million. Copenhagen and Skoal market share improved to 48.7% from 47.7% while Red Seal/Other's declined to 6.7% from 8.5%. Overall, MO's total market share of smokeless products fell to 55.4% from 56.2%.

Cigars: Revenues grew 17.4% to \$135 million from higher pricing related to higher FET. Net of FET, revenues declined 12.1% to \$87 million resulting from lower volumes. OCI for this unit decreased 13% to \$47 million from lower volumes partially offset by higher pricing. 1Q09's OCI rose 31.7% due to trade purchases in advance of last year's increase in FET. OCI for the cigar unit, including integration costs, declined 15.8% to \$48 million from \$57 million. Excluding integration costs, OCI fell 13% to \$47 million from \$54 million. Middleton's cigar volume declined 18.3% to 282 million as wholesalers accumulated cigar inventory ahead of FET increases and since there was no floor tax in the 2009 FET increase for machine-made cigars. Additionally, Middleton shipped new product pipeline volume for "Black & Mild" Wood Tip during 1Q09 and wholesalers reduced inventory levels on Middleton's products during 1Q10. Factoring out these items, MO estimated Middleton shipments were flat. Black & Mild's market share increased to 28.2% from 27.9% and total cigars grew slightly to 28.6% from 28.5%.

Wine: Net revenues improved 26.7% to \$95 million from \$75 million. Adjusted OCI grew 33.3% to \$12 million from \$9 million. Factoring out exit/integration/acquisition related costs, OCI rose to \$7 million from \$1 million. Ste. Michelle's quarterly wine shipments increased 22% to 1.4 million cases from rising sales of the Chateau Ste. Michelle wines as wholesalers rebuilt inventory levels from 2009, and improved on-premise channel volume which includes bars, restaurants, and calendar differences. Adjusting for calendar differences, Ste. Michelle's wine shipment volumes increased 16%.

Financial Services: OCI for this unit declined to \$21 million from \$120 million resulting lower gains on asset sales during the latest quarter. The allowance for loan losses at the end of 1Q10 decreased \$64 million to \$202 million reflecting write-offs related to General Motors LLC leases.



EQUITY RESEARCH

OUR THOUGHTS

Rising revenues and lower operating costs, as well as declining exit/integration/acquisition costs improved MO's 1Q10 earnings when compared to 1Q09. Operating income improved 20.1% to \$1.43 billion from \$1.19 billion and EBIT grew 33.3% to \$1.29 billion from \$961 million, showing MO's ability to increase its cash flow. Management continued its program of cost cutting as the company attained another \$43 million in cost savings during the quarter working towards its goal of \$1.5 billion in overall cost savings by year-end 2011 from 2006 levels. The company anticipates another \$419 million in cost savings will be realized during 2010. Interest/debt expense declined to \$287 million from \$336 million and the SAB equity investment results improved to \$138 million compared to \$106 million.

During the earnings conference call MO said 2Q10 profits may not match 2Q09's results, however, 2H10 results could boost overall earnings for the year. Management also reaffirmed earlier 2010 reported diluted EPS guidance of \$1.78-\$1.82/share, up from \$1.54/share during 2009. Revenue growth and cost cutting efforts could lead to improved earnings going forward and allow MO to raise its dividend again in 2010. Following a 2.9% dividend increase this past February, the company announced it was increasing the dividend pay out ratio to 80% from 75% of adjusted diluted earnings. MO is an attractive income vehicle for investors seeking a stock offering the potential of future dividend increases. Given the prospect of higher earnings in 2H10 we are raising our earnings estimate to \$1.80/share for 2010. Additionally, we are raising our target price to \$23/share, equating to 12.8x our 2010 earnings estimate. MO is rated OUTPERFORM.

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.

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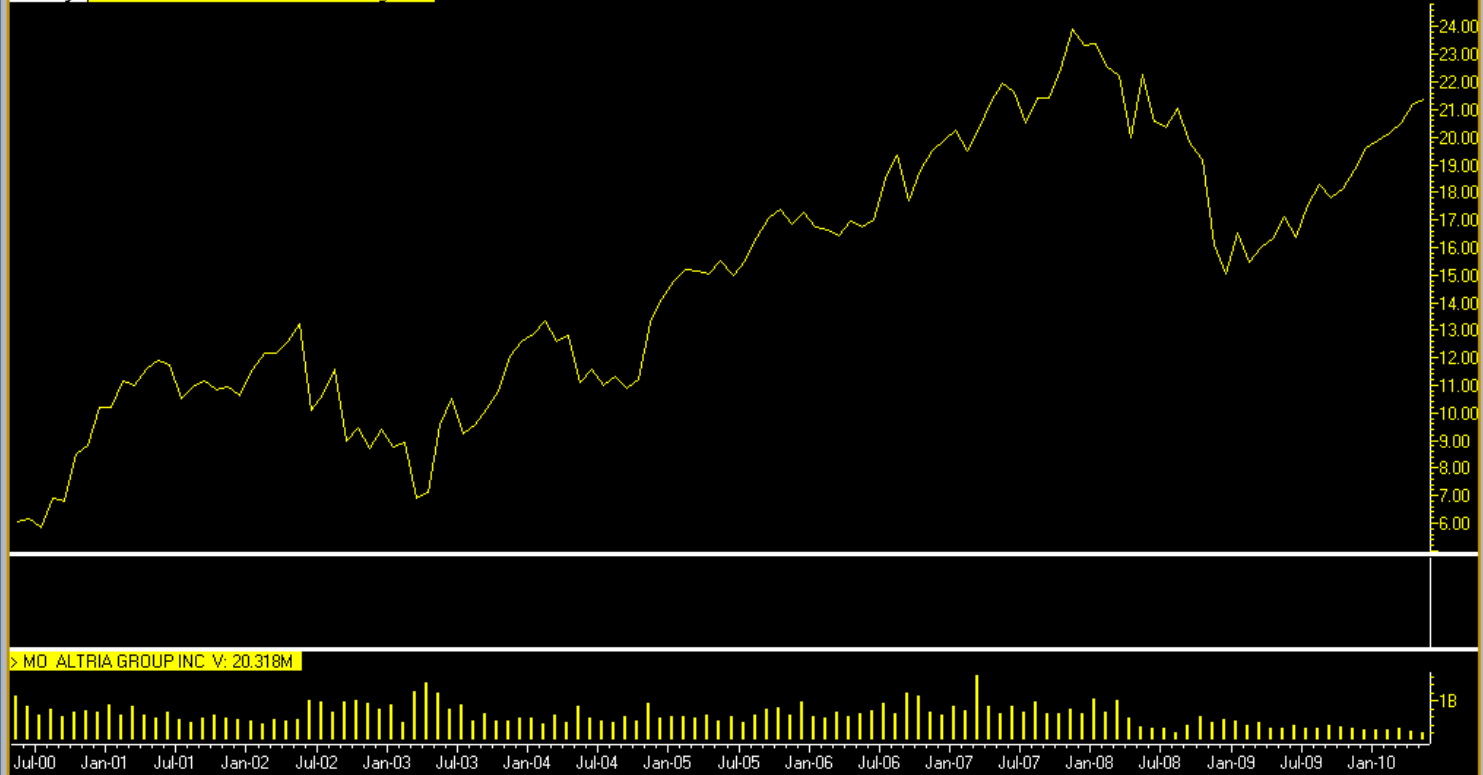
EQUITY RESEARCH

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

	1Q09	2Q09	3Q09	4Q09	2009	1Q10	2Q10e	3Q10e	4Q10e	2010e
Net revenues	\$4,523	\$6,719	\$6,300	\$6,014	\$23,556	\$5,760	\$6,389	6,792	6,729	\$25,670
Cost of sales	1,770	2,138	2,033	2,049	7,990	1,867	2,075	2,064	2,054	8,060
Excise taxes on products	711	2,125	1,982	1,914	6,732	1,809	2,012	2,106	2,102	8,029
Gross profit	2,042	2,456	2,295	2,051	8,844	2,084	2,302	2,622	2,573	9,581
Marketing, administration, & research costs	604	688	628	659	2,579	594	665	674	689	2,622
Exit cost/asset impairment	122	37	79	92	330	7	14	27	23	71
Operating companies income	1,316	1,731	1,578	1,300	5,925	1,483	1,623	1,921	1,861	6,888
Amortization of intangibles	-6	-3	-7	-4	20	-6	-5	-7	-5	-23
General corporate expenses	-53	-50	-35	-66	-204	-47	-61	-69	-68	-245
Acquisition related transaction costs	-60									
Adjustment to 3rd party guarantee accrual										
Corporate exit cost							-35	-43		-78
Operating income	1,191	1,677	1,394	1,200	5,462	1,430	1,522	1,802	1,788	6,542
Interest & other debt expense, net	-336	-287	-279	-283	-1,185	-287	-255	-253	-248	-1,043
Loss on early debt extinguishment										
Earnings from SABMiller equity investment	106	217	-119	175	379	138	124	84	89	435
Earnings before income taxes	961	1,607	1,234	1,075	4,877	1,281	1,391	1,633	1,629	5,934
Income taxes	372	596	352	349	1,669	468	468	637	635	2,208
Net earnings (continuing ops.)	589	1,011	882	726	3,208	813	923	996	994	3,726
Earnings from discontinued ops.										
Net earnings attributable to noncontrolling interests		-1		-1	-2				-2	-2
Net earnings attributable to Altria	\$589	\$1,010	\$882	\$725	\$3,206	\$813	\$923	\$996	\$992	\$3,724
Earnings per share	\$0.28	\$0.49	\$0.42	\$0.35	\$1.54	\$0.39	\$0.45	\$0.48	\$0.48	\$1.80
Continuing operations earnings per share	\$0.28	\$0.49	\$0.42	\$0.35	\$1.54	\$0.39	\$0.45	\$0.48	\$0.48	\$1.80

Important Disclosures

Monthly > MO ALTRIA GROUP INC C: 21.37 Chg -0.33



9/14/09 \$17.99 Initiate Outperform

5/18/10 Raised price target to \$23/share

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- (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.
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