

September 14, 2009

CURRENT PRICE: \$17.99
RATING: OUTPERFORM
PRICE TARGET: \$21.00
CURRENT YIELD: 7.5%

EPS Estimates - Non-GAAP

	DEC 08A	DEC 09E
1Q	\$00.29A	\$00.28a
2Q	\$00.45A	\$00.49a
3Q	\$00.42A	\$00.47e
4Q	\$00.33A	\$00.49e
	\$1.49	\$1.73

Trading Data

52-WEEK PRICE RANGE: **\$21.18 - \$14.34**
 SHARES OUTSTANDING: **2,071(M)**
 MARKET CAP: **\$37,257(M)**
 AVG. DAILY TRADING VOLUME: **15.26(M)**
 S&P 500: **1,049**

Valuation Data

BOOK VALUE: **\$1.62**
 PRICE TO BOOK: **11.1**
 DIVIDEND: **\$1.36**

Altria Corp (NYSE: MO)

Initiating Coverage with an Outperform Rating

Highlights

- Recent US Tobacco acquisition expected to grow revenues
- MO's goal is to improve cash flow to +\$4billion/year through cost savings of \$1.5 billion
- 2Q09 earnings improve 8.9% to \$0.45/share
- Attractive dividend yield of 7.5% (potential for future increases)
- \$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-\$17.99), 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 7.5%, 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, John Middleton, and Philip Morris Capital Corp (PMCC). The company operates five segments: domestic cigarettes, smokeless tobacco products, machine made cigars, Ste. Michelle Estate 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 49.5% market share of the US cigarette market. Through 12/31/08 Philip Morris USA generated approximately 97% of overall revenues, or \$19.36 billion. Recently MO completed its purchase of US Tobacco (Skoal/Copenhagen brands & Ste. Michele Wines) giving MO 56% 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

In 2007 the company purchased the John Middleton Co which sells and manufactures machine-made cigars (Black & Mild)/pipe tobacco and has 29% market share. This business generated 2% of MO's revenues, or \$387 million during FY08. PMCC owns a portfolio of leveraged/direct finance leases and produced 1% of revenues, or \$216 million. 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 two years the company spun-off Kraft Foods (KFT-\$26.11) and Philip Morris Intl (PM-\$47.66). MO's 2008 earnings from continuing operations totaled \$3.97 billion with \$3.75 billion (94.3%) from Philip Morris USA, \$128 million (3.2%) from John Middleton, and \$97 million (2.5%) from PMCC.

Business Overview

MO's primary focus is the US domestic tobacco business which was an \$80 billion market in 2008. The company has dominant market shares in the cigarette category (41.2% for Marlboro & 49.5% with all its brands), in the smokeless market (56.1% for all brands) and in the cigar category (28.3% for Black & Mild). Domestic smoking trends are declining 3%-4% per year. However, management's growth plan is to grow earnings through margin improvement, cost cutting, increasing market share through its cigarette/cigar business, and offering smokeless tobacco products. Potential margin improvement could come from product price increases and cost saving efforts. Cigarette brand volume increases and growing cigar/smokeless tobacco product sales could raise MO's US market share. MO's management believes the addition of Middleton (cigars) and US Tobacco (smokeless tobacco products) will generate revenue growth offsetting the expected 3%-4% annual decline in US smoking volumes going forward. Management may seek to monetize its ownership of Ste. Michelle Wines and is reviewing its stake in SABMiller, with both currently valued at \$9 billion-\$10 billion. PMCC invests in power plants, automobile, and airline assets. MO plans to wind this business down over 10-15 years.

Corporate Strategy

MAXIMIZE INCOME & MARLBORO'S RETAIL SHARE GROWTH IN THE CIGARETTE CATEGORY. Grow cigarette market share efficiently, while focusing on the Marlboro brand

COST SAVINGS FROM US TOBACCO INTEGRATION, WHILE RETURNING "COPENHAGEN" & "SKOAL" TO MODERATE RETAIL SHARE & VOLUME GROWTH IN MST CATEGORY. Management anticipates ~\$300 million in cost savings from UST acquisition through eliminating duplicate positions and moving headquarters to Richmond. Recently, lowered price of "Skoal" & "Copenhagen" smokeless products to address price gap issue with competing "Grizzly" product, resulting in sales volume increases.

GROW RETAIL/SHARE VOLUME OF BLACK & MILD CIGARS WHILE MAXIMIZING MIDDLETON'S INCOME. MO will focus on product line extensions and improving equity from the "Black & Mild" brand. The company sales force is focusing on marketing cigars, which appears to be producing increased sales.

LOWER OPERATING COSTS. Reduce cigarette related infrastructure ahead of volume declines & leveraging shared services across MO's operating companies. MO estimates \$1.5 billion of total potential cost savings by 2011, compared to 2006's expense levels, by eliminating \$1.312 billion in corporate/SG&A expenses, and moving the Cabarrus facility to Richmond producing annual savings of \$188 million.



EQUITY RESEARCH

MAINTAIN A STRONG BALANCE SHEET & RETURN CASH TO SHAREHOLDERS THROUGH DIVIDENDS. MO could reduce debt, and re-establish its share repurchase program, while increasing overall product revenues. Management anticipates annual cash flow can improve to over \$4 billion/year from \$3.5 billion/year due to the potential of realizing \$1.5 billion in cost savings. MO anticipates paying 75% of earnings to shareholders as dividends.

Recent Earnings

MO recently reported 2Q09 diluted earnings of \$0.49/share, representing an 8.9% increase from \$0.45/share during 2Q08. On a quarter-to-quarter comparison, 2Q09's adjusted diluted earnings were \$0.50/share versus \$0.46/share. MO's net revenues grew 32.9% to \$6.7 billion due to higher pricing reflecting the increased federal excise tax and the acquisition of US Tobacco (UST). Operating income improved 25% to \$1.7 billion as operating income before corporate expenses and amortization of intangibles (OCI) from cigarettes, financial services, and UST grew and from lower general operating corporate expenses. MO's net earnings improved 8.6% to \$1.0 billion due to higher operating income/earnings from MO's equity investment in SABMiller, which was partially offset by higher interest expense related to debt used to acquire UST.

Cigarette Business: Net revenues rose 22.5% to \$6.0 billion because of higher pricing related to an increase in the Federal excise tax. Net of excise taxes, revenues declined 2.1% to \$4.0 billion. OCI improved 6.7% to \$1.4 billion reflect higher list prices offsetting lower volumes and higher costs related to the closing of the Cabarrus manufacturing facility. Factoring out exit/implementation costs, adjusted OCI rose 7.4% to \$1.5 billion. MO's overall cigarette retail market share decreased 1.5 basis points to 49.5 from 51.0.

Smokeless Products: Net revenues were \$373 million and revenues net of excise taxes totaled \$349 million. OCI, when comparing quarters, was negatively impacted by UST acquisition costs, inventory adjustments, integration costs, and expenses from Marlboro/UST smokeless tobacco brands. Excluding these OCI was \$213 million. Volume shipments were lower by 3.4% but were flat when adjusting for trade inventory changes, discontinuing multi-pack deals, and ending its Rooster brand. MO's moist smokeless tobacco retail share declined 1.1 basis points to 56.1 from 57.2.

Cigar Business: Net income rose 16.8% to \$118 million due to higher pricing resulting from increased Federal excise taxes. Revenues, net of excise taxes, declined 12.9% to \$74 million. Lower volumes, partially offset by higher prices, caused OCI to fall 28.0% to \$36 million. Excluding integration costs, OCI declined 21.6% to \$40 million. Middleton's volumes fell 23.8%. However, when adjusted for changes in trade inventories, calendar differences, and timing of promotional shipments, volumes showed moderate growth. MO's cigar retail share increased 2.6 basis points to 31.0 from 28.4.

Wine Business: Revenues were \$94 million. OCI generated \$9 million, which included acquisition-related (via UST purchase) and integration costs of \$6 million, producing adjusted OCI of \$15 million. Wine shipment volumes declined 1.5% to 1.4 million cases as wholesalers reduced inventories.

Financial Services: OCI increased by \$53 million to \$83 million. The increase came primarily from higher gains on asset sales, partially offset by an increase in allowance for losses of \$15 million. PMCC restated its focus on managing its leased asset portfolio to maximize financial contributions to MO's overall earnings. PMCC is not making new investments & emphasized OCI will vary on a quarter-to-quarter based as its investments are sold or mature.



Our Thoughts

Paying a high dividend yield of 7.5%, and earnings growth potential, MO's shares look attractive for income/growth investors seeking a company in an industry with steady revenue streams. Future cash flow growth could allow MO to continue to raise its dividend, following a 10.8% and 6.3% increase in 2008 and 2009, respectively, while maintaining a 75% payout of earnings to investors.

The key for MO will be its ability to successfully grow cash flow despite a potential decline in future cigarette smoking consumption. This may be accomplished if management executes its plan to improve annual cash flow to over \$4 billion/year, from \$3.5 billion/year, through product sale increases of cigarette/cigar brands, and attaining targeted overall cost savings. MO has already achieved \$750 million of the planned \$1.5 billion in cost savings targeted for year-end 2011. Additionally, we are encouraged with MO raising its 2009 continuing operations earnings guidance from \$1.70-\$1.75/share to \$1.72-\$1.77/share.

Dividend/earnings growth, and the re-establishment of the share repurchase program, may prompt investors to reward MO with a higher price/earnings ratio, thus, providing appreciation potential for this stock. Given MO's attractive 7.5% dividend yield, dividend/earnings growth prospects, and price appreciation potential, these shares are recommended for income/growth investors. We are initiating coverage of MO with An OUTPERFORM rating and a \$21/share target price, or 12.1x our 2009 earnings estimate of \$1.73/share.

Risk

There is no guarantee MO will improve earnings/cash flow. Declining US cigarette volumes may hurt the company's revenues and profits. Litigation risks surround cigarette manufacturers. Rising interest rates, higher tobacco prices, 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.



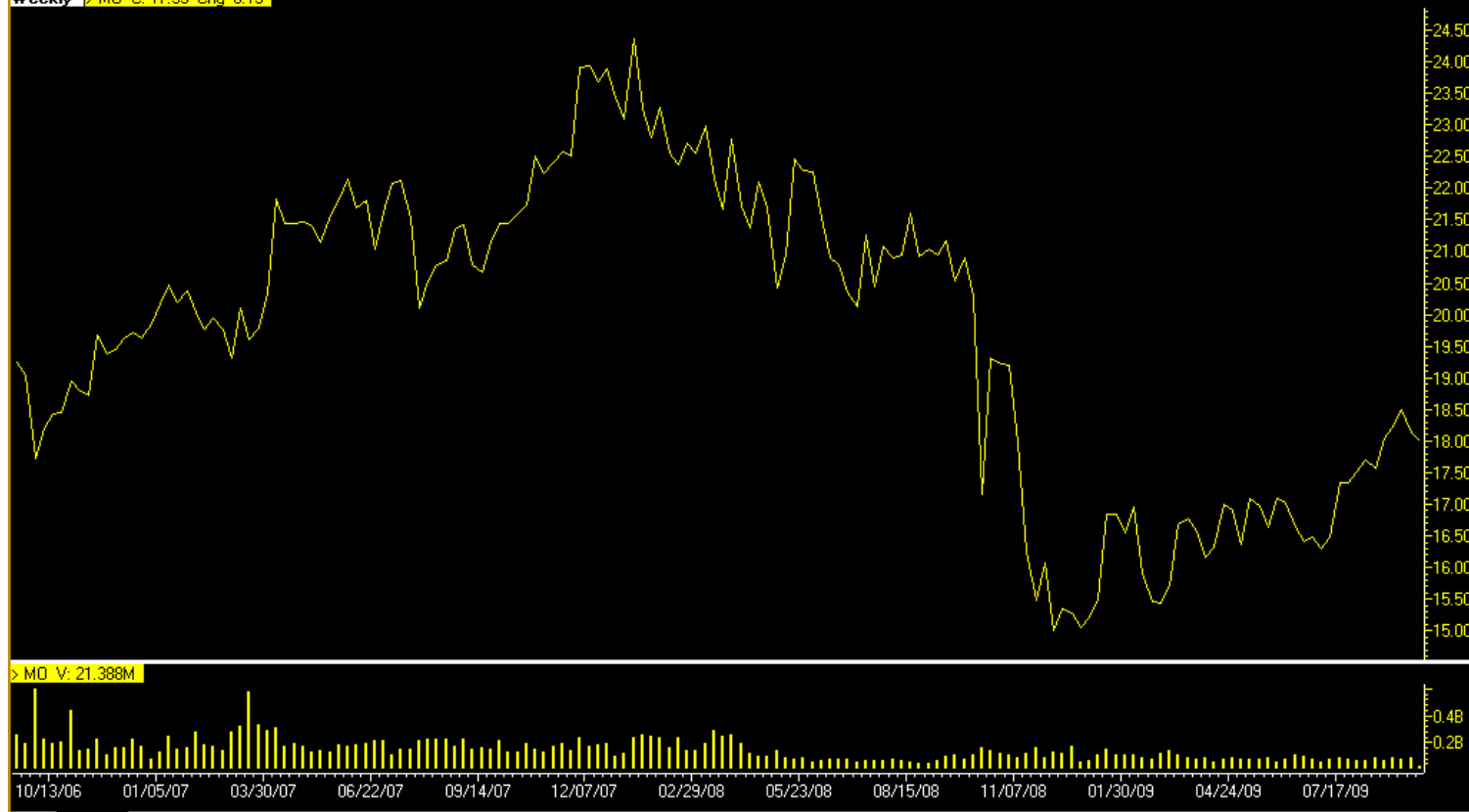
EQUITY RESEARCH

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

	1Q08	2Q08	3Q08	4Q08	2008	1Q09	2Q09	3Q09e	4Q09e	2009e
Net revenues	\$4,410	\$5,054	\$5,238	\$4,654	\$19,356	\$4,523	\$6,719	\$6,525	\$6,775	\$24,542
Cost of sales	1,887	2,168	2,230	1,985	8,270	1,770	2,138	2,012	2,154	8,074
Excise taxes on products	806	875	897	821	3,399	711	2,125	2,037	2,133	7,006
Gross profit	1,717	2,011	2,111	1,848	7,687	2,042	2,456	2,476	2,488	9,462
Marketing, administration, & research costs	551	576	697	663	2,487	604	688	676	682	2,650
Exit cost/asset impairment	11	18	15	55	99	122	37	23	15	197
Operating companies income	1,155	1,417	1,399	1,130	5,101	1,316	1,731	1,777	1,791	6,615
Amortization of intangibles	-2	-1	-2	-2	-7	-6	-3	-7	-2	-18
General corporate expenses	-97	-73	-66	-40	-276	-53	-50	-50	-50	-203
Acquisition related transaction costs						-60				-60
Adjustment to 3rd party guarantee accrual				10	10					
Gain on sale of Corp headquarters	404				404					
Corporate exit cost	-247	-1	-2	-100	-350	-6	-1	-7	-3	-17
Operating income	1,213	1,342	1,329	998	4,882	1,191	1,677	1,713	1,736	6,317
Interest & other debt expense, net	16	-18	-25	-140	-167	-336	-287	-293	-294	-1,210
Loss on early debt extinguishment	-393				-393					
Earnings from SABMiller equity investment	143	147	54	123	467	106	217	136	162	621
Earnings before income taxes	979	1,471	1,358	981	4,789	961	1,607	1,556	1,604	5,728
Income taxes	365	541	491	302	1,699	372	596	584	602	2,154
Net earnings (continuing ops.)	614	930	867	679	3,090	589	1,011	972	1,002	3,574
Earnings from discontinued ops.	1,901				1,901					
Net earnings attributable to noncontrolling interests	-61				-61		-1			-1
Net earnings attributable to Altria	2,454	\$930	\$867	\$679	4,930	\$589	\$1,010	\$972	\$1,002	3,573
Earnings per share	\$1.16	\$0.45	\$0.42	\$0.33	\$2.36	\$0.28	\$0.49	\$0.47	\$0.49	\$1.73
Continuing operations earnings per share	\$0.29	\$0.45	\$0.42	\$0.33	\$1.49	\$0.28	\$0.49	\$0.47	\$0.49	\$1.73
Discontinued operations earnings per share	\$0.87				\$0.87					

Important Disclosures

Weekly > MU L: 17.99 Chg: 0.15



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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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