

November 16, 2010

CURRENT PRICE: \$24.38
RATING: OUTPERFORM
PRICE TARGET: \$26.00
CURRENT YIELD: 6.2%

EPS Estimates - Non-GAAP

	DEC 09A	DEC 10E
1Q	\$0.28 A	\$0.39
2Q	\$0.49 A	\$0.50
3Q	\$0.42 A	\$0.54
4Q	\$0.35 A	\$0.44e
	\$1.54	\$1.87

Trading Data

52-WEEK PRICE RANGE: **\$26.22-\$18.75**
 SHARES OUTSTANDING: **2,080(M)**
 MARKET CAP: **\$50,669(M)**
 AVG. DAILY TRADING VOLUME: **12.3(M)**
 S&P 500: **1,178**

Valuation Data

BOOK VALUE: **\$2.47**
 PRICE TO BOOK: **10.0x**
 DIVIDEND: **\$1.52**

Altria Corp (NYSE:MO)

3Q Earnings update: Maintain Outperform Rating & Raising Price Target

HIGHLIGHTS

- 3Q10 operating earnings of \$0.54/share vs \$0.42/share
- Higher OCI, lower impairment/exit costs, & tax benefits drive 2Q results
- 2010 earnings guidance raised to \$1.83-\$1.87/sh. from \$1.81-\$1.85/sh.
- Dividend increased for 2nd time during 2010
- Raising price target to \$26/share from \$24/share

INVESTMENT THESIS

Given the current economic malaise, 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-\$24.38), 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 6.1%, and our price target of \$26/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-\$30.84) and Philip Morris Intl (PM-\$58.53). 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

MO's 3Q10 diluted earnings rose 28.6% to \$0.54/share from \$0.42/share during 3Q09. The improved results were due to higher operating companies income (OCI) from the cigarettes and smokeless units (benefitting from lower 2010 exit/implementation costs), and increased profit contributions from MO's equity stake in SABMiller plc. Adjusted diluted earnings during, on a quarter-to-quarter comparison, increased 12.5% to \$0.54/share from \$0.48/share. Net revenues grew 1.6% to \$6.4 billion from \$6.3 billion while gross profit rose 8.45% to \$2.48 billion from \$2.29 billion. Total OCI increased 15.7% to \$1.82 billion from \$1.58 billion. MO's operating income was \$1.78 billion, compared to \$1.4 billion, representing a 27.4% increase due to the absence of charges related to Kraft inventory and corporate exit costs which were incurred during 3Q09.

During 3Q10 results were impacted by tax benefits of \$33 million produced from a reversal of tax reserves/interest associated with the 2000-2003 tax audits. 3Q comparisons also reflect 2009 's tax events which consisted of lower state taxes and an \$88 million reversal of tax reserves/interest related to MO's former ownership in Kraft Foods (KFT-\$30.84). The \$88 million tax benefit was offset by a reduction of a corresponding receivable from KFT.

MO continues to make progress on its cost saving initiative as the company achieved an additional \$80 million of cost savings during 3Q10. Thus far, in 2010, MO has achieved \$252 million in cost savings and anticipates another \$210 million by year-end 2011. If this goal is achieved then the company will have eliminated \$1.5 billion of costs compared to 2006's levels.



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SEGMENT RESULTS

Cigarette Business: Revenues rose 1.8% to \$5.73 billion from \$5.63 billion, including excise taxes, due to higher product pricing. Net of excise taxes segment revenues increased 4.0% to \$3.88 billion from \$3.73 billion. OCI rose 15.0% to \$1.53 billion due to higher list prices, cost savings, and lower promotional spending partially offset by lower volume and higher FDA user fees. Factoring out restructuring costs associated with the closing of the Cabarrus manufacturing facility, adjusted OCI grew 9% to \$1.57 billion. MO's domestic cigarette shipments fell 2.4%. When adjusting mainly for trade inventory changes, shipments were down 4%. Marlboro cigarette's retail share increased 0.7% to 42.6% from 41.9%, offsetting declines in Other Premium (-0.3%) and Discount cigarettes (-0.5%).

Smokeless Products: MO purchased UST in January 2009 adding new smokeless items to its own product line. Revenues, net of excise taxes, increased 11.3% to \$363 million from \$326 million. Reported OCI grew 65.4% to \$210 million from \$127 million due to lower exit/integration expenses, higher volume, and cost savings. Factoring out restructuring and UST acquisition-related costs, adjusted OCI improved 36.5% to \$213 million from \$156 million. Shipment volumes of domestic smokeless products, when adjusting for trade inventory changes, grew 10%. Total smokeless products' volume increased 16.4% to 183.9 million units from 158 million units. Copenhagen shipments rose 19.3% to 80.9 million, Skoal's increased 4.3% to 69.8 million, and Red Seal/Other gained 42.8% to 33.2 million. Retail share of Copenhagen increased to 25.5% from 23.2%, Skoal's declined to 22.6% from 23.5%, and Red Seal/other grew to 7.5% from 7.0%. Overall, MO's total market share of smokeless products increased 1.9% to 55.6% from 53.7%.

Cigars: Net of excise taxes, segment revenue declined 3.9% to \$147 million from \$153 million due to higher spending on its brands and partially offset by higher pricing. Net of FET, segment revenues fell 9.1% to \$90 million from \$99 million. Adjusted OCI declined 12.2% to \$43 million from \$49 million resulting from higher costs associated with brand-building initiatives and new products. Total Cigar volume declined 0.8% to 338 million due to lower sales of Black & Mild (332 million vs 333 million) from increased competition. When adjusting for trade inventory changes, total volume shipments were down 4% for the quarter. Middelton estimates a 2% volume increase in machine made large cigars. Black & Mild's retail share declined to 29.1% from 30.5% while MO's overall cigar share fell to 29.4% from 31.1%.

Wine: Revenues increased 4.9% to \$107 million from \$102 million because of higher sales volumes. Net of excise taxes, revenues rose 3% to \$102 million. OCI was flat at \$12 million and when excluding exit/integration and UST acquisition-related costs, OCE declined 10.5% to \$17 million. Total wine volumes grew 4.5% to 1,538 (cases in thousands) as Ste. Michelle improved by 11% and Other wines increased 12.6%. This offset a 9.8% decline in Columbia Crest volumes. Management stated the improvement in Ste. Michelle came from higher off-premise channel volume (drugstore, liquor store, supermarket sales) and calendar differences. After adjusting for the calendar differences, Ste. Michelle's wine shipments rose 3% and 3Q10's volume growth slowdown occurred as wholesalers depleted inventories built up in during 1H10.

Financial Services: OCI declined 52.6% to \$27 million from \$57 million due to lower gains on asset sales. The allowance for losses was \$202 million, which equaled the amount during 2Q10. PMCC is not making any new investments and anticipates this segment's OCI will vary depending on the sale of assets or maturity of its holdings.



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OUR THOUGHTS

MO's 3Q10 diluted earnings rose 28.6% to \$0.54/share from \$0.42/share during 3Q09. Earnings improved due to lower cost of sales (\$1.99B vs. \$2.03B), higher total OCI (\$1.83 billion vs \$1.59 billion) driven by cigarette/smokeless units' results, and higher contributions from MO's equity stake in SABMiller plc (\$186 million vs. \$119 million). Earnings before income taxes rose 36.4% to \$1.68 billion from \$1.23 billion. The cost cutting initiatives of management started two years ago appears to be working given the improvement in cash flow/earnings, allowing MO to raise its dividend twice during 2010 from \$1.36/share to \$1.52/share. Given the company's stated objective of paying out approximately 80% of earnings as dividends, higher future profits could produce an increase of MO's common stock dividend. During the earnings conference call management raised 2010's earnings guidance to \$1.83-\$1.87/share from \$1.81-\$1.85/share.

Given the low-interest rate environment, investor demand for MO's shares (yielding 6.2%) appears to have increased as Wall Street seeks high-yielding stocks as an alternative to the low-yielding bond market. We are raising our MO price target to \$26/share from \$24/share, assuming interest rates remain at current levels. This new target price would equal 13.9x our 2010 estimate of \$1.87/share. These shares are 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.

Steve Marascia
Director of Research
Capitol Securities Management
804-612-9715
smarascia@capitolsecurities.com

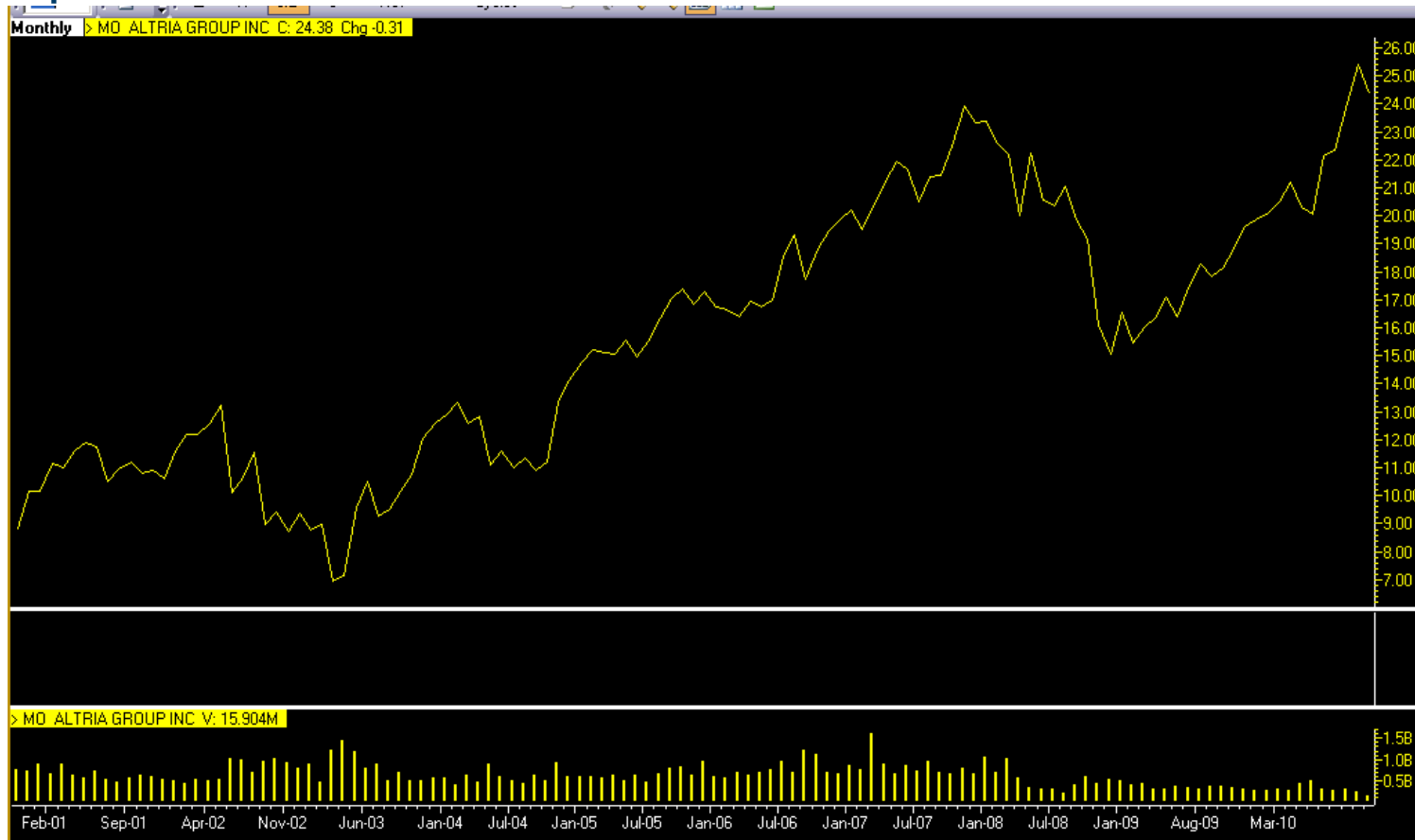


EQUITY RESEARCH

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

	1Q09	2Q09	3Q09	4Q09	2009	1Q10	2Q10	3Q10	4Q10e	2010e
Net revenues	\$4,523	\$6,719	\$6,300	\$6,014	\$23,556	\$5,760	\$6,274	6,402	6,489	\$24,925
Cost of sales	1,770	2,138	2,033	2,049	7,990	1,867	1,967	1,985	2,024	7,843
Excise taxes on products	711	2,125	1,982	1,914	6,732	1,809	1,933	1,941	2,018	7,701
Gross profit	2,042	2,456	2,295	2,051	8,844	2,084	2,374	2,476	2,447	9,381
Marketing, administration, & research costs	604	688	628	659	2,579	594	599	648	683	2,524
Exit cost/asset impairment	122	37	79	92	330	7	20	3	16	46
Operating companies income	1,316	1,731	1,578	1,300	5,925	1,483	1,755	1,825	1,764	6,827
Amortization of intangibles	-6	-3	-7	-4	20	-6	-4	-6	-5	-21
General corporate expenses	-53	-50	-35	-66	-204	-47	-52	-43	-65	-207
Acquisition related transaction costs	-60									
Adjustment to 3rd party guarantee accrual										
Reduction of Kraft & PMI receivables							-169			-169
Corporate exit cost							-1			-1
Operating income	1,191	1,677	1,394	1,200	5,462	1,430	1,529	1,776	1,694	6,429
Interest & other debt expense, net	-336	-287	-279	-283	-1,185	-287	-290	-279	-282	-1,138
Loss on early debt extinguishment										
Earnings from SABMiller equity investment	106	217	-119	175	379	138	113	186	68	505
Earnings before income taxes	961	1,607	1,234	1,075	4,877	1,281	1,352	1,683	1,480	5,796
Income taxes	372	596	352	349	1,669	468	309	552	562	1,891
Net earnings (continuing ops.)	589	1,011	882	726	3,208	813	1,043	1,131	918	3,905
Earnings from discontinued ops.										
Net earnings attributable to noncontrolling interests		-1		-1	-2		-1		-2	-3
Net earnings attributable to Altria	\$589	\$1,010	\$882	\$725	\$3,206	\$813	\$1,042	\$1,131	\$916	\$3,902
Earnings per share	\$0.28	\$0.49	\$0.42	\$0.35	\$1.54	\$0.39	\$0.50	\$0.54	\$0.44	\$1.87
Continuing operations earnings per share	\$0.28	\$0.49	\$0.42	\$0.35	\$1.54	\$0.39	\$0.50	\$0.54	\$0.44	\$1.85

Important Disclosures



9/14/09 \$17.99 Initiate Outperform
 5/18/10 Raised price target to \$23/share
 8/17/10 Raised price target to \$24/share
 11/16/10 Raised price target to \$26/share

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