



**May 20, 2015**

**CURRENT PRICE:** \$51.80  
**RATING:** HOLD  
**PRICE TARGET:** N/A  
**CURRENT YIELD:** 4.0%

**EPS Estimates - Non-GAAP**

	DEC 14A	DEC 15E
1Q	\$0.59 A	\$0.52A
2Q	\$0.43 A	\$0.65
3Q	\$0.71 A	\$0.71
4Q	\$0.63 A	\$0.69
	<b>\$2.58</b>	<b>\$2.57</b>

**Trading Data**

52-WEEK PRICE RANGE: **\$56.69 - \$40.01**  
 SHARES OUTSTANDING: **1,970(M)**  
 MARKET CAP: **\$102.1(B)**  
 AVG. DAILY TRADING VOLUME: **6.4(M)**  
 S&P 500: **2,125**

**Valuation Data**

BOOK VALUE: **\$1.29**  
 PRICE TO BOOK: **40.2x**  
 DIVIDEND: **\$2.08**

**Altria Corp (NYSE: MO)**

*1Q15 Earnings Results*

**Highlights**

- 1Q15 diluted earnings of \$0.52/share vs. \$0.59/share during 1Q14
- Higher OCI in 3 operating units
- Resolved Engle lawsuits
- Reaffirmed 2015 adjusted diluted EPS growth of 7%-9%
- Maintain HOLD rating

**Investment Thesis**

Altria Corp (MO-\$51.80), formerly known as Philip Morris, is 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, share repurchases, and cost reductions. Earnings growth may generate dividend increases in the future. MO's stock pays a current dividend yield of 4.0%.

**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 9,900 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 50.9% market share of the US cigarette market. Through 12/31/14 Philip Morris USA generated approximately 89.4% of overall revenues, or \$21.9 billion. During 2009 MO completed its purchase of US Tobacco (Skoal/Copenhagen brands & Ste. Michele Wines) and currently gives MO 55.3% 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 two pages of this report.*

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# 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 29.4% current market share. The Smokeable business unit (includes cigarettes/cigars) generated 89.4% of MO's revenues, or \$21.9 billion during FY14. PMCC owns a portfolio of leveraged/direct finance leases and produced less than 1% of 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 (KRFT-\$85.45) and Philip Morris Intl (PM-\$85.41).

## Recent Earnings

MO reported 1Q15 diluted earnings of \$0.52/share vs. \$0.59/share during 1Q14. The 11.9% decrease was due to a loss from the early extinguishment of debt, lower earnings contribution from SABMiller (\$134 million vs. \$225 million), comparisons to 1Q14 interest income benefiting from NPM adjustment items, and higher investment in new products. These negatives were partly offset by higher OCI in the smokeable unit and fewer outstanding shares. Net revenues improved 5.2% to \$5.80 billion from \$5.52 billion and overall operating income grew 7.6% to \$1.87 billion from \$1.73 billion. MO's adjusted diluted improved 10.5% to \$0.63/share from \$0.57/share due mainly to higher adjusted OCI in the smokeable products unit and fewer outstanding shares, partially offset by increased spending on new products.

## SEGMENT RESULTS

**SMOKEABLE PRODUCTS:** OCI improved 10.1% to \$1.69 billion from \$1.53 billion due to higher pricing, increased volumes, and lower resolution expenses (end of fed tobacco quota buy-out payments). These positives were partly offset by higher costs (mainly pension/benefits and timing of SG&A spending), and higher tobacco/litigation items. Adjusted OCI grew 12.6% to \$1.73 billion from \$1.54 billion and adjusted OCI increased 2.3 percentage points to 46.4% from 44.1%.

Total domestic shipment volume grew 1.6% to 29.5 billion sticks resulting from a moderation in the industry's rate of consumption decline, trade inventory movements, and retail share gains. Marlboro's and Discount's volumes improved 1.2% and 8.6% respectively, while Other Premium's fell 3.1%. When adjusted for trade inventory changes, and other factors, 1Q15's cigarette shipment volumes were flat, compared to an average industry wide decline of 0.5%.

MO's overall cigarette market share rose 0.4 percentage points to 51.1% from 50.7%. Marlboro's and Discount's increased to 44.0% from 43.7%, and to 4.3% from 4.1%, respectively. Other Premium's decreased 0.1 percentage points to 2.8% from 2.9%.



# EQUITY RESEARCH

Cigar shipment volume improved 10.2% to 302 million from 274 million due to strong performance in “Black & Mild’s” tipped cigars. “Black & Mild’s” volume grew 10.4% to 298 million while Other’s was flat at 4 million. In terms of market share, “Black & Mild’s” decreased 0.6 percentage points to 27.1% from 27.7% and Other’s increased 0.1 percentage points to 0.3% from 0.2%.

**SMOKELESS PRODUCTS:** OCI during 1Q15 increased 5.0% to \$251 million from \$239 million during 1Q14 mainly due to higher pricing and was partly offset by higher promotional expenses. OCI margins improved 1 percentage point to 63.1% from 62.1%. This segment’s revenue increased 3.65 to \$430 million and reflected higher pricing, which was partially offset by higher promotional expenses.

Overall smokeless product shipments rose 2.7% to 191.1 million cans/packs from 186.1 million cans/packs. After adjusting for trade inventory changes, and other factors, MO estimates its smokeless product shipments grew about 4% during 1Q15 and 2% over the past 12 months. Copenhagen shipments improved 6.0% to 110.1 million cans/packs while Skoal was flat at 64.0 million cans/packs. The “Other” category volume shipments decreased 6.6% to 17.0 million cans/packs from 18.2 million cans/packs.

Total market share for MO’s smokeless products improved 0.2 share points to 54.9% from 54.7%. Copenhagen’s improved 1 percentage point to 31.3% from 30.3%, Skoal declined 0.5 share points to 19.9% from 20.4%, and “Other” decreased 0.3 share points to 3.7% from 4.0%.

**WINE SEGMENT:** Reported and adjusted OCI increased 22.7% to \$27 million from \$22 million due to an improved premium mix. Net revenues improved 3.9% to \$134 million, from \$129 million, and OCI margins rose 3.2 percentage points to 20.9% from 17.7%. Total wine shipments grew 0.5% to 1.71 million cases from 1.70 million cases as higher “Columbia Crest” shipments were countered by lower shipments of “14 Hands” and “Chateau Ste. Michelle”, while “Other” was flat. “Columbia Crest” shipments increased 18.2% to 227 million cases while “14 Hands” declined 1.3% to 381 million cases and “Chateau Ste. Michelle” fell 3.8% to 551 million cases.



## RECENT DEVELOPMENTS

During 1Q15 MO repurchased approximately 3.6 million shares of its common stock and has roughly \$326 million remaining in the current \$1 billion program scheduled for conclusion by year end.

MO's smokeless product, Nu Mark, began shipping its next generation e-vapor cigarette (MarkTen XL) into lead markets last month (April). This new product delivers twice the liquid and battery life versus the earlier MarkTen products.

During March of 2015, MO completed a tender offer for approximately \$793 million of its senior unsecured 9.70% notes due 2018.

MO announced, as did other cigarette manufacturers, reaching a tentative agreement to resolve the approximately 415 "Engle" progeny lawsuits pending in Federal Court. Under this tentative agreement, MO paid \$43 million into escrow and recorded a pre-tax charge of approximately \$0.01/share against 1Q15's earnings.

Management reaffirmed 2015 adjusted diluted earnings per share guidance of \$2.75-\$2.80/share, equating to 7%-9% growth over 2014's earnings.

## Our Thoughts

The 11.9% earnings decline in 1Q15's diluted earnings was not as bad as the headline number suggests as results were negatively impacted by a loss from the early extinguishment of debt, lower SABMiller contributions, higher new product expenses, and the absence of interest income from NPM adjustments in 1Q14. All three operating units reported higher OCI. MO reported 1Q15 diluted earnings of \$0.52/share vs. \$0.59/share during 1Q14, while adjusted diluted earnings rose 10.5% to \$0.63/share from \$0.57/share. Going forward, the company will maintain efforts to expand its US e-cigarette market share as its products are now offered nationwide. Wall Street is eager to see when, and if, profits start to materialize from e-cigs given none of the US tobacco companies have provided any type of profit/loss statements from this business. During the 1Q15 earnings conference call MO reaffirmed adjusted diluted eps guidance of \$2.75-\$2.80/share. Given this guidance, we anticipate the common stock dividend could be increased during the next 12 months. However, since MO is trading at approximately 20x our 2015 diluted earnings estimate (\$2.57/share), we rate this stock a HOLD.



## **Risks**

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.

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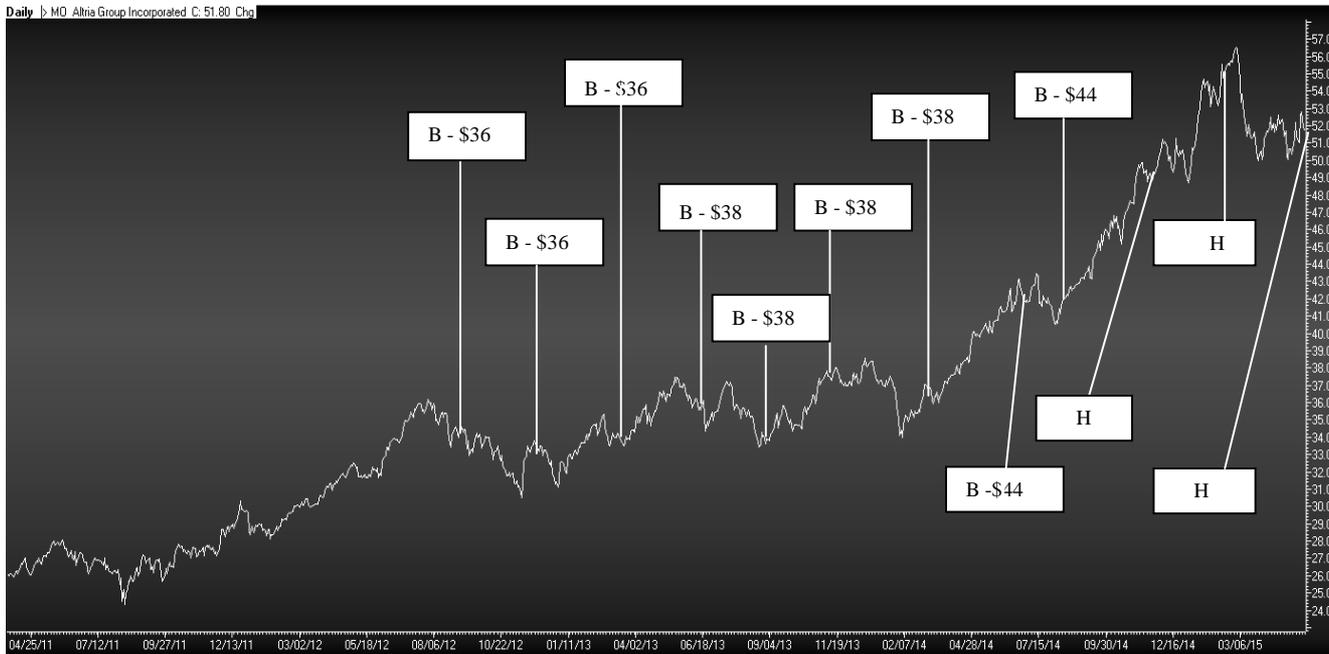
# EQUITY RESEARCH

Altria Group, Inc.  
(dollars in millions, except per share data)

	1Q14	2Q14	3Q14	4Q14	FY14	1Q15	2Q15e	3Q15e	4Q15e	FY15e
Net revenues	\$5,517	\$6,256	\$6,491	\$6,258	\$24,522	\$5,804	\$6,452	\$6,527	\$6,598	\$25,381
Cost of sales	1,752	1,968	2,079	1,986	7,785	1,797	2,045	2,069	2,091	8,002
Excise taxes on products	1,509	1,685	1,738	1,645	6,577	1,532	1,742	1,762	1,782	6,818
Gross profit	2,256	2,603	2,674	2,627	10,160	2,475	2,665	2,696	2,725	10,561
Marketing, administration, & research costs	463	564	605	646	2,278	552	661	612	632	2,457
Exit cost/asset impairment	2	10	7		1					
Operating companies income	1,791	2,049	2,062	1,981	7,883	1,923	2,004	2,084	2,093	8,104
Amortization of intangibles	-5	-5	-5	-5	-20	-5	-6	-5	-5	-21
General corporate expenses	-52	-69	-53	-67	-241	-53	-68	-66	-62	-249
Changes to MDLZ/PM tax-related receivables			-5	3	-2					
Reduction of Kraft & PMI receivables										
Corporate asset impairment/exit costs										
Corporate exit cost										
Operating income	1,734	1,975	1,999	1,912	7,620	1,865	1,930	2,013	2,026	7,834
Restructuring charge										
Interest & other debt expense, net	153	230	213	212	808	209	222	223	223	877
Loss on early debt extinguishment				-44	-44	-228				-228
Earnings from SABMiller equity investment	225	200	328	253	1,006	134	267	348	273	1,022
Earnings before income taxes	1,806	1,945	2,114	1,909	7,774	1,562	1,975	2,138	2,076	7,751
Income taxes	631	683	717	673	2,704	544	691	748	726	2,709
Net earnings (continuing ops.)	1,175	1,262	1,397	1,236	5,070	1,018	1,284	1,390	1,350	5,042
Earnings from discontinued ops.										
Net earnings	\$1,175	\$1,262	\$1,397	\$1,236	\$5,070	\$1,018	\$1,284	\$1,390	\$1,350.00	\$5,042
Net earnings attributable to Altria	\$0.59	\$0.64	\$0.71	\$0.63	\$2.56	\$0.52	\$0.65	\$0.71	\$0.69	\$2.57
Earnings per share	\$0.57	\$0.65	\$0.69	\$0.66	\$2.57	\$0.63	\$0.71	\$0.73	\$0.73	\$2.80
Continuing operations earnings per share	\$0.59	\$0.64	\$0.71	\$0.63	\$2.56	\$0.52	\$0.65	\$0.71	\$0.69	\$2.57

## Important Disclosures

Daily | MO Altria Group Incorporated C: 51.80 Chg



9/14/09 \$17.99 Initiate BUY  
 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  
 5/10/11 Raised price target to \$29/share  
 2/28/12 Raised price target to \$31/share  
 5/16/12 Raised price target to \$33/share  
 8/31/12 Raised price target to \$36/share  
 6/07/13 Raised price target to \$38/share  
 6/24/14 Raised price target to \$44/share  
 11/26/14 Reduced rating to HOLD  
 Ratings:  
 Buy: B  
 Hold: H  
 Sell: S

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