



November 25, 2014

CURRENT PRICE: \$49.46
RATING: HOLD
PRICE TARGET: N/A
CURRENT YIELD: 4.2%

EPS Estimates - Non-GAAP

	DEC 13A	DEC 14E
1Q	\$0.69 A	\$0.59A
2Q	\$0.63 A	\$0.64A
3Q	\$0.70 A	\$0.71A
4Q	\$0.59 A	\$0.65
	\$2.61	\$2.59

Trading Data

52-WEEK PRICE RANGE: **\$43.70 - \$33.12**
SHARES OUTSTANDING: **1,976(M)**
MARKET CAP: **\$97,733(M)**
AVG. DAILY TRADING VOLUME: **6.8(M)**
S&P 500: **2,067**

Valuation Data

BOOK VALUE: **\$2.18**
PRICE TO BOOK: **22.7x**
DIVIDEND: **\$2.08**

Altria Corp (NYSE: MO)

3Q14 Earnings Results

Highlights

- 3Q14 diluted earnings of \$0.71/share vs. \$0.70/share during 3Q13
- Results benefit from higher OCI in 3 operating units
- Expanding e-cig marketing into eastern retail outlets
- Dividend increased 8.3%
- Price target achieved, lower rating to HOLD

Investment Thesis

Altria Corp (MO-\$49.46), 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 4.2%. The Board of Directors may raise the dividend, going forward, based on future growth of adjusted diluted earnings.

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 50.7% market share of the US cigarette market. Through 12/31/13 Philip Morris USA generated approximately 89.9% of overall revenues, or \$21.9 billion. During 2009 MO completed its purchase of US Tobacco (Skool/Copenhagen brands & Ste. Michele Wines) and currently gives MO 55.0% 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.



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 89.9% of MO's revenues, or \$21.9 billion during FY13. 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-\$59.30) and Philip Morris Intl (PM-\$86.49). MO's 2013 diluted earnings increased to \$2.61/share vs. \$2.06/share during 2012.

Recent Earnings

MO reported 3Q14 diluted earnings of \$0.71/share vs. \$0.70/share during 3Q13. The 1.4% improvement was due to higher contributions from the company's SABMiller equity investment, lower interest/debt expense, lower tax rate, and fewer shares outstanding. These positives were partly offset by increased investments in new tobacco products (e-cigs) and lower results from PMCC when comparing 3Q14 vs. 3Q13. Net revenues decreased 0.9% to \$6.49 billion from \$6.55 billion and overall operating income declined 7.2% to \$2.06 billion from \$2.22 billion. SAB Millers earnings contribution rose to \$328 million from \$255 million and overall net diluted earnings increased to \$1.397 billion from \$1.396 billion. MO's adjusted diluted earnings, which excludes the impact of special items, rose 6.2% to \$0.69/share. Outstanding weighted-average diluted shares outstanding decreased to 1.976 billion from 1.998 billion.

SEGMENT RESULTS

SMOKEABLE PRODUCTS: Reported OCI rose 0.8% to \$1.84 billion from \$1.83 billion attributable to higher product pricing, partly offset by NPM Adjustment Items in 2013 and lower shipped volumes. Adjusted OCI increased 9.0% to \$1.85 billion and adjusted OCI margins increased 2.5 percentage points to 44.3% from 41.8%. Domestic total cigarette volumes decreased 2.8% to 33.17 million reflecting overall industry smoking declines, and were partly offset by gains in MO's retail market share.

Marlboro's shipment volumes decreased 2.8% to 28.58 million from 29.40 million, other Premium's fell 8.3% to 1.85 million from 2.02 million, and Discount's increased 1.3% to 2.74 million from 2.70 million. When adjusted for trade inventory changes, and other factors, MO estimates 3Q14's shipped cigarette volumes declined 3%.

MO's total cigar shipments rose 8.4% to 347 million as "Black & Mild's" volumes improved 9.6% to 341 million and was partly offset by a 33% decline in "Other" cigars to 6 million. Total cigar market share rose to 29.7% from 29.4% as "Black & Mild's" was flat and "Other's" increased to 0.5% from 0.2%.



EQUITY RESEARCH

SMOKELESS PRODUCTS: Reported OCI increased 1.1% to \$280 million from \$277 million. The improvement was due to higher pricing and lower costs, which were partly offset by lower volume and higher promotional spending. Adjusted OCI rose to \$279 million from \$277 million and adjusted OCI margins grew to 64.9% from 61.8%. Revenues decreased 3.9% to \$466 million from \$485 million because of lower volumes and higher promotional spending. These were partly offset by higher pricing of smokeless products.

Overall smokeless product volumes fell 4.6% to 203 million resulting from one less shipping week. After adjusting for trade inventory changes and calendar differences, MO stated overall domestic smokeless product shipment volume increased 2.5%. All smokeless products experienced volume declines with Copenhagen falling 0.5%, Skoal declining 9.7%, and Other dropping 9.1%. MO said smokeless volumes, during the past 12 months, increased 3% reflecting slower industry volume growth during 2Q14 and 3Q14.

Retail market share for smokeless products improved 0.3 percentage points to 55.4% from 55.1%. Copenhagen's market share rose 1.4 percentage points to 31.1% from 29.7%, Skoal's declined 1.0 percentage points to 20.2% from 21.2%, and Other's fell 0.1 percentage points to 4.1% from 4.2%. Copenhagen's improvement came mainly from its Copenhagen Long Cut Wintergreen product.

WINE SEGMENT: Reported and adjusted OCI increased 10.7% to \$31 million from \$28 million due to higher shipments. OCI margins rose 1.3 percentage points to 20.9% from 19.6%. Revenues improved 3.4% to \$153 million due to higher product shipments as total wine shipments increased 4.2% to 1.95 million cases from 1.87 million cases. The wine segment experienced increased volumes in Chateau Ste. Michelle (+3.5%), 14 Hands (+24.7%), and Other (+0.2%), while seeing a decline in Columbia Crest (-7.6%).

RECENT DEVELOPMENTS

The Board of Directors increased the common stock dividend 8.3% during 3Q14. Management's stated objective is to pay-out 80% of adjusted earnings to shareholders as dividends. Additionally, the Board of Directors authorized a new \$1 billion share repurchase program which is expected to be completed by year end 2015. This follows an earlier \$1 billion repurchase program completed this past July.

MO continues to expand its Nu-Mark retail presence. Currently, the product is sold in 80,000 retail outlets west of the Mississippi River in the US. Plans are to expand into eastern US retail markets by the end of 4Q14 with the goal of having 80,000 retail outlets in the eastern half of the US



Our Thoughts

OUR THOUGHTS: MO produced another good quarterly earnings report as the diluted earnings rose to \$0.71/share from \$0.70/share, when comparing 3Q14 to 3Q13. The 1.4% improvement was due to higher contributions from SABMiller, lower interest/debt expense, lower tax rate, and fewer shares outstanding. These were partly offset by increased investments in new tobacco products (e-cigs) and lower comparison from PMCC. The Board of Directors increased the dividend by 8.3% and authorized a new \$1 billion share repurchase program. Wall Street rewarded MO shares by pushing its stock up to all-time highs. As result, MO's stock has exceeded our \$44 target price & now trades at 19x our 2014 earnings estimate of \$2.59/share. This valuation is higher then the S&P 500's current P/E ratio of 18x 2014 projected earnings. Given this high earnings multiple, we are reducing our rating to HOLD from BUY.



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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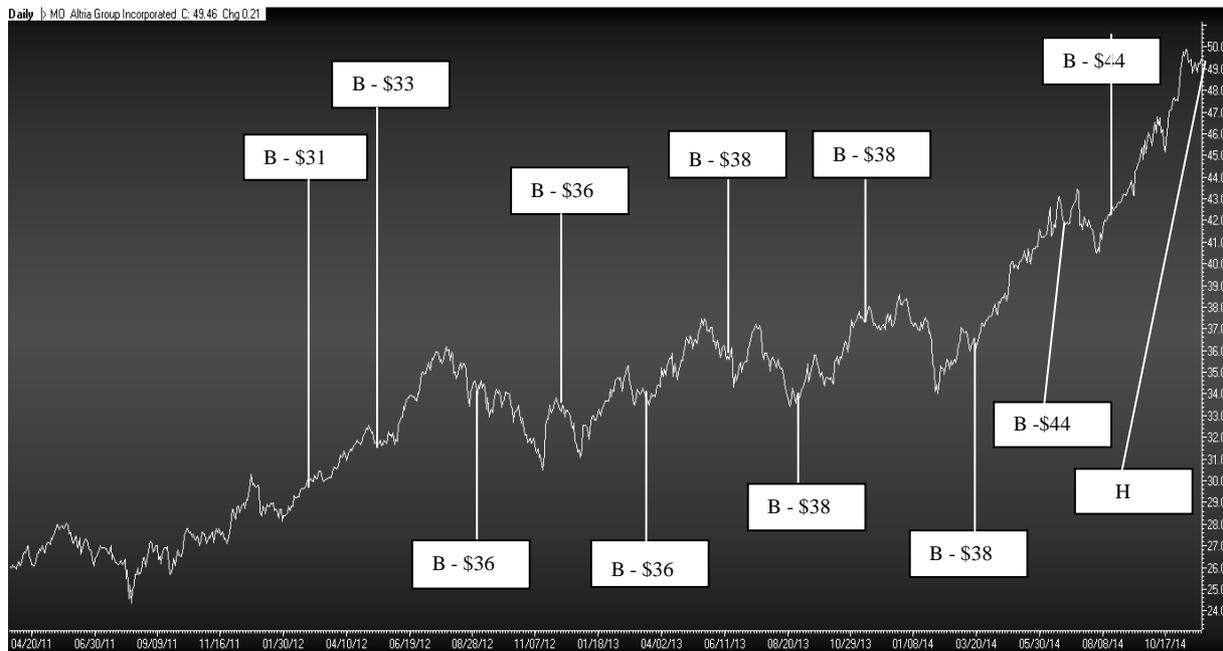


EQUITY RESEARCH

	1Q13	2Q13	3Q13	4Q13	FY13	1Q14	2Q14	3Q14	4Q14e	FY14e
Net revenues	\$5,528	\$6,305	\$6,553	\$6,080	\$24,466	\$5,517	\$6,256	\$6,491	\$6,106	\$24,370
Cost of sales	1,299	1,972	1,939	1,996	7,206	1,752	1,968	2,079	1,756	7,555
Excise taxes on products	1,555	1,779	1,793	1,676	6,803	1,509	1,685	1,738	1,688	6,620
Gross profit	2,674	2,554	2,821	2,408	10,457	2,256	2,603	2,674	2,662	10,195
Marketing, administration, & research costs	462	489	599	535	2,085	463	564	605	625	2,357
Exit cost/asset impairment		1		10	11	2	10	7	4	23
Operating companies i income	2,212	2,064	2,222	1,863	8,361	1,791	2,049	2,062	2,033	7,935
Amortization of intangibles		-5	-5	-5	-20	-5	-5	-5	-5	-20
General corporate expenses		-55	-58	-60	-62	-52	-69	-53	-69	-243
Changes to MDLZ/PM tax-related receivables			25	-3	22					
Adjustment to 3rd party guarantee accrual										
Reduction of Kraft & PMI receivables										
Corporate asset impairment/exit costs									-1	-2
Corporate exit cost										
Operating income	2,152	2,001	2,132	1,799	8,084	1,734	1,975	1,999	1,958	7,666
Interest & other debt expense, net	-261	-264	-269	-255	-1,049	153	230	213	235	831
Loss on early debt extinguishment				1,080	1,080					
Earnings from SABMiller equity investment	256	227	255	253	991	225	200	328	205	958
Earnings before income taxes	2,147	1,964	2,118	713	6,942	1,806	1,945	2,114	1,928	7,793
Income taxes	762	698	722	255	2,407	631	683	717	636	2,667
Net earnings (continuing ops.)	1,385	1,266	1,396	488	4,535	1,175	1,262	1,397	1,292	5,126
Earnings from discontinued ops.										
Net earnings	\$1,385	\$1,266	\$1,396	\$488	\$4,535	\$1,175	\$1,262	\$1,397	\$1,292	\$5,126
Net earnings attributable to Altria	\$0.69	\$0.63	\$0.70	\$0.24	\$2.26	\$0.59	\$0.64	\$0.71	\$0.65	\$2.59
Earnings per share	\$0.54	\$0.62	\$0.65	\$0.57	\$2.38	\$0.57	\$0.65	\$0.69	\$0.68	\$2.59
Continuing operations earnings per share	\$0.69	\$0.63	\$0.70	\$0.24	\$2.26	\$0.59	\$0.64	\$0.71	\$0.65	\$2.59

Important Disclosures

Daily b MD Alpha Group Incorporated C: 49.46 Chg 0.21



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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