



February 9, 2016

CURRENT PRICE: \$60.45
RATING: HOLD
PRICE TARGET: N/A
CURRENT YIELD: 3.7%

EPS Estimates - Non-GAAP

	DEC 15A	DEC 16E
1Q	\$0.52 A	\$0.64
2Q	\$0.74 A	\$0.74
3Q	\$0.78 A	\$0.73
4Q	\$0.64 A	\$0.65
	\$2.68	\$2.76

Trading Data

52-WEEK PRICE RANGE: **\$61.74 - \$47.31**
SHARES OUTSTANDING: **1,958(M)**
MARKET CAP: **\$118.4(B)**
AVG. DAILY TRADING VOLUME: **7.0(M)**
S&P 500: **1,852**

Valuation Data

BOOK VALUE: **\$1.47**
PRICE TO BOOK: **41.1x**
DIVIDEND: **\$2.26**

Altria Corp (NYSE: MO)

4Q15 & FY15 Earnings Results

Highlights

- 4Q15 diluted earnings of \$0.64/share vs. \$0.63/share during 4Q14
- Higher OCI in all 3 operating units
- Provides 2016 adjusted earnings guidance of \$3.00-\$3.05/share
- Announces new cost cutting plan
- Maintain HOLD rating

Investment Thesis

Altria Corp (MO-\$60.45), 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 3.7%.

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 51.4% market share of the US cigarette market. Through 12/31/15 Philip Morris USA generated approximately 89.6% of overall revenues, or \$22.8 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 89.4% 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 (KHC-\$71.51) and Philip Morris Intl (PM-\$90.02).

Recent Earnings

MO reported 4Q15 diluted earnings of \$0.64/share vs. \$0.63/share during 4Q14. The improvement was mainly due to higher OCI from the smokeable and smokeless units and the absence of the 2014 early debt extinguishment charge. These positives were partly offset by lower earnings from MO's investment in SABMiller (\$211 million vs. \$254 million) and a higher reported tax rate. When comparing the two quarters, overall revenues rose 1.0% to \$6.32 billion from \$6.26 billion, cost of sales grew to \$2.01 billion from \$1.99 billion, and gross profit increased 3.6% to \$2.72 billion from \$2.63 billion. Earnings attributable to SABMiller decreased to \$211 million from \$253 million. During 4Q15, MO took a \$42 million pre-tax charge related to NPM adjustment items. Additionally, the company took a pre-tax \$25 million charge related to the Schwarz legal lawsuit and \$10 million of interest costs. Adjusted diluted per share rose 1.5% to \$0.67/share from \$0.66/share created by higher adjusted OCI in the smokeable and smokeless units, lower interest/debt expense, and were partly offset by lower SABMiller earnings and a higher corporate tax rate. FY15 diluted earnings rose 4.3% to \$2.67/share from \$2.56/share as total revenues increased 3.7% to \$25.4 billion from \$24.5 billion, and gross profit grew 9.4% to \$11.1 billion from \$10.2 billion.

SEGMENT RESULTS

SMOKEABLE PRODUCTS: OCI increased 0.8% to \$5.56 billion from \$5.51 billion due to higher pricing and was partly offset by lower shipment volumes. Reported OCI rose 1.5% to \$1.74 billion from \$1.71 billion as a result of higher pricing. This was offset by lower volumes, higher resolution expenses, increased SG&A expense, NPM adjustments, and larger tobacco/health litigation items. Adjusted OCI margins increased 0.8 percentage points to 44.7% 43.9%.

Total domestic cigarette shipment volumes declined 2.6% to 30.51 billion sticks from 31.3 billion sticks, attributable to elevated trade inventory levels during 3Q15 which moderated during 4Q15. Decreases in volume shipments of Marlboro (-3.1%) and Other Premium (-5.9%) were partly offset by a increase in Discount shipments (+4.3%).



EQUITY RESEARCH

After adjusting for trade inventory movements and other factors, MO estimates its domestic cigarettes shipment volumes grew approximately 0.5% and overall industry volumes were unchanged when comparing 4Q15 and 4Q14.

MO's overall retail market share improved 0.5 percentage points to 51.4% from 50.9%. This increase was due to higher Marlboro share (44.0% vs 43.8%) and Discount share (4.6% vs 4.2%) and was partly offset by lower results in Other Premium (2.8% vs. 2.9%) shipments.

Cigar shipment volumes grew 6% to 338 million from 319 million from increases in both "Black & Mild" (332 million vs. 315 million) and Other (6 million vs. 4 million). Total cigar market share declined 1.3 percentage points to 27.4% from 28.7% as "Black & Mild's" share fell to 27.0% from 28.3% while Other was flat at 0.4%.

SMOKELESS PRODUCTS: OCI rose 8.2% to \$278 million from \$257 million and net revenues improved 4.7% to \$486 million from \$464 million. Both rose because of higher pricing, increased volume shipments, and were partially offset by higher promotional expenses. Adjusted OCI also increased to \$278 million from \$257 million and adjusted OCI margins grew 1.4 percentage points to 61.4% from 60.0%.

Overall domestic shipment volumes improved 4.0% to 208.5 million cans/packs as Copenhagen's rose 8.2% to 123.2 million cans/packs. This more than offset shipment declines in Skoal (-0.9% to 67.4 million cans/packs) and Other (-3.2% to 17.9 million cans/packs). When adjusting for trade inventory movements and other factors, MO estimates its domestic smokeless shipment volumes grew 3.0% during 4Q15 and the overall smokeless products category volumes increased 2.5% during the past six months.

MO's total smokeless market share declined 0.2 percentage points to 55.0% from 55.2%. This occurred as an increase in Copenhagen's market share (32.1% vs. 31.0%) was not enough to offset decreases in those of Skoal (19.3% vs. 20.2%) and Other's (3.6% vs. 4.0%).

WINE: Reported and adjusted OCI improved 3.8% to \$55 million from \$53 million due to higher prices and were partly offset by higher costs. OCI margins decreased to 24.8% from 25.6%. Net revenues rose 7.4% to \$231 million and net revenues, net of excise taxes, increased 7.2% to \$222 million. Total wine shipments improved 5.9% to 2.98 million cases from 2.81 million cases due to gains in Chateau Ste. Michelle (+11.4%) and 14 Hands (+23.7%). These were partly offset by declines in Columbia Crest (-15.3%) and Other (-1.5%).

RECENT DEVELOPMENTS

Management announced the implementation of a productivity initiative aimed at reducing cost \$300 million annually by year end 2017. Plans are to achieve savings through reduced spending on certain SG&A infrastructure and a smaller organization.



MO, holding approximately a 27% stake in SABMiller, stated it was in favor of the proposed Anheuser-Busch InBev and SABMiller merger.

During November, the company expanded the distribution of “Marlboro Midnight” menthol products to a nationwide basis. Additionally, MO increased the marketing of its “Mark 10 XL” e-vapor products to additional US retail chains.

MO announced, during the 4Q15 conference call, 2016 adjusted diluted earnings guidance of \$3.00-\$3.05/share and its intent to continue paying 80% of adjusted earnings to shareholders as dividends.

Our Thoughts

MO produced another good earnings report as 4Q15 diluted earnings rose to \$0.64/share from \$0.63/share due to higher OCI from its three operating units and the absence of an early debt extinguishment charge. The company experienced product volume growth in cigars (+6.0%), smokeless (+4.0%), wine (5.9%), but saw a decrease in cigarettes (-2.6%) due to trade inventory movements. SABMiller’s contribution to profits decreased to \$211 million from \$253 million.

To help grow future earnings, MO announced a new \$1 billion share repurchase program last quarter and another cost cutting program aimed at reducing annual costs by \$300 million during the conference call. These are needed given the prospect of flat industry tobacco revenues during the next few years. While these steps are appropriate on a short term basis, longer term we believe MO may need to develop other revenue streams if the e-cigarette market fails to generate anticipated profits during the next 2-4 years. Given the stock currently trades at 21.9x our 2016 earnings estimate of \$2.76/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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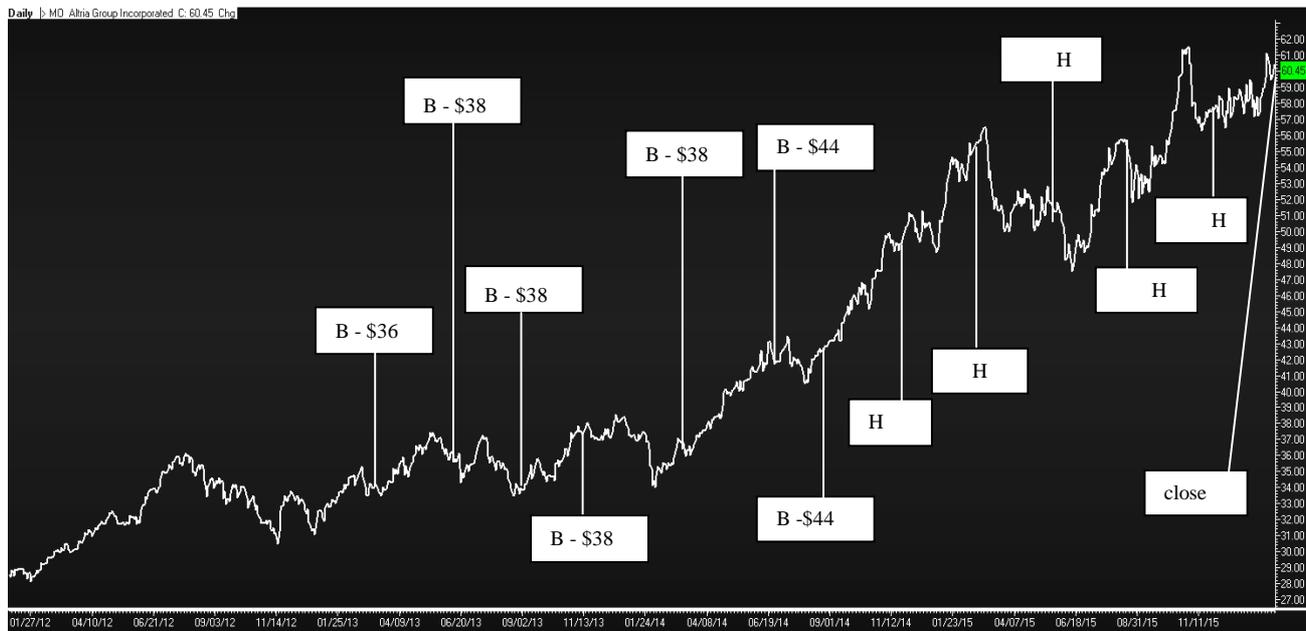


EQUITY RESEARCH

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

	1Q15	2Q15	3Q15	4Q15	FY15	1Q16e	2Q16e	3Q16e	4Q16e	FY16e
Net revenues	\$5,804	\$6,613	\$6,699	\$6,318	\$25,434	\$5,872	\$6,726	\$6,598	\$6,356	\$25,552
Cost of sales	1,797	2,004	1,932	2,007	7,740	1,819	2,085	2,045	1,971	7,920
Excise taxes on products	1,532	1,738	1,721	1,589	6,580	1,526	1,749	1,715	1,653	6,643
Gross profit	2,475	2,871	3,046	2,722	11,114	2,527	2,892	2,838	2,732	10,989
Marketing, administration, & research costs	552	578	619	681	2,450	543	588	604	711	2,446
Exit cost/asset impairment		4			4					
Operating companies income	1,923	2,289	2,407	2,041	8,660	1,984	2,304	2,234	2,021	8,543
Amortization of intangibles	-5	-5	-6	-5	-21	-5	-6	-5	-5	-21
General corporate expenses	-53	-60	-53	-71	-237	-52	-63	-57	-66	-238
Changes to MDLZ/PM tax-related receivables			-41		-41					
Reduction of Kraft & PMI receivables										
Corporate asset impairment/exit costs										
Corporate exit cost										
Operating income	1,865	2,224	2,307	1,965	8,361	1,927	2,235	2,172	1,950	8,284
Restructuring charge										
Interest & other debt expense, net	209	195	205	208	817	208	209	208	205	830
Loss on early debt extinguishment	-228				-228					
Earnings from SABMiller equity investment	134	225	187	211	757	207	226	241	183	857
Other income				5	5					
Earnings before income taxes	1,562	2,254	2,289	1,973	8,078	1,926	2,252	2,205	1,928	8,311
Income taxes	544	805	761	725	2,835	674	811	772	656	2,913
Net earnings (continuing ops.)	1,018	1,449	1,528	1,248	5,243	1,252	1,441	1,433	1,272	5,398
Earnings from discontinued ops.										
Earnings attributable to non-controlling interests		1		-1	-2	-2	-2	-1	-2	-7
Net earnings	\$1,018	\$1,448	\$1,528	\$1,247	\$5,241	\$1,250	\$1,439	\$1,432	\$1,270	\$5,391
Net earnings attributable to Altria	\$0.52	\$0.74	\$0.78	\$0.64	\$2.67	\$0.64	\$0.74	\$0.73	\$0.65	\$2.76
Earnings per share	\$0.63	\$0.74	\$0.75	\$0.67	\$2.80	\$0.72	\$0.77	\$0.81	\$0.71	\$3.01
Continuing operations earnings per share	\$0.52	\$0.74	\$0.78	\$0.64	\$2.67	\$0.64	\$0.74	\$0.73	\$0.65	\$2.76

Important Disclosures



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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- (2) Hold – 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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