



**CAPITOL
SECURITIES**
MANAGEMENT, INC.

EQUITY RESEARCH

May 10, 2016

CURRENT PRICE: \$64.60
RATING: HOLD
PRICE TARGET: N/A
CURRENT YIELD: 3.5%

EPS Estimates - Non-GAAP

	DEC 15A	DEC 16E
1Q	\$0.52 A	\$0.62A
2Q	\$0.74 A	\$0.74
3Q	\$0.78 A	\$0.73
4Q	\$0.64 A	\$0.65
	\$2.68	\$2.74

Trading Data

52-WEEK PRICE RANGE: **\$64.65 - \$47.31**
SHARES OUTSTANDING: **1,956(M)**
MARKET CAP: **\$126.4(B)**
AVG. DAILY TRADING VOLUME: **6.2(M)**
S&P 500: **2,084**

Valuation Data

BOOK VALUE: **\$1.47**
PRICE TO BOOK: **44.0x**
DIVIDEND: **\$2.26**

Altria Corp (NYSE: MO)

1Q16 Earnings Results

Highlights

- 1Q16 diluted earnings of \$0.62/share vs. \$0.52/share during 1Q15
- Higher OCI in all 3 operating units
- Share repurchase program continues through 2016
- Getting 2 seats on combined InBev/SABMiller Board
- Maintain HOLD rating

Investment Thesis

Altria Corp (MO-\$64.60), 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 3.5%.

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 (Skoal/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.

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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 25.9% current market share. The Smokeable business unit (includes cigarettes/cigars) generated 89.4% of MO's revenues, or \$21.9 billion during FY15. 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-\$86.14) and Philip Morris Intl (PM-\$101.89).

Recent Earnings

MO reported 1Q15 diluted earnings rose 19.2% to \$0.62/share from \$0.52/share during 1Q15. There was improved OCI in Smokeable Products (+3.9%), Smokeless Products (+11.6%), and the Wine Segment (+3.7%). Total operating companies income rose 6.0% to \$2.04 billion from \$1.92 billion due to higher revenues, more than offsetting higher cost of sales and excise taxes. MO's overall revenues rose 4.4% to \$6.07 billion from \$5.80 billion. Operating income increased 6% to \$1.98 billion from \$1.87 billion. During 1Q16 the company took a pre-tax charge of \$122 million in connection with its recently announced cost-cutting program. MO's equity ownership in SABMiller contributed earnings of \$66 million vs. \$134 million. 1Q16's adjusted diluted earnings, excluding special items, rose 14.3% to \$0.72/share from \$0.63/share during 1Q15. The improvement was the result of higher adjusted OCI in the smokeable and smokeless units, lower interest expense, and decline in other debt expense.

SEGMENT RESULTS

SMOKEABLE PRODUCTS: When comparing 1Q16 vs. 1Q15, OCI increased 3.9% to \$1.75 billion, from \$1.69 billion, due to higher product pricing/volume, and lower SG&A/manufacturing costs. These were partly offset by restructuring expenses related to the new cost-cutting program, higher resolution/promotional expenses. Revenues rose 3.8% resulting from higher pricing/volumes and were partly offset by higher promotional expenses. Adjusted OCI improved 9.2% to \$1.89 billion from \$1.73 billion and adjusted OCI margins rose to 48.1% from 46.4%.

Domestic cigarette shipment volumes rose 1.2% to 29,539 million sticks from 29,198 million sticks due to an extra shipping day, trade inventory movements, and retail share gains. If adjusted for the extra shipping day, trade inventory movements, and other factors, MO estimates its shipment volumes declined 0.5% while the overall industry saw a volume decrease of 1%. Shipments of Marlboro and Discount cigarettes both rose, 1.0% and 6.4%, respectively, while Other Premium fell 4.1%.



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MO's overall market share increased 0.3 percentage points to 51.4% following a market share gain in Discount (4.7% vs. 4.1%), flat results in Marlboro (44.0% vs. 44.0%), and a decline in Other Premium (2.7% vs. 2.8%). Cigar shipments rose 8.3% to 327 million from 302 million due mainly to increases in "Black & Mild" shipments. "Black & Mild's" shipments rose 6.4% to 317 million from 298 million and Others increased to 10 million from 4 million. MO's total cigar market share decreased to 26.4% from 26.9% as "Black & Mild's" share fell to 25.9%, from 26.6%, and was partly offset by an increase in Other, rising to 0.5% from 0.3%.

SMOKELESS PRODUCTS: OCI rose 11.6% to \$280 million from \$251 million due to higher pricing/volumes which were partly offset by restructuring costs associated with the new cost-cutting program and higher promotional spending. Higher volumes were driven by the national expansion of "Copenhagen Mint" and overall market share gains. Adjusted OCI increased 16.7% to \$293 million from \$251 million and adjusted OCI margins improved to 65.5% from 63.1%.

Overall domestic shipment volumes improved 7.8% to 206.1 million cans/packs from increases in Copenhagen (+13.4% to 124.8 million cans/packs) and Skoal shipments (+0.8% to 64.5 million cans/packs). These gains were partly offset by a decline in Others (-1.2% to 16.8 million cans/packs). According to MO, after adjusting for trade inventory movements, its domestic smokeless shipment volumes grew approximately 3% during 1Q16 while the overall industry category increased 2.5% during the past 6 months.

MO's smokeless market share increased to 55.1% from 54.9% as market share for Copenhagen improved to 32.4% from 31.3%. Copenhagen's gain more than offset declines in Skoal, 19.2% vs. 19.8%, and Other, 3.5% vs. 3.8%.

WINE: Both reported OCI and adjusted OCI rose 3.7% to \$28 million from \$27 million due to revenues increasing 8.2% to \$145 million from \$134 million and excise taxes remaining flat at \$5 million. Revenues grew 8.1% increase to 1,851 thousand cases resulting from higher volume shipments of Ste. Michele's core premium wines and the timing of an early Easter holiday.

RECENT DEVELOPMENTS

MO continued its share repurchase program during 1Q16 buying back 2.8 million shares \$168 million. Approximately \$797 million remain in this \$1 billion program scheduled to be completed by year end 2016.

InBev (BUD-\$128.10) is acquiring SABMiller and the deal is expected to close during 2H16. MO noted when completed it will exchange its 27% SABMiller ownership/voting interest for approximately a 10.5% equity interest in the resulting combined company, two seats on the new board, and \$2.5 billion in pre-tax cash.

This past January, MO announced it was launching a new cost-cutting program aimed at reducing SG&A expenses by \$300 million/year. This program will produce \$140 million of pretax charges with a \$122 million charge taken during 1Q16 and the balance taken throughout FY16.



During 1Q16 MP took a \$38 million pre-tax charge for tobacco/health litigation items mainly related to an April 2016 agreement to resolve the Aspinall case. This settlement remains subject to court approval and includes \$4.9 million in statutory damages awarded at trial and \$10 million in interest costs and other fees/costs.

Our Thoughts

Positive results from MO as 1Q16 reported diluted earnings rose 19.2% to \$0.62/share from \$0.52/share during 1Q15. All three operating units generated higher OCI and adjusted OCI when comparing the two quarters. Positive results were driven mainly by higher revenues and lower costs. 1Q16's adjusted diluted earnings, excluding special items, rose 14.3% to \$0.72/share from \$0.63/share during 1Q15. SABMillers contribution to earnings declined to \$66 million from \$134 million, however, the larger news is the planned purchase of SABmiller by InBev (BUD-\$128.10). Once completed, MO will get two seats on the Board of Directors of the combined companies, a 10.5% equity interest, and \$2.5 billion pretax cash payment.

Going forward, MO plans to raise cash flow and earnings through another announced cost cutting program and hopes recent product pricing/volume increases will continue throughout 2016. If this materializes, then MO could increase its common stock dividend later this year. Management provided FY16 adjusted diluted earnings guidance of \$3.00-\$3.05/share. Given, the company's recent investments in e-cigarette products, it will be interesting to see what effect the new proposed Federal regulations will have upon this sector during the next 2 years. We rate this stock a HOLD given MO is currently trading at 23.5x our 2016 diluted earnings estimate of \$2.74/share.



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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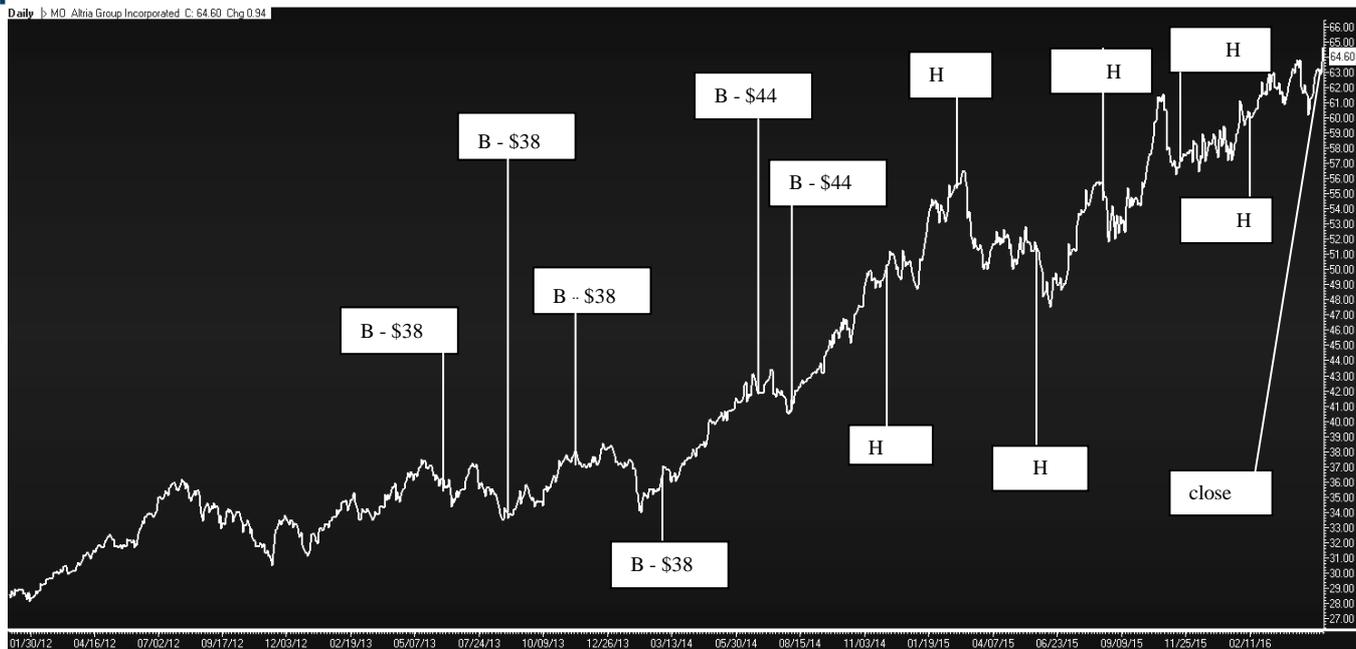


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Altria Group, Inc.
(dollars in millions, except per share data)

	1Q15	2Q15	3Q15	4Q15	FY15	1Q16	2Q16e	3Q16e	4Q16e	FY16e
Net revenues	\$5,804	\$6,613	\$6,699	\$6,318	\$25,434	\$6,066	\$6,726	\$6,598	\$6,356	\$25,746
Cost of sales	1,797	2,004	1,932	2,007	7,740	1,874	2,085	2,045	1,971	7,975
Excise taxes on products	1,532	1,738	1,721	1,589	6,580	1,536	1,749	1,715	1,653	6,653
Gross profit	2,475	2,871	3,046	2,722	11,114	2,656	2,892	2,838	2,732	11,118
Marketing, administration, & research costs	552	578	619	681	2,450	503	588	604	711	2,406
Exit cost/asset impairment		4			4	115			15	130
Operating companies income	1,923	2,289	2,407	2,041	8,660	2,038	2,304	2,234	2,006	8,582
Amortization of intangibles	-5	-5	-6	-5	-21	-5	-6	-5	-5	-21
General corporate expenses	-53	-60	-53	-71	-237	-51	-63	-57	-66	-237
Changes to MDLZ/PM tax-related receivables			-41		-41					
Reduction of Kraft & PMI receivables										
Corporate asset impairment/exit costs						-5				-5
Corporate exit cost										
Operating income	1,865	2,224	2,307	1,965	8,361	1,977	2,235	2,172	1,935	8,319
Restructuring charge										
Interest & other debt expense, net	209	195	205	208	817	200	209	208	205	822
Loss on early debt extinguishment	-228				-228					
Earnings from SABMiller equity investment	134	225	187	211	757	66	226	241	183	716
Other income					5		40			40
Earnings before income taxes	1,562	2,254	2,289	1,973	8,078	1,883	2,252	2,205	1,913	8,253
Income taxes	544	805	761	725	2,835	665	811	772	646	2,894
Net earnings (continuing ops.)	1,018	1,449	1,528	1,248	5,243	1,218	1,441	1,433	1,267	5,359
Earnings from discontinued ops.										
Earnings attributable to non-controlling interests		1		-1	-2	-1	-2	-1	-2	-6
Net earnings	\$1,018	\$1,448	\$1,528	\$1,247	\$5,241	\$1,217	\$1,439	\$1,432	\$1,265	\$5,353
Net earnings attributable to Altria	\$0.52	\$0.74	\$0.78	\$0.64	\$2.67	\$0.62	\$0.74	\$0.73	\$0.65	\$2.74
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	\$0.62	\$0.74	\$0.73	\$0.65	\$2.74

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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