



August 8, 2016

CURRENT PRICE: \$66.49
RATING: HOLD
PRICE TARGET: N/A
CURRENT YIELD: 3.4%

EPS Estimates - Non-GAAP

	DEC 15A	DEC 16E
1Q	\$0.52 A	\$0.62A
2Q	\$0.74 A	\$0.84A
3Q	\$0.78 A	\$0.73
4Q	\$0.64 A	\$0.65
	\$2.68	\$2.84

Trading Data

52-WEEK PRICE RANGE: **\$70.14 - \$47.41**
 SHARES OUTSTANDING: **1,954(M)**
 MARKET CAP: **\$129.9(B)**
 AVG. DAILY TRADING VOLUME: **6.0(M)**
 S&P 500: **2,181**

Valuation Data

BOOK VALUE: **\$1.51**
 PRICE TO BOOK: **44.0x**
 DIVIDEND: **\$2.26**

Altria Corp (NYSE: MO)

2Q16 Earnings Results

Highlights

- 2Q16 diluted earnings of \$0.84/share vs. \$0.74/share during 2Q15
- Higher OCI in smokeable and smokeless
- Share repurchase program continues through 2016
- InBev/SABMiller revised deal adds \$500 million to MO
- Maintain HOLD rating

Investment Thesis

Altria Corp (MO-\$66.49), 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 3.4%.

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.

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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 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 few years the company spun-off Kraft Foods (KHC-\$88.75) and Philip Morris Intl (PM-\$98.55).

Recent Earnings

MO reported 2Q16 diluted earnings of \$0.84/share vs. \$0.74/share during 2Q15. The 13.5% increase was due to higher OCI in the smokeable and smokeless units, an unrealized gain on a British pound hedge derivative related to the AB InBev/SAB Miller deal, higher earnings from the PMCC unit, and lower spending on e-cig product lines. Operating income rose 8.4% to \$2.41 billion as OCI increased to \$2.46 billion, from \$2.29 billion, and general corporate expenses declined to \$42 million, from \$60 million. Overall net revenues fell 1.4% to \$6.52 billion from \$6.61 billion and MO's gross profit improved to \$2.96 billion, from \$2.87 billion due to lower cost of sales and excise taxes. MO's 2Q16 adjusted diluted earnings increased 9.5% to \$.81/share from \$0.74/share during 2Q15. Excluding special items, the improvement in adjusted earnings resulted from higher adjusted OCI in the smokeable, smokeless, PMCC units, lower corporate expenses and spending in the e-cig area.

SEGMENT RESULTS

SMOKEABLE PRODUCTS: OCI rose 4.6% to \$2.12 billion, from \$2.02 billion, when comparing 2Q16 to 2Q15. The rise came from higher pricing and lower SG&A costs which were partly offset by lower volume and higher resolution expenses. Revenues fell to \$5.83 billion from \$5.98 billion and excise taxes decreased to \$1.6 billion from \$1.7 billion. Adjusted OCI margin increased 4.5% to \$2.12 billion from \$2.03 billion and adjusted OCI margins improved to 50.1% from 47.5%.

Domestic cigarette shipment volumes decreased 5% to 31,470 million sticks from 33,124 million sticks due to the industry's overall decline and trade inventory shipments. PMUSA estimates its domestic shipment volumes fell approximately 3%, in line with its estimate for total industry cigarette volumes. Shipments of Marlboro and Other Premium products decreased 5.5% and 6.1%, respectively, while the Discount brands rose 0.6%.

Total cigar shipments increased 7.5% to 359 million sticks from 335 million sticks. Black & Mild's volumes rose 8.9% to 354 million and Others declined 44% to 5 million.



EQUITY RESEARCH

MO's total cigarette market share was unchanged at 51.4% as decreases in Marlboro's (44.1% vs. 44.2%) and Other Premium's (2.7% vs. 2.8%) was offset by an increase in Discount (4.6% vs. 4.4%). Total cigar market share declined to 26.7% from 27.8% as Black & Mild's decreased (26.3% vs. 27.5%) and was partly offset by Other's (0.4% vs. 0.3%).

SMOKELESS PRODUCTS: OCI improved 15.4% to \$338 million from \$293 million driven by higher pricing/volumes and were partly offset by product mix from higher popular price product volumes and higher promotional investments. Revenues rose 8.7% to \$523 million, from \$481 million, and OCI adjusted margins increased 2.9% to 69.3% from 66.4%.

Domestic shipment volumes increased 4.3% to 217.9 million cans/packs from 209.0 million cans/packs. The improvement was the result of higher Copenhagen shipments (+10.6% to 134.0 million cans/packs) and was partially offset by decreases in shipments of Skoal (-4.0% to 66.6 million cans/packs) and Other (-6.0% to 17.3 million cans/packs). After making adjustments for trade inventory movements and other factors, MO estimates domestic smokeless products shipment volumes grew around 5% during 2Q16.

MO's overall smokeless market share increased 1.1% to 55.8% from 54.7%. The increase occurred as Copenhagen gained market share (34.0% vs. 31.2%) and more than offset declines in Skoal (18.5% vs. 19.8%) and Other (3.3% vs. 3.7%).

WINE: Reported OCI fell to \$34 million from \$35 million due to higher costs partly offset by higher volumes. Adjusted OCI rose to \$37 million from \$35 million and adjusted OCI margins were flat at 22.4%. Net revenues increased 6.2% to \$171 million from \$161 million. 2Q16's wine shipment volumes improved 3.4%, to 2,124 thousand cases, driven mainly by a strong performance among its core premium wines.

RECENT DEVELOPMENTS

MO continued its share repurchase program during 2Q16 buying back 2.7 million shares for \$173 million. Approximately \$624 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. Additionally, BUD recently increased the cash portion offer of its purchase of SABMiller-this should increase MO's cash portion of this deal to \$3 billion from \$2.5 billion.



BUD/SABMiller deal, MO announced in the future results from the BUD/SABMiller combined entity, due to accounting procedures, will be reported on a one quarter delayed basis

This past January, MO announced it was launching a new cost-cutting program aimed at reducing SG&A expenses by \$300 million/year. The company estimates taking approximately \$140 million in pre-tax restructuring charges associated with this program.

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

Another good earnings report from MO as 2Q16 diluted earnings rose to \$0.84/share from \$0.74/share during 2Q15. The increase was due to higher OCI from the smokeable and smokeless units, an unrealized gain on a British pound hedge derivative related to the AB InBev/SAB Miller deal, higher earnings from the PMCC unit, and lower spending on e-cig product lines. 1H16 diluted earnings rose to \$1.47/share from \$1.25/share. 2Q16 adjusted diluted earnings improved to \$0.81/share from \$0.74/share and 1H16 adjusted diluted earnings to \$1.53/share from \$1.38/share.

Management downplayed the decrease in cigarette sales during 2Q16 which caught Wall Street by surprise. Investors await to see whether the company can continue to grow profits in the face of declining revenues. MO plans to counter this trend by growing the appeal of its alternative tobacco products (e.g., e-vapor and e-cigs). Going forward, MO intends 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 and continue its share repurchase program. Management raised FY16 adjusted diluted earnings guidance to \$3.01-\$3.07/share from \$3.00-\$3.05/share. We rate this stock a HOLD given MO is currently trading at 23.4x our 2016 diluted earnings estimate of \$2.84/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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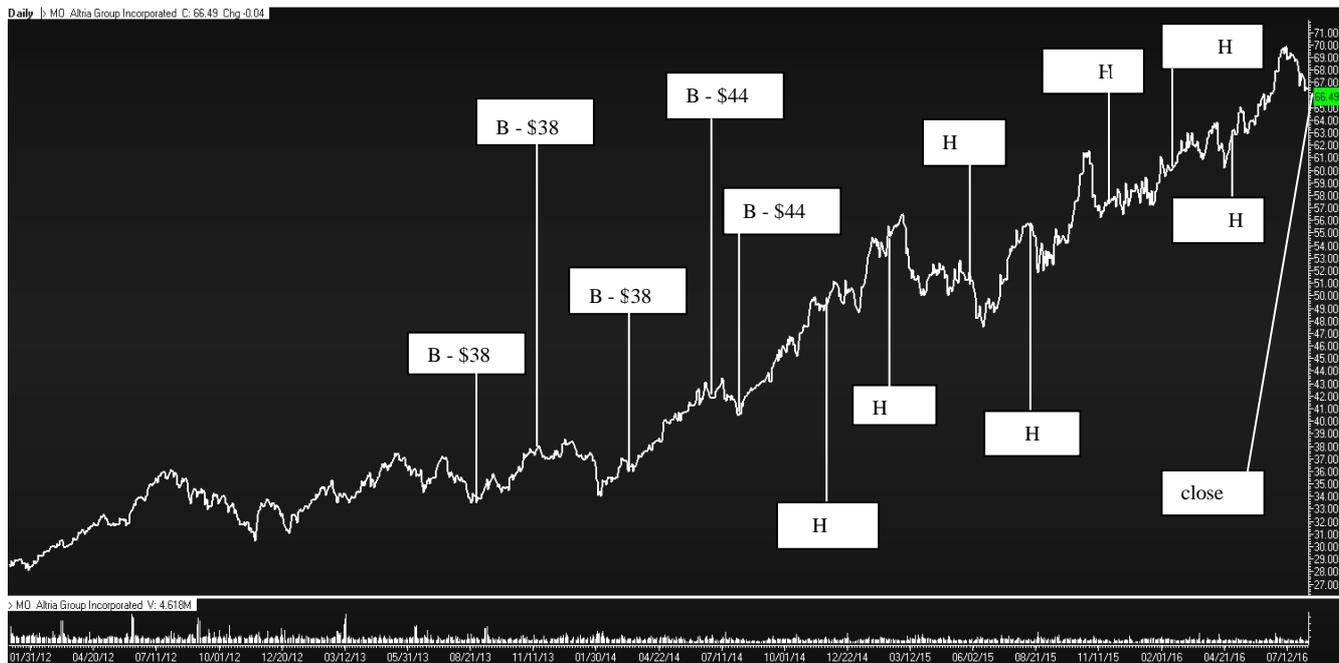
EQUITY RESEARCH

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

	1Q15	2Q15	3Q15	4Q15	FY15	1Q16	2Q16	3Q16e	4Q16e	FY16e
Net revenues	\$5,804	\$6,613	\$6,699	\$6,318	\$25,434	\$6,066	\$6,521	\$6,598	\$6,356	\$25,541
Cost of sales	1,797	2,004	1,932	2,007	7,740	1,874	1,924	2,045	1,971	7,814
Excise taxes on products	1,532	1,738	1,721	1,589	6,580	1,536	1,640	1,715	1,653	8,080
Gross profit	2,475	2,871	3,046	2,722	11,114	2,656	2,957	2,838	2,732	11,183
Marketing, administration, & research costs	552	578	619	681	2,450	503	499	604	711	2,317
Exit cost/asset impairment		4			4	115	1		15	131
Operating companies income	1,923	2,289	2,407	2,041	8,660	2,038	2,457	2,234	2,006	8,735
Amortization of intangibles	-5	-5	-6	-5	-21	-5	-5	-5	-5	-20
General corporate expenses	-53	-60	-53	-71	-237	-51	-42	-57	-66	-216
Changes to MDLZ/PM tax-related receivables			-41		-41					
Adjustment to 3rd party guarantee accrual										
Corporate asset impairment/exit costs						-5				-5
Corporate exit cost										
Operating income	1,865	2,224	2,307	1,965	8,361	1,977	2,410	2,172	1,935	8,494
Restructuring charge										
Interest & other debt expense, net	209	195	205	208	817	200	192	208	205	805
Loss on early debt extinguishment	-228				-228					
Earnings from SABMiller equity investment	134	225	187	211	757	66	199	241	183	689
Other income				5	5	40				40
Gain on derivative financial instruments							117			117
Earnings before income taxes	1,562	2,254	2,289	1,973	8,078	1,883	2,534	2,205	1,913	8,535
Income taxes	544	805	761	725	2,835	665	880	772	646	2,963
Net earnings (continuing ops.)	1,018	1,449	1,528	1,248	5,243	1,218	1,654	1,433	1,267	5,572
Earnings from discontinued ops.										
Earnings attributable to non-controlling interests		1		-1	-2	-1	-1	-1	-2	-5
Net earnings	\$1,018	\$1,448	\$1,528	\$1,247	\$5,241	\$1,217	\$1,653	\$1,432	\$1,265	\$5,567
Net earnings attributable to Altria	\$0.52	\$0.74	\$0.78	\$0.64	\$2.67	\$0.62	\$0.84	\$0.73	\$0.65	\$2.84
Earnings per share	\$0.63	\$0.74	\$0.75	\$0.67	\$2.80	\$0.72	\$0.81	\$0.81	\$0.71	\$3.05
Continuing operations earnings per share	\$0.52	\$0.74	\$0.78	\$0.64	\$2.67	\$0.62	\$0.84	\$0.73	\$0.65	\$2.84

Important Disclosures

Daily | M0 Altra Group Incorporated C: 66.49 Chg: 0.04



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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