



November 15, 2016

CURRENT PRICE: \$61.81
RATING: HOLD
PRICE TARGET: N/A
CURRENT YIELD: 4.0%

EPS Estimates - Non-GAAP

	DEC 15A	DEC 16E
1Q	\$0.52 A	\$0.62A
2Q	\$0.74 A	\$0.84A
3Q	\$0.78 A	\$0.56A
4Q	\$0.64 A	\$0.65
	\$2.68	\$2.67

Trading Data

52-WEEK PRICE RANGE: **\$70.14 - \$56.15**
 SHARES OUTSTANDING: **1,952(M)**
 MARKET CAP: **\$120.7(B)**
 AVG. DAILY TRADING VOLUME: **6.0(M)**
 S&P 500: **2,180**

Valuation Data

BOOK VALUE: **\$1.51**
 PRICE TO BOOK: **40.9x**
 DIVIDEND: **\$2.44**

Altria Corp (NYSE: MO)

3Q16 Earnings Results

Highlights

- 3Q16 diluted earnings of \$0.56/share vs. \$0.78/share during 3Q15
- Increased dividend 8%
- Balance sheet benefits from AB InBev merger
- Extends share repurchase program into 2018
- Maintain HOLD rating

Investment Thesis

Altria Corp (MO-\$61.81), 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 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.

100 Concourse Boulevard, Suite 101
 Glen Allen, Virginia 23059

804.612.9700 ■ 800.612.1484
 804.527.1104

www.CapitolSecurities.com

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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 few years the company spun-off Kraft Foods (KHC-\$81.14) and Philip Morris Intl (PM-\$87.50).

Recent Earnings

MO reported 3Q16 diluted earnings \$0.56/share vs. \$0.78/share during 3Q15. The decrease in results were due to a \$0.28/share charge from early debt retirement during 2016 and was partially offset by higher earnings from MO's SABMiller investment, and unrealized gains from currency derivatives. Operating income rose 3.3% to \$2.38 billion as OCI increased to \$2.44 billion from \$2.41 billion despite higher general corporate expenses of \$57 million vs. \$53 million. Overall net revenues rose 3.1% to \$6.91 billion and gross profit increased 3.4% to \$3.15 billion. Adjusted diluted earnings, when comparing the two quarters, rose 9.3% to \$0.82/share primarily due to higher OCI in the smokeable and smokeless units as well as higher earnings from the SABMiller equity investment. During 3Q16 MO recorded an \$45 million pre-tax charge for tobacco/health litigation item related to the Minor case resolution. Also, PMUSA incurred a \$54 million pre-tax charge related to tobacco/health judgements in six state Engel progeny lawsuits and \$13 million related to interest costs.

SEGMENT RESULTS

SMOKEABLE PRODUCTS: OCI decreased 1.7% to \$2.09 billion, from \$2.12, due to NPM Adjustment Items, higher promotional investments, state excise tax ballot initiative spending, higher resolution expenses, and lower volume. These negatives were partly offset by higher pricing, and lower manufacturing expenses coming from a decrease in pension/benefit costs. Revenues rose to \$6.15 billion from \$6.04 billion and excise taxes fell to \$1.67 billion from \$1.68 billion. Adjusted OCI margins increased 4.2% to \$2.14 billion and adjusted OCI margins improved to 47.7% from 47.0%.

Domestic cigarette shipments declined 1% to 32.86 million sticks from 33.18 million sticks due to the industry's rate of decline while being partly offset by trade inventory movements. PMUSA estimates 3Q16 shipment volumes fell 3% the company says was in line with its total industry estimates. Marlboro and Other Premium volumes declined 0.8% and 4.8%, respectively, while discount rose 0.2%.



MO's total cigarette market share rose to 51.4% from 51.3%. This occurred as Marlboro's market share increased to 44.0% from 43.9% and Discounts improved to 4.7% from 4.6%. Other Premium cigarettes saw its market share fall to 2.7% from 2.8%.

Total Cigar shipment volumes rose 2.8% to 361 million sticks, from 351 million sticks, driven by "Black & Mild's" tipped cigars segment. "Black & Mild's" shipments rise 5.0% to 357 million sticks, from 340 million sticks, and Other decreased 64% to 4 million sticks from 11 million sticks. MO's overall cigar market share decreased to 27.1% from 28.4% as "Black & Mild's" fell to 26.8%, from 27.9%, and Others dropped to 0.3% from 0.5%.

SMOKELESS PRODUCTS: OCI increased 9.1% to \$312 million due to higher pricing/volumes which were partly offset by higher promotional investments and product mix, a rise in manufacturing costs, mix, and spending on state excise tax ballot initiatives. Revenues improved 9.5% to \$528 million and OCI margins grew 9.4% to \$313 million. Total US shipment volumes increased 5.6% to 216.4 million cans/packs from 204.9 million cans/packs. The higher results came from a rise in Copenhagen (+11.1% to 133.5 million cans/packs), spearheaded by the national retail expansion of Copenhagen's "Mint" product, and offset declines in shipments of Skoal (-1.3% to 66.2 million cans/packs) and Other (-5.1% to 16.7 million cans/packs). After adjusting for trade inventory movements, and other factors, MO estimates shipment volumes grew approximately 6% during 3Q16.

MO's total smokeless market share improved 0.9 percentage points to 55.9% from 55.0%. The improvement came from Copenhagen's gaining market share (34.4% vs. 31.7%) and offset declines in Skoal (18.2% vs. 19.7%) and Other (3.3% vs. 3.6%).

WINE: Reported OCI increased to \$38 million from \$35 million due to higher volumes from Ste. Michelle. Overall wine shipment volumes rose 6.3% during 3Q13 to 2.3 million cases due to growth of its core premium brands. Wine revenues grew 9.6% to \$182 million from \$166 million. Adjusted OCI improved 8.6% to \$38 million and adjusted OCI margins decreased 0.1 percentage points to 21.6% from 21.7%.



RECENT DEVELOPMENTS

During 3Q16 MO raised its annual dividend 8% to \$2.44/share.

MO's Board of Directors expanded, and extended the share repurchase program by \$1 billion following the cash received from the Anheuser-Busch InBev SA business combination with SABMiller. The company anticipates the additional share repurchases will continue through 2Q18. Additionally, MO has approximately \$453 million remaining in a prior share repurchase program.

This past September MO purchased approximately \$441 million of its senior unsecured 9.95% note due in 2038 and approximately \$492 of senior unsecured 10.2% notes due in 2039. These transactions created a one-time pre-tax charge against 3Q16 earnings of \$823 million. In conjunction with repurchasing debt, MO issued \$2 billion of new debt.

MO announced the consolidation of some of its manufacturing facilities to streamline operations, reduce costs, and increase operating efficiencies. The John Middleton subsidiary will move its Limerick PA operations to MO's Richmond VA manufacturing facilities. The US Smokeless Tobacco subsidiary will move its Franklin Park IL facility operations to the Nashville TN facility and the Richmond VA manufacturing facilities. This consolidation is expected to finished by 1Q18 and generated roughly \$50 million in annual savings by year end 2018. MO expects the consolidation efforts will generate pre-tax charges of \$150 million, or \$0.05/share.

SABMiller's ownership by the merged companies of Anheuser-Busch and InBev will have a positive impact on MO. In connection with the closing of the deal MO will receive 185.1 million shares (restricted) of AB InBev, equating to a 9.6% ownership of this combined entity. MO purchased additional shares of AB InBev bringing its total equity ownership to 10.2%. Additionally, MO will get approximately \$5.3 billion in pre-tax cash. In total, the company anticipates a \$13.7 billion pre-tax earnings gain, or \$4.55/share, expected to be recorded in 4Q16. Since MO will be using the equity method of accounting for its AB InBev investment, MO will be reporting its share of AB InBev's results using a one-quarter lag since the results will not be available in time to record them for MO's accounting quarter. Thus 4Q16 AB InBev results will be recorded during 1Q17.

MO reaffirmed its 2016 adjusted diluted earnings guidance of \$2.98-\$3.04/share and excludes the gains from the AB InBev merger, currency derivatives, and charges associated with the facilities consolidation announcement.

The state of California recently passed legislation to increase the cigarette tax by \$2/pack.



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Our Thoughts

Overall, a decent earnings report for MO after peeling-out certain numbers-such as the tax effect of debt reduction charge. MO reported 3Q16 diluted earnings \$0.56/share vs. \$0.78/share during 3Q15. The decrease in per share results were due to a \$0.28/share charge from early debt retirement during 2016 and was partly offset by higher earnings from MO's SABMiller investment and unrealized gains from currency derivatives. There were mixed results with the three operating units as OCI improved in the smokeless unit (\$312 million vs. \$286 million), and wine unit (\$38 million vs. \$35 million), but fell in the smokeable unit (\$2.09 billion vs. \$2.12 billion). The major news from 3Q16 earnings report was the positive impact on MO from the AB InBev merger.

The AB InBev merger will generate approximately \$5.3 billion of pre-tax cash and 185.1 million restricted shares of AB InBev stock for MO. These restricted shares, and additional shares purchased, will allow MO to have a 10.2% equity stake in AB InBev going forward. Additionally, the \$5.3 billion in cash could allow MO to buyback additional shares, raise its dividend, provide funds for new product development, or make future acquisitions. Given MO trades at 23.2x our 2016 diluted earnings estimate of \$2.67/share, we maintain our HOLD rating.

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.

Steven F. Marascia
Director of Research
Capitol Securities Management
804-612-9715

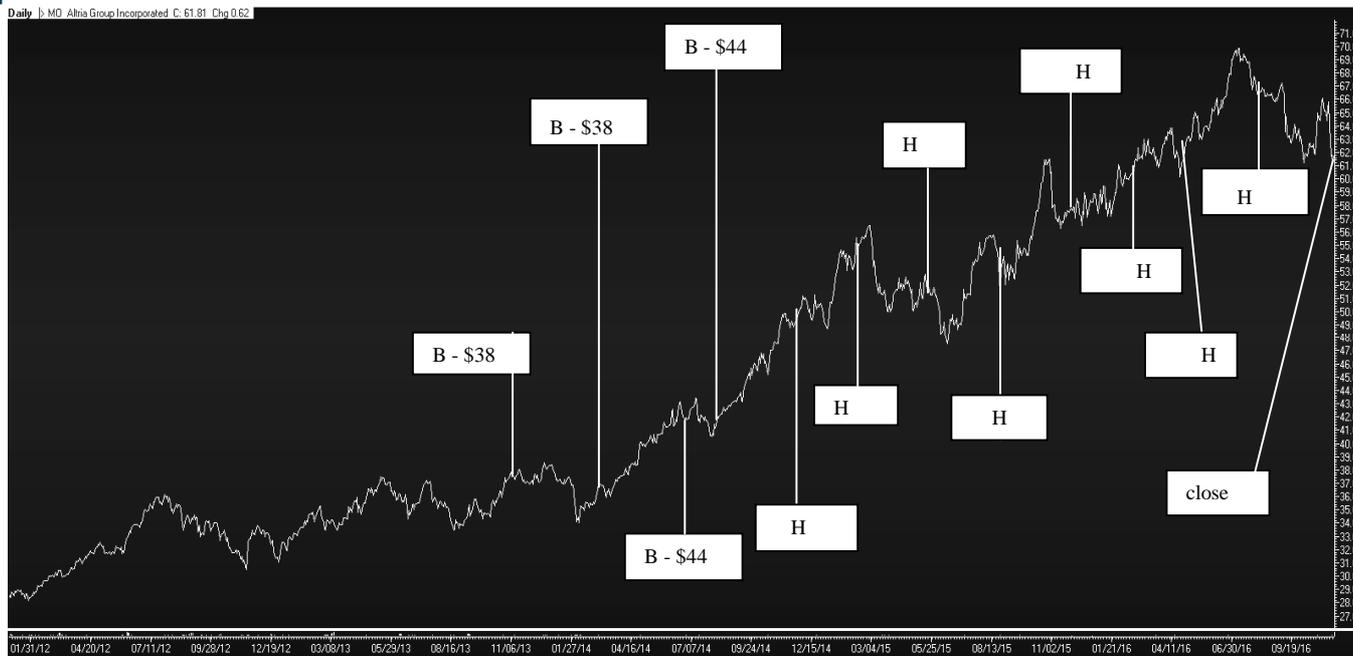


EQUITY RESEARCH

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

	1Q15	2Q15	3Q15	4Q15	FY15	1Q16	2Q16	3Q16	4Q16e	FY16e
Net revenues	\$5,804	\$6,613	\$6,699	\$6,318	\$25,434	\$6,066	\$6,521	\$6,905	\$6,356	\$25,848
Cost of sales	1,797	2,004	1,932	2,007	7,740	1,874	1,924	2,043	1,971	7,812
Excise taxes on products	1,532	1,738	1,721	1,589	6,580	1,536	1,640	1,712	1,653	6,541
Gross profit	2,475	2,871	3,046	2,722	11,114	2,656	2,957	3,150	2,732	11,495
Marketing, administration, & research costs	552	578	619	681	2,450	503	499	704	711	2,417
Exit cost/asset impairment		4			4	115	1	2	15	133
Operating companies income	1,923	2,289	2,407	2,041	8,660	2,038	2,457	2,444	2,006	8,945
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	2,382	1,935	8,704
Restructuring charge										
Interest & other debt expense, net	209	195	205	208	817	200	192	179	205	776
Loss on early debt extinguishment	-228				-228			-823		-823
Earnings from SABMiller equity investment	134	225	187	211	757	66	199	299	183	747
Other income				5	5	40				40
Gain on derivative financial instruments							117	49		166
Earnings before income taxes	1,562	2,254	2,289	1,973	8,078	1,883	2,534	1,727	1,913	8,057
Income taxes	544	805	761	725	2,835	665	880	633	646	2,824
Net earnings (continuing ops.)	1,018	1,449	1,528	1,248	5,243	1,218	1,654	1,094	1,267	5,233
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	\$1,093	\$1,265	\$5,228
Net earnings attributable to Altria	\$0.52	\$0.74	\$0.78	\$0.64	\$2.67	\$0.62	\$0.84	\$0.56	\$0.65	\$2.67
Earnings per share	\$0.63	\$0.74	\$0.75	\$0.67	\$2.80	\$0.72	\$0.81	\$0.82	\$0.69	\$3.04
Continuing operations earnings per share	\$0.52	\$0.74	\$0.78	\$0.64	\$2.67	\$0.62	\$0.84	\$0.56	\$0.65	\$2.67

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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