



February 17, 2017

CURRENT PRICE: \$72.97
RATING: HOLD
PRICE TARGET: N/A
CURRENT YIELD: 3.3%

EPS Estimates - Non-GAAP

	DEC 16A	DEC 17E
1Q	\$0.62 A	\$0.67
2Q	\$0.84 A	\$0.69
3Q	\$0.56 A	\$0.77
4Q	\$5.27 A	\$0.70
	\$7.28	\$2.83

Trading Data

52-WEEK PRICE RANGE: **\$72.98 - \$59.48**
SHARES OUTSTANDING: **1,946(M)**
MARKET CAP: **\$142.0(B)**
AVG. DAILY TRADING VOLUME: **6.3(M)**
S&P 500: **2,351**

Valuation Data

BOOK VALUE: **\$6.58**
PRICE TO BOOK: **11.1x**
DIVIDEND: **\$2.44**

Altria Corp (NYSE: MO)

4Q16 Earnings Results

Highlights

- 4Q16 diluted earnings of \$5.27/share vs. \$0.64/share during 4Q15
- Earnings benefitted from InBev acquisition of SABMiller
- Improved OCI at the Smokeable & Wine units
- MO provides 2017 adjusted earnings guidance of \$3.26-\$3.32/share
- Maintain HOLD rating

Investment Thesis

Altria Corp (MO-\$72.97), 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 3.3%.

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 12/31/16 Philip Morris USA generated approximately 88.7% of overall revenues, or \$22.9 billion. During 2009 MO completed its purchase of US Tobacco (Skool/Copenhagen brands & Ste. Michele Wines) and currently gives MO 55.8% 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 26.6% current market share. The Smokeable business unit (includes cigarettes/cigars) generated 88.9% of MO's revenues, or \$22.9 billion during FY16. PMCC owns a portfolio of leveraged/direct finance leases and produced less than 1% of revenues. MO also owns approximately a 10.2 economic equity interest, with voting rights, in Anheuser-Busch InBev (BUD-\$108.82). 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-\$96.65) and Philip Morris Intl (PM-\$103.66).

Recent Earnings

MO reported 4Q16 earnings of \$5.27/share vs. \$0.64/share during 4Q15. The unusually large increase was due mainly to the gain recognized by MO of its SABMiller equity stake acquired by Anheuser-Busch InBev (BUD-\$108.82). This transaction added approximately \$1.7 billion (pre-tax) to MO's 4Q16 quarterly results. Absent this transaction MO's operating company income increased 1.5% to \$2.07 billion, and operating income rose 1.4% to \$1.99 and operating \$2.07 billion. Overall revenues decreased 1.0% to \$6.25 billion from \$6.32 billion. On a full year basis, 2017 earnings rose to \$7.28/share vs. \$2.67/share during 2016 and full year operating revenues grew 1.5% to \$25.74 billion from \$25.43 billion. MO's 4Q16 adjusted diluted earnings, when excluding special items, increased 1.5% to \$0.68/share from \$0.67/share during 4Q15 and FY16 adjusted diluted earnings improved to \$3.03/share from \$2.82/share.

SEGMENT RESULTS

SMOKEABLE PRODUCTS: When comparing 4Q16 to 4Q15, OCI increased 4.3%, to \$1.81 billion from \$1.74 billion, due to higher product pricing, 2015 NPM adjustment items, and lower benefits costs. These positives were partly offset by lower volume, charges for facilities consolidations, and higher promotional investments. Adjusted OCI margins rose to 46.7% from 44.7% and net revenues declined 1.9% to \$5.45 billion.

Domestic cigarette shipments fell 4.8% to 29,057 million sticks from 30,514 million sticks. This occurred as Marlboro shipments decreased 4.8% to 24,851 sticks, Discount dropped 3.1% to 2,682 million sticks, and Other Premium declined 7.0% to 1,524 million sticks. MO stated this occurrence was due to the industry's rate of decline and one fewer shipping day and noted when adjusted for the lack of a shipping day, MO's 4Q16 shipment volumes decreased by 3.5%. MO's total domestic cigarette market share was flat at 51.4%. Marlboro's market share held steady at 44.0%, while Discount's rose 0.1% and Other Premium's declined 0.1%.



EQUITY RESEARCH

Total cigar shipment volume rose 5.3% during 4Q16 due mainly to increased “Black & Mild” shipments rising to 351 million sticks from 332 million sticks. This gain was partly offset as Other decreased 16.3% to 5 million sticks from 6 million sticks. Total market share fell to 26.6% from 27.4% as “Black & Mild’s” decreased to 26.4% from 26.9% and Other’s fell to 0.2% from 0.5%.

SMOKELESS PRODUCTS: OCI declined 11.2% to \$247 million from \$278 million due to charges for facility consolidation, higher promotional investments, and increased SG&A and manufacturing costs/mix. These increases were partly offset by improved product pricing and volume. Adjusted OCI grew 4.3% to \$290 million from \$278 million while adjusted OCI margins declined to 59.4% from 61.4%. Revenues increased 7.2% to \$521 million from \$486 million.

Domestic product shipment volumes improved 2.2%, to 213.1 million cans/packs from 208.5 cans/packs, mainly due to strength in Copenhagen volumes. Copenhagen’s rose 7.8% to 132.8 million cans/packs, from 123.2 million cans/packs while Skoals fell 5.6%, to 63.6 million cans/packs, and Other decreased 6.7% to 16.7 million cans/packs. After adjusting for trade inventory movements and other factors, MO estimated smokeless product shipments increased approximately 4.5% during 4Q16.

Total smokeless market share increased to 55.8% from 55.0% due to gains from Copenhagen as its market share rose to 34.5% from 32.1%. Copenhagen’s improvement resulted mainly from the national retail expansion of “Copenhagen Mint” earlier in 2016. This gain was partly offset by declines in Skoal, 18.0% vs. 19.3%, and Other, 3.3% vs. 3.6%.

WINE: OCI, and adjusted OCI, both increased 16.4% \$64 million from \$55 million driven by higher volumes and mix. Adjusted OCI margins improved to 26.7% from 24.8% and revenues, when comparing the two quarters, rose to \$248 million from \$231 million. Wine shipments improved 4.2% to approximately 3,1 million cases due mainly to growth in its core premium brands.

RECENT DEVELOPMENTS

During 3Q16 Altria’s Board of Directors expanded and extended its \$1 billion share repurchase program to \$3 billion with expectations of completing the program by the end of 2Q18. During 4Q16 MO repurchased 8.1 million shares for a total cost of approximately \$518 million and for FY16 spent approximately \$1 billion to repurchase 16.2 million shares.

The company expanded its “MarkTen” product rollout to where it equates to about 55% of the e-vapor category volume in US retail channels.



MO continues to work with Philip Morris (PM-\$103.66) in the development of its joint heated tobacco product, “IQOS”. This past December, PM submitted its modified tobacco risk FDA application to the US Food & Drug Administration.

Management announced a productivity initiative to reduce spending on certain SG&A infrastructure and expects to generate approximately \$300 million in annual savings by YE17.

MO recently purchased privately-owned Sherman Group Holdings LLC and its subsidiaries, “Nat Sherman”. This business sells super-premium cigarettes and premium cigars.

During 4Q16 Anheuser-Busch InBev (BUD-\$108.82) completed its acquisition of SABMiller. This transaction gave MO a 9.6% ownership stake in the newly combined companies. Afterwards, MO bought another 12 million shares of BUD increasing its total ownership to 10.2%. As a result of the SABMiller purchase, and currency derivatives owned, MO recorded a pretax gain of \$13.9 billion. This benefit was evident in the large increase in MO’s 4Q16 results.

Our Thoughts

MO reported 4Q16 diluted earnings of \$5.27/share vs. \$0.64/share during 4Q15. The large increase was due mainly to the benefits of the company’s equity ownership in SABMiller being acquired by Anheuser-Busch InBev (BUD-\$108.82). OCI rose in the Smokeable unit (\$1.81 billion vs. \$1.74 billion) and Wine unit (\$64 million vs. \$55 million), while the Smokeless unit saw a decrease (\$247 million vs. \$278 million). Adjusted diluted earnings during 4Q16 rose to \$0.68/share vs. \$0.67/share. When comparing FY16 to FY15, diluted earnings increased to \$7.28 share from \$2.67/share and adjusted diluted earnings rose to \$3.03/share from \$2.80/share.

MO will receive a large infusion of cash on its balance sheet because of BUD’s purchase of SABMiller. Potentially, these funds will be used to repurchase shares, invest in product development, and increase the quarterly dividend. Since management provided 2017 adjusted diluted earnings guidance of \$3.26-\$3.32/share, and the company’s intention of paying out 80% of these earnings in dividends, MO shareholders could experience an increase in dividends during the next year. However, given MO trades at 25.8x our 2017 diluted earnings estimate of \$2.83/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.

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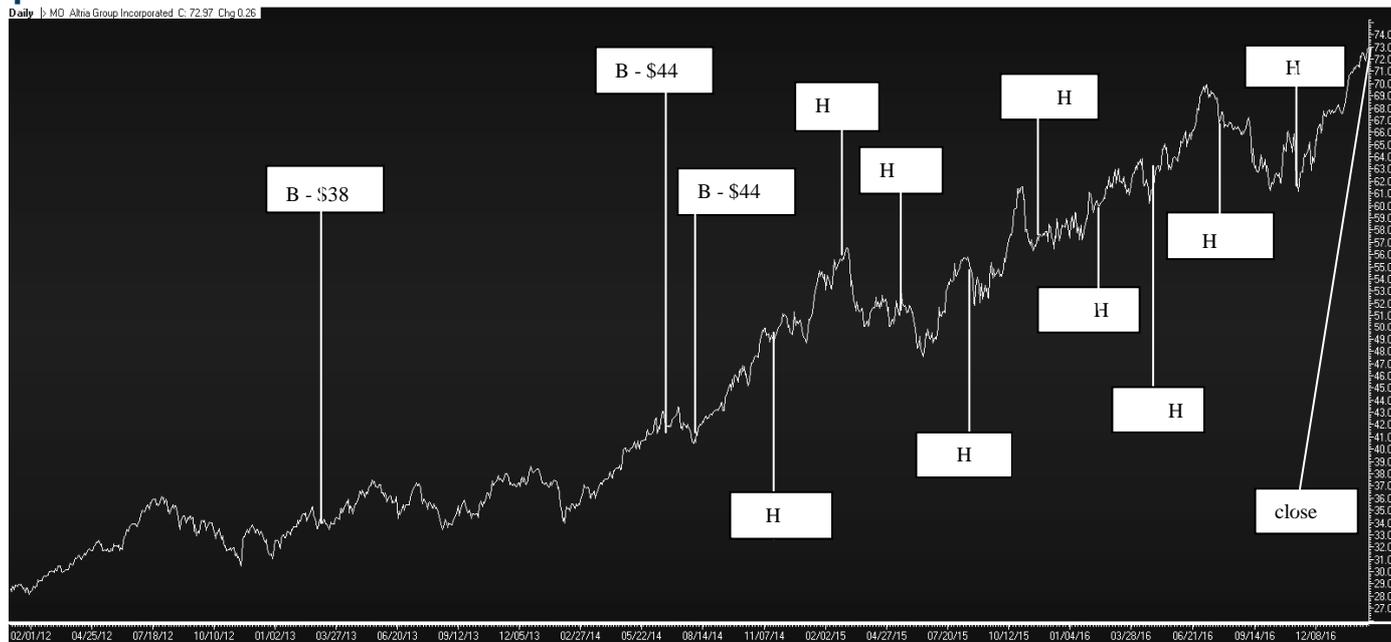
EQUITY RESEARCH

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

	1Q16	2Q16	3Q16	4Q16	FY17	1Q17e	2Q17e	3Q17e	4Q17e	FY17e
Net revenues	\$6,066	\$6,521	\$6,905	\$6,252	\$25,744	\$6,187	\$6,491	\$6,983	\$6,277	\$25,938
Cost of sales	1,874	1,924	2,043	1,905	7,746	1,887	1,977	2,095	1,883	7,842
Excise taxes on products	1,536	1,640	1,712	1,519	6,407	1,546	1,648	1,885	1,632	6,711
Gross profit	2,656	2,957	3,150	2,828	11,591	2,754	2,966	3,003	2,762	11,485
Marketing, administration, & research costs	503	499	704	701	2,407	682	672	646	623	2,623
Exit cost/asset impairment	115	1	2	56	174	23	2	1	2	28
Operating companies income	2,038	2,457	2,444	2,071	9,010	2,049	2,192	2,357	2,137	8,735
Amortization of intangibles	-5	-5	-5	-6	-21	-5	-5	-5	-5	-20
General corporate expenses	-51	-42	-57	-72	-222	-61	-58	-57	-59	-235
Changes to MDLZ/PM tax-related receivables										
Adjustment to 3rd party guarantee accrual										
Corporate asset impairment/exit costs	-5				-5	-2	-3	-1	-2	-8
Corporate exit cost										
Operating income	1,977	2,410	2,382	1,993	8,762	1,983	2,126	2,293	2,071	8,473
Restructuring charge										
Interest & other debt expense, net	200	192	179	176	747	174	178	174	177	703
Loss on early debt extinguishment			-823		-823					
Earnings from SABMiller equity investment	66	199	299	231	795	193	151	212	243	799
Other income/SABMiller gain	40			13,660	13,700	35	12			37
Gain on derivative financial instruments		117	49		166					
Earnings before income taxes	1,883	2,534	1,727	15,708	21,852	2,037	2,111	2,331	2,137	8,616
Income taxes	665	880	633	5,430	7,608	733	759	839	769	3,100
Net earnings (continuing ops.)	1,218	1,654	1,094	10,278	14,244	1,304	1,352	1,492	1,368	5,516
Earnings from discontinued ops.										
Earnings attributable to non-controlling interests	-1	-1	-1	-2	-5	-3	-2	-2	-2	-9
Net earnings	\$1,217	\$1,653	\$1,093	\$10,276	\$14,239	\$1,301	\$1,350	\$1,490	\$1,366	
Net earnings attributable to Altria	\$0.62	\$0.84	\$0.56	\$5.27	\$7.28	\$0.67	\$0.69	\$0.77	\$0.70	\$2.83
Earnings per share	\$0.72	\$0.81	\$0.82	\$0.68	\$3.03	\$0.71	\$0.85	\$0.92	\$0.81	\$3.29
Continuing operations earnings per share	\$0.62	\$0.84	\$0.56	\$5.27	\$7.28	\$0.67	\$0.69	\$0.77	\$0.70	\$2.83

Important Disclosures

Daily | MD Altria Group Incorporated C: 72.97 Chg 0.26



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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