CAPITOL SECURITIES MANAGEMENT, INC.
EQUITY RESEARCH

May 31, 2017

CURRENT PRICE:	**$75.44**
RATING:	**HOLD**
PRICE TARGET:	**N/A**
CURRENT YIELD:	**3.2%**

EPS Estimates - Non-GAAP

	DEC 16A	DEC 17E
1Q	$0.62 A	$0.72A
2Q	$0.84 A	$0.69
3Q	$0.56 A	$0.77
4Q	$5.27 A	$0.70
	$7.28	**$2.88**

Trading Data

52-WEEK PRICE RANGE:	**$76.54 - $60.32**
SHARES OUTSTANDING:	**1,939(M)**
MARKET CAP:	**$146.3(B)**
AVG. DAILY TRADING VOLUME:	**6.2(M)**
S&P 500:	**2,412**

Valuation Data

BOOK VALUE:	**$6.77**
PRICE TO BOOK:	**11.1x**
DIVIDEND:	**$2.44**

Altria Corp (NYSE: MO)

1Q17 Earnings Results

Highlights

- 1Q17 earnings of $0.72/share vs. $0.62/share during 1Q16
- Smokeable OCI drives improved results
- Smokeless OCI suffered from product recall
- MO maintains 2017 adjusted earnings guidance of $3.26-$3.32/share
- Maintain HOLD rating

Investment Thesis

Altria Corp (MO-$75.44), formerly known asPhilip 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 3.2%.

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 (Skoal/Copenhagen brands & Ste. Michele Wines) and currently gives MO 53.5% 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.

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 lees than 1% of revenues. MO also owns approximately a 10.2 economic equity interest, with voting rights, in Anheuser-Busch InBev (BUD-$116.95). 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-$92.90) and Philip Morris Intl (PM-$119.80).

Recent Earnings

MO reported 1Q17 operating earnings of $0.72/share vs. $0.62/share during 1Q16. The 16.1% improvement was due to higher OCI from the smokeable segment, which included charges related to 2016 productivity initiatives, and the positive effects of tax items. These were positives were partly offset by a lower equity contribution from the company's investment in Anheuser-Busch InBev (BUD-$116.95), and lower OCI from the smokeless (related to a product recall) and wine units. 1Q17 total revenues rose to $6.08 billion from $6.07 billion. Gross profit increased 4.6% to $2.78 billion, total OCI improved 12.8% to $2.23 billion, and overall operating income rose 13.7% to $2.25 billion. 1Q17 adjusted diluted earnings improved 1.8% to $0.73/share from $0.72/share during 1Q16. The higher results came from the smokeable segment's higher adjusted OCI and fewer outstanding shares. These were partly offset by lower earnings from the equity investment in Anheuser-Busch InBev (BUD-$116.95) and lower OCI from the smokeless segment coming from its product recall.

SEGMENT RESULTS

SMOKEABLE PRODUCTS: 1Q17's OCI increased 16.6% to $2.04 billion, from $1.75 billion, when comparing to 1Q16's results. The improvement was due to higher product pricing, 2016 restructuring charges for the Productivity Initiative program, lower resolution expenses, lower health/litigation items, and favorable NPM adjustment items. These were partly offset by lower volume and higher promotional expense. Adjusted OCI rose 8.3% to $2.04 billion and adjusted OCI margins improved 2.9 percentage points to 51.0% from 48.1%.

Domestic cigarette shipments declined 2.7% to 28,727 sticks from 29,539 sticks due to the industry's rate of decline, while being partly offset by trade inventory movements. After adjusting for trade inventory movements, and other factors, the company estimates volume shipment declines would have fallen approximately 3%. Marlboro, Other Premium, and Discount brands fell 2.6%, 4.2%, and 3.1%, respectively. MO's domestic cigarette market share declined 0.1 percentage points to 51.0%. This was caused by market share decreases of Marlboro (-0.2%) and Other Premium brands (-0.1%), and was partly offset by a market share gain in the Discount brand (+0.2%).

Total cigar shipments rose 12.2% to 29,094 sticks from 29,866 sticks. The improvement came mainly from gains in "Black & Mild" (+14.5%) and trade inventory movements, offsetting a decrease in other (-60%). MO has decided not to report its retail cigar market share going forward, and including the just reported quarter.

SMOKELESS PRODUCTS: 1Q17's results were impacted by the recall of smokeless products because of metal contamination. As a result, OCI fell 11.1% to $249 million from $280 million due to the recall and a $27 million pre-tax facilities consolidation charges. These were partly offset by higher product pricing and restructuring charge benefit. Revenues decreased to $466 million from $479 million. Adjusted OCI, when factoring in special items, fell 7.8% to $270 million from $293 million and adjusted OCI margins declined 3.6 percentage points to 61.9% from 65.5%.

Total smokeless shipment volumes decreased 5% to 195.8 million cans/packs from 206.1 million cans/packs due mainly to the product recall. MO experienced a decline in its Copenhagen (-0.2%), Skoal (-13.8%), and Other brands (-6.5%). Total retail market share fell 0.7 percentage points to 53.5% from 54.2%. The decreases in Skoal (-1.6 percentage points) and Other (-0.3 percentage points) was partly offset by an increase in Copenhagen (+1.2%).

WINE SEGMENT: Reported and adjusted OCI fell 25% to $21 million from $28 million as net revenues decreased to $136 million from $140 million. This occurred primarily due to lower volume and higher costs. OCI margins decline 4.6 percentage points to 15.4% from 20.0%. Overall, Ste. Michelle's wine shipments decreased 10.0% during 1Q17, to approximately 1.7 million cases, because of wholesalers reducing of year-end inventory and timing of the Easter holiday.

During 1Q17 MO's earnings contribution from AB-InBev (BUD-$116.95) included net pre-tax charges of $73 million. This consisted mainly of MO's share of mark-to-market losses on AB-InBev's (BUD-$) derivative financial instruments used to hedge certain share commitments. MO also recognized a pre-tax charge of $27 million connected to its facilities consolidation program. Additionally, MO recorded $58 million in income tax benefits, including $42 million related to prior audit years and $16 million related to tax benefits for share-based rewards vested during 1Q17.

RECENT DEVELOPMENTS

The FDA's Center for Tobacco Products initiated a study of Philip Morris's (PM-$119.80) marketing application seeking approval of its electronically heated tobacco product. There is no given timeline for the conclusion of this review but it is anticipated it will take approximately one year. MO will have the rights to market this product, also known as "IQOS" in the US.

The facilities consolidation initiative will cause MO to record total pre-tax charges of roughly $150 million, or approximately $0.05/share. The company took pre-tax charges of $71 million in 2016 and expects another $70 million pre-tax charge in 2017 and the remainder in 2018. $27 million of these charges was recognized during 1Q17.

MO recalled smokeless tobacco products produced at its Franklin Park IL plant, including some Skoal & Copenhagen brands following consumer reports of finding metal objects inside the cans.

MO acquired privately-held Sherman Group Holdings and its subsidiaries for an undisclosed amount. The acquired company sells Nat Sherman premium cigarettes and cigars and will become part of the Philip Morris USA and John Middleton as part of its smokeable products segment.

Our Thoughts

Despite a few “bumps in the road”, MO reported a 16.1% improvement in 1Q17 operating earnings of $0.72/share vs. $0.62/share during 1Q16. The improved results were due to higher OCI from the smokeable segment, which include charges related to 2016 productivity initiatives, and the positive effects of tax items. These positives offset the “bumps in the road” of lower contributions in MO’s equity investment in AB-InBev (BUD-$108.82), lower OCI from the smokeless and wine units, and the negative impact from the recall of smokeless products produced at the Franklin Park IL facility. Despite these negatives management expects 2017 adjusted earnings to grow 7%-9% over 2016 results and provided 2017 adjusted earnings guidance of $3.26-$3.32/share. MO believes earnings will improve due to higher OCI from its three operating units and larger earnings contributions from the AB-InBev (BUD-$116.95) equity stake. Given this potential scenario, the Board of Directors could again increase MO’s common stock dividend sometime during 2H17. We continue to rate MO a HOLD given the shares trade at 26.2x our 2017 operating earnings estimate of $2.88/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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Altria Group, Inc.
(dollars in millions, except per share data

	1Q16	2Q16	3Q16	4Q16e	FY16	1Q17	2Q17e	3Q17e	4Q17e	FY17e
Net revenues	$6,066	$6,521	$6,905	$6,356	$25,744	$6,083	$6,491	$6,983	$6,277	$25,834
Cost of sales	1,874	1,924	2,043	1,971	7,746	1,810	1,977	2,095	1,883	7,765
Excise taxes on products	1,536	1,640	1,712	1,653	6,407	1,494	1,648	1,885	1,632	6,659
Gross profit	2,656	2,957	3,150	2,732	11,591	2,779	2,966	3,003	2,762	11,510
Marketing, administration, & research costs	503	499	704	711	2,407	477	672	646	623	2,418
Exit cost/asset impairment	115	1	2	15	174	4	2	1	2	9
Operating companies income	2,038	2,457	2,444	2,006	9,010	2,298	2,192	2,357	2,137	8,984
Amortization of intangibles	-5	-5	-5	-5	-21	-5	-5	-5	-5	-20
General corporate expenses	-51	-42	-57	-66	-222	-46	-58	-57	-59	-220
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	1,935	8,762	2,247	2,126	2,293	2,071	8,737
Restructuring charege										
Interest & other debt expense,net	200	192	179	205	747	179	178	174	177	708
Loss on early debt extinguishment			-823		-823					
Earnings from SABMiller equity investment	66	199	299	183	795	23	151	212	243	629
Other Income	40				13,700		12			12
Gain on derivative financial instruments		117	49		166					
Earnings before income taxes	1,883	2,534	1,727	1,913	21,852	2,091	2,111	2,331	2,137	8,670
Income taxes	665	880	633	646	7,608	689	759	839	769	3,056
Net earnings (continuing ops.)	1,218	1,654	1,094	1,267	14,244	1,402	1,352	1,492	1,368	5,614
Earningns from discontinued ops.										
Earnings attributable to non-controlling interests	-1	-1	-1	-2	-5	-1	-2	-2	-2	-7
Net earnings	$1,217	$1,653	$1,093	$1,265	$14,239	$1,401	$1,350	$1,490	$1,366	$5,607
Net earnings attributable to Altria	$0.62	$0.84	$0.56	$0.65	$7.28	$0.72	$0.69	$0.77	$0.70	$2.88
Earnings per share	$0.72	$0.81	$0.82	$0.69	$3.03	$0.73	$0.85	$0.92	$0.81	$3.31
Continuing operations earnings per share	$0.62	$0.84	$0.56	$0.65	$7.28	$0.72	$0.69	$0.77	$0.70	$2.88

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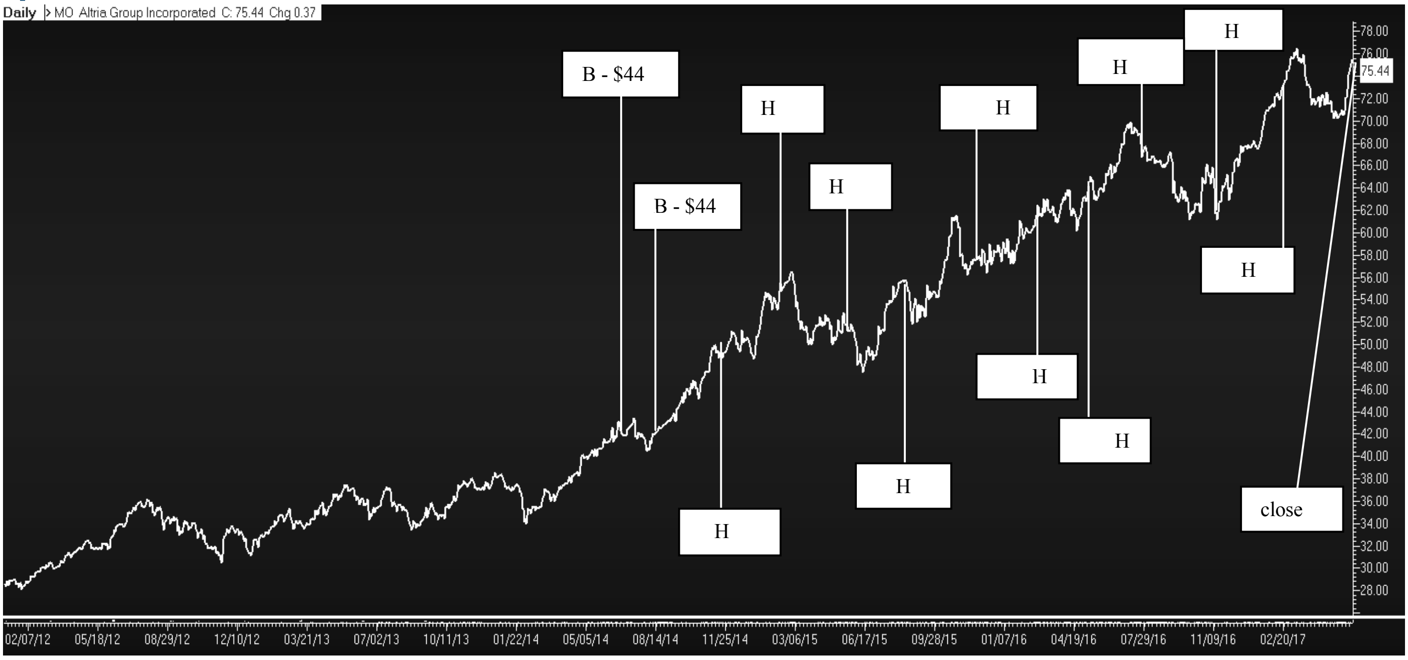
Important Disclosures



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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Stock ratings used in this report are defined as follows:

(1) Buy – The stock's total return including dividends is expected to exceed the industry or market average by at least 10% over the next twelve months.
(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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Other Disclosures

For more information on this report, please contact us at 800.612.1484 or write to Capitol Securities, 100 Concourse Boulevard, Suite 101, Glen Allen, Virginia 23059