



August 2, 2017

CURRENT PRICE: \$65.55
RATING: HOLD
PRICE TARGET: N/A
CURRENT YIELD: 3.7%

EPS Estimates - Non-GAAP

	DEC 16A	DEC 17E
1Q	\$0.62 A	\$0.72A
2Q	\$0.84 A	\$1.03A
3Q	\$0.56 A	\$0.77
4Q	\$5.27 A	\$0.70
	\$7.28	\$3.22

Trading Data

52-WEEK PRICE RANGE: **\$77.79 - \$60.01**
 SHARES OUTSTANDING: **1,933(M)**
 MARKET CAP: **\$126.7(B)**
 AVG. DAILY TRADING VOLUME: **6.8(M)**
 S&P 500: **2,412**

Valuation Data

BOOK VALUE: **\$6.29**
 PRICE TO BOOK: **10.4x**
 DIVIDEND: **\$2.44**

Altria Corp (NYSE: MO)

1Q17 Earnings Results

Highlights

- 2Q17 earnings of \$1.03/share vs. \$0.84/share during 2Q16
- Earnings helped by beer investment, tax adjustment, higher OCI
- Stock suffered from FDA announcement
- MO maintains 2017 adjusted earnings guidance of \$3.26-\$3.32/share
- Maintain HOLD rating

Investment Thesis

Altria Corp (MO-\$65.55), 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 3.7%.

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 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.

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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 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-\$118.76). 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-\$86.67) and Philip Morris Intl (PM-\$114.46).

Recent Earnings

MO reported 2Q17 diluted earnings of \$1.03/share vs. \$0.84/share during 2Q16. The 22.6% increase was due to a higher contribution from the InBev/SABMiller (BUD-\$118.76) equity stake, favorable tax items, and higher OCI in the smokeable and smokeless units. These positives were partly offset by lower earnings from MO's beer investment. Revenues rose 2.2% to \$6.66 billion from \$6.52 billion when comparing the two quarters. Gross profit increased 5.5% to \$3.12 billion and overall OCI improved 5.8% to \$2.60 billion. 2Q17 adjusted earnings grew 4.9% to \$0.85/share from \$0.81/share during 2Q16. This improvement came from higher adjusted OCI in the smokeable and smokeless operating units and fewer outstanding shares, while being partly offset by lower equity earnings from MO's beer investment. During 2Q17 MO repurchased 14.4 million shares, through the company's share repurchase plan, for approximately \$1.05 billion.

SEGMENT RESULTS

SMOKEABLE PRODUCTS: OCI increased 5.4% to \$2.23 billion, from \$2.12 billion, when comparing 2Q17 to 2Q16. The increase was the result of higher product pricing and was partly offset by higher promotional expense, as well as lower volumes produced by an increase in cigarette taxes in California. Adjusted OCI grew 6.4% to \$2.26 billion from \$2.12 billion and adjusted OCI margins rose 1.6 percentage points to 51.7%

MO's shipped cigarette volumes declined 2.9% to 30,569 million sticks, from 31,470 million sticks, due mainly to the smoking industry's overall rate of decline (4.5%) and was partly offset by trade inventory movements. When adjusting for these inventory movements, MO estimates overall volumes fell 5%. Shipped cigarette volumes for Marlboro, Other Premiums, and Discount decreased -2.9%, -6.6%, and 0.5%, respectively. MO's overall cigarette market share fell 0.4 percentage points to 50.8% from 51.2%. This occurred as both Marlboro's and Other Premiums market shares declined, to 43.5%, and 2.7%, respectively, while Discount's was flat at 4.6%.



Total shipped cigar volumes rose 13.1% to 406 million sticks from 339 million sticks. This occurred as Black & Mild shipments increased 13.6% to 402 million sticks and more than offset a 20.0% drop in Other shipments.

SMOKELESS PRODUCTS: OCI rose 3.6% to \$350 million from \$338 million resulting from higher pricing/shipments which were partly offset by facilities consolidation charges, higher SG&A expenses, and an unfavorable mix. Adjusted OCI increased 9.8% to \$371 million from \$338 million while adjusted OCI margins grew 0.7 percentage points to 70.0% from 69.3%. Total revenues increased 7.8% to \$564 million from \$523 million.

Total smokeless shipment volumes improved 1.4% to 221.0 million cans/packs from 217.9 million cans/packs. The improvement occurred as Skoal experienced a 2.6% increase to 137.5 million cans/packs and Other rose 2.3% to 17.7 million cans/packs. Partly offsetting these gains was a decline in Copenhagen's volumes, falling 1.2% to 65.8 million cans/packs. Total smokeless retail market share decreased 0.8 percentage points to 54.1% to 54.9% as an increase in Copenhagen, +0.7 percentage points to 34.1%, was more than offset by decreases in Skoal, -1.4 percentage points to 16.7%, and Other, -0.1% percentage points to 3.3%

WINE SEGMENT: OCI declined 26.5%, to \$25 million from \$34 million, and adjusted OCI fell 32.9%, to \$25 million from \$37 million, due to lower volume shipments produced by trade inventory reductions and increased competition in the wine sector. Adjusted OCI margins dropped to 17.2% from 22.4%. 2Q17's total revenues decreased 12.3%, to \$150 million from \$170 million, as Ste. Michelle's wine shipments declined 14.5% to 1.8 million cases.

During 2Q17 MO's earnings incurred a \$29 million pre-tax charge related to its facilities consolidation program. The company also recorded pre-tax unrealized gains of \$117 million for the change in the fair value of currency derivative used by MO to hedge its British Pound exposure on the cash consideration received from the AB/InBev-SABMiller business merger. Another \$108 million tax benefit, resulting from the 2010-2013 IRS audit, was recorded by MO during 2Q17.



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Our Thoughts

Solid quarterly results for MO as 2Q17 diluted earnings grew to \$1.03/share vs. \$0.84/share during 2Q16. The 22.6% increase was due to a higher contribution from the InBev/SABMiller (BUD-\$118.76) equity stake, favorable tax items, and higher OCI in the smokeable and smokeless units. These positives were partly offset by lower earnings from MO's beer investment. During the conference call management reaffirmed 2017 adjusted earnings guidance of \$3.26-\$3.32/share. While investors initially applauded the earnings release by pushing MO's shares higher, a sell-off in the stock ensued following a new FDA announcement.

The following week, the FDA announced their intent to lower the amount of nicotine in US tobacco products, causing a sell-off in virtually all tobacco stocks. The day of the announcement, MO's shares, after trading near \$74/share, fell as low as \$60/share before closing around \$66/share. Investors should expect further volatility in these shares pending new FDA declarations or Wall Street upgrades/downgrades on the tobacco sector. However, MO still has \$335 million left in its latest share repurchase program and the company may create short-term support for its stock if they buy back shares at these current levels. Given MO bought back its own stock during 2Q17 at an average price of \$72.85/share, more could be bought at the current mid-to-low \$60s level. We are maintaining our NEUTRAL rating MO.



Risks

There is no guarantee MO will improve earnings/cash flow. Declining US cigarette volumes may hurt the company's revenues and profits. Litigation/regulation 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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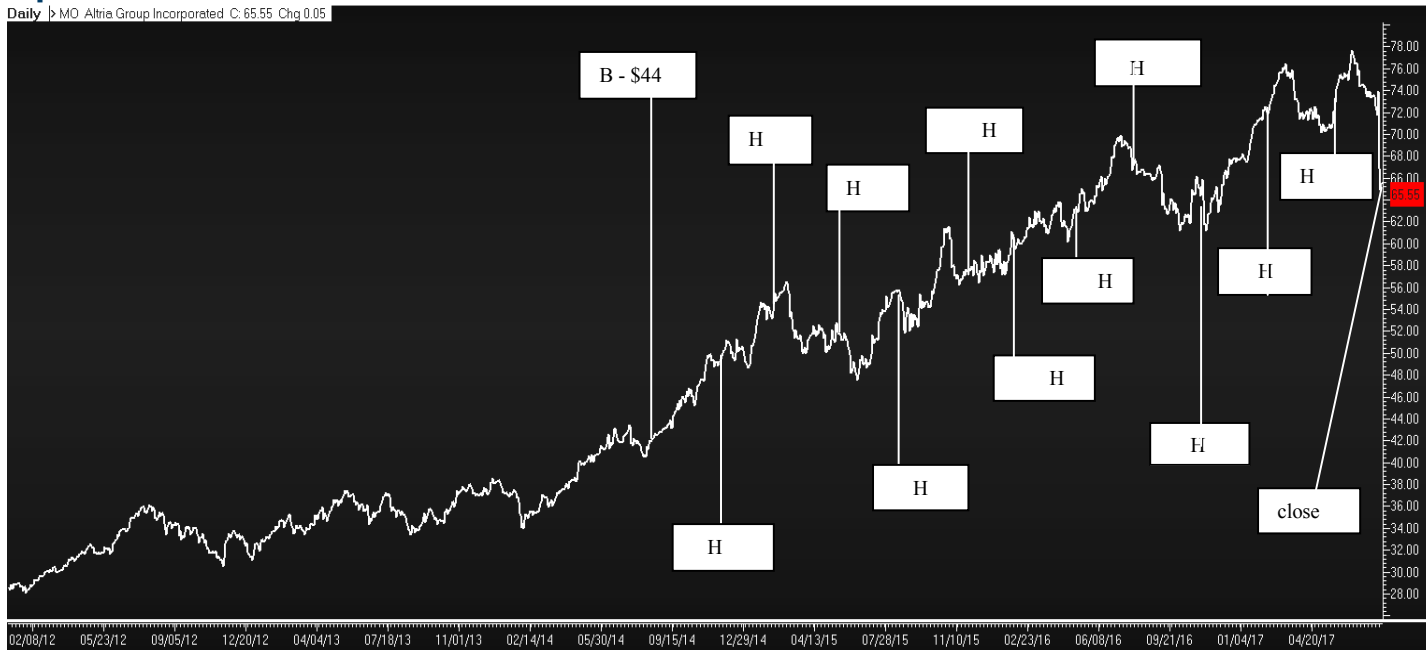
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Altria Group, Inc.
(dollars in millions, except per share data)

	1Q16	2Q16	3Q16	4Q16e	FY16	1Q17	2Q17	3Q17e	4Q17e	FY17e
Net revenues	\$6,066	\$6,521	\$6,905	\$6,356	\$25,744	\$6,083	\$6,663	\$6,983	\$6,277	\$26,006
Cost of sales	1,874	1,924	2,043	1,971	7,746	1,810	1,949	2,095	1,883	7,737
Excise taxes on products	1,536	1,640	1,712	1,653	6,407	1,494	1,595	1,885	1,632	6,606
Gross profit	2,656	2,957	3,150	2,732	11,591	2,779	3,119	3,003	2,762	11,632
Marketing, administration, & research costs	503	499	704	711	2,407	477	507	646	623	2,253
Exit cost/asset impairment	115	1	2	15	174	4	12	1	2	19
Operating companies income	2,038	2,457	2,444	2,006	9,010	2,298	2,600	2,357	2,137	9,392
Amortization of intangibles	-5	-5	-5	-5	-21	-5	-5	-5	-5	-20
General corporate expenses	-51	-42	-57	-66	-222	-46	-56	-57	-59	-218
Changes to MDLZ/PM tax-related receivables										
Adjustment to 3rd party guarantee accrual										
Corporate asset impairment/exit costs	-5				-5	-2		-1	-2	-5
Corporate exit cost										
Operating income	1,977	2,410	2,382	1,935	8,762	2,247	2,539	2,293	2,071	9,150
Restructuring charge										
Interest & other debt expense, net	200	192	179	205	747	179	177	174	177	707
Loss on early debt extinguishment			-823		-823					
Earnings from SABMiller equity investment	66	199	299	183	795	23	140	212	243	618
Other Income	40				13,700		408			408
Gain on derivative financial instruments		117	49		166					
Earnings before income taxes	1,883	2,534	1,727	1,913	21,852	2,091	2,910	2,331	2,137	9,469
Income taxes	665	880	633	646	7,608	689	920	839	769	3,217
Net earnings (continuing ops.)	1,218	1,654	1,094	1,267	14,244	1,402	1,990	1,492	1,368	6,252
Earnings from discontinued ops.										
Earnings attributable to non-controlling interests	-1	-1	-1	-2	-5	-1	-1	-2	-2	-6
Net earnings	\$1,217	\$1,653	\$1,093	\$1,265	\$14,239	\$1,401	\$1,989	\$1,490	\$1,366	\$6,246
Net earnings attributable to Altria	\$0.62	\$0.84	\$0.56	\$0.65	\$7.28	\$0.72	\$1.03	\$0.77	\$0.70	\$3.22
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	\$1.03	\$0.77	\$0.70	\$3.22

Important Disclosures

Daily | MO Altria Group Incorporated | C: 65.55 | Chg 0.05



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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