



November 2, 2017

CURRENT PRICE: \$63.90
RATING: HOLD
PRICE TARGET: N/A
CURRENT YIELD: 4.1%

EPS Estimates - Non-GAAP

	DEC 16A	DEC 17E
1Q	\$0.62 A	\$0.72A
2Q	\$0.84 A	\$1.03A
3Q	\$0.56 A	\$0.97A
4Q	\$5.27 A	\$0.70
	\$7.28	\$3.29

Trading Data

52-WEEK PRICE RANGE: **\$77.79 - \$60.01**
 SHARES OUTSTANDING: **1,915(M)**
 MARKET CAP: **\$122.4(B)**
 AVG. DAILY TRADING VOLUME: **7.1(M)**
 S&P 500: **2,580**

Valuation Data

BOOK VALUE: **\$6.44**
 PRICE TO BOOK: **9.92x**
 DIVIDEND: **\$2.64**

Altria Corp (NYSE: MO)

3Q17 Earnings Results

Highlights

- 3Q17 earnings of \$0.97/share vs. \$0.56/share during 2Q17
- Higher OCI in 2 of 3 operating units
- Board of Directors increased dividend 8.2%
- MO maintains 2017 adjusted earnings guidance of \$3.26-\$3.32/share
- Maintain HOLD rating

Investment Thesis

Altria Corp (MO-\$63.90), 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 4.1%.

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.

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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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-\$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 3Q17 diluted earnings of \$0.97/share vs. \$0.56/share during 3Q16. The improvement was due to favorable tax items, higher OCI in the smokeable segment, fewer outstanding shares, and the absence of a 2016's loss created by early retirement of debt. This was partly offset by lower earnings contribution from MO's beer investment. When comparing the two quarters, revenues declined 2.5% to \$6.73 billion from \$6.91 billion and operating income improved 9.4% to \$2.61 billion from \$2.38 billion. 3Q17's adjusted diluted earnings per share rose to \$0.90/share from \$0.82/share during 3Q16. The increase came from higher adjusted OCI in the smokeable and smokeless units and fewer shares outstanding, and was partly offset by lower equity earnings from MO's beer investment.

SEGMENT RESULTS

SMOKEABLE PRODUCTS: OCI increased 9.8% to \$2.29 billion from \$2.09 billion when comparing 3Q17 to 3Q16. The higher results were due to increased pricing, lower SG&A/resolution costs, and lower tobacco/health litigation items. These were partly offset by lower sales volumes. Revenues decreased 2.8% to \$5.98 billion from \$6.15 billion as the negative affects of lower volume was partially offset by higher pricing. Adjusted OCI increased to \$2.30 billion from \$2.14 billion and adjusted OCI margins rose to 52.2% from 47.7%.

MO's cigarette shipments declined 6.2% to 30,828 million sticks from 32,864 million sticks resulting from the industry wide rate of decline (-3.5%), trade inventory movements, retail shares decline, and one fewer shipping day. Adjusting for inventory trade movements and the one day less of shipping, MO estimates its cigarette shipments fell 4.5%. MO's overall cigarette market share declined 0.6 percentage points to 50.5% from 51.1% as both Marlboro's and Other premiums decreased to 43.2% from 43.6%, and to 2.7% from 2.8%, respectively, while Discount was flat



at 4.6%. Marlboro's decline was attributed to the new cigarette tax in California (\$2/pack) and increased competition in the segment.

Cigar's shipment volumes rose 6.6% to 385 million sticks from 361 million sticks. This occurred as "Black & Mild's" improved 6.7% to 381 million sticks from 357 million sticks while Other was flat at 4 million sticks.

SMOKELESS PRODUCTS: OCI increased 12.8% to \$352 million from \$312 million driven by higher pricing, lower costs/promotional expense, and was partly offset by volume declines, unfavorable mix, and facility consolidation charges. Adjusted OCI improved 15.7% to \$362 million from \$313 million and adjusted OCI margins rose to 70.3% from 63.5%. Net revenues rose 4.2% to \$550 million from \$528 million.

Total smokeless shipment volumes decreased 1.8% to 212.6 million cans/packs from 216.4 million cans/packs due to lower "Skoal" shipments. "Copenhagen" shipments rose 0.4% to 134.1 million cans/packs, "Other" increased 1.2% to 16.9 million cans, and "Skoal" declined 6.9% to 61.6 million cans. On a similar track, "Copenhagen's" market share rose to 33.9% from 33.7%, "Other's" improved to 16.9% from 16.7%, and "Skoal's" fell to 16.5% from 17.9%.

WINE SEGMENT: OCI and adjusted OCI both decreased 5.3% to \$36 million from \$38 million, as the unit was negatively impacted by increased competition, ongoing trade inventory reductions, and slower growth in the premium wine category. Net revenues fell to \$181 million from \$182 million while adjusted OCI margins declined to 20.6% from 21.6%. Wine shipment volumes were unchanged at approximately 2.2 million cases.

OTHER ITEMS:

During 3Q17 MO purchased 1.1 million shares of common stock through its share repurchase program for an average price of \$67.99/share. As of 9/30/17 MO has \$576 million remaining in the \$4 billion repurchase program and anticipates it being completed by the end of 2Q18.

MO's e-vapor product, "MarkTen", grew its sales by 50% mainly through expanded distribution and category growth. "MarkTen" has a third of the national retail share of approximately 13.5% in mainstream retail chains and is present in stores representing about 65% of e-vapor category volumes in those channels. Plans are to expand to another 15,000 retail stores during 4Q17.

The FDA began its science review process of Phillip Morris's (MO) heated tobacco product, "IQOS", while MO "continues to build its commercialization plans" for the potential US rollout of this product.

This past July, the FDA presented a new plan for tobacco and nicotine regulations. These new regulations may take a couple of years before they are finalized and placed into a final regulatory order.



MO made a minority investment in Avail Vapor LLC. Avail has opened 102 stores in 12 states specializing in sales of high-end electronic cigarettes.

Our Thoughts

Overall, a good earnings report for MO as the company reported diluted earnings of \$0.97/share during 3Q17 vs. \$0.56/share during 3Q16. The improvement was due to favorable tax items, higher OCI in the smokeable segment, fewer outstanding shares, and the absence of a 2016's loss created by early retirement of debt. This was partly offset by a lower earnings contribution from MO's beer investment (\$169 million vs. \$299 million). Both the smokeable and smokeless units delivered improved OCI, +9.8% and 12.8%, respectively while the Wine segment experienced a decline of 5.3%.

Going forward, we anticipate MO will continue to reward investors with higher dividend payouts as the company strives to pay out approximately 80% of adjusted earnings to shareholders as dividends. To this end the Board of Directors raised the dividend 8.2% in August and during the earnings call reaffirmed 2017 adjusted earnings guidance of \$3.26-\$3.32/share. A challenge for the company will be to counter declining smoking volumes in the US. While recent cost cutting efforts and product price increases have allowed recent earnings to grow despite declining US cigarette consumption levels, MO may need to grow sales of its alternative tobacco (e-vapor and heated tobacco) products to generate higher future profits. While prospects for the future growth of MO's dividend outlook looks promising, we continue to rate the stock a HOLD, given it currently trades at 19.8x our 2017 diluted earnings estimate of \$3.29/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/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.

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



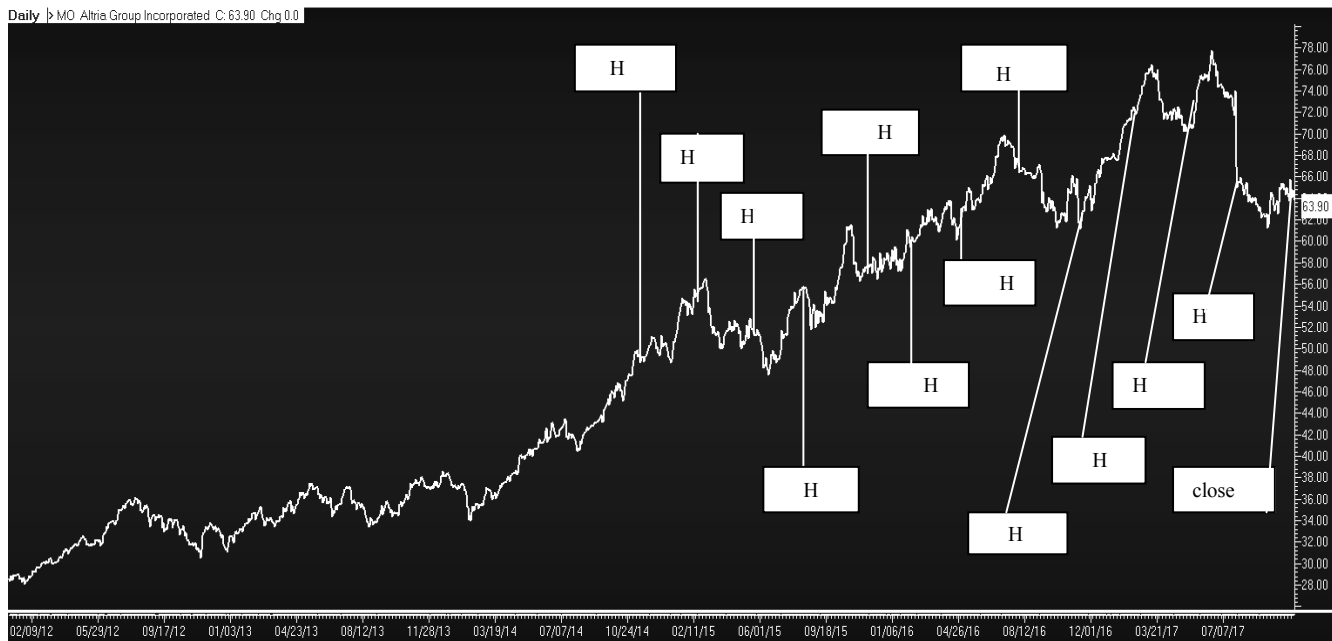
EQUITY RESEARCH

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

	1Q16	2Q16	3Q16	4Q16e	FY16	1Q17	2Q17	3Q17	4Q17e	FY17e
Net revenues	\$6,066	\$6,521	\$6,905	\$6,356	\$25,744	\$6,083	\$6,663	\$6,729	\$6,277	\$25,752
Cost of sales	1,874	1,924	2,043	1,971	7,746	1,810	1,949	1,940	1,883	7,582
Excise taxes on products	1,536	1,640	1,712	1,653	6,407	1,494	1,595	1,606	1,632	6,327
Gross profit	2,656	2,957	3,150	2,732	11,591	2,779	3,119	3,183	2,762	11,843
Marketing, administration, & research costs	503	499	704	711	2,407	477	507	507	623	2,114
Exit cost/asset impairment	115	1	2	15	174	4	12	8	2	26
Operating companies income	2,038	2,457	2,444	2,006	9,010	2,298	2,600	2,668	2,137	9,703
Amortization of intangibles	-5	-5	-5	-5	-21	-5	-5	-5	-5	-20
General corporate expenses	-51	-42	-57	-66	-222	-46	-56	-56	-59	-217
Changes to MDLZ/PM tax-related receivables										
Adjustment to 3rd party guarantee accrual										
Corporate asset impairment/exit costs	-5				-5	-2			-2	-4
Corporate exit cost										
Operating income	1,977	2,410	2,382	1,935	8,762	2,247	2,539	2,607	2,071	9,464
Restructuring charge										
Interest & other debt expense, net	200	192	179	205	747	179	177	169	177	768
Loss on early debt extinguishment			-823		-823					
Earnings from SABMiller equity investment	66	199	299	183	795	23	140	169	243	575
Other Income	40				13,700		408	37		445
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	2,644	2,137	9,782
Income taxes	665	880	633	646	7,608	689	920	777	769	3,155
Net earnings (continuing ops.)	1,218	1,654	1,094	1,267	14,244	1,402	1,990	1,867	1,368	6,627
Earnings from discontinued ops.										
Earnings attributable to non-controlling interests	-1	-1	-1	-2	-5	-1	-1	-1	-2	-5
Net earnings	\$1,217	\$1,653	\$1,093	\$1,265	\$14,239	\$1,401	\$1,989	\$1,866	\$1,366	\$6,622
Net earnings attributable to Altria	\$0.62	\$0.84	\$0.56	\$0.65	\$7.28	\$0.72	\$1.03	\$0.97	\$0.70	\$3.42
Earnings per share	\$0.72	\$0.81	\$0.82	\$0.69	\$3.03	\$0.73	\$0.85	\$0.90	\$0.81	\$3.29
Continuing operations earnings per share	\$0.62	\$0.84	\$0.56	\$0.65	\$7.28	\$0.72	\$1.03	\$0.97	\$0.70	\$3.42

Important Disclosures

Daily | MO Altria Group Incorporated C: 63.90 Chg 0.0



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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