



February 26, 2018

CURRENT PRICE: \$65.43
RATING: HOLD
PRICE TARGET: N/A
CURRENT YIELD: 4.0%

EPS Estimates - Non-GAAP

	DEC 17A	DEC 18E
1Q	\$0.72 A	\$0.91
2Q	\$1.03 A	\$0.96
3Q	\$0.97 A	\$0.98
4Q	\$2.60 A	\$0.92
	\$5.31	\$3.77

Trading Data

52-WEEK PRICE RANGE: **\$77.79 - \$60.01**
 SHARES OUTSTANDING: **1,905(M)**
 MARKET CAP: **\$124.6(B)**
 AVG. DAILY TRADING VOLUME: **7.6(M)**
 S&P 500: **2,780**

Valuation Data

BOOK VALUE: **\$8.10**
 PRICE TO BOOK: **8.08x**
 DIVIDEND: **\$2.64**

Altria Corp (NYSE: MO)

4Q17 Earnings Results

Highlights

- 4Q17 earnings of \$5.31/share vs. \$7.28/share during 4Q16
- Higher OCI in all 3 operating units
- Chariman/CEO Barrinton retiring
- MO provides 2018 adjusted earnings guidance of \$3.90-\$4.03/share
- Maintain HOLD rating

Investment Thesis

Altria Corp (MO-\$65.43), 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 12/31/17 Philip Morris USA generated approximately 87.9% of overall revenues, or \$22.6 billion. During 2009 MO completed its purchase of US Tobacco (Skool/Copenhagen brands & Ste. Michele Wines) and currently gives MO 53.7% 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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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-\$69.74) and Philip Morris Intl (PM-\$106.68).

Recent Earnings

MO reported 4Q17 diluted earnings of \$2.60/share vs. \$5.27/share during 4Q16. The reason for the decline was the absence of 4Q16's \$13.7 billion one-time gain from the AB InBev/SAB Miller combination. 4Q17's revenues declined 2.4% to \$6.10 billion, from \$6.25 billion due to lower revenues from the smokeable products segment. MO's adjusted diluted 4Q17 earnings rose to \$0.91/share from \$0.68/share resulting from higher equity earnings contribution from the company's SABMiller equity investment, higher adjusted OCI in the smokeable and smokeless units, fewer outstanding shares, and a lower tax rate. Recent passage of the Tax Reform Act caused a one-time charge to 4Q17's diluted earnings and added about \$0.10/share towards 4Q17's adjusted diluted earnings. When comparing FY17 to FY16, diluted earnings decreased to \$5.31/share from \$7.28/share and adjusted diluted earnings increased to \$3.39/share from \$3.03/share. During 4Q17, MO repurchased 8.4 million shares of its common stock through its share repurchase program.

SEGMENT RESULTS

SMOKEABLE PRODUCTS: OCI increased 1.7% to \$1.84 billion from \$1.81 billion, when comparing 4Q17 to 4Q16. The improvement came from higher pricing, lower SG&A, and decreased spending on promotional investments. These positives were partly offset by lower volumes, higher resolution expense and settlement charges for lump sum pension payments (\$81 million). Revenues decreased 3.2% to \$5.28 billion from \$5.45 billion. Adjusted OCI rose to \$1.96 billion from \$1.86 billion and adjusted OCI margins increased to 49.9% from 46.7%.

MO's cigarette shipment volume decreased 8.9% resulting from the industry's overall rate of decline, trade inventory movements, and lower retail share. Adjusting for trade inventory movements, MO's cigarette shipments fell 6.5% while total cigarette industry volumes dropped 4.5%. "Marlboro's" market share fell 0.7 share points to 43.3% from 44.0%, because of competitive activity and last year's cigarette tax increase in CA. "Other



Premium's" market share was flat at 2.7% and "Discount's" declined to 4.6% from 4.7%. MO's overall share of the US cigarette market decreased to 50.3% from 51.1% when comparing 4Q17 vs. 4Q16.

Cigar shipments rose 7.9% to 384 million from 356 million as "Black & Mild's volumes increased 8.5% to 381 million from 351 million. Partly offsetting this was a decline in "Other" shipments, falling to 3 million from 5 million.

SMOKELESS PRODUCTS: OCI rose 41.3% to \$349 million from \$247 million based on higher product pricing, lower facilities consolidation charges, reduced SG&A/manufacturing costs, and a decrease in promotional investments. These were partly offset by lump sum pension payment settlements. Adjusted OCI increased to \$369 million from \$290 million while adjusted OCI margins rose to 68.1% from 59.4%. This unit's revenues rose 10.4% to \$575 million from \$521 million.

Total smokeless shipment volumes decreased 0.6% to 211.9 million cans/packs from 213.1 million cans/packs. Following adjustments for trade inventory movements and other factors, MO estimates shipment volumes fell approximately 2.5%. "Copenhagen" shipments increased 2.0% to 135.5 million cans/packs from 132.8 million cans/packs, and "Others" improved 4.8% to 17.5 million cans/packs from 16.7 million cans/packs. However, these were offset by a decline in "Skool" shipments, from 58.9 million to 63.6 million.

MO's overall market share of smokeless decreased 1.1 percentage points to 53.6% from 54.7%. "Copenhagen's" market share was flat at 33.8%, "Other's" rose 0.2 percentage points to 3.5% from 3.3%, while "Skool's" fell 1.3 percentage points to 16.3% from 17.6%.

WINE SEGMENT: OCI and adjusted OCI both increased 1.6% to \$65 million from \$64 million and adjusted OCI margins rose to 29.7% from 26.7%. This occurred due to lower costs, higher product pricing, and a favorable sales mix. However, these positives were offset by lower volumes as revenues declined 8.5% to \$227 million from \$248 million. Falling revenues were the result of competitive activity, continued trade inventory reductions, and slower growth of premium wine sales. Reported wine shipments fell 9.7% to approximately 2.8 million cases.

RECENT DEVELOPMENTS:

Chairman/CEO Marty Barrington announced he was retiring effective May 17, 2018. MO's Board of Directors elected Howard Willard to serve as the succeeding Chairman/CEO. Additionally, the Board elected Billy Gifford to serve as Vice Chairman/CFO.

Following the completion of its last share repurchase program in January 2018, the Board of Directors authorized a new \$1 billion share repurchase program with its completion expected by year end 2018.

MO's e-vapor product, "Mark Ten", full year volume grew 60% through expanded distribution and category growth. During 2017, "Mark Ten" achieved a mainstream retail channel national share of 12.5% and is currently offered in approximately 25,000 stores, representing 70% of e-vapor category in those channels.



Given the Tax Reform Act passed by Congress, MO estimates its 2018 corporate tax rate will be 23%-24%.

Our Thoughts

When looking at the “brass-tacks” of MO’s 4Q17 results, profitability improved when examining core operations as OCI rose in all three of its operating units. Smokeable’s OCI increased 1.7% to \$1.84 billion, Smokeless rose 41.3% to \$349 million, and Wine’s improved 1.6% to \$65 million. Revenues decreased 2.4% to \$6.10 billion, as the US cigarette market continues to contract from declining smoking volumes. However, MO is attempting to offset these declines by developing alternative smoking products like “Mark Ten” and “IQOS”.

Going forward, MO should see earnings growth this year after management provided 2018 adjusted earnings guidance of \$3.90-\$4.03/share. This is achievable assuming further OCI improvement from its three operating units in 2018, a lower corporate tax rate, and MO’s new \$1 billion share repurchase program. If this comes to fruition, then shareholders could receive another annual dividend increase later this year. We continue to rate MO a HOLD since it currently trades at a 17.4x P/E multiple of our 2018 earnings estimate of \$3.77. Investors should be aware the stock’s PE multiple trades in tandem with the broader stock market’s P/E multiple. Thus, the potential exists that rising US Treasury bill/bond rates could cause a lowering of the broader market’s P/E multiple, as well as MO’s.



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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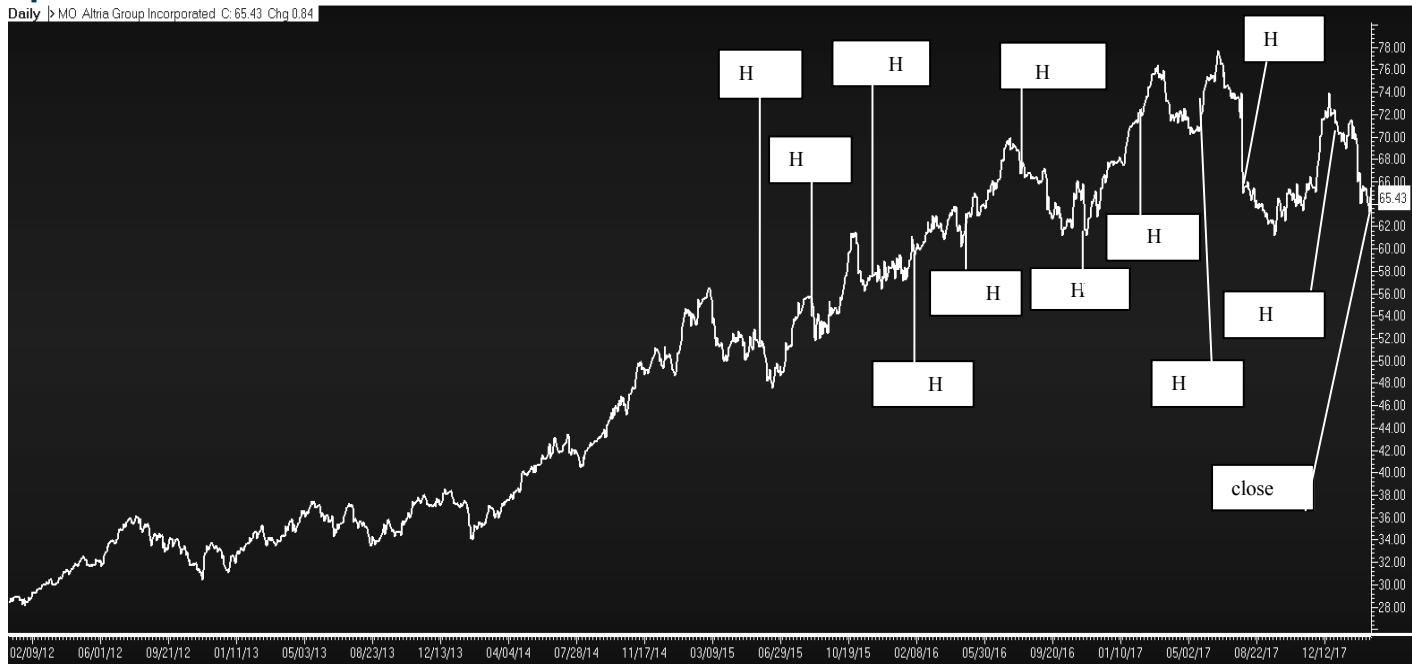
EQUITY RESEARCH

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

	1Q17	2Q17	3Q17	4Q17	FY17e	1Q18e	2Q18e	3Q18e	4Q18e	FY18e
Net revenues	\$6,083	\$6,663	\$6,729	\$6,101	\$25,576	\$6,219	\$6,576	\$6,692	\$6,246	\$25,733
Cost of sales	1,810	1,949	1,940	1,844	7,543	1,865	1,973	2,008	1,874	7,720
Excise taxes on products	1,494	1,595	1,606	1,387	6,082	1,430	1,512	1,606	1,493	6,041
Gross profit	2,779	3,119	3,183	2,870	11,951	2,924	3,091	3,078	2,879	11,972
Marketing, administration, & research costs	477	507	507	623	2,114	626	612	588	523	2,349
Exit cost/asset impairment	4	12	8	9	33	11	6	4	3	24
Operating companies income	2,298	2,600	2,668	2,238	9,804	2,287	2,473	2,486	2,353	9,599
Amortization of intangibles	-5	-5	-5	-6	-21	-5	-5	-5	-5	-20
General corporate expenses	-46	-56	-56	-69	-227	-58	-54	-57	-59	-228
Changes to MDLZ/PM tax-related receivables										
Adjustment to 3rd party guarantee accrual										
Corporate asset impairment/exit costs										
Corporate exit cost										
Operating income	2,247	2,539	2,607	2,163	9,556	2,224	2,414	2,424	2,289	9,351
Restructuring charge										
Interest & other debt expense, net	179	177	169	180	705	179	182	185	186	732
Loss on early debt extinguishment										
Earnings from SABMiller equity investment	23	140	169	200	532	228	173	215	196	812
Other Income		408	37		445					
Gain on derivative financial instruments										
Earnings before income taxes	2,091	2,910	2,644	2,183	9,828	2,273	2,405	2,454	2,299	9,431
Income taxes	689	920	777	2,785	399	546	577	589	552	2,264
Net earnings (continuing ops.)	1,402	1,990	1,867	4,968	10,227	1,727	1,828	1,865	1,747	
Earnings from discontinued ops.										
Earnings attributable to non-controlling interests	-1	-1	-1	-2	-5	-2	-2	-1	-2	-7
Net earnings	\$1,401	\$1,989	\$1,866	\$4,966	\$10,222	\$1,725	\$1,826	\$1,864	\$1,745	\$7,160
Net earnings attributable to Altria	\$0.72	\$1.03	\$0.97	\$2.60	\$5.31	\$0.91	\$0.96	\$0.98	\$0.92	\$3.77
Earnings per share	\$0.73	\$0.85	\$0.90	\$0.91	\$3.39	\$0.94	\$0.98	\$1.02	\$0.97	\$3.91
Continuing operations earnings per share	\$0.72	\$1.03	\$0.97	\$2.60	\$5.31	\$0.91	\$0.96	\$0.98	\$0.92	\$3.77

Important Disclosures

Daily | MO Altria Group Incorporated C: 65.43 Chg 0.84



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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