



August 24, 2018

CURRENT PRICE: \$58.78
RATING: HOLD
PRICE TARGET: N/A
CURRENT YIELD: 5.4%

EPS Estimates - Non-GAAP

	DEC 17A	DEC 18E
1Q	\$0.72 A	\$1.00A
2Q	\$1.03 A	\$0.99A
3Q	\$0.97 A	\$0.98
4Q	\$2.60 A	\$0.92
	\$5.31	\$3.89

Trading Data

52-WEEK PRICE RANGE: **\$74.38 - \$53.91**
 SHARES OUTSTANDING: **1,891(M)**
 MARKET CAP: **\$111.2(B)**
 AVG. DAILY TRADING VOLUME: **7.2(M)**
 S&P 500: **2,875**

Valuation Data

BOOK VALUE: **\$8.35**
 PRICE TO BOOK: **7.04x**
 DIVIDEND: **\$3.20**

Altria Corp (NYSE: MO)

2Q18 Earnings Results

Highlights

- 2Q18 earnings of \$0.99/share vs. \$1.03/share during 1Q17
- Increased dividend by 14.3%
- Maintained 2018 guidance of \$3.90-\$4.03/share
- Awaiting IQOS approval
- Maintain HOLD rating

Investment Thesis

Altria Corp (MO-\$58.78), 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 5.4%.

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 (Skoal/Copenhagen brands & Ste. Michele Wines) and currently gives MO 53.8% 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.

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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. The Smokeable business unit (includes cigarettes/cigars) generated 88.9% of MO's revenues, or \$22.9 billion during FY17. 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-\$98.21). 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-\$59.03) and Philip Morris Intl (PM-\$79.69).

Recent Earnings

MO reported 2Q18 earnings of \$0.99/share vs. \$1.03/share during 2Q17. The 3.9% decrease was due to absence of the 2017 gain on the AB InBev/SAB Miller combination, higher investment spending on the tobacco products segment, and lower OCI in smokeable operating unit. These were partly offset by lower income taxes, higher earnings from AB InBev, higher OCI from the smokeless unit, and fewer shares outstanding. MO's 2Q18 adjusted diluted earnings rose 18.1% to \$1.01/share from \$0.85/share during 2Q17. The improvement was mainly due to lower income taxes and fewer outstanding shares. These positives were partly offset by lower adjusted OCI in the smokeables operating unit and higher investment spending in the tobacco products segment. During 2Q18 MO took a pre-tax \$0.03/share charge for a NPM adjustment settlement with the state of PA, and pre-tax \$0.03/share charges for both a tobacco/health litigation item and related interest costs. Also a \$0.05/share income tax charge was taken related to tax basis adjustments related to the company's AB InBev investment and for a valuation allowance on foreign tax credit carryforwards which are not realizable for MO.

SEGMENT RESULTS

SMOKEABLE PRODUCTS: OCI fell 1.0% to \$2.20 billion from \$2.22 billion when comparing 2Q18 to 2Q17. The decline was due to lower volumes and higher tobacco/health litigation items. These were partly offset by higher pricing, lower promotional investments, and NPM adjustment items. Adjusted OCI decreased 2.8% to \$2.19 billion from \$2.25 billion resulting from lower volumes and was partially offset by higher pricing and lower promotional investments. Adjusted OCI margins improved 1.1 percentage points to 52.6% from 51.5% and revenues, net of excise taxes, fell 4.8% to \$4.16 billion from \$4.37 billion.

MO's total cigarette shipments 10.8% to 27.3 million sticks from 30.6 million sticks due to the industry's rate of decline (4%-5%), retail share loss, and trade inventory adjustments. When adjusted for trade inventory movements MO estimates cigarette shipments decreased 5%. There were volume declines in the three cigarette categories: Marlboro (-10.0%), Other Premium (-9.4%), and Discount (10.8%).



Overall retail market share for MO declined to 50.2% from 50.9%. This occurred as Marlboro's market share fell to 43.2% from 43.5%, Discount's declined to 4.4% from 4.7%, and Other Premiums dropped to 2.6% from 2.7%.

Cigar shipments rose 2.7% to 417 million sticks from 406 million sticks. The increase came from "Black & Mild" cigar volumes rising 3% to 414 million sticks and offset a decline in Other's from 3 million sticks to 4 million sticks.

SMOKELESS PRODUCTS: OCI increased 8.6% to \$377 million from \$347 million due to higher product pricing and lower asset impairment, and exit/implantation costs. These were partly offset by lower shipment volumes. Adjusted OCI increased 3.5% to \$381 million from \$368 million resulting from higher pricing while being partially offset by lower volumes. Adjusted OCI margins rose to 69.9% from 69.4% and revenues, net of excise taxes, increased to \$545 million from \$530 million

Total smokeless decreased 2.4% to 215.7 million cans/packs from 221.0 million cans/packs. The decrease came from lower shipments of Skoal (-9.1%) and was partially offset by higher shipments from Copenhagen (+0.4%) and Other (+0.6%). MO stated the overall decline was produced by the industry's rate of decline and the company's retail share loss.

MO's smokeless retail share fell to 54.1% from 54.3% as Skoal's decreased to 16.4% from 16.8%, Copenhagen's was flat at 34.3%, and Other's increased to 3.4% from 3.2%.

WINE SEGMENT: Reported and adjusted OCI rose 8% to \$27 million from \$25 million because of higher volumes and a favorable product mix. These positives were partly offset by increased marketing and sales costs. Revenues, net of excise taxes, increased 11.7% due to favorable product mix and higher shipped volumes. Wine shipments rose 6.3% to 1.9 million cases. OCI margins declined 0.5 percentage points to 16.7% from 17.2%.



RECENT DEVELOPMENTS:

MO's Board of Directors increased the quarterly dividend by 14.3% to \$0.80/share. The increased dividend will be paid beginning in September 2018.

This past May, MO authorized a new \$1 billion share repurchase program in addition to the existing \$1 billion repurchase program. As of 6/30/18, the company had \$1 billion remaining in its overall share repurchase program and expects it to be completed by 2Q19.

MO participated with Philip Morris's (PM-\$79.69) presentation to the FDA's Tobacco Products Scientific Advisory Committee seeking approval the product, "IQOS MRTPA". Assuming the product gains approval, MO has plans to immediately market the IQOS product throughout the USA.

The company's NuMark unit announced it grew its e-vapor volumes by 16% during 2Q18, reflecting its expansion of MarkTen Elite to over 23,000 retail stores.

Our Thoughts

A decent quarter of earnings for MO with 2Q18 earnings of \$0.99/share vs. \$1.03/share and adjusted diluted earnings rising 18.1% to \$1.01/share from \$0.85/share, when comparing the two quarters. OCI fell in the Smokeable segment (-1.0%) while rising in the Smokeless (+8.6%) and the Wine segment (8.0%). MO continues to deal with declining cigarette consumption of approximately 4%-5% per year in the US, as are all cigarette manufacturers. The company hopes to counter this trend with roll-out of its recent alternative cigarette products like NuMark. Additionally, MO is awaiting the potential approval of the IQOS product, by the FDA, with plans to do an immediate rollout across the US. If this product is approved, then MO's shares could rally, over the short term, based on this potential positive announcement.

Shareholders should be happy given the recent dividend increase of 14.3% and the prospects of further dividend growth, assuming future improvement in earnings. The current dividend yield of 5.4% should reward patient investors. Additionally, MO's management believes the company could grow earnings by 7%-9% annually through 2020.



Risks

There is no guarantee MO will improve earnings/cash flow. Declining US cigarette consumption/volumes may hurt the company's revenues and profits. Litigation/regulation risks and excise taxes threaten cigarette manufacturers. Rising interest rates, economic recessions, 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, geopolitical events, wars, cyber hacking, terrorist attacks, and failure to comply with Sarbanes Oxley and generally accepted accounting guidelines.

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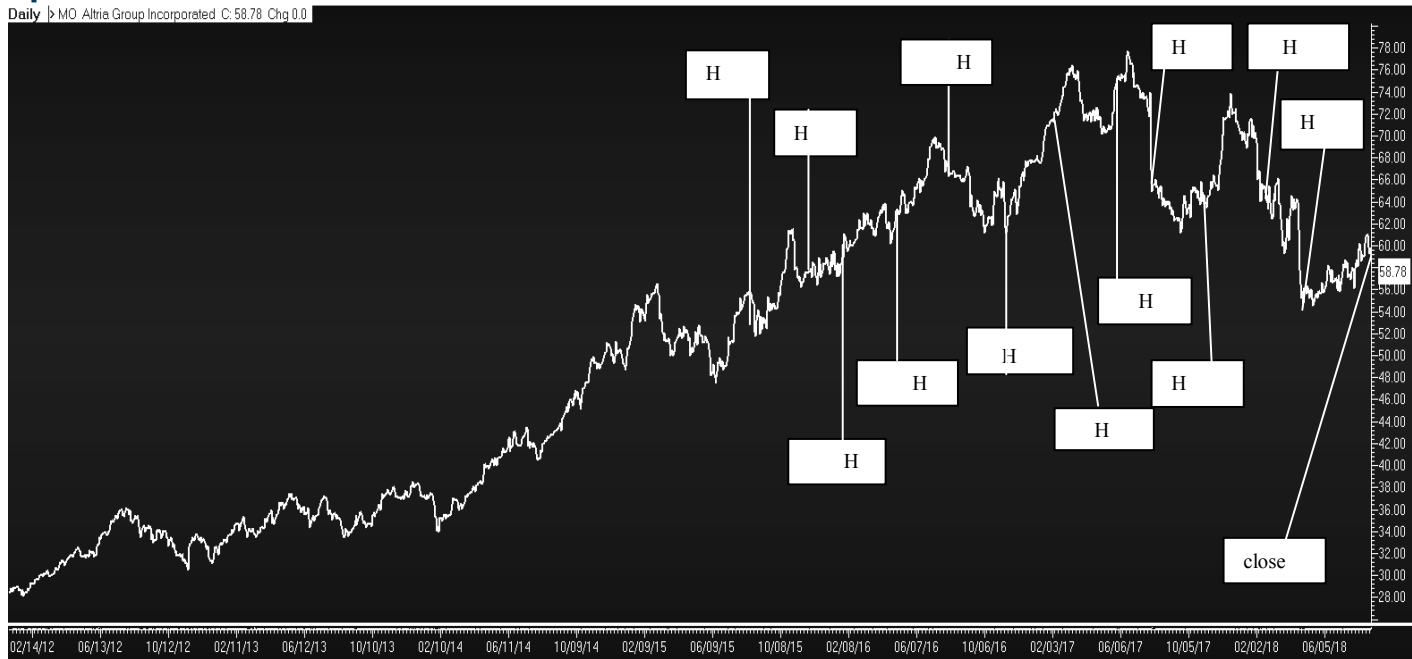
EQUITY RESEARCH

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

	1Q17	2Q17	3Q17	4Q17	FY17e	1Q18	2Q18	3Q18e	4Q18e	FY18e
Net revenues	\$6,083	\$6,663	\$6,729	\$6,101	\$25,576	\$6,108	\$6,305	\$6,692	\$6,246	\$25,351
Cost of sales	1,810	1,949	1,940	1,844	7,543	1,734	1,738	2,008	1,874	7,354
Excise taxes on products	1,494	1,595	1,606	1,387	6,082	1,438	1,426	1,606	1,493	5,963
Gross profit	2,779	3,119	3,183	2,870	11,951	2,936	3,141	3,078	2,879	12,034
Marketing, administration, & research costs	477	507	507	623	2,114	567	591	588	523	2,269
Exit cost/asset impairment	4	12	8	9	33	2	2	4	3	11
Operating companies income	2,298	2,600	2,668	2,238	9,804	2,367	2,548	2,486	2,353	9,754
Amortization of intangibles	-5	-5	-5	-6	-21	-5	-5	-5	-5	-20
General corporate expenses	-46	-56	-56	-69	-227	-46	-45	-57	-59	-207
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	2,316	2,498	2,424	2,289	9,527
Restructuring charge										
Interest & other debt expense, net	179	177	169	180	705	166	179	185	186	716
Loss on early debt extinguishment										
Earnings from SABMiller equity investment	23	140	169	200	532	342	228	215	196	981
Other Income		408	37		445		9			9
Loss on AB InBev/SAB Miller business combination						33				33
Earnings before income taxes	2,091	2,910	2,644	2,183	9,828	2,466	2,557	2,454	2,299	9,776
Income taxes	689	920	777	2,785	399	571	680	589	552	2,392
Net earnings (continuing ops.)	1,402	1,990	1,867	4,968	10,227	1,895	1,877	1,865	1,747	7,384
Earnings from discontinued ops.										
Earnings attributable to non-controlling interests	-1	-1	-1	-2	-5	-1	-1	-1	-2	-6
Net earnings	\$1,401	\$1,989	\$1,866	\$4,966	\$10,222	\$1,894	\$1,876	\$1,864	\$1,745	\$7,379
Net earnings attributable to Altria	\$0.72	\$1.03	\$0.97	\$2.60	\$5.31	\$1.00	\$0.99	\$0.98	\$0.92	\$3.89
Earnings per share	\$0.73	\$0.85	\$0.90	\$0.91	\$3.39	\$0.95	\$1.01	\$1.02	\$0.97	\$3.95
Continuing operations earnings per share	\$0.72	\$1.03	\$0.97	\$2.60	\$5.31	\$1.00	\$0.99	\$0.98	\$0.92	\$3.89

Important Disclosures

Daily | MO Altria Group Incorporated C: 58.78 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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