CAPITOL SECURITIES MANAGEMENT, INC.
EQUITY RESEARCH

May 21, 2019

CURRENT PRICE:	**$51.87**
RATING:	**HOLD**
PRICE TARGET:	**N/A**
CURRENT YIELD:	**6.2%**

EPS Estimates - Non-GAAP

	DEC 18A	DEC 19E
1Q	$1.00 A	$0.60A
2Q	$0.99 A	$0.93
3Q	$1.03 A	$1.04
4Q	$0.66 A	$0.88
	$3.68	**$3.45**

Trading Data

52-WEEK PRICE RANGE:	**$66.04 - $42.40**
SHARES OUTSTANDING:	**1,874(M)**
MARKET CAP:	**$97.2(B)**
AVG. DAILY TRADING VOLUME:	**9.6(M)**
S&P 500:	**2,864**

Valuation Data

BOOK VALUE:	**$7.52**
PRICE TO BOOK:	**6.9x**
DIVIDEND:	**$3.20**

Altria Corp (NYSE: MO)

1Q19 Earnings Results

Highlights

- 1Q19 earnings of $0.60/share vs. $1.00/share during 1Q18
- Acquired equity stakes in JUUL & CRONOS
- Debt level increased from $13 billion to $26 billion
- Provided 2019 adjusted earnings guidance of $4.15-$4.27/share
- Maintain HOLD rating

Investment Thesis

Altria Corp (MO-$51.87), 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 6.2%.

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 50% market share of the US cigarette market. Through 12/31/18 Philip Morris USA generated approximately 87.9% of overall revenues, or $22.3 billion. During 2009 MO completed its purchase of US Tobacco (Skoal/Copenhagen brands & Ste. Michele Wines) and currently gives MO 53.9% 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. The Smokeable business unit (includes cigarettes/cigars) generated 87.9% of MO's revenues, or $22.3 billion during FY18. 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-$81.00). 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-$31.98) and Philip Morris Intl (PM-$85.76). To reduce its dependence of tobacco revenue streams, MO recently acquired equity stakes in Juul Labs and Cronos (CRON-$15.60).

Recent Earnings

MO reported 1Q19 diluted earnings of $0.60/share vs. $1.00 /share during 1Q18. The decrease came from a 2019 unrealized pre-tax $425 million loss on Cronos' (CRON-$15.60) related financial instruments, lower equity earnings from AB InBev (BUD-$81.00), higher asset impairment/exit/implementation and acquisition-related costs, increased interest expense in 2019, and 2018 NPM adjustment items ($68 million). These negatives were partly offset by higher OCI from the smokeless unit. MO's overall revenues decreased 7.9% to $5.63 billion from $6.12 billion while operating income declined 3.4% to $2.24 billion, from $2.32 billion, due to higher asset impairment/exit costs and lower gross profits. MO's 1Q19 adjusted earnings fell to $0.90/share from $0.95/share during 1Q18 primarily because of higher interest expense and lower contributions from AB InBev. These were partly offset by higher adjusted OCI in the smokeless unit. During 1Q19, AB InBev's equity earnings included a pre-tax charge of $114 million, mainly consisting of MO's share of AB InBev's mark-to-market losses on AB InBev's derivative financial instruments used to hedge certain share commitments.

SEGMENT RESULTS

SMOKEABLE PRODUCTS: Reported OCI for 1Q19 decreased to $1.93 billion from $2.04 billion during 1Q18 due to lower shipment volumes, 2018 NPM adjustment items, and higher asset impairment/exit/ implementation costs. These were partly offset by higher product pricing, lower promotional investments, and decreased costs. When comparing the two quarters, adjusted OCI was flat at $1.99 billion as lower shipment volumes were offset by higher pricing, lower promotional investments and costs. Adjusted OCI margins improved 3.6 percentage points to 53.3% from 49.7%.

MO's total cigarette shipments fell 14.3% to 23.98 billion sticks from 27.52 billion sticks resulting from trade inventory movements, the overall rate of industry decline, retail share losses, and one less shipping day. If adjusted for trade inventory movements and one less shipping day, then domestic volume shipments only fell 7%, and if adjusted for the overall industry decline then shipments fell 5%. Marlboro shipments decreased 13.5%, Other Premium's fell 17.3%, and Discount's declined 20.2%. Cigar shipment volumes rose 1.1% to 382 million from 378 million, as "Black & Mild'' improved 1.3% while Other fell 33.3%.

Overall cigarette market share for MO decreased to 49.8% from 50.5%. This occurred following declines in Marlboro (43.1% vs. 43.3%), Other Premium (2.5% vs. 2.6%), and Discount (4.2% vs. 4.6%).

SMOKELESS PRODUCTS: 1Q19 reported OCI improved 5.9% to $358 million from $338 million during 1Q18. The increase came from higher pricing along with lower promotional investments and costs. These were partly offset by lower shipment volumes and higher asset impairment/exit/implementation costs. Adjusted OCI rose 7.9% to $367 million, resulting from higher pricing, lower promotional investments/costs and offset by lower shipment volumes. Meanwhile, adjusted OCI margins increased 3.1 percentage points to 72.1% from 69.0%.

Total smokeless product volumes declined 2.2% to 191.4 million cans/packs from 195.7 million cans/ packs. MO explained the decrease came from the overall industry's rate of decline and one less shipping day. Copenhagen shipments rose slightly to 125.2 million can/packs, from 124.4 million can/packs, but was offset by decreased volumes in Skoal, falling 8.5% to 50.3 million cans/packs, and Other, dropping 2.5% to 15.9 million cans/packs.

MO's overall smokeless retail share increased 0.1 percentage points to 53.9% from 53.8%. This occurred due to market share increases for Copenhagen (35.0% vs. 34.3%) and Other (3.5% vs. 3.3%). Partially offsetting these gains was the decrease in Skoal's market share (15.4% vs 16.2%).

WINE: This segment's reported and adjusted OCI decreased 11.8% to $15 million from $17 million due to higher costs and increased promotional investments, while being partly offset by higher shipments (+8% to 1.9 million cases). Revenues, net of excise taxes, rose 6.3% to $151 million from $142 million, because of higher shipment volumes, and were partly countered by larger promotional investments.

RECENT DEVELOPMENTS:

During 1Q19 MO repurchased 2.7 million shares for approximately $151 million. There is $195 million remaining in the current $2 billion share repurchase program.

MO completed its $1.8 billion investment in the Canadian Cannabinoid Company, Cronos (CRON-$15.60). It will give MO a 45% stake in the company with an option to buy an additional 10% during the next few years.

To fund its investment in JUUL and CRON, MO issued $16.3 billion of senior unsecured debt.

To counter the added annual interest expense ($500 million-$600 million) generated by newly issued debt, MO announced a cost reduction program anticipated to deliver approximately $575 million of annualized cost savings by the end of 2019. The program will entail third party spending reductions across MO's business units and workforce reductions. To this end, the company recorded a $61 million of pre-tax charges during 1Q19.

The FDA authorized the sale of IQOS heated tobacco systems in the US. MO plans to initially introduce the product in the Atlanta GA market during 3Q19.

NEW DEBT INCURRED BY MO

To finance these acquisitions MO took a $14.6 billion term loan from JPMorgan (JPM-$111.73) , with $1.8 billion of the loan un-used and at an interest rate 100 bps above LIBOR, or ~3.5%. MO's total debt will rise to $26.4 billion from $13 billion and MO's debt/EBITDA ratio will rise to 2.7x from 1.3x. This additional debt will increase annual interest payments from $500 million - $600 million to over $1.1 billion. To counter this interest expense increase, MO announced a new cost-cutting program aimed at reducing annual operating costs by $575 million.

Due to the additional debt, S&P lowered MO's credit rating to BBB from A- (with a steady outlook) and Moody's cut its rating to a "negative outlook". S&P believes FDA statements, about fighting underage use of e-vapes, creates uncertainty over JUUL's long term valuation. Additionally, S&P said it "does not believe JUUL or Cronos will provide significant near term investment returns to Altria and will not allow MO to deleverage new debt levels over the near term." S&P further said, while the JUUL/CRONOS investments will not be adding to the company's profits over the near term, MO is paying for future growth-assuming JUUL & Cronos grow revenues.

Our Thoughts

MO reported 1Q19 diluted earnings of $0.60/share vs. $1.00 /share during 1Q18 and adjusted earnings fell to $0.90/share from $0.95/share. Prior to 1Q19 earnings results, MO's shares had come under selling pressure given the company's transitionary move into alternative smoking products, attempting to shift from dependence on declining cigarette revenue sales, towards potential rising revenue streams from JUUL and CRON. To finance these moves, the company raised its balance sheet debt to $26.4 billion from $13 billion, causing concern on Wall Street, and thus, the subsequent sell-off of MO's stock. As a result, MO's shares decreased to a 13 P/E multiple from a 17 P/E multiple, as shares now hover in the low-$50s area.

This stock offers an attractive dividend yield of 6.2%, however, MO will need to prove they can grow overall revenues in the face of the cigarette industry's overall annual rate of decline of 4%-5% and overcome investor fears of increased balance sheet debt. Until then the stock may see limited upside until investments in JUUL and CRON begin to generate positive returns for MO. Management believes JUUL may begin to contribute to its bottom line in 2020 while a contribution from Cronos is unlikely until marijuana is legalized in the US. During the 1Q19 earnings call, MO provided 2019 adjusted earnings guidance of $4.15-$4.27/share and stressed its goal of paying an attractive dividend to shareholders. We continue to rate this stock a HOLD.

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/debt expense 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.

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

CAPITOL SECURITIES MANAGEMENT, INC.

EQUITY RESEARCH

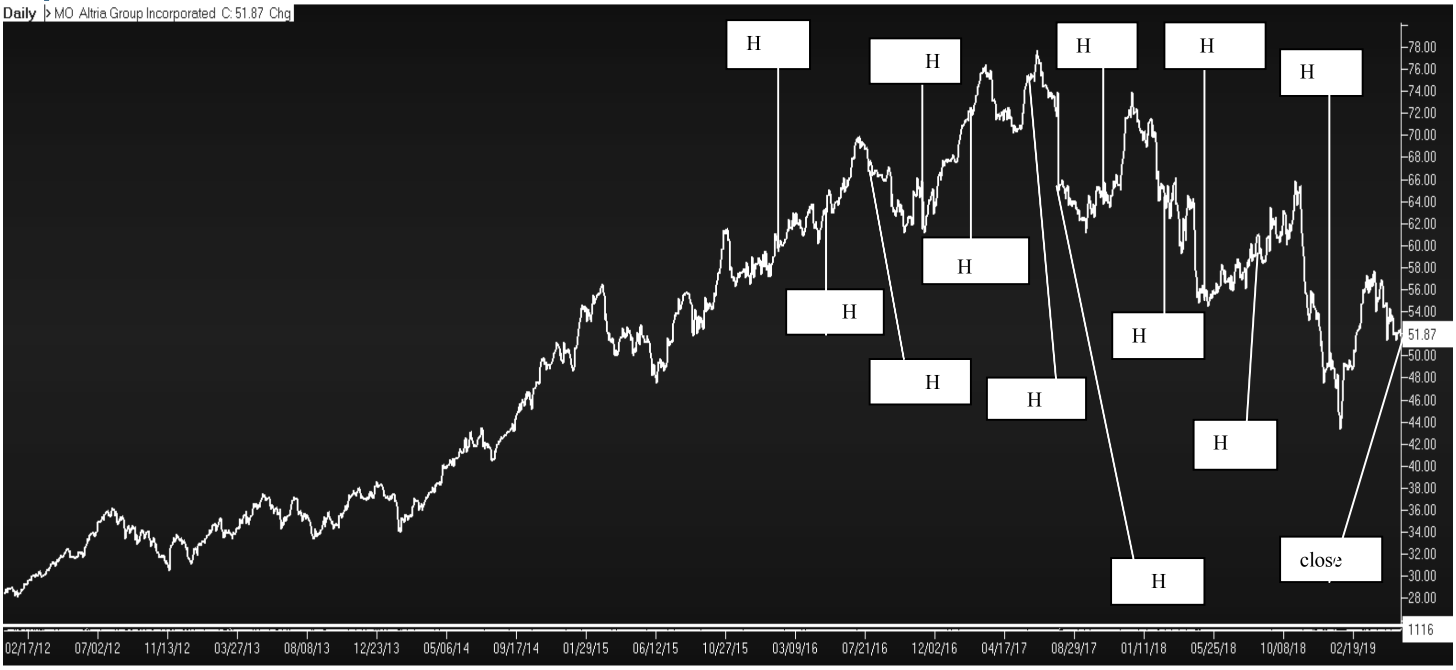
Altria Group, Inc.
(dollars in millions, except per share data

	1Q18	2Q18	3Q18	4Q18	FY18	1Q19	2Q19e	3Q19e	4Q19e	FY19e
Net revenues	$6,108	$6,305	$6,837	$6,114	$25,364	$5,628	$6,277	$6,798	$ 5,993	$24,696
Cost of sales	1,734	1,738	2,037	1,864	7,373	1,578	1,758	1,903	1,678	6,917
Excise taxes on products	1,438	1,426	1,545	1,328	5,737	1,239	1,412	1,529	1,348	5,528
Gross profit	2,936	3,141	3,255	2,922	12,254	2,811	3,107	3,366	2,967	12,251
Marketing, administration, & research costs	567	591	619	626	2,403	479	536	521	514	2,050
Exit cost/asset impairment	2	2	2	381	383	39	4	5	8	56
Operating companies income	2,367	2,548	2,638	1,915	9,468	2,293	2,567	2,840	2,445	10,145
Amortization of intangibles	5	5	20	8	38	8	8	17	12	45
General corporate expenses	46	45	61	163	315	46	61	52	55	214
Changes to MDLZ/PM tax-related receivables										
Adjustment to 3rd party guarantee accrual										
Corporate asset impairment/exit costs						1				1
Corporate exit cost										
Operating income	2,316	2,498	2,557	1,744	9,115	2,238	2,498	2,771	2,378	9,885
Restructuring charege										
Interest & other debt expense,net	166	179	159	162	665	384	382	382	379	1,527
Loss on early debt extinguishment										
Earnings from SABMiller equity investment	342	228	189	131	890	86	214	219	199	718
Other Income		9	21	3	34	1	7	5	8	21
Loss on AB InBev/SAB Miller business combination	33				33					
Loss on Cronos-related financial instruments						425				425
Earnings before income taxes	2,466	2,557	2,608	1,710	9,341	1,516	2,337	2,613	2,206	8,672
Income taxes	571	680	664	459	2,374	395	598	669	565	2,227
Net earnings (continuing ops.)	1,895	1,877	1,944	1,251	6,967	1,121	1,739	1,944	1,641	6,445
Earningns from discontinued ops.										
Earnings attributable to non-controlling interests	-1	-1	-1	-1	-4	-1	-1	-1	-1	-4
Net earnings	$1,894	$1,876	$1,943	$1,251	$6,963	$1,120	$1,738	$1,943	$1,640	$6,441
Net earnings attributable to Altria	$1.00	$0.99	$1.03	$0.66	$3.68	$0.60	$0.93	$1.04	$0.88	$3.45
Earnings per share	$0.95	$1.01	$1.08	$0.95	$3.99	$0.90	$1.06	$1.20	$1.02	$4.18
Continuing operations earnings per share	$1.00	$0.99	$1.03	$0.66	$3.68	$0.60	$0.93	$1.04	$0.88	$3.45

Capitol Securities Management, Inc.

EQUITY RESEARCH

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

Steven Marascia certifies, with respect to the companies or securities that he analyzes, that (1) the views expressed in this report accurately reflect his personal views about all of the subject companies and securities and (2) no part of his compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

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.
(3) Sell – The Stock's total return including dividends is expected to be below the industry or market average by 10% or more over the next twelve months.

The distribution of investment ratings for all companies in our coverage universe are as follows: (1) 33.3%, (2) 66.7%, (3) 0%

The distribution of investment ratings used for companies whom we have performed banking services in the last 12 months are (1)100%, (2) 0%, (3) 0%

Capitol Securities Management's Investment Banking/Public Finance unit has not received compensation for investment banking services from the subject company in the past 12 months. Nor does it expect to receive, or intend to seek compensation for, investment banking services from the subject company in the next 3 months.

No affiliate of Capitol Securities Management, or Capitol Securities Management, received compensation from the subject company for products or services during the past 12 months.

The subject company is not, or during the past 12 months, was not, a client of Capitol Securities Management's Investment Banking/Public Finance unit.

Other Disclosures

This report is not directed to, or intended for distribution to or use by any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would subject Capitol Securities or its affiliates to any registration or licensing requirement within such jurisdiction. The information presented in this report is provided to you for information purposes only and is not to be used or considered as an offer or the solicitation of an offer to sell or buy or subscribe for securities or other financial instruments. Capitol Securities may not have taken any steps to ensure that the securities referred to in this report are suitable for any particular investor. Capitol Securities will not treat recipients of this report as its customers by virtue of their receiving this report. The investments and services contained or referred to in this report may not be suitable for you and it is recommended that you consult an independent investment advisor if you are in doubt about such investments or investment services. Nothing in this report constitutes investment, legal, accounting or tax advice, or a representation that any investment or strategy is suitable or appropriate to your individual circumstances, or otherwise constitutes a personal recommendation to you. Capitol Securities does not advise on the tax consequences of investments and you are advised to contact an independent tax advisor. Information and opinions presented in this report have been obtained or derived from sources believed by Capitol Securities to be reliable, but Capitol Securities

makes no representation as to their accuracy or completeness. This report is not to be relied upon in substitution for the exercise of independent judgment. Capitol Securities may have issued, and may in the future issue, other reports that are inconsistent with, and reach different conclusions from, the informationpresented in this report. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. Information, opinions and estimates contained in this report reflect a judgment at its original date of publication by Capitol Securities and are subject to change without notice. The price,value of and income from any of the securities mentioned in this report can fall as well as rise.

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