CAPITOL SECURITIES MANAGEMENT, INC.
EQUITY RESEARCH

**_September 20, 2023_**

| | |
|---|---|
| **CURRENT PRICE:** | **$43.04** |
| **RATING:** | **BUY** |
| **PRICE TARGET:** | **$56** |
| **CURRENT YIELD:** | **9.1%** |

### *EPS Estimates*

| | DEC 22A | DEC 23E |
|---|---|---|
| 1Q | $1.12 | $1.18A |
| 2Q | $1.26 | $1.31A |
| 3Q | $1.28 | $1.30 |
| 4Q | $1.18 | $1.23 |
| | **$4.84** | **$5.02** |

### *Trading Data*

| | |
|---|---|
| 52-WEEK PRICE RANGE: | **$48.99 - $40.35** |
| SHARES OUTSTANDING: | **1,782(M)** |
| MARKET CAP: | **$76.7(B)** |
| AVG. DAILY TRADING VOLUME: | **7.61(M)** |
| S&P 500: | **4,402** |

### *Valuation Data*

| | |
|---|---|
| BOOK VALUE: | **n/a** |
| PRICE TO BOOK: | **n/a** |
| DIVIDEND: | **$3.92** |

# Altria Corp (NYSE: MO)

***2Q23 Earnings Results***

## Highlights

- 2Q23 adjusted earnings of $1.31/share vs. $1.26/share during 2Q22
- Results improved from fewer outstanding shares & higher OCI
- Completed purchase of NJOY
- Annual dividend increased 4.3%
- Maintain BUY rating & price target to $56

## Investment Thesis

Altria Corp (MO-$43.04), 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 & dividend growth, on a pro-forma basis. After a recent drop in MO's shares, from the recent stock market declined sparked by the US spread of Covid pandemic, and investor disappointment over the company's JUUL investment, and holding of Anheuser-Busch InBev (BUD-$57.39) stock, its shares may be poised for a rebound. Additionally, MO offers investors a dividend yield of 9.1%. These shares are recommended for moderate-to-aggressive risk-tolerant income/growth investors.

## Company Summary

Altria Group, headquartered in Richmond VA, is the parent company of Philip Morris USA, US Smokeless Tobacco, John Middleton, and Philip Morris Capital Corp (PMCC). The company operates four segments: domestic cigarettes, smokeless tobacco products, machine made cigars, 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 12/31/22 Philip Morris USA generated approximately 89.6% of overall revenues. After selling its wine business, MO has two primary revenue generating units: Smokeable Products & Oral Tobacco Products.

***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 89.6% of MO's revenues, or $22.5 billion during FY21. 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-$57.39). 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-$34.02) and Philip Morris Intl (PM-$97.71). In 2009 MO purchased of US Tobacco (Skoal/Copenhagen brands) currently giving MO 44.0% of the US smokeless tobacco market share. To diversify its revenue stream, MO acquired equity stakes in JUUL Labs and Cronos (CRON-$2.18). During 2021, MO completed the sale of Ste. Michele Wines business.

Given the industry wide declines in tobacco consumption, MO began offering tobacco alternative products. To this end, the company purchased NJOY Holdings whose product portfolio is led by NJOY ACE, currently the only pod-based e-vapor product with FDA market authorization. MO also has a majority-owned joint venture with the JT Group, called Horizontal Innovations, for the US marketing/commercialization of heated tobacco stick products. An agreement with Philip Morris International (PMI-$97.71) allows MO exclusive rights to market "IQOS" and three Marlboro heatstick variants in the US through 1Q24.

# Recent Earnings

MO reported 2Q23 diluted earnings of $1.19/share vs. $0.49/share during 4Q22. The primary reason for improved results was the absence of charges taken during 2Q22's related to MO's equity invest in JUUL, Cronos, Anheuser-Busch InBev, higher operating companies income (OCI) during 2Q23, and fewer shares outstanding. These were partly offset by higher tobacco/health/other litigation items and acquisition costs related to the NJOY purchase. Operating revenues declined 0.5% to $6.51 billion, OCI rose 3.4% to $3.29 billion, and operating income fell 6.5% to $2.91 billion. When comparing the two quarters, adjusted earnings increased to $1.31/share from $1.26/share. The increase was from higher adjusted OCI and fewer outstanding shares which were partly offset by lower net periodic benefit income.

SEGMENT RESULTS

SMOKEABLE PRODUCTS: OCI improved 3.0% to $2.85 billion, from $2.80 billion, driven by higher product pricing while partially offset by lower shipments, increased promotional spending, and higher per unit settlement charges/costs. Net revenues fell 0.9% to $5.82 billion, from $5.87 billion, because of lower shipments and higher promotional spending. These were partly offset by higher product pricing.

Adjusted OCI increased 3.1% to $2.89 billion from $2.80 billion due to higher product pricing and was partly offset by lower shipments, increased promotional spending, and higher per unit settlement charges/costs. Meanwhile, adjusted OCI margins rose to 60.4% from 59.1%.

On a quarter-to-quarter comparison, overall cigarette shipments decreased 8.7% to 20.6 billion sticks from 22.5 billion sticks. The decline came from the industry's rate of decline and loss of retail market share. These were partly offset by trade inventory movements. When adjusted for trade inventory movements, smokeable products shipment volumes fell 10%.

Marlboro cigarette shipments fell 7.6% to 18.5 billion sticks, Other Premium declined 6.2% to 954 million, and Discount decreased 24.4% to 1.1 million sticks. Total cigar shipments rose 7.6% to 466 million cigars due to higher "Black & Mild" shipments (465 million) while Other was flat (1 million).

MO's total cigarette market share decreased to 46.9%, from 48.2%, due to market share declines of Marlboro (42.1% vs. 42.7%) and Discount (2.5% vs. 3.2%), while Other Premium was flat (2.3 million). Management attributed this to the negative effects of inflation and higher gasoline prices as consumers shifted their spending patterns.

ORAL TOBACCO PRODUCTS: Both reported and adjusted OCI rose 3% to $443 million from $430 million due mainly to higher product pricing which was partly offset by lower shipments, higher promotional expenses, and change of products sold mix. Revenues increased 2.3% to $680 million from $665 million. Reported and adjusted OCI margins were higher at 68.0% vs. 67.9%.

Oral tobacco product shipments fell 1.7% to 204.4 million cans/packs from 208.0 million cans/packs because of retail share loss and was partly offset by the industry's growth rate, trade inventory movements, and calendar differences. When adjusted for calendar differences and trade industry movements, MO estimates shipments decreased by 2.5%.

Copenhagen shipments declined 6.7% to 114.9 million cans/packs, Skoal's decreased 9.2% to 42.6 million cans/packs, and Others fell 4.5% to 16.9 million packs/cans. These declines were partly offset by a 47.8% increase of "on!" shipments which totaled 30.0 million cans/packs.

Retail market share decreased to 44.0% from 46.8% as declines were seen in the market shares of Copenhagen (24.3% vs. 27.3%), Skoal (9.9% vs. 11.5%), and Others (2.8% vs. 3.1%). These were partially offset by an increase in the market share of “on!” (7.0% vs. 4.9%).

RECENT DEVELOPMENTS

The Board of Directors recently increased the annual dividend 4.3% to $3.92/share.

During the 2Q23 earnings call, management reaffirmed adjusted earnings guidance of $4.89-$5.03/share. Also, an additional 10.4 million shares were bought through its current share repurchase program as of 6/30/23. Currently $528 million remains under the existing $3.5 million share repurchase program expected to be completed by 12/31/23.

On 6/1/23 MO completed the acquisition of NJOY Holdings paying $2.75 billion in cash consisting of a $2 billion term loan, commercial paper, and cash. An additional $500 million may be paid contingent on receipt of FDA authorizations regarding to certain NJOY products. NJOY is the largest vaping company in the US.

This past July, MO received a final $1.8 million payment from Philip Morris Intl. (PMI-$97.71) as part of a $2.7 billion transition agreement for the IQOS Tobacco Heating System. These proceeds were used to repay the outstanding $2 billion term loan.

When comparing 2Q23 to 2Q22, MO took pre-tax charges of $290 million vs. $46 million related to tobacco/health, certain litigation items, and related interest costs. The 2Q23 charges came mainly from settlement of JUUL-related litigation.

In a July 2023 transaction MO exchanged it’s entire minority economic interest in JUUL for a non-exclusive, irrevocable global license to certain JUUL heated tobacco intellectual property. As a result, a $250 million non-cash/pre-tax loss was taken including changes in the fair value of MO’s former investment in JUUL during 2022.

## Our Thoughts

A good earnings report as MO's 2Q23 diluted earnings rose to $1.19/share from $0.49/share during 2Q22. The main reason for improved results was the absence of charges taken during 2Q22's related to MO's equity invest in JUUL, Cronos, Anheuser-Busch InBev, higher OCI during 2Q23, and fewer shares outstanding. When comparing the two quarters, adjusted earnings increased to $1.31/share from $1.26/share. While overall tobacco shipments decreased, seen industry wide, MO benefitted from three price increases of its Marlboro Brand during 2023. Additionally, results benefited from increased "on!" shipments partly offsetting declining shipments of Copenhagen, Skoal, and Other chewing tobacco products.

We continue to recommend MO to income/growth investors seeking a high dividend yield of XX%. Management reaffirmed forward 2023 adjusted earnings guidance of $4.89-$5.03/share, equating to a 1%-4% growth rate from 2022's adjusted earnings base of $4.84/share. Operations appears to be generating sufficient cash flow allowing the Board of Director's to recently increase the dividend to $3.92/share, and maintain its existing $3.5 million share repurchase program, expected to be completed by 12/31/23. We believe further cash flow growth in 2024 may allow the Board to initiate another share repurchase program and, potentially again, raise the annual dividend. We rate MO a BUY with a $56/share price target, equating to 11.2x our adjusted earnings 2023 estimate of $5.02/share.

RISKS TO OUR $56/SHARE PRICE TARGET

Decreasing earnings/cash flow at MO. Decreasing US cigarette consumption, lower oral tobacco product sales, or falling consumption volumes may also hurt the company's revenues/profits. Declining earnings for MO's two operating units poses a risk to the company. Ownership stakes in Cronos & JUUL may not be profitable or produce profits to pay higher interest payments on subsequent debt incurred for these investments. Additionally, there is no guarantee non-combustible product sales will be profitable, or offset declining sales of traditional tobacco revenues. This stock could decline in value if MO reduces/eliminates the common stock dividend or is unable to pay its debt. Litigation/regulation risks and excise taxes are a threat to MO. Rising interest rates/inflation, corporate taxes, economic recessions, higher tobacco prices, increased gasoline prices, rising operating costs/debt expense, or tax issues could negatively impact MO's future earnings. This stock may be adversely impacted by negative equity/credit markets, credit ratings agencies downgrading MO's debt, geopolitical events, wars, cyber hacking, supply chain issues, black swan events, terrorist attacks, and failure to comply with Sarbanes Oxley and generally accepted accounting guidelines. All factors mentioned above could cause a decline in MO's stock price or its ability to maintain its common stock dividend.

## Risks

There is no guarantee MO will improve earnings/cash flow. Declining US cigarette consumption/volumes may hurt the company's revenues and profits. Declining earnings from MO's two operating units pose a risk to the company. Additonally, there is no guarantee non-combustible product sales growth will occur and offset declining traditional tobacco product revenues. Ownership stakes in Cronos and JUUL may not be profitable or produce profits to pay higher interest payments on subsequent debt incurred for these investments. This stock could decline in value if MO reduces/eliminates the common stock dividend. Litigation/regulation risks and excise taxes are a threat to MO. Rising interest rates/inflation, corporate tax rates, economic recessions, higher tobacco prices, increased gasoline prices, rising operating costs/debt expense, or tax issues could negatively impact MO's future earnings. This stock may be adversely impacted by negative equity/credit markets, credit ratings agencies downgrades of MO's debt, geopolitical events, wars, cyber hacking, supply chain issues, black swan events, terrorist attacks, and failure to comply with Sarbanes Oxley and generally accepted accounting guidelines. All factors mentioned above could cause a decrease or elimination of MO's common stock dividend.

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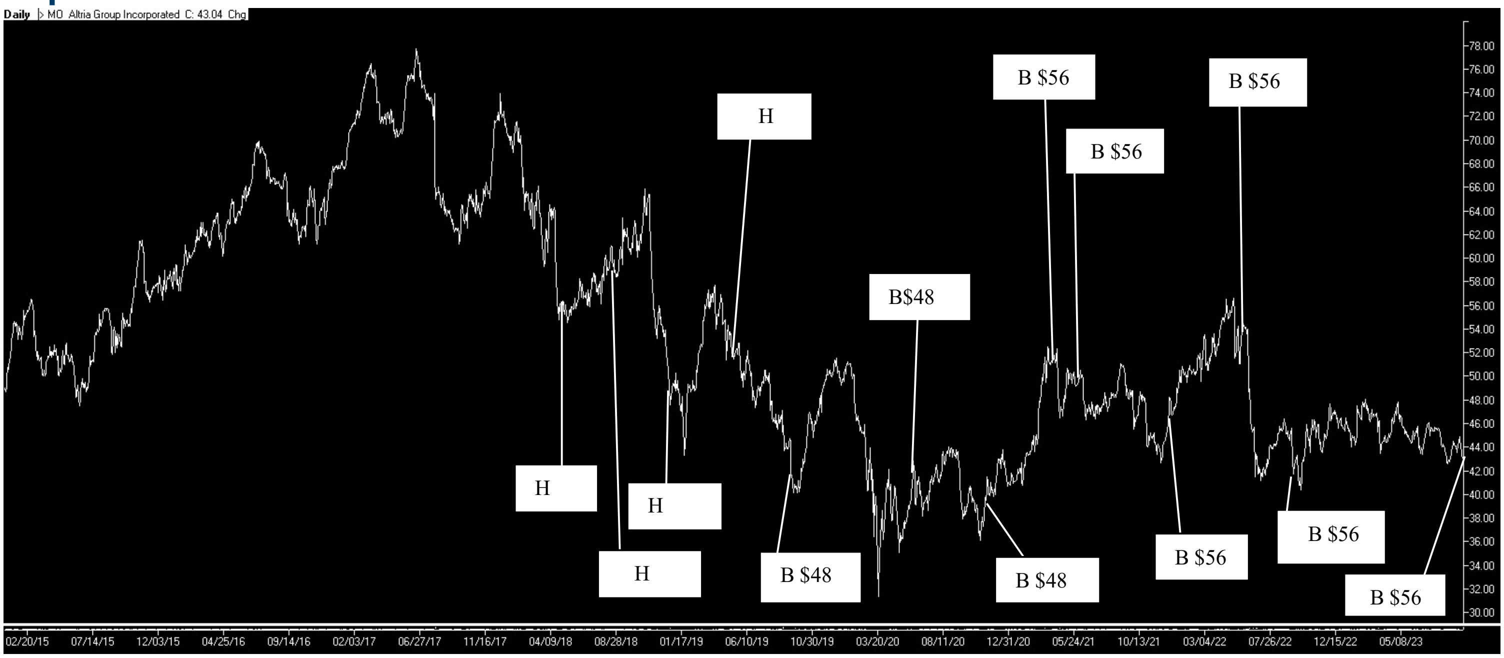
Capitol Securities Management, Inc. Equity Research

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

| | 1Q22 | 2Q22 | 3Q22 | 4Q22 | FY22 | 1Q23 | 2Q23 | 3Q23e | 4Q23e | FY23e |
|---|---|---|---|---|---|---|---|---|---|---|
| Net revenues | $5,892 | $6,543 | $6,550 | $6,111 | $25,096 | $5,719 | $6,508 | $6,583 | $6,492 | $24,762 |
| Cost of sales | 1,446 | 1,708 | 1,715 | 1,573 | 6,442 | 1,434 | 1,681 | 1,698 | 1,674 | 6,487 |
| Excise taxes on products | 1,073 | 1,169 | 1,138 | 1,028 | 4,408 | 956 | 1,070 | 1,078 | 1,064 | 4,168 |
| Gross profit | 3,373 | 3,666 | 3,697 | 3,510 | 14,246 | 3,329 | 3,757 | 3,807 | 3,754 | 14,647 |
| Marketing, administration, & research costs | 412 | 489 | 488 | 573 | 1,962 | 419 | 472 | 482 | 448 | 1,821 |
| Exit cost/asset impairment | | | | | | | | | | |
| Operating companies income | 2,961 | 3,177 | 3,209 | 2,937 | 12,284 | 2,910 | 3,285 | 3,325 | 3,306 | 12,826 |
| Amortization of intangibles | 17 | 18 | 19 | 19 | 73 | 18 | 27 | 18 | 19 | 82 |
| General corporate expenses | 60 | 54 | 78 | 100 | 292 | 135 | 353 | 337 | 324 | 1,149 |
| Changes to MDLZ/PM tax-related receivables | | | | | | | | | | |
| Adjustment to 3rd party guarantee accrual | | | | | | | | | | |
| Corporate asset impairment/exit costs | | | | | | | | | | |
| Corporate exit cost | | | | | | | | | | |
| Operating income | 2,884 | 3,105 | 3,112 | 2,818 | 11,919 | 2,757 | 2,905 | 2,970 | 2,963 | 11,695 |
| Restructuring charege | | | | | | | | | | |
| Interest & other debt expense,net | 281 | 280 | 271 | 226 | 1,058 | 229 | 257 | 262 | 274 | 1,022 |
| Loss on early extinguishment of debt | | | | | | | | | | |
| Net periodic benefit income, excluding svc cost | 46 | 47 | -44 | -47 | -184 | 31 | 31 | 32 | 39 | 133 |
| Earnings from equity investments | 34 | -1,263 | -2,478 | -66 | -3,641 | 80 | 127 | 133 | 148 | 488 |
| Other Income | | | | | | | | | | |
| Loss on AB InBev/SAB Miller business combination | | | | | | | | | | |
| Gain/loss on Cronos-related financial instruments | 10 | 4 | | 1 | 15 | | | | | |
| Impairment on JUUL investment | | | | | | | | | | |
| Earnings before income taxes | 2,673 | 1,605 | 407 | 2,704 | 7,389 | 2,479 | 2,806 | 2,873 | 2,876 | 11,034 |
| Income taxes | 714 | 714 | 183 | 14 | 1,625 | 692 | 689 | 706 | 708 | 2,795 |
| Net earnings (continuing ops.) | 1,959 | 891 | 224 | 2,690 | 5,764 | 1,787 | $2,117 | $2,167 | $2,168 | $8,239 |
| Earningns from discontinued ops. | | | | | | | | | | |
| Earnings attributable to non-controlling interests | | | | | | | | | | |
| Net earnings | $1,959 | $891 | $224 | $2,690 | $5,764 | 1,787 | $2,117 | $2,167 | $2,168 | $8,239 |
| Net earnings attributable to Altria | $1.08 | $0.49 | $0.12 | $1.50 | $3.19 | $1.00 | $1.19 | $1.22 | $1.22 | $4.63 |
| Earnings per share | $1.12 | $1.26 | $1.28 | $1.18 | $4.84 | $1.18 | $1.31 | $1.30 | $1.23 | $5.02 |
| Continuing operations earnings per share | $1.08 | $0.49 | $0.12 | $1.50 | $3.19 | $1.00 | $1.19 | $1.22 | $1.22 | $4.63 |

# 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
6/12/20 Raise rating to BUY with a $48 price target
3/29/21 Raised price target to $56/share
Ratings:
Buy: B
Hold: H
Sell: S

$56 price target equates to 11.2x our 2023 adjusted earnings estimate of $5.02/share

RISKS TO OUR PRICE TARGET: Declining earnings/cash flow at MO. Decreasing US cigarette and oral tobacco, consumption/volumes may also hurt the company's revenues/profits. Declining earnings fro MO's two operating units pose a risk to the company. Ownership stakes in Cronos and JUUL may not be profitable or produce profits to pay higher interest payment on subsequent debt incurred for these investments. Additionally, there is no guarantee non-combustible product sales will be profitable or offset declining sales of traditional tobacco product revenues. This stock could decline in value if MO reduces/eliminates the common stock dividend or is unable to pay its debt. Litigation /regulation risks and exise taxes are a threat to MO. Rising interest rates/inflation, corporate tax rates, economic recessions, higher tobacco prices, increased gasoline prices, rising operating costs/debt expense, or tax issues could negatively impact MO's future earnings. This stock may be adversely impacted by negative equity/credit markets, credit ratings agencies' downgrades of MO's debt, geopolitical events, wars, cyber hacking, supply chain issues, black swan events, terrorist attacks, and failure to comply with Sarbanes Oxley and generally accepted accounting guidelines. All factors mentioned above could cause a declne in MO's stock price or its ability to maintain its common stock dividend.

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.

Analyst Steven Marascia owns shares of Altria Corp.

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)0%, (2) 0%, (3) 0%

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## Other Disclosures



**For more information on this report, please contact us at 800.612.1484 or write to Capitol Securities, 4050 Innslake Dr., Suite 250, Glen Allen, Virginia 23060**