CAPITOL SECURITIES MANAGEMENT, INC.
EQUITY RESEARCH

November 11, 2020

CURRENT PRICE:	$39.76
RATING:	BUY
PRICE TARGET:	$48
CURRENT YIELD:	8.7%

EPS Estimates - Non-GAAP

	DEC 19A	DEC 20E
1Q	$0.60	$0.83A
2Q	$1.07	$1.04A
3Q	($1.39)	($0.51)A
4Q	($1.00)	$0.84
	($0.70)	**$2.20**

Trading Data

52-WEEK PRICE RANGE:	$51.78 - $30.95
SHARES OUTSTANDING:	1,859(M)
MARKET CAP:	$73.9(B)
AVG. DAILY TRADING VOLUME:	11.5(M)
S&P 500:	3,573

Valuation Data

BOOK VALUE:	$1.69
PRICE TO BOOK:	23.5x
DIVIDEND:	$3.44

Altria Corp (NYSE: MO)

3Q20 earnings - Maintain BUY rating

Highlights

- 3Q20 earnings of ($0.51)/share vs. ($1.39)/share during 3Q19
- Maintaining cash levels
- Additional JUUL writedown
- Management reinstates 2020 earnings guidance
- Maintain BUY rating with a $48 price target

Investment Thesis

Altria Corp (MO-$39.76), 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. 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, its shares may be poised for a rebound, in addition to offering investors a dividend yield of 8.7%. These shares are recommended for moderate-to-aggressive risk-tolerant investors.

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 12/31/19 Philip Morris USA generated approximately 87.5% of overall revenues, or $22.0 billion. In 2009 MO completed its purchase of US Tobacco (Skoal/Copenhagen brands & Ste. Michele Wines) currently giving MO 49.9% 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 87.5% of MO's revenues, or $22.0 billion during FY19. 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-$66.99). 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-$31.35) and Philip Morris Intl (PM-$75.11). To reduce its dependence of tobacco revenue streams, MO recently acquired equity stakes in JUUL Labs and Cronos (CRON-$7.12).

Recent Earnings

MO reported 3Q20 operating earnings of ($0.51)/share vs. ($1.39)/share during 3Q19. The improvement came as JUUL impairment charges were larger in 3Q19 vs. those taken during 3Q20 ($4.5 billion vs. $2.6 billion), lower net losses related to the Cronos (CRON-$) investment ($105 million vs. $636 million), and higher OCI income in the smokeable products unit. These were somewhat offset by a lower earnings contribution from the InBev (BUD-$66.99) equity stake, and higher income taxes. OCI improved 2.6% to $2.86 billion and operating income rose 2.9% to $2.80 billion
.

Adjusted earnings were flat at $1.19/share when comparing 3Q20 to 3Q19. Lower adjusted earnings from MO’s BUD and CRON investments were partly offset by higher adjusted OCI in the smokeable products segment. When comparing the two quarters, net revenues rose 3.9%, to $7.12 billion, and operating income improved 7.3%, to $3.16 billion. Through 3Q20 MO has spent $50 million (pre-tax) related to Covid-19, including disruption costs/mitigation efforts, premium pay, personal protective equipment costs, and health screenings.

SEGMENT RESULTS

SMOKEABLE PRODUCTS: 3Q20’s reported OCI improved 8.9% to $2.80 billion from $2.56 billion during 3Q19. The increase was due to higher product pricing (+5.9%), as well as lower costs, and was partly offset by higher promotional investments, increased resolution expenses and tobacco/health litigation items. Overall net revenues rose 4.4% to $6.31 billion due to higher product pricing with a partial offset from increased promotional investments. Adjusted OCI rose 9.9% to $2.82 billion from pricing increases and lower costs. These were partially offset by higher promotional costs and resolution expenses. Adjusted OCI margins increased to 57.5% from 55.3%.

When comparing the two quarters, cigarette shipment volumes decreased 0.4% from retail share loss, and other factors, while being partly offset by the industry's growth rate and trade inventory. The industry growth rate has been helped by the switching of vape-users back to cigarettes during 2020. If adjusted for trade inventory moments, and other factors, then MO's cigarette shipment volumes decreased 1% while total domestic cigarette industry shipments rose 1%. MO's reported cigar shipments improved 10.0%
.
MO's overall cigarette market share decreased to 49.4% form 49.7% due to adult cigarette smoker migration across different tobacco products and the dynamics of the discount cigarette segment. Marlboro's market share was flat at 43.3%, Other Premiums' fell to 2.3% from 2.4%, and Discount's dipped to 3.8% from 4.0%.

During the earnings call, management stated its belief the annual cigarette volumes for 2020 will be flat, versus earlier 2020 estimates of a 4%-6% decline. MO attributed this to better industry performance since January and the anticipation of continued category resilience with tobacco products as E-vape users move back towards traditional tobacco products, and consumer's recent stay-at-home habits (saving money), allowing for more disposal income towards tobacco products.

ORAL TOBACCO PROUCTS: During 3Q20, OCI rose 4.6% to $436 million from $417 million during 3Q19. The increase came from higher product prices while being partly offset by lower shipment volumes. Overall net revenues climbed 3.2% to $640 million, also due to higher pricing, and was partially offset by lower shipment volumes, and higher promotional investments. Adjusted OCI increased 4.3% to $440 million, also benefiting from higher pricing/volumes and was partly offset by increased investments in "on!". Adjusted OCI margins rose to 72.5% from 71.9%
.
Domestic shipping volumes of MO's oral products fell 1.1% due market share loss (from growth of oral nicotine pouches), trade inventory movements, and calendar differences. These were partially offset by the industry growth rate and other factors. When adjusted for trade inventory movements, calendar differences, and other factors, shipment volumes rose 4%. Copenhagen shipments fell 3.0% to 131.1 million cans/packs, Skoal dropped 6.1% to 52.3 million cans/packs, and Other increased 28.7% to 23.3 million cans/packs.

MO's oral product market share declined to 49.9% from 52.3% due to growth of oral nicotine pouches. Copenhagen's market share decreased to 31.8% from 33.8%, Skoal's fell to 13.6% from 15.0%, and Other's rose to 4.5% from 3.5%. Copenhagen was expanded to 20,000 stores in 36 states during 1H20 and "on!" was increased to 56,000 stores during 3Q20

WINE: Reported OCI increased 18.8% to $19 million, and adjusted OCI rose 25.0% to $20 million, when comparing 3Q20 and 3Q19 results. This unit was severely impacted by the Covid economic slowdown created by Covid, causing lower on-premise and direct-to-consumer sales. Net revenues decreased 6.0% because of lower shipments as shipments fell 3.9% to approximately 1.9 million cases. Lower restaurant, bar, hospitality venue, and cruise line sales created by the pandemic, caused a decline in Ste. Michelle's wine sales.

MO'S NONCOMBUSTIBLE PRODUCTS BUSINESS PLATFORM

IQOS: This past July, the US Food & Drug Administration authorized IQOS and "Heatsticks" to be marketed with a reduced exposure claim as Modified Risk Tobacco Products. Recently, PMUSA (MO's subsidiary) began selling IQOS in Charlotte NC and "Heatsticks" in approximately 700 US retail locations throughout Charlotte, Richmond VA, & Atlanta GA. During the next 1 ½ years MO plans to expand IQOS to four additional markets and partner with trade retailers and make IQOS and "Heatstick" products available in surrounding areas of seven lead markets.

There are two key exclusive license/distribution agreements MO has with Philip Morris Intl. (PM-$) regarding IQOS distribution: a) MO would maintain exclusive US distribution rights after achieving a 0.5% dollar share in a specific geographical region by April 2022, and b) MO's distribution rights are subject to an initial five-year term which expires in April 2024. It can be renewed at MO's option for another five-year period after achieving a 0.5% dollar share of the cigarette category in a certain number of geographic regions during a specified time period.

On!: During 2Q20, Helix (maker of On!) submitted Premarket Tobacco applications to the FDA for its 35 On! products. Meanwhile, Helix continues to install additional manufacturing equipment and expand its distribution channel in advance of an expected increase in customer demand for this product. Expectations are for manufacturing capacity of 50 million cans by YE20 with potentially more added in 2021. As of 3Q20, Helix expanded its distribution channels to over 56,000 stores-representing an increase of 40% from 2Q20. MO estimates its store distribution channels of "on!" achieved a 2.1% market share of the oral tobacco category through 3Q20.

MO'S OTHER BUSINESS INTERESTS

Cronos (CRON-$7.12): The company named Kurt Schmidt as its new President/CEO during 1H20. Previously, he served at consumer packaged goods companies such as Blue Buffalo, Nestle, Gerber, & Kraft Foods. Mike Gorenstein was appointed Executive Chairman after having earlier served as Chairman, President, & CEO. CRON reported an adjusted operating loss of $40.2 million during 3Q20 vs. an operating loss of $30.7 million due to a decrease in gross profit, higher marketing and R&D costs. Revenues increased 96% when comparing 3Q20 to 3Q19. Results were hurt by fewer retail stores operating due to the Covid pandemic. MO has a 45% equity stake in CRON and assessed Covid-19's has impact on the fair value of its investment, and will determine if part of the investment needs to be written down. According to MO, the fair value of its investment in CRON is currently 20% less then its carrying value of $1 billion. Management believes this temporary and will continue to monitor the situation.

JUUL: MO acquired a 35% in JUUL in 2018 for $12.8 billion. Since then, and because of ongoing problems, MO has written off approximately $11 billion of its initial investment into JUUL, including a $2.6 billion pre-tax charge during 3Q20. The investment was originally made to profit in the growing popularity of JUUL's vape products. However, the FDA banned the sale of vapes to minors and ordered the removal of all flavored vape products. Due to falling E-vape sales, JUUL announced a further reduction in headcount following a similar announcement earlier this year of the elimination of a third of the 3,000 employees working at the company.

MO warned there could be a potential pause in vape sales during the next few years following regulatory orders to remove flavored vape products from the marketplace and if regulators do not grant future market authorization for these products. MO plans to challenge the Federal Trade Commission's filing of an administrative complaint against MO and JUUL to challenge MO's minority investment in JUUL. MO is defending this action and expects the legal process to take 2-3 years.

Management believes that JUUL's E-vape products can play a role in providing reduced tobacco products to the public. This past July, MO submitted a pre-market tobacco application (PMTA) to the FDA for its JUUL device and four JUUL pod SKUs. The PMTA was accepted by the FDA and has moved these products into a scientific review.

INBEV: MO has an equity investment stake in InBev (BUD-$66.99) and receives quarterly distributions from the company. The Covid pandemic has caused a decline in beer consumption because of the closings of bars, restaurants, public sporting events/gatherings/concerts, and cruise line bookings. As a result, the amount of the adjusted equity earnings going to MO, from BUD, decreased to $95 million during 3Q20, representing a 58% decrease from 3Q19. Through 3Q20 the total adjusted equity earnings from BUD was $383 million, a 41% drop for the amount recorded through 3Q19. Due to the steep decline in BUD's stock price during the past year, MO's current investment in BUD is below its carrying value. MO believes this is temporary and will continue to monitor BUD's situation and the market valuation of its investment.

KEY TAKEAWAYS FROM 3Q20 EARNINGS CONFERENCE CALL

-Management narrowed its full year 2020 adjusted earnings guidance, following the decreasing equity contribution from InBev (BUD-$66.99) to $4.30-$4.38/share, representing a 2%-4% growth rate over 2019's adjusted earnings.

-MO revised FY20 expected domestic cigarette industry volumes declines to be 0% to -1.5% vs. an earlier projected decline rate of 2%-3.5% due to recent consumer spending habits caused by the stay-at-home effects of the pandemic.

-Wrote down another $2.6 billion of its JUUL investment, bringing the total amount of write downs (on MO's original $12.8 billion in Juul) to approximately $11 billion. Management noted these write downs could be used in the future to offset gains from asset sales. Theoretically, this could apply towards future sales of InBev stock owned by MO (~$7 billion) assuming it would show a taxable gain. MO's lock up period for its InBev stock ends during 4Q21.

-Management is committed to its shareholder dividends as a primary way to return value to its shareholders. Presently, MO plans to pay out 80% of adjusted earnings as dividends.

-While the pandemic is present MO plans to be financially prudent with its cash and keep a larger-than-normal amount of cash on the balance sheet. There are currently no share repurchase programs for MO's stock, however, the Board of Directors may consider it in the future after the pandemic fades, allowing the company an option to reduce its current levels of balance sheet cash. As of 3Q20, MO has approximately $4.1 billion of cash, and cash equivalents on its balance sheet.

Our Thoughts

A decent earnings report for MO as 3Q20 adjusted earnings were flat at $1.19/share when compared to 3Q19. Lower adjusted earnings from MO's BUD investment was partly offset by higher adjusted OCI in the smokeable products segment. When comparing the two quarters, net revenues rose 3.9%, to $7.12 billion, and operating income improved 7.3%, to $3.16 billion. Management believes, despite the challenges with JUUL, and lower returns from InBev, the potential exists to overcome these challenges, and grow revenues from non-combustible products like IQOS, "Heatsticks", and ON!.

This stock is recommended for risk-tolerant, given its generous 8.7% dividend yield, and appreciation potential. The annual dividend was recently increased 2.6% to $3.44/share and this trend may continue with future earnings growth, given management's intention of paying 80% of adjusted earnings to shareholders as dividends. MO offers appreciation potential if it is able to overcome the challenges surrounding JUUL, InBev's decreased earnings contributions, and grow core segment revenues, as well as non-combustible products. Should the company successfully navigate these challenges, then investor demand may increase for MO's stock, and push shares higher from current levels. We rate MO a BUY, and our price target is $48/share, equating to the stock trading at 21.8x our 2020 operating earnings estimate of $2.20/share.

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 three 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 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.

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

Capitol Securities Management, Inc.

Equity Research

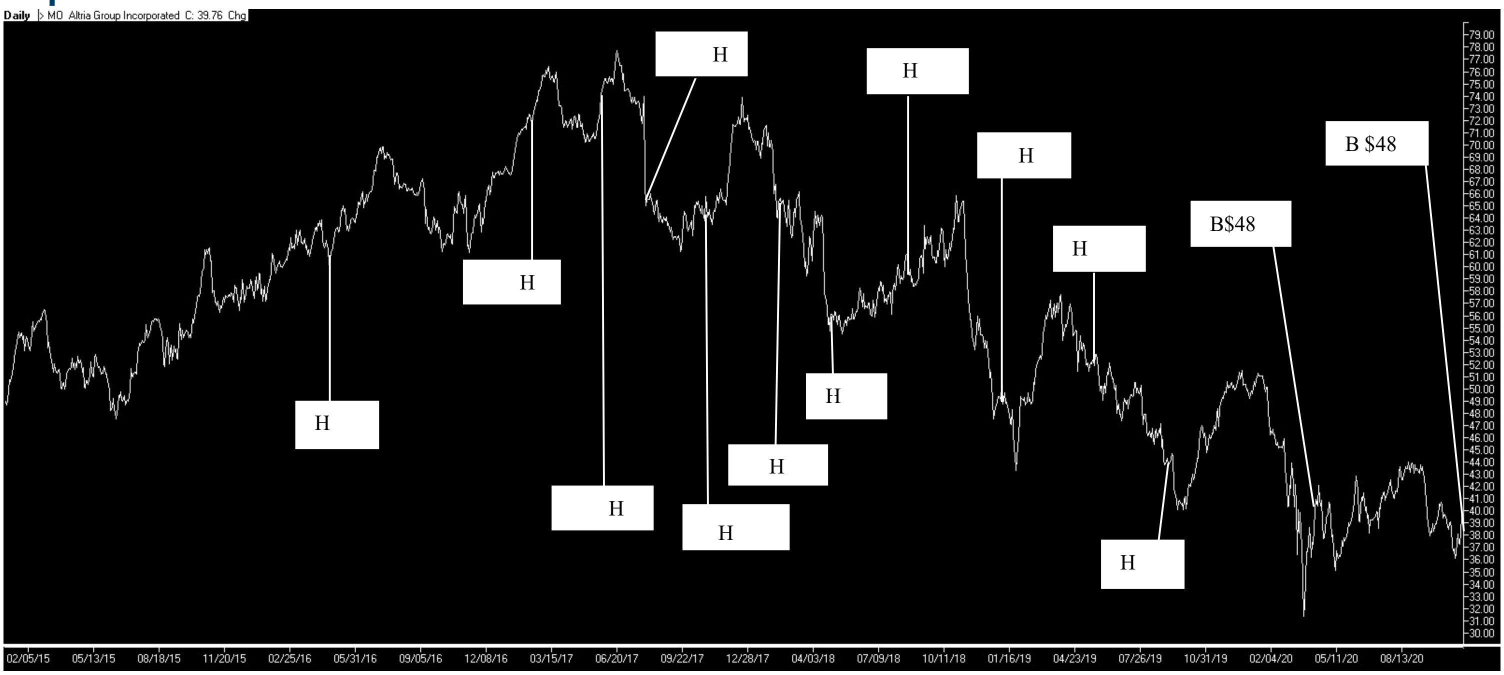
Altria Group, Inc.
(dollars in millions, except per share data

	1Q19	2Q19	3Q19	4Q19	FY19	1Q20	2Q20	3Q20	4Q20e	FY20e
Net revenues	$5,628	$6,619	$6,856	$ 6,007	$25,110	$6,359	$6,367	$7,123	$5,861	$25,740
Cost of sales	1,578	1,874	1,915	1,718	7,085	2,173	1,775	1,961	1,659	7,568
Excise taxes on products	1,239	1,426	1,444	1,205	5,314	1,313	1,305	1,445	1,231	5,294
Gross profit	2,811	3,319	3,497	3,084	12,711	2,873	3,287	3,717	2,971	12,848
Marketing, administration, & research costs	479	499	494	511	1,983	473	428	480	519	1,900
Exit cost/asset impairment	39	33	1	85	158				64	64
Operating companies income	2,293	2,787	3,002	2,488	10,570	2,400	2,859	3,237	2,388	10,884
Amortization of intangibles	8	8	12	16	44	19	18	17	6	60
General corporate expenses	46	62	46	45	199	45	45	60	53	203
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	2,238	2,717	2,771	2,427	10,326	2,336	2,796	3,160	2,329	10,621
Restructuring charege										
Interest & other debt expense,net	384	312	293	291	1,280	275	308	310	278	1,171
Loss on early debt extinguishment										
Earnings from equity investments	86	447	333	859	1,725	157	9	-472	155	151
Other Income	1	15	24	-3	37	27	28	3	4	72
Loss on AB InBev/SAB Miller business combination										
Gain/loss on Cronos-related financial instruments	425	266	636	115	1,442	137	40	105	106	388
Impairment on JUUL investment			4,500	4,100	8,600			2,600		2,600
Earnings before income taxes	1,516	2,601	-2,128	-1,223	766	2,108	2,565	-324	2,104	6,453
Income taxes	395	604	474	591	2,064	558	627	632	537	2,354
Net earnings (continuing ops.)	1,121	1,997	-2,602	-1,814	-1,298	1,550	1,938	-956	1,567	4,099
Earningns from discontinued ops.										
Earnings attributable to non-controlling interests	-1	-1	2	5	5	2	5	4	-1	10
Net earnings	$1,120	$1,996	($2,600)	($1,809)	$1,293	$1,552	$1,943	($952)	$1,566	$4,109
Net earnings attributable to Altria	$0.60	$1.07	($1.39)	($1.00)	($0.70)	$0.83	$1.04	($0.51)	$0.84	$2.20
Earnings per share	$0.90	$1.10	$1.19	$1.02	$4.22	$1.09	$1.09	$1.19	$1.01	$4.38
Continuing operations earnings per share	$0.60	$1.07	($1.39)	($1.00)	($0.70)	$0.83	$1.04	($0.51)	$0.84	$2.20

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
6/12/20 Raise rating to BUY with a $48 price target
Ratings:
Buy: B
Hold: H
Sell: S

$48 price target equates to 21.8x our 2020 operating earnings estimate of $2.20/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 three operating units pose a risk to the company. Ownership stakes in Cronos and JUUL may not produce profits to pay higher interest payment on subsequent debt incurred for these investments. Additionally, there is no guarantee non-combustible product sales will occur and be able to offset declining sales of traditional tobacco product revenues. This stock could decline in value if MO reduces/eliminates the common stock dividend. 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 or its ability to maintain its common stock dividend.

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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) 50%, (2) 50%, (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%

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