June 12, 2020

CURRENT PRICE:	$39.13
RATING:	BUY
PRICE TARGET:	$48
CURRENT YIELD:	8.6%

EPS Estimates - Non-GAAP

	DEC 19A	DEC 20E
1Q	$0.60	$0.83A
2Q	$1.07	$0.92
3Q	($1.39)	$1.01
4Q	($1.00)	$0.84
	($0.70)	**$3.60**

Trading Data

52-WEEK PRICE RANGE:	$52.45 - $30.95
SHARES OUTSTANDING:	1,858(M)
MARKET CAP:	$72.7(B)
AVG. DAILY TRADING VOLUME:	11.5(M)
S&P 500:	3,041

Valuation Data

BOOK VALUE:	$3.51
PRICE TO BOOK:	11.2x
DIVIDEND:	$3.36

Altria Corp (NYSE: MO)

1Q20 earnings, Covid-19 update, & raising rating to BUY

Highlights

- 1Q20 earnings of $0.83/share vs. $0.60/share during 1Q19
- Maintaining cash levels
- Change of CEO & CFO due to retirement
- Management withdraws 2020 earnings guidance
- Raise rating to BUY with a $48 price target

Investment Thesis

Altria Corp (MO-$39.13), 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-19, its shares may be poised for a rebound, in addition to offering investors a dividend yield of 8.6%. 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 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 87.5% 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-$51.48). 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-$31.79) and Philip Morris Intl (PM-$70.42). To reduce its dependence of tobacco revenue streams, MO recently acquired equity stakes in JUUL Labs and Cronos (CRON-$6.47).

Covid-19 Update

Management said as of the end of 1Q20, MO had not experienced any material adverse effects from the onset of Covid-19 and government actions to restrict consumer movement and business operations. However, they will continue to monitor the situation.

MO stated, due to the growing unemployment rate, it expects consumers to increase down-trading in cigarettes and moist smokeless tobacco products. The degree of down-trading will depend on the depth and duration of higher unemployment and severity of Covid-19 health effects. MO will monitor adults' spending trends towards non-combustable products.

Howard Willard announced his retirement as MO's Chairman of the Board and CEO on 4/14/20. Billy Gifford, formerly the company's Vice Chairman and CFO, will serve as the CEO. Thomas Farrell, a board member, will serve as independent Chairman. The Board of Directors appointed Salvatore Mancuso to serve as CFO.

After closing the Richmond Manufacturing Center, due to detection of the Corona virus, the facility was reopened under enhanced safety protocols. MO plans to monitor ongoing operations for any potential disruptions and workforce availability based on uncertainty produced by Covid-19.

In the Richmond Manufacturing Center, Helix continues to build domestic manufacturing capacity for MO's new "on!" product (nicotine pouches) with annual capacity expected to be 25 million cans. Due to Covid-19, this is below the originally targeted production levels 75 million cans by year-end 2020.

This past March, MO temporarily closed its Atlanta and Richmond "IQOS" stores and ceased its in-person marketing efforts. These will re-open in the future based on public health authorities' recommendations. The company did delay the opening of its Charlotte NC "IQOS" operations because of Covid-19.

Lower restaurant, bar, hospitality venue, and cruise line sales, caused by Covid-19, caused a decline in Ste. Michelle's wine sales. As a result of uncertain wine demand, MO recorded inventory-related charges, including a write-down and estimated loss on non-cancelable future grape purchase commitments.

MO has a significant equity ownership stake in InBev (BUD-$51.48) and receives a significant annual dividend from this investment. Due to Covid-19's negative affect on liquor/beer sales in bars, restaurants,etc., on BUD's revenues, and the decline in its stock price plus a reduction of its dividend, MO stated the fair value of its BUD shares is now below its carrying value of its stake. MO will continue to monitor this situation.

Management reviewed the impact of Covid-19 on its JUUL and Cronos businesses and saw no material impact on either of these units as of 3/31/20. However, due to the uncertain effects of the virus, MO withdrew its 2020 adjusted earnings guidance of $4.39-$4.51/share. Guidance was also withdrawn for the previously stated compounded annual earnings growth guidance for 2020-2022 of 4%-7%.

In order to maintain appropriate cash levels, MO did not repurchase any shares of its common stock, during 1Q20, through its authorized share repurchase program. Furthermore, the Board rescinded it's $1 billion share repurchase program with a remaining balance of $500 million. MO stated it would maintain higher than normal cash balances to preserve its financial flexibility in face of Covid-19. Management also used its $3 billion credit facility to maintain adequate levels of operational cash. The balance sheet now has net cash of $2.7 billion as of 3/31/20.

Regarding its dividend policy, MO intends to maintain its payout ratio of 80% of adjusted earnings but has withdrawn 2020 earnings guidance due to Covid-19. Going forward, management expects to pay a dividend rate that reflects strong internal cash generation and the strength of its balance sheet.

OTHER ITEMS

MO reiterated its belief of 2020 estimated full year domestic cigarette industry adjusted decline rate of 4%-6%. 2020 capital expenditures should be $200 million-$250 million and depreciation/amortization expenses of roughly $240 million.

On 4/1/20, the Federal Trade Commission (FTC) announced it will file an administrative complaint against MO and JUUL to challenge MO's minority investment in JUUL. MO intends to "vigorously defend the transaction" and expects the process to take 2-3 years.

The US Food and Drug Administration (FDA), on 3/17/20, issued a final rule requiring graphic health warnings on cigarette packs and advertisements. MO believes the final rule goes beyond what is allowed, per the First Amendment, and the FDA's stated research provides insufficient support for the proposed warnings. Further action and options are being evaluated by MO.

On 5/15/20 MO submitted premarket tobacco product applications to the FDA for 35 "on!" products (nicotine pouches) on behalf of Helix Innovations LLC.-a joint venture used for the manufacture/sale of this product.

MO recently filed a lawsuit against Reynolds America Inc., a subsidiary of British Tobacco (BTI-$) claiming it infringed on its intellectual property rights in connection with some-vapor and smokeless tobacco products. The suit was filed in the US District Court in North Carolina.

Recent Earnings

MO reported 1Q20 earnings of $0.83/share vs. $0.60/share during 1Q19. The improvement was due mainly to higher revenue in the smokeable and oral tobacco segments. Management noted results were helped by "pantry loading" during 1Q20. Net revenues, when comparing the two quarters rose to 13% to 6.36 billion from $5.63 billion. Operating company income (OCI) increased 4.7% to $2.40 billion and operating income improved 4.4% to $2.34 billion. Benefitting 1Q20's results was a lower loss on Cronos related financial instruments of $137 million vs. $425 million during 1Q19. Also helping 1Q20's earnings was a decrease in acquisition costs related to Cronos and JUUL, higher earnings contribution from MO's equity stake in InBev (BUD-$), and fewer outstanding shares of common stock. These positives were partly offset by higher asset exit/implementation/acquisition related costs when comparing the two quarters.

1Q20's adjusted earnings rose to $1.09/share from $0.90/share during 1Q19. The 18.5% improvement resulted from higher adjusted OCI in the smokeable and oral tobacco segments, as well as fewer shares outstanding. These were partly offset by lower adjusted earnings from MO's stake in InBev (BUD-$).

SEGMENT RESULTS

SMOKEABLE PRODUCTS: 1Q20's reported OCI improved 22.7% to $2.37 billion from $1.93 billion during 1Q19. This occurred due to higher shipment volumes/pricing and absence of a 2019 impairment/exit/ and implementation costs while being partly offset by higher resolution expense. Overall net revenues rose 13.6% to $5.61 billion. Adjusted OCI rose 20.1% to $2.39 billion and adjusted OCI margins increased to 55.3% from 53.3%.

When comparing the two quarters, cigarette shipment volumes improved 6.1% due to trade inventory movements, calendar differences, and "consumer pantry loading" caused by Covid-19. These factors partly offset the industry's rate of decline, retail share loss, and other factors. When adjusting for the factors mentioned above, MO believes its domestic shipment volumes decreased approximately 5%. Reported cigar shipment volume increased 13.1%.

MO's overall share of the cigarette market decreased to 49.2% from 49.9% which management believes occurred to recessionary pressures causing cigarette buyers to move towards lower-costing brands. Marlboro's share decreased to 42.8% from 42.3%, Other premiums declined to 2.4% from 2.5%, and Discount fell to 4.0% from 4.1%.

ORAL TOBACCO PRODUCTS: Reported OCI, during 1Q20, rose 15.6% to $424 million from $358 million during 1Q19. The improvement came from higher pricing and shipment volumes, while being partly offset by increased costs associated with the expansion of MO's product, "on!". Overall net revenues improved 11.3% to $601 million. Adjusted OCI grew 13.4% to $416 million and OCI margins rose to 73.0% from 72.1%.

Domestic shipping volumes, when comparing 1Q20 to 1Q19, increased 2.8% because of the industry growth rate, calendar differences, as well as retail and consumer "pantry loading" due to Covid-19. These were partly offset by retail share losses and wholesale trade inventory movements. Copenhagen shipment volumes decreased 0.2% to 125 million cans/packs, Skoal's improved 2.0% to 51.3 million cans/packs, and Other rose 28.3% to 20.4 million cans/packs.

MO estimates, when factoring in wholesale trade inventory movements, calendar differences, and other factors, shipment volumes decreased 1%. MO stated the overall oral tobacco industry volume increased by about 6% over the past 6 months. When adjusted for MO's preliminary estimates of retail/consumer "pantry loading", total oral tobacco industry volume rose by 5%.

MO's total oral tobacco product market share declined to 50.4% from 53.2% due to rapid growth of oral nicotine pouches related to volume declines in MSTs and "snus". Copenhagen's market share fell to 32.4% from 34.6%, Skoal's decreased to 14.3% from 15.1%, and Other rose to 3.7% from 3.5%. "on!" was sold in over 28,000 retail locations during 1Q20 and Helix submitted its PMTA on 5/15/20.

WINE: Reported 1Q20 OCI fell to ($379 million) vs. $15 million during 1Q19. The decline resulted from inventory related charges (included in implementation costs of $392 million), lower shipment volumes, and higher SG&A costs. These were partially offset by higher pricing and a favorable mix. Adjusted OCI decreased 13.3% to $13 million and adjusted OCI margins fell to 9.2% from 10.3%. Overall wine shipments fell 10.2% to approximately 1.7 million cases.

NEW DEBT INCURRED BY MO

To finance the acquisition of JUUL, MO took a $14.6 billion term loan from JPMorgan (JPM-$99.87) , 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 rose to $26.9 billion from $13 billion and MO's debt/EBITDA ratio increased to 2.5x from 1.3x. This additional debt increased annual interest payments from $500 million - $600 million to over $1.1 billion. To counter additional interest expense, MO announced a new cost-cutting program in 2019 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 also 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 1Q20 earnings of $0.83/share vs. $0.60/share during 1Q19. The improvement was due mainly to higher revenue in the smokeable and oral tobacco segments. Management noted results were helped by "pantry loading" during 1Q20. Adjusted earnings rose to $1.09/share during 1Q20 from $0.90/share during 1Q19. The 18.5% improvement resulted from higher adjusted OCI in the smokeable and oral tobacco segments, as well as fewer shares outstanding. These were partly offset by lower adjusted earnings from MO's stake in InBev (BUD-$51.48).

Going forward, the key to MO's earnings will be whether US consumers continue restrained spending, and/or move into lower cost products, in light of the Covid-19 induced recession. Given this uncertainty, MO suspended forward earnings guidance but maintained its emphasis of paying its current dividend at the rate of 80% of adjusted earnings. Further, to maintain appropriate cash levels, MO rescinded it's $1 billion share repurchase program, drew upon its $3 billion credit facility, and stated it would maintain higher than normal cash balances to preserve financial flexibility in face of Covid-19.

Given, the recent decline in MO's share price during the past few months, and a high annual dividend yield of 8% we are raising our rating on this stock from neutral to BUY. Our upgrade is based on the potential of MO successfully navigating the current US economic downturn, mainting sufficient cash levels/current dividend, and the return of Wall Street confidence in the company's ability to grow future earnings. We are assigning a $48/share price target to MO, equating to a price/earnings ratio of 13.3x our 2020 operating earnings estimate of $3.60/share. These shares are recommended for moderate-to-aggressive risk-tolerant investors.

Risks

There is no guarantee MO will improve earnings/cash flow. Declining US cigarette consumption/volumes may hurt the company's revenues and profits. Decining earnings from MO's three operating units pose a risk to the company. Ownership stakes in Cronos (CRON-$6.47) 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

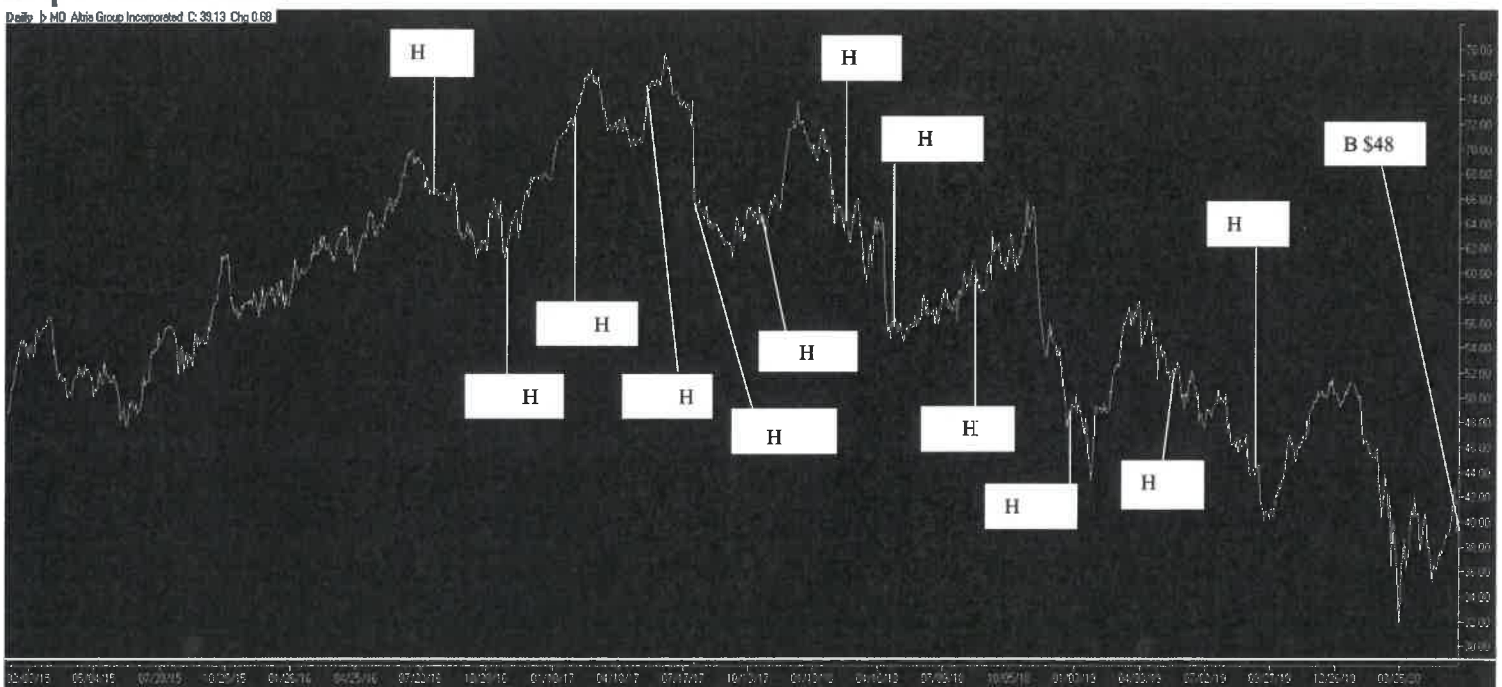
Altria Group, Inc.
(dollars in millions, except per share data

	1Q19	2Q19	3Q19	4Q19	FY19	1Q20	2Q20e	3Q20e	4Q20e	FY20e
Net revenues	$5,628	$6,619	$6,856	$ 6,007	$25,110	$6,359	$6,096	$6,587	$5,861	$24,903
Cost of sales	1,578	1,874	1,915	1,718	7,085	2,173	1,768	1,811	1,659	7,411
Excise taxes on products	1,239	1,426	1,444	1,205	5,314	1,313	1,280	1,344	1,231	5,168
Gross profit	2,811	3,319	3,497	3,084	12,711	2,873	3,048	3,432	2,971	12,324
Marketing, administration, & research costs	479	499	494	511	1,983	473	516	513	519	2,021
Exit cost/asset impairment	39	33	1	85	158		12	26	64	102
Operating companies income	2,293	2,787	3,002	2,488	10,570	2,400	2,520	2,893	2,388	10,201
Amortization of intangibles	8	8	12	16	44	19	9	14	6	48
General corporate expenses	46	62	46	45	199	45	47	48	53	193
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	2,464	2,831	2,329	9,960
Restructuring charege										
Interest & other debt expense,net	384	312	293	291	1,280	275	272	277	278	1,102
Loss on early debt extinguishment										
Earnings from SABMiller equity investment	86	447	333	859	1,725	157	163	138	155	613
Other Income	1	15	24	-3	37	27	16	23	4	70
Loss on AB InBev/SAB Miller business combination										
Loss on Cronos-related financial instruments	425	266	636	115	1,442	137	119	168	106	530
Impairment on JUUL investment			4,500	4,100	8,600					
Earnings before income taxes	1,516	2,601	-2,128	-1,223	766	2,108	2,252	2,547	2,104	9,011
Income taxes	395	604	474	591	2,064	558	554	667	537	2,316
Net earnings (continuing ops.)	1,121	1,997	-2,602	-1,814	-1,298	1,550	1,698	1,880	1,567	6,695
Earningns from discontinued ops.										
Earnings attributable to non-controlling interests	-1	-1	2	5	5	2	4	-2	-1	3
Net earnings	$1,120	$1,996	($2,600)	($1,809)	$1,293	$1,552	$1,702	$1,878	$1,566	$6,698
Net earnings attributable to Altria	$0.60	$1.07	($1.39)	($1.00)	($0.70)	$0.83	$0.92	$1.01	$0.84	$3.60
Earnings per share	$0.90	$1.10	$1.19	$1.02	$4.22	$1.09	$1.05	$1.10	$1.01	$4.25
Continuing operations earnings per share	$0.60	$1.07	($1.39)	($1.00)	($0.70)	$0.83	$0.92	$1.01	$0.84	$3.60

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 13.3x our 2020 operating earnings estimate of $3.60/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. 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 decline in MO's stock or its ability to maintain its common stock dividend.

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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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