



# Altria Group Inc. (MO)

Updated July 26<sup>th</sup>, 2018 by Bob Ciura

## Key Metrics

<b>Current Price:</b> \$56	<b>5 Year CAGR Estimate:</b> 14.7%	<b>Volatility Percentile:</b> XX.X%
<b>Fair Value Price:</b> \$64	<b>5 Year Growth Estimate:</b> 7.0%	<b>Momentum Percentile:</b> XX.X%
<b>% Fair Value:</b> 88%	<b>5 Year Valuation Multiple Estimate:</b> 2.7%	<b>Valuation Percentile:</b> XX.X%
<b>Dividend Yield:</b> 5.0%	<b>5 Year Price Target</b> \$90	<b>Total Return Percentile:</b> XX.X%

## Overview & Current Events

Altria Group was founded by Philip Morris in 1847. Today, it is a consumer staples giant. It sells the Marlboro cigarette brand in the U.S., and a number of other non-smokeable brands, including Skoal, Copenhagen, and Ste. Michelle. Altria also has a 10% ownership stake in global beer giant Anheuser Busch Inbev.

On 7/26/18, Altria released mixed second-quarter earnings. Revenue net of excise taxes declined 5.4% and missed analyst expectations by \$140 million. However, adjusted earnings-per-share of \$1.01 increased by 19% from the same quarter a year ago and beat expectations by \$0.01 per share. The revenue decline was due primarily to the continued decline in smoking rates. After adjusting for trade inventory movements, Altria's cigarette shipment volume declined by 5%, worse than the industry decline of 3.5%. This caused smokeable products revenue to decline by 4.8% last quarter, net of excise taxes. Fortunately, earnings still grew, thanks to cost cuts, share repurchases, and a lower tax rate.

## Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>EPS</b>	\$1.66	\$1.76	\$1.87	\$1.64	\$2.06	\$2.26	\$2.56	\$2.67	\$2.76	\$3.39	<b>\$3.96</b>	<b>\$5.55</b>
<b>DPS</b>	\$1.68	\$1.32	\$1.46	\$1.58	\$1.70	\$1.84	\$2.08	\$2.17	\$2.35	\$2.54	<b>\$2.90</b>	<b>\$4.07</b>

Altria has generated steady earnings and dividend growth for many years, after accounting for the spin-offs of Kraft Foods and Philip Morris International. In fact, Altria has increased its dividend in 49 of the past 52 years. Going forward, Altria's growth will be fueled by price increases and new products. Altria enjoys strong brands across its product portfolio, including the No. 1 cigarette brand. As a result, it has pricing power over the consumer. The average pack of Marlboros cost \$6.79 last quarter, up 2.3% from the same quarter last year.

In addition, Altria is innovating new products, to help offset the declining smoking rate. Altria's non-combustible product portfolio includes e-vapor and e-cigarettes. Altria's Nu Mark subsidiary grew shipment volume by 16% last quarter, as the MarkTen Elite e-vapor product has been expanded to over 23,000 retail stores. And, Altria is awaiting regulatory approval from the Food & Drug Administration for its new reduced-risk product line called IQOS. Altria's reduced-risk products heat tobacco rather than burn it, which Altria believes results in fewer harmful side effects. We forecast 7% annual earnings growth through 2023 for Altria. Dividend growth is expected to mimic the rate of earnings growth.

## Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
<b>Avg. P/E</b>	11.9	9.9	11.8	16.2	15.7	15.7	16.5	20.1	23.4	20.6	<b>14.2</b>	<b>16.2</b>
<b>Avg. Yld.</b>	8.5%	7.6%	6.6%	6.0%	5.3%	5.2%	4.9%	4.0%	3.7%	3.6%	<b>5.0%</b>	<b>4.5%</b>

At the midpoint of Altria's 2018 guidance, the company expects earnings-per-share of approximately \$3.96. As a result, Altria stock trades for a price-to-earnings ratio of 14.2. In the past 10 years, Altria stock traded for an average price-to-earnings ratio of 16.2. The 10-year average price-to-earnings ratio is a reasonable estimate of fair value for Altria. We view the stock as undervalued. If Altria stock returned to a price-to-earnings ratio of 16.2 by 2023, the expanding  
*Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.*

valuation would boost annual returns by approximately 3%. Altria's dividend yield has returned to 5.0%, after dipping below 4% in 2016 and 2017. Altria shares are attractive for income investors as well as value investors.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

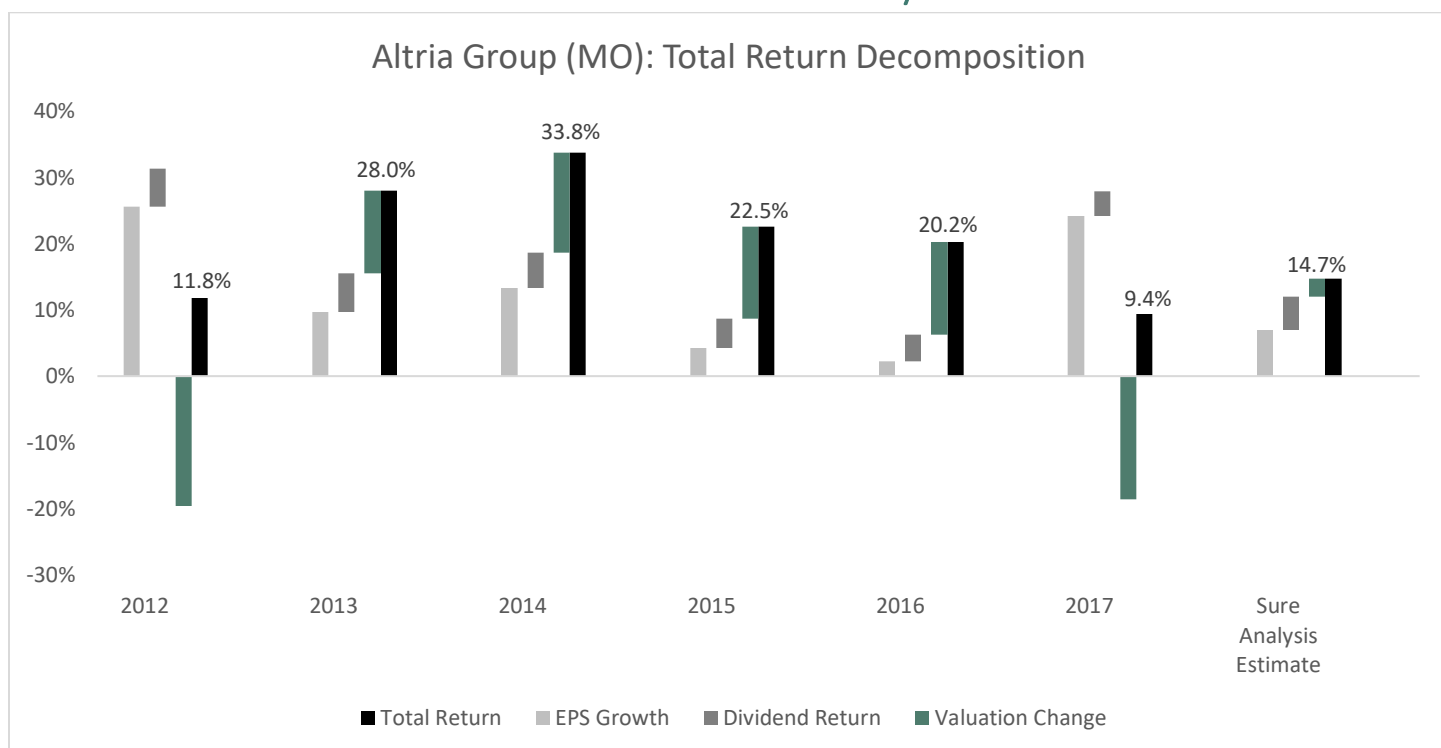
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>GP/A</b>	28.2%	24.1%	24.6%	24.3%	27.1%	30.0%	29.5%	35.3%	25.2%	27.7%	<b>28.0%</b>	<b>28.0%</b>
<b>Int. Cov.</b>	30.1	5.1	6.0	5.6	6.7	7.6	10.7	10.9	30.3	15.0	<b>23.0%</b>	<b>23.0%</b>
<b>Payout</b>	101%	75.0%	78.1%	96.3%	82.5%	81.4%	81.2%	81.3%	86.1%	74.9%	<b>73.2%</b>	<b>73.3%</b>
<b>Std. Dev.</b>	21.8%	18.0%	15.0%	12.9%	15.4%	13.5%	13.9%	19.6%	12.5%	20.6%	<b>21.0%</b>	<b>21.0%</b>
<b>Debt/A</b>	89.6%	88.8%	86.0%	89.9%	90.9%	88.1%	91.2%	90.7%	72.2%	64.4%	<b>65.0%</b>	<b>65.0%</b>

Altria ranks very highly in terms of safety because the company has tremendous competitive advantages. It operates in a highly regulated industry, which virtually eliminates the threat of new competition in the tobacco industry. In addition, tobacco companies enjoy high brand loyalty. This gives the company the ability to raise prices over time. Lastly, Altria's manufacturing and distribution costs are very low, thanks to its economies of scale. Altria spent just \$199 million in capital expenditures last year and generated \$4.9 billion of operating cash flow. Altria's business model is highly resistant to recessions. Sales of cigarettes and other tobacco products hold up well, even when the economy declines. This explains why Altria's earnings rose steadily throughout the Great Recession, and why the company's earnings will likely continue to rise even if a recession occurs over the next few years.

## Final Thoughts & Recommendation

Altria stock has declined 22% to start 2018, as investor sentiment has turned negative toward tobacco companies due to falling smoking rates. There is a credible long-term risk for tobacco stocks, but Altria is investing in next-generation products to meet the changing consumer habits. In the meantime, investors are paid well to be patient, with a 5.0% dividend yield. Through earnings growth, dividends, and valuation changes, we expect 14.7% annual returns for Altria stock over the next five years.

## Total Return Breakdown by Year



*Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.*