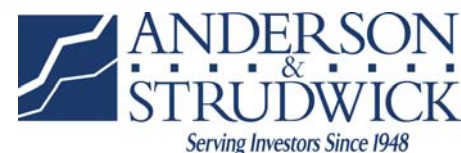


Altria Group
(MO-NYSE)



November 24, 2008

Rating: OUTPERFORM

Initiating Coverage

Price and Trading Data		EPS Estimates - Diluted	
Current Price	\$15.43	2008E	2009E
S&P 500	851.81	1Q	\$0.37A
52-Week Price Range	\$24.54-\$14.34	2Q	\$0.46A
Shares Outstanding (bil - diluted)	2.06	3Q	\$0.46A
Market Cap (bil - diluted)	31.7	4Q	\$0.38
Avg. Daily Trading Volume (mil)	24.83		\$1.66
12 - Month Price Target	\$19		\$1.82
Valuation Data			
Book Value	\$2.03		
Price to Book	7.6		
Long-term debt to total capital	13%		
Dividend	\$1.28		
Current Yield	8.1%		

Highlights

- ◆ \$1.2B in potential cost savings.
- ◆ Grow annual cash flow from \$3.5B to \$4.5B.
- ◆ Plans to offset declining smoking volumes with UST products.
- ◆ Recently raised dividend 10% to \$1.28/share.
- ◆ Initiating coverage with an OUTPERFORM rating and \$19 price target.

Company Summary

Altria Group, headquartered in Richmond VA, is the parent company of Philip Morris USA, John Middleton, and Philip Morris Capital Corp PMCC). The company operates three segments: domestic cigarettes, machine made cigars, and financial services/real estate. 11,000 employees are 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% share of the US cigarette market. Through the nine months ended 9/30/08 Philip Morris USA generated approximately 97% of overall revenues, or \$14.23 billion. Last year the company purchased the John Middleton Co which sells and manufactures machine-made cigars and pipe tobacco. This unit generated 2% of MO's revenues, or \$290 million, through 9/30/08. PMCC owns a portfolio of leveraged/direct finance leases and produces 1% of MO's revenues, or \$179 million. MO also owns a 28.5% equity interest, with voting rights in the beer company SABMiller. Over the past twenty years, the company at one

For Important Disclosure information regarding the Firm's rating system, valuation methods and potential conflicts of interest, please refer to the last page of this report.

time owned, or acquired Miller Brewing, Nabisco, Kraft, and Jacobs Suchard AG. These business were subsequently either sold or spun-off. During the past two years the company spun-off Kraft Foods (KFT-\$26.83) and Philip Morris Intl (PM-\$38.35). Earnings from continuing operations totaled \$3.97 billion with \$3.75 billion (94.3%) from Philip Morris USA, \$128 million (3.2%) from John Middleton, and \$97 million (2.5%) from PMCC. Total revenues through 9/30/08 were \$14.7 billion.

Corporate Strategy

MO's primary focus is on the domestic tobacco business in the US. To this end, it recently spun-off food company Kraft Foods and Philip Morris International which operates in the overseas tobacco markets. Given a 50% US market share (41% for Marlboro), domestic smoking trends are declining 3%-4% per year. However, management's growth plan is to grow earnings through margin improvement, cost cutting, increasing market share through its cigarette/cigar business, and offering smokeless tobacco products following the close of the US tobacco acquisition. Potential margin improvement could come from product price increases and cost saving efforts. MO estimates \$1.2 billion of total potential cost savings during the next 2-3 years from Philip Morris USA (~\$750 million), headquarter relocation/KFT spin-off/downsizing (~\$250 million), and the announced US Tobacco acquisition (~\$250 million). Cigarette brand volume decreases and growing cigar/smokeless tobacco product sales could grow MO's US market share. Recently, MO entered into an agreement to purchase US Tobacco (UST-\$68.60) for \$69.50/share. This acquisition would add the "Skool" and "Copenhagen" smokeless tobacco brands as well as "San Michele's Wines" to MO's product lines. MO believes smokeless tobacco products offer an alternative to adult smokers. PMCC invests in power plants, automobile, and airline assets. MO plans to wind this business down over 10-15 years. On 8/28/08 the annual dividend was increased 10.3% to \$1.28/share and management intends to pay out 75% of earnings to shareholders as dividends.

Improving cash flow/earnings

The focus on improving margins, reducing operating costs, and increasing market share could increase MO's cash flow, currently \$3.5 billion/year to over \$4 billion/year after the UST purchase, and ultimately grow future earnings. One area of improving margins could come from cost cutting throughout its corporate structure. Philip Morris USA has been targeted to produce over \$750 million in cost savings with approximately \$340 million already attained from SG&A savings and \$156 million from the recent announced closing of the Cabarrus Manufacturing Plant in North Carolina. Another \$250 million/year in savings will be realized in 2009 from the moving of MO's corporate headquarters to Richmond VA, from New York City, the Kraft spin-off, and downsizing of the company's overall structure. These savings, along with another \$250 million in savings from the proposed acquisition of UST, could generate a reduction in overall SG&A and save approximately \$1.2 billion/per year beginning in 2011. Despite the trend of 3%-4% annual declines in US cigarette volumes MO believes its other products could increase revenues.

Middleton's cigar business has a \$200 million market share of a \$700 million annual cigar business. Management believes this business can grow 5% per year as the company utilizes the PM USA sales forces to promote cigars along with its cigarette brands. MO's cigar business has profit margins over 50% while the cigarettes business is approximately 34%.

The US Tobacco acquisition is an important strategic move for MO. This purchase will increase MO's smokeless tobacco products and will include the popular brands of "Skool" and "Copenhagen" which has sales of \$700 million in the \$1 billion dollar a year market. Smokeless product sales could generate 6%-7% annual revenue growth while producing 50% profit margins for MO, off-setting the decline in the US cigarette business. Since 2000 the moist smokeless tobacco volume has grown at annual rate of 5%. MO believes \$250 in annual savings should come from synergies with UST. Potentially, cost savings and the UST merger could increase MO's overall annual cash flow from \$3.5 billion to over \$4 billion. Improving cash flow going forward could lead to higher earnings over the next few years and allow the company to increase its annual dividend.

Recent Earnings

MO reported 3Q08 earnings from continuing operations of \$0.42/share vs. \$0.43/share. The decline was due to lower contributions from the SABMiller equity stake due to intangible asset impairment charges (\$85 million), a higher income tax rate, and increased allowances for losses at PMCC. These negatives were partially offset by higher operating income from the operating units Philip Morris USA and John Middleton Co. and lower corporate expenses. Adjusted earnings from continuing operations was \$0.46/share vs. \$0.40/share. Philip Morris USA's operating income increased 5.7% to \$1.37 billion from \$1.30 billion due to decreased lower wholesale promotional allowance rates and lower SG&A costs. These were partially offset lower volumes, increased resolution expenses, higher leaf costs, costs related to a reduction of contract volume manufactured for Philip Morris Int (PM-\$38.35), and charges for the closing of the Cabarrus plant. Overall adjusted Philip Morris USA's operating companies income rose 6.3% to \$1.4 billion. Domestic cigarette shipment volumes declined 4.8% to 44.9 billion units and down only 4% when adjusted for changes in trade inventories and calendar differences. However, the Marlboro brand increased its quarterly retail share to 41.6% from 41.1%.

John Middleton reported operating income of \$37 million, including a \$9 million integration cost charge, on \$84 million of revenues net of excise taxes. Cigar shipment volumes grew 2.3% to 329 million units as shipment volume was affected by the timing of promotional shipments. Middleton's retail share increased 1.9 share points to 30.0% for machine-made large cigar shipment. PMCC'S operating income declined \$52 million to (\$7 million) from \$45 million due to a \$50 million allowance for losses during the just completed quarter. MO affirmed 2008 earnings guidance of \$1.63-\$1.67/share equating to 9%-11% growth over 2007's earnings of \$1.50/share.

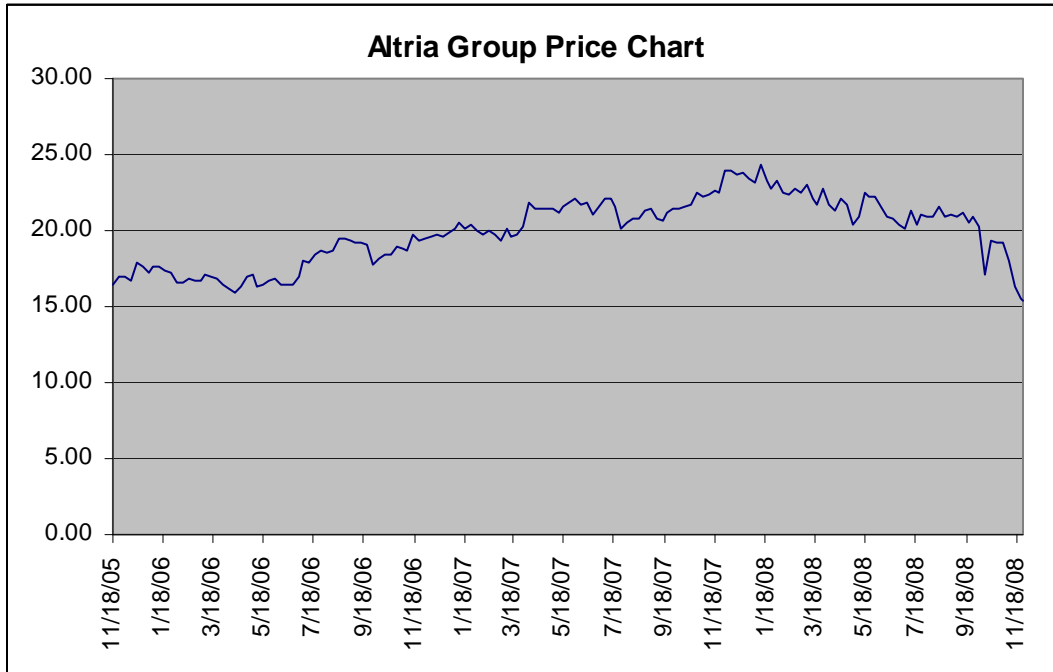
Our Thoughts

MO's strong cash flow, steady revenues, and attractive dividend yield make these shares attractive for income growth investors. While domestic cigarette volumes will decline, these could be offset by UST's smokeless tobacco products. An already strong cash flow stream potentially will improve to \$4 billion from \$3.5 billion following the UST acquisition. Furthermore, an anticipated \$1.2 billion in cash savings may further bolster and strengthen MO's cash flow and balance sheet. Management has stated its intent to pay out approximately 75% of earnings to shareholders as dividends. MO's current dividend yield is 8% with the potential of further increases as earnings increase during the next few years. Our 2008 and 2009 earnings estimates are \$1.66/share and \$1.82/share, respectively. We recommend these shares for income and growth investors given MO's attractive 8% dividend yield and potential earnings growth over the next few years as the company benefits from cost synergies and the addition of UST. Our price target is \$19/share, equating to a 10.4 x price-to-earnings multiple based on 2009 estimates. These shares are rated OUTPERFORM.

Risks

There is no guarantee MO will improve earnings and cash flow. Declining US cigarette volumes may hurt the company's revenues and profits. Litigation risks surround cigarette manufacturers. Rising interest rates, higher tobacco prices, or rising operating costs could negatively impact MO's earnings. MO's stock may be adversely impacted by negative equity/credit markets and failure to comply with Sarbanes Oxley guidelines.

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11/17/08 \$16.20 Initiating coverage with OUTPERFORM TP: \$19

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