

Research Brief

Altria Group Inc (MO)

Hazy outlook for Altria; ESG issues tied to search for replacement market

Nov. 8, 2019

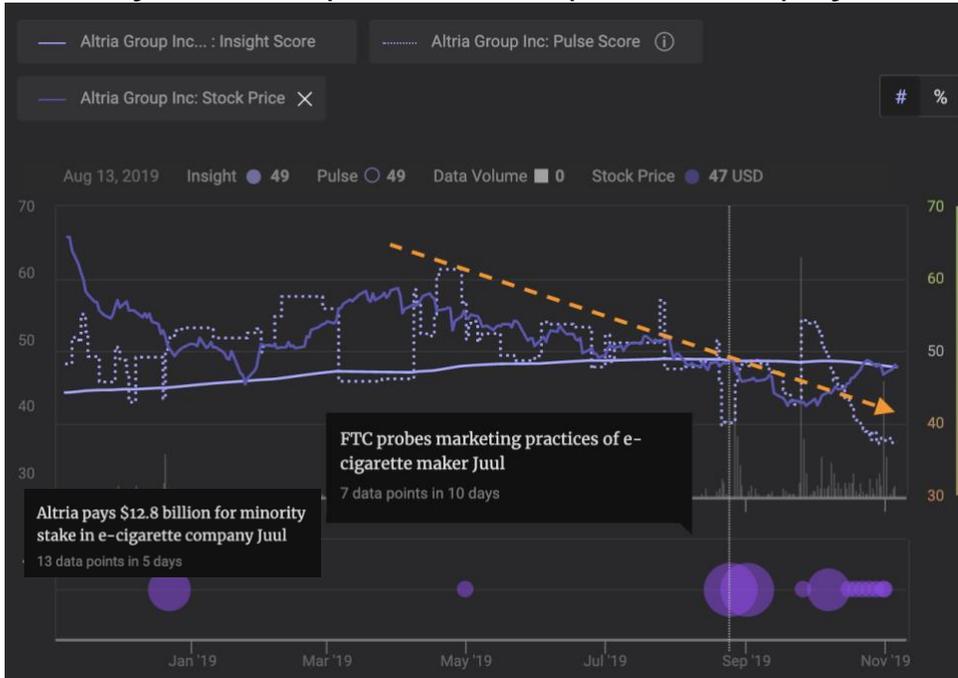
Up in a puff? JUUL Labs investment write-down a bellwether for vaping outlook

Dec. 20, 2018, the news broke of Altria’s purchase of a 35% stake in JUUL Labs for \$12.8 billion. Reuters reported it as “a marriage between an old-line tobacco giant and a fast-growing electronic-cigarette rival looking to make inroads among smokers.” At the time, the FDA had already moved to restrict sales of fruit-flavored e-cigarettes, citing concerns about introducing teens to nicotine addiction. It didn’t dampen Altria’s interest in JUUL; but by September 2019, JUUL became the focus of a growing public safety debate over e-cigarettes, and it was also the subject of an FTC probe of its marketing using youth influencers on social media. That month, potential merger talks were called off between Altria, which focuses on U.S. markets, and Philip Morris, which is focused on international markets. The merger talks ended as it was announced that JUUL’s CEO would step down. In October, Altria wrote down the value of its JUUL stake by \$4.5 billion. [Then this week Reuters reported](#) that heavy demand among teens was closely monitored by JUUL in 2015, internally debated, and that no controls were used to curb use by teenagers. The internal awareness and external silence, or claims of no harm, echo [Exxon’s divergent behavior profiled in a brief one year ago](#).

Beyond vaping: JUUL deal exposes profound strategic needs bordering on desperation

The JUUL write-down represents a massive portion of Altria’s investment, but perhaps not too surprising; if you run with the wild unicorns, you have to be prepared to get knocked around by an errant hoof or horn. Worse than lost billions, the JUUL affair represents a failing bet that was important to Altria’s strategy.

Altria “falling knife”: Stock drops as JUUL troubles captured in Truvalue Spotlight Events™



Source: Truvalue Platform

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Research Briefs highlight material events that move Truvalue Labs scores and may shape future company valuation.

AT A GLANCE

Altria Group Inc

Insight Score	48
Industry Percentile	61 st
Momentum Score	72
Industry Percentile	61 st
NTM P/E	10.2x
Peers	10.3x
NTM EV/EBITDA	9.9x
Peers	8.9x

Top Score Drivers - TTM	Impact
Customer Welfare	38%
Selling Practices and Product Labelling	37%
Management of the Legal and Regulatory Environment	9%

For all scores in this section, SASB’s Materiality lens is off, to show a wide selection of key categories. Valuation as of November 2019. Valuation Source: Refinitiv

Evidence

ESG picture shows underperformance in key areas of Dynamic Materiality™: categories which are most discussed by stakeholders and third parties



Source: Truvalue Platform

Secular demand challenges lead to a roving search for new markets by Altria

It's no wonder that Altria wants in on e-cigarettes.

Per [CDC data](#):

“From 2012 through 2016, e-cigarette unit sales in the United States generally increased as product prices decreased. Nationally, the average monthly e-cigarette sales rate as summed across all product types sold increased by 132% during this timeframe (i.e., from 667 units per 100,000 people in 2012 to 1,547 units per 100,000 people in 2016).”

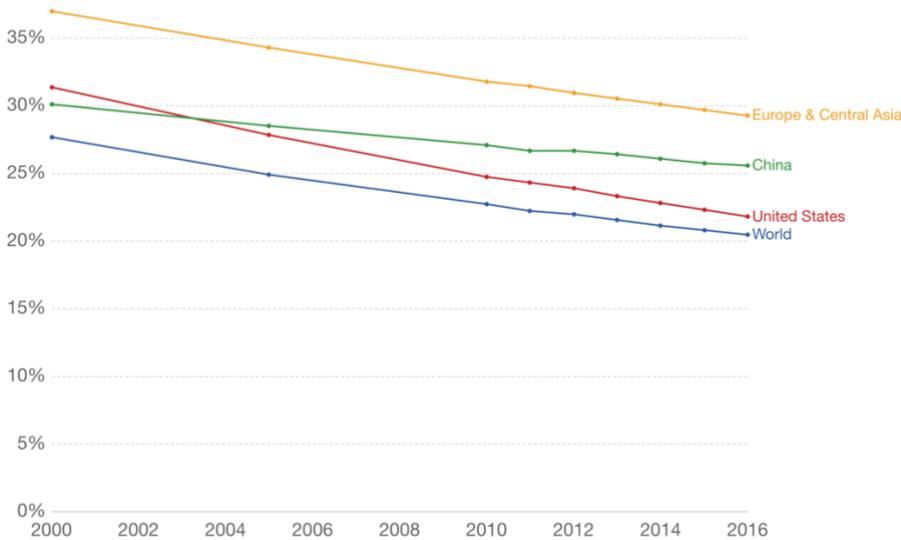
In 2017, traditional cigarette sales fell to ~249 billion cigarettes – down 3.5% from a year earlier.

It's a continuation of the undeniable long-term trend, that fewer Americans, and citizens of other countries around the world, are smokers (see chart at top of next page).

In 2017, traditional cigarette sales fell to ~249 billion cigarettes – down 3.5% from a year earlier.

Share of adults who smoke

The share of men and women aged 15 and older who smoke any tobacco product on a daily or non-daily basis. It excludes smokeless tobacco use.



Source: World Bank

OurWorldInData.org/smoking • CC BY

Source: [Our World in Data](https://ourworldindata.org)

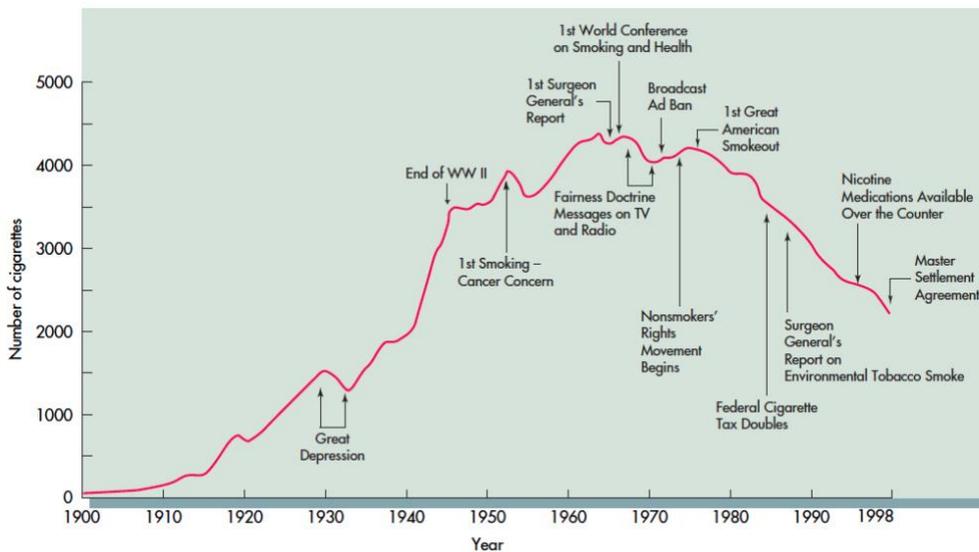
As seen below, the long-term historical view of tobacco industry is a consistent story of increasing regulation over decades of secular decline.

Regulators are keenly aware of the levers to pull to reduce public consumption of tobacco: the CDC reports that a “10% increase in price has been estimated to reduce overall cigarette consumption by 3–5%....(and) research on cigarette consumption suggests that both youth and young adults are two to three times more likely to respond to increases in price than adults.”

The CDC reports that a “10% increase in price has been estimated to reduce overall cigarette consumption by 3–5%.

This is important for regulators’ approach, but also necessary to consider given Altria’s current strategy of raising prices (see Outlook section at end of brief)

Historical annual adult per capita cigarette consumption and major smoking and health events in United States, from 1900–1998



Source: Hanson, Venturelli, and Fleckenstein (2009)

Menthol flavored cigarettes and e-cigarette crackdown represents multiple windows closing for new growth markets to replace flagging cigarette demand

British American Tobacco plunges on threat of **menthol** ban

Irish Times · 12 Nov 2018 · powered by LexisNexis

Altria Group Inc	DATA SECURITY
British American ...	DATA SECURITY

- Tobacco companies likely to mount a legal challenge that would delay the process British American Tobacco (BAT) shares plunged to the lowest level in more than four years on news of a possible ban on **menthol** cigarettes in the US, which would eliminate products such as Newport that generate as...
- A senior US Food and Drug Administration official said last week that the agency is looking at restricting **menthol** in traditional cigarettes.
- British American Tobacco shares fell as much as 11 per cent in London, destroying £8.4 billion of market value.

Summarized by ©

Source: Truvalue Platform

As captured by Truvalue Labs in events from November 2018, FDA Commissioner Scott Gottlieb wants to ban menthol cigarettes, along with restrictions related to flavored e-cigarettes (see next page). Menthol cigarettes have been targeted towards African-Americans, and minorities and teenagers alike [smoke them at a disproportionate rate](#).

The FDA Is Pushing Ahead With A Ban On Most Flavored E-Cigarettes. Here's Why

Fortune · 9 Nov 2018

Imperial Brands PLC	SELLING PRACTICES AND PRODUCT LABELING *
Japan Tobacco Inc	SELLING PRACTICES AND PRODUCT LABELING *
Altria Group Inc	CUSTOMER WELFARE * SELLING PRACTICES AND PRODUCT LABELING *
British American ...	SELLING PRACTICES AND PRODUCT LABELING *

- The U.S. Food and Drug Administration is pushing back against the unchecked growth of the e-cigarette industry.
- While vaping itself is less harmful than tobacco smoking, research shows many e-cigarette users are likely to develop nicotine addictions and some will probably end up on regular cigarettes, a product that kills half of its long-term users.
- In September, Gottlieb gave five e-cigarette manufacturers — Juul, British American Tobacco's Vuse, Altria's MarkTen, Imperial Brands' Blu E-cigs and Japan Tobacco's Logic — until this Sunday to submit proposals on how to combat youth e-cigarette use.

Support ^

Source: Truvalue Platform

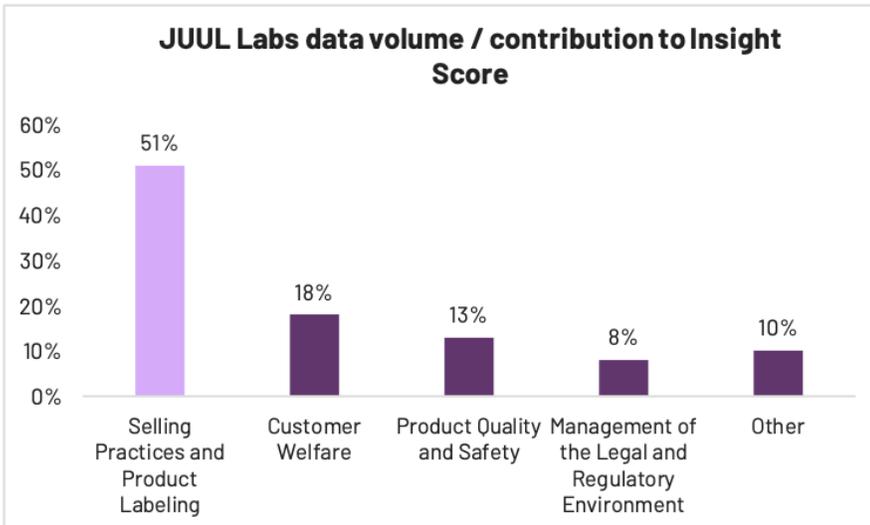
As seen at left, the FDA is keen on limiting flavored e-cigarettes—the same ones that are JUUL's most popular with teens.

Reuters reported this week that the company discussed that fact years ago and didn't act.

Altria itself acknowledges the severity of the threat the FDA actions represent, as seen in its February 2019 10-K. A worst-case scenario for the company is described (bold added for emphasis):

The FDA is monitoring youth tobacco usage rates, particularly usage rates of e-vapor products, and has indicated that it may exercise its regulatory authority by implementing measures designed to decrease youth tobacco use, **potentially including the removal of e-vapor products from the market.**

JUUL Labs data on Truvalue Platform™ demonstrates range of ESG issues that mainly can be tied back to Customer Welfare



Source: Truvalue Labs

This week, a District Attorney in Montgomery County, Pennsylvania, sued JUUL for “illegal, predatory business practices aimed at turning minors into addicts.” The story, captured by Truvalue, was tagged to Customer Welfare and Selling Practices and Product Labelling. It’s not just Pennsylvania seeking to reign JUUL in: San Francisco’s Board of Supervisors banned e-cigarettes pending an FDA review, and when the company lobbied voters to overturn the ban in a proposition on the ballot, spending \$4.5 million, voters upheld it instead.

In news captured by Truvalue Labs this same week: A U.S. House subcommittee is seeking records pertaining to JUUL’s possible knowing use of contaminated pods from a supplier: The subcommittee is requesting documents and information ‘about disturbing reports’ that Juul ‘may have knowingly sold nearly one million contaminated Juul pods.’”

The categories tagged to the second story? Product Quality and Safety and Supply Chain Management.

The common thread is that from the existential question of whether JUUL knowingly targeted teens, to the daily business practices of a quickly ramping startup, JUUL is raising red flags left and right about the sustainability of its operation. Altria got flack for its investment nearly a year ago because of those concerns, and as time goes on, they are growing, not shrinking.

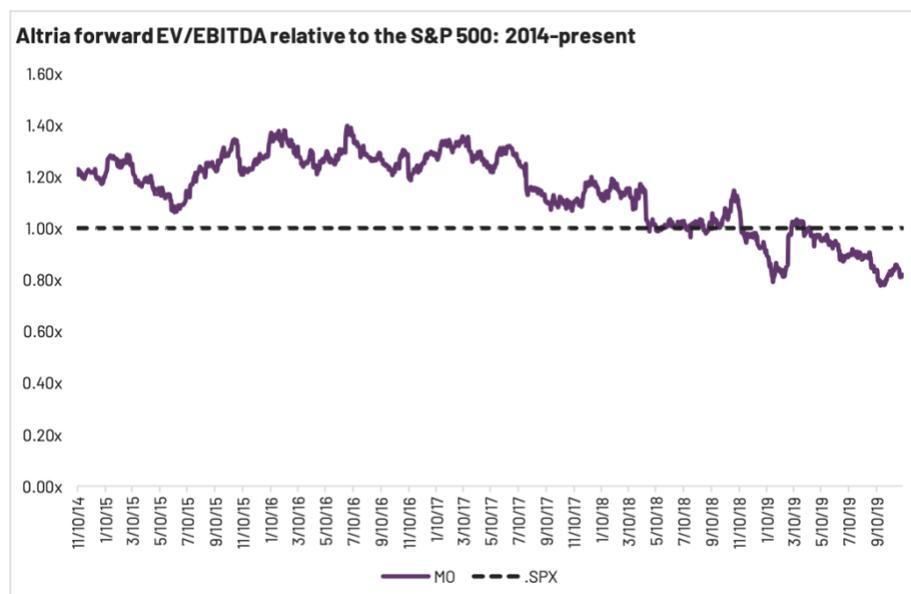
Outlook

“Beaten-up” stock status not much of a silver lining

Company Name	Forward P/E (NTM) - Mean	Forward Enterprise Value To EBITDA (Daily Time Series Ratio) (NTM)
Imperial Brands PLC	6.01	6.99
Japan Tobacco Inc	12.32	8.26
British American Tobacco PLC	7.98	8.83
Philip Morris International Inc	14.95	11.67
Peer Average	10.32	8.94
Altria Group Inc	10.15	9.94

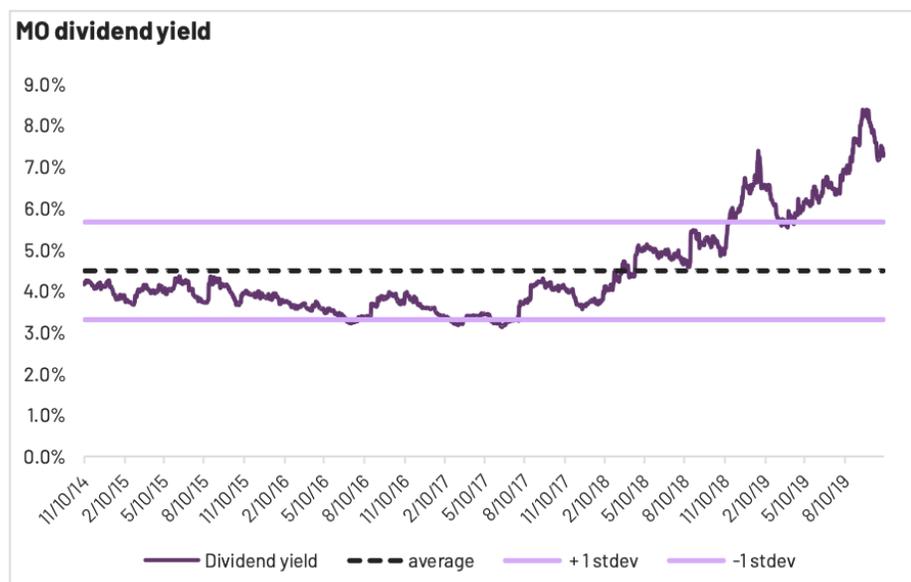
While some analysts point out upside to Altria, the fact is that when compared with peers, Altria is in-line with comparable big tobacco players around the world.

While Altria’s valuation has been getting cheaper for 15 years...



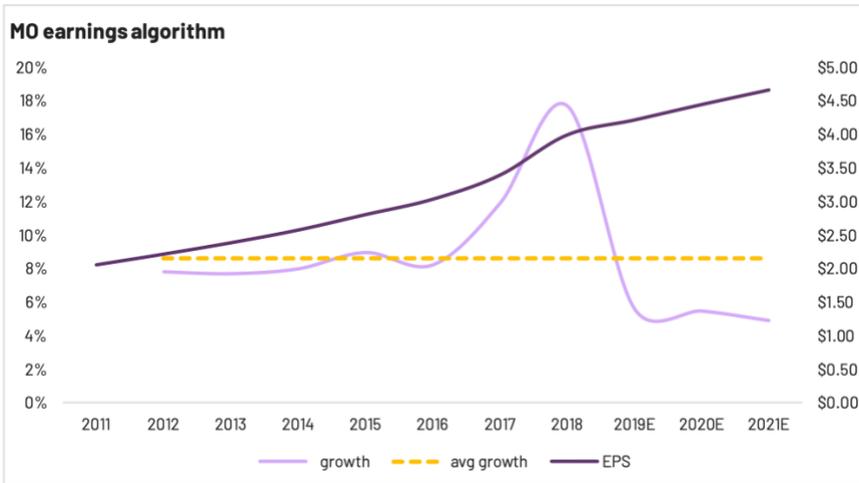
Source: Eikon data

And dividend yields are on the rise...



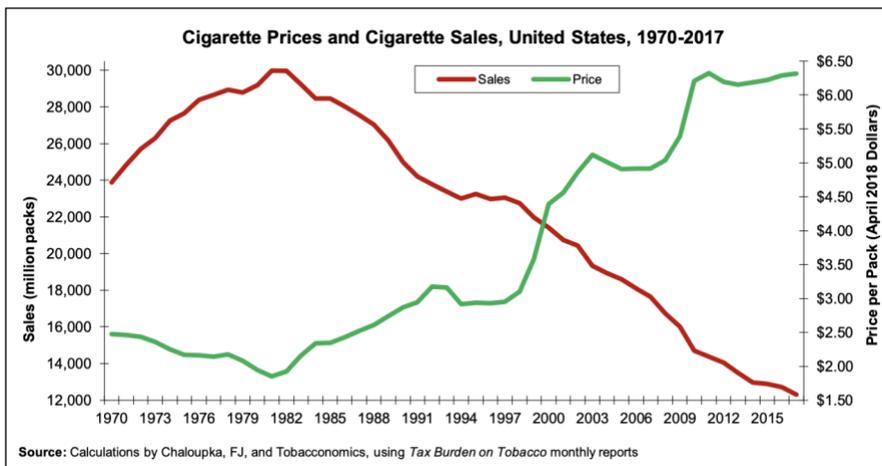
Source: Eikon data

Price increases fuel the earnings algorithm, not growing demand



Source: Eikon data

Leveraging pricing to increase dividends for investors has limits: studies and price increases show that smokers are price-sensitive



Source: Calculations by Chaloupka, F.J., and Tobacconomics, using *Tax Burden on Tobacco* monthly reports

As the [CDC reports](#),

Increasing the price of tobacco products is the single most effective way to reduce consumption. A 10% increase in price has been estimated to reduce overall cigarette consumption by 3-5%. Research on cigarette consumption suggests that both youth and young adults are two to three times more likely to respond to increases in price than adults.

Buying low is a dangerous course of action, as Altria is a classic case of a "falling knife" given the secular decline of cigarettes and regulators' focus on preventing a new generation of tobacco users from nicotine addiction.

What is "business as usual" for Altria? Or what is a best-case scenario for what it could be? The argument that Altria can pivot to less harmful nicotine products via JUUL and proprietary e-cigarettes would be positive for the category of Customer Welfare.

But consistent negative ESG sentiment in the areas of Business Ethics, Selling Practices and Product Labelling undercuts claims of helping customers avoid negative health effects. Regulators, likewise, are not slowing their interventions that have hollowed out Big Tobacco's outlook for the past several decades.

Bargain-hunter buyers should beware, and certainly incorporate timely ESG data into any careful DCF analyses.

About Truvalue Labs

Truvalue Labs is the first company to apply AI to uncover timely ESG data on a variety of asset classes. The company's mission is to deliver increased transparency to investment professionals by providing data and analytics that go beyond traditional fundamentals.

Visit www.truvaluelabs.com to learn more about the SaaS and API products.

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