

April 13, 2016

MO-NYSE--Outperform (1)  
PM-NYSE--Outperform (1)  
RAI-NYSE--Outperform (1)

Tobacco

## Tobacco--Negative Reaction To Potential Release Of The Final Deeming E-Cig Regs Is Overdone--Buy On Weakness

**Bonnie Herzog, Senior Analyst (212) 214-5051**

### Sector Rating: Tobacco, Overweight

We've fielded numerous questions today (4/13) given the weakness in the tobacco stocks. Overall, it appears there's concern with potential headline risk from the long overdue final deeming e-cig regulations which are speculated to be released imminently. In our opinion, this reaction is overdone and we encourage investors to take advantage of the weakness and buy the stocks. As a reminder, regulation of the e-cig/vapor industry is broadly positive for the big tobacco manufacturers since it will increase the barriers to entry and likely entrench them even further. The key concern in our mind is if the final regs stifle or restrict innovation which would be an overall negative for the industry and public health. We've long believed innovation is crucial for the long-term success of this category! Keep in mind, even if regs prove restrictive to innovation, this doesn't mean the end of the category, it just means growth could be slower. However, I think this could be a net positive for MO given IQOS and how that will be regulated. At the end of the day, I remain very bullish on the sector and the stocks given the strength in the companies' core businesses.

### Altria Group, Inc. (MO-NYSE)

Price as of 4/13/2016: \$61.52  
FY 16 EPS: \$3.06  
FY 17 EPS: \$3.31  
Shares Out.: 1,958.0 MM  
Market Cap.: \$120,456.16 MM

### Reynolds American Inc. (RAI-NYSE)

Price as of 4/13/2016: \$49.05  
FY 16 EPS: \$2.37  
FY 17 EPS: \$2.65  
Shares Out.: 1,139.0 MM  
Market Cap.: \$55,867.95 MM

### Philip Morris International Inc. (PM-NYSE)

Price as of 4/13/2016: \$99.93

**Please see page 3 for rating definitions, important disclosures and analyst certifications.  
All estimates/forecasts are as of 04/13/16 unless otherwise stated.**

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FY 16 EPS: \$4.39  
FY 17 EPS: \$4.90  
Shares Out.: 1,549.0 MM  
Market Cap.: \$154,785.53 MM

**Rating Basis Information:**

**MO Thesis:** We believe Altria is achieving a better balance between stabilizing Marlboro market share and growing profitably. We see further upside from strong pricing trends and potential of vapor that isn't currently reflected in the stock.

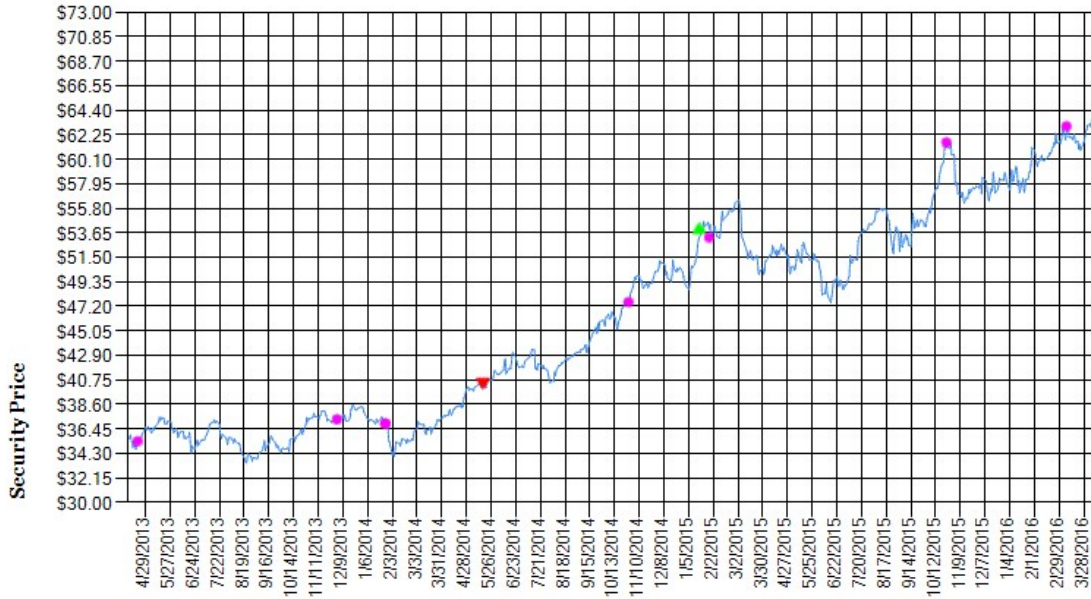
**RAI Thesis:** We believe RAI has transformed itself into a leaner, more focused, total tobacco company, driven by innovation and a methodical approach to driving sustainable growth. We believe the stock has further upside potential given several growth drivers.

**PM Thesis:** We expect PM to outperform over the long term given its (1) superior and re-invigorated Marlboro brand franchise, (2) its industry-leading, diverse brand portfolio, and (3) its impressive ROIC and improving economic profit. PM has emerged in a class of its own and we believe it is poised for further growth.

# DISCLOSURE APPENDIX

## Required Disclosures

### Altria Group, Inc. (MO) 3-yr. Price Performance



**Date**

Date	Published Price (\$)	Rating Code	Val. Rng. Low	Val. Rng. High	Close Price (\$)
4/9/2013		Herzog			
4/9/2013	NA	1	37.00	39.00	35.48
4/22/2013	35.94	1	39.00	41.00	35.28
12/3/2013	37.23	1	40.00	42.00	37.17
1/27/2014	35.35	1	39.00	41.00	36.83
1/27/2014	38.40	1	41.00	43.00	36.83
5/19/2014	40.69	2	41.00	43.00	40.21
10/30/2014	47.55	2	46.00	48.00	47.50
1/20/2015	53.05	1	56.00	58.00	53.83
1/30/2015	53.10	1	59.00	61.00	53.10
10/26/2015	61.05	1	64.00	66.00	61.40
3/9/2016	62.30	1	69.00	71.00	62.81

Source: Wells Fargo Securities, LLC estimates and Reuters data

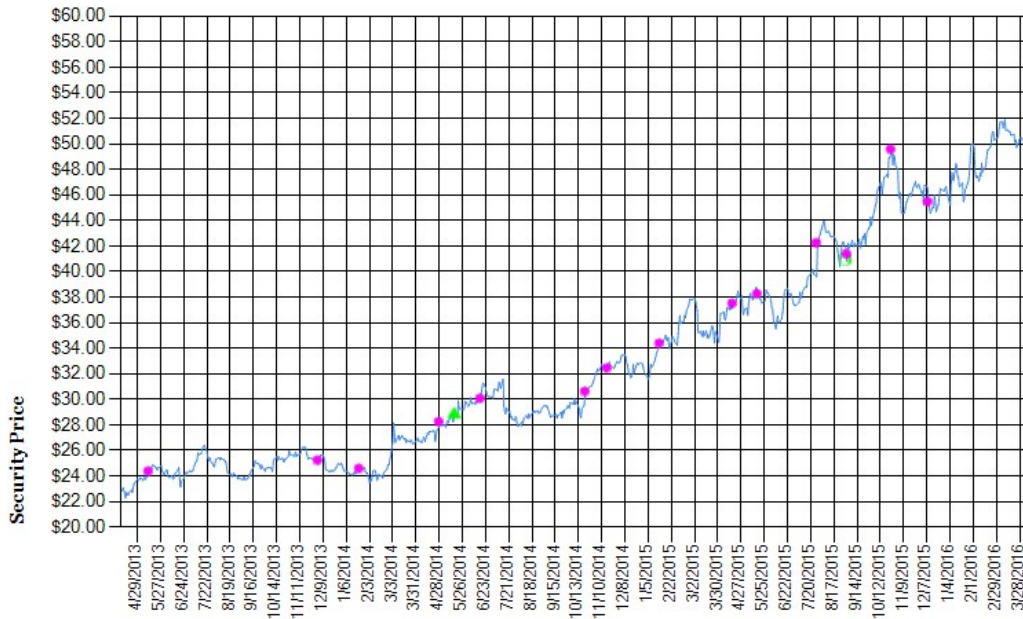
**Symbol Key**

- ▼ Rating Downgrade
- ▲ Rating Upgrade
- ◆ Initiation, Resumption, Drop or Suspend
- Analyst Change
- Valuation Range Change
- Split Adjustment

**Rating Code Key**

- 1 Outperform/Buy
- 2 Market Perform/Hold
- 3 Underperform/Sell
- SR Suspended
- NR Not Rated
- NE No Estimate

## Reynolds American Inc. (RAI) 3-yr. Price Performance



### Date

Date	Published Price (\$)	Rating Code	Val. Rng. Low	Val. Rng. High	Close Price (\$)
4/9/2013		Herzog			
4/9/2013	NA	2	22.50	23.50	22.75
5/14/2013	24.65	2	24.50	25.50	24.31
12/3/2013	25.32	2	25.50	26.50	25.10
1/23/2014	24.04	2	24.50	25.50	24.52
4/29/2014	28.12	2	29.50	30.50	28.12
5/19/2014	28.67	1	30.00	31.00	28.74
6/17/2014	29.99	1	32.00	33.00	29.99
10/21/2014	30.52	1	33.50	34.50	30.52
11/17/2014	32.35	1	34.50	35.50	32.35
1/20/2015	33.79	1	39.50	40.50	34.26
4/17/2015	37.35	1	40.50	41.50	37.35
5/18/2015	38.18	1	44.50	45.50	38.18
7/28/2015	84.20	1	47.00	48.00	42.10
9/1/2015		2-for-1 stock split			
9/2/2015	40.94	1	47.00	49.00	41.25
10/26/2015	48.89	1	52.00	54.00	49.49
12/9/2015	45.42	1	53.00	55.00	45.42

Source: Wells Fargo Securities, LLC estimates and Reuters data

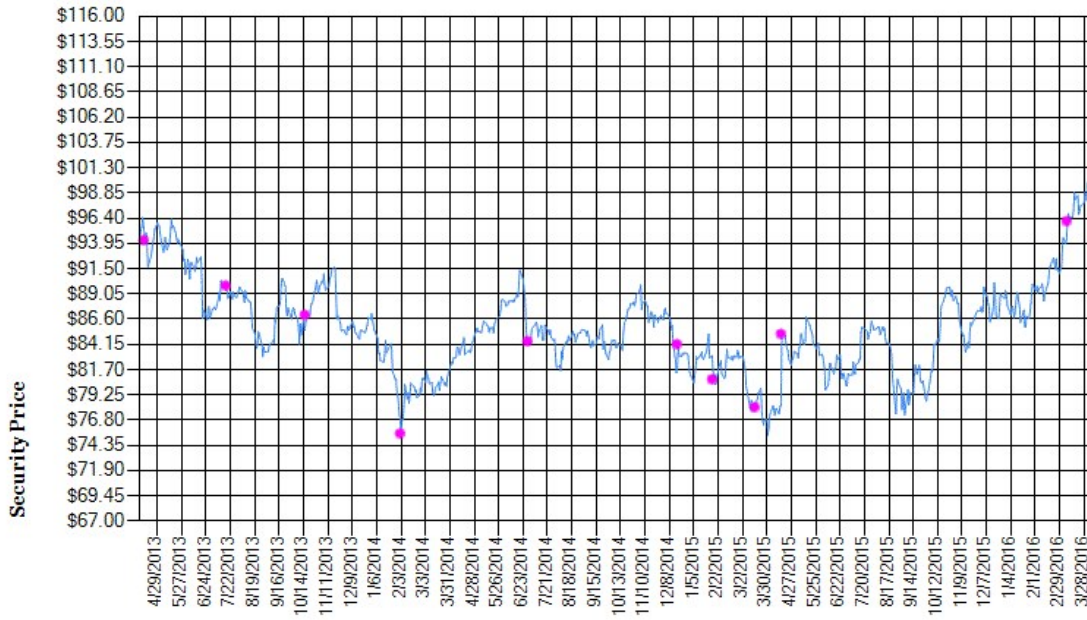
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▲ Rating Upgrade	■ Analyst Change
● Valuation Range Change	□ Split Adjustment

### Rating Code Key

1 Outperform/Buy	SR Suspended
2 Market Perform/Hold	NR Not Rated
3 Underperform/Sell	NE No Estimate

## Philip Morris International Inc. (PM) 3-yr. Price Performance



Date

Date	Published Price (\$)	Rating Code	Val. Rng. Low	Val. Rng. High	Close Price (\$)
4/9/2013		Herzog			
4/9/2013	NA	1	95.00	97.00	94.54
4/15/2013	91.69	1	101.00	103.00	94.11
7/17/2013	89.25	1	99.00	101.00	89.71
10/17/2013	86.89	1	96.00	98.00	86.89
2/3/2014	78.11	1	94.00	96.00	75.39
6/30/2014	84.85	1	92.00	94.00	84.31
12/18/2014	84.02	1	91.00	93.00	84.02
1/28/2015	80.58	1	88.00	90.00	80.58
3/17/2015	77.89	1	87.00	89.00	77.89
4/16/2015	84.96	1	94.00	96.00	84.96
3/9/2016	94.45	1	109.00	111.00	96.01

Source: Wells Fargo Securities, LLC estimates and Reuters data

### Symbol Key

▼ Rating Downgrade  
▲ Rating Upgrade  
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### Rating Code Key

1 Outperform/Buy SR Suspended  
 2 Market Perform/Hold NR Not Rated  
 3 Underperform/Sell NE No Estimate

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**MO:** Risks include increased price competition and increased downtrading by consumers.

**RAI:** Risks to our valuation include increased competitive pressure within the category and a pullback in consumer spending.

**PM:** Risks to our valuation range include currency fluctuations and a broad-based pullback in consumer spending.

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**1 = Outperform:** The stock appears attractively valued, and we believe the stock's total return will exceed that of the market over the next 12 months. BUY

**2 = Market Perform:** The stock appears appropriately valued, and we believe the stock's total return will be in line with the market over the next 12 months. HOLD

**3 = Underperform:** The stock appears overvalued, and we believe the stock's total return will be below the market over the next 12 months. SELL

#### **SECTOR RATING**

**O = Overweight:** Industry expected to outperform the relevant broad market benchmark over the next 12 months.

**M = Market Weight:** Industry expected to perform in-line with the relevant broad market benchmark over the next 12 months.

**U = Underweight:** Industry expected to underperform the relevant broad market benchmark over the next 12 months.

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