ALTRIA GROUP, INC.
Form 10-Q
November 03, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2008

OR

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number 1-8940

Altria Group, Inc.

(Exact name of registrant as specified in its charter)

Virginia (State or other jurisdiction of incorporation or organization)	13-3260245 (I.R.S. Employer Identification No.)
6601 West Broad Street, Richmond, Virginia (Address of principal executive offices)	23230 (Zip Code)

Registrant s telephone number, including area code (804) 274-2200

Former name, former address and former fiscal year, if changed since last report

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant is required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No þ

At October 27, 2008, there were 2,060,397,687 shares outstanding of the registrant s common stock, par value $0.33 1/3 per share.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

Altria Group, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(in millions of dollars)

(Unaudited)

	September 30, 2008	December 31, 2007
ASSETS		
Consumer products		
Cash and cash equivalents	$ 915	$ 4,842
Receivables (less allowances of $3 in 2008 and 2007)	52	83
Inventories:		
Leaf tobacco	643	861
Other raw materials	160	160
Finished product	257	233
	1,060	1,254
Current assets of discontinued operations		14,767
Other current assets	1,818	1,944
Total current assets	3,845	22,890
Property, plant and equipment, at cost	5,316	5,626
Less accumulated depreciation	3,154	3,204
	2,162	2,422
Goodwill	81	76
Other intangible assets, net	3,041	3,049
Prepaid pension assets	960	912
Investment in SABMiller	4,146	3,960
Long-term assets of discontinued operations		16,969
Other assets	876	870
Total consumer products assets	15,111	51,148
Financial services		
Finance assets, net	5,527	6,029
Other assets	32	34
Total financial services assets	5,559	6,063

TOTAL ASSETS	$	20,670	$	57,211

See notes to condensed consolidated financial statements.

Continued

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Altria Group, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets (Continued)

(in millions of dollars, except share and per share data)

(Unaudited)

	September 30, 2008	December 31, 2007
LIABILITIES		
Consumer products		
Current portion of long-term debt	$ 284	$ 2,354
Accounts payable	293	611
Payable to Philip Morris International Inc.	28	257
Accrued liabilities:		
Marketing	321	327
Taxes, except income taxes	43	70
Employment costs	204	283
Settlement charges	3,696	3,986
Other	916	849
Income taxes	23	184
Dividends payable	665	1,588
Current liabilities of discontinued operations		8,273
Total current liabilities	6,473	18,782
Long-term debt	101	1,885
Deferred income taxes	1,180	968
Accrued pension costs	172	198
Accrued postretirement health care costs	1,894	1,916
Long-term liabilities of discontinued operations		8,065
Other liabilities	1,236	1,240
Total consumer products liabilities	11,056	33,054
Financial services		
Long-term debt	500	500
Deferred income taxes	4,635	4,911
Other liabilities	301	192
Total financial services liabilities	5,436	5,603
Total liabilities	16,492	38,657
Contingencies (Note 12)		
STOCKHOLDERS EQUITY		
Common stock, par value $0.33 1/3 per share (2,805,961,317 shares issued)	935	935
Additional paid-in capital	6,369	6,884
Earnings reinvested in the business	22,113	34,426
Accumulated other comprehensive losses	(795)	(237)

		28,622		42,008
Less cost of repurchased stock (745,701,112 shares in 2008 and 698,284,555 shares in 2007)		(24,444)		(23,454)
Total stockholders equity		4,178		18,554
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	20,670	$	57,211

See notes to condensed consolidated financial statements.

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Altria Group, Inc. and Subsidiaries

Condensed Consolidated Statements of Earnings

(in millions of dollars, except per share data)

(Unaudited)

	For the Nine Months Ended September 30, 2008	For the Nine Months Ended September 30, 2007
Net revenues	$ 14,702	$ 14,136
Cost of sales	6,285	5,905
Excise taxes on products	2,578	2,626
Gross profit	5,839	5,605
Marketing, administration and research costs	2,060	2,059
Asset impairment and exit costs	294	392
Gain on sale of corporate headquarters building	(404)	
Recoveries from airline industry exposure		(214)
Amortization of intangibles	5	
Operating income	3,884	3,368
Interest and other debt expense, net	27	190
Loss on early extinguishment of debt	393	
Equity earnings in SABMiller	(344)	(392)
Earnings from continuing operations before income taxes	3,808	3,570
Provision for income taxes	1,397	1,259
Earnings from continuing operations	2,411	2,311
Earnings from discontinued operations, net of income taxes and minority interest	1,840	5,287
Net earnings	$ 4,251	$ 7,598
Per share data:		
Basic earnings per share:		
Continuing operations	$ 1.16	$ 1.10
Discontinued operations	0.88	2.52
Net earnings	$ 2.04	$ 3.62
Diluted earnings per share:		
Continuing operations	$ 1.15	$ 1.09
Discontinued operations	0.88	2.50
Net earnings	$ 2.03	$ 3.59
Dividends declared	$ 1.36	$ 2.30

See notes to condensed consolidated financial statements.

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Altria Group, Inc. and Subsidiaries

Condensed Consolidated Statements of Earnings

(in millions of dollars, except per share data)

(Unaudited)

	For the Three Months Ended September 30, 2008	2007
Net revenues	$ 5,238	$ 4,987
Cost of sales	2,230	2,096
Excise taxes on products	897	927
Gross profit	2,111	1,964
Marketing, administration and research costs	763	736
Asset impairment and exit costs	17	13
Recoveries from airline industry exposure		(7)
Amortization of intangibles	2	
Operating income	1,329	1,222
Interest and other debt expense, net	25	27
Equity earnings in SABMiller	(54)	(132)
Earnings from continuing operations before income taxes	1,358	1,327
Provision for income taxes	491	427
Earnings from continuing operations	867	900
Earnings from discontinued operations, net of income taxes and minority interest		1,733
Net earnings	$ 867	$ 2,633
Per share data:		
Basic earnings per share:		
Continuing operations	$ 0.42	$ 0.43
Discontinued operations		0.82
Net earnings	$ 0.42	$ 1.25
Diluted earnings per share:		
Continuing operations	$ 0.42	$ 0.43
Discontinued operations		0.81
Net earnings	$ 0.42	$ 1.24
Dividends declared	$ 0.32	$ 0.75

See notes to condensed consolidated financial statements.

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Altria Group, Inc. and Subsidiaries

Condensed Consolidated Statements of Stockholders Equity

for the Year Ended December 31, 2007 and

the Nine Months Ended September 30, 2008

(in millions of dollars, except per share data)

(Unaudited)

				Accumulated Other Comprehensive Earnings (Losses)				
	Common Stock	Additional Paid-in Capital	Earnings Reinvested in the Business	Currency Translation Adjustments	Other	Total	Cost of Repurchased Stock	Total Stock-holders Equity
Balances, January 1, 2007	$ 935	$ 6,356	$ 59,879	$ (97)	$ (3,711)	$ (3,808)	$ (23,743)	$ 39,619
Comprehensive earnings:								
Net earnings			9,786					9,786
Other comprehensive earnings (losses), net of income taxes:								
Currency translation adjustments				736		736		736
Change in net loss and prior service cost					744	744		744
Change in fair value of derivatives accounted for as hedges					(18)	(18)		(18)
Total other comprehensive earnings								1,462
Total comprehensive earnings								11,248
Adoption of FIN 48 and FAS 13-2			711					711
Exercise of stock options and issuance of other stock awards (1)		528					289	817
Cash dividends declared ($3.05 per share)			(6,430)					(6,430)
Spin-off of Kraft Foods Inc.			(29,520)	89	2,020	2,109		(27,411)
Balances, December 31, 2007	935	6,884	34,426	728	(965)	(237)	(23,454)	18,554
Comprehensive earnings:								
Net earnings			4,251					4,251
Other comprehensive earnings (losses), net of income taxes:								
Currency translation adjustments				233		233		233
Change in net loss and prior service cost					41	41		41
Change in fair value of derivatives accounted for as hedges					(177)	(177)		(177)
Total other comprehensive earnings								97

Total comprehensive earnings								4,348
Exercise of stock options and issuance of other stock awards (2)		(515)					176	(339)
Cash dividends declared ($1.36 per share)			(2,844)					(2,844)
Stock repurchased							(1,166)	(1,166)
Spin-off of Philip Morris International Inc.			(13,720)	(961)	306	(655)		(14,375)
Balances, September 30, 2008	$ 935	$ 6,369	$ 22,113	$	$ (795)	$ (795)	$ (24,444)	$ 4,178

(1) Includes $179 million increase to additional paid-in capital for the reimbursement from Kraft as a result of modifications to Altria Group, Inc. stock awards.

(2) Includes $449 million decrease to additional paid-in capital for the reimbursement to PMI as a result of modifications to Altria Group, Inc. stock awards. See Note 1.

Total comprehensive earnings were $880 million and $2,564 million for the quarters ended September 30, 2008 and 2007, respectively, and $8,461 million for the nine months ended September 30, 2007.

See notes to condensed consolidated financial statements.

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Altria Group, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(in millions of dollars)

(Unaudited)

		For the Nine Months Ended September 30, 2008	2007
CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES			
Earnings from continuing operations	- Consumer products	$ 2,363	$ 2,104
	- Financial services	48	207
Earnings from discontinued operations, net of income taxes and minority interest		1,840	5,287
Net earnings		4,251	7,598
Impact of earnings from discontinued operations, net of income taxes and minority interest		(1,840)	(5,287)
Adjustments to reconcile net earnings to operating cash flows:			
Consumer products			
Depreciation and amortization		162	174
Deferred income tax provision		128	157
Equity earnings in SABMiller		(344)	(392)
Asset impairment and exit costs, net of cash paid		84	328
Gain on sale of corporate headquarters building		(404)	
Loss on early extinguishment of debt		393	
Cash effects of changes, net of the effects from acquired and divested companies:			
Receivables, net		(102)	149
Inventories		194	370
Accounts payable		(157)	(161)
Income taxes		19	(358)
Accrued liabilities and other current assets		(114)	(68)
Accrued settlement charges		(290)	129
Pension plan contributions		(37)	(27)
Pension provisions and postretirement, net		92	163
Other		259	320
Financial services			
Deferred income tax benefit		(276)	(253)
Other		224	(34)
Net cash provided by operating activities, continuing operations		2,242	2,808
Net cash provided by operating activities, discontinued operations		1,666	5,477
Net cash provided by operating activities		3,908	8,285

See notes to condensed consolidated financial statements.

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Altria Group, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows (Continued)

(in millions of dollars)

(Unaudited)

	For the Nine Months Ended September 30, 2008	2007
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES		
Consumer products		
Capital expenditures	$ (131)	$ (210)
Proceeds from sale of corporate headquarters building	525	
Other	110	108
Financial services		
Investments in finance assets		(4)
Proceeds from finance assets	389	363
Net cash provided by investing activities, continuing operations	893	257
Net cash used in investing activities, discontinued operations	(317)	(1,152)
Net cash provided by (used in) investing activities	576	(895)
CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES		
Consumer products		
Net issuance of short-term borrowings		2
Long-term debt repaid	(3,908)	(500)
Financial services		
Long-term debt repaid		(617)
Repurchase of Altria Group, Inc. common stock	(1,166)	
Dividends paid on Altria Group, Inc. common stock	(3,767)	(5,069)
Issuance of Altria Group, Inc. common stock	79	357
Kraft Foods Inc. dividends paid to Altria Group, Inc.		728
Philip Morris International Inc. dividends paid to Altria Group, Inc.	3,019	2,480
Tender and consent fees related to the early extinguishment of debt	(371)	
Changes in amounts due to/from Philip Morris International Inc.	(721)	480
Other	(227)	90
Net cash used in financing activities, continuing operations	(7,062)	(2,049)
Net cash used in financing activities, discontinued operations	(1,648)	(2,966)
Net cash used in financing activities	(8,710)	(5,015)
Effect of exchange rate changes on cash and cash equivalents:		
Discontinued operations	(126)	165

Cash and cash equivalents, continuing operations:		
(Decrease) increase	(3,927)	1,016
Balance at beginning of period	4,842	3,105
Balance at end of period	$ 915	$ 4,121

See notes to condensed consolidated financial statements.

Altria Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 1. Basis of Presentation and PMI Spin-Off:

Basis of Presentation

The interim condensed consolidated financial statements of Altria Group, Inc. and subsidiaries (Altria Group, Inc.) are unaudited. It is the opinion of Altria Group, Inc. s management that all adjustments necessary for a fair statement of the interim results presented have been reflected therein. All such adjustments were of a normal recurring nature. Net revenues and net earnings for any interim period are not necessarily indicative of results that may be expected for the entire year.

These statements should be read in conjunction with the consolidated financial statements and related notes, which appear in Altria Group, Inc. s Current Report on Form 8-K filed with the Securities and Exchange Commission (SEC) on June 5, 2008 (the June Form 8-K) and on September 8, 2008 (the September Form 8-K). Altria Group, Inc. s June Form 8-K revised certain information disclosed in Altria Group, Inc. s Annual Report on Form 10-K for the year ended December 31, 2007 in order to reflect Philip Morris International Inc. (PMI) as a discontinued operation, and to reflect the change in reportable segments both of which are discussed further below. Altria Group, Inc. s September Form 8-K was filed to provide subsequent event footnotes to the financial statements of Altria Group, Inc. for the year ended December 31, 2007 as filed on the June Form 8-K. These subsequent event footnotes included condensed consolidating financial information provided in connection with the issuance by Philip Morris USA Inc. (PM USA) of guarantees of certain of Altria Group, Inc. s indebtedness, which is discussed further in Note 14. *Condensed Consolidating Financial Information*.

Balance sheet accounts are segregated by two broad types of businesses. Consumer products assets and liabilities are classified as either current or non-current, whereas financial services assets and liabilities are unclassified, in accordance with respective industry practices. The financial services long-term debt of $500 million matures in July 2009.

On March 28, 2008, Altria Group, Inc. distributed all of its interest in PMI to Altria Group, Inc. s stockholders in a tax-free distribution, as discussed below. Altria Group, Inc. has reflected the results of PMI prior to the distribution as discontinued operations on the condensed consolidated statements of earnings and the condensed consolidated statements of cash flows. The assets and liabilities related to PMI were reclassified and reflected as discontinued operations on the condensed consolidated balance sheet at December 31, 2007.

On March 30, 2007, Altria Group, Inc. distributed all of its remaining interest in Kraft Foods Inc. (Kraft) on a pro-rata basis to Altria Group, Inc. stockholders in a tax-free distribution. Altria Group, Inc. has reflected the results of Kraft prior to the Kraft distribution date as discontinued operations on the condensed consolidated statements of earnings and the condensed consolidated statements of cash flows.

The products of Altria Group, Inc. s subsidiaries include cigarettes and other tobacco products sold in the United States by PM USA, and machine-made large cigars and pipe tobacco sold by John Middleton Co. (Middleton). Beginning with the first quarter of 2008, Altria Group, Inc. revised its reportable segments to reflect the change in the way in which Altria Group, Inc. s management reviews the business as a result of the acquisition of Middleton and the PMI spin-off. Altria Group, Inc. s revised segments, which are reflected in these financial statements, are Cigarettes and other tobacco products; Cigars; and Financial services. Accordingly, prior period segment results have been revised.

Certain prior year amounts have been reclassified to conform with the current year s presentation, due primarily to the classification of PMI as a discontinued operation and revised segment information.

Altria Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

PMI Spin-Off

On March 28, 2008 (the Distribution Date), Altria Group, Inc. distributed all of its interest in PMI to Altria Group, Inc. stockholders of record as of the close of business on March 19, 2008 (the Record Date), in a tax-free distribution. Altria Group, Inc. distributed one share of PMI common stock for every share of Altria Group, Inc. common stock outstanding as of the Record Date. Following the Distribution Date, Altria Group, Inc. does not own any shares of PMI stock.

Holders of Altria Group, Inc. stock options were treated similarly to public stockholders and, accordingly, had their stock awards split into two instruments. Holders of Altria Group, Inc. stock options received the following stock options, which, immediately after the spin-off, had an aggregate intrinsic value equal to the intrinsic value of the pre-spin Altria Group, Inc. options:

a new PMI option to acquire the same number of shares of PMI common stock as the number of Altria Group, Inc. options held by such person on the Distribution Date; and

an adjusted Altria Group, Inc. option for the same number of shares of Altria Group, Inc. common stock with a reduced exercise price.

As set forth in the Employee Matters Agreement, the exercise price of each option was developed to reflect the relative market values of PMI and Altria Group, Inc. shares, by allocating the share price of Altria Group, Inc. common stock before the spin-off ($73.83) to PMI shares ($51.44) and Altria Group, Inc. shares ($22.39) and then multiplying each of these allocated values by the Option Conversion Ratio. The Option Conversion Ratio was equal to the exercise price of the Altria Group, Inc. option, prior to any adjustment for the spin-off, divided by the share price of Altria Group, Inc. common stock before the spin-off ($73.83). As a result, the new PMI option and the adjusted Altria Group, Inc. option had an aggregate intrinsic value equal to the intrinsic value of the pre-spin Altria Group, Inc. option.

Holders of Altria Group, Inc. restricted stock or deferred stock awarded prior to January 30, 2008, retained their existing awards and received the same number of shares of restricted or deferred stock of PMI. The restricted stock and deferred stock will not vest until the completion of the original restriction period (typically, three years from the date of the original grant). Recipients of Altria Group, Inc. deferred stock awarded on January 30, 2008, who were employed by Altria Group, Inc. after the Distribution Date, received additional shares of deferred stock of Altria Group, Inc. to preserve the intrinsic value of the award. Recipients of Altria Group, Inc. deferred stock awarded on January 30, 2008, who were employed by PMI after the Distribution Date, received substitute shares of deferred stock of PMI to preserve the intrinsic value of the award.

To the extent that employees of the remaining Altria Group, Inc. received PMI stock options, Altria Group, Inc. reimbursed PMI in cash for the Black-Scholes fair value of the stock options received. To the extent that PMI employees held Altria Group, Inc. stock options, PMI reimbursed Altria Group, Inc. in cash for the Black-Scholes fair value of the stock options. To the extent that employees of Altria Group, Inc. received PMI deferred stock, Altria Group, Inc. paid to PMI the fair value of the PMI deferred stock less the value of projected forfeitures. To the extent that PMI employees held Altria Group, Inc. restricted stock or deferred stock, PMI reimbursed Altria Group, Inc. in cash for the fair value of the restricted or deferred stock less the value of projected forfeitures and any amounts previously charged to PMI for the restricted or deferred stock. Based upon the number of Altria Group, Inc. stock awards outstanding at the Distribution Date, the net amount of these reimbursements resulted in a payment of $449 million from Altria Group, Inc. to PMI. The reimbursement to PMI is reflected as a decrease to the additional paid-in capital of Altria Group, Inc. on the September 30, 2008 condensed consolidated balance sheet.

Altria Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

In connection with the spin-off, PMI paid to Altria Group, Inc. $4.0 billion in special dividends in addition to its normal dividends to Altria Group, Inc. PMI paid $3.1 billion of these special dividends in 2007 and paid the additional $900 million in the first quarter of 2008.

Prior to the PMI spin-off, PMI was included in the Altria Group, Inc. consolidated federal income tax return, and PMI s federal income tax contingencies were recorded as liabilities on the balance sheet of Altria Group, Inc. Altria Group, Inc. reimbursed PMI in cash for these liabilities, which were $97 million.

Prior to the PMI spin-off, certain employees of PMI participated in the U.S. benefit plans offered by Altria Group, Inc. The benefits previously provided by Altria Group, Inc. are now provided by PMI. As a result, new plans were established by PMI, and the related plan assets (to the extent that the benefit plans were previously funded) and liabilities were transferred to the PMI plans. The transfer of these benefits resulted in Altria Group, Inc. reducing its benefit plan liabilities by $129 million and increasing its prepaid pension assets by $33 million in its condensed consolidated balance sheet, partially offset by the related deferred tax assets ($23 million) and the corresponding Statement of Financial Accounting Standards (SFAS) No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans adjustment to stockholders equity ($27 million). Altria Group, Inc. paid PMI a corresponding amount of $112 million in cash, which is net of the related tax benefit.

A subsidiary of Altria Group, Inc. previously provided PMI with certain corporate services at cost plus a management fee. After the Distribution Date, PMI independently undertook most of these activities. Any remaining limited services provided to PMI by the Altria Group, Inc. service subsidiary under the Transition Services Agreement are expected to cease in 2008. The settlement of the intercompany accounts (including the amounts discussed above related to stock awards, tax contingencies and benefit plans) resulted in a net payment from Altria Group, Inc. to PMI of $332 million. In March 2008, Altria Group, Inc. made an estimated payment of $427 million to PMI, thereby resulting in PMI reimbursing $95 million to Altria Group, Inc. in the second quarter of 2008.

The distribution resulted in a net decrease to Altria Group, Inc. s stockholders equity of $14.4 billion on the Distribution Date.

Dividends and Share Repurchases

During the second quarter of 2008, Altria Group, Inc. s Board of Directors adjusted Altria Group, Inc. s quarterly dividend rate to $0.29 per common share. This adjustment was intended to allow Altria Group, Inc. stockholders who retained their PMI shares to initially receive, in the aggregate, the same cash dividend rate that existed before the spin-off. During the third quarter of 2008, Altria Group, Inc. s Board of Directors approved a 10.3% increase in the quarterly dividend rate to $0.32 per common share. The present annualized dividend rate is $1.28 per Altria Group, Inc. common share. The dividend remains subject to the discretion of the Board of Directors.

In conjunction with the announced acquisition of UST Inc. (UST) (for further discussion see Note 2. *UST Acquisition*) the Altria Group, Inc. Board of Directors modified its previously announced two-year $7.5 billion share repurchase program and authorized the repurchase of up to $4.0 billion in Altria Group, Inc. common stock over a three-year (2008 to 2010) period. As of September 30, 2008, Altria Group, Inc. had repurchased 53.5 million shares of its common stock at an aggregate cost of approximately $1.2 billion, or an average price of $21.81 per share. Altria Group, Inc. s share repurchase program is at the discretion of the Board of Directors.

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Altria Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Tender Offer for Altria Group, Inc. Notes

In connection with the spin-off of PMI, in the first quarter of 2008, Altria Group, Inc. and its subsidiary, Altria Finance (Cayman Islands) Ltd., completed tender offers to purchase for cash $2.3 billion of notes and debentures denominated in U.S. dollars, and 373 million in euro-denominated bonds, equivalent to $568 million in U.S. dollars.

As a result of the tender offers and consent solicitations, Altria Group, Inc. recorded a pre-tax loss of $393 million, which included tender and consent fees of $371 million, on the early extinguishment of debt in the first quarter of 2008.

Note 2. UST Acquisition:

On September 8, 2008, Altria Group, Inc. and UST announced that they had entered into a definitive agreement for Altria Group, Inc. to acquire all outstanding shares of UST, the world s leading moist smokeless tobacco manufacturer. Under the terms of the agreement, shareholders of UST will receive $69.50 in cash for each share of UST common stock. The transaction is valued at approximately $11.7 billion, which includes the assumption of approximately $1.3 billion of debt.

On October 2, 2008, Altria Group, Inc. and UST agreed to extend, at Altria Group, Inc. s option, the closing date of the transaction in the event conditions for closing are met prior to the end of 2008. As part of the extension, Altria Group, Inc. agreed to increase the termination fee it must pay to $300 million under certain circumstances where Altria Group, Inc. is required to close the acquisition but does not do so. On October 16, 2008, Altria Group, Inc. and UST announced that Altria Group, Inc. s proposed acquisition of UST had passed federal antitrust review. Completion of the transaction remains subject to UST shareholder approval and certain other customary closing conditions. If such conditions to closing are satisfied, Altria Group, Inc. expects the transaction to close during the first full week of January 2009 and no later than January 7, 2009.

Altria Group, Inc. has entered into a commitment letter with two banks to provide up to $7.0 billion under a senior 364-day bridge loan facility, which, together with Altria Group, Inc. s existing credit facilities and cash, is expected to be more than sufficient to fund the acquisition.

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Altria Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 3. Asset Impairment and Exit Costs:

Pre-tax asset impairment and exit costs consisted of the following:

		For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
		2008	2007	2008	2007
		(in millions)			
Separation program	Cigarettes and other tobacco products	$ 44	$ 293	$ 15	$ 10
Separation program	General corporate	195	17	2	
Asset impairment	Cigarettes and other tobacco products		35		
Kraft spin-off fees	General corporate		47		3
PMI spin-off fees	General corporate	55			
Asset impairment and exit costs		$ 294	$ 392	$ 17	$ 13

The movement in the asset impairment and exit cost liabilities for Altria Group, Inc. for the nine months ended September 30, 2008 was as follows:

	Severance	Other	Total
		(in millions)	
Liability balance, January 1, 2008	$ 279	$ 3	$ 282
Charges	144	150	294
Cash spent	(119)	(91)	(210)
Other	4	(22)	(18)
Liability balance, September 30, 2008	$ 308	$ 40	$ 348

Other charges in the table above primarily represent PMI spin-off fees, as well as pension and postretirement termination benefits.

Manufacturing Optimization Program

In June 2007, PMI established plans to move the U.S.-based production of cigarettes from PM USA to PMI facilities. Due to declining U.S. cigarette volume, as well as PMI s decision to re-source its production, PM USA will close its Cabarrus, North Carolina manufacturing facility and consolidate manufacturing for the U.S. market at its Richmond, Virginia manufacturing center. PM USA anticipates that its cigarette production for PMI, which approximated 57 billion cigarettes in 2007, will end during the fourth quarter of 2008. PM USA expects to close its Cabarrus manufacturing facility by the end of 2010.

As a result of this program, from 2007 through 2011, PM USA expects to incur total pre-tax charges of approximately $670 million, comprised of accelerated depreciation of $143 million, employee separation costs of $353 million and other charges of $174 million, primarily related to the relocation of employees and equipment, net of estimated gains on sales of land and buildings. Approximately $440 million, or 66% of the total pre-tax charges, will result in cash expenditures.

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PM USA recorded total pre-tax charges for this program as follows:

	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2008	2007	2008	2007
	(in millions)			
Asset impairment and exit costs	$ 44	$ 328	$ 15	$ 10
Implementation costs	48	12	16	12
Total	$ 92	$ 340	$ 31	$ 22

The pre-tax implementation costs were primarily related to accelerated depreciation and were included in cost of sales in the condensed consolidated statements of earnings for the nine months and three months ended September 30, 2008 and 2007. Total pre-tax charges incurred since the inception of the program were $463 million. Pre-tax charges of approximately $32 million are expected during the remainder of 2008 for the program. Cash payments related to the program of $53 million and $24 million were made during the nine and three months ended September 30, 2008, respectively, for a total of $64 million since inception.

Corporate Asset Impairment and Exit Costs

During the first quarter of 2008, in connection with the PMI spin-off, Altria Group, Inc. restructured its corporate headquarters and incurred pre-tax charges of $195 million for the nine months ended September 30, 2008, consisting primarily of employee separation costs. Substantially all of these charges will result in cash expenditures. Cash payments for the program of $121 million and $52 million were made during the nine months and three months ended September 30, 2008, respectively.

In addition, during the nine months ended September 30, 2008 and 2007, corporate asset impairment and exit costs also included investment banking and legal fees associated with the PMI spin-off in 2008 and the Kraft spin-off in 2007, as well as the streamlining of various corporate functions in 2007.

Note 4. Benefit Plans:

Altria Group, Inc. sponsors noncontributory defined benefit pension plans covering substantially all employees. In addition, Altria Group, Inc. and its subsidiaries provide health care and other benefits to substantially all retired employees.

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Pension Plans

Components of Net Periodic Benefit Cost

Net periodic pension cost consisted of the following:

	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2008	2007	2008	2007
	(in millions)			
Service cost	$ 73	$ 80	$ 23	$ 26
Interest cost	228	229	75	76
Expected return on plan assets	(319)	(316)	(109)	(105)
Amortization:				
Net loss	46	78	12	28
Prior service cost	7	7	3	1
Other	40	31	2	7
Net periodic pension cost	$ 75	$ 109	$ 6	$ 33

Other pension cost of $40 million for the nine months ended September 30, 2008, primarily reflects termination benefits related to Altria Group, Inc. s restructuring of its corporate headquarters. Other pension costs of $31 million and $7 million for the nine months and three months ended September 30, 2007, respectively, were due primarily to curtailment losses and an early retirement program related to PM USA s announced closure of its Cabarrus, North Carolina manufacturing facility.

Employer Contributions

Altria Group, Inc. presently makes, and plans to make, contributions, to the extent that they are tax deductible, in order to maintain plan assets in excess of the accumulated benefit obligation of its funded plans and to pay benefits that relate to plans for salaried employees that cannot be funded under Internal Revenue Service regulations. Employer contributions of $37 million were made to Altria Group, Inc. s pension plans during the nine months ended September 30, 2008. Currently, Altria Group, Inc. anticipates making additional contributions during the remainder of 2008 of approximately $20 million to its pension plans, based on current tax law. However, these estimates are subject to change as a result of changes in tax and other benefit laws, as well as asset performance significantly above or below the assumed long-term rate of return on pension assets, or changes in interest rates.

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Postretirement Benefit Plans

Net postretirement health care costs consisted of the following:

	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2008	2007	2008	2007
	(in millions)			
Service cost	$ 29	$ 36	$ 10	$ 12
Interest cost	87	93	29	30
Amortization:				
Net loss	18	25	5	8
Prior service credit	(6)	(6)	(2)	(2)
Other	9	(4)	1	
Net postretirement health care costs	$ 137	$ 144	$ 43	$ 48

Other postretirement cost of $9 million for the nine months ended September 30, 2008, primarily reflects termination benefits related to Altria Group, Inc. s restructuring of its corporate headquarters. Other postretirement gains of $4 million for the nine months ended September 30, 2007, were due primarily to curtailment gains related to PM USA s announced closure of its Cabarrus, North Carolina manufacturing facility.

Note 5. Goodwill and Other Intangible Assets, net:

Goodwill and other intangible assets, net, by segment were as follows (in millions):

	Goodwill		Other Intangible Assets, net	
	September 30, 2008	December 31, 2007	September 30, 2008	December 31, 2007
Cigarettes and other tobacco products	$ -	$ -	$ 283	$ 283
Cigars	81	76	2,758	2,766
Total	$ 81	$ 76	$ 3,041	$ 3,049

Intangible assets were as follows (in millions):

	September 30, 2008		December 31, 2007	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization

Non-amortizable intangible assets	$ 2,923			$ 2,894		
Amortizable intangible assets	123	$	5	155	$	-
Total intangible assets	$ 3,046	$	5	$ 3,049	$	-

Non-amortizable intangible assets substantially consist of trademarks from the December 2007 acquisition of Middleton. Amortizable intangible assets consist primarily of customer relationships. Pre-tax amortization expense for intangible assets during the nine months and three months ended September 30, 2008, was $5 million and $2 million, respectively. Annual amortization expense for each of the next five

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years is estimated to be $10 million or less, excluding any impact from the UST acquisition and assuming no additional transactions occur that require the amortization of intangible assets.

Goodwill relates to the December 2007 acquisition of Middleton. The change in goodwill and gross carrying amount of intangible assets from December 31, 2007 to September 30, 2008, is as follows (in millions):

	Goodwill	Intangible Assets
Balance at December 31, 2007	$ 76	$ 3,049
Changes due to:		
Purchase price revisions	5	(3)
Balance at September 30, 2008	$ 81	$ 3,046

The changes in goodwill and intangible assets resulted from revisions to the purchase price allocation as appraisals for the acquisition of Middleton were finalized during the first quarter of 2008.

Note 6. Financial Instruments:

During the nine months ended September 30, 2008 and 2007, and the three months ended September 30, 2007, ineffectiveness related to fair value hedges and cash flow hedges was not material. During the first quarter of 2008, Altria Group, Inc. purchased forward foreign exchange contracts to mitigate its exposure to changes in exchange rates from its euro-denominated debt. While these forward exchange contracts were effective as economic hedges, they did not qualify for hedge accounting treatment and therefore $21 million of gains for the nine months ended September 30, 2008 relating to these contracts were reported in Altria Group, Inc. s condensed consolidated statements of earnings. These contracts and the related debt matured in the second quarter of 2008. Subsequent to the maturities of these contracts, Altria Group, Inc. has had no derivative financial instruments remaining.

Within currency translation adjustments during the nine months ended September 30, 2008 and 2007, Altria Group, Inc. recorded losses, net of income taxes, of $85 million and gains, net of income taxes, of $2 million, respectively, which represented effective hedges of net investments. The accumulated losses recorded as net investment hedges of foreign operations were recognized and recorded in connection with the PMI distribution. Subsequent to the PMI distribution, Altria Group, Inc. has had no such net investment hedges remaining.

Hedging activity affected accumulated other comprehensive earnings (losses), net of income taxes, as follows:

	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2008	2007	2008	2007
	(in millions)			
(Loss) gain at beginning of period	$ (5)	$ 13	$ -	$ 8
Derivative losses (gains) transferred to earnings	93	(38)		3
Change in fair value	(270)	45		11
Kraft spin-off		2		

PMI spin-off	182			
Gain as of September 30	$ -	$ 22	$ -	$ 22

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See Note 11. *Fair Value Measurements*, for disclosures related to the fair value of derivative financial instruments.

Note 7. Divestitures:

Discontinued Operations

As further discussed in Note 1. *Basis of Presentation and PMI Spin-Off*, on March 28, 2008, Altria Group, Inc. distributed all of its interest in PMI to Altria Group, Inc. stockholders in a tax-free distribution. The distribution resulted in a net decrease to Altria Group, Inc. s stockholders equity of $14.4 billion on March 28, 2008.

On March 30, 2007, Altria Group, Inc. distributed all of its remaining interest in Kraft on a pro-rata basis to Altria Group, Inc. stockholders in a tax-free distribution. The distribution resulted in a net decrease of $27.4 billion to Altria Group, Inc. s stockholders equity on March 30, 2007.

Altria Group, Inc. has reflected the results of PMI and Kraft prior to their respective distribution dates as discontinued operations on the condensed consolidated statements of earnings and the condensed consolidated statements of cash flows. The assets and liabilities related to PMI were reclassified and reflected as discontinued operations on the condensed consolidated balance sheet at December 31, 2007.

Summarized financial information for discontinued operations for the nine months ended September 30, 2008 and 2007, and for the three months ended September 30, 2007 were as follows (in millions):

	For the Nine Months Ended September 30, 2008	For the Nine Months Ended September 30, 2007		
	PMI	PMI	Kraft	Total
Net revenues	$ 15,376	$ 41,436	$ 8,586	$ 50,022
Earnings before income taxes and minority interest	$ 2,701	$ 6,834	$ 1,059	$ 7,893
Provision for income taxes	(800)	(1,975)	(356)	(2,331)
Minority interest in earnings from discontinued operations	(61)	(197)	(78)	(275)
Earnings from discontinued operations, net of income taxes and minority interest	$ 1,840	$ 4,662	$ 625	$ 5,287

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	For the Three Months Ended September 30, 2007 PMI
Net revenues	$ 14,220
Earnings before income taxes and minority interest	$ 2,499
Provision for income taxes	(690)
Minority interest in earnings from discontinued operations	(76)
Earnings from discontinued operations, net of income taxes and minority interest	$ 1,733

Summarized assets and liabilities of discontinued operations for PMI as of December 31, 2007 were as follows (in millions):

	December 31, 2007
Assets:	
Cash and cash equivalents	$ 1,656
Receivables, net	3,240
Inventories	9,317
Other current assets	554
Current assets of discontinued operations	