

ALTRIA GROUP, INC.

Form 10-K

February 27, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2016

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 1-08940

ALTRIA GROUP, INC.

(Exact name of registrant as specified in its charter)

Virginia 13-3260245

(State or other jurisdiction of (I.R.S. Employer

incorporation or organization) Identification No.)

6601 West Broad Street, Richmond, Virginia 23230  
(Address of principal executive offices) (Zip Code)

804-274-2200

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class Name of each exchange on which registered

Common Stock, \$0.33 1/3 par value New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.  Yes  No

Yes  No

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 was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days  Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files)  Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K

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

Accelerated filer

Non-accelerated filer  (Do not check if smaller reporting company) Smaller operating company

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

As of June 30, 2016, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was approximately \$135 billion based on the closing sale price of the common stock as reported on the New

York Stock Exchange.

Class

Outstanding at February 13, 2017

Common Stock, \$0.33 <sup>1</sup>/<sub>3</sub> par value 1,939,420,437 shares

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for use in connection with its annual meeting of shareholders to be held on May 18, 2017, to be filed with the Securities and Exchange Commission on or about April 6, 2017, are incorporated by reference into Part III hereof.

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Part I

Item 1. Business.

General Development of Business

General: Altria Group, Inc. is a holding company incorporated in the Commonwealth of Virginia in 1985. At December 31, 2016, Altria Group, Inc.'s wholly-owned subsidiaries included Philip Morris USA Inc. ("PM USA"), which is engaged in the manufacture and sale of cigarettes in the United States; John Middleton Co. ("Middleton"), which is engaged in the manufacture and sale of machine-made large cigars and pipe tobacco and is a wholly-owned subsidiary of PM USA; and UST LLC ("UST"), which through its wholly-owned subsidiaries, including U.S. Smokeless Tobacco Company LLC ("USSTC") and Ste. Michelle Wine Estates Ltd. ("Ste. Michelle"), is engaged in the manufacture and sale of smokeless tobacco products and wine. Altria Group, Inc.'s other operating companies included Nu Mark LLC ("Nu Mark"), a wholly-owned subsidiary that is engaged in the manufacture and sale of innovative tobacco products, and Philip Morris Capital Corporation ("PMCC"), a wholly-owned subsidiary that maintains a portfolio of finance assets, substantially all of which are leveraged leases. Other Altria Group, Inc. wholly-owned subsidiaries included Altria Group Distribution Company, which provides sales, distribution and consumer engagement services to certain Altria Group, Inc. operating subsidiaries, and Altria Client Services LLC, which provides various support services in areas, such as legal, regulatory, finance, human resources and external affairs, to Altria Group, Inc. and its subsidiaries.

At September 30, 2016, Altria Group, Inc. had an approximate 27% ownership of SABMiller plc ("SABMiller"), which Altria Group, Inc. accounted for under the equity method of accounting. On October 10, 2016, Anheuser-Busch InBev SA/NV ("Legacy AB InBev") completed a business combination with SABMiller in a cash and stock transaction (the "Transaction"). A newly formed Belgian company, which retained the name Anheuser-Busch InBev SA/NV ("AB InBev"), became the holding company for the combined SABMiller and Legacy AB InBev businesses. Upon completion of the Transaction, Altria Group, Inc. had a 9.6% ownership of AB InBev based on AB InBev's shares outstanding at October 10, 2016. Following completion of the Transaction, Altria Group, Inc. purchased 12,341,937 ordinary shares of AB InBev for a total cost of approximately \$1.6 billion, thereby increasing Altria Group, Inc.'s ownership to approximately 10.2%. At December 31, 2016, Altria Group, Inc. had an approximate 10.2% ownership of AB InBev, which Altria Group, Inc. accounts for under the equity method of accounting using a one-quarter lag. As a result of the one-quarter lag and the timing of the completion of the Transaction, no earnings from Altria Group, Inc.'s equity investment in AB InBev were recorded for the year ended December 31, 2016. For further discussion, see Note 7. Investment in AB InBev/SABMiller to the consolidated financial statements in Item 8. Financial Statements and Supplementary Data of this Annual Report on Form 10-K ("Item 8").

In January 2017, Altria Group, Inc. acquired the privately-held Sherman Group Holdings, LLC and its subsidiaries ("Nat Sherman"). Nat Sherman sells super-premium cigarettes and premium cigars and joins PM USA and Middleton as part of Altria Group, Inc.'s smokeable products segment.

Source of Funds: Because Altria Group, Inc. is a holding company, its access to the operating cash flows of its wholly-owned subsidiaries consists of cash received from the payment of dividends and distributions, and the payment of interest on intercompany loans by its subsidiaries. At December 31, 2016, Altria Group, Inc.'s principal wholly-owned subsidiaries were not limited by long-term debt or other agreements in their ability to pay cash dividends or make other distributions with respect to their equity interests. In addition, Altria Group, Inc. receives cash dividends on its interest in AB InBev if and when AB InBev pays such dividends.

Financial Information About Segments

Altria Group, Inc.'s reportable segments are smokeable products, smokeless products and wine. The financial services and the innovative tobacco products businesses are included in an all other category due to the continued reduction of the lease portfolio of PMCC and the relative financial contribution of Altria Group, Inc.'s innovative tobacco products businesses to Altria Group, Inc.'s consolidated results.

Altria Group, Inc.'s chief operating decision maker (the "CODM") reviews operating companies income to evaluate the performance of, and allocate resources to, the segments. Operating companies income for the segments is defined as operating income before general corporate expenses and amortization of intangibles. Interest and other debt expense,

net, and provision for income taxes are centrally managed at the corporate level and, accordingly, such items are not presented by segment since they are excluded from the measure of segment profitability reviewed by the CODM. Net revenues and operating companies income (together with a reconciliation to earnings before income taxes) attributable to each such segment for each of the last three years are set forth in Note 16. Segment Reporting to the consolidated financial statements in Item 8 (“Note 16”). Information about total assets by segment is not disclosed because such information is not reported to or used by the CODM. Segment goodwill and other intangible assets, net, are disclosed in Note 4. Goodwill and Other Intangible Assets, net to the consolidated financial statements in Item 8 (“Note 4”). The accounting policies of the segments are the same as those described in Note 2. Summary of Significant Accounting Policies to the consolidated financial statements in Item 8 (“Note 2”).

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The relative percentages of operating companies income (loss) attributable to each reportable segment and the all other category were as follows:

	2016	2015	2014	
Smokeable products	86.2	% 87.4	% 87.2	%
Smokeless products	13.1	12.8	13.4	
Wine	1.8	1.8	1.7	
All other	(1.1 )	(2.0 )	(2.3 )	
Total	100.0	% 100.0	% 100.0	%

For items affecting the comparability of the relative percentages of operating companies income (loss) attributable to each reportable segment, see Note 16.

## Narrative Description of Business

Portions of the information called for by this Item are included in Operating Results by Business Segment in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations of this Annual Report on Form 10-K ("Item 7").

## Tobacco Space

Altria Group, Inc.'s tobacco operating companies include PM USA, USSTC and other subsidiaries of UST, Middleton, Nu Mark and Nat Sherman. Altria Group Distribution Company provides sales, distribution and consumer engagement services to Altria Group, Inc.'s tobacco operating companies.

The products of Altria Group, Inc.'s tobacco subsidiaries include smokeable tobacco products, consisting of cigarettes manufactured and sold by PM USA and Nat Sherman, machine-made large cigars and pipe tobacco manufactured and sold by Middleton and premium cigars sold by Nat Sherman; smokeless tobacco products manufactured and sold by USSTC; and innovative tobacco products, including e-vapor products manufactured and sold by Nu Mark.

**Cigarettes:** PM USA is the largest cigarette company in the United States, with total cigarette shipment volume in the United States of approximately 122.9 billion units in 2016, a decrease of 2.5% from 2015. Marlboro, the principal cigarette brand of PM USA, has been the largest-selling cigarette brand in the United States for over 40 years. Nat Sherman sells substantially all of its super-premium cigarettes in the United States.

**Cigars:** Middleton is engaged in the manufacture and sale of machine-made large cigars and pipe tobacco to customers, substantially all of which are located in the United States. Middleton sources a portion of its cigars from an importer through a third-party contract manufacturing arrangement. Total shipment volume for cigars was approximately 1.4 billion units in 2016, an increase of 5.9% from 2015. Black & Mild is the principal cigar brand of Middleton. Nat Sherman sources its premium cigars from importers through third-party contract manufacturing arrangements and sells substantially all of its cigars in the United States.

**Smokeless tobacco products:** USSTC is the leading producer and marketer of moist smokeless tobacco ("MST") products. The smokeless products segment includes the premium brands, Copenhagen and Skoal, and value brands, Red Seal and Husky. Substantially all of the smokeless tobacco products are manufactured and sold to customers in the United States. Total smokeless products shipment volume was 853.5 million units in 2016, an increase of 4.9% from 2015.

**Innovative tobacco products:** Nu Mark participates in the e-vapor category and has developed and commercialized other innovative tobacco products. In addition, Nu Mark sources the production of its e-vapor products through overseas contract manufacturing arrangements. In 2013, Nu Mark introduced MarkTen e-vapor products. In April 2014, Nu Mark acquired the e-vapor business of Green Smoke, Inc. and its affiliates ("Green Smoke"), which began selling e-vapor products in 2009. For a further discussion of the acquisition of Green Smoke, see Note 3. Acquisition of Green Smoke to the consolidated financial statements in Item 8 ("Note 3").

In December 2013, Altria Group, Inc.'s subsidiaries entered into a series of agreements with Philip Morris International Inc. ("PMI") pursuant to which Altria Group, Inc.'s subsidiaries provide an exclusive license to PMI to sell Nu Mark's e-vapor products outside the United States, and PMI's subsidiaries provide an exclusive license to Altria Group, Inc.'s subsidiaries to sell two of PMI's heated tobacco product platforms in the United States. Further, in July

2015, Altria Group, Inc. announced the expansion of its strategic framework with PMI to include a joint research, development and technology-sharing agreement. Under this agreement, Altria Group, Inc.'s subsidiaries and PMI will collaborate to develop e-vapor products for commercialization in the United States by Altria Group, Inc.'s subsidiaries and in markets outside the United States by PMI. This agreement also provides for exclusive technology cross licenses, technical information sharing and cooperation on scientific assessment, regulatory engagement and approval related to e-vapor products.

In the fourth quarter of 2016, PMI submitted a Modified Risk Tobacco Product ("MRTP") application for an electronically heated tobacco product with the United States Food and Drug Administration's ("FDA") Center for Tobacco Products and announced that it plans to file its corresponding pre-market tobacco product application during the first quarter of 2017. The FDA must determine whether to accept the applications for substantive review. Upon regulatory authorization by the FDA, Altria Group, Inc.'s subsidiaries will have an exclusive license to sell this heated tobacco product in the United States.

**Distribution, Competition and Raw Materials:** Altria Group, Inc.'s tobacco subsidiaries sell their tobacco products principally to wholesalers (including distributors), large retail organizations, including chain stores, and the armed services.

The market for tobacco products is highly competitive, characterized by brand recognition and loyalty, with product quality, taste, price, product innovation, marketing, packaging and distribution constituting the significant methods of competition. Promotional activities include, in certain instances and where

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permitted by law, allowances, the distribution of incentive items, price promotions, product promotions, coupons and other discounts.

In June 2009, the President of the United States of America signed into law the Family Smoking Prevention and Tobacco Control Act (“FSPTCA”), which provides the FDA with broad authority to regulate the design, manufacture, packaging, advertising, promotion, sale and distribution of tobacco products; the authority to require disclosures of related information; and the authority to enforce the FSPTCA and related regulations. The FSPTCA went into effect in 2009 for cigarettes, cigarette tobacco and smokeless tobacco products and in August 2016 for all other tobacco products, including cigars, e-vapor products, pipe tobacco and oral tobacco-derived nicotine products (“Other Tobacco Products”). The FSPTCA imposes restrictions on the advertising, promotion, sale and distribution of tobacco products, including at retail. PM USA and USSTC are subject to quarterly user fees as a result of the FSPTCA. Their respective FDA user fee amounts are determined by an allocation formula administered by the FDA that is based on the respective market shares of manufacturers and importers of each kind of tobacco product. PM USA, USSTC and other U.S. tobacco manufacturers have agreed to other marketing restrictions in the United States as part of the settlements of state health care cost recovery actions.

In the United States, under a contract growing program, PM USA purchases burley and flue-cured leaf tobaccos of various grades and styles directly from tobacco growers. Under the terms of this program, PM USA agrees to purchase the amount of tobacco specified in the grower contracts. PM USA also purchases a portion of its tobacco requirements through leaf merchants. Nat Sherman purchases its tobacco requirements through leaf merchants. USSTC purchases burley, dark fire-cured and air-cured tobaccos of various grades and styles from domestic tobacco growers under a contract growing program as well as from leaf merchants.

Middleton purchases burley, dark air-cured and flue-cured tobaccos of various grades and styles through leaf merchants. Middleton does not have a contract growing program.

Altria Group, Inc.’s tobacco subsidiaries believe there is an adequate supply of tobacco in the world markets to satisfy their current and anticipated production requirements. See Item 1A. Risk Factors of this Annual Report on Form 10-K (“Item 1A”) and Tobacco Space - Business Environment - Price, Availability and Quality of Agricultural Products in Item 7 for a discussion of risks associated with tobacco supply.

### Wine

Ste. Michelle is a producer and supplier of premium varietal and blended table wines and of sparkling wines. Ste. Michelle is a leading producer of Washington state wines, primarily Chateau Ste. Michelle, Columbia Crest and 14 Hands, and owns wineries in or distributes wines from several other domestic and foreign wine regions. Ste. Michelle’s total 2016 wine shipment volume of approximately 9.3 million cases increased 5.3% from 2015.

Ste. Michelle holds an 85% ownership interest in Michelle-Antinori, LLC, which owns Stag’s Leap Wine Cellars in Napa Valley. Ste. Michelle also owns Conn Creek in Napa Valley, Patz & Hall in Sonoma and Erath in Oregon. In addition, Ste. Michelle imports and markets Antinori, Torres and Villa Maria Estate wines and Champagne Nicolas Feuillatte in the United States.

**Distribution, Competition and Raw Materials:** Key elements of Ste. Michelle’s strategy are expanded domestic distribution of its wines, especially in certain account categories such as restaurants, wholesale clubs, supermarkets, wine shops and mass merchandisers, and a focus on improving product mix to higher-priced, premium products. Ste. Michelle’s business is subject to significant competition, including competition from many larger, well-established domestic and international companies, as well as from many smaller wine producers. Wine segment competition is primarily based on quality, price, consumer and trade wine tastings, competitive wine judging, third-party acclaim and advertising. Substantially all of Ste. Michelle’s sales occur in the United States through state-licensed distributors. Ste. Michelle also sells to domestic consumers through retail and e-commerce channels and exports wines to international distributors.

Federal, state and local governmental agencies regulate the beverage alcohol industry through various means, including licensing requirements, pricing rules, labeling and advertising restrictions, and distribution and production policies. Further regulatory restrictions or additional excise or other taxes on the manufacture and sale of alcoholic beverages may have an adverse effect on Ste. Michelle’s wine business.

Ste. Michelle uses grapes harvested from its own vineyards or purchased from independent growers, as well as bulk wine purchased from other sources. Grape production can be adversely affected by weather and other forces that may limit production. At the present time, Ste. Michelle believes that there is a sufficient supply of grapes and bulk wine available in the market to satisfy its current and expected production requirements. See Item 1A for a discussion of risks associated with competition, unfavorable changes in grape supply and governmental regulations.

#### Financial Services Business

In 2003, PMCC ceased making new investments and began focusing exclusively on managing its portfolio of finance assets in order to maximize its operating results and cash flows from its existing lease portfolio activities and asset sales. For further information on PMCC's finance assets, see Note 8. Finance Assets, net to the consolidated financial statements in Item 8 ("Note 8").

#### Other Matters

Customers: The largest customer of PM USA, USSTC and Middleton, McLane Company, Inc., accounted for approximately 25%, 26% and 27% of Altria Group, Inc.'s consolidated net revenues for the years ended December 31, 2016, 2015 and 2014, respectively. In addition, Core-Mark Holding Company, Inc.

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accounted for approximately 14% and 10% of Altria Group, Inc.'s consolidated net revenues for the years ended December 31, 2016 and 2015, respectively. Substantially all of these net revenues were reported in the smokeable products and smokeless products segments.

Sales to three distributors accounted for approximately 69%, 66% and 67% of net revenues for the wine segment for the years ended December 31, 2016, 2015 and 2014, respectively.

Employees: At December 31, 2016, Altria Group, Inc. and its subsidiaries employed approximately 8,300 people.

Executive Officers of Altria Group, Inc.: The disclosure regarding executive officers is included in Item 10. Directors, Executive Officers and Corporate Governance - Executive Officers as of February 13, 2017 of this Annual Report on Form 10-K.

Research and Development: Research and development expense for the years ended December 31, 2016, 2015 and 2014 is set forth in Note 18. Additional Information to the consolidated financial statements in Item 8.

Intellectual Property: Trademarks are of material importance to Altria Group, Inc. and its operating companies, and are protected by registration or otherwise. In addition, as of December 31, 2016, the portfolio of over 700 United States patents owned by Altria Group, Inc.'s businesses, as a whole, was material to Altria Group, Inc. and its tobacco businesses. However, no one patent or group of related patents was material to Altria Group, Inc.'s business or its tobacco businesses as of December 31, 2016. Altria Group, Inc.'s businesses also have proprietary secrets, technology, know-how, processes and other intellectual property rights that are protected by appropriate confidentiality measures. Certain trade secrets are material to Altria Group, Inc. and its tobacco and wine businesses.

Environmental Regulation: Altria Group, Inc. and its subsidiaries (and former subsidiaries) are subject to various federal, state and local laws and regulations concerning the discharge of materials into the environment, or otherwise related to environmental protection, including, in the United States: The Clean Air Act, the Clean Water Act, the Resource Conservation and Recovery Act and the Comprehensive Environmental Response, Compensation and Liability Act (commonly known as "Superfund"), which can impose joint and several liability on each responsible party. Subsidiaries (and former subsidiaries) of Altria Group, Inc. are involved in several matters subjecting them to potential costs of remediation and natural resource damages under Superfund or other laws and regulations. Altria Group, Inc.'s subsidiaries expect to continue to make capital and other expenditures in connection with environmental laws and regulations. As discussed in Note 2, Altria Group, Inc. provides for expenses associated with environmental remediation obligations on an undiscounted basis when such amounts are probable and can be reasonably estimated. Such accruals are adjusted as new information develops or circumstances change. Other than those amounts, it is not possible to reasonably estimate the cost of any environmental remediation and compliance efforts

that subsidiaries of Altria Group, Inc. may undertake in the future. In the opinion of management, however, compliance with environmental laws and regulations, including the payment of any remediation and compliance costs or damages and the making of related expenditures, has not had, and is not expected to have, a material adverse effect on Altria Group, Inc.'s consolidated results of operations, capital expenditures, financial position or cash flows.

### Financial Information About Geographic Areas

Substantially all of Altria Group, Inc.'s net revenues are from sales generated in the United States for each of the last three fiscal years and substantially all of Altria Group, Inc.'s long-lived assets are located in the United States.

### Available Information

Altria Group, Inc. is required to file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission ("SEC"). Investors may read and copy any document that Altria Group, Inc. files, including this Annual Report on Form 10-K, at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Investors may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet site at <http://www.sec.gov> that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC, from which investors can electronically access Altria Group, Inc.'s SEC filings.

Altria Group, Inc. makes available free of charge on or through its website ([www.altria.com](http://www.altria.com)) its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"),

as soon as reasonably practicable after Altria Group, Inc. electronically files such material with, or furnishes it to, the SEC. Investors can access Altria Group, Inc.'s filings with the SEC by visiting [www.altria.com/secfilings](http://www.altria.com/secfilings).

The information on the respective websites of Altria Group, Inc. and its subsidiaries is not, and shall not be deemed to be, a part of this report or incorporated into any other filings Altria Group, Inc. makes with the SEC.

Item 1A. Risk Factors

The following risk factors should be read carefully in connection with evaluating our business and the forward-looking statements contained in this Annual Report on Form 10-K. Any of the following risks could materially adversely affect our business, our results of operations, our cash flows, our financial position and the actual outcome of matters as to which forward-looking statements are made in this Annual Report on Form 10-K.

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We <sup>(1)</sup> may from time to time make written or oral forward-looking statements, including earnings guidance and other statements contained in filings with the SEC, reports to security holders, press releases and investor webcasts. You can identify these forward-looking statements by use of words such as “strategy,” “expects,” “continues,” “plans,” “anticipates,” “believes,” “will,” “estimates,” “forecasts,” “intends,” “projects,” “goals,” “objectives,” “guidance,” “targets” and other words of meaning. You can also identify them by the fact that they do not relate strictly to historical or current facts.

We cannot guarantee that any forward-looking statement will be realized, although we believe we have been prudent in our plans and assumptions. Achievement of future results is subject to risks, uncertainties and assumptions that may prove to be inaccurate. Should known or unknown risks or uncertainties materialize, or should underlying assumptions prove inaccurate, actual results could vary materially from those anticipated, estimated or projected. You should bear this in mind as you consider forward-looking statements and whether to invest in or remain invested in Altria Group, Inc.’s securities. In connection with the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995, we are identifying important factors that, individually or in the aggregate, could cause actual results and outcomes to differ materially from those contained in any forward-looking statements made by us; any such statement is qualified by reference to the following cautionary statements. We elaborate on these and other risks we face throughout this document, particularly in the “Business Environment” sections preceding our discussion of the operating results of our subsidiaries’ businesses in Item 7. You should understand that it is not possible to predict or identify all risk factors. Consequently, you should not consider the following to be a complete discussion of all potential risks or uncertainties. We do not undertake to update any forward-looking statement that we may make from time to time except as required by applicable law.

Unfavorable litigation outcomes could materially adversely affect the consolidated results of operations, cash flows or financial position of Altria Group, Inc., or the businesses of one or more of its subsidiaries.

Legal proceedings covering a wide range of matters are pending or threatened in various United States and foreign jurisdictions against Altria Group, Inc. and its subsidiaries, including PM USA and UST and its subsidiaries, as well as their respective indemnitees. Various types of claims may be raised in these proceedings, including product liability, consumer protection, antitrust, tax, contraband-related claims, patent infringement, employment matters, claims for contribution and claims of competitors and distributors.

Litigation is subject to uncertainty and it is possible that there

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<sup>1</sup> This section uses the terms “we,” “our” and “us” when it is not necessary to distinguish among Altria Group, Inc. and its various operating subsidiaries or when any distinction is clear from the context.

could be adverse developments in pending or future cases. An unfavorable outcome or settlement of pending tobacco-related or

other litigation could encourage the commencement of additional litigation. Damages claimed in some tobacco-related or other

litigation are significant and, in certain cases, range in the billions of dollars. The variability in pleadings in multiple jurisdictions, together with the actual experience of management in litigating claims, demonstrate that the monetary relief that may be specified in a lawsuit bears little relevance to the ultimate outcome. In certain cases, plaintiffs claim that defendants’ liability is joint and several. In such cases, Altria Group, Inc. or its subsidiaries may face the risk that one or more co-defendants decline or otherwise fail to participate in the bonding required for an appeal or to pay their proportionate or jury-allocated share of a judgment. As a result, Altria Group, Inc. or its subsidiaries under certain circumstances may have to pay more than their proportionate share of any bonding- or judgment-related amounts. Furthermore, in those cases where plaintiffs are successful, Altria Group, Inc. or its subsidiaries may also be required to pay interest and attorneys’ fees.

Although PM USA has historically been able to obtain required bonds or relief from bonding requirements in order to prevent plaintiffs from seeking to collect judgments while adverse verdicts have been appealed, there remains a risk that such relief may not be obtainable in all cases. This risk has been substantially reduced given that 47 states and Puerto Rico now limit the dollar amount of bonds or require no bond at all. As discussed in Note 19. Contingencies to the consolidated financial statements in Item 8 (“Note 19”), tobacco litigation plaintiffs have challenged the

constitutionality of Florida's bond cap statute in several cases and plaintiffs may challenge state bond cap statutes in other jurisdictions as well. Such challenges may include the applicability of state bond caps in federal court. Although we cannot predict the outcome of such challenges, it is possible that the consolidated results of operations, cash flows or financial position of Altria Group, Inc., or the businesses of one or more of its subsidiaries, could be materially adversely affected in a particular fiscal quarter or fiscal year by an unfavorable outcome of one or more such challenges.

In certain litigation, Altria Group, Inc. and its subsidiaries may face potentially significant non-monetary remedies. For example, in the lawsuit brought by the United States Department of Justice, discussed in Note 19, the district court did not impose monetary penalties but ordered significant non-monetary remedies, including the issuance of "corrective statements" in various media.

Altria Group, Inc. and its subsidiaries have achieved substantial success in managing litigation. Nevertheless, litigation is subject to uncertainty, and significant challenges remain.

It is possible that the consolidated results of operations, cash flows or financial position of Altria Group, Inc., or the businesses of one or more of its subsidiaries, could be materially adversely affected in a particular fiscal quarter or fiscal year by an unfavorable outcome or settlement of certain pending litigation. Altria Group, Inc. and each of its subsidiaries named as a

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defendant believe, and each has been so advised by counsel handling the respective cases, that it has valid defenses to the litigation pending against it, as well as valid bases for appeal of adverse verdicts. Each of the companies has defended, and will continue to defend, vigorously against litigation challenges. However, Altria Group, Inc. and its subsidiaries may enter into settlement discussions in particular cases if they believe it is in the best interests of Altria Group, Inc. to do so. See Item 3. Legal Proceedings of this Annual Report on Form 10-K (“Item 3”), Note 19 and Exhibits 99.1 and 99.2 to this Annual Report on Form 10-K for a discussion of pending tobacco-related litigation. Significant federal, state and local governmental actions, including actions by the FDA, and various private sector actions may continue to have an adverse impact on our tobacco subsidiaries’ businesses and sales volumes.

As described in Tobacco Space - Business Environment in Item 7, our cigarette subsidiaries face significant governmental and private sector actions, including efforts aimed at reducing the incidence of tobacco use and efforts seeking to hold these subsidiaries responsible for the adverse health effects associated with both smoking and exposure to environmental tobacco smoke. These actions, combined with the diminishing social acceptance of smoking, have resulted in reduced cigarette industry volume, and we expect that these factors will continue to reduce cigarette consumption levels.

Actions by the FDA and other federal, state or local governments or agencies, including those specific actions described in Tobacco Space - Business Environment in Item 7, may impact the adult tobacco consumer acceptability of or access to tobacco products (for example, through product standards including those that our tobacco companies may be unable to achieve), limit adult tobacco consumer choices, delay or prevent the launch of new or modified tobacco products or products with claims of reduced risk, require the recall or other removal of tobacco products from the marketplace (for example as a result of product contamination or a determination by the FDA that one or more tobacco products do not satisfy the statutory requirements for substantial equivalence), restrict communications to adult tobacco consumers, restrict the ability to differentiate tobacco products, create a competitive advantage or disadvantage for certain tobacco companies, impose additional manufacturing, labeling or packing requirements, interrupt manufacturing or otherwise significantly increase the cost of doing business, or restrict or prevent the use of specified tobacco products in certain locations or the sale of tobacco products by certain retail establishments. Any one or more of these actions may have a material adverse impact on the business, consolidated results of operations, cash flows or financial position of Altria Group, Inc. and its tobacco subsidiaries. See Tobacco Space - Business Environment in Item 7 for a more detailed discussion.

Tobacco products are subject to substantial taxation, which could have an adverse impact on sales of the tobacco products of Altria Group, Inc.’s tobacco subsidiaries.

Tobacco products are subject to substantial excise taxes, and significant increases in tobacco product-related taxes or fees have been proposed or enacted and are likely to continue to be proposed or enacted within the United States at the state, federal and local levels. Tax increases are expected to continue to have an adverse impact on sales of the tobacco products of our tobacco subsidiaries through lower consumption levels and the potential shift in adult consumer purchases from the premium to the non-premium or discount segments or to other low-priced or low-taxed tobacco products or to counterfeit and contraband products. Such shifts may have an adverse impact on the reported share performance of tobacco products of Altria Group, Inc.’s tobacco subsidiaries. For further discussion, see Tobacco Space - Business Environment - Excise Taxes in Item 7.

Our tobacco businesses face significant competition and their failure to compete effectively could have an adverse effect on the consolidated results of operations or cash flows of Altria Group, Inc., or the business of Altria Group, Inc.’s tobacco subsidiaries.

Each of Altria Group, Inc.’s tobacco subsidiaries operates in highly competitive tobacco categories. Significant methods of competition include product quality, taste, price, product innovation, marketing, packaging, distribution and promotional activities. A highly competitive environment could negatively impact the profitability, market share and shipment volume of our tobacco subsidiaries, which could have an adverse effect on the consolidated results of operations or cash flows of Altria Group, Inc.

PM USA also faces competition from lowest priced brands sold by certain United States and foreign manufacturers that have cost advantages because they are not parties to settlements of certain tobacco litigation in the United States.

These settlements, among other factors, have resulted in substantial cigarette price increases. These manufacturers may fail to comply with related state escrow legislation or may avoid escrow deposit obligations on the majority of their sales by concentrating on certain states where escrow deposits are not required or are required on fewer than all such manufacturers' cigarettes sold in such states. Additional competition has resulted from diversion into the United States market of cigarettes intended for sale outside the United States, the sale of counterfeit cigarettes by third parties, the sale of cigarettes by third parties over the Internet and by other means designed to avoid collection of applicable taxes, and imports of foreign lowest priced brands. USSTC faces significant competition in the smokeless tobacco category and has experienced consumer down-trading to lower-priced brands. In the cigar category, additional competition has resulted from increased imports of machine-made large cigars manufactured offshore. Altria Group, Inc. and its subsidiaries may be unsuccessful in anticipating changes in adult consumer preferences, responding to changes in consumer purchase behavior or managing through difficult competitive and economic conditions.

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Each of our tobacco and wine subsidiaries is subject to intense competition and changes in adult consumer preferences. To be successful, they must continue to:

- promote brand equity successfully;
- anticipate and respond to new and evolving adult consumer preferences;
- develop, manufacture, market and distribute products that appeal to adult consumers (including, where appropriate, through arrangements with, or investments in, third parties);
- improve productivity; and
- protect or enhance margins through cost savings and price increases.

See Tobacco Space - Business Environment - Summary in Item 7 for additional discussion concerning evolving adult tobacco consumer preferences, including e-vapor products. Growth of this product category could contribute to reductions in cigarette consumption levels and cigarette industry sales volume and could adversely affect the growth rates of other tobacco products.

The willingness of adult consumers to purchase premium consumer product brands depends in part on economic conditions. In periods of economic uncertainty, adult consumers may purchase more discount brands and/or, in the case of tobacco products, consider lower-priced tobacco products, which could have a material adverse effect on the business, consolidated results of operations, cash flows or financial position of Altria Group, Inc. and its subsidiaries. Our tobacco and wine subsidiaries work to broaden their brand portfolios to compete effectively with lower-priced products.

Our financial services business (conducted through PMCC) holds investments in finance leases, principally in transportation (including aircraft), power generation, real estate and manufacturing equipment. Its lessees are subject to significant competition and uncertain economic conditions. If parties to PMCC's leases fail to manage through difficult economic and competitive conditions, PMCC may have to increase its allowance for losses, which would adversely affect our earnings.

Altria Group, Inc.'s tobacco subsidiaries may be unsuccessful in developing and commercializing adjacent products or processes, including innovative tobacco products that may reduce the health risks associated with current tobacco products and that appeal to adult tobacco consumers, which may have an adverse effect on their ability to grow new revenue streams.

Altria Group, Inc. and its subsidiaries have growth strategies involving moves and potential moves into adjacent products or processes, including innovative tobacco products. Some innovative tobacco products may reduce the health risks associated with current tobacco products, while continuing to offer adult tobacco consumers (within and outside the United States) products that meet their taste expectations and evolving preferences. Examples include tobacco-containing and nicotine-

containing products that reduce or eliminate exposure to cigarette smoke and/or constituents identified by public health authorities as harmful. These efforts may include arrangements with, or investments in, third parties. Our tobacco subsidiaries may not succeed in these efforts, which would have an adverse effect on the ability to grow new revenue streams.

Further, we cannot predict whether regulators, including the FDA, will permit the marketing or sale of products with claims of reduced risk to consumers, the speed with which they may make such determinations or whether regulators will impose an unduly burdensome regulatory framework on such products. Nor can we predict whether adult tobacco consumers' purchasing decisions would be affected by such claims if permitted. Adverse developments on any of these matters could negatively impact the commercial viability of such products.

If our tobacco subsidiaries do not succeed in their efforts to develop and commercialize innovative tobacco products or to obtain regulatory approval for the marketing or sale of products with claims of reduced risk, but one or more of their competitors do succeed, our tobacco subsidiaries may be at a competitive disadvantage.

Significant changes in tobacco leaf price, availability or quality could have an adverse effect on the profitability and business of Altria Group, Inc.'s tobacco subsidiaries.

Any significant change in tobacco leaf prices, quality or availability could adversely affect our tobacco subsidiaries' profitability and business. For further discussion, see Tobacco Space - Business Environment - Price, Availability and

Quality of Agricultural Products in Item 7.

Because Altria Group, Inc.'s tobacco subsidiaries rely on a few significant facilities and a small number of significant suppliers, an extended disruption at a facility or in service by a supplier could have a material adverse effect on the business, the consolidated results of operations, cash flows or financial position of Altria Group, Inc. and its tobacco subsidiaries.

Altria Group, Inc.'s tobacco subsidiaries face risks inherent in reliance on a few significant facilities and a small number of significant suppliers. A natural or man-made disaster or other disruption that affects the manufacturing operations of any of Altria Group, Inc.'s tobacco subsidiaries or the operations of any significant suppliers of any of Altria Group, Inc.'s tobacco subsidiaries could adversely impact the operations of the affected subsidiaries. An extended disruption in operations experienced by one or more of Altria Group, Inc.'s subsidiaries or significant suppliers could have a material adverse effect on the business, the consolidated results of operations, cash flows or financial position of Altria Group, Inc. and its tobacco subsidiaries.

Altria Group, Inc.'s subsidiaries could decide or be required to recall products, which could have a material adverse effect on the business, the consolidated results of operations, cash flows or financial position of Altria Group, Inc. and its subsidiaries.

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In addition to a recall required by the FDA, as referenced above, our subsidiaries could decide, or laws or regulations could require them, to recall products due to the failure to meet quality standards or specifications, suspected or confirmed and deliberate or unintentional product contamination, or other adulteration, product misbranding or product tampering. In January 2017, USSTC announced that it was voluntarily recalling certain of its smokeless tobacco products manufactured at a USSTC facility due to product tampering. USSTC will record a charge during the first quarter of 2017 related to this recall. While this charge is not expected to be material to Altria Group, Inc.'s financial statements, future recalls (if any) could have a material adverse effect on the business, consolidated results of operations, cash flows or financial position of Altria Group, Inc. and its subsidiaries.

Altria Group, Inc. may be unable to attract and retain the best talent due to the impact of decreasing social acceptance of tobacco usage and tobacco control actions.

Our ability to implement our strategy of attracting and retaining the best talent may be impaired by the impact of decreasing social acceptance of tobacco usage and tobacco regulation and control actions. The tobacco industry competes for talent with the consumer products industry and other companies that enjoy greater societal acceptance. As a result, we may be unable to attract and retain the best talent.

Acquisitions or other events may adversely affect Altria Group, Inc.'s credit rating, and Altria Group, Inc. may not achieve its anticipated strategic or financial objectives.

From time to time, Altria Group, Inc. considers acquisitions and may engage in confidential acquisition negotiations that are not publicly announced unless and until those negotiations result in a definitive agreement. Although we seek to maintain or improve our credit ratings over time, it is possible that completing a given acquisition or the occurrence of other events could impact our credit ratings or the outlook for those ratings. Any such change in ratings or outlook may negatively affect the amount of credit available to us and may also increase our costs and adversely affect our earnings or our dividend rate.

Furthermore, acquisition opportunities are limited, and acquisitions present risks of failing to achieve efficient and effective integration, strategic objectives and anticipated revenue improvements and cost savings. There can be no assurance that we will be able to acquire attractive businesses on favorable terms or that we will realize any of the anticipated benefits from an acquisition.

Disruption and uncertainty in the debt capital markets could adversely affect Altria Group, Inc.'s access to the debt capital markets, earnings and dividend rate.

Access to the debt capital markets is important for us to satisfy our liquidity and financing needs. Disruption and uncertainty in the credit and debt capital markets and any resulting adverse impact on credit availability, pricing, credit terms or credit rating may negatively affect the amount of credit available to us and

may also increase our costs and adversely affect our earnings or our dividend rate.

Altria Group, Inc. may be required to write down intangible assets, including goodwill, due to impairment, which would reduce earnings.

We periodically calculate the fair value of our reporting units and intangible assets to test for impairment. This calculation may be affected by several factors, including general economic conditions, regulatory developments, changes in category growth rates as a result of changing adult consumer preferences, success of planned new product introductions, competitive activity and tobacco-related taxes. Certain events can also trigger an immediate review of intangible assets. If an impairment is determined to exist in either situation, we will incur impairment losses, which will reduce our earnings.

Competition, unfavorable changes in grape supply and new governmental regulations or revisions to existing governmental regulations could adversely affect Ste. Michelle's wine business.

Ste. Michelle's business is subject to significant competition, including from many large, well-established domestic and international companies. The adequacy of Ste. Michelle's grape supply is influenced by consumer demand for wine in relation to industry-wide production levels as well as by weather and crop conditions, particularly in eastern Washington. Supply shortages related to any one or more of these factors could increase production costs and wine prices, which ultimately may have a negative impact on Ste. Michelle's sales. In addition, federal, state and local governmental agencies regulate the alcohol beverage industry through various means, including licensing

requirements, pricing, labeling and advertising restrictions, and distribution and production policies. New regulations or revisions to existing regulations, resulting in further restrictions or taxes on the manufacture and sale of alcoholic beverages, may have an adverse effect on Ste. Michelle's wine business. For further discussion, see Wine Segment - Business Environment in Item 7.

The failure of Altria Group, Inc.'s information systems or service providers' information systems to function as intended, or cyberattacks or security breaches, could result in loss of revenue, assets, personal data, intellectual property, trade secrets or other sensitive data, violation of applicable privacy and data security laws, reputational harm and significant costs.

Altria Group, Inc. and its subsidiaries rely on information systems to help manage business processes, collect and interpret business data, comply with regulatory, financial reporting and tax requirements, engage in marketing and e-commerce activities, collect and store sensitive data and confidential information, and communicate internally and externally with employees, investors, suppliers, trade customers, adult consumers and others. Many of these information systems are managed by third-party service providers. We have implemented administrative, technical and physical safeguards, including testing and auditing protocols,

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backup systems and business continuity plans, intended to protect our systems and data. However, because the techniques used in cyberattacks and security breaches change frequently and often are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. To date, interruptions of our information systems have been infrequent and have not had a material impact on our operations. Failure of our systems or service providers' systems to function as intended or cyberattacks or security breaches by parties intent on extracting or corrupting information or otherwise disrupting business processes could result in loss of revenue, assets, personal data, intellectual property, trade secrets or other sensitive and confidential data, violation of applicable privacy and data security laws, damage to the reputation of our companies and their brands, legal challenges and significant remediation and other costs to Altria Group, Inc. and its subsidiaries. Unfavorable outcomes of any governmental investigations could materially affect the businesses of Altria Group, Inc. and its subsidiaries.

From time to time, Altria Group, Inc. and its subsidiaries are subject to governmental investigations on a range of matters. We cannot predict whether new investigations may be commenced or the outcome of such investigations, and it is possible that our business could be materially adversely affected by an unfavorable outcome of future investigations.

Expanding international business operations subjects Altria Group, Inc. and its subsidiaries to various United States and foreign laws and regulations, and violations of such laws or regulations could result in reputational harm, legal challenges and/or significant costs.

While Altria Group, Inc. and its subsidiaries are primarily engaged in business activities in the United States, they do engage (directly or indirectly) in certain international business activities that are subject to various United States and foreign laws and regulations, such as the U.S. Foreign Corrupt Practices Act and other laws prohibiting bribery and corruption. Although we have a Code of Conduct and a compliance system designed to prevent and detect violations of applicable law, no system can provide assurance that it will always protect against improper actions by employees or third parties. Violations of these laws, or allegations of such violations, could result in reputational harm, legal challenges and/or significant costs.

Altria Group, Inc.'s reported earnings from and carrying value of its equity investment in AB InBev and the dividends paid by AB InBev on shares owned by Altria Group, Inc. may be adversely affected by unfavorable foreign currency exchange rates and other factors.

For purposes of financial reporting, the earnings from and carrying value of our equity investment in AB InBev are translated into U.S. dollars from various local currencies. In addition, AB InBev pays dividends in euros, which we convert into U.S. dollars. During times of a strengthening U.S. dollar

against these currencies, our reported earnings from and carrying value of our equity investment in AB InBev will be reduced because these currencies will translate into fewer U.S. dollars and the dividends that we receive from AB InBev will convert into fewer U.S. dollars. Dividends and earnings from and carrying value of our equity investment in AB InBev are also subject to the risks encountered by AB InBev in its business.

AB InBev may not achieve the intended benefits of the Transaction, which could have a negative effect on our reported earnings from and carrying value of our equity investment in AB InBev.

There can be no assurance that AB InBev will be able to successfully integrate SABMiller's business or otherwise realize the expected benefits of the Transaction. Any of these outcomes could result in increased costs to AB InBev, and could adversely affect AB InBev's financial condition, results of operations or cash flows and Altria Group, Inc.'s reported earnings from and carrying value of our equity investment in AB InBev.

We received a substantial portion of our consideration from the Transaction in the form of restricted shares subject to a five-year lock-up. Furthermore, if our percentage ownership in AB InBev were to be decreased below certain levels, we may be subject to additional tax liabilities, suffer a reduction in the number of directors that we can have appointed to the AB InBev Board of Directors, and be unable to account for our investment under the equity method of accounting.

Upon completion of the Transaction, we received a substantial portion of our consideration in the form of restricted shares that cannot be sold or transferred for a period of five years following the Transaction, subject to limited

exceptions. These transfer restrictions will require us to bear the risks associated with our investment in AB InBev for a five-year period that expires on October 10, 2021. Further, in the event that our ownership percentage in AB InBev were to be decreased below certain levels, we may be subject to additional tax liabilities, the number of directors that we have the right to have appointed to the AB InBev Board of Directors could be reduced from two to one or zero, and our use of the equity method of accounting for investment in AB InBev could be challenged.

Our tax treatment of the Transaction consideration may be challenged and the tax treatment of AB InBev dividends is not expected to be as favorable as prior SABMiller dividends.

While we expect the equity consideration that we received from the Transaction to qualify for tax-deferred treatment, we cannot provide any assurance that federal and state tax authorities will not challenge the expected tax treatment and, if they do, what the outcome of any such challenge will be. We also anticipate that the tax treatment of the dividends Altria Group, Inc. expects to receive from AB InBev will not be as favorable as that associated with the dividends we received from SABMiller.

Item 1B. Unresolved Staff Comments.

None.

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### Item 2. Properties.

The property in Richmond, Virginia that serves as the headquarters facility for Altria Group, Inc., PM USA, USSTC, Middleton, Nu Mark and certain other subsidiaries is under lease.

At December 31, 2016, the smokeable products segment used four manufacturing and processing facilities. PM USA owns and operates two tobacco manufacturing and processing facilities located in the Richmond, Virginia area that are used in the manufacturing and processing of cigarettes. Middleton owns and operates two manufacturing and processing facilities - one in King of Prussia, Pennsylvania and one in Limerick, Pennsylvania - that are used in the manufacturing and processing of cigars and pipe tobacco. In addition, PM USA owns a research and technology center in Richmond, Virginia that is leased to an affiliate, Altria Client Services LLC.

At December 31, 2016, the smokeless products segment used four smokeless tobacco manufacturing and processing facilities located in Franklin Park, Illinois; Nashville, Tennessee; and two facilities in Hopkinsville, Kentucky, all of which are owned and operated by USSTC.

As disclosed in Note 5. Asset Impairment, Exit and Implementation Costs to the consolidated financial statements in Item 8 (“Note 5”), in October 2016, Altria Group, Inc. announced the consolidation of certain of its operating companies’ manufacturing facilities to streamline operations and achieve greater efficiencies. Middleton will transfer its Limerick, Pennsylvania operations to the Manufacturing Center site in Richmond, Virginia (“Richmond Manufacturing Center”). USSTC will transfer its Franklin Park, Illinois operations to its Nashville, Tennessee facility and the Richmond Manufacturing Center. The consolidation is expected to be completed by the first quarter of 2018.

At December 31, 2016, the wine segment used 12 wine-making facilities - seven in Washington, four in California and one in Oregon. All of these facilities are owned and operated by Ste. Michelle, with the exception of a facility that is leased by Ste. Michelle in Washington. In addition, in order to support the production of its wines, the wine segment used vineyards in Washington, California and Oregon that are leased or owned by Ste. Michelle.

The plants and properties owned or leased and operated by Altria Group, Inc. and its subsidiaries are maintained in good condition and are believed to be suitable and adequate for present needs.

### Item 3. Legal Proceedings.

The information required by this Item is included in Note 19 and Exhibits 99.1 and 99.2 to this Annual Report on Form 10-K. Altria Group, Inc.’s consolidated financial statements and accompanying notes for the year ended December 31, 2016 were filed on Form 8-K on February 1, 2017 (such consolidated financial statements and accompanying notes are also included in Item 8). The following summarizes certain developments in Altria Group, Inc.’s litigation since the filing of such Form 8-K.

#### Recent Developments

##### Smoking and Health Litigation

###### Engle Progeny Trial Results:

In *McKeever*, in February 2017, PM USA filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court.

In *Pardue*, in February 2017, the trial court granted PM USA’s and R.J. Reynolds Tobacco Company’s (“R.J. Reynolds”) motion for a remittitur, reducing the compensatory damages award from approximately \$5.9 million to approximately \$5.2 million.

In *Varner*, in February 2017, PM USA paid plaintiff approximately \$600,000 to satisfy the judgment, interest and related costs. PM USA will record a pre-tax provision of approximately \$600,000 in the first quarter of 2017.

In *J. Brown*, in February 2017, a Pinellas County jury returned verdict in favor of plaintiff and against PM USA and R.J. Reynolds awarding \$5.4 million in compensatory damages and allocating 35% of the fault to PM USA. The jury also awarded plaintiff \$200,000 in punitive damages against PM USA. The court ruled that it will not apply the comparative fault reduction to the compensatory damages.

In *Martin*, in February 2017, PM USA and R.J. Reynolds filed a notice of appeal to the Florida Fourth District Court of Appeal.

In *Allen*, in February 2017, the Florida First District Court of Appeal affirmed the trial court’s verdict.

##### Health Care Cost Recovery Litigation

NPM Adjustment Disputes: As discussed in Note 19, in 1998, PM USA and certain other U.S. tobacco product manufacturers entered into the 1998 Master Settlement Agreement (the “MSA”). PM USA is participating in proceedings regarding potential downward adjustments (the “NPM Adjustment”) to MSA payments made by manufacturers that are signatories to the MSA (the “Participating Manufacturers”) for 2003-2015. In February 2017, the Supreme Court of Missouri denied Missouri’s motion to order the Participating Manufacturers to arbitrate the question of its diligent enforcement in a single-state arbitration for 2004, but granted Missouri’s motion to modify, with respect to Missouri, the pro rata judgment reduction related to the 2003 NPM Adjustment. As a result of the judgment reduction decision, PM USA will be required to return approximately \$12 million of the 2003 NPM Adjustment and \$7 million of the interest it received (in each case subject to confirmation by the independent auditor), plus applicable interest. In addition, PM USA will record a corresponding reduction to its pre-tax earnings in the first quarter of 2017.

Item 4. Mine Safety Disclosures.

Not applicable.

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## Part II

## Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

## Performance Graph

The graph below compares the cumulative total shareholder return of Altria Group, Inc.'s common stock for the last five years with the cumulative total return for the same period of the S&P 500 Index and the Altria Group, Inc. Peer Group <sup>(1)</sup>. The graph assumes the investment of \$100 in common stock and each of the indices as of the market close on December 31, 2011 and the reinvestment of all dividends on a quarterly basis.

Date	Altria Group, Inc.	Altria Group, Inc. Peer Group	S&P 500
December 2011	\$100.00	\$100.00	\$100.00
December 2012	\$111.77	\$108.78	\$115.99
December 2013	\$143.69	\$135.61	\$153.55
December 2014	\$193.28	\$151.74	\$174.55
December 2015	\$237.92	\$177.04	\$176.94
December 2016	\$286.61	\$192.56	\$198.09

Source: Bloomberg - "Total Return Analysis" calculated on a daily basis and assumes reinvestment of dividends as of the ex-dividend date.

<sup>(1)</sup>In 2016, the Altria Group, Inc. Peer Group consisted of U.S.-headquartered consumer product companies that are competitors to Altria Group, Inc.'s tobacco operating companies subsidiaries or that have been selected on the basis of revenue or market capitalization: Campbell Soup Company, The Coca-Cola Company, Colgate-Palmolive Company, Conagra Brands, Inc., General Mills, Inc., The Hershey Company, Kellogg Company, Kimberly-Clark Corporation, The Kraft Heinz Company, Mondelēz International, Inc., PepsiCo, Inc. and Reynolds American Inc.

Note - On October 1, 2012, Kraft Foods Inc. (KFT) spun off Kraft Foods Group, Inc. (KRFT) to its shareholders and then changed its name from Kraft Foods Inc. to Mondelēz International, Inc. (MDLZ). On July 2, 2015, Kraft Foods Group, Inc. merged with and into a wholly owned subsidiary of H.J. Heinz Holding Corporation, which was renamed The Kraft Heinz Company (KHC). On June 12, 2015, Reynolds American Inc. (RAI) acquired Lorillard, Inc. (LO). On November 9, 2016, ConAgra Foods, Inc. (CAG) spun off Lamb Weston Holdings, Inc. (LW) to its shareholders and then changed its name from ConAgra Foods, Inc. to Conagra Brands, Inc. (CAG).

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## Market and Dividend Information

The principal stock exchange on which Altria Group, Inc.'s common stock (par value \$0.33 1/3 per share) is listed is the New York Stock Exchange. At February 13, 2017, there were approximately 68,000 holders of record of Altria Group, Inc.'s common stock.

The table below discloses the high and low sales prices and cash dividends declared per share for Altria Group, Inc.'s common stock as reported by the New York Stock Exchange.

	Price Per Share		Cash
	High	Low	Dividends
			Declared
			Per Share

2016:

Fourth Quarter	\$68.03	\$60.82	\$ 0.61
Third Quarter	\$70.15	\$62.46	\$ 0.61
Second Quarter	\$69.26	\$59.48	\$ 0.565
First Quarter	\$63.15	\$56.15	\$ 0.565

2015:

Fourth Quarter	\$61.74	\$53.68	\$ 0.565
Third Quarter	\$56.39	\$47.41	\$ 0.565
Second Quarter	\$52.99	\$47.31	\$ 0.52
First Quarter	\$56.70	\$48.52	\$ 0.52

## Issuer Purchases of Equity Securities During the Quarter Ended December 31, 2016

In July 2015, Altria Group, Inc.'s Board of Directors (the "Board of Directors") authorized a \$1.0 billion share repurchase program that it expanded to \$3.0 billion in October 2016 (as expanded, the "July 2015 share repurchase program"). Altria Group, Inc. expects to complete the July 2015 share repurchase program by the end of the second quarter of 2018. The timing of share repurchases under the July 2015 share repurchase program depends upon marketplace conditions and other factors, and the program remains subject to the discretion of the Board of Directors. Altria Group, Inc.'s share repurchase activity for each of the three months in the period ended December 31, 2016, was as follows:

Period	Total Number of Shares Purchased (1)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs
October 1- October 31, 2016	2,393,027	\$ 62.61	2,392,200	\$2,302,733,059
November 1- November 30, 2016	3,395,434	\$ 63.19	3,394,623	\$2,088,226,586
December 1- December 31, 2016	2,343,025	\$ 65.46	2,340,000	\$1,935,041,770
For the Quarter Ended December 31, 2016	8,131,486	\$ 63.67	8,126,823	

The total number of shares purchased includes (a) shares purchased under the July 2015 share repurchase program (which totaled 2,392,200 shares in October, 3,394,623 shares in November and 2,340,000 shares in December) and (1) (b) shares withheld by Altria Group, Inc. in an amount equal to the statutory withholding taxes for holders who vested in restricted stock units, and forfeitures of restricted stock for which consideration was paid in connection with termination of employment of certain employees (which totaled 827 shares in October, 811 shares in November and 3,025 shares in December).



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## Item 6. Selected Financial Data.

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

	2016	2015	2014	2013	2012	
Summary of Operations:						
Net revenues	\$ 25,744	\$ 25,434	\$ 24,522	\$ 24,466	\$ 24,618	
Cost of sales	7,746	7,740	7,785	7,206	7,937	
Excise taxes on products	6,407	6,580	6,577	6,803	7,118	
Operating income	8,762	8,361	7,620	8,084	7,253	
Interest and other debt expense, net	747	817	808	1,049	1,126	
Earnings from equity investment in SABMiller	795	757	1,006	991	1,224	
Gain on AB InBev/SABMiller business combination	13,865	5	—	—	—	
Earnings before income taxes <sup>(1)</sup>	21,852	8,078	7,774	6,942	6,477	
Pre-tax profit margin <sup>(1)</sup>	84.9	% 31.8	% 31.7	% 28.4	% 26.3	%
Provision for income taxes <sup>(1)</sup>	7,608	2,835	2,704	2,407	2,294	
Net earnings <sup>(1)</sup>	14,244	5,243	5,070	4,535	4,183	
Net earnings attributable to Altria Group, Inc. <sup>(1)</sup>	14,239	5,241	5,070	4,535	4,180	
Basic and Diluted EPS — net earnings attributable to Altria Group, Inc. <sup>(1)</sup>	7.28	2.67	2.56	2.26	2.06	
Dividends declared per share	2.35	2.17	2.00	1.84	1.70	
Weighted average shares (millions) — Basic and Diluted	1,952	1,961	1,978	1,999	2,024	
Capital expenditures	189	229	163	131	124	
Depreciation	183	204	188	192	205	
Property, plant and equipment, net	1,958	1,982	1,983	2,028	2,102	
Inventories	2,051	2,031	2,040	1,879	1,746	
Total assets <sup>(1)(2)</sup>	45,932	31,459	33,440	33,858	34,252	
Long-term debt <sup>(2)</sup>	13,881	12,843	13,610	13,907	12,346	
Total debt <sup>(2)</sup>	13,881	12,847	14,610	14,432	13,805	
Total stockholders' equity <sup>(1)</sup>	12,773	2,873	3,010	4,118	3,170	
Common dividends declared as a % of Basic and Diluted EPS <sup>(1)</sup>	32.3	% 81.3	% 78.1	% 81.4	% 82.5	%
Book value per common share outstanding <sup>(1)</sup>	6.57	1.47	1.53	2.07	1.58	
Market price per common share — high/low	70.15-56.15	61.74-47.31	51.67-33.80	38.58-31.85	36.29-28.00	
Closing price per common share at year end	67.62	58.21	49.27	38.39	31.44	
Price/earnings ratio at year end — Basic and Diluted	9	22	19	17	15	
Number of common shares outstanding at year end (millions)	1,943	1,960	1,971	1,993	2,010	
Approximate number of employees	8,300	8,800	9,000	9,000	9,100	

<sup>(1)</sup> Certain 2016 amounts include the impact of the Gain on AB InBev/SABMiller business combination. For further information, see Note 7 in Item 8.

<sup>(2)</sup> Certain prior-years' amounts have been reclassified to conform with the current-year's presentation due to the adoptions of certain accounting standards updates. For further information, see Note 1 in Item 8.

The Selected Financial Data should be read in conjunction with Item 7 and Item 8.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read in conjunction with the other sections of this Annual Report on Form 10-K, including the consolidated financial statements and related notes contained in Item 8, and the discussion of cautionary factors that may affect future results in Item 1A.

Description of the Company

At December 31, 2016, Altria Group, Inc.'s wholly-owned subsidiaries included PM USA, which is engaged in the manufacture and sale of cigarettes in the United States; Middleton, which is engaged in the manufacture and sale of machine-made large cigars and pipe tobacco and is a wholly-owned subsidiary of PM USA; and UST, which through its wholly-owned subsidiaries, including USSTC and Ste. Michelle, is engaged in the manufacture and sale of smokeless tobacco products and wine. Altria Group, Inc.'s other operating companies included Nu Mark, a wholly-owned subsidiary that is engaged in the manufacture and sale of innovative tobacco products, and PMCC, a wholly-owned subsidiary that maintains a portfolio of finance assets, substantially all of which are leveraged leases. Other Altria Group, Inc. wholly-owned subsidiaries included Altria Group Distribution Company, which provides sales, distribution and consumer engagement services to certain Altria Group, Inc. operating subsidiaries, and Altria Client Services LLC, which provides various support services in areas, such as legal, regulatory, finance, human resources and external affairs, to Altria Group, Inc. and its subsidiaries. In addition, Nu Mark and Middleton use third-party contract manufacturing arrangements in the manufacture of their products. Altria Group, Inc.'s access to the operating cash flows of its wholly-owned subsidiaries consists of cash received from the payment of dividends and distributions, and the payment of interest on intercompany loans by its subsidiaries. At December 31, 2016, Altria Group, Inc.'s principal wholly-owned subsidiaries were not limited by long-term debt or other agreements in their ability to pay cash dividends or make other distributions with respect to their equity interests.

At September 30, 2016, Altria Group, Inc. had an approximate 27% ownership of SABMiller, which Altria Group, Inc. accounted for under the equity method of accounting. On October 10, 2016, Legacy AB InBev completed the Transaction, and AB InBev became the holding company for the combined SABMiller and Legacy AB InBev businesses. Upon completion of the Transaction, Altria Group, Inc. had a 9.6% ownership of AB InBev based on AB InBev's shares outstanding at October 10, 2016. Following completion of the Transaction, Altria Group, Inc. purchased 12,341,937 ordinary shares of AB InBev for a total cost of approximately \$1.6 billion, thereby increasing Altria Group, Inc.'s ownership to approximately 10.2%. At December 31, 2016, Altria Group, Inc. had an approximate 10.2% ownership of AB InBev, which

Altria Group, Inc. accounts for under the equity method of accounting using a one-quarter lag. As a result of the one-quarter lag and the timing of the completion of the Transaction, no earnings from Altria Group, Inc.'s equity investment in AB InBev were recorded for the year ended December 31, 2016. Altria Group, Inc. receives cash dividends on its interest in AB InBev if and when AB InBev pays such dividends. For further discussion, see Note 7. Investment in AB InBev/SABMiller to the consolidated financial statements in Item 8 ("Note 7").

Altria Group, Inc.'s reportable segments are smokeable products, smokeless products and wine. The financial services and the innovative tobacco products businesses are included in an all other category due to the continued reduction of the lease portfolio of PMCC and the relative financial contribution of Altria Group, Inc.'s innovative tobacco products businesses to Altria Group, Inc.'s consolidated results.

In January 2017, Altria Group, Inc. acquired Nat Sherman, which sells super-premium cigarettes and premium cigars and joins PM USA and Middleton as part of Altria Group, Inc.'s smokeable products segment.

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## Executive Summary

The following executive summary is intended to provide significant highlights of the Discussion and Analysis that follows.

## Consolidated Results of Operations

The changes in Altria Group, Inc.'s net earnings and diluted earnings per share ("EPS") attributable to Altria Group, Inc. for the year ended December 31, 2016, from the year ended December 31, 2015, were due primarily to the following:

(in millions, except per share data)	Net Earnings	Diluted EPS
For the year ended December 31, 2015	\$5,241	\$ 2.67
2015 NPM Adjustment Items	(51 )	(0.03 )
2015 Asset impairment, exit and integration costs	9	—
2015 Tobacco and health litigation items	94	0.05
2015 SABMiller special items	82	0.04
2015 Loss on early extinguishment of debt	143	0.07
2015 Gain on AB InBev/SABMiller business combination	(3 )	—
2015 Tax items	(11 )	—
Subtotal 2015 special items	263	0.13
2016 NPM Adjustment Items	(11 )	(0.01 )
2016 Asset impairment, exit, implementation and acquisition-related costs	(135 )	(0.07 )
2016 Tobacco and health litigation items	(71 )	(0.04 )
2016 SABMiller special items	57	0.03
2016 Loss on early extinguishment of debt	(541 )	(0.28 )
2016 Patent litigation settlement	(13 )	(0.01 )
2016 Gain on AB InBev/SABMiller business combination	9,001	4.61
2016 Tax items	30	0.02
Subtotal 2016 special items	8,317	4.25
Fewer shares outstanding	—	0.02
Change in tax rate	82	0.04
Operations	336	0.17
For the year ended December 31, 2016	\$14,239	\$ 7.28

See the discussion of events affecting the comparability of statement of earnings amounts in the Consolidated Operating Results section of the following Discussion and Analysis.

Fewer Shares Outstanding: Fewer shares outstanding during 2016 compared with 2015 were due primarily to shares repurchased by Altria Group, Inc. under its share repurchase programs.

Change in Tax Rate: The change in tax rate was driven by tax benefits associated with the higher cumulative dividends received from SABMiller and AB InBev in 2016.

Operations: The increase of \$336 million in operations shown in the table above was due primarily to the following: higher income from the smokeable products and smokeless products segments; lower investment spending in the innovative tobacco products businesses;

lower interest and other debt expense, net; and

higher operating results from the financial services business;

partially offset by:

lower earnings from Altria Group, Inc.'s equity investment in SABMiller (excluding special items).

For further details, see the Consolidated Operating Results and Operating Results by Business Segment sections of the following Discussion and Analysis.

## 2017 Forecasted Results

In February 2017, Altria Group, Inc. forecasted that its 2017 full-year adjusted diluted EPS growth rate is expected to be in the range of 7.5% to 9.5% over 2016 full-year adjusted diluted EPS. This forecasted growth rate excludes the

income and expense items in the table below. Altria Group, Inc. expects that its 2017 full-year effective tax rate on operations will be approximately 36%.

Altria Group, Inc.'s full-year adjusted diluted EPS guidance and full-year forecast for its effective tax rate on operations exclude the impact of certain income and expense items that management believes are not part of underlying operations. These items may include, for example, loss on early extinguishment of debt, restructuring charges, gain on the Transaction, AB InBev/SABMiller special items, certain tax items, charges associated with tobacco and health litigation items, and settlements of, and determinations made in connection with, disputes with certain states and territories related to the Non-Participating Manufacturer ("NPM") adjustment provision under the 1998 Master Settlement Agreement (such settlements and determinations are referred to collectively as "NPM Adjustment Items" and are more fully described in Health Care Cost Recovery Litigation - NPM Adjustment Disputes in Note 19).

Altria Group, Inc.'s management cannot estimate on a forward-looking basis the impact of certain income and expense items, including those items noted in the preceding paragraph, on Altria Group, Inc.'s reported diluted EPS and reported effective tax rate because these items, which could be significant, are difficult to predict and may be highly variable. As a result, Altria Group, Inc. does not provide a corresponding United States generally accepted accounting principles ("U.S. GAAP") measure for, or reconciliation to, its adjusted diluted EPS guidance or its effective tax rate on operations forecast.

In addition, the factors described in Item 1A represent continuing risks to this forecast.

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Expense (Income), Net Excluded from Adjusted Diluted EPS	2017	2016
NPM Adjustment Items	\$—	\$0.01
Asset impairment, exit and implementation costs	0.02 <sup>(1)</sup>	0.07
Tobacco and health litigation items	—	0.04
SABMiller special items	—	(0.03 )
Loss on early extinguishment of debt	—	0.28
Patent litigation settlement	—	0.01
Gain on AB InBev/SABMiller business combination	—	(4.61 )
Tax items	—	(0.02 )
	\$0.02	\$(4.25)

<sup>(1)</sup> Represents restructuring charges in connection with the facilities consolidation announced in October 2016. For further discussion, see Note 5.

Altria Group, Inc. reports its financial results in accordance with U.S. GAAP. Altria Group, Inc.'s management reviews certain financial results, including diluted EPS, on an adjusted basis, which excludes certain income and expense items, including those items noted above. Altria Group, Inc.'s management does not view any of these special items to be part of Altria Group, Inc.'s underlying results as they may be highly variable, are difficult to predict and can distort underlying business trends and results. Altria Group, Inc.'s management also reviews income tax rates on an adjusted basis. Altria Group, Inc.'s effective tax rate on operations may exclude certain tax items from its reported effective tax rate. Altria Group, Inc.'s management believes that adjusted financial measures provide useful insight into underlying business trends and results and provide a more meaningful comparison of year-over-year results. Adjusted financial measures are used by management and regularly provided to the CODM for planning, forecasting and evaluating business and financial performance, including allocating resources and evaluating results relative to employee compensation targets. These adjusted financial measures are not consistent with U.S. GAAP and may not be calculated the same as similarly titled measures used by other companies. These adjusted financial measures should thus be considered as supplemental in nature and not considered in isolation or as a substitute for the related financial information prepared in accordance with U.S. GAAP.

## Discussion and Analysis

## Critical Accounting Policies and Estimates

Note 2 includes a summary of the significant accounting policies and methods used in the preparation of Altria Group, Inc.'s consolidated financial statements. In most instances, Altria Group, Inc. must use an accounting policy or method because it is the only policy or method permitted under U.S. GAAP.

The preparation of financial statements includes the use of estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities at the dates of the financial statements and the reported amounts of net revenues and expenses during the reporting periods. If

actual amounts are ultimately different from previous estimates, the revisions are included in Altria Group, Inc.'s consolidated results of operations for the period in which the actual amounts become known. Historically, the aggregate differences, if any, between Altria Group, Inc.'s estimates and actual amounts in any year have not had a significant impact on its consolidated financial statements.

The following is a review of the more significant assumptions and estimates, as well as the accounting policies and methods, used in the preparation of Altria Group, Inc.'s consolidated financial statements:

**Consolidation:** The consolidated financial statements include Altria Group, Inc., as well as its wholly-owned and majority-owned subsidiaries. Investments in which Altria Group, Inc. has the ability to exercise significant influence are accounted for under the equity method of accounting. All intercompany transactions and balances have been eliminated.

**Revenue Recognition:** Altria Group, Inc.'s businesses recognize revenues, net of sales incentives and sales returns, and including shipping and handling charges billed to customers, upon shipment of goods when title and risk of loss pass to customers. Payments received in advance of revenue recognition are deferred and recorded in other accrued

liabilities until revenue is recognized. Altria Group, Inc.'s businesses also include excise taxes billed to customers in net revenues. Shipping and handling costs are classified as part of cost of sales.

Depreciation, Amortization, Impairment Testing and Asset Valuation: Altria Group, Inc. depreciates property, plant and equipment and amortizes its definite-lived intangible assets using the straight-line method over the estimated useful lives of the assets. Machinery and equipment are depreciated over periods up to 25 years, and buildings and building improvements over periods up to 50 years. Definite-lived intangible assets are amortized over their estimated useful lives up to 25 years.

Altria Group, Inc. reviews long-lived assets, including definite-lived intangible assets, for impairment whenever events or changes in business circumstances indicate that the carrying value of the assets may not be fully recoverable. Altria Group, Inc. performs undiscounted operating cash flow analyses to determine if an impairment exists. These analyses are affected by general economic conditions and projected growth rates. For purposes of recognition and measurement of an impairment for assets held for use, Altria Group, Inc. groups assets and liabilities at the lowest level for which cash flows are separately identifiable. If an impairment is determined to exist, any related impairment loss is calculated based on fair value. Impairment losses on assets to be disposed of, if any, are based on the estimated proceeds to be received, less costs of disposal. Altria Group, Inc. also reviews the estimated remaining useful lives of long-lived assets whenever events or changes in business circumstances indicate the lives may have changed.

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Goodwill and indefinite-lived intangible assets recorded by Altria Group, Inc. at December 31, 2016 relate primarily to the acquisitions of Green Smoke in 2014, UST in 2009 and Middleton in 2007. Altria Group, Inc. conducts a required annual review of goodwill and indefinite-lived intangible assets for potential impairment, and more frequently if an event occurs or circumstances change that would require Altria Group, Inc. to perform an interim review. If the carrying value of goodwill exceeds its fair value, which is determined using discounted cash flows, goodwill is considered impaired. The amount of impairment loss is measured as the difference between the carrying value and the implied fair value. If the carrying value of an indefinite-lived intangible asset exceeds its fair value, which is determined using discounted cash flows, the intangible asset is considered impaired and is reduced to fair value.

Goodwill and indefinite-lived intangible assets, by reporting unit at December 31, 2016 were as follows:

(in millions)	Goodwill	Indefinite-Lived Intangible Assets
Cigarettes	\$ —	\$ 2
Smokeless products	5,023	8,801
Cigars	77	2,640
Wine	74	287
E-vapor	111	10
Total	\$ 5,285	\$ 11,740

During 2016, 2015 and 2014, Altria Group, Inc. completed its quantitative annual impairment test of goodwill and indefinite-lived intangible assets, and no impairment charges resulted. At December 31, 2016, the estimated fair values of all reporting units and indefinite-lived intangible assets substantially exceeded their carrying values.

In 2016, Altria Group, Inc. used an income approach to estimate the fair values of substantially all of its reporting units and indefinite-lived intangible assets. The income approach reflects the discounting of expected future cash flows to their present value at a rate of return that incorporates the risk-free rate for the use of those funds, the expected rate of inflation and the risks associated with realizing expected future cash flows. The discount rate used in performing substantially all of the valuations was 8.5%.

In performing the 2016 discounted cash flow analysis, Altria Group, Inc. made various judgments, estimates and assumptions, the most significant of which were volume, income, growth rates and discount rates. The analysis incorporated assumptions used in Altria Group, Inc.'s long-term financial forecast, which is used by Altria Group, Inc.'s management to evaluate business and financial performance, including allocating resources and evaluating results relative to setting employee compensation targets. The assumptions incorporated the highest and best use of Altria Group, Inc.'s indefinite-lived intangible assets and also included perpetual growth rates for periods beyond the long-term financial forecast. The perpetual growth rate used in performing all of the valuations was 2%. Fair value calculations are sensitive to changes in these estimates and assumptions, some of which

relate to broader macroeconomic conditions outside of Altria Group, Inc.'s control.

Although Altria Group, Inc.'s discounted cash flow analysis is based on assumptions that are considered reasonable and based on the best available information at the time that the discounted cash flow analysis is developed, there is significant judgment used in determining future cash flows. The following factors have the most potential to impact expected future cash flows and, therefore, Altria Group, Inc.'s impairment conclusions: general economic conditions; federal, state and local regulatory developments; category growth rates; consumer preferences; success of planned product expansions; competitive activity; and income and tobacco-related taxes. For further discussion of these factors, see Operating Results by Business Segment - Tobacco Space - Business Environment below.

While Altria Group, Inc.'s management believes that the estimated fair values of each reporting unit and indefinite-lived intangible asset are reasonable, actual performance in the short-term or long-term could be significantly different from forecasted performance, which could result in impairment charges in future periods. For additional information on goodwill and other intangible assets, see Note 4.

**Marketing Costs:** Altria Group, Inc.'s businesses promote their products with consumer engagement programs, consumer incentives and trade promotions. Such programs include discounts, coupons, rebates, in-store display

incentives, event marketing and volume-based incentives. Consumer engagement programs are expensed as incurred. Consumer incentive and trade promotion activities are recorded as a reduction of revenues, a portion of which is based on amounts estimated as being due to wholesalers, retailers and consumers at the end of a period, based principally on historical volume, utilization and redemption rates. For interim reporting purposes, consumer engagement programs and certain consumer incentive expenses are charged to operations as a percentage of sales, based on estimated sales and related expenses for the full year.

Contingencies: As discussed in Note 19 and Item 3, legal proceedings covering a wide range of matters are pending or threatened in various United States and foreign jurisdictions against Altria Group, Inc. and its subsidiaries, including PM USA and UST and its subsidiaries, as well as their respective indemnitees. In 1998, PM USA and certain other U.S. tobacco product manufacturers entered into the MSA with 46 states and various other governments and jurisdictions to settle asserted and unasserted health care cost recovery and other claims. PM USA and certain other U.S. tobacco product manufacturers had previously entered into agreements to settle similar claims brought by Mississippi, Florida, Texas and Minnesota (together with the MSA, the "State Settlement Agreements"). PM USA's portion of ongoing adjusted payments and legal fees is based on its relative share of the settling manufacturers' domestic cigarette shipments, including roll-your-own cigarettes, in the

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year preceding that in which the payment is due. PM USA, USSTC and Middleton were also subject to payment obligations imposed by the Fair and Equitable Tobacco Reform Act of 2004 (“FETRA”). The FETRA payment obligations expired after the third quarter of 2014. In addition, in June 2009, PM USA and USSTC became subject to quarterly user fees imposed by the FDA as a result of the FSPTCA. Payments under the State Settlement Agreements and the FDA user fees are based on variable factors, such as volume, operating income, market share and inflation, depending on the subject payment. Altria Group, Inc.’s subsidiaries account for the cost of the State Settlement Agreements, FETRA and FDA user fees as a component of cost of sales. For the years ended December 31, 2016, 2015 and 2014, the aggregate amount recorded in cost of sales with respect to the State Settlement Agreements, FETRA (which expired after the third quarter of 2014) and FDA user fees was approximately \$4.9 billion, \$4.8 billion and \$4.9 billion, respectively.

Altria Group, Inc. and its subsidiaries record provisions in the consolidated financial statements for pending litigation when they determine that an unfavorable outcome is probable and the amount of the loss can be reasonably estimated. At the present time, while it is reasonably possible that an unfavorable outcome in a case may occur, except to the extent discussed in Note 19 and Item 3: (i) management has concluded that it is not probable that a loss has been incurred in any of the pending tobacco-related cases; (ii) management is unable to estimate the possible loss or range of loss that could result from an unfavorable outcome in any of the pending tobacco-related cases; and (iii) accordingly, management has not provided any amounts in the consolidated financial statements for unfavorable outcomes, if any. Litigation defense costs are expensed as incurred and included in marketing, administration and research costs in the consolidated statements of earnings.

Employee Benefit Plans: As discussed in Note 17. Benefit Plans to the consolidated financial statements in Item 8 (“Note 17”), Altria Group, Inc. provides a range of benefits to its employees and retired employees, including pension, postretirement health care and postemployment benefits. Altria Group, Inc. records annual amounts relating to these plans based on calculations specified by U.S. GAAP, which include various actuarial assumptions as to discount rates, assumed rates of return on plan assets, mortality, compensation increases, turnover rates and health care cost trend rates. Altria Group, Inc. reviews its actuarial assumptions on an annual basis and makes modifications to the assumptions based on current rates and trends when it is deemed appropriate to do so. Any effect of the modifications is generally amortized over future periods.

Altria Group, Inc. recognizes the funded status of its defined benefit pension and other postretirement plans on the consolidated balance sheet and records as a component of other comprehensive earnings (losses), net of deferred income taxes, the gains or losses and prior service costs or credits that have not been recognized as components of net periodic benefit cost. The gains or losses and prior service costs or credits recorded as

components of other comprehensive earnings (losses) are subsequently amortized into net periodic benefit cost in future years.

At December 31, 2016, Altria Group, Inc.’s discount rate assumptions for its pension and postretirement plans obligations decreased to 4.1% from 4.4% at December 31, 2015. Altria Group, Inc. presently anticipates its 2017 pre-tax pension and postretirement expense will be essentially unchanged versus 2016, excluding amounts in each year related to termination, settlement and curtailment. Higher expected return on plan assets due to the impact of voluntary pension contributions totaling \$500 million in September 2016 is expected to be offset by the impact of higher amortization of unrecognized losses, which includes the impact of the lower discount rate. Assuming no change to the shape of the yield curve, a 50 basis point decrease in Altria Group, Inc.’s discount rates would increase Altria Group, Inc.’s pension and postretirement expense by approximately \$49 million, and a 50 basis point increase in Altria Group, Inc.’s discount rates would decrease Altria Group, Inc.’s pension and postretirement expense by approximately \$45 million. Similarly, a 50 basis point decrease (increase) in the expected return on plan assets would increase (decrease) Altria Group, Inc.’s pension expense by approximately \$38 million. See Note 17 for a sensitivity discussion of the assumed health care cost trend rates.

Income Taxes: Significant judgment is required in determining income tax provisions and in evaluating tax positions. Altria Group, Inc.’s deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities, using enacted tax rates in effect for the year in which the differences

are expected to reverse. Altria Group, Inc. records a valuation allowance when it is more-likely-than-not that some portion or all of a deferred tax asset will not be realized. Altria Group, Inc. may be required to change the valuation allowance with respect to foreign tax credit carryforwards, based upon additional information to be received from AB InBev in 2017.

Altria Group, Inc. recognizes a benefit for uncertain tax positions when a tax position taken or expected to be taken in a tax return is more-likely-than-not to be sustained upon examination by taxing authorities. The amount recognized is measured as the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement.

Altria Group, Inc. recognizes accrued interest and penalties associated with uncertain tax positions as part of the provision for income taxes in its consolidated statements of earnings.

Altria Group, Inc. recognized income tax benefits and charges in the consolidated statements of earnings during 2016, 2015 and 2014 as a result of various tax events.

For additional information on income taxes, see Note 15. Income Taxes to the consolidated financial statements in Item 8 ("Note 15").

Leasing: Substantially all of PMCC's net revenues in 2016 related to income on leveraged leases and related gains on asset sales. Income attributable to leveraged leases is initially

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recorded as unearned income, which is included in the line item finance assets, net, on Altria Group, Inc.'s consolidated balance sheets and subsequently recognized as revenue over the terms of the respective leases at constant after-tax rates of return on the positive net investment balances. PMCC lessees are affected by bankruptcy filings, credit rating changes and financial market conditions.

PMCC's investment in leases is included in the line item finance assets, net, on the consolidated balance sheets as of December 31, 2016 and 2015. At December 31, 2016, PMCC's net finance receivables of approximately \$1.1 billion, which are included in finance assets, net, on Altria Group, Inc.'s consolidated balance sheet, consisted of rents receivable (\$1.6 billion) and the residual value of assets under lease (\$0.5 billion), reduced by third-party nonrecourse debt (\$0.8 billion) and unearned income (\$0.2 billion). The repayment of the nonrecourse debt is collateralized by lease payments receivable and the leased property, and is nonrecourse to the general assets of PMCC. As required by U.S. GAAP, the third-party nonrecourse debt has been offset against the related rents receivable and has been presented on a net basis within finance assets, net, on Altria Group, Inc.'s consolidated balance sheets. Finance assets, net, of \$1.0 billion at December 31, 2016 also included an allowance for losses.

Estimated residual values represent PMCC's estimate at lease inception as to the fair values of assets under lease at the end of the non-cancelable lease terms. The estimated residual values are reviewed at least annually by PMCC's management, which includes analysis of a number of factors, including activity in the relevant industry. If necessary, revisions are recorded to reduce the residual values. In 2016, 2015 and 2014, PMCC's review of estimated residual values resulted in a decrease of \$28 million, \$65 million and \$63 million, respectively, to unguaranteed residual values. These decreases in unguaranteed residual values resulted in a reduction to PMCC's net revenues of \$18 million, \$41 million and \$26 million in 2016, 2015 and 2014, respectively.

PMCC considers rents receivable past due when they are beyond the grace period of their contractual due date. PMCC stops recording income ("non-accrual status") on rents receivable when contractual payments become 90 days past due or earlier if management believes there is significant uncertainty of collectability of rent payments, and resumes recording income when collectability of rent payments is reasonably certain. Payments received on rents receivable that are on non-accrual status are used to reduce the rents receivable balance. Write-offs to the allowance for losses are recorded when amounts are deemed to be uncollectible. There were no rents receivable on non-accrual status at December 31, 2016.

To the extent that rents receivable due to PMCC may be uncollectible, PMCC records an allowance for losses against its finance assets. Losses on such leases are recorded when probable and estimable. PMCC regularly performs a systematic assessment of each individual lease in its portfolio to determine potential credit or collection issues that might indicate impairment. Impairment takes into consideration both

the probability of default and the likelihood of recovery if default were to occur. PMCC considers both quantitative and qualitative factors of each investment when performing its assessment of the allowance for losses. For further discussion, see Note 8.

## Consolidated Operating Results

(in millions)	For the Years Ended		
	December 31,		
	2016	2015	2014
Net Revenues:			
Smokeable products	\$22,851	\$22,792	\$21,939
Smokeless products	2,051	1,879	1,809
Wine	746	692	643
All other	96	71	131
Net revenues	\$25,744	\$25,434	\$24,522
Excise Taxes on Products:			
Smokeable products	\$6,247	\$6,423	\$6,416
Smokeless products	135	133	138
Wine	25	24	23

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Excise taxes on products	\$6,407	\$6,580	\$6,577
Operating Income:			
Operating companies income (loss):			
Smokeable products	\$7,768	\$7,569	\$6,873
Smokeless products	1,177	1,108	1,061
Wine	164	152	134
All other	(99 )	(169 )	(185 )
Amortization of intangibles	(21 )	(21 )	(20 )
General corporate expenses	(222 )	(237 )	(241 )
Reductions of PMI and Mondelēz tax-related receivables	—	(41 )	(2 )
Corporate asset impairment and exit costs	(5 )	—	—
Operating income	\$8,762	\$8,361	\$7,620

As discussed further in Note 16, the CODM reviews operating companies income to evaluate the performance of, and allocate resources to, the segments. Operating companies income for the segments is defined as operating income before general corporate expenses and amortization of intangibles. Management believes it is appropriate to disclose this measure to help investors analyze the business performance and trends of the various business segments.

The following events that occurred during 2016, 2015 and 2014 affected the comparability of statement of earnings amounts.

Gain on AB InBev/SABMiller Business Combination: As a result of the Transaction, during 2016, Altria Group, Inc. recorded a pre-tax gain of approximately \$13.9 billion. For further discussion, see Note 7.

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NPM Adjustment Items: For the years ended December 31, 2016, 2015 and 2014, pre-tax expense (income) for NPM Adjustment Items was recorded in Altria Group, Inc.'s consolidated statements of earnings as follows:

(in millions)	2016	2015	2014
Smokeable products segment	\$ 12	\$(97)	\$(43)
Interest and other debt expense, net	6	13	(47)
Total	\$ 18	\$(84)	\$(90)

The amounts shown in the table above for the smokeable products segment were recorded by PM USA as increases (reductions) to costs of sales, which decreased (increased) operating companies income in the smokeable products segment. For further discussion, see Health Care Cost Recovery Litigation - NPM Adjustment Disputes in Note 19.

Tobacco and Health Litigation Items: For the years ended December 31, 2016, 2015 and 2014, pre-tax charges related to certain tobacco and health litigations items were recorded in Altria Group, Inc.'s consolidated statements of earnings as follows:

(in millions)	2016	2015	2014
Smokeable products segment	\$88	\$127	\$ 27
General corporate	—	—	15
Interest and other debt expense, net	17	23	2
Total	\$105	\$150	\$ 44

During 2016, PM USA recorded pre-tax charges of \$88 million in marketing, administration and research costs, primarily related to settlements in the Miner and Aspinall cases totaling approximately \$67 million and \$16 million related to a judgment in the Merino case. In addition, during 2016, PM USA recorded \$17 million in interest costs primarily related to Aspinall. For further discussion, see Note 19.

During 2015, PM USA recorded pre-tax charges in marketing, administration and research costs related to tobacco and health judgments in seven state Engle progeny lawsuits and Schwarz of \$59 million and \$25 million, respectively, as well as \$14 million and \$9 million, respectively, in interest costs related to these cases. Additionally in 2015, PM USA and certain other cigarette manufacturers reached an agreement to resolve approximately 415 pending federal Engle progeny cases. As a result of the agreement, PM USA recorded a pre-tax provision of approximately \$43 million in marketing, administration and research costs. For further discussion, see Smoking and Health Litigation in Note 19.

During 2014, Altria Group, Inc. and PM USA recorded an aggregate pre-tax charge of \$31 million in marketing, administration and research costs for the estimated costs of implementing the corrective communications remedy in connection with the federal government's lawsuit against Altria Group, Inc. and PM USA. For further discussion, see Health Care Cost Recovery Litigation - Federal Government's Lawsuit in Note 19.

Asset Impairment, Exit, Implementation, Integration and Acquisition-Related Costs: Pre-tax asset impairment, exit, implementation, integration and acquisition-related costs for the years ended December 31, 2016, 2015 and 2014 were \$206 million, \$11 million and \$21 million, respectively.

In October 2016, Altria Group, Inc. announced the consolidation of certain of its operating companies' manufacturing facilities to streamline operations and achieve greater efficiencies. The consolidation is expected to be completed by the first quarter of 2018 and deliver approximately \$50 million in annualized cost savings by the end of 2018.

As a result of the consolidation, Altria Group, Inc. expects to record total pre-tax charges of approximately \$150 million, or \$0.05 per share. Altria Group, Inc. incurred \$71 million of this amount during 2016 and expects to record approximately \$70 million in 2017 and the remainder in 2018.

In January 2016, Altria Group, Inc. announced a productivity initiative designed to maintain its operating companies' leadership and cost competitiveness. The initiative, which reduces spending on certain selling, general and administrative infrastructure and implements a leaner organizational structure, is expected to deliver approximately \$300 million in annualized productivity savings by the end of 2017. As a result of the initiative, during 2016, Altria Group, Inc. incurred total pre-tax restructuring charges of \$132 million. Total pre-tax charges related to the initiative have been substantially completed.

For further discussion on 2016 asset impairment, exit and implementation costs, including a breakdown of these costs by segment, see Note 5.

For 2014, these costs consisted primarily of integration and acquisition-related costs of \$28 million related to the acquisition of Green Smoke, partially offset by a pre-tax gain of \$10 million from the sale of PM USA's Cabarrus, North Carolina manufacturing facility in 2014. For further discussion of the Green Smoke acquisition, see Note 3.

Loss on Early Extinguishment of Debt: During 2016 and 2015, Altria Group, Inc. completed debt tender offers to purchase for cash certain of its senior unsecured notes in aggregate principal amounts of \$0.9 billion and \$0.8 billion, respectively.

During 2014, UST redeemed in full its \$300 million (aggregate principal amount) 5.75% senior notes due 2018.

As a result of the Altria Group, Inc. debt tender offers and the UST debt redemption, pre-tax losses on early extinguishment of debt were recorded as follows:

(in millions)	2016	2015	2014
Premiums and fees	\$809	\$226	\$44
Write-off of unamortized debt discounts and debt issuance costs	14	2	—
Total	\$823	\$228	\$44

For further discussion, see Note 10. Long-Term Debt to the consolidated financial statements in Item 8 ("Note 10").

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SABMiller Special Items: Altria Group, Inc.'s earnings from its equity investment in SABMiller for 2016 included net pre-tax income of \$89 million, due primarily to a pre-tax non-cash gain of \$309 million, reflecting Altria Group, Inc.'s share of SABMiller's increase to shareholders' equity, resulting from the completion of the SABMiller, The Coca-Cola Company and Gutsche Family Investments transaction, combining bottling operations in Africa, partially offset by Altria Group, Inc.'s share of SABMiller's costs related to the Transaction and asset impairment charges. Altria Group, Inc.'s earnings from its equity investment in SABMiller for 2015 included net pre-tax charges of \$126 million, consisting primarily of Altria Group, Inc.'s share of SABMiller's asset impairment charges.

Tax Items: Tax items for 2016 primarily included the reversal of tax accruals no longer required. Tax items for 2015 primarily included the reversal of tax reserves and associated interest due primarily to the closure in August 2015 of the Internal Revenue Service audit of Altria Group, Inc. and its consolidated subsidiaries' 2007-2009 tax years, partially offset by a reversal of foreign tax credits primarily associated with SABMiller dividends. Tax items for 2014 included the reversal of tax accruals no longer required. For further discussion, see Note 15.

2016 Compared with 2015

The following discussion compares consolidated operating results for the year ended December 31, 2016 with the year ended December 31, 2015.

Net revenues, which include excise taxes billed to customers, increased \$310 million (1.2%), due primarily to higher net revenues in the smokeless products, smokeable products and wine segments.

Cost of sales was essentially unchanged as higher per unit settlement charges and NPM Adjustment Items in 2015 were offset by lower shipment volume and lower pension and benefit costs in the smokeable products segment. Excise taxes on products decreased \$173 million (2.6%), due primarily to lower smokeable products shipment volume.

Marketing, administration and research costs decreased \$58 million (2.1%), due primarily to lower costs in the smokeable products segment (which included lower tobacco and health litigation items), partially offset by higher costs in the smokeless products segment.

Operating income increased \$401 million (4.8%), due primarily to higher operating results from the smokeable products and smokeless products segments (which included asset impairment, exit and implementation costs in connection with the facilities consolidation and productivity initiative in 2016), lower investment spending in the innovative tobacco products businesses, a reduction of a PMI tax-related receivable in 2015 and higher operating results from the financial services business.

Interest and other debt expense, net, decreased \$70 million (8.6%), due primarily to lower interest costs on debt as a result

of a debt maturity in 2015 and debt tender offers in 2016 and 2015.

Earnings from Altria Group, Inc.'s equity investment in SABMiller, which increased \$38 million (5.0%), were positively impacted by SABMiller special items, mostly offset by three fewer months of SABMiller's earnings in 2016 versus 2015, as a result of the timing of the completion of the Transaction.

Net earnings attributable to Altria Group, Inc. of \$14,239 million increased \$8,998 million (171.7%), due primarily to the gain on the Transaction, higher operating income and lower interest and other debt expense, partially offset by a higher loss on early extinguishment of debt. Diluted and basic EPS attributable to Altria Group, Inc. of \$7.28, each increased by 172.7% due to higher net earnings attributable to Altria Group, Inc. and fewer shares outstanding.

2015 Compared with 2014

The following discussion compares consolidated operating results for the year ended December 31, 2015 with the year ended December 31, 2014.

Net revenues, which include excise taxes billed to customers, increased \$912 million (3.7%), due primarily to higher net revenues in the smokeable products segment.

Cost of sales decreased \$45 million (0.6%), due primarily to lower resolution expenses (due principally to the end of the federal tobacco quota buy-out payments after the third quarter of 2014) and higher NPM Adjustment Items in 2015, partially offset by higher manufacturing costs in the smokeable products and smokeless products segments.

Marketing, administration and research costs increased \$169 million (6.7%), due primarily to higher costs in the smokeable products segment (which included higher tobacco and health litigation items).

Operating income increased \$741 million (9.7%), due primarily to higher operating results from the smokeable products and smokeless products segments.

Interest and other debt expense, net, increased \$9 million (1.1%), due primarily to interest income recorded during 2014 and the reversal of interest income recorded during 2015 as a result of the NPM Adjustment Items, and higher interest costs related to tobacco and health litigation items, mostly offset by lower interest costs on debt as a result of debt refinancing activities in 2015 and 2014.

Earnings from Altria Group, Inc.'s equity investment in SABMiller, which decreased \$249 million (24.8%), were negatively affected by SABMiller special items and unfavorable currency impacts from a stronger U.S. dollar.

Net earnings attributable to Altria Group, Inc. of \$5,241 million increased \$171 million (3.4%), due primarily to higher operating income, partially offset by lower earnings from Altria Group, Inc.'s equity investment in SABMiller and higher losses on early extinguishment of debt. Diluted and basic EPS attributable to Altria Group, Inc. of \$2.67, each increased by 4.3% due to higher net earnings attributable to Altria Group, Inc. and fewer shares outstanding.

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Operating Results by Business Segment

Tobacco Space

Business Environment

Summary

The United States tobacco industry faces a number of business and legal challenges that have adversely affected and may adversely affect the business and sales volume of our tobacco subsidiaries and our consolidated results of operations, cash flows or financial position. These challenges, some of which are discussed in more detail below, in Note 19, Item 1A and Item 3, include:

- pending and threatened litigation and bonding requirements;
- the requirement to issue “corrective statements” in various media in connection with the federal government’s lawsuit;
- restrictions and requirements imposed by the FSPTCA, and restrictions and requirements (and related enforcement actions) that have been, and in the future will be, imposed by the FDA;
- actual and proposed excise tax increases, as well as changes in tax structures and tax stamping requirements;
- bans and restrictions on tobacco use imposed by governmental entities and private establishments and employers;
- other federal, state and local government actions, including:
  - increases in the minimum age to purchase tobacco products above the current federal minimum age of 18;
  - restrictions on the sale of tobacco products by certain retail establishments, the sale of certain tobacco products with certain characterizing flavors and the sale of tobacco products in certain package sizes;
- additional restrictions on the advertising and promotion of tobacco products;
- other actual and proposed tobacco product legislation and regulation; and
- governmental investigations;
- the diminishing prevalence of cigarette smoking and increased efforts by tobacco control advocates and others (including employers and retail establishments) to further restrict tobacco use;
- changes in adult tobacco consumer purchase behavior, which is influenced by various factors such as economic conditions, excise taxes and price gap relationships, may result in adult tobacco consumers switching to discount products or other lower priced tobacco products;
  - the highly competitive nature of the tobacco categories in which our tobacco subsidiaries operate, including

competitive disadvantages related to cigarette price increases attributable to the settlement of certain litigation; illicit trade in tobacco products; and

potential adverse changes in tobacco leaf price, availability and quality.

In addition to and in connection with the foregoing, evolving adult tobacco consumer preferences pose challenges for Altria Group, Inc.’s tobacco subsidiaries. Our tobacco subsidiaries believe that a significant number of adult tobacco consumers switch between tobacco categories, use multiple forms of tobacco products and try innovative tobacco products, such as e-vapor products. While the e-vapor category grew rapidly from 2012 through early 2015, the category has slowed since that time. Nu Mark believes the category will continue to be dynamic as adult tobacco consumers explore a variety of tobacco product options.

Altria Group, Inc. and its tobacco subsidiaries work to meet these evolving adult tobacco consumer preferences over time by developing, manufacturing, marketing and distributing products both within and outside the United States through innovation and adjacency growth strategies (including, where appropriate, arrangements with, or investments in, third parties). For example, Nu Mark entered the e-vapor category in 2013. See the discussions regarding new product technologies, adjacency growth strategy and evolving consumer preferences in Cautionary Factors That May Affect Future Results below for certain risks associated with the foregoing discussion.

We have provided additional detail on the following topics below:

FSPTCA and FDA Regulation;

Excise Taxes;

International Treaty on Tobacco Control;

State Settlement Agreements;

Other Federal, State and Local Regulation and Activity;  
Illicit Trade in Tobacco Products;  
Price, Availability and Quality of Agricultural Products; and  
Timing of Sales.

**FSPTCA and FDA Regulation**

**The Regulatory Framework:** The FSPTCA expressly establishes certain restrictions and prohibitions on our tobacco businesses and authorizes or requires further FDA action. Under the FSPTCA, the FDA has broad authority to (1) regulate the design, manufacture, packaging, advertising, promotion, sale and distribution of tobacco products; (2) require disclosures of related information; and (3) enforce the FSPTCA and related regulations. The FSPTCA went into effect in 2009 for cigarettes, cigarette tobacco and smokeless tobacco products and in August 2016 for Other Tobacco Products. See FDA Regulatory Actions - Deeming Regulations below.

Among other measures, the FSPTCA or its implementing regulations:

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imposes restrictions on the advertising, promotion, sale and distribution of tobacco products, including at retail; bans descriptors such as “light,” “mild” or “low” or similar descriptors when used as descriptors of modified risk unless expressly authorized by the FDA;

requires extensive product disclosures to the FDA and may require public disclosures;

prohibits any express or implied claims that a tobacco product is or may be less harmful than other tobacco products without FDA authorization;

imposes reporting obligations relating to contraband activity and grants the FDA authority to impose recordkeeping and other obligations to address illicit trade in tobacco products;

changes the language of the cigarette and smokeless tobacco product health warnings, enlarges their size and requires the development by the FDA of graphic warnings for cigarettes, establishes warning requirements for Other Tobacco Products, and gives the FDA the authority to require new warnings for any type of tobacco products;

authorizes the FDA to adopt product regulations and related actions, including imposing tobacco product standards that are appropriate for the protection of the public health (e.g., related to the use of menthol in cigarettes, nicotine yields and other constituents or ingredients) and imposing manufacturing standards for tobacco products;

establishes pre-market review pathways for new and modified tobacco products for the FDA to follow, including: subjecting cigarettes, cigarette tobacco and smokeless tobacco products modified or first introduced into the market after March 22, 2011, and Other Tobacco Products modified or first introduced into the market after August 8, 2016, to new tobacco product application and pre-market review and authorization requirements unless a manufacturer can demonstrate they are “substantially equivalent” to products commercially marketed as of February 15, 2007, and possibly to deny any such new tobacco product application, thereby preventing the distribution and sale of any product affected by such denial;

determining that cigarettes, cigarette tobacco and smokeless tobacco products modified or introduced into the market for the first time between February 15, 2007 and March 22, 2011 for which a manufacturer submitted a substantial equivalence report are not “substantially equivalent” to products commercially marketed as of February 15, 2007, in which case the FDA could require the removal of such products from the marketplace (see FDA Regulatory Actions - Substantial Equivalence and Other New Product Processes/Pathways below);

determining that Other Tobacco Products modified or introduced into the market for the first time between February 15, 2007 and August 8, 2016 for which a manufacturer submits a substantial equivalence report by

February 8, 2018 are not “substantially equivalent” to products commercially marketed as of February 15, 2007, or to reject a new tobacco product application submitted by a manufacturer by August 8, 2018, both of which could require the removal of such products from the marketplace (see FDA Regulatory Actions - Substantial Equivalence and Other New Product Processes/Pathways below); and

equips the FDA with a variety of investigatory and enforcement tools, including the authority to inspect tobacco product manufacturing and other facilities.

**Implementation Timing, Rulemaking and Guidance:** The implementation of the FSPTCA began in 2009 for cigarettes, cigarette tobacco and smokeless tobacco products and in August 2016 for Other Tobacco Products and will continue over time. The provisions of the FSPTCA that require the FDA to take action through rulemaking generally involve consideration of public comment and, for some issues, scientific review. From time to time, the FDA issues guidance that also generally involves public comment, which may be issued in draft or final form.

Altria Group, Inc.’s tobacco subsidiaries participate actively in processes established by the FDA to develop and implement the FSPTCA’s regulatory framework, including submission of comments to various FDA proposals and participation in public hearings and engagement sessions.

The implementation of the FSPTCA and related regulations and guidance also may have an impact on enforcement efforts by states, territories and localities of the United States of their laws and regulations as well as of the State Settlement Agreements discussed below (see State Settlement Agreements below). Such enforcement efforts may adversely affect our tobacco subsidiaries’ ability to market and sell regulated tobacco products in those states, territories and localities.

Impact on Our Business; Compliance Costs and User Fees: Regulations imposed and other regulatory actions taken by the FDA under the FSPTCA could have a material adverse effect on the business, consolidated results of operations, cash flows or financial position of Altria Group, Inc. and its tobacco subsidiaries in a number of different ways. For example, actions by the FDA could:

- impact the consumer acceptability of tobacco products;
- delay, discontinue or prevent the sale or distribution of existing, new or modified tobacco products;
- limit adult tobacco consumer choices;
- impose restrictions on communications with adult tobacco consumers;
- create a competitive advantage or disadvantage for certain tobacco companies;
- impose additional manufacturing, labeling or packaging requirements;
- impose additional restrictions at retail;
- result in increased illicit trade in tobacco products; or

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otherwise significantly increase the cost of doing business.

The failure to comply with FDA regulatory requirements, even inadvertently, and FDA enforcement actions could also have a material adverse effect on the business, consolidated results of operations, cash flows or financial position of Altria Group, Inc. and its tobacco subsidiaries.

The FSPTCA imposes user fees on cigarette, cigarette tobacco, smokeless tobacco, cigar and pipe tobacco manufacturers and importers to pay for the cost of regulation and other matters. The FSPTCA does not impose user fees on e-vapor product manufacturers. The cost of the FDA user fee is allocated first among tobacco product categories subject to FDA regulation and then among manufacturers and importers within each respective category based on their relative market shares, all as prescribed by the statute and FDA regulations. Payments for user fees are adjusted for several factors, including inflation, market share and industry volume. For a discussion of the impact of the FDA user fee payments on Altria Group, Inc., see Financial Review - Off-Balance Sheet Arrangements and Aggregate Contractual Obligations - Payments Under State Settlement Agreements, FETRA and FDA Regulation below. In addition, compliance with the FSPTCA's regulatory requirements has resulted and will continue to result in additional costs for our tobacco businesses. The amount of additional compliance and related costs has not been material in any given quarter or year to date period but could become material, either individually or in the aggregate, to one or more of our tobacco subsidiaries.

**Investigation and Enforcement:** The FDA has a number of investigatory and enforcement tools available to it, including document requests and other required information submissions, facility inspections, examinations and investigations, injunction proceedings, monetary penalties, product withdrawal and recall orders, and product seizures. The use of any of these investigatory or enforcement tools by the FDA could result in significant costs to the tobacco businesses of Altria Group, Inc. or otherwise have a material adverse effect on the business, consolidated results of operations, cash flows or financial position of Altria Group, Inc. and its tobacco subsidiaries.

### TPSAC

**The Role of the TPSAC:** As required by the FSPTCA, the FDA has established a tobacco product scientific advisory committee (the "TPSAC"), which consists of voting and non-voting members, to provide advice, reports, information and recommendations to the FDA on scientific and health issues relating to tobacco products.

**Challenge to TPSAC Membership:** In February 2011, Lorillard Tobacco Company ("Lorillard") and R.J. Reynolds filed suit in the U.S. District Court for the District of Columbia against the United States Department of Health and Human Services and individual defendants (sued in their official capacities) asserting that the composition of the TPSAC and the composition of the Constituents Subcommittee of the TPSAC violates several federal laws,

including the Federal Advisory Committee Act, because four of the voting members of the TPSAC have financial and other conflicts (including service as paid experts for plaintiffs in tobacco litigation). In July 2014, the district court granted plaintiffs' summary judgment motion, in part, and denied defendants' summary judgment motion, ordering the FDA to reconstitute the TPSAC and barring defendants from relying on the TPSAC report on menthol, discussed below. The FDA appealed to the U.S. Court of Appeals for the District of Columbia Circuit in September 2014. In January 2016, the U.S. Court of Appeals for the District of Columbia Circuit vacated the trial court's ruling on procedural grounds, finding that plaintiffs lacked standing to bring suit. In February 2016, plaintiffs filed a petition for rehearing, which was denied in May 2016.

**TPSAC Action on Menthol:** As mandated by the FSPTCA, in March 2011, the TPSAC submitted to the FDA a report on the impact of the use of menthol in cigarettes on the public health and related recommendations. The TPSAC report recommended, among other things, that the "[r]emoval of menthol cigarettes from the marketplace would benefit public health in the United States." The TPSAC report noted the potential that any ban on menthol cigarettes could lead to an increase in contraband cigarettes and other potential unintended consequences and suggested that the FDA consult with appropriate experts on this matter.

In March 2011, PM USA submitted a report to the FDA outlining its position that neither science nor other evidence demonstrates that regulatory actions or restrictions related to the use of menthol cigarettes are warranted. The report noted PM USA's belief that significant restrictions on the use of menthol cigarettes would have unintended consequences detrimental to public health and society. The FDA has stated that the TPSAC report is only a

recommendation, and, in July 2013, the FDA released its preliminary scientific evaluation on menthol, which states “that menthol cigarettes pose a public health risk above that seen with non-menthol cigarettes.” At the same time, the FDA also issued an advance notice of proposed rulemaking requesting comments on the FDA’s preliminary scientific evaluation and information that may inform potential regulatory actions regarding menthol in cigarettes or other tobacco products. In November 2013, PM USA submitted comments to the FDA raising a number of concerns with the preliminary scientific evidence and about unintended consequences detrimental to public health and society. No future action can be taken by the FDA to regulate the manufacture, marketing or sale of menthol cigarettes (including a possible ban) until the completion of the rulemaking process.

**Final Tobacco Marketing Rule:** As required by the FSPTCA, the FDA re-promulgated in March 2010 a wide range of advertising and promotion restrictions in substantially the same form as regulations that were previously adopted in 1996 (but never imposed on tobacco manufacturers due to a United States Supreme Court ruling) (the “Final Tobacco Marketing Rule”). The May 2016 amendments to the Final Tobacco Marketing Rule

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(instituted as part of the FDA's deeming regulations) apply certain provisions to certain "covered tobacco products," which include cigars, e-vapor products containing nicotine or other tobacco derivatives, pipe tobacco and oral tobacco-derived nicotine products, but do not include any component or part that is not made or derived from tobacco. The Final Tobacco Marketing Rule as so amended:

bans the use of color and graphics in cigarette and smokeless tobacco product labeling and advertising;  
prohibits the sale of cigarettes, smokeless tobacco and covered tobacco products to persons under the age of 18;  
restricts the use of non-tobacco trade and brand names on cigarettes and smokeless tobacco products;  
requires the sale of cigarettes and smokeless tobacco in direct, face-to-face transactions;  
prohibits sampling of cigarettes and covered tobacco products and prohibits sampling of smokeless tobacco products except in qualified adult-only facilities;  
prohibits gifts or other items in exchange for buying cigarettes or smokeless tobacco products;  
prohibits the sale or distribution of items such as hats and tee shirts with cigarette or smokeless tobacco brands or logos; and  
prohibits cigarettes and smokeless tobacco brand name sponsorship of any athletic, musical, artistic or other social or cultural event, or any entry or team in any event.

Subject to the limitations described below, the Final Tobacco Marketing Rule took effect in June 2010 for cigarettes and smokeless tobacco products and in August 2016 for covered tobacco products. At the time of the re-promulgation of the Final Tobacco Marketing Rule, the FDA also issued an advance notice of proposed rulemaking regarding the so-called "1000 foot rule," which would establish restrictions on the placement of outdoor tobacco advertising in relation to schools and playgrounds. PM USA and USSTC submitted comments on this advance notice.

Since enactment in 2009, several lawsuits have been filed challenging various provisions of the FSPTCA, the Final Tobacco Marketing Rule and the deeming regulations, including their constitutionality and the scope of the FDA's authority thereunder. As a result of one such challenge (Commonwealth Brands), the portion of the Final Tobacco Marketing Rule that bans the use of color and graphics in labeling and advertising is unenforceable by the FDA. For a further discussion of the Final Tobacco Marketing Rule and the status of graphic warnings for cigarette packages and advertising, see FDA Regulatory Actions - Graphic Warnings below.

In a separate lawsuit that challenged the constitutionality of an FDA regulation that restricts tobacco manufacturers from using the trade or brand name of a non-tobacco product on cigarettes or smokeless tobacco products, the case was dismissed without prejudice pursuant to a stipulation by which the FDA agreed not to enforce the current or any amended trade name rule against plaintiffs until at least 180 days after rulemaking on the amended

rule concludes. This relief only applies to plaintiffs in the case. However, in May 2010, the FDA issued guidance on the use of non-tobacco trade and brand names applicable to all cigarette and smokeless tobacco product manufacturers. This guidance indicated the FDA's intention not to commence enforcement actions under the regulation while it considers how to address the concerns raised by various manufacturers. In November 2011, the FDA proposed an amended rule, but has not yet issued a final rule. PM USA and USSTC submitted comments on the proposed amended rule.

**FDA Regulatory Actions**

**Graphic Warnings:** In June 2011, as required by the FSPTCA, the FDA issued its final rule to modify the required warnings that appear on cigarette packages and in cigarette advertisements. The FSPTCA requires the warnings to consist of nine new textual warning statements accompanied by color graphics depicting the negative health consequences of smoking. The graphic health warnings will (i) be located beneath the cellophane, and comprise the top 50% of the front and rear panels of cigarette packages and (ii) occupy 20% of a cigarette advertisement and be located at the top of the advertisement. After a legal challenge to the rule initiated by R.J. Reynolds, Lorillard and several other plaintiffs, in which plaintiffs prevailed both at the federal trial and appellate levels, the FDA decided not to seek further review of the U.S. Court of Appeals' decision and announced its plans to propose a new graphic warnings rule in the future.

**Substantial Equivalence and Other New Product Processes/Pathways:** In January 2011, the FDA issued guidance concerning reports that manufacturers must submit for certain tobacco products that the manufacturer modified or

introduced for the first time into the market after February 15, 2007. These reports must be reviewed by the FDA to determine if such tobacco products are “substantially equivalent” to products commercially available as of February 15, 2007. In general, in order to continue marketing cigarette, cigarette tobacco and smokeless tobacco products commercially available before March 22, 2011, manufacturers of such products were required to send to the FDA a report demonstrating substantial equivalence by March 22, 2011. These products are referred to as “provisional products.” All cigarette and smokeless tobacco products currently marketed by PM USA and USSTC are provisional products, as are some of the products currently marketed by Nat Sherman. Our subsidiaries submitted timely reports for these products and can continue marketing these products unless the FDA makes a determination that a specific product is not substantially equivalent. If the FDA ultimately makes such a determination, it could require the removal of such products from the marketplace. While our cigarette and smokeless tobacco subsidiaries believe that all of their current products meet the statutory requirements of the FSPTCA, they cannot predict whether, when or how the FDA ultimately will apply its guidance to their various

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respective substantial equivalence reports or seek to enforce the law and regulations consistent with its guidance. The FDA began announcing its decisions on substantial equivalence reports for provisional cigarette, cigarette tobacco and smokeless tobacco products in 2013. There are a significant number of substantial equivalence reports for such products for which the FDA has not announced decisions, including reports submitted by our cigarette and smokeless tobacco subsidiaries. At the request of the FDA, our cigarette and smokeless tobacco subsidiaries have provided additional information with respect to certain substantial equivalence reports. At this time, it is not possible to predict how long reviews by the FDA of substantial equivalence reports or new tobacco product applications for any tobacco product will take. A “not substantially equivalent” determination or denial of a new tobacco product application on one or more products could have a material adverse impact on the business, consolidated results of operations, cash flows or financial position of Altria Group, Inc. and its tobacco subsidiaries.

In order to continue marketing Other Tobacco Products modified or introduced into the market for the first time between February 15, 2007 and August 8, 2016, manufacturers are required to send to the FDA a report demonstrating substantial equivalence by February 8, 2018 or a new tobacco product application by August 8, 2018. If a manufacturer does not obtain a “substantial equivalence order” from the FDA by February 8, 2019 or a “new tobacco product marketing order” from the FDA by August 8, 2019, the FDA could require the manufacturer to remove such product from the marketplace.

Because of the limited number of e-vapor products on the market as of February 14, 2007, Nu Mark may not be able to file substantial equivalence reports with the FDA on its e-vapor products in the market as of August 8, 2016. In such case, Nu Mark would have to file new tobacco product applications which, among other things, demonstrate that the marketing of the e-vapor products would be appropriate for the protection of the public health. It is uncertain how the FDA will interpret the requirements for obtaining a “new tobacco product marketing order.”

Manufacturers intending to first introduce new and certain modified cigarette, cigarette tobacco and smokeless tobacco products into the market after March 22, 2011 or intending to first introduce new and certain modified Other Tobacco Products into the market after August 8, 2016, must submit a substantial equivalence report to the FDA and obtain a “substantial equivalence order” from the FDA or submit a new tobacco product application to the FDA and obtain a “new tobacco product marketing order” from the FDA before introducing the products into the market.

In March 2015, the FDA issued a document entitled “Guidance for Industry: Demonstrating the Substantial Equivalence of a New Tobacco Product: Responses to Frequently Asked Questions” (“Substantial Equivalence Guidance”). In that document, the FDA announced that (i)

certain label changes and (ii) changes to the quantity of tobacco product(s) in a package would each require submission of newly required substantial equivalence reports and authorization from the FDA prior to marketing tobacco products with such changes, even when the tobacco product itself is not changed. Our cigarette and smokeless tobacco subsidiaries market various products that fall within the scope of the Substantial Equivalence Guidance.

In April 2015, PM USA, USSTC and other tobacco product manufacturers filed a lawsuit in the U.S. District Court for the District of Columbia against the FDA, the United States Department of Health and Human Services, and the heads of both agencies seeking to declare these new requirements invalid and to enjoin defendants from enforcing them. In May 2015, the FDA announced that it was continuing to consider the Substantial Equivalence Guidance in light of comments received and that it would not enforce the requirements under such guidance until further notice. In light of the FDA’s announcement, the plaintiffs dismissed the pending lawsuit without prejudice in June 2015.

In September 2015, the FDA issued a second edition of the Substantial Equivalence Guidance (the “Revised SE Guidance”), which continued to require FDA pre-authorization for certain label changes and for product quantity changes. PM USA, USSTC and other tobacco product manufacturers filed a new lawsuit in the U.S. District Court for the District of Columbia against the same defendants named in the prior suit seeking to declare the requirements of the Revised SE Guidance invalid and to enjoin defendants from enforcing them. In October 2015, plaintiffs filed a motion for summary judgment. Defendants opposed the motion for summary judgment and moved to dismiss the complaint in December 2015. In August 2016, the court held that a modification to an existing product’s label does not result in a “new tobacco product” and therefore such a label change does not give rise to the substantial equivalence review process. Accordingly, the court vacated the Revised SE Guidance insofar as it pertains to label changes, but upheld the

guidance in all other respects, including its treatment of product quantity changes as modifications that give rise to a new tobacco product requiring substantial equivalence review. The parties did not appeal this decision, concluding the litigation.

Deeming Regulations: As discussed above under FSPTCA and FDA Regulation - The Regulatory Framework, in May 2016, the FDA issued final regulations for all Other Tobacco Products, imposing the FSPTCA regulatory framework on the tobacco products manufactured, marketed and sold by Middleton and Nu Mark. At the same time the FDA issued its final deeming regulations, it also amended the Final Tobacco Marketing Rule as described above in FSPTCA and FDA Regulation - Final Tobacco Marketing Rule. Under the new regulations, for Other Tobacco Products modified or introduced into the market for the first time between February 15, 2007 and August 8, 2016, manufacturers must

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demonstrate substantial equivalence to a product on the market as of February 15, 2007 or obtain a “new tobacco marketing order” by certain specified dates to continue marketing those products. For further details, see FSPTCA and FDA Regulation - FDA Regulatory Actions - Substantial Equivalence and Other New Product Processes/Pathways above.

Among the FSPTCA requirements that apply to Other Tobacco Products is a ban on descriptors, including “mild,” when used as descriptors of modified risk unless expressly authorized by the FDA. In May 2016, Middleton filed a lawsuit in the U.S. District Court for the District of Columbia against the FDA challenging the application of the descriptor ban on the use of the word “mild” as it relates to the “Black & Mild” trademark. In July 2016, the Department of Justice, on behalf of the FDA, informed Middleton that at present the FDA does not intend to bring an enforcement action against Middleton for the use of the term “mild” in the trademark “Black & Mild.” Consequently, Middleton dismissed its lawsuit without prejudice. If the FDA were to change its mind at some later date, Middleton would have the opportunity to make a submission to the FDA and ultimately, if necessary, to bring another lawsuit.

**Smokeless Tobacco Product Standard:** In January 2017, the FDA proposed a product standard for N-nitrosornicotine (NNN) levels in finished smokeless tobacco products. USSTC believes that the FDA has not adequately considered whether the proposed standard is technically achievable and further believes it would have a significant negative impact on farmers and manufacturers. USSTC is advocating for withdrawal of the proposed rule. If the FDA does not withdraw the rule, USSTC plans to submit comments. If the proposed rule as presently formulated were to become final and upheld in the courts, it could have a material adverse effect on the business, consolidated results of operations, cash flows or financial position of Altria Group, Inc. and USSTC.

**Good Manufacturing Practices:** The FSPTCA requires that the FDA promulgate good manufacturing practice regulations (referred to by the FDA as “Requirements for Tobacco Product Manufacturing Practice”) for tobacco product manufacturers, but does not specify a timeframe for such regulations.

### Excise Taxes

Tobacco products are subject to substantial excise taxes in the United States. Significant increases in tobacco-related taxes or fees have been proposed or enacted (including with respect to e-vapor products) and are likely to continue to be proposed or enacted at the federal, state and local levels within the United States.

Federal, state and local excise taxes have increased substantially over the past decade, far outpacing the rate of inflation. By way of example, in 2009, the federal excise tax on cigarettes increased from \$0.39 per pack to approximately \$1.01

per pack, in 2010, the New York state excise tax increased by \$1.60 to \$4.35 per pack and in October 2014, Philadelphia, Pennsylvania enacted a \$2.00 per pack local cigarette excise tax. Between the end of 1998 and February 23, 2017, the weighted-average state and certain local cigarette excise taxes increased from \$0.36 to \$1.61 per pack. During 2016, Pennsylvania, Louisiana and West Virginia enacted legislation to increase their cigarette excise taxes and California passed a ballot measure to increase its cigarette excise tax by \$2.00 per pack and impose corresponding increases on other tobacco products and e-vapor products. As of February 23, 2017, no state has increased its cigarette excise tax in 2017.

Tax increases are expected to continue to have an adverse impact on sales of the tobacco products of our tobacco subsidiaries through lower consumption levels and the potential shift in adult consumer purchases from the premium to the non-premium or discount segments or to other low-priced or low-taxed tobacco products or to counterfeit and contraband products. Such shifts may have an adverse impact on the sales volume and reported share performance of tobacco products of Altria Group, Inc.’s tobacco subsidiaries.

A majority of states currently tax smokeless tobacco products using an ad valorem method, which is calculated as a percentage of the price of the product, typically the wholesale price. This ad valorem method results in more tax being paid on premium products than is paid on lower-priced products of equal weight. Altria Group, Inc.’s subsidiaries support legislation to convert ad valorem taxes on smokeless tobacco to a weight-based methodology because, unlike the ad valorem tax, a weight-based tax subjects cans of equal weight to the same tax. As of February 23, 2017, the federal government, 23 states, Puerto Rico, Philadelphia, Pennsylvania and Cook County, Illinois have adopted a weight-based tax methodology for smokeless tobacco.

#### International Treaty on Tobacco Control

The World Health Organization's Framework Convention on Tobacco Control (the "FCTC") entered into force in February 2005. As of February 23, 2017, 179 countries, as well as the European Community, have become parties to the FCTC. While the United States is a signatory of the FCTC, it is not currently a party to the agreement, as the agreement has not been submitted to, or ratified by, the United States Senate. The FCTC is the first international public health treaty and its objective is to establish a global agenda for tobacco regulation with the purpose of reducing initiation of tobacco use and encouraging cessation. The treaty recommends (and in certain instances, requires) signatory nations to enact legislation that would, among other things: establish specific actions to prevent youth tobacco product use; restrict or eliminate all tobacco product advertising, marketing, promotion and sponsorship; initiate public education campaigns to inform the public about the health consequences of tobacco consumption and exposure to tobacco smoke and the benefits of quitting; implement regulations imposing product testing, disclosure and performance standards; impose health warning requirements on packaging; adopt measures intended to combat tobacco product smuggling and counterfeit tobacco

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products, including tracking and tracing of tobacco products through the distribution chain; and restrict smoking in public places.

There are a number of proposals currently under consideration by the governing body of the FCTC, some of which call for substantial restrictions on the manufacture, marketing, distribution and sale of tobacco products. In addition, the Protocol to Eliminate Illicit Trade in Tobacco Products (the “Protocol”) was approved by the Conference of Parties to the FCTC in November 2012. It includes provisions related to the tracking and tracing of tobacco products through the distribution chain and numerous other provisions regarding the regulation of the manufacture, distribution and sale of tobacco products. The Protocol has not yet entered into force, but in any event will not apply to the United States until the Senate ratifies the FCTC and until the President signs, and the Senate ratifies, the Protocol. It is not possible to predict the outcome of these proposals or the impact of any FCTC actions on legislation or regulation in the United States, either indirectly or as a result of the United States becoming a party to the FCTC, or whether or how these actions might indirectly influence FDA regulation and enforcement.

### State Settlement Agreements

As discussed in Note 19, during 1997 and 1998, PM USA and other major domestic tobacco product manufacturers entered into the State Settlement Agreements. These settlements require participating manufacturers to make substantial annual payments, which are adjusted for several factors, including inflation, operating income, market share and industry volume. For a discussion of the impact of the State Settlement Agreements on Altria Group, Inc., see Financial Review - Off-Balance Sheet Arrangements and Aggregate Contractual Obligations - Payments Under State Settlement Agreements, FETRA and FDA Regulation below and Note 19. The State Settlement Agreements also place numerous requirements and restrictions on participating manufacturers’ business operations, including prohibitions and restrictions on the advertising and marketing of cigarettes and smokeless tobacco products. Among these are prohibitions of outdoor and transit brand advertising, payments for product placement and free sampling (except in adult-only facilities). Restrictions are also placed on the use of brand name sponsorships and brand name non-tobacco products. The State Settlement Agreements also place prohibitions on targeting youth and the use of cartoon characters. In addition, the State Settlement Agreements require companies to affirm corporate principles directed at reducing underage use of cigarettes; impose requirements regarding lobbying activities; mandate public disclosure of certain industry documents; limit the industry’s ability to challenge certain tobacco control and underage use laws; and provide for the dissolution of certain tobacco-related organizations and place restrictions on the establishment of any replacement organizations.

In November 1998, USSTC entered into the Smokeless Tobacco Master Settlement Agreement (the “STMSA”) with the attorneys general of various states and United States territories to resolve the remaining health care cost reimbursement cases

initiated against USSTC. The STMSA required USSTC to adopt various marketing and advertising restrictions.

USSTC is the only smokeless tobacco manufacturer to sign the STMSA.

### Other Federal, State and Local Regulation and Activity

**Federal, State and Local Regulation:** A number of states and localities have enacted or proposed legislation that imposes restrictions on tobacco products (including innovative tobacco products, such as e-vapor products), such as legislation that (1) prohibits the sale of certain tobacco products with certain characterizing flavors, (2) requires the disclosure of health information separate from or in addition to federally-mandated health warnings and (3) restricts commercial speech or imposes additional restrictions on the marketing or sale of tobacco products (including proposals to ban all tobacco product sales). The legislation varies in terms of the type of tobacco products, the conditions under which such products are or would be restricted or prohibited, and exceptions to the restrictions or prohibitions. For example, a number of proposals involving characterizing flavors would prohibit smokeless tobacco products with characterizing flavors without providing an exception for mint- or wintergreen-flavored products. Whether other states or localities will enact legislation in these areas, and the precise nature of such legislation if enacted, cannot be predicted. Altria Group, Inc.’s tobacco subsidiaries have challenged and will continue to challenge certain state and local legislation, including through litigation.

State and Local Legislation to Increase the Legal Age to Purchase Tobacco Products: An increasing number of states and localities have proposed legislation to increase the minimum age to purchase tobacco products above the current Federal minimum age of 18. The following states have enacted such legislation: California (21), Hawaii (21), Alabama (19), Alaska (19), New Jersey (19) and Utah (19). Various localities (such as New York City (21) and Chicago (21)) have taken similar actions.

Health Effects of Tobacco Consumption and Exposure to Environmental Tobacco Smoke (“ETS”): Altria Group, Inc. and its tobacco subsidiaries believe that the public should be guided by the messages of the United States Surgeon General and public health authorities worldwide in making decisions concerning the use of tobacco products. Reports with respect to the health effects of smoking have been publicized for many years, including in a January 2014 United States Surgeon General report titled “The Health Consequences of Smoking - 50 Years of Progress” and in a June 2006 United States Surgeon General report on ETS titled “The Health Consequences of Involuntary Exposure to Tobacco Smoke.”

Most jurisdictions within the United States have restricted smoking in public places. Some public health groups have called for, and various jurisdictions have adopted or proposed, bans on smoking in outdoor places, in private apartments and in cars transporting minors. It is not possible to predict the results of ongoing scientific research or the types of future scientific research into the health risks of tobacco exposure and the impact of such research on regulation.

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**Other Legislation or Governmental Initiatives:** In addition to the actions discussed above, other regulatory initiatives affecting the tobacco industry have been adopted or are being considered at the federal level and in a number of state and local jurisdictions. For example, in recent years, legislation has been introduced or enacted at the state or local level to subject tobacco products to various reporting requirements and performance standards (such as reduced cigarette ignition propensity standards); establish educational campaigns relating to tobacco consumption or tobacco control programs, or provide additional funding for governmental tobacco control activities; restrict the sale of tobacco products in certain retail establishments and the sale of tobacco products in certain package sizes; require tax stamping of MST products; require the use of state tax stamps using data encryption technology; and further restrict the sale, marketing and advertising of cigarettes and other tobacco products. Such legislation may be subject to constitutional or other challenges on various grounds, which may or may not be successful.

It is not possible to predict what, if any, additional legislation, regulation or other governmental action will be enacted or implemented (and, if challenged, upheld) relating to the manufacturing, design, packaging, marketing, advertising, sale or use of tobacco products, or the tobacco industry generally. It is possible, however, that legislation, regulation or other governmental action could be enacted or implemented that could have a material adverse impact on the business and volume of our tobacco subsidiaries and the consolidated results of operations, cash flows or financial position of Altria Group, Inc. and its tobacco subsidiaries.

**Governmental Investigations:** From time to time, Altria Group, Inc. and its subsidiaries are subject to governmental investigations on a range of matters. Altria Group, Inc. and its subsidiaries cannot predict whether new investigations may be commenced.

### **Illicit Trade in Tobacco Products**

Illicit trade in tobacco products can have an adverse impact on the businesses of Altria Group, Inc. and its tobacco subsidiaries. Illicit trade can take many forms, including the sale of counterfeit tobacco products; the sale of tobacco products in the United States that are intended for sale outside the country; the sale of tobacco products over the Internet and by other means designed to avoid the collection of applicable taxes; and diversion into one taxing jurisdiction of tobacco products intended for sale in another. Counterfeit tobacco products, for example, are manufactured by unknown third parties in unregulated environments. Counterfeit versions of our tobacco subsidiaries' products can negatively affect adult tobacco consumer experiences with and opinions of those brands. Illicit trade in tobacco products also harms law-abiding wholesalers and retailers by depriving them of lawful sales and undermines the significant investment Altria Group, Inc.'s tobacco subsidiaries have made in legitimate distribution channels. Moreover, illicit trade in tobacco products results in federal, state and local governments losing tax revenues. Losses in tax revenues can cause such governments to

take various actions, including increasing excise taxes; imposing legislative or regulatory requirements that may adversely impact Altria Group, Inc.'s consolidated results of operations and cash flows and the businesses of its tobacco subsidiaries; or asserting claims against manufacturers of tobacco products or members of the trade channels through which such tobacco products are distributed and sold.

Altria Group, Inc. and its tobacco subsidiaries devote significant resources to help prevent illicit trade in tobacco products and to protect legitimate trade channels. For example, Altria Group, Inc.'s tobacco subsidiaries are engaged in a number of initiatives to help prevent illicit trade in tobacco products, including communication with wholesale and retail trade members regarding illicit trade in tobacco products and how they can help prevent such activities; enforcement of wholesale and retail trade programs and policies that address illicit trade in tobacco products; engagement with and support of law enforcement and regulatory agencies; litigation to protect their trademarks; and support for a variety of federal and state legislative initiatives. Legislative initiatives to address illicit trade in tobacco products are designed to protect the legitimate channels of distribution, impose more stringent penalties for the violation of illegal trade laws and provide additional tools for law enforcement. Regulatory measures and related governmental actions to prevent the illicit manufacture and trade of tobacco products continue to evolve as the nature of illicit tobacco products evolves.

### **Price, Availability and Quality of Agricultural Products**

Shifts in crops (such as those driven by economic conditions and adverse weather patterns), government mandated prices, economic trade sanctions, geopolitical instability and production control programs may increase or decrease the cost or reduce the supply or quality of tobacco and other agricultural products used to manufacture our companies' products. As with other agriculture commodities, the price of tobacco leaf can be influenced by economic conditions and imbalances in supply and demand and crop quality and availability can be influenced by variations in weather patterns, including those caused by climate change. Certain types of tobacco are also only available in limited geographies. Tobacco production in certain countries is subject to a variety of controls, including government mandated prices and production control programs. Changes in the patterns of demand for agricultural products and the cost of tobacco production could impact tobacco leaf prices and tobacco supply. Certain types of tobacco are available in limited geographies and loss of their availability could impact adult tobacco consumer product acceptability. Any significant change in the price, quality or availability of tobacco leaf or other agricultural products used to manufacture our products could impact adult consumer product acceptability and adversely affect our subsidiaries' profitability and businesses.

#### Timing of Sales

In the ordinary course of business, our tobacco subsidiaries are subject to many influences that can impact the timing of sales to

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customers, including the timing of holidays and other annual or special events, the timing of promotions, customer incentive programs and customer inventory programs, as well as the actual or speculated timing of pricing actions and tax-driven price increases.

**Operating Results**

The following table summarizes operating results for the smokeable and smokeless products segments:

(in millions)	For the Years Ended December 31,					
	Net Revenues			Operating Companies Income		
	2016	2015	2014	2016	2015	2014
Smokeable products	\$22,851	\$22,792	\$21,939	\$7,768	\$7,569	\$6,873
Smokeless products	2,051	1,879	1,809	1,177	1,108	1,061
Total smokeable and smokeless products	\$24,902	\$24,671	\$23,748	\$8,945	\$8,677	\$7,934

**Smokeable Products Segment**

The smokeable products segment's operating companies income and operating companies income margin increased during 2016 due primarily to higher pricing. PM USA grew total cigarettes retail share by 0.1 percentage point for 2016.

The following table summarizes the smokeable products segment shipment volume performance:

(sticks in millions)	Shipment Volume		
	For the Years Ended		
	December 31,		
	2016	2015	2014
<b>Cigarettes:</b>			
Marlboro	105,297	108,113	108,023
Other premium	6,382	6,753	7,047
Discount	11,251	11,152	10,320
Total cigarettes	122,930	126,018	125,390
<b>Cigars:</b>			
Black & Mild	1,379	1,295	1,246
Other	24	30	25
Total cigars	1,403	1,325	1,271
Total smokeable products	124,333	127,343	126,661

Cigarettes shipment volume includes Marlboro; Other premium brands, such as Virginia Slims, Parliament and Benson & Hedges; and Discount brands, which include L&M and Basic. Cigarettes volume includes units sold as well as promotional units, but excludes units sold for distribution to and in Puerto Rico, and units sold in U.S. Territories, to overseas military and by Philip Morris Duty Free Inc., none of which, individually or in the aggregate, is material to the smokeable products segment.

The following table summarizes the smokeable products segment retail share performance:

	Retail Share		
	For the Years Ended		
	December 31,		
	2016	2015	2014
<b>Cigarettes:</b>			
Marlboro	44.0 %	44.0 %	43.8 %
Other premium	2.7	2.8	2.9
Discount	4.7	4.5	4.2
Total cigarettes	51.4 %	51.3 %	50.9 %
<b>Cigars:</b>			
Black & Mild	26.3 %	27.3 %	28.3 %

Other	0.4	0.3	0.4
Total cigars	26.7 %	27.6 %	28.7 %

Retail share results for cigarettes are based on data from IRI/Management Science Associate Inc., a tracking service that uses a sample of stores and certain wholesale shipments to project market share and depict share trends. Retail share results for cigars are based on data from IRI InfoScan, a tracking service that uses a sample of stores to project market share and depict share trends. Both services track sales in the food, drug and mass merchandisers (including Wal-Mart), convenience, military, dollar store and club trade classes. For other trade classes selling cigarettes, retail share is based on shipments from wholesalers to retailers through the Store Tracking Analytical Reporting System (“STARS”). These services are not designed to capture sales through other channels, including the internet, direct mail and some illicitly tax-advantaged outlets. Retail share results for cigars are based on data for machine-made large cigars. Middleton defines machine-made large cigars as cigars, made by machine, that weigh greater than three pounds per thousand, except cigars sold at retail in packages of 20 cigars. Because the cigars service represents retail share performance only in key trade channels, it should not be considered a precise measurement of actual retail share. It is IRI’s standard practice to periodically refresh its services, which could restate retail share results that were previously released in these services.

PM USA executed the following pricing and promotional allowance actions during 2016, 2015 and 2014:

Effective November 13, 2016, PM USA reduced its wholesale promotional allowance on Marlboro by \$0.02 per pack and L&M by \$0.08 per pack. In addition, PM USA increased the list price on Marlboro by \$0.06 per pack and on all of its other cigarette brands by \$0.08 per pack, except for L&M, which had no list price change.

Effective May 15, 2016, PM USA increased the list price on all of its cigarette brands by \$0.07 per pack.

Effective November 15, 2015, PM USA increased the list price on all of its cigarette brands by \$0.07 per pack.

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Effective May 17, 2015, PM USA increased the list price on all of its cigarette brands by \$0.07 per pack.

Effective November 16, 2014, PM USA reduced its wholesale promotional allowance on L&M by \$0.07 per pack. In addition, PM USA increased the list price on all of its other cigarette brands by \$0.07 per pack.

Effective May 11, 2014, PM USA reduced its wholesale promotional allowance on Marlboro and L&M by \$0.06 per pack. In addition, PM USA increased the list price on all of its other cigarette brands by \$0.06 per pack, except for Parliament, which PM USA increased by \$0.11 per pack.

The following discussion compares operating results for the smokeable products segment for the year ended December 31, 2016 with the year ended December 31, 2015.

Net revenues, which include excise taxes billed to customers, increased \$59 million (0.3%), due primarily to higher pricing, which includes higher promotional investments, partially offset by lower shipment volume (\$577 million). Operating companies income increased \$199 million (2.6%), due primarily to higher pricing, which includes higher promotional investments, lower costs (due primarily to lower pension and benefit costs) and lower tobacco and health litigation items (\$39 million). These factors were partially offset by lower shipment volume (\$298 million), higher per unit settlement charges, costs in connection with the productivity initiative and facilities consolidation (\$134 million) and NPM Adjustment Items in 2015 (\$97 million).

Marketing, administration and research costs for the smokeable products segment include PM USA's cost of administering and litigating product liability claims. Litigation defense costs are influenced by a number of factors, including the number and types of cases filed, the number of cases tried annually, the results of trials and appeals, the development of the law controlling relevant legal issues, and litigation strategy and tactics. For further discussion on these matters, see Note 19 and Item 3. For the years ended December 31, 2016, 2015 and 2014, product liability defense costs for PM USA were \$234 million, \$228 million and \$230 million, respectively. The factors that have influenced past product liability defense costs are expected to continue to influence future costs. PM USA does not expect future product liability defense costs to be significantly different from product liability defense costs incurred in the last few years.

Total smokeable products reported shipment volume decreased 2.4%. PM USA's reported and adjusted domestic cigarettes shipment volume decreased approximately 2.5% driven primarily by the industry's rate of decline. PM USA estimates that full-year total industry cigarette volumes also declined by approximately 2.5%.

PM USA's shipments of premium cigarettes accounted for 90.8% of its reported domestic cigarettes shipment volume for 2016, versus 91.2% for 2015.

Middleton's reported cigars shipment volume increased 5.9%, driven primarily by Black & Mild in the tipped cigars segment.

Marlboro's retail share was unchanged in 2016. PM USA grew its total retail share 0.1 share point.

In the machine-made large cigars category, Black & Mild's retail share declined 1.0 share point.

The following discussion compares operating results for the smokeable products segment for the year ended December 31, 2015 with the year ended December 31, 2014.

Net revenues, which include excise taxes billed to customers, increased \$853 million (3.9%), due primarily to higher pricing, which includes higher promotional investments, and higher shipment volume (\$133 million).

Operating companies income increased \$696 million (10.1%), due primarily to higher pricing, which includes higher promotional investments, lower resolution expenses (due principally to the end of the federal tobacco quota buy-out payments after the third quarter of 2014), higher shipment volume (\$68 million) and higher NPM Adjustment Items in 2015 (\$54 million). These factors were partially offset by higher costs (due primarily to higher pension and benefit costs, and marketing, administration and research costs) and higher tobacco and health litigation items (\$100 million). Total smokeable products reported shipment volume increased 0.5%. PM USA's reported domestic cigarettes shipment volume increased 0.5%, due to a moderation in the industry's decline rate and retail share gains. When adjusted for trade inventory movements and other factors, PM USA estimates that its domestic cigarettes shipment volume increased approximately 0.5%, and that total industry cigarette volumes declined approximately 0.5%.

PM USA's shipments of premium cigarettes accounted for 91.2% of its reported domestic cigarettes shipment volume for 2015, versus 91.8% for 2014.

Middleton's reported cigars shipment volume increased 4.2%, driven primarily by Black & Mild in the tipped cigars segment.

Marlboro's retail share increased 0.2 share points.

PM USA grew its total retail share by 0.4 share points, due to gains by Marlboro and L&M in Discount, partially offset by share losses on other portfolio brands.

In the machine-made large cigars category, while Black & Mild's retail share declined 1.0 share point, Black & Mild gained retail share in the more profitable tipped cigars segment.

#### Smokeless Products Segment

During 2016, the smokeless products segment grew net revenues and operating companies income, primarily through higher shipment volume and higher pricing. USSTC increased Copenhagen and Skoal's combined retail share versus 2015.

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The following table summarizes smokeless products segment shipment volume performance:

	Shipment Volume For the Years Ended December 31,		
(cans and packs in millions)	2016	2015	2014
Copenhagen	525.1	474.7	448.6
Skoal	260.9	267.9	269.6
Copenhagen and Skoal	786.0	742.6	718.2
Other	67.5	70.9	75.1
Total smokeless products	853.5	813.5	793.3

Smokeless products shipment volume includes cans and packs sold, as well as promotional units, but excludes international volume, which is not material to the smokeless products segment. New types of smokeless products, as well as new packaging configurations of existing smokeless products, may or may not be equivalent to existing MST products on a can-for-can basis. To calculate volumes of cans and packs shipped, one pack of snus, irrespective of the number of pouches in the pack, is assumed to be equivalent to one can of MST.

The following table summarizes smokeless products segment retail share performance (excluding international volume):

	Retail Share For the Years Ended December 31,		
	2016	2015	2014
Copenhagen	33.8 %	31.6 %	30.7 %
Skoal	18.4	19.7	20.3
Copenhagen and Skoal	52.2	51.3	51.0
Other	3.4	3.6	4.0
Total smokeless products	55.6 %	54.9 %	55.0 %

Retail share results for smokeless products are based on data from IRI InfoScan, a tracking service that uses a sample of stores to project market share and depict share trends. The service tracks sales in the food, drug and mass merchandisers (including Wal-Mart), convenience, military, dollar store and club trade classes on the number of cans and packs sold. Smokeless products is defined by IRI as moist smokeless and spit-free tobacco products. New types of smokeless products, as well as new packaging configurations of existing smokeless products, may or may not be equivalent to existing MST products on a can-for-can basis. For example, one pack of snus, irrespective of the number of pouches in the pack, is assumed to be equivalent to one can of MST. Because this service represents retail share performance only in key trade channels, it should not be considered a precise measurement of actual retail share. It is IRI's standard practice to periodically refresh its InfoScan services, which could restate retail share results that were previously released in this service.

USSTC executed the following pricing actions during 2016, 2015 and 2014:

Effective December 6, 2016, USSTC increased the list price on Copenhagen and Skoal popular price products by \$0.12 per can. In addition, USSTC increased the list price on all its brands, except for Copenhagen and Skoal popular price products, by \$0.07 per can.

Effective May 10, 2016, USSTC increased the list price on all its brands by \$0.07 per can.

Effective December 8, 2015, USSTC increased the list price on Copenhagen and Skoal popular price products by \$0.12 per can. In addition, USSTC increased the list price on all its brands, except for Copenhagen and Skoal popular price products, by \$0.07 per can.

Effective May 5, 2015, USSTC increased the list price on all its brands by \$0.07 per can.

Effective November 25, 2014, USSTC increased the list price on all its brands by \$0.07 per can.

Effective May 11, 2014, USSTC increased the list price on all of its brands by \$0.06 per can.

The following discussion compares operating results for the smokeless products segment for the year ended December 31, 2016 with the year ended December 31, 2015.

Net revenues, which include excise taxes billed to customers, increased \$172 million (9.2%), due primarily to higher shipment volume (\$111 million) and higher pricing, which includes higher promotional investments, partially offset by mix due to growth in popular price products.

Operating companies income increased \$69 million (6.2%), due primarily to higher shipment volume (\$98 million) and higher pricing, which includes higher promotional investments, partially offset by costs in connection with the productivity initiative and facilities consolidation (\$57 million), product mix, higher marketing, administration and research costs and higher manufacturing costs.

The smokeless products segment's reported domestic shipment volume increased 4.9%, driven by Copenhagen, partially offset by declines in Skoal and Other portfolio brands. Copenhagen and Skoal's combined reported domestic shipment volume increased 5.8%.

After adjusting for trade inventory movements and other factors, USSTC estimates that its domestic smokeless products shipment volume grew approximately 5% for 2016. USSTC estimates that the smokeless products category volume grew approximately 2.5% over the six months ended December 31, 2016.

Copenhagen and Skoal's combined retail share increased 0.9 share points to 52.2%. Copenhagen's retail share increased 2.2 share points and Skoal's retail share declined 1.3 share points.

Total smokeless products retail share increased 0.7 share points to 55.6%.

The following discussion compares operating results for the smokeless products segment for the year ended December 31, 2015 with the year ended December 31, 2014.

Net revenues, which include excise taxes billed to customers, increased \$70 million (3.9%), due primarily to higher pricing, which includes higher promotional investments.

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Operating companies income increased \$47 million (4.4%), due primarily to higher pricing, which includes higher promotional investments, partially offset by higher costs.

The smokeless products segment's reported domestic shipment volume increased 2.5% as volume growth in Copenhagen was partially offset by declines in Skoal and Other portfolio brands. Copenhagen and Skoal's combined reported domestic shipment volume increased 3.4%.

After adjusting for trade inventory movements and other factors, USSTC estimates that its domestic smokeless products shipment volume grew approximately 2.5% for 2015. USSTC estimates that the smokeless products category volume grew approximately 2.5% over the six months ended December 31, 2015 as compared with approximately 2.0% for the six months ended December 31, 2014.

Copenhagen and Skoal's combined retail share increased 0.3 share points to 51.3%. Copenhagen's retail share increased 0.9 share points and Skoal's retail share declined 0.6 share points.

Total smokeless products retail share declined 0.1 share point to 54.9%.

Wine Segment

Business Environment

Ste. Michelle is a leading producer of Washington state wines, primarily Chateau Ste. Michelle, Columbia Crest and 14 Hands, and owns wineries in or distributes wines from several other domestic and foreign wine regions. Ste. Michelle holds an 85% ownership interest in Michelle-Antinori, LLC, which owns Stag's Leap Wine Cellars in Napa Valley. Ste. Michelle also owns Conn Creek in Napa Valley, Patz & Hall in Sonoma and Erath in Oregon. In addition, Ste. Michelle imports and markets Antinori, Torres and Villa Maria Estate wines and Champagne Nicolas Feuillatte in the United States. Key elements of Ste. Michelle's strategy are expanded domestic distribution of its wines, especially in certain account categories such as restaurants, wholesale clubs, supermarkets, wine shops and mass merchandisers, and a focus on improving product mix to higher-priced, premium products.

Ste. Michelle's business is subject to significant competition, including competition from many larger, well-established domestic and international companies, as well as from many smaller wine producers. Wine segment competition is primarily based on quality, price, consumer and trade wine tastings, competitive wine judging, third-party acclaim and advertising. Substantially all of Ste. Michelle's sales occur in the United States through state-licensed distributors. Ste. Michelle also sells to domestic consumers through retail and e-commerce channels and exports wines to international distributors.

Federal, state and local governmental agencies regulate the beverage alcohol industry through various means, including licensing requirements, pricing rules, labeling and advertising restrictions, and distribution and production policies. Further regulatory restrictions or additional excise or other taxes on the manufacture and sale of alcoholic beverages may have an adverse effect on Ste. Michelle's wine business.

Operating Results

Ste. Michelle's net revenues and operating companies income increased in 2016, due primarily to higher shipment volume. The following table summarizes operating results for the wine segment:

	For the Years Ended December 31,		
(in millions)	2016	2015	2014
Net revenues	\$746	\$692	\$643
Operating companies income	\$164	\$152	\$134

The following discussion compares operating results for the wine segment for the year ended December 31, 2016 with the year ended December 31, 2015.

Net revenues, which include excise taxes billed to customers, increased \$54 million (7.8%), due primarily to higher shipment volume. Operating companies income increased \$12 million (7.9%), due primarily to higher shipment volume and improved premium mix, partially offset by higher costs.

For 2016, Ste. Michelle's reported wine shipment volume of 9,333 thousand cases grew 5.3%, driven primarily by growth among its core premium brands.

The following discussion compares operating results for the wine segment for the year ended December 31, 2015 with the year ended December 31, 2014.

Net revenues, which include excise taxes billed to customers, increased \$49 million (7.6%), due primarily to higher shipment volume and improved premium mix. Operating companies income increased \$18 million (13.4%), due primarily to higher shipment volume and improved premium mix, partially offset by higher costs.

For 2015, Ste. Michelle's reported wine shipment volume of 8,866 thousand cases increased 6.2%.

#### Financial Review

##### Net Cash Provided by Operating Activities

During 2016, net cash provided by operating activities was \$3.8 billion compared with \$5.8 billion during 2015. This decrease was due primarily to the following:

- income taxes paid on both the cash proceeds from the Transaction and gains from exercising derivative financial instruments associated with the Transaction in 2016; and
- voluntary contributions totaling \$500 million to Altria Group, Inc.'s pension plans during 2016;

partially offset by:

- higher cumulative dividends received from AB InBev and SABMiller in 2016.

During 2015, net cash provided by operating activities was \$5.8 billion compared with \$4.7 billion during 2014. This increase was due primarily to the following:

- higher net revenues in the smokeable products segment in 2015; and

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the end of the federal tobacco quota buy-out payments after the third quarter of 2014;

partially offset by:

higher settlement payments during 2015, driven by the impact of NPM Adjustment Items in 2014.

Altria Group, Inc. had a working capital deficit at December 31, 2016 and 2015. Altria Group, Inc.'s management believes that it has the ability to fund these working capital deficits with cash provided by operating activities and/or short-term borrowings under its commercial paper program as discussed in the Debt and Liquidity section below.

Net Cash Provided by/Used in Investing Activities

During 2016, net cash provided by investing activities was \$3.7 billion compared with net cash used in investing activities of \$15 million during 2015. This change was due primarily to the following:

proceeds of \$4.8 billion from the Transaction during 2016; and

proceeds of \$0.5 billion from exercising derivative financial instruments associated with the Transaction during 2016;

partially offset by:

payment of approximately \$1.6 billion for the purchase of ordinary shares of AB InBev during 2016.

During 2015, net cash used in investing activities was \$15 million compared with net cash provided by investing activities of \$177 million during 2014. This change was due primarily to the following:

\$132 million payment for a derivative financial instrument during 2015;

the sale of PM USA's Cabarrus, North Carolina manufacturing facility during 2014; and

higher capital expenditures during 2015, due primarily to a new USSTC manufacturing facility in Hopkinsville, Kentucky that was completed in 2016;

partially offset by:

Nu Mark's acquisition of the e-vapor business of Green Smoke during 2014.

Capital expenditures for 2016 decreased 17.5% to \$189 million, due primarily to higher capital expenditures during 2015 for the new USSTC manufacturing facility noted above. Capital expenditures for 2017 are expected to be in the range of \$180 million to \$220 million, and are expected to be funded from operating cash flows. The increase in expected capital expenditures in 2017 compared with 2016 is due primarily to spending related to the facilities consolidation.

Net Cash Used in Financing Activities

During 2016, net cash used in financing activities was \$5.3 billion compared with \$6.7 billion during 2015. This decrease was due primarily to the following:

debt issuance of \$2.0 billion of senior unsecured notes used in part to repurchase senior unsecured notes in connection with the 2016 debt tender offer, as more fully described in Note 10; and

\$1.0 billion repayment of Altria Group, Inc. senior unsecured notes at scheduled maturity in 2015;

partially offset by:

higher premiums, fees and repayments of debt in connection with debt tender offers during 2016;

higher share repurchases during 2016; and

higher dividends paid during 2016.

During 2015, net cash used in financing activities was \$6.7 billion compared with \$4.7 billion during 2014. This increase was due primarily to the following:

debt tender offer completed during 2015, which resulted in the repurchase of \$793 million of senior unsecured notes and a \$226 million payment of premiums and fees, as more fully described in Note 10;

\$1.0 billion repayment of Altria Group, Inc. senior unsecured notes at scheduled maturity in 2015;

debt issuance of \$1.0 billion in 2014; and

higher dividends paid during 2015;

partially offset by:

\$525 million repayment of Altria Group, Inc. senior unsecured notes at scheduled maturity in 2014;

lower share repurchases during 2015; and

full redemption of UST senior notes of \$300 million in 2014.

Debt and Liquidity

Credit Ratings - Altria Group, Inc.'s cost and terms of financing and its access to commercial paper markets may be impacted by applicable credit ratings. As a result of credit rating upgrades by both Moody's Investors Service, Inc. ("Moody's") and Standard & Poor's Ratings Services ("Standard & Poor's") in the first quarter of 2016, the provision in certain of Altria Group, Inc.'s senior unsecured notes issued in 2008 and 2009 that required an adjustment to the cost of borrowings upon a change in credit rating terminated in accordance with its terms. The impact of credit ratings on the cost of borrowings under Altria Group, Inc.'s credit agreement is discussed below. See the discussion in Item 1A regarding the potential adverse impact of certain events on Altria Group, Inc.'s credit ratings.

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At December 31, 2016, the credit ratings and outlook for Altria Group, Inc.'s indebtedness by major credit rating agencies were:

	Short-term Debt	Long-term Debt	Outlook
Moody's <sup>1</sup>	P-2	A3	Stable
Standard & Poor's <sup>2</sup>	A-1	A-	Stable
Fitch Ratings Ltd.	F2	BBB+	Stable

<sup>1</sup> On March 9, 2016, Moody's raised the long-term debt credit rating for Altria Group, Inc. to A3 from Baa1.

<sup>2</sup> On March 30, 2016, Standard & Poor's raised the long-term debt credit rating for Altria Group, Inc. to A- from BBB+ and the short-term debt credit rating for Altria Group, Inc. to A-1 from A-2.

Credit Lines - From time to time, Altria Group, Inc. has short-term borrowing needs to meet its working capital requirements and generally uses its commercial paper program to meet those needs. At December 31, 2016, 2015 and 2014, Altria Group, Inc. had no short-term borrowings.

At December 31, 2016, Altria Group, Inc. had in place a senior unsecured 5-year revolving credit agreement (the "Credit Agreement"). The Credit Agreement provides for borrowings up to an aggregate principal amount of \$3.0 billion and expires August 19, 2020.

Pricing for interest and fees under the Credit Agreement may be modified in the event of a change in the rating of Altria Group, Inc.'s senior unsecured long-term debt. Interest rates on borrowings under the Credit Agreement are expected to be based on the London Interbank Offered Rate ("LIBOR") plus a percentage based on the higher of the ratings of Altria Group, Inc.'s long-term senior unsecured debt from Moody's and Standard & Poor's. The applicable percentage based on Altria Group, Inc.'s long-term senior unsecured debt ratings at December 31, 2016 for borrowings under the Credit Agreement was 1.125%. The Credit Agreement does not include any other rating triggers, nor does it contain any provisions that could require the posting of collateral. At December 31, 2016, credit available to Altria Group, Inc. under the Credit Agreement was \$3.0 billion.

The Credit Agreement is used for general corporate purposes and to support Altria Group, Inc.'s commercial paper issuances. The Credit Agreement requires that Altria Group, Inc. maintain (i) a ratio of debt to consolidated earnings before interest, taxes, depreciation and amortization ("EBITDA") of not more than 3.0 to 1.0 and (ii) a ratio of consolidated EBITDA to consolidated interest expense of not less than 4.0 to 1.0, each calculated as of the end of the applicable quarter on a rolling four quarters basis.

At December 31, 2016, the ratios of debt to consolidated EBITDA and consolidated EBITDA to consolidated interest expense, calculated in accordance with the Credit Agreement, were 1.4 to 1.0 and 13.5 to 1.0, respectively. Altria Group, Inc. expects to continue to meet its covenants associated with the Credit Agreement. The terms "consolidated EBITDA," "debt" and "consolidated interest expense," as defined in the Credit Agreement, include certain adjustments. Exhibit 99.3 to Altria Group, Inc.'s Quarterly Report on Form 10-Q for the period ended September 30, 2013 sets forth the definitions of these terms as they appear in the Credit Agreement and is incorporated herein by reference.

Any commercial paper issued by Altria Group, Inc. and borrowings under the Credit Agreement are guaranteed by PM USA as further discussed in Note 20. Condensed Consolidating Financial Information to the consolidated financial statements in Item 8 ("Note 20").

Financial Market Environment - Altria Group, Inc. believes it has adequate liquidity and access to financial resources to meet its anticipated obligations and ongoing business needs in the foreseeable future. Altria Group, Inc. continues to monitor the credit quality of its bank group and is not aware of any potential non-performing credit provider in that group. Altria Group, Inc. believes the lenders in its bank group will be willing and able to advance funds in accordance with their legal obligations. See Item 1A for certain risk factors associated with the foregoing discussion. Debt - At December 31, 2016 and 2015, Altria Group, Inc.'s total debt was \$13.9 billion and \$12.8 billion, respectively.

During 2016, Altria Group, Inc. issued \$0.5 billion aggregate principal amount of 2.625% senior unsecured notes due 2026 and \$1.5 billion aggregate principal amount of 3.875% senior unsecured notes due 2046. In addition, during 2016, Altria Group, Inc. completed a debt tender offer to purchase for cash certain of its senior unsecured notes in the

aggregate principal amount of \$933 million.

All of Altria Group, Inc.'s debt was fixed-rate debt at December 31, 2016 and 2015. The weighted-average coupon interest rate on total debt was approximately 4.9% and

5.5% at December 31, 2016 and 2015, respectively.

For further details on long-term debt, see Note 10.

In October 2014, Altria Group, Inc. filed a registration statement on Form S-3 with the SEC, under which Altria Group, Inc. may offer debt securities or warrants to purchase debt securities from time to time over a three-year period from the date of filing.

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## Off-Balance Sheet Arrangements and Aggregate Contractual Obligations

Altria Group, Inc. has no off-balance sheet arrangements, including special purpose entities, other than guarantees and contractual obligations that are discussed below.

Guarantees and Other Similar Matters - As discussed in Note 19, Altria Group, Inc. and certain of its subsidiaries had unused letters of credit obtained in the ordinary course of business, guarantees (including third-party guarantees) and a redeemable noncontrolling interest outstanding at December 31, 2016. From time to time, subsidiaries of Altria Group, Inc. also issue lines of credit to affiliated entities. In addition, as discussed in Note 20, PM USA has issued guarantees relating to Altria Group, Inc.'s obligations under its outstanding debt securities, borrowings under the Credit Agreement and amounts outstanding under its commercial paper program. These items have not had, and are not expected to have, a significant impact on Altria Group, Inc.'s liquidity.

Aggregate Contractual Obligations - The following table summarizes Altria Group, Inc.'s contractual obligations at December 31, 2016:

(in millions)	Payments Due				
	Total	2017	2018 - 2019	2020 - 2021	2022 and Thereafter
Long-term debt <sup>(1)</sup>	\$ 14,017	\$ —	\$ 2,008	\$ 2,500	\$ 9,509
Interest on borrowings <sup>(2)</sup>	9,096	693	1,303	933	6,167
Operating leases <sup>(3)</sup>	259	52	81	54	72
Purchase obligations: <sup>(4)</sup>					
Inventory and production costs	3,118	968	1,211	499	440
Other	807	588	186		