ALTRIA GROUP, INC.
Form 10-Q
November 09, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2006

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission file number 1-8940

Altria Group, Inc.

(Exact name of registrant as specified in its charter)

Virginia	**13-3260245**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
120 Park Avenue, New York, New York	**10017**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code (917) 663-4000

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

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

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

filer x Accelerated filer ¨ Non-accelerated filer ¨

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

At October 31, 2006, there were 2,095,880,572 shares outstanding of the registrant s common stock, par value $0.33 1/3 per share.

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ALTRIA GROUP, INC.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

Altria Group, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(in millions of dollars)

(Unaudited)

	September 30, 2006	December 31, 2005
ASSETS		
Consumer products		
Cash and cash equivalents	$ 5,695	$ 6,258
Receivables (less allowances of $105 in 2006 and $112 in 2005)	5,826	5,361
Inventories:		
Leaf tobacco	4,279	4,060
Other raw materials	2,493	2,232
Finished product	4,993	4,292
	11,765	10,584
Other current assets	2,913	3,578
Total current assets	26,199	25,781
Property, plant and equipment, at cost	31,784	29,956
Less accumulated depreciation	14,741	13,278
	17,043	16,678
Goodwill	33,142	31,219
Other intangible assets, net	11,868	12,196
Other assets	12,768	14,667
Total consumer products assets	101,020	100,541
Financial services		
Finance assets, net	6,732	7,189
Other assets	27	219
Total financial services assets	6,759	7,408
TOTAL ASSETS	$ 107,779	$ 107,949

See notes to condensed consolidated financial statements.

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Altria Group, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets (Continued)

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

(Unaudited)

	September 30, 2006	December 31, 2005
LIABILITIES		
Consumer products		
Short-term borrowings	$ 3,172	$ 2,836
Current portion of long-term debt	3,243	3,430
Accounts payable	3,589	3,645
Accrued liabilities:		
Marketing	2,329	2,382
Taxes, except income taxes	3,461	2,871
Employment costs	1,391	1,296
Settlement charges	3,351	3,503
Other	3,200	3,130
Income taxes	1,775	1,393
Dividends payable	1,810	1,672
Total current liabilities	27,321	26,158
Long-term debt	12,117	15,653
Deferred income taxes	7,618	8,492
Accrued postretirement health care costs	3,569	3,412
Minority interest	3,796	4,141
Other liabilities	5,352	6,260
Total consumer products liabilities	59,773	64,116
Financial services		
Long-term debt	1,104	2,014
Non-recourse debt		201
Deferred income taxes	5,458	5,737
Other liabilities	254	174
Total financial services liabilities	6,816	8,126
Total liabilities	66,589	72,242
Contingencies (Note 11)		
STOCKHOLDERS EQUITY		
Common stock, par value $0.33 1/3 per share (2,805,961,317 shares issued)	935	935
Additional paid-in capital	6,239	6,061
Earnings reinvested in the business	58,724	54,666
Accumulated other comprehensive losses (including currency translation of ($309) in 2006 and ($1,317) in 2005)	(917)	(1,853)

		64,981		59,809
Less cost of repurchased stock (710,420,222 shares in 2006 and 721,696,918 shares in 2005)		(23,791)		(24,102)
Total stockholders equity		41,190		35,707
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	107,779	$	107,949

See notes to condensed consolidated financial statements.

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Altria Group, Inc. and Subsidiaries

Condensed Consolidated Statements of Earnings

(in millions of dollars, except per share data)

(Unaudited)

	For the Nine Months Ended September 30, 2006	2005
Net revenues	$ 76,009	$ 73,364
Cost of sales	27,573	26,887
Excise taxes on products	23,670	22,271
Gross profit	24,766	24,206
Marketing, administration and research costs	10,945	10,817
Domestic tobacco headquarters relocation charges		3
Domestic tobacco loss on U.S. tobacco pool		138
Domestic tobacco quota buy-out		(115)
Italian antitrust charge	61	
Asset impairment and exit costs	676	302
Gain on redemption of United Biscuits investment	(251)	
Losses (gains) on sales of businesses, net	14	(115)
Provision for airline industry exposure	103	200
Amortization of intangibles	23	14
Operating income	13,195	12,962
Interest and other debt expense, net	702	907
Earnings from continuing operations before income taxes, minority interest, and equity earnings, net	12,493	12,055
Provision for income taxes	3,275	3,581
Earnings from continuing operations before minority interest, and equity earnings, net	9,218	8,474
Minority interest in earnings from continuing operations, and equity earnings, net	155	95
Earnings from continuing operations	9,063	8,379
Loss from discontinued operations, net of income taxes and minority interest		(233)
Net earnings	$ 9,063	$ 8,146
Per share data:		
Basic earnings per share:		
Continuing operations	$ 4.34	$ 4.05
Discontinued operations		(0.11)
Net earnings	$ 4.34	$ 3.94

Diluted earnings per share:				
Continuing operations	$	4.31	$	4.01
Discontinued operations				(0.11)
Net earnings	$	4.31	$	3.90
Dividends declared	$	2.46	$	2.26

See notes to condensed consolidated financial statements.

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Altria Group, Inc. and Subsidiaries

Condensed Consolidated Statements of Earnings

(in millions of dollars, except per share data)

(Unaudited)

	For the Three Months Ended September 30, 2006	2005
Net revenues	$ 25,885	$ 24,962
Cost of sales	9,265	9,082
Excise taxes on products	8,229	7,656
Gross profit	8,391	8,224
Marketing, administration and research costs	3,726	3,619
Domestic tobacco loss on U.S. tobacco pool		138
Domestic tobacco quota buy-out		(115)
Asset impairment and exit costs	193	61
Gain on redemption of United Biscuits investment	(251)	
Losses on sales of businesses	3	
Provision for airline industry exposure		200
Amortization of intangibles	7	6
Operating income	4,713	4,315
Interest and other debt expense, net	193	306
Earnings before income taxes, minority interest, and equity earnings, net	4,520	4,009
Provision for income taxes	1,598	1,098
Earnings before minority interest, and equity earnings, net	2,922	2,911
Minority interest in earnings, and equity earnings, net	47	28
Net earnings	$ 2,875	$ 2,883
Per share data:		
Basic earnings per share:	$ 1.38	$ 1.39
Diluted earnings per share:	$ 1.36	$ 1.38
Dividends declared	$ 0.86	$ 0.80

See notes to condensed consolidated financial statements.

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Altria Group, Inc. and Subsidiaries

Condensed Consolidated Statements of Stockholders Equity

for the Year Ended December 31, 2005 and

the Nine Months Ended September 30, 2006

(in millions of dollars, except per share data)

(Unaudited)

				Accumulated Other Comprehensive Earnings (Losses)				
	Common Stock	Addi- tional Paid-in Capital	Earnings Reinvested in the Business	Currency Translation Adjustments	Other	Total	Cost of Repurchased Stock	Total Stock- holders Equity
Balances, January 1, 2005	$ 935	$ 5,176	$ 50,595	$ (610)	$ (531)	$ (1,141)	$ (24,851)	$ 30,714
Comprehensive earnings:								
Net earnings			10,435					10,435
Other comprehensive earnings (losses), net of income taxes:								
Currency translation adjustments				(707)		(707)		(707)
Additional minimum pension liability					(54)	(54)		(54)
Change in fair value of derivatives accounted for as hedges					38	38		38
Other					11	11		11
Total other comprehensive losses								(712)
Total comprehensive earnings								9,723
Exercise of stock options and issuance of other stock awards		519	(6)				749	1,262
Cash dividends declared ($3.06 per share)			(6,358)					(6,358)
Other		366						366
Balances, December 31, 2005	935	6,061	54,666	(1,317)	(536)	(1,853)	(24,102)	35,707
Comprehensive earnings:								
Net earnings			9,063					9,063
Other comprehensive earnings (losses), net of income taxes:								
Currency translation adjustments				1,008		1,008		1,008
Additional minimum pension liability					(22)	(22)		(22)
Change in fair value of derivatives accounted for as hedges					(45)	(45)		(45)
Other					(5)	(5)		(5)
Total other comprehensive earnings								936

Total comprehensive earnings								9,999
Exercise of stock options and issuance of other stock awards		178	145				311	634
Cash dividends declared ($2.46 per share)			(5,150)					(5,150)
Balances, September 30, 2006	$ 935	$ 6,239	$ 58,724	$ (309)	$ (608)	$ (917)	$ (23,791)	$ 41,190

Total comprehensive earnings were $2,999 million and $2,501 million, respectively, for the quarters ended September 30, 2006 and 2005, and $7,439 million for the first nine months of 2005.

See notes to condensed consolidated financial statements.

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Altria Group, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(in millions of dollars)

(Unaudited)

	For the Nine Months Ended September 30, 2006	2005
CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES		
Net earnings - Consumer products	$ 8,975	$ 8,155
- Financial services	88	(9)
Net earnings	9,063	8,146
Adjustments to reconcile net earnings to operating cash flows:		
Consumer products		
Depreciation and amortization	1,339	1,223
Deferred income tax benefit	(269)	(299)
Minority interest in earnings from continuing operations, and equity earnings, net	155	95
Domestic tobacco headquarters relocation charges, net of cash paid	(1)	(9)
Domestic tobacco loss on U.S. tobacco pool, net of cash paid		2
Domestic tobacco quota buy-out		(115)
Escrow bond for the *Price* domestic tobacco case, net of cash paid	1,850	(420)
Asset impairment and exit costs, net of cash paid	446	130
Integration costs, net of cash paid		(1)
Loss on sale of discontinued operations		32
Gain on redemption of United Biscuits investment	(251)	
Losses (gains) on sales of businesses, net	14	(115)
Income tax reserve reversal	(1,006)	
Cash effects of changes, net of the effects from acquired and divested companies:		
Receivables, net	(128)	211
Inventories	(779)	(569)
Accounts payable	(48)	(116)
Income taxes	210	416
Accrued liabilities and other current assets	135	(597)
Domestic tobacco accrued settlement charges	(158)	(193)
Pension plan contributions	(574)	(1,028)
Pension provisions and postretirement, net	602	565
Other	620	509
Financial services		
Deferred income tax benefit	(295)	(193)
Provision for airline industry exposure	103	200
Other	116	81
Net cash provided by operating activities	11,144	7,955

See notes to condensed consolidated financial statements.

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Altria Group, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows (Continued)

(in millions of dollars)

(Unaudited)

	For the Nine Months Ended September 30,	
	2006	2005
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES		
Consumer products		
Capital expenditures	$ (1,501)	$ (1,489)
Purchases of businesses, net of acquired cash		(4,897)
Proceeds from sales of businesses	759	1,652
Other	128	84
Financial services		
Investments in finance assets	(13)	(2)
Proceeds from finance assets	339	446
Net cash used in investing activities	(288)	(4,206)
CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES		
Consumer products		
Net (repayment) issuance of short-term borrowings	(2,274)	3,782
Long-term debt proceeds	49	52
Long-term debt repaid	(2,193)	(1,762)
Financial services		
Long-term debt repaid	(1,015)	
Repurchase of Kraft Foods Inc. common stock	(943)	(783)
Dividends paid on Altria Group, Inc. common stock	(5,012)	(4,527)
Issuance of Altria Group, Inc. common stock	421	801
Other	(566)	(416)
Net cash used in financing activities	(11,533)	(2,853)
Effect of exchange rate changes on cash and cash equivalents	114	(445)
Cash and cash equivalents:		
(Decrease) Increase	(563)	451
Balance at beginning of period	6,258	5,744
Balance at end of period	$ 5,695	$ 6,195

See notes to condensed consolidated financial statements.

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Altria Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 1. Accounting Policies:

Basis of Presentation

The interim condensed consolidated financial statements of Altria Group, Inc. and subsidiaries (Altria Group, Inc.) are unaudited. It is the opinion of Altria Group, Inc. s management that all adjustments necessary for a fair statement of the interim results presented have been reflected therein. All such adjustments were of a normal recurring nature. Net revenues and net earnings for any interim period are not necessarily indicative of results that may be expected for the entire year. Throughout this Form 10-Q, the term Altria Group, Inc. refers to the consolidated financial position, results of operations and cash flows of the Altria family of companies and the term ALG refers solely to the parent company.

These statements should be read in conjunction with the consolidated financial statements and related notes, which appear in Altria Group, Inc. s Annual Report to Stockholders and which are incorporated by reference into Altria Group, Inc. s Annual Report on Form 10-K for the year ended December 31, 2005 (the 2005 Form 10-K).

Balance sheet accounts are segregated by two broad types of businesses. Consumer products assets and liabilities are classified as either current or non-current, whereas financial services assets and liabilities are unclassified, in accordance with respective industry practices.

In June 2005, Kraft Foods Inc. (Kraft) sold substantially all of its sugar confectionery business for pre-tax proceeds of approximately $1.4 billion. Altria Group, Inc. has reflected the results of Kraft s sugar confectionery business prior to the closing date as discontinued operations on the condensed consolidated statements of earnings.

Stock-Based Compensation Expense

Effective January 1, 2006, Altria Group, Inc. adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123 (Revised 2004) Share-Based Payment (SFAS No. 123(R)) using the modified prospective method, which requires measurement of compensation cost for all stock-based awards at fair value on date of grant and recognition of compensation over the service periods for awards expected to vest. The fair value of restricted stock and rights to receive shares of stock is determined based on the number of shares granted and the market value at date of grant. The fair value of stock options is determined using a modified Black-Scholes methodology. The impact of adoption was not material.

The adoption of SFAS No. 123(R) in the first quarter of 2006 resulted in a cumulative effect gain of $9 million, which is net of $5 million in taxes, in the condensed consolidated statement of earnings for the nine months ended September 30, 2006. This gain resulted from the impact of estimating future forfeitures on restricted stock and rights to receive shares of stock in the determination of periodic expense for unvested awards, rather than recording forfeitures only when they occur. The gross cumulative effect was recorded in marketing, administration and research costs in the first quarter of 2006.

Altria Group, Inc. previously applied the recognition and measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, (APB 25) and provided the pro forma disclosures required by SFAS No. 123, Accounting for Stock-Based Compensation (SFAS No. 123). No compensation expense for employee stock options was reflected in net earnings in 2005, as all stock options granted under those plans had an exercise price not less than the market value of the common stock on the date of the grant. Historical condensed consolidated statements of earnings already include the compensation expense for restricted stock and rights to receive shares of stock. The following table illustrates the effect on net earnings and earnings per share (EPS) if Altria Group, Inc. had applied the fair value recognition provisions of SFAS No. 123 to measure stock-based compensation expense for stock option awards for the nine months and three months ended September 30, 2005 (in millions, except per share data):

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Altria Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

	For the Nine Months Ended September 30, 2005		For the Three Months Ended September 30, 2005	
Net earnings, as reported	$	8,146	$	2,883
Deduct:				
Total stock-based employee compensation expense determined under fair value method for all stock option awards, net of related tax effects		12		5
Pro forma net earnings	$	8,134	$	2,878
Earnings per share:				
Basic as reported	$	3.94	$	1.39
Basic pro forma	$	3.94	$	1.39
Diluted as reported	$	3.90	$	1.38
Diluted pro forma	$	3.89	$	1.37

Altria Group, Inc. has not granted stock options to employees since 2002. The amounts shown above as stock-based compensation expense relate to Executive Ownership Stock Options (EOSOs). Under certain circumstances, senior executives who exercise outstanding stock options, using shares to pay the option exercise price and taxes receive EOSOs equal to the number of shares tendered. During the nine months and three months ended September 30, 2005, Altria Group, Inc. granted 1.5 million and 0.3 million EOSOs, respectively.

Altria Group, Inc. elected to calculate the initial pool of tax benefits resulting from tax deductions in excess of the stock-based employee compensation expense recognized in the statement of earnings (Excess tax benefits) under the Financial Accounting Standards Board (FASB) Staff Position 123(R)-3, Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards. Excess tax benefits occur when the tax deduction claimed at vesting exceeds the fair value compensation expense accrued under SFAS No. 123(R). Excess tax benefits of $161 million were recognized for the nine months ended September 30, 2006 and were presented as financing cash flows. Previously, these tax benefits were included in operating cash flows. Under SFAS No. 123(R), tax shortfalls occur when actual tax deductible compensation expense is less than cumulative stock-based compensation expense recognized in the financial statements. Tax shortfalls of $9 million at Kraft were recognized for the nine months ended September 30, 2006, and were recorded in additional paid-in capital.

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Altria Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 2. Asset Impairment and Exit Costs:

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

		For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
		2006	2005	2006	2005
		(in millions)			
Separation program	International tobacco*	$ 85	$ 26	$ 62	$ 8
Separation program	General corporate**	33	40	3	2
Restructuring program	North American food	217	31	62	2
Restructuring program	International food	226	81	63	24
Asset impairment	International tobacco	3	31	3	25
Asset impairment	North American food	99	93		
Asset impairment	International food	11			
Asset impairment	General corporate	2			
Asset impairment and exit costs		$ 676	$ 302	$ 193	$ 61

* Pre-tax charges at Philip Morris International, Inc. (PMI) primarily related to the streamlining of various operations. On July 6, 2006, PMI announced its intention to close its factory in Munich, Germany, in 2009, with the terms and conditions having since been finalized with the local Works Council. PMI estimates that the total cost to close the facility will be approximately $100 million, of which approximately $20 million will be due to accelerated depreciation through 2009. During the third quarter of 2006, PMI incurred $51 million of costs related to the Munich factory closure.

** Altria Group, Inc. s pre-tax charges primarily related to the streamlining of various corporate functions.

Kraft Restructuring Program

In January 2004, Kraft announced a three-year restructuring program with the objectives of leveraging Kraft s global scale, realigning and lowering its cost structure, and optimizing capacity utilization. In January 2006, Kraft announced plans to expand its restructuring efforts through 2008. The entire restructuring program is expected to result in $3.7 billion in pre-tax charges reflecting asset disposals, severance and implementation costs. As part of this program, Kraft anticipates the closure of up to 40 facilities and the elimination of approximately 14,000 positions. Approximately $2.3 billion of the $3.7 billion in pre-tax charges are expected to require cash payments. Pre-tax restructuring charges during 2006 are expected to be approximately $1 billion, including $496 million incurred during the first nine months of 2006. Total pre-tax restructuring charges incurred since the inception of the program in January 2004 were $1.4 billion.

The condensed consolidated statements of earnings include asset impairment and exit costs at Kraft as follows:

	For the Nine Months Ended September 30, 2006	For the Nine Months Ended September 30, 2005	For the Three Months Ended September 30, 2006	For the Three Months Ended September 30, 2005
Restructuring program	$ 443	$ 112	$ 125	$ 26
Other asset impairments	110	93		
	$ 553	$ 205	$ 125	$ 26

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Altria Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Charges under the restructuring program for the first nine months of 2006 resulted from the announced closures of 7 plants, for a total of 26 since the commencement of the restructuring program in January 2004, and the continuation of a number of workforce reduction programs. Other asset impairment charges consist of write-downs in 2006 related to Kraft s sale of its pet snacks brand and assets, as well as charges following its annual review of goodwill and intangible assets. The asset impairments in 2005 relate to Kraft s sale of its fruit snacks assets. Approximately $243 million of the pre-tax charges incurred during the first nine months of 2006 will require cash payments.

Pre-tax restructuring liability activity for the nine months ended September 30, 2006, was as follows (in millions):

	For the Nine Months Ended September 30, 2006			
	Severance	Asset Write-downs	Other	Total
Liability balance, January 1, 2006	$ 114	$ -	$ 1	$ 115
Charges	186	204	53	443
Cash spent	(149)		(15)	(164)
Charges against assets	(11)	(204)	(4)	(219)
Currency	4			4
Liability balance, September 30, 2006	$ 144	$ -	$ 35	$ 179

Severance costs in the above schedule, which relate to the workforce reduction programs, include the cost of related benefits. Specific programs announced since 2004, as part of the overall restructuring program, will result in the elimination of approximately 9,200 positions. At September 30, 2006, approximately 7,800 of these positions have been eliminated. Asset write-downs relate to the impairment of assets caused by the plant closings and related activity. Other costs incurred relate primarily to contract termination costs associated with the plant closings and the termination of leasing agreements. Severance costs taken against assets relate to incremental pension costs, which reduce prepaid pension assets.

Kraft recorded pre-tax implementation costs associated with the restructuring program. These costs include the discontinuance of certain product lines and incremental costs related to the integration and streamlining of functions and closure of facilities. Substantially all implementation costs incurred during the first nine months of 2006 will require cash payments. These costs were recorded on the condensed consolidated statements of earnings as follows (in millions):

	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2006	2005	2006	2005
Net revenues	$ -	$ 1	$ -	$ -
Cost of sales	13	34	2	8
Marketing, administration and research costs	40	26	21	8
Implementation costs	$ 53	$ 61	$ 23	$ 16

Kraft Asset Impairment Charges

During the third quarter of 2006, Kraft completed the sale of its pet snacks brand and assets for $580 million and recorded tax expense of $57 million related to the sale. In the first quarter of 2006, Kraft recorded a pre-tax asset impairment charge of $86 million in recognition of the sale. The charge, which included the write-off of a portion of the associated goodwill and intangible and fixed assets, was recorded as asset impairment and exit costs on the condensed consolidated statement of earnings.

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Altria Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

During the first quarter of 2006, Kraft completed its annual review of goodwill and intangible assets, and recorded non-cash pre-tax charges of $24 million related to an intangible asset impairment for biscuits assets in Egypt and hot cereal assets in the United States. These charges were recorded as asset impairment and exit costs on the condensed consolidated statement of earnings.

During the second quarter of 2005, Kraft completed the sale of its fruit snacks assets. In the first quarter of 2005, Kraft recorded a pre-tax asset impairment charge of $93 million in recognition of the sale. The charge, which includes the write-off of all associated intangible assets, was recorded as asset impairment and exit costs on the condensed consolidated statement of earnings.

International Tobacco Asset Impairment Charge

During the third quarter of 2005, PMI recorded a $25 million non-cash pre-tax charge related to obsolete equipment.

Note 3. Benefit Plans:

Altria Group, Inc. sponsors noncontributory defined benefit pension plans covering substantially all U.S. employees. Pension coverage for employees of ALG s non-U.S. subsidiaries is provided, to the extent deemed appropriate, through separate plans, many of which are governed by local statutory requirements. In addition, ALG and its U.S. and Canadian subsidiaries provide health care and other benefits to substantially all retired employees. Health care benefits for retirees outside the United States and Canada are generally covered through local government plans.

Pension Plans

Components of Net Periodic Benefit Cost

Net periodic pension cost consisted of the following:

	U.S. Plans For the Nine Months Ended September 30,		Non-U.S. Plans For the Nine Months Ended September 30,	
	2006	2005	2006	2005
	(in millions)			
Service cost	$ 216	$ 213	$ 164	$ 156
Interest cost	481	470	209	215
Expected return on plan assets	(675)	(649)	(270)	(265)
Amortization:				
Unrecognized net loss from experience differences	263	210	72	54
Prior service cost	15	12	10	10
Other expense	5	20	2	6
Net periodic pension cost	$ 305	$ 276	$ 187	$ 176

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Altria Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

	U.S. Plans For the Three Months Ended September 30,		Non-U.S. Plans For the Three Months Ended September 30,	
	2006	2005	2006	2005
	(in millions)			
Service cost	$ 73	$ 70	$ 56	$ 51
Interest cost	162	155	70	71
Expected return on plan assets	(223)	(217)	(90)	(87)
Amortization:				
Unrecognized net loss from experience differences	90	69	26	18
Prior service cost	6	4	3	3
Other expense			2	1
Net periodic pension cost	$ 108	$ 81	$ 67	$ 57

Other expense, above, is due primarily to additional pension benefits related to workforce reduction programs under Kraft s restructuring program and workforce reduction programs within Altria Group, Inc.

Employer Contributions

Altria Group, Inc. presently makes, and plans to make, contributions, to the extent that they are tax deductible and do not generate an excise tax liability, in order to maintain plan assets in excess of the accumulated benefit obligation of its funded U.S. and non-U.S. plans. Employer contributions of $419 million and $155 million were made to U.S. plans and non-U.S. plans, respectively, during the nine months ended September 30, 2006. These amounts include $140 million and $67 million of employer contributions that Kraft made to its U.S. and non-U.S. plans, respectively. Currently, Altria Group, Inc. anticipates making additional contributions during the remainder of 2006 of approximately $10 million to its U.S. plans and approximately $75 million to its non-U.S. plans, based on current tax law. These amounts include approximately $10 million and $40 million that Kraft anticipates making to its U.S. and non-U.S. plans, respectively. However, these estimates are subject to change as a result of changes in tax and other benefit laws, as well as asset performance significantly above or below the assumed long-term rate of return on pension assets, or significant changes in interest rates.

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Postretirement Benefit Plans

Net postretirement health care costs consisted of the following:

	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2006	2005	2006	2005
	(in millions)			
Service cost	$ 79	$ 75	$ 27	$ 25
Interest cost	222	214	74	72
Amortization:				
Unrecognized net loss from experience differences	85	62	26	21
Unrecognized prior service cost	(22)	(21)	(8)	(7)
Other	3	3		
Net postretirement health care costs	$ 367	$ 333	$ 119	$ 111

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans (SFAS No. 158). SFAS No. 158 requires that employers recognize the funded status of their defined benefit pension and other postretirement plans on the consolidated balance sheet and recognize as a component of other comprehensive income, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost. Altria Group, Inc. will adopt the recognition and related disclosure provisions of SFAS No. 158, prospectively, on December 31, 2006. Altria Group, Inc. is currently assessing the impact of SFAS No. 158 on the consolidated financial statements. However, based on the funded status of Altria Group, Inc. s defined benefit pension, postretirement medical and postemployment plans as of December 31, 2005, Altria Group, Inc. estimates that total assets will decrease by approximately $3.9 billion, total liabilities will increase by approximately $0.4 billion and stockholders equity will decrease by approximately $4.3 billion, net of taxes. Included in these amounts are a decrease to Kraft s total assets of approximately $2.6 billion, an increase to Kraft s total liabilities of approximately $0.2 billion and a decrease to Kraft s stockholders equity of approximately $2.8 billion, net of taxes. The actual impact of implementing SFAS No. 158 is highly dependent on a number of assumptions, including the discount rates in effect at December 31, 2006, and the actual rate of return on pension assets for 2006. These factors could increase or decrease the expected impact of implementing SFAS No. 158 in Altria Group, Inc. s consolidated financial statements at December 31, 2006.

SFAS No. 158 also requires an entity to measure plan assets and benefit obligations as of the date of its fiscal year-end statement of financial position for fiscal years ending after December 15, 2008. Altria Group, Inc. s non-U.S. pension plans (other than Canadian pension plans) are measured at September 30 of each year. Subsidiaries of PMI and Kraft Foods International are expected to adopt the measurement date provision beginning December 31, 2008. Altria Group, Inc. is presently evaluating the impact of the measurement date change.

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Note 4. Goodwill and Other Intangible Assets, net:

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

	Goodwill		Other Intangible Assets, net	
	September 30, 2006	December 31, 2005	September 30, 2006	December 31, 2005
Domestic tobacco	$	$	$ 281	$ 281
International tobacco	6,049	5,571	1,512	1,399
North American food	20,971	20,803	9,881	10,311
International food	6,122	4,845	194	205
Total	$ 33,142	$ 31,219	$ 11,868	$ 12,196

Intangible assets were as follows (in millions):

	September 30, 2006		December 31, 2005	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Non-amortizable intangible assets	$ 11,500		$ 11,867	
Amortizable intangible assets	473	$ 105	410	$ 81
Total intangible assets	$ 11,973	$ 105	$ 12,277	$ 81

Non-amortizable intangible assets substantially consist of brand names from Kraft s acquisition of Nabisco Holdings Corp. (Nabisco) in 2000 and the PMI 2005 acquisition of a business in Indonesia. Amortizable intangible assets consist primarily of certain trademark licenses and non-compete agreements. Pre-tax amortization expense for intangible assets during the nine months ended September 30, 2006 and 2005, was $23 million and $14 million, respectively, and $7 million and $6 million for the three months ended September 30, 2006 and 2005, respectively. Amortization expense for each of the next five years is estimated to be $35 million or less, assuming no additional transactions occur that require the amortization of intangible assets.

The movement in goodwill and gross carrying amount of intangible assets from December 31, 2005, is as follows (in millions):

	Goodwill	Intangible Assets

Balance at December 31, 2005	$ 31,219	$ 12,277
Changes due to:		
Currency	778	125
Acquisitions	952	
Divestitures	(161)	(356)
Asset impairment	(25)	(79)
Other	379	6
Balance at September 30, 2006	$ 33,142	$ 11,973

As a result of Kraft s common stock repurchases, ALG s ownership percentage of Kraft has increased from 87.2% at December 31, 2005 to 88.6% at September 30, 2006, thereby resulting in an increase in goodwill. Other, above, includes this additional goodwill. The increase in goodwill from acquisitions is related to preliminary allocations of purchase price for Kraft s acquisition of certain United Biscuits operations and Nabisco trademarks as discussed in Note 6. *Acquisitions*. The allocations are based upon preliminary estimates and assumptions and are subject to revision when appraisals are finalized, which is expected within the next six months.

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During the first quarter of 2006, Altria Group, Inc. completed its annual review of goodwill and intangible assets, and recorded non-cash pre-tax charges of $24 million related to intangible asset impairments at Kraft.

Note 5. Financial Instruments:

During the nine months and three months ended September 30, 2006 and 2005, ineffectiveness related to fair value hedges and cash flow hedges was not material. Altria Group, Inc. is hedging forecasted transactions for periods not exceeding the next fifteen months. At September 30, 2006, Altria Group, Inc. estimates that substantially all amounts reported in accumulated other comprehensive earnings (losses) will be reclassified to the consolidated statement of earnings within the next twelve months.

Within currency translation adjustments at September 30, 2006 and 2005, Altria Group, Inc. recorded losses of $134 million, net of income taxes, and gains of $242 million, net of income taxes, respectively, which represented effective hedges of net investments.

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

	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2006	2005	2006	2005
	(in millions)			
Gain (loss) at beginning of period	$ 24	$ (14)	$ 17	$ 65
Derivative gains transferred to earnings	(51)	(42)	(33)	(23)
Change in fair value	6	126	(5)	28
(Loss) gain as of September 30	$ (21)	$ 70	$ (21)	$ 70

Note 6. Acquisitions:

United Biscuits:

During the third quarter of 2006, Kraft acquired the Spanish and Portuguese operations of United Biscuits (UB), and rights to all Nabisco trademarks in the European Union, Eastern Europe, the Middle East and Africa, which UB has held since 2000, for a total cost of approximately $1.1 billion.

The Spanish and Portuguese operations of UB include its biscuits, dry desserts, canned meats, tomato and fruit juice businesses as well as seven manufacturing facilities and 1,300 employees. Together, these businesses generated net revenues of approximately $400 million in 2005. Due to the timing of the closing of the acquisition, these financial statements do not reflect earnings from these operations, the amounts of which were not material.

The non-cash acquisition was financed by Kraft s assumption of approximately $541 million of debt issued by the acquired business immediately prior to the acquisition, as well as $530 million of value for the redemption of Kraft s outstanding investment in UB, primarily deep-discount securities. The redemption of Kraft s investment in UB resulted in a $251 pre-tax gain on closing, benefiting Altria Group, Inc. by $0.06 per diluted share.

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Sampoerna:

In March 2005, a subsidiary of PMI acquired 40% of the outstanding shares of PT HM Sampoerna Tbk (Sampoerna), an Indonesian tobacco company. In May 2005, PMI purchased an additional 58%, for a total of 98%. The total cost of the transaction was approximately $4.8 billion, including Sampoerna s cash of approximately $0.3 billion and debt of the U.S. dollar equivalent of approximately $0.2 billion. The purchase price was primarily financed through a euro 4.5 billion bank credit facility arranged for PMI and its subsidiaries in May 2005, consisting of a euro 2.5 billion three-year term loan facility (which, through repayments has been reduced to euro 1.5 billion) and a euro 2.0 billion five-year revolving credit facility. These facilities are not guaranteed by ALG.

The acquisition of Sampoerna allowed PMI to enter the profitable kretek cigarette category in Indonesia. Sampoerna s financial position and results of operations have been fully consolidated with PMI as of June 1, 2005. From March 2005 to May 2005, PMI recorded equity earnings in Sampoerna. During the first nine months of 2006 and 2005, Sampoerna contributed $450 million and $201 million, respectively, of operating income and $200 million and $91 million, respectively, of net earnings.

During the second quarter of 2006, the allocation of purchase price relating to the acquisition of Sampoerna was completed. Assets purchased consist primarily of goodwill of $3.5 billion, other intangible assets (primarily brands) of $1.3 billion, inventories of $0.5 billion and property, plant and equipment of $0.4 billion. Liabilities assumed in the acquisition consist principally of long-term debt of $0.3 billion and accrued liabilities.

Other:

During the nine months ended September 30, 2005, PMI acquired a 98.1% stake in Coltabaco, the largest tobacco company in Colombia, for approximately $300 million. The effect of this acquisition was not material to Altria Group, Inc. s consolidated financial position, results of operations or operating cash flows in any of the periods presented.

On September 29, 2006, PMI entered into an agreement with British American Tobacco to purchase the *Muratti* and *Ambassador* trademarks in certain markets, as well as rights to *L&M* and *Chesterfield* in Hong Kong, in exchange for the rights to *Benson & Hedges* in certain African markets and a payment of $115 million. The transactions are subject to regulatory approval.

Note 7. Divestitures:

Discontinued Operations:

In June 2005, Kraft sold substantially all of its sugar confectionery business for pre-tax proceeds of approximately $1.4 billion. The sale included the *Life Savers*, *Creme Savers*, *Altoids*, *Trolli* and *Sugus* brands. Altria Group, Inc. has reflected the results of Kraft s sugar confectionery business prior to the closing date as discontinued operations on the condensed consolidated statements of earnings.

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Summary results of operations for the sugar confectionery business were as follows (in millions):

		For the Nine Months Ended September 30, 2005
Net revenues	$	228
Earnings before income taxes and minority interest	$	41
Provision for income taxes		(16)
Loss on sale of discontinued operations		(297)
Minority interest in loss from discontinued operations, net		39
Loss from discontinued operations, net of income taxes and minority interest	$	(233)

As a result of the sale, Kraft recorded a net loss on sale of discontinued operations of $297 million in the second quarter of 2005, related largely to taxes on the transaction. ALG s share of the loss, net of minority interest, was $255 million.

Other:

During the third quarter of 2006, Kraft completed the sale of its pet snacks brand and assets, and recorded tax expense of $57 million related to the sale. In the first quarter of 2006, Kraft recorded a pre-tax asset impairment charge of $86 million in recognition of this sale. During the second quarter of 2006, Kraft sold its industrial coconut assets. During the first quarter of 2006, Kraft sold certain Canadian assets and a small U.S. biscuit brand, and incurred pre-tax asset impairment charges of $176 million in the fourth quarter of 2005 in recognition of these sales. During the second quarter of 2005, Kraft sold its fruit snacks assets and incurred a pre-tax asset impairment charge of $93 million in the first quarter of 2005 in recognition of this sale. During the first quarter of 2005, Kraft sold its desserts assets in the U.K. and its U.S. yogurt assets. The aggregate proceeds received from the sales of other businesses in the first nine months of 2006 and 2005 were $759 million and $218 million, respectively, on which pre-tax losses of $14 million and pre-tax gains of $115 million, respectively, were recorded.

In July 2006, Kraft announced that it had agreed to sell its rice brand and assets for approximately $280 million. The transaction closed in October 2006 and resulted in an after-tax gain to Altria Group, Inc. of approximately $140 million or $0.07 per diluted share, which will be recorded in the fourth quarter of 2006.

The operating results of the other divestitures, discussed above, in the aggregate, were not material to Altria Group, Inc. s consolidated financial position, results of operations or cash flows in any of the periods presented.

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