

Philip Morris(PM)

\$85.57 (As of 02/24/20)

Price Target (6-12 Months): **\$90.00**

Long Term: 6-12 Months

Zacks Recommendation:
Neutral

(Since: 05/02/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: D

Growth: B

Momentum: A

Summary

Philip Morris has outperformed the industry in the past six months, courtesy of its robust pricing in the combustible category and focus on RRPs. Notably, strong pricing aided the company's revenues and adjusted operating income in the fourth quarter of 2019. Results were also aided by cost-efficiencies and gains from RRPs, which, in turn, is benefiting from broad-based IQOS growth. During the quarter, the top line grew and topped the consensus mark. Management expects pricing to be a driver in 2020, and remains focused on its RRP investments. However, the company continues to battle receding cigarette volumes due to stringent regulations and rising health consciousness. Cigarette volumes are likely to drop in 2020, wherein international industry volumes are also expected to decline due to hurdles in Indonesia among other factors.

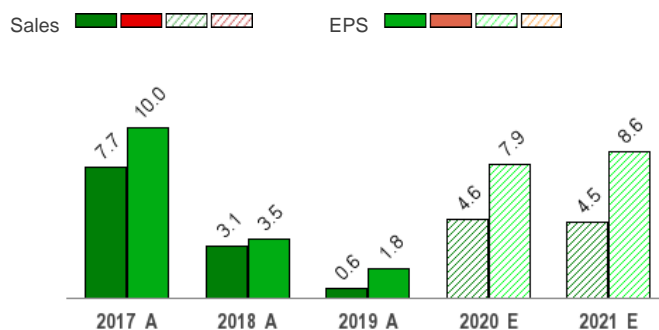
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$92.74 - \$69.27
20 Day Average Volume (sh)	4,597,755
Market Cap	\$133.1 B
YTD Price Change	0.6%
Beta	1.02
Dividend / Div Yld	\$4.68 / 5.5%
Industry	<u>Tobacco</u>
Zacks Industry Rank	Bottom 16% (214 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	0.0%
Last Sales Surprise	0.4%
EPS F1 Est- 4 week change	0.2%
Expected Report Date	04/16/2020
Earnings ESP	0.0%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	7,049 E	8,525 E	8,575 E	8,655 E	32,571 E
2020	6,770 E	8,075 E	8,124 E	8,198 E	31,169 E
2019	6,751 A	7,699 A	7,642 A	7,713 A	29,805 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.24 E	\$1.66 E	\$1.70 E	\$1.49 E	\$6.08 E
2020	\$1.16 E	\$1.52 E	\$1.58 E	\$1.38 E	\$5.60 E
2019	\$1.09 A	\$1.46 A	\$1.43 A	\$1.22 A	\$5.19 A

*Quarterly figures may not add up to annual.

P/E TTM	16.5
P/E F1	15.3
PEG F1	1.9
P/S TTM	1.7

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/24/2020. The reports text is as of 02/25/2020.

Overview

Philip Morris International is progressing well with its business transformation in the face of consumers rising health consciousness and stern regulations to dissuade smoking. To this end, the tobacco giant has been expanding in the reduced risk products (RRPs) category, evident from the launch of IQOS (a heating tobacco device) that counts amongst one of the leading RRP in the industry. We note that RRP formed close to 19% of the company's total revenues in 2019, including about 13% contribution from IQOS devices. Nevertheless, the company's combustible category presently remains its major revenue contributor.

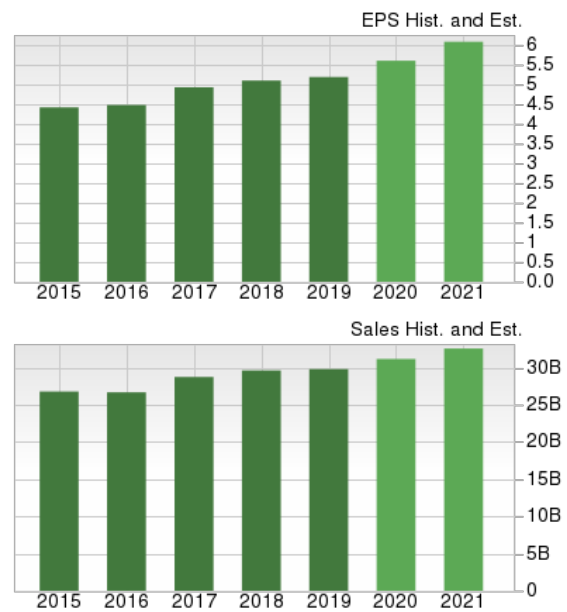
Philip Morris manufactures and sells cigarettes, other tobacco products and other nicotine-containing products outside the United States in more than 180 countries. Also, the company ships a form of its Platform 1 device sanctioned by the FDA, to Altria Group, for sale in the United States. In fact, Philip Morris shares a licensing agreement with Altria for the sale of IQOS in United States.

In Mar 2008, Philip Morris International was spun off from the Altria Group. However, Philip Morris USA, Inc. (PM USA) continues to be a subsidiary of the Altria Group.

Philip Morris participates in the profitable premium cigarette category with its Marlboro, Parliament and Virginia Slims brands; in the mid-price category with its L&M, Lark, Merit, Muratti and Philip Morris brands. Other leading international brands include Bond Street, Chesterfield, Next and Red & White.

The company is also engaged in the development and commercialization of RRP, which generally are less harmful than cigarette smoking. The company expects that RRP are likely to help smokers in quitting cigarette consumption.

On a product basis, Philip Morris reports results under the combustible and RRP categories. From Jan 1, 2018, Philip Morris started operating through the following reporting segments: the European Union Region (EU); the Eastern Europe Region (EE); the Middle East & Africa Region (ME&A); the South & Southeast Asia Region (S&SA); the East Asia & Australia Region (EA&A); and the Latin America & Canada Region (LA&C). Notably, the ME&A region also include PMI Duty Free.



Reasons To Buy:

- ▲ **Strong Pricing a Growth Driver:** Philip Morris has always managed to remain afloat and generate revenues with higher cigarette pricing even in the face of unfavorable tax environment and declining cigarette volumes. Though higher pricing might lead to possible decline in cigarette consumption, it is seen that smokers tend to absorb price increases owing to the addictive quality of cigarettes. Evidently, higher pricing at the combustible tobacco portfolio has been aiding the company's performance for a while. In fact, higher pricing variance was an upside to the company's performance across several regions during the fourth quarter of 2019. In the said quarter, favorable pricing variance boosted the top line that improved 6.3% on a like-for-like basis, after excluding currency. Pricing also drove the company's adjusted operating income. In 2019, the company recorded a solid combustible tobacco pricing variance of 6.5%. Despite the anticipated hurdles related to Indonesia, the company expects pricing to be strong in 2020.

Philip Morris continues to benefit from efficient cigarette pricing and advancement in the RRP category.

Such upsides, combined with other growth-oriented moves, are likely to keep boosting investors' optimism. Notably, shares of the company have appreciated nearly 11% in the past six months compared with the industry's growth of 9.8%.

- ▲ **RRPs a Key Catalyst:** Serious health hazards due to cigarette smoking have pushed consumers toward low-risk, reduced risk products (RRP's). The company is progressing well with its business transformation, with about 8% of shipment volumes and one-fifth of net revenues coming from smoke-free products as of the end of 2019. Toward this end, the company's IQOS, a smokeless cigarette, counts amongst one of the leading RRP's in the industry. Notably, the marketing and technology sharing agreement between Philip Morris and Altria Group, pertaining to the sale of IQOS in the United States, has been approved by the FDA. We note that RRP's formed close to 19% of the company's total revenues in 2019, including about 13% contribution from IQOS devices. These next generation devices, are backed by substantial scientific insights and research. The company expects such advanced and high-quality products to aid adult smokers to switch from traditional cigarettes to smoke-free options. In fact, strong growth in IQOS boosted revenues in the RRP's unit, which increased 36.2% to \$1,534 million in the December-end quarter. Moreover, heated tobacco unit shipment volume of 17.1 billion units surged 40.7% year over year. Markedly, IQOS is now available in nearly 52 markets worldwide, which forms 44% of the total international market.

Going ahead, the company expects consistent growth in IQOS and Heated Tobacco category, and therefore remains committed toward expanding these products. In this context, the company launched IQOS 3 DUO in 2019, which is now available in all of its international markets. Philip Morris has also been undertaking plant conversions, transforming them from cigarette to RRP's manufacturing facilities. Markedly, IQOS is presently the only heat-not-burn product in the U.S. market, which has been approved by the FDA. This is expected to radically boost the business of the companies. Among other initiatives, Philip Morris announced a partnership with South Korea's KT&G this January in order to commercialize the latter's smoke-free products outside the country. This global collaboration aims at expanding the reach of KT&G's smoke-free products to many other markets. In earlier developments, Philip Morris inked a deal with Canada-based Parallax that provides low-risk tobacco alternatives. To further propel growth of this category, the company launched 'The Year of Unsmoke' in April, 2019. The action is aimed at creating a better future for smokers, by encouraging them to either quit smoking or shift to low-risk alternatives.

- ▲ **Impressive Earnings View:** In fourth-quarter 2019, Philip Morris' earnings improved 4.3% year over year, on a like-for-like basis and after excluding currency. Further, the top line surpassed estimates and improved year on year in the quarter. The quarterly results benefited from increased shipment volumes in the heated tobacco category. Also, favorable pricing was a key growth driver across most regions. Management is impressed with its 2019 performance, which witnessed broad-based IQOS improvement, as well as robust pricing for the combustible tobacco category.

While management foresees some hurdles in Indonesia this year, it expects to deliver currency-neutral net revenue and bottom-line growth (on an LFL basis). In 2020, currency-neutral revenues are expected to rise about 5% on an LFL basis. Currency-neutral adjusted operating margin is expected to expand 150 bps on an LFL basis, thanks to cost-control measures, which are expected to completely offset additional investments in RRP's. Finally, the company envisions adjusted earnings per share of \$5.50 for 2020. Excluding the expected currency impact of 4 cents, earnings are anticipated to be at least \$5.54, which indicates growth of at least 8% from the year-ago quarter's reported figure.

- ▲ **Strong Brand Portfolio:** Philip Morris commands a leading market position in the tobacco industry supported by its strong brand portfolio. Its portfolio boasts popular names like Marlboro, L&M, Bond Street, Parliament, Philip Morris, Chesterfield, Sampoerna A, Virginia Slims, Champion and Benson & Hedges. Marlboro leads the brands and has the largest market share.
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Reasons To Sell:

- ▼ **Cigarette Category to Remain Weak:** Receding cigarette sales volumes has been taking a toll on Philip Morris' performance for quite some time now. Total industry volume for cigarettes and heated tobacco units fell 2% in 2019, wherein Cigarette shipment volumes declined 1.4%. Further, in the final quarter of 2019, total cigarette and heated tobacco unit shipment volumes dropped 5% to 192.2 billion units. Cigarette shipment volumes slid 8% to 175.1 billion units. Furthermore, revenues from combustible products fell 3% to \$6,179 million in the quarter due to declines in all regions, except South & Southeast Asia. In 2020, total cigarette and heated tobacco unit shipment volumes are likely to drop 2.5-3.5% on an LFL basis. In fact, international industry volumes are also expected to decline, due to higher excise taxes in Indonesia and the cigarillo category gaining traction in Japan.

Philip Morris struggles with soft cigarette volumes due to reduced demand, rising health concerns and anti-tobacco campaigns.

We note that cigarette shipment volumes are being adversely impacted by lower demand for cigarettes, stemming from anti-tobacco campaigns and consumers' rising health consciousness. Moreover, regulatory hurdles (discussed below) have created limitation for marketing cigarettes, further hindering its sales volumes.

- ▼ **Restrictions on Tobacco Consumption:** The tobacco industry faces many challenges as governments around the world are imposing restrictions on tobacco companies which, in turn, are lowering cigarette consumption. The U.S. Food and Drug Administration (FDA) has made it mandatory for tobacco companies to use precautionary labels on cigarette packets to dissuade customers from smoking. In fact, per court orders, Reynolds American along with Altria Group and other cigarette makers have been directed to put up self-critical advertisements on television and newspapers to dissuade customers from smoking. Apart from this, the court wants tobacco companies to admit that cigarettes have been made addictive, through the issuance of corrective ads. To add to the woes, the FDA is now bent on drastically reducing nicotine in cigarettes to minimally addictive levels. The initiative was proposed in 2017 but was delayed, due to ongoing research. If enacted, lowering of nicotine levels will undoubtedly prove disastrous for cigarette manufacturing companies. In more recent developments, the FDA has raised concerns surrounding the consumption of e-cigarettes amongst the youth. This has propelled the agency to issue warning letters and enforce fines upon several retailers who illegally sold e-cigarettes to minors.

Apart from these, FDA had earlier announced that tobacco makers must seek marketing authorization for any tobacco product introduced after Feb 15, 2007. The law was extended by the FDA to include e-cigarettes, pipe tobacco, cigars and hookah. Also, the European Union and the FDA have proposed a ban on menthol in accordance with the Tobacco Control Act which essentially states that menthol cigarettes have an adverse impact on public health and suggests the removal of menthol.

- ▼ **Currency Headwinds:** Philip Morris' significant international presence exposes it to the risk of adverse currency fluctuations. In fact, currency had an unfavorable impact on the company's performance in the fourth quarter of 2019. Management expects currency to have adverse impact of nearly 4 cents upon earnings in 2020. That said, volatility in exchange rates always remains a concern.
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Last Earnings Report

Philip Morris Q4 Earnings Match Estimates, Revenues Beat

Philip Morris reported fourth-quarter 2019 results. Adjusted earnings per share of \$1.22 came in line with the Zacks Consensus Estimate. The bottom line edged down 2.4% year over year. On a like-for-like (LFL) basis, after excluding currency, the bottom line rose 4.3%.

Net revenues of \$7,713 million beat the Zacks Consensus Estimate of \$7,680 million. The top line grew 2.9% in the reported quarter. On an LFL basis, the metric was up 6.3%, excluding currency. This was backed by favorable pricing variance, partly negated by adverse volume/mix.

During the quarter under review, revenues from combustible products fell 3% to \$6,179 million due to declines in all regions, except South & Southeast Asia. Further, revenues in the RRP's improved 36.2% to \$1,534 million. Most regions saw growth in RRP's, apart from South & Southeast Asia wherein revenues remained flat.

Total cigarette and heated tobacco unit shipment volumes dropped 5% to 192.2 billion units. Cigarette shipment volumes fell 8% to 175.1 billion units in the quarter, while heated tobacco unit shipment volumes of nearly 17.1 billion units surged 40.7% year over year.

Adjusted operating income grew nearly 6% to reach \$2,863 million. On an LFL basis, after excluding currency, adjusted operating income improved 11.9% year over year. Adjusted operating margin expanded 1.1 points to 37.1% and 1.8 points to 36.7% (excluding currency and on an LFL basis).

Region-Wise Performance

Net revenues in the European Union increased 4.1% to \$2,436 million. Revenues grew 8.6% at cc, courtesy of favorable pricing and volume/mix. Total shipment volumes in the region slipped 1.9% to 44,985 million units.

In Eastern Europe, net revenues grew 20.3% to \$982 million and rose 16.8% at cc. The upside can be attributed to favorable pricing and volume/mix. Total shipment volumes inched up 1.2% to 31,105 million units.

In the Middle East & Africa region, net revenues declined 0.4% (down 1.6% at cc) to \$984 million. Further, total shipment volumes fell 8.6% to 33,204 million units.

Revenues in South & Southeast Asia rose 21.7% (up 16.1% at cc) to \$1,487 million. The upside was driven by favorable pricing variance, partly offset by adverse volume/mix. Shipment volumes declined 6.1% to 44,704 million units.

Revenues from East Asia & Australia fell 5.6% (at cc) to \$1,270 million due to unfavorable volume/mix, partly compensated by pricing gains. Total shipment volumes dropped 5.8% to 18,725 million units.

Finally, revenues from Latin America & Canada decreased 29.7% (down 28.6% at cc) to \$554 million. Moreover, total shipment volumes declined 11.3% to 19,484 million units.

Other Financials

The company ended the quarter with cash and cash equivalents of \$6,861 million. Also, the company had long-term debt of \$26,656 million and shareholders' deficit of \$9,599 million.

Guidance

While management foresees some hurdles in Indonesia in 2020, it expects to deliver currency-neutral net revenue and bottom-line growth in 2020 (on an LFL basis). In 2020, currency-neutral revenues are expected to rise about 5% on an LFL basis. Total cigarette and heated tobacco unit shipment volumes are likely to drop 2.5-3.5% on an LFL basis. In fact, international industry volumes are also expected to decline, owing to higher excise taxes in Indonesia and the cigarillo category gaining traction in Japan.

Currency-neutral adjusted operating margin is expected to expand 150 bps on an LFL basis, thanks to cost-control measures, which are expected to completely offset additional investments in RRP's. Further, management expects effective tax rate for 2020 to be roughly 23%.

Finally, the company envisions adjusted earnings per share of \$5.50 for 2020. Excluding the expected currency impact of 4 cents, earnings are anticipated to be at least \$5.54, which indicates growth of at least 8% from the year-ago quarter's reported figure.

Quarter Ending **12/2019**

Report Date	Feb 06, 2020
Sales Surprise	0.43%
EPS Surprise	0.00%
Quarterly EPS	1.22
Annual EPS (TTM)	5.20

Recent News

Philip Morris Expands Smoke-Free Offerings With KT&G Alliance - Jan 28, 2020

Philip Morris announced a partnership with South Korea's KT&G to commercialize the latter's smoke-free products outside the country. Philip Morris' deal with this South Korean nicotine and tobacco company will be effective for three years initially. This global collaboration aims at expanding the reach of KT&G's smoke-free products to many other markets. The agreement doesn't include the South Korean region or even combustible products. Currently, there are no plans to commercialize this South Korean company's products in the United States.

With this deal, Phillip Morris can exclusively distribute KT&G's current smoke-free products, as well as their evolutions, and continue distributing its own and other third-party products. Markedly, KT&G's smoke-free products portfolio includes heat-not-burn tobacco systems (such as Lil Mini and Lil Plus); hybrid technologies, which unite heat-not-burn tobacco and e-vapor technologies (such as Lil Hybrid); and e-vapor products (like Lil Vapor).

However, the products sold as part of this collaboration will undergo the required assessments. Also, both companies will have to obtain any necessary regulatory approvals, which may be required.

Valuation

Philip Morris shares are up 0.6% in the year-to-date period and down 1.1% over the trailing 12-month period. Stocks in the Zacks sub-industry are up 0.5% in the year-to-date period, while the Zacks Consumer Staples sector gained 0.1%. Over the past year, the Zacks sub-industry is up 1.8%, while the sector gained 11.2%.

The S&P 500 index is up 3.6% in the year-to-date period and 18.7% in the past year.

The stock is currently trading at 15.02X forward 12-month earnings, which compares to 11.99X for the Zacks sub-industry, 19.71X for the Zacks sector and 19.08X for the S&P 500 index.

Over the past five years, the stock has traded as high as 23.71X and as low as 12.47X, with a 5-year median of 18.45X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$90 price target reflects 15.8X forward 12-month earnings.

The table below shows summary valuation data for PM

Valuation Multiples - PM					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	15.02	11.99	19.71	19.08
	5-Year High	23.71	21.23	22.38	19.34
	5-Year Low	12.47	10.54	16.66	15.18
	5-Year Median	18.45	17.47	19.71	17.47
P/S F12M	Current	4.24	3.8	10.05	3.51
	5-Year High	6.47	6.8	11.13	3.51
	5-Year Low	3.41	3.13	8.09	2.54
	5-Year Median	4.8	4.9	9.88	3
EV/EBITDA F12M	Current	11.83	9.41	34.39	13.54
	5-Year High	16.45	17.13	37.23	13.72
	5-Year Low	9.99	8.03	29.38	9.08
	5-Year Median	13.05	12.89	33.59	10.81

As of 02/22/2020

Industry Analysis Zacks Industry Rank: Bottom 16% (214 out of 255)



Top Peers

British American Tobacco p.l.c. (BTI)	Neutral
Imperial Tobacco Group PLC (IMBBY)	Neutral
JAPAN TOB INC (JAPAY)	Neutral
Altria Group, Inc. (MO)	Neutral
Constellation Brands Inc (STZ)	Neutral
Schweitzer-Mauduit International, Inc. (SWM)	Neutral
Turning Point Brands, Inc. (TPB)	Neutral
Vector Group Ltd. (VGR)	Neutral

Industry Comparison Industry: Tobacco				Industry Peers		
	PM Neutral	X Industry	S&P 500	BTI Neutral	IMBBY Neutral	MO Neutral
VGM Score	B	-	-	B	A	A
Market Cap	133.14 B	1.59 B	23.50 B	95.52 B	21.02 B	81.82 B
# of Analysts	9	1	13	5	4	8
Dividend Yield	5.47%	4.97%	1.83%	6.25%	16.93%	7.67%
Value Score	D	-	-	C	A	B
Cash/Price	0.05	0.09	0.04	0.04	0.14	0.02
EV/EBITDA	13.41	8.69	13.56	NA	NA	10.43
PEG Ratio	1.89	1.48	2.02	1.40	0.92	1.55
Price/Book (P/B)	NA	2.00	3.20	1.05	2.95	12.95
Price/Cash Flow (P/CF)	14.71	8.49	13.05	8.49	4.30	10.31
P/E (F1)	15.53	10.74	18.56	9.67	6.34	9.93
Price/Sales (P/S)	1.71	1.71	2.60	NA	NA	3.26
Earnings Yield	6.54%	9.35%	5.38%	10.33%	15.75%	10.07%
Debt/Equity	-2.78	0.29	0.70	0.63	2.09	4.28
Cash Flow (\$/share)	5.82	3.09	7.03	4.91	5.11	4.25
Growth Score	B	-	-	D	A	B
Hist. EPS Growth (3-5 yrs)	2.70%	5.36%	10.85%	NA	NA	10.82%
Proj. EPS Growth (F1/F0)	7.94%	4.52%	6.90%	3.95%	3.13%	4.56%
Curr. Cash Flow Growth	1.35%	1.47%	6.78%	20.53%	-3.71%	2.23%
Hist. Cash Flow Growth (3-5 yrs)	-2.07%	2.16%	8.38%	8.12%	1.08%	8.44%
Current Ratio	1.09	1.20	1.22	0.73	0.90	0.59
Debt/Capital	NA%	38.82%	42.37%	38.82%	67.69%	81.06%
Net Margin	9.21%	5.83%	11.57%	NA	NA	-5.15%
Return on Equity	-84.30%	9.89%	16.80%	NA	NA	67.74%
Sales/Assets	1.92	0.90	0.55	NA	NA	0.46
Proj. Sales Growth (F1/F0)	4.58%	0.59%	4.03%	0.59%	-70.21%	2.49%
Momentum Score	A	-	-	A	B	A
Daily Price Chg	-4.54%	-1.77%	-2.98%	-4.40%	-2.74%	-4.55%
1 Week Price Chg	1.29%	-1.00%	-0.94%	0.23%	-5.42%	1.59%
4 Week Price Chg	1.02%	-4.92%	-0.94%	-4.68%	-12.96%	-12.00%
12 Week Price Chg	3.60%	-7.42%	1.75%	5.06%	-1.52%	-13.44%
52 Week Price Chg	-1.19%	-23.21%	10.97%	10.31%	-36.13%	-15.51%
20 Day Average Volume	4,597,755	325,291	2,001,782	1,241,852	325,291	9,415,653
(F1) EPS Est 1 week change	0.64%	0.00%	0.00%	0.00%	0.00%	0.17%
(F1) EPS Est 4 week change	0.18%	-0.14%	-0.05%	-0.28%	-2.46%	0.28%
(F1) EPS Est 12 week change	0.22%	0.09%	-0.21%	0.42%	-3.95%	0.08%
(Q1) EPS Est Mthly Chg	2.44%	2.44%	-0.49%	NA	NA	2.50%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	D
Growth Score	B
Momentum Score	A
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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