
M.A. WRIGHT FUND EQUITY RESEARCH



Vineet Majmudar
majmudar@rice.edu

Phillip Morris (NYSE: MO)

Hold

February 6, 2002

S&P Sector – Consumer Staples

Industry – Tobacco

MARKET DATA

Price	52-Wk Range	Price Target	Shares Out.	Market Cap.	Beta	Book Value	P/S	P/E
1-30-02 close	low on 9-25-01	Valuation Result	(billion)	(billion)	Yahoo Finance	per share	(ttm)	(ttm)
\$46.89	\$41.47-\$53.88	\$55.67	2.17	\$107.3	0.19	\$9.10	1.21	12.73

COMPANY OVERVIEW – FROM YAHOO! FINANCE

Phillips Morris Companies Inc. is a holding company. Its principal wholly owned subsidiaries are manufacturers and marketers of various consumer products, most notably Marlboro cigarettes, Kraft packaged goods, and Miller beer. The company's businesses have about 90 brands that generate annual revenues of over \$100 million each, with 15 of those brands generating sales exceeding \$1 billion each.

Phillip Morris U.S.A. is the largest U.S. tobacco company; Kraft Foods is the largest packaged food company in North America and Miller Brewing is the second leading U.S. brewer.

Tobacco, the company's flagship business accounts for about 60% of the revenue, with Marlboro, Benson & Hedges, Merit, and Virginia Slims as some of their major brands. Food, with 34% of the total revenue, includes coffee, Post cereals, and packaged foods (Jell-O, Kool-Aid, Oscar Meyer, Kraft, Velveeta, and Miracle Whip). Beverages, with about 5% of the revenue, include the Miller brand; and financial services / real estate contribute about 1% of the total revenue.

INVESTMENT RECOMMENDATION

- ☐ Hold 400 shares of MO.

SUMMARY

- ☐ The stock is currently undervalued by approximately 10-12%. Bloomberg's Dividend Discount Model, on February 5, 2002 rendered an intrinsic value of \$55.67. Valuepro's DCF evaluation of MO rendered an intrinsic value of \$55.20.
 - ☐ The company completed the Kraft Foods Inc. initial public offering and used the net proceeds of \$8.4 billion to repay a portion of the debt incurred to finance the acquisition of Nabisco (Nov. 2000). The litigation issues surrounding their tobacco operations had significantly undercut the value of Kraft, hence the spin off.
 - ☐ The company spent \$4.0 billion to repurchase 84.6 million shares of its common stock, representing 3.8% of its shares outstanding at December 31, 2000.
 - ☐ The company remains the leading player in the domestic tobacco arena, with a retail share of 50.7%. Its share in the premium market is even more dominant at 62%.
 - ☐ Management's tone has become more cautious, with long term growth expected to be around 10% instead of 12%.
 - ☐ Louis Camilleri will succeed Geoffrey Bible as Philip Morris president and chief executive officer in April.
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- ☐ The company has left open the possibility of selling Miller Brewing if the right offer comes on the table
- ☐ The company may change its name to Altria Group in April 2002 if shareholders approve.

INDUSTRY INSIGHT

News & Trends The near term outlook for the tobacco industry is positive, since their defensive appeal in this environment is attractive

The improving litigation and regulatory environment should also help the industry. The most important near-term litigation threat is the Engle Class action case in Florida, which resulted in a \$145 billion damage award against the industry. The legal precedent remains on the side of the industry and it is most likely this award will be overturned. With a Republican president, the industry should benefit from a tobacco friendly environment and the risk of future federal excise tax increases has diminished.

It is expected that annual domestic cigarette consumption should decline by 1 – 2%. Therefore, long term growth will have to be fueled by international expansion and price increases.

INVESTMENT HIGHLIGHTS

**Overall Effect on
Wright Fund**

The recommendation to hold 400 shares of MO has no effect on the assets of our fund. MO represents about 3.2% of the Wright Fund's assets and almost 60% of the consumer staples sector. We believe MO is an investment with a time horizon of 2 to 3 years. Since the demand for cigarettes is fairly inelastic, they recent price increases should show decent growth in the coming quarters for the tobacco industry.

Based on our recent analysis of the consumer staples sector, we feel that the current weighting in relation to the S&P 500 index is acceptable. Investors have used this sector to hedge their other investments. The economic slowdown, combined with the fact that the NASDAQ is significantly off its peak has driven more money into this sector, such that current evaluations are quite high.

Risks

The company's tobacco subsidiaries continue to be subject to health concerns relating to the use of their products, including increasing marketing, regulatory, and smoking restrictions; the effects on consumptions rates due to price increases; governmental investigations; and litigation, including risks associated with adverse jury and judicial determinations.

**Recent Results
& Guidance**

Company Results:

- ☐ MO reported fiscal year 2001 net earnings up 0.6% to \$8.6 billion. Reported diluted earnings per share were up 3.2% to \$3.87, while reported operating companies income rose 7.7% to \$17.5 billion.
- ☐ According to Geoffrey C. Bible, chairman of the board and chief executive officer, "Philip Morris continued to deliver solid results in a difficult global environment in 2001. We look forward to another year of strong performance.

Our underlying diluted earnings per share are projected to grow in the range of 9% to 11%. The strength of the U.S. dollar versus foreign currencies and economic weakness in certain international markets, represent continuing risks to this projection.

Investment rationale:

- ❑ MO is currently trading at 12.73 time trailing earnings. This is a huge discount compared to the S&P 500 index. Many of the lawsuits currently pending against the tobacco industry will begin to fade out late in 2002. Unless the courts really go after tobacco companies, P/E valuations throughout the industry should gradually rise over the next couple of years.
- ❑ MO shares carry a dividend yield of 4.8%.
- ❑ They have done well in spite of the strong dollar. Any devaluation would accrue strongly to their advantage.
- ❑ Its strong management team has been buying back shares to help bolster MO's stock price. This provides some evidence that the stock is undervalued.
- ❑ Compared to its competitors, MO is the only company with a credit quality rating of A. It also has the highest return on equity, of 56.2% compared to its peer group.

MO Earnings & Growth Estimates:

First Call Consensus Estimate Snapshot				
PHILIP MORRIS INC.(EX GW) (MO) Last Updated: 31-Jan-02				
Current Period	Mean EPS	# of Brokers	Report Date	Year Ago EPS
Dec/2001 Q	0.99	9	30-Jan-02	0.87
Dec/2001 FY	4.04	10	30-Jan-02	3.71
P/E Ratio:	12.3			
Consensus Recommendation:	1.5			
Consensus Future 5-yr Growth Rate:	10.50%			

Key Ratios

	2000	1999	1998	1997	1996	1995	1994	1993	1992	1991
Current Ratio	0.7	1.2	1.2	1.2	1.1	1.4	NA	NA	NA	NA
% LT Debt of Cap.	46.9	36.8	37.2	42.3	44.2	42.6	48.1	50.6	48.0	48.7
% Net Inc. of Revs.	10.6	9.8	7.2	11.2	11.6	10.3	8.8	7.0	9.9	8.2
% Ret. On Assets	12.1	12.7	9.3	11.4	11.6	10.3	9.2	7.1	10.3	8.4
% Ret. On Equity	56.2	48.7	34.5	43.3	44.7	41.0	39.2	29.8	40.0	32.2

Phillips Morris: Recent Annual Financials (from Hoovers.com)

Annual Financials			
Income Statement All amounts in millions of US Dollars except per share amounts.			
	Dec 01 (Prelim.)	Dec-00	Dec-99
Revenue	89,924.00	80,356.00	78,596.00
Cost of Goods Sold	--	28,022.00	28,441.00
Gross Profit	--	52,334.00	50,155.00
Gross Profit Margin	--	65.10%	63.80%
SG&A Expense	--	18,858.00	18,118.00
Depreciation & Amortization	--	1,717.00	1,702.00
Operating Income	--	14,679.00	13,490.00
Operating Margin	--	18.30%	17.20%
Total Net Income	8,560.00	8,510.00	7,675.00
Net Profit Margin	9.50%	10.60%	9.80%
Diluted EPS (\$)	3.87	3.75	3.19
Balance Sheet			
	Dec 01 (Prelim.)	Dec-00	Dec-99
Cash	--	937	5,100.00
Net Receivables	--	5,019.00	4,313.00
Inventories	--	8,765.00	9,028.00
Total Current Assets	--	17,238.00	20,895.00
Total Assets	--	79,067.00	61,381.00
Short-Term Debt	--	9,968.00	2,242.00
Total Current Liabilities	--	26,976.00	18,017.00
Long-Term Debt	--	19,154.00	12,226.00
Total Liabilities	--	64,062.00	46,076.00
Total Equity	--	15,005.00	15,305.00
Shares Outstanding (mil.)	2,166.70	2,208.90	2,338.50

Some figures may not add up due to rounding.

SUMMARY OF MODEL

Current Price: 49.87
 Theoretical Price: 55.67 (Bloomberg Dividend Discount Model)
 Percent Change from Close: 12.87%
 Growth Rate: 9.5%
 Growth Years: 5, Transitional Growth Years: 5
 Long term Growth Rate: 4.0%
 Risk Premium: 5.0%
 IRR: 11.11%

CHARTS / TECHNICAL**MO Daily Stock Chart (source: YahooFinance 2/05/02)**Philip Morris Companies Inc
as of 4-Feb-2002

Splits: ▼

**MO Performance v/s S&P 500 index**Philip Morris Companies Inc
as of 31-Jan-2002

Splits: ▼



REFERENCES

Yahoo Finance
Bloomberg DDM
S&P500 Report
MSN Money
ValuePro.Net