

ALTRIA GROUP, INC.

Form 10-Q

October 27, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 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)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant 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 Web site, 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 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 a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

At October 17, 2016, there were 1,950,270,736 shares outstanding of the registrant's common stock, par value \$0.33 1/3 per share.

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## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements.

Altria Group, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(in millions of dollars)

(Unaudited)

	September 30, December 31,	
	2016	2015
Assets		
Cash and cash equivalents	\$ 2,298	\$ 2,369
Receivables	146	124
Inventories:		
Leaf tobacco	844	957
Other raw materials	174	181
Work in process	410	444
Finished product	552	449
	1,980	2,031
Deferred income taxes	1,188	1,175
Other current assets	791	387
Total current assets	6,403	6,086
Property, plant and equipment, at cost	4,820	4,877
Less accumulated depreciation	2,851	2,895
	1,969	1,982
Goodwill	5,285	5,285
Other intangible assets, net	12,042	12,028
Investment in SABMiller	5,826	5,483
Finance assets, net	1,046	1,239
Other assets	363	360
Total Assets	\$ 32,934	\$ 32,463

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, 2016	December 31, 2015
<b>Liabilities</b>		
Current portion of long-term debt	\$ —	\$ 4
Accounts payable	296	400
Accrued liabilities:		
Marketing	797	695
Employment costs	216	198
Settlement charges	3,429	3,590
Other	964	1,081
Dividends payable	1,193	1,110
Total current liabilities	6,895	7,078
Long-term debt	13,878	12,843
Deferred income taxes	5,607	5,663
Accrued pension costs	863	1,277
Accrued postretirement health care costs	2,296	2,245
Other liabilities	412	447
Total liabilities	29,951	29,553
Contingencies (Note 11)		
Redeemable noncontrolling interest	36	37
Stockholders' Equity		
Common stock, par value \$0.33 1/3 per share (2,805,961,317 shares issued)	935	935
Additional paid-in capital	5,864	5,813
Earnings reinvested in the business	27,816	27,257
Accumulated other comprehensive losses	(3,278	) (3,280
Cost of repurchased stock (854,558,381 shares at September 30, 2016 and 845,901,836 shares at December 31, 2015)	(28,393	) (27,845
Total stockholders' equity attributable to Altria Group, Inc.	2,944	2,880
Noncontrolling interests	3	(7
Total stockholders' equity	2,947	2,873
Total Liabilities and Stockholders' Equity	\$ 32,934	\$ 32,463
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,	
	2016	2015
Net revenues	\$19,492	\$19,116
Cost of sales	5,841	5,733
Excise taxes on products	4,888	4,991
Gross profit	8,763	8,392
Marketing, administration and research costs	1,871	1,951
Reduction of PMI tax-related receivable	—	41
Asset impairment and exit costs	123	4
Operating income	6,769	6,396
Interest and other debt expense, net	571	609
Loss on early extinguishment of debt	823	228
Earnings from equity investment in SABMiller	(564 )	(546 )
Gain on derivative financial instruments	(205 )	—
Earnings before income taxes	6,144	6,105
Provision for income taxes	2,178	2,110
Net earnings	3,966	3,995
Net earnings attributable to noncontrolling interests	(3 )	(1 )
Net earnings attributable to Altria Group, Inc.	\$3,963	\$3,994
Per share data:		
Basic and diluted earnings per share attributable to Altria Group, Inc.	\$2.02	\$2.03
Dividends declared	\$1.74	\$1.605

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,	
	2016	2015
Net revenues	\$6,905	\$6,699
Cost of sales	2,043	1,932
Excise taxes on products	1,712	1,721
Gross profit	3,150	3,046
Marketing, administration and research costs	766	698
Reduction of PMI tax-related receivable	—	41
Asset impairment and exit costs	2	—
Operating income	2,382	2,307
Interest and other debt expense, net	179	205
Loss on early extinguishment of debt	823	—
Earnings from equity investment in SABMiller	(299 )	(187 )
Gain on derivative financial instruments	(48 )	—
Earnings before income taxes	1,727	2,289
Provision for income taxes	633	761
Net earnings	1,094	1,528
Net earnings attributable to noncontrolling interests	(1 )	—
Net earnings attributable to Altria Group, Inc.	\$1,093	\$1,528
Per share data:		
Basic and diluted earnings per share attributable to Altria Group, Inc.	\$0.56	\$0.78
Dividends declared	\$0.61	\$0.565
See notes to condensed consolidated financial statements.		

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Altria Group, Inc. and Subsidiaries  
 Condensed Consolidated Statements of Comprehensive Earnings  
 (in millions of dollars)  
 (Unaudited)

	For the Nine Months Ended September 30,	
	2016	2015
Net earnings	\$3,966	\$3,995
Other comprehensive earnings (losses), net of deferred income taxes:		
Currency translation adjustments	1	(3 )
Benefit plans	(116 )	121
SABMiller	117	(593 )
Other comprehensive earnings (losses), net of deferred income taxes	2	(475 )
Comprehensive earnings	3,968	3,520
Comprehensive earnings attributable to noncontrolling interests	(3 )	(1 )
Comprehensive earnings attributable to Altria Group, Inc.	\$3,965	\$3,519
See notes to condensed consolidated financial statements.		



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Altria Group, Inc. and Subsidiaries  
 Condensed Consolidated Statements of Comprehensive Earnings  
 (in millions of dollars)  
 (Unaudited)

	For the Three Months Ended September 30,	
	2016	2015
Net earnings	\$1,094	\$1,528
Other comprehensive earnings (losses), net of deferred income taxes:		
Currency translation adjustments	—	(2 )
Benefit plans	28	40
SABMiller	34	(317 )
Other comprehensive earnings (losses), net of deferred income taxes	62	(279 )
Comprehensive earnings	1,156	1,249
Comprehensive earnings attributable to noncontrolling interests	(1 )	—
Comprehensive earnings attributable to Altria Group, Inc.	\$1,155	\$1,249

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, 2015 and  
the Nine Months Ended September 30, 2016  
(in millions of dollars, except per share data)  
(Unaudited)

	Attributable to Altria Group, Inc.						Total
	Common Stock	Additional Paid-in Capital	Earnings Reinvested in the Business	Accumulated Other Comprehensive Losses	Cost of Repurchased Stock	Non-controlling Interests	Stockholders' Equity
Balances, December 31, 2014	\$935	\$5,735	\$26,277	\$ (2,682 )	\$ (27,251 )	\$ (4 )	\$ 3,010
Net earnings (losses) <sup>(1)</sup>	—	—	5,241	—	—	(3 )	5,238
Other comprehensive losses, net of deferred income taxes	—	—	—	(598 )	—	—	(598 )
Stock award activity	—	78	—	—	(40 )	—	38
Cash dividends declared (\$2.17 per share)	—	—	(4,261 )	—	—	—	(4,261 )
Repurchases of common stock	—	—	—	—	(554 )	—	(554 )
Balances, December 31, 2015	935	5,813	27,257	(3,280 )	(27,845 )	(7 )	2,873
Net earnings <sup>(1)</sup>	—	—	3,963	—	—	—	3,963
Other comprehensive earnings, net of deferred income taxes	—	—	—	2	—	—	2
Stock award activity	—	61	—	—	(36 )	—	25
Cash dividends declared (\$1.74 per share)	—	—	(3,404 )	—	—	—	(3,404 )
Repurchases of common stock	—	—	—	—	(512 )	—	(512 )
Other	—	(10 )	—	—	—	10	—
Balances, September 30, 2016	\$935	\$5,864	\$27,816	\$ (3,278 )	\$ (28,393 )	\$ 3	\$ 2,947

Amounts attributable to noncontrolling interests for the nine months ended September 30, 2016 and for the year ended December 31, 2015 exclude net earnings of \$3 million and \$5 million, respectively, due to the redeemable noncontrolling interest related to Stag's Leap Wine Cellars, which is reported in the mezzanine equity section in the condensed consolidated balance sheets at September 30, 2016 and December 31, 2015.

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,  
2016 2015

Cash Provided by (Used in) Operating Activities		
Net earnings	\$3,966	\$3,995
Adjustments to reconcile net earnings to operating cash flows:		
Depreciation and amortization	149	150
Deferred income tax benefit	(69)	(1)
Earnings from equity investment in SABMiller	(564)	(546)
Dividends from SABMiller	403	374
Gain on derivative financial instruments	(205)	—
Asset impairment and exit costs, net of cash paid	71	2
Loss on early extinguishment of debt	823	228
Cash effects of changes:		
Receivables	(21)	9
Inventories	54	59
Accounts payable	(132)	(102)
Income taxes	(122)	(6)
Accrued liabilities and other current assets	(257)	22
Accrued settlement charges	(161)	(284)
Pension plan contributions	(520)	(23)
Pension provisions and postretirement, net	(56)	78
Other	141	135
Net cash provided by operating activities	3,500	4,090
Cash Provided by (Used in) Investing Activities		
Capital expenditures	(128)	(162)
Proceeds from finance assets	207	255
Other	(44)	2
Net cash provided by investing activities	35	95
Cash Provided by (Used in) Financing Activities		
Long-term debt issued	1,976	—
Long-term debt repaid	(933)	(1,793)
Repurchases of common stock	(512)	(518)
Dividends paid on common stock	(3,321)	(3,071)
Premiums and fees related to early extinguishment of debt	(809)	(226)
Other	(7)	9
Net cash used in financing activities	(3,606)	(5,599)
Cash and cash equivalents:		
Decrease	(71)	(1,414)
Balance at beginning of period	2,369	3,321
Balance at end of period	\$2,298	\$1,907

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. Background and Basis of Presentation:

Background

At September 30, 2016, Altria Group, Inc.'s wholly-owned subsidiaries included Philip Morris USA Inc. ("PM USA"), which is engaged predominantly 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. 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 September 30, 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 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 its previously-announced 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"), has become 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 at October 10, 2016 based on AB InBev's shares outstanding. 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 October 24, 2016. For further discussion, see Note 4. Investment in SABMiller/AB InBev.

Dividends and Share Repurchases

During the third quarter of 2016, Altria Group, Inc.'s Board of Directors (the "Board of Directors") approved an 8.0% increase in the quarterly dividend rate to \$0.61 per common share versus the previous rate of \$0.565 per common share. The current annualized dividend rate is \$2.44 per Altria Group, Inc. common share. Future dividend payments remain subject to the discretion of the Board of Directors.

In July 2014, the Board of Directors authorized a \$1.0 billion share repurchase program (the "July 2014 share repurchase program"). During the third quarter of 2015, Altria Group, Inc. completed the July 2014 share repurchase program, under which Altria Group, Inc. repurchased a total of 20.4 million shares of its common stock at an average price of \$48.90 per share.

In July 2015, the Board of Directors authorized a \$1.0 billion share repurchase program, of which approximately \$453 million was remaining at September 30, 2016. In October 2016, the Board of Directors authorized a \$2.0 billion expansion of this program from \$1.0 billion to \$3.0 billion. The timing of share repurchases under this program depends upon marketplace conditions and other factors, and the program remains subject to the discretion of the Board of Directors.

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Altria Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Altria Group, Inc.'s share repurchase activity was as follows:

	For the Nine Months Ended September 30, 2016		For the Three Months Ended September 30, 2015	
	2016	2015	2016	2015
	(in millions, except per share data)			
Total number of shares repurchased	8.1	10.0	2.6	1.2
Aggregate cost of shares repurchased	\$512	\$518	\$171	\$63
Average price per share of shares repurchased	\$63.28	\$51.47	\$66.23	\$50.39

## Basis of Presentation

The interim condensed consolidated financial statements of 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 in the interim condensed consolidated financial statements. All such adjustments were of a normal recurring nature. Net revenues and net earnings for any interim period are not necessarily indicative of results that may be expected for the entire year.

These statements should be read in conjunction with the consolidated financial statements and related notes, which appear in Altria Group, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2015 (the "2015 Form 10-K").

On January 1, 2016, Altria Group, Inc. adopted Accounting Standards Update ("ASU") No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs ("ASU No. 2015-03"), which requires that debt issuance costs related to a recognized debt liability be presented on the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts, rather than as a deferred charge (an asset). As a result of the adoption, \$79 million of debt issuance costs have been presented on Altria Group, Inc.'s condensed consolidated balance sheet at September 30, 2016 as a deduction from the carrying amount of long-term debt. In addition, \$72 million of debt issuance costs were reclassified from other assets to long-term debt on Altria Group, Inc.'s condensed consolidated balance sheet at December 31, 2015.

For a description of recently issued accounting guidance that Altria Group, Inc. has not yet adopted, see Note 13. Recent Accounting Guidance Not Yet Adopted.

Note 2. Asset Impairment, Exit and Implementation Costs:

## Productivity Initiative

In January 2016, Altria Group, Inc. announced a productivity initiative designed to maintain its operating companies' leadership and cost competitiveness. The initiative reduces spending on certain selling, general and administrative infrastructure and implements a leaner organizational structure. As a result of this initiative, Altria Group, Inc. expects to incur total pre-tax restructuring charges of approximately \$140 million, or \$0.05 per share, substantially all of which are expected to be recorded in 2016 and result in cash expenditures. The charges consist of employee separation costs of approximately \$120 million and other associated costs of approximately \$20 million.





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Altria Group, Inc. and Subsidiaries  
 Notes to Condensed Consolidated Financial Statements  
 (Unaudited)

Pre-tax restructuring charges for the nine and three months ended September 30, 2016 of \$130 million, or \$0.04 per share, and \$6 million, respectively, recorded in connection with the productivity initiative consisted of the following:

	For the Nine Months Ended September 30, 2016			For the Three Months Ended September 30, 2016		
	Asset Impairment and Exit Costs (1)	Implementation Costs	Total	Asset Impairment and Exit Costs	Implementation Costs	Total
	(in millions)					
Smokeable products	\$99	\$ 6	\$105	\$ 1	\$ 3	\$ 4
Smokeless products	13	1	14	—	1	1
All other	6	—	6	1	—	1
General corporate	5	—	5	—	—	—
Total	\$123	\$ 7	\$130	\$ 2	\$ 4	\$ 6

(1) Includes termination and curtailment costs of \$20 million. See Note 3. Benefit Plans.

The movement in the restructuring liabilities (excluding termination and curtailment costs), substantially all of which are severance liabilities, was as follows:

	For the Nine Months Ended September 30, 2016 (in millions)
Charges	\$ 103
Cash spent	(52 )
Balances at September 30, 2016	\$ 51

#### Facilities Consolidation

On October 27, 2016, Altria Group, Inc. announced the consolidation of certain 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. USSTC will transfer its Franklin Park, Illinois operations to its Nashville, Tennessee facility and the Manufacturing Center site in Richmond, Virginia. Employees affected by the consolidation will be offered the opportunity to transfer into available positions; those who do not do so will be offered separation benefits. 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 this consolidation, Altria Group, Inc. expects to record total pre-tax charges of approximately \$150 million, or \$0.05 per share. Of this amount, Altria Group, Inc. expects to record pre-tax charges of approximately \$60 million, or \$0.02 per share, in the fourth quarter of 2016, \$75 million in 2017 and the remainder in 2018. The estimated charges relate primarily to accelerated depreciation (\$55 million), employee separation costs (\$45 million)

and other exit and implementation costs (\$50 million). Approximately \$90 million of the total pre-tax charges are expected to result in cash expenditures. These estimated charges do not reflect the non-cash impact that may result from pension settlement and curtailment accounting.

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Altria Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

## Note 3. Benefit Plans:

Subsidiaries of Altria Group, Inc. sponsor noncontributory defined benefit pension plans covering the majority of all employees of Altria Group, Inc. and its subsidiaries. However, employees hired on or after a date specific to their employee group are not eligible to participate in these noncontributory defined benefit pension plans but are instead eligible to participate in a defined contribution plan with enhanced benefits. This transition for new hires occurred from October 1, 2006 to January 1, 2008. In addition, effective January 1, 2010, certain employees of UST's subsidiaries and Middleton who were participants in noncontributory defined benefit pension plans ceased to earn additional benefit service under those plans and became eligible to participate in a defined contribution plan with enhanced benefits. Altria Group, Inc. and its subsidiaries also provide postretirement health care and other benefits to the majority of retired employees.

## Components of Net Periodic Benefit Cost (Income)

Net periodic benefit cost (income) consisted of the following:

	For the Nine Months Ended September 30,				For the Three Months Ended September 30,			
	Pension		Postretirement		Pension		Postretirement	
	2016	2015	2016	2015	2016	2015	2016	2015
	(in millions)							
Service cost	\$55	\$65	\$ 12	\$ 13	\$18	\$22	\$ 4	\$ 4
Interest cost	211	252	58	75	70	84	18	24
Expected return on plan assets	(416)	(405)	—	—	(139)	(135)	—	—
Amortization:								
Net loss	130	175	19	33	43	58	3	10
Prior service cost (credit)	4	6	(29 )	(30 )	2	2	(10 )	(10 )
Termination and curtailment	20	—	—	—	—	—	—	—
Net periodic benefit cost (income)	\$4	\$93	\$ 60	\$ 91	\$(6 )	\$31	\$ 15	\$ 28

Termination and curtailment costs shown in the table above relate to the productivity initiative discussed in Note 2. Asset Impairment, Exit and Implementation Costs. In conjunction with the curtailment, in the first quarter of 2016 Altria Group, Inc. remeasured the pension benefit obligations, pension plan assets and postretirement benefit obligations of the impacted benefit plans. This remeasurement resulted in an increase to the liabilities for accrued pension costs and accrued postretirement health care costs of approximately \$250 million and \$70 million, respectively, and a corresponding increase to accumulated other comprehensive losses.

## Employer Contributions

Altria Group, Inc. makes contributions to the pension plans to the extent that the contributions are tax deductible and pays benefits that relate to plans for salaried employees that cannot be funded under Internal Revenue Service regulations. In September 2016, Altria Group, Inc. made voluntary contributions totaling \$500 million to its pension plans. Additional employer contributions of \$20 million were made to the pension plans during the nine months ended September 30, 2016. Currently, Altria Group, Inc. anticipates making additional employer contributions to its pension plans during the remainder of 2016 of up to approximately \$15 million, based on current tax law. However, this estimate is subject to change as a result of changes in tax and other benefit laws, as well as asset performance significantly above or below the assumed long-term rate of return on pension assets, or changes in interest rates.

## Note 4. Investment in SABMiller/AB InBev:

At September 30, 2016, Altria Group, Inc. had an approximate 27% ownership of SABMiller. Altria Group, Inc. accounted for its investment in SABMiller under the equity method of accounting.

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Altria Group, Inc. and Subsidiaries  
Notes to Condensed Consolidated Financial Statements  
(Unaudited)

AB InBev and SABMiller Business Combination

On October 10, 2016, Legacy AB InBev completed the Transaction, and AB InBev has become the holding company for the combined SABMiller and Legacy AB InBev businesses. Under the terms of the Transaction, SABMiller shareholders received 45 British pounds (“GBP”) in cash for each SABMiller share held, with a partial share alternative (“PSA”), which was subject to proration, available for approximately 41% of the SABMiller shares.

Pursuant to the terms and conditions of an Irrevocable Undertaking, previously delivered by Altria Group, Inc. in November 2015, Altria Group, Inc. voted its 430,000,000 SABMiller shares in favor of the Transaction and elected the PSA.

Upon completion of the Transaction and taking into account proration, Altria Group, Inc. received, in respect of its 430,000,000 SABMiller shares, (i) an interest that was converted into 185,115,417 restricted shares of AB InBev (the “Restricted Shares”), representing a 9.6% ownership of AB InBev at October 10, 2016 based on AB InBev’s shares outstanding, and (ii) approximately \$4.8 billion in pre-tax cash as the cash component of the PSA. Additionally, Altria Group, Inc. received pre-tax cash proceeds of approximately \$0.5 billion from exercising the derivative financial instruments (discussed below), which together with the pre-tax cash from the Transaction totaled approximately \$5.3 billion in pre-tax cash. 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 October 24, 2016.

The Restricted Shares:

are unlisted and not admitted to trading on any stock exchange;  
are subject to a five-year lock-up (subject to limited exceptions) ending October 10, 2021;  
are convertible into ordinary shares of AB InBev on a one-for-one basis after the end of this five-year lock-up period;  
rank equally with ordinary shares of AB InBev with regards to dividends and voting rights; and  
have director nomination rights with respect to AB InBev.

As a result of the Transaction, Altria Group, Inc. expects to record a total estimated pre-tax gain in its reported earnings of approximately \$13.7 billion, or \$8.9 billion after-tax, which is based on the following:

the Legacy AB InBev share price and GBP-to-United States dollar (“USD”) exchange rate as of October 10, 2016;  
the book value of Altria Group, Inc.’s investment in SABMiller at September 30, 2016; and  
the impact of AB InBev’s expected divestitures of certain SABMiller assets and businesses in connection with Legacy AB InBev obtaining necessary regulatory clearances for the Transaction.

Substantially all of the gain will be recorded in the fourth quarter of 2016. Altria Group, Inc. expects that its gain on the Transaction will be deferred for United States corporate income tax purposes, except to the extent of the cash consideration received.

Altria Group, Inc. will account for its investment in AB InBev under the equity method of accounting because Altria Group, Inc. will have the ability to exercise significant influence over the operating and financial policies of AB InBev. This conclusion is based on the fact that Altria Group, Inc. will have active representation on AB InBev’s Board of Directors (“AB InBev Board”) and certain of its Committees. Through its AB InBev Board and Committee representation, Altria Group, Inc. will participate in AB InBev policy making processes. Altria Group, Inc. will report its share of AB InBev’s results using a one-quarter lag because AB InBev’s results will not be available in time to record them in the concurrent period.



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## Derivative Financial Instruments

In November 2015 and August 2016, Altria Group, Inc. entered into a derivative financial instrument, each in the form of a put option (together the “options”) to hedge Altria Group, Inc.’s exposure to foreign currency exchange rate movements in the GBP to the USD, in relation to the pre-tax cash consideration that Altria Group, Inc. expected to receive under the PSA pursuant to the revised and final offer announced by Legacy AB InBev on July 26, 2016. The notional amounts of the November 2015 and August 2016 options were \$2,467 million (1,625 million GBP) and \$480 million (378 million GBP), respectively. The options did not qualify for hedge accounting; therefore, changes in the fair values of the options were recorded as gain on derivative financial instruments in Altria Group, Inc.’s consolidated statements of earnings in the periods in which the changes occurred. For the nine and three months ended September 30, 2016, Altria Group, Inc. recorded pre-tax gains of \$205 million and \$48 million, respectively, for the changes in the fair values of the options. Exercising the options in October 2016 resulted in approximately \$0.5 billion in pre-tax cash proceeds. In the fourth quarter of 2016, Altria Group, Inc. will record a pre-tax gain of approximately \$145 million for the changes in the fair values of the options.

The fair values of the options were determined using binomial option pricing models, which reflect the contractual terms of the options and other observable market-based inputs, and are classified in Level 2 of the fair value hierarchy. At September 30, 2016 and December 31, 2015, the fair values of the options totaling \$360 million and \$152 million, respectively, were recorded in other current assets on Altria Group, Inc.’s condensed consolidated balance sheets.

Note 5. Earnings Per Share:

Basic and diluted earnings per share (“EPS”) were calculated using the following:

	For the Nine Months Ended September 30, 2016		For the Three Months Ended September 30, 2015	
	2016	2015	2016	2015
	(in millions)			
Net earnings attributable to Altria Group, Inc.	\$3,963	\$3,994	\$1,093	\$1,528
Less: Distributed and undistributed earnings attributable to unvested restricted shares and restricted stock units	(6)	(8)	(1)	(3)
Earnings for basic and diluted EPS	\$3,957	\$3,986	\$1,092	\$1,525
Weighted-average shares for basic and diluted EPS	1,954	1,962	1,952	1,958

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## Note 6. Other Comprehensive Earnings/Losses:

The following tables set forth the changes in each component of accumulated other comprehensive losses, net of deferred income taxes, attributable to Altria Group, Inc.:

	For the Nine Months Ended September 30, 2016			
	Currency Translation Adjustments	Benefit Plans	SABMiller	Accumulated Other Comprehensive Losses
	(in millions)			
Balances, December 31, 2015	\$ (5)	\$ (2,010)	\$ (1,265 )	\$ (3,280 )
Other comprehensive earnings (losses) before reclassifications	1	(318 )	158	(159 )
Deferred income taxes	—	122	(56 )	66
Other comprehensive earnings (losses) before reclassifications, net of deferred income taxes	1	(196 )	102	(93 )
Amounts reclassified to net earnings	—	127	24	151
Deferred income taxes	—	(47 )	(9 )	(56 )
Amounts reclassified to net earnings, net of deferred income taxes	—	80	15	95
Other comprehensive earnings (losses), net of deferred income taxes	1	(116 )	117	(1) 2
Balances, September 30, 2016	\$ (4)	\$ (2,126)	\$ (1,148 )	\$ (3,278 )
	For the Three Months Ended September 30, 2016			
	Currency Translation Adjustments	Benefit Plans	SABMiller	Accumulated Other Comprehensive Losses
	(in millions)			
Balances, June 30, 2016	\$ (4)	\$ (2,154)	\$ (1,182 )	\$ (3,340 )
Other comprehensive earnings before reclassifications	—	—	48	48
Deferred income taxes	—	—	(17 )	(17 )
Other comprehensive earnings before reclassifications, net of deferred income taxes	—	—	31	31
Amounts reclassified to net earnings	—	42	5	47
Deferred income taxes	—	(14 )	(2 )	(16 )
Amounts reclassified to net earnings, net of deferred income taxes	—	28	3	31
Other comprehensive earnings, net of deferred income taxes	—	28	34	(1) 62



Balances, September 30, 2016

\$(4) \$(2,126) \$(1,148 ) \$ (3,278 )

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	For the Nine Months Ended September 30, 2015			
	Currency Translation Adjustments	Benefit Plans	SABMiller	Accumulated Other Comprehensive Losses
	(in millions)			
Balances, December 31, 2014	\$ (2)	\$ (2,040)	\$ (640 )	\$ (2,682 )
Other comprehensive losses before reclassifications	(4 )	—	(927 )	(931 )
Deferred income taxes	1	—	324	325
Other comprehensive losses before reclassifications, net of deferred income taxes	(3 )	—	(603 )	(606 )
Amounts reclassified to net earnings	—	198	14	212
Deferred income taxes	—	(77 )	(4 )	(81 )
Amounts reclassified to net earnings, net of deferred income taxes	—	121	10	131
Other comprehensive (losses) earnings, net of deferred income taxes	(3 )	121	(593 ) <sup>(1)</sup>	(475 )
Balances, September 30, 2015	\$ (5)	\$ (1,919)	\$ (1,233 )	\$ (3,157 )
	For the Three Months Ended September 30, 2015			
	Currency Translation Adjustments	Benefit Plans	SABMiller	Accumulated Other Comprehensive Losses
	(in millions)			
Balances, June 30, 2015	\$ (3)	\$ (1,959)	\$ (916 )	\$ (2,878 )
Other comprehensive losses before reclassifications	(3 )	—	(493 )	(496 )
Deferred income taxes	1	—	173	174
Other comprehensive losses before reclassifications, net of deferred income taxes	(2 )	—	(320 )	(322 )
Amounts reclassified to net earnings	—	64	5	69
Deferred income taxes	—	(24 )	(2 )	(26 )
Amounts reclassified to net earnings, net of deferred income taxes	—	40	3	43
Other comprehensive (losses) earnings, net of deferred income taxes	(2 )	40	(317 ) <sup>(1)</sup>	(279 )
Balances, September 30, 2015	\$ (5)	\$ (1,919)	\$ (1,233 )	\$ (3,157 )

<sup>(1)</sup> For the nine and three months ended September 30, 2016 and 2015, Altria Group, Inc.'s proportionate share of SABMiller's other comprehensive earnings/losses consisted primarily of currency translation adjustments.



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The following table sets forth pre-tax amounts by component, reclassified from accumulated other comprehensive losses to net earnings:

	For the Nine Months Ended September 30, 2016		For the Three Months Ended September 30, 2015	
	2016	2015	2016	2015
	(in millions)			
Benefit Plans: <sup>(1)</sup>				
Net loss	\$162	\$222	\$50	\$72
Prior service cost/credit	(35 )	(24 )	(8 )	(8 )
	127	198	42	64
SABMiller <sup>(2)</sup>	24	14	5	5
Pre-tax amounts reclassified from accumulated other comprehensive losses to net earnings	\$151	\$212	\$47	\$69

<sup>(1)</sup> Amounts are included in net defined benefit plan costs. For further details, see Note 3. Benefit Plans.

<sup>(2)</sup> Amounts are included in earnings from equity investment in SABMiller.

Note 7. Segment Reporting:

The products of Altria Group, Inc.'s subsidiaries include smokeable tobacco products, consisting of cigarettes manufactured and sold by PM USA and machine-made large cigars and pipe tobacco manufactured and sold by Middleton; smokeless tobacco products, substantially all of which are manufactured and sold by USSTC; and wine produced and/or distributed by Ste. Michelle. The products and services of these subsidiaries constitute Altria Group, Inc.'s reportable segments of smokeable products, smokeless products and wine. The financial services and the innovative tobacco products businesses are included in all other.

Altria Group, Inc.'s chief operating decision maker 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 Altria Group, Inc.'s chief operating decision maker.

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Segment data were as follows:

	For the Nine Months Ended September 30, 2016		For the Three Months Ended September 30, 2015	
	2016	2015	2016	2015
	(in millions)			
Net revenues:				
Smokeable products	\$17,398	\$17,235	\$6,147	\$6,040
Smokeless products	1,530	1,393	528	482
Wine	498	461	182	166
All other	66	27	48	11
Net revenues	\$19,492	\$19,116	\$6,905	\$6,699
Earnings before income taxes:				
Operating companies income (loss):				
Smokeable products	\$5,955	\$5,831	\$2,086	\$2,121
Smokeless products	930	830	312	286
Wine	100	97	38	35
All other	(46 )	(139 )	8	(35 )
Amortization of intangibles	(15 )	(16 )	(5 )	(6 )
General corporate expenses	(150 )	(166 )	(57 )	(53 )
Reduction of PMI tax-related receivable	—	(41 )	—	(41 )
Corporate asset impairment and exit costs	(5 )	—	—	—
Operating income	6,769	6,396	2,382	2,307
Interest and other debt expense, net	(571 )	(609 )	(179 )	(205 )
Loss on early extinguishment of debt	(823 )	(228 )	(823 )	—
Earnings from equity investment in SABMiller	564	546	299	187
Gain on derivative financial instruments	205	—	48	—
Earnings before income taxes	\$6,144	\$6,105	\$1,727	\$2,289

The comparability of operating companies income for the reportable segments was affected by the following:

Non-Participating Manufacturer (“NPM”) Adjustment Items - Pre-tax expense (income) for NPM adjustment items was recorded in Altria Group, Inc.’s condensed consolidated statements of earnings as follows:

	For the Nine Months Ended September 30, 2016	For the Three Months Ended September 30, 2015
	(in millions)	
Smokeable products segment	\$12	\$(126)
Interest and other debt expense, net	6	—
Total	\$18	\$(126)

NPM adjustment items result from the settlement of, and determinations made in connection with, disputes with certain states and territories related to the 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 11. Contingencies). The amounts shown in the table above for the smokeable products segment were recorded by PM USA as increases (reductions) to cost of sales, which decreased (increased) operating companies income in the smokeable products segment.

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Tobacco and Health Litigation Items - Pre-tax charges related to certain tobacco and health litigation items were recorded in Altria Group, Inc.'s condensed consolidated statements of earnings as follows:

	For the Nine Months Ended September 30, 2016	For the Three Months Ended September 30, 2015	For the Nine Months Ended September 30, 2016	For the Three Months Ended September 30, 2015
	(in millions)			
Smokeable products segment	\$72	\$102	\$45	\$54
Interest and other debt expense, net	16	13	—	13
Total	\$88	\$115	\$45	\$67

During the third quarter of 2016, PM USA recorded a pre-tax charge related to the Miner case of \$45 million in marketing, administration and research costs. During the first quarter of 2016, PM USA recorded pre-tax charges, primarily related to the Aspinall case, of \$26 million in marketing, administration and research costs and \$12 million in interest costs. For further discussion, see "Lights/Ultra Lights" Cases - State Trial Court Class Certifications in Note 11. Contingencies.

During the third quarter of 2015, PM USA recorded pre-tax charges of \$54 million in marketing, administration and research costs related to tobacco and health judgments in six state Engle progeny lawsuits, as well as \$13 million in interest costs related to those cases. During the first quarter of 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, during the first quarter of 2015, 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 11. Contingencies.

Asset Impairment, Exit and Implementation Costs - See Note 2. Asset Impairment, Exit and Implementation Costs for a breakdown of these costs by segment.

Note 8. Finance Assets, net:

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. Accordingly, PMCC's operating companies income will fluctuate over time as investments mature or are sold.

At September 30, 2016, finance assets, net, of \$1,046 million were comprised of investments in finance leases of \$1,079 million, reduced by the allowance for losses of \$33 million. At December 31, 2015, finance assets, net, of \$1,239 million were comprised of investments in finance leases of \$1,281 million, reduced by the allowance for losses of \$42 million.

During the second quarter of 2016 and 2015, as a result of updated market value information, PMCC determined that the estimated unguaranteed residual values on certain aircraft should be reduced by \$28 million and \$35 million, respectively. These decreases in unguaranteed residual values resulted in a reduction to PMCC's net revenues of \$18 million and \$29 million in the second quarter of 2016 and 2015, respectively.

PMCC assesses the adequacy of its allowance for losses relative to the credit risk of its leasing portfolio on an ongoing basis. PMCC believes that, as of September 30, 2016, the allowance for losses of \$33 million was adequate. PMCC continues to monitor economic and credit conditions, and the individual situations of its lessees and their

respective industries, and may increase or decrease its allowance for losses if such conditions change in the future. The activity in the allowance for losses on finance assets was as follows:

	For the Nine Months Ended September 30, 2016 2015 (in millions)	
Balance at beginning of the year	\$ 42	\$ 42
Decrease to allowance	(9 )	—
Balance at September 30	\$ 33	\$ 42



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All PMCC lessees were current on their lease payment obligations as of September 30, 2016.

The credit quality of PMCC's investments in finance leases as assigned by Standard & Poor's Ratings Services ("Standard & Poor's") and Moody's Investors Service, Inc. ("Moody's") at September 30, 2016 and December 31, 2015 was as follows:

	September 30, 2016	December 31, 2015
	(in millions)	
Credit Rating by Standard & Poor's/Moody's:		
"AAA/Aaa" to "A-/A3"	\$217	\$ 212
"BBB+/Baa1" to "BBB-/Baa3"	528	702
"BB+/Ba1" and Lower	334	367
Total	\$1,079	\$ 1,281

Note 9. Debt:

At September 30, 2016 and December 31, 2015, Altria Group, Inc. had no short-term borrowings.

## Long-term Debt

In September 2016, Altria Group, Inc. issued \$0.5 billion aggregate principal amount of 2.625% senior unsecured long-term notes due 2026 and \$1.5 billion aggregate principal amount of 3.875% senior unsecured long-term notes due 2046. Interest on these notes is payable semi-annually. The net proceeds from the issuance of these senior unsecured notes were added to Altria Group, Inc.'s general funds and were used to repurchase certain of its senior unsecured notes in connection with the 2016 debt tender offer described below and for other general corporate purposes, including voluntary contributions to Altria Group, Inc.'s pension plans.

The notes are Altria Group, Inc.'s senior unsecured obligations and rank equally in right of payment with all of Altria Group, Inc.'s existing and future senior unsecured indebtedness. Upon the occurrence of both (i) a change of control of Altria Group, Inc. and (ii) the notes ceasing to be rated investment grade by each of Moody's, Standard & Poor's and Fitch Ratings Ltd. within a specified time period, Altria Group, Inc. will be required to make an offer to purchase the notes at a price equal to 101% of the aggregate principal amount of such notes, plus accrued and unpaid interest to the date of repurchase as and to the extent set forth in the terms of the notes.

The obligations of Altria Group, Inc. under the notes are guaranteed by PM USA. For further discussion, see Note 12. Condensed Consolidating Financial Information.

During the third quarter of 2016 and the first quarter of 2015, Altria Group, Inc. completed debt tender offers to purchase for cash certain of its senior unsecured notes in aggregate principal amounts of \$933 million and \$793 million, respectively. Details of these debt tender offers were as follows:

	2016	2015
	(in millions)	
Notes Purchased		
9.95% Notes due 2038	\$441	\$—
10.20% Notes due 2039	492	—
9.70% Notes due 2018	—	793
Total	\$933	\$793



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As a result of the debt tender offers, Altria Group, Inc. recorded the following pre-tax losses on early extinguishment of debt:

	For the Nine Months Ended September 30, 2016		For the Three Months Ended September 30, 2015	
	2016	2015	2016	2015
Premiums and fees	\$809	\$226	\$ 809	\$ —
Write-off of unamortized debt discounts and debt issuance costs	14	2	14	—
Total	\$823	\$228	\$ 823	\$ —

With respect to \$2.5 billion aggregate principal amount of Altria Group, Inc.'s senior unsecured long-term notes issued in 2008 and 2009, the interest rate payable on each series of notes was subject to adjustment from time to time if the rating assigned to the notes of such series by Moody's or Standard & Poor's was downgraded (or subsequently upgraded) as and to the extent set forth in the terms of the notes. As a result of credit rating upgrades by both Moody's and Standard & Poor's in the first quarter of 2016, this interest rate adjustment provision terminated in accordance with its terms.

On January 1, 2016, Altria Group, Inc. adopted ASU No. 2015-03. For further discussion, see Note 1. Background and Basis of Presentation.

Altria Group, Inc.'s estimate of the fair value of its debt is based on observable market information derived from a third-party pricing source and is classified in Level 2 of the fair value hierarchy. The aggregate fair value of Altria Group, Inc.'s total long-term debt at September 30, 2016 and December 31, 2015, was \$16.1 billion and \$14.5 billion, respectively, as compared with its carrying value of \$13.9 billion and \$12.8 billion, respectively.

#### Note 10. Income Taxes:

The income tax rate of 35.4% for the nine months ended September 30, 2016 increased 0.8 percentage points from the nine months ended September 30, 2015. The income tax rate of 36.7% for the three months ended September 30, 2016 increased 3.5 percentage points from the three months ended September 30, 2015. The increases were due primarily to the following:

the reversal of \$59 million 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 ("IRS 2007-2009 Audit") that was recorded during the third quarter of 2015; and

the resolution of various Philip Morris International Inc. ("PMI") tax matters in the third quarter of 2015; partially offset by:

a \$41 million reversal of foreign tax credits primarily associated with SABMiller dividends that was recorded during the third quarter of 2015.

Under a tax sharing agreement entered into in connection with the 2008 spin-off between Altria Group, Inc. and PMI, its former subsidiary, PMI is responsible for its pre-spin-off tax obligations. Altria Group, Inc., however, remains severally liable for PMI's pre-spin-off federal tax obligations pursuant to regulations governing federal consolidated income tax returns, and continued to include the pre-spin-off federal income tax reserves of PMI in its liability for

uncertain tax positions. As of December 31, 2015, there were no remaining pre-spin-off tax reserves for PMI.

During the third quarter of 2015, net tax benefits of \$41 million were recorded for PMI tax matters relating to the IRS 2007-2009 Audit. These net tax benefits were offset by a reduction of a PMI tax-related receivable, which was recorded as a decrease to operating income on Altria Group, Inc.'s condensed consolidated statement of earnings. Due to the offset, the PMI tax matters had no impact on Altria Group, Inc.'s net earnings for the nine and three months ended September 30, 2015.

Altria Group, Inc. is subject to income taxation in many jurisdictions. Uncertain tax positions reflect the difference between tax positions taken or expected to be taken on income tax returns and the amounts recognized in the financial statements. Resolution of the related tax positions with the relevant tax authorities may take many years to complete, and such timing is not

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entirely within the control of Altria Group, Inc. At September 30, 2016, Altria Group, Inc.'s total unrecognized tax benefits were \$184 million. The amount of unrecognized tax benefits that, if recognized, would impact the effective tax rate at September 30, 2016 was \$82 million, along with \$102 million affecting deferred taxes. It is reasonably possible that within the next 12 months certain examinations will be resolved, which could result in a decrease in unrecognized tax benefits of approximately \$140 million. At December 31, 2015, Altria Group, Inc.'s total unrecognized tax benefits were \$158 million. The amount of unrecognized tax benefits that, if recognized, would impact the effective tax rate at December 31, 2015 was \$76 million, along with \$82 million affecting deferred taxes.

Note 11. Contingencies:

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 shipments, patent infringement, employment matters, claims for contribution and claims of competitors or distributors.

Litigation is subject to uncertainty and it is possible that there 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 and other litigation are or can be 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 limit the dollar amount of bonds or require no bond at all. As discussed below, however, 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 Altria Group, Inc. 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 one or more of its subsidiaries, could be materially affected in a particular fiscal quarter or fiscal year by an unfavorable outcome of one or more such challenges.

Altria Group, Inc. and its subsidiaries record provisions in the condensed 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 elsewhere in this Note 11. Contingencies: (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 condensed consolidated financial statements for unfavorable outcomes, if any. Litigation defense costs are expensed as incurred.

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 one or more of its subsidiaries, could be materially 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 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.

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## Overview of Altria Group, Inc. and/or PM USA Tobacco-Related Litigation

## Types and Number of Cases

Claims related to tobacco products generally fall within the following categories: (i) smoking and health cases alleging personal injury brought on behalf of individual plaintiffs; (ii) smoking and health cases primarily alleging personal injury or seeking court-supervised programs for ongoing medical monitoring and purporting to be brought on behalf of a class of individual plaintiffs, including cases in which the aggregated claims of a number of individual plaintiffs are to be tried in a single proceeding; (iii) health care cost recovery cases brought by governmental (both domestic and foreign) plaintiffs seeking reimbursement for health care expenditures allegedly caused by cigarette smoking and/or disgorgement of profits; (iv) class action suits alleging that the uses of the terms “Lights” and “Ultra Lights” constitute deceptive and unfair trade practices, common law or statutory fraud, unjust enrichment, breach of warranty or violations of the Racketeer Influenced and Corrupt Organizations Act (“RICO”); and (v) other tobacco-related litigation described below. Plaintiffs’ theories of recovery and the defenses raised in pending smoking and health, health care cost recovery and “Lights/Ultra Lights” cases are discussed below.

The table below lists the number of certain tobacco-related cases pending in the United States against PM USA<sup>(1)</sup> and, in some instances, Altria Group, Inc. as of October 24, 2016, October 26, 2015 and October 27, 2014:

	October 24, 2016	October 26, 2015	October 27, 2014
Individual Smoking and Health Cases <sup>(2)</sup>	66	65	67
Smoking and Health Class Actions and Aggregated Claims Litigation <sup>(3)</sup>	5	5	5
Health Care Cost Recovery Actions <sup>(4)</sup>	1	1	1
“Lights/Ultra Lights” Class Actions	9	12	13

<sup>(1)</sup> Does not include 24 cases filed on the asbestos docket in the Circuit Court for Baltimore City, Maryland, which seek to join PM USA and other cigarette-manufacturing defendants in complaints previously filed against asbestos companies.

<sup>(2)</sup> Does not include 2,493 cases brought by flight attendants seeking compensatory damages for personal injuries allegedly caused by exposure to environmental tobacco smoke (“ETS”). The flight attendants allege that they are members of an ETS smoking and health class action in Florida, which was settled in 1997 (Broin). The terms of the court-approved settlement in that case allowed class members to file individual lawsuits seeking compensatory damages, but prohibited them from seeking punitive damages. Also, does not include individual smoking and health cases brought by or on behalf of plaintiffs in Florida state and federal courts following the decertification of the Engle case (discussed below in Smoking and Health Litigation - Engle Class Action).

<sup>(3)</sup> Includes as one case the 600 civil actions (of which 344 were actions against PM USA) that were to be tried in a single proceeding in West Virginia (In re: Tobacco Litigation). The West Virginia Supreme Court of Appeals ruled that the United States Constitution did not preclude a trial in two phases in this case. Issues related to defendants’ conduct and whether punitive damages are permissible were tried in the first phase. Trial in the first phase of this case began in April 2013. In May 2013, the jury returned a verdict in favor of defendants on the claims for design defect, negligence, failure to warn, breach of warranty, and concealment and declined to find that the defendants’ conduct warranted punitive damages. Plaintiffs prevailed on their claim that ventilated filter cigarettes should have included use instructions for the period 1964 - 1969. The second phase will consist of trials to determine liability and compensatory damages. In November 2014, the West Virginia Supreme Court of Appeals affirmed the final judgment. In July 2015, the trial court entered an order that will result in the entry of final judgment in favor of defendants and

against all but 30 plaintiffs who potentially have a claim against one or more defendants that may be pursued in a second phase of trial. The court intends to try the claims of these 30 plaintiffs in six consolidated trials, each with a group of five plaintiffs. The first trial is currently scheduled to begin May 1, 2018. Dates for the five remaining consolidated trials have not been scheduled.

<sup>(4)</sup> See Health Care Cost Recovery Litigation - Federal Government's Lawsuit below.

#### International Tobacco-Related Cases

As of October 24, 2016, PM USA is a named defendant in 10 health care cost recovery actions in Canada, eight of which also name Altria Group, Inc. as a defendant. PM USA and Altria Group, Inc. are also named defendants in seven smoking and health class actions filed in various Canadian provinces. See Guarantees and Other Similar Matters below for a discussion of the Distribution Agreement between Altria Group, Inc. and PMI that provides for indemnities for certain liabilities concerning tobacco products.



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Tobacco-Related Cases Set for Trial

As of October 24, 2016, five Engle progeny cases are set for trial through December 31, 2016. There is one individual smoking and health case and no “Lights/Ultra Lights” class actions or medical monitoring cases against PM USA set for trial during this period. Cases against other companies in the tobacco industry are scheduled for trial during this period. Trial dates are subject to change.

Trial Results

Since January 1999, excluding the Engle progeny cases (separately discussed below), verdicts have been returned in 61 smoking and health, “Lights/Ultra Lights” and health care cost recovery cases in which PM USA was a defendant. Verdicts in favor of PM USA and other defendants were returned in 41 of the 61 cases. These 41 cases were tried in Alaska (1), California (7), Florida (10), Louisiana (1), Massachusetts (2), Mississippi (1), Missouri (4), New Hampshire (1), New Jersey (1), New York (5), Ohio (2), Pennsylvania (1), Rhode Island (1), Tennessee (2) and West Virginia (2). A motion for a new trial was granted in one of the cases in Florida and in the case in Alaska. In the Alaska case (Hunter), the trial court withdrew its order for a new trial upon PM USA’s motion for reconsideration. In December 2015, the Alaska Supreme Court reversed the trial court decision and remanded the case with directions for the trial court to reassess whether to grant a new trial. In March 2016, the trial court granted a new trial and PM USA filed a petition for review of that order with the Alaska Supreme Court, which the court denied in July 2016. The retrial began on October 17, 2016 and is ongoing. See Types and Number of Cases above for a discussion of the trial results in In re: Tobacco Litigation (West Virginia consolidated cases).

Of the 20 non-Engle progeny cases in which verdicts were returned in favor of plaintiffs, 17 have reached final resolution. A verdict against PM USA in a purported “Lights” class action in Illinois (Price) was reversed and ultimately resolved in PM USA’s favor. See “Lights/Ultra Lights” Cases - The Price Case below for further discussion.

As of October 24, 2016, 102 state and federal Engle progeny cases involving PM USA have resulted in verdicts since the Florida Supreme Court’s Engle decision as follows: 56 verdicts were returned in favor of plaintiffs; 43 verdicts were returned in favor of PM USA. Three verdicts in favor of plaintiffs were partially or entirely reversed on appeal. See Smoking and Health Litigation - Engle Progeny Trial Court Results below for a discussion of these verdicts.

Judgments Paid and Provisions for Tobacco and Health Litigation Items (Including Engle Progeny Litigation)

After exhausting all appeals in those cases resulting in adverse verdicts associated with tobacco-related litigation, since October 2004, PM USA has paid in the aggregate judgments (and related costs and fees) totaling approximately \$428 million and interest totaling approximately \$183 million as of October 24, 2016. These amounts include payments for Engle progeny judgments (and related costs and fees) totaling approximately \$82 million, interest totaling approximately \$21 million and payment of approximately \$43 million in connection with the Federal Engle Agreement, discussed below.

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The changes in Altria Group, Inc.'s accrued liability for tobacco and health litigation items, including related interest costs, for the periods specified below are as follows:

	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2016	2015	2016	2015
	(in millions)			
Accrued liability for tobacco and health litigation items at beginning of period	\$132	\$39	\$30	\$77
Pre-tax charges for:				
Tobacco and health judgments	5	59	—	54
Related interest costs	6	13	—	13
Agreement to resolve federal Engle progeny cases	—	43	—	—
Agreement to resolve Aspinall including related interest costs	32	—	—	—
Agreement to resolve Miner	45	—	45	—
Payments	(145)	(13)	—	(3)
Accrued liability for tobacco and health litigation items at end of period	\$75	\$141	\$75	\$141

The accrued liability for tobacco and health litigation items, including related interest costs, was included in liabilities on Altria Group, Inc.'s condensed consolidated balance sheets. Pre-tax charges for tobacco and health judgments, the agreement to resolve federal Engle progeny cases, the agreement to resolve the Aspinall case (excluding related interest costs of approximately \$10 million) and the agreement to resolve the Miner case were included in marketing, administration and research costs on Altria Group, Inc.'s condensed consolidated statements of earnings. Pre-tax charges for related interest costs were included in interest and other debt expense, net on Altria Group, Inc.'s condensed consolidated statements of earnings.

#### Security for Judgments

To obtain stays of judgments pending current appeals, as of September 30, 2016, PM USA has posted various forms of security totaling approximately \$72 million, the majority of which has been collateralized with cash deposits that are included in other assets on the condensed consolidated balance sheet.

#### Smoking and Health Litigation

##### Overview

Plaintiffs' allegations of liability in smoking and health cases are based on various theories of recovery, including negligence, gross negligence, strict liability, fraud, misrepresentation, design defect, failure to warn, nuisance, breach of express and implied warranties, breach of special duty, conspiracy, concert of action, violations of deceptive trade practice laws and consumer protection statutes, and claims under the federal and state anti-racketeering statutes. Plaintiffs in the smoking and health cases seek various forms of relief, including compensatory and punitive damages, treble/multiple damages and other statutory damages and penalties, creation of medical monitoring and smoking cessation funds, disgorgement of profits, and injunctive and equitable relief. Defenses raised in these cases include

lack of proximate cause, assumption of the risk, comparative fault and/or contributory negligence, statutes of limitations and preemption by the Federal Cigarette Labeling and Advertising Act.

#### Non-Engle Progeny Litigation

Summarized below are the non-Engle progeny smoking and health cases pending during 2016 in which verdicts were returned in favor of plaintiffs and against PM USA. Charts listing the verdicts for plaintiffs in the Engle progeny cases can be found in Smoking and Health Litigation - Engle Progeny Trial Results below.

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**Bullock:** In December 2015, a jury in the U.S. District Court for the Central District of California returned a verdict in favor of plaintiff, awarding \$900,000 in compensatory damages. In January 2016, the plaintiff moved for a new trial, which the district court denied in February 2016. In March 2016, PM USA filed a notice of appeal to the U.S. Court of Appeals for the Ninth Circuit and plaintiff cross-appealed.

**Schwarz:** In March 2002, an Oregon jury awarded \$168,500 in compensatory damages and \$150 million in punitive damages against PM USA. In May 2002, the trial court reduced the punitive damages award to \$100 million. In May 2006, the Oregon Court of Appeals affirmed the compensatory damages verdict, reversed the award of punitive damages and remanded the case to the trial court for a second trial to determine the amount of punitive damages, if any. In June 2010, the Oregon Supreme Court affirmed the court of appeals' decision and remanded the case to the trial court for a new trial limited to the question of punitive damages. Upon retrial, in February 2012, the jury awarded plaintiff \$25 million in punitive damages, which was ultimately upheld on appeal. In the fourth quarter of 2015, PM USA recorded a provision on its consolidated balance sheet of approximately \$34 million for the judgment plus interest and associated costs. In June 2016, PM USA paid the final judgment plus interest and associated costs of approximately \$34 million, concluding this litigation.

**Federal Government's Lawsuit:** See Health Care Cost Recovery Litigation - Federal Government's Lawsuit below for a discussion of the verdict and post-trial developments in the United States of America health care cost recovery case.

**Engle Class Action**

In July 2000, in the second phase of the Engle smoking and health class action in Florida, a jury returned a verdict assessing punitive damages totaling approximately \$145 billion against various defendants, including \$74 billion against PM USA. Following entry of judgment, PM USA appealed.

In May 2001, the trial court approved a stipulation providing that execution of the punitive damages component of the Engle judgment will remain stayed against PM USA and the other participating defendants through the completion of all judicial review. As a result of the stipulation, PM USA placed \$500 million into an interest-bearing escrow account that, regardless of the outcome of the judicial review, was to be paid to the court and the court was to determine how to allocate or distribute it consistent with Florida Rules of Civil Procedure. In May 2003, the Florida Third District Court of Appeal reversed the judgment entered by the trial court and instructed the trial court to order the decertification of the class. Plaintiffs petitioned the Florida Supreme Court for further review.

In July 2006, the Florida Supreme Court ordered that the punitive damages award be vacated, that the class approved by the trial court be decertified and that members of the decertified class could file individual actions against defendants within one year of issuance of the mandate. The court further declared the following Phase I findings are entitled to res judicata effect in such individual actions brought within one year of the issuance of the mandate: (i) that smoking causes various diseases; (ii) that nicotine in cigarettes is addictive; (iii) that defendants' cigarettes were defective and unreasonably dangerous; (iv) that defendants concealed or omitted material information not otherwise known or available knowing that the material was false or misleading or failed to disclose a material fact concerning the health effects or addictive nature of smoking; (v) that defendants agreed to misrepresent information regarding the health effects or addictive nature of cigarettes with the intention of causing the public to rely on this information to their detriment; (vi) that defendants agreed to conceal or omit information regarding the health effects of cigarettes or their addictive nature with the intention that smokers would rely on the information to their detriment; (vii) that all defendants sold or supplied cigarettes that were defective; and (viii) that defendants were negligent. The court also reinstated compensatory damages awards totaling approximately \$6.9 million to two individual plaintiffs and found

that a third plaintiff's claim was barred by the statute of limitations. In February 2008, PM USA paid approximately \$3 million, representing its share of compensatory damages and interest, to the two individual plaintiffs identified in the Florida Supreme Court's order.

In August 2006, PM USA sought rehearing from the Florida Supreme Court on parts of its July 2006 opinion, including the ruling (described above) that certain jury findings have res judicata effect in subsequent individual trials timely brought by Engle class members. The rehearing motion also asked, among other things, that legal errors that were raised but not expressly ruled upon in the Florida Third District Court of Appeal or in the Florida Supreme Court now be addressed. Plaintiffs also filed a motion for rehearing in August 2006 seeking clarification of the applicability of the statute of limitations to non-members of the decertified class. In December 2006, the Florida Supreme Court refused to revise its July 2006 ruling, except that it revised the set of Phase I findings entitled to res judicata effect by excluding finding (v) listed above (relating to agreement to misrepresent information), and added the finding that defendants sold or supplied cigarettes that, at the time of sale or supply,

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did not conform to the representations of fact made by defendants. In January 2007, the Florida Supreme Court issued the mandate from its revised opinion. Defendants then filed a motion with the Florida Third District Court of Appeal requesting that the court address legal errors that were previously raised by defendants but have not yet been addressed either by the Florida Third District Court of Appeal or by the Florida Supreme Court. In February 2007, the Florida Third District Court of Appeal denied defendants' motion. In May 2007, defendants' motion for a partial stay of the mandate pending the completion of appellate review was denied by the Florida Third District Court of Appeal. In May 2007, defendants filed a petition for writ of certiorari with the United States Supreme Court, which the United States Supreme Court denied later in 2007.

In February 2008, the trial court decertified the class, except for purposes of the May 2001 bond stipulation, and formally vacated the punitive damages award pursuant to the Florida Supreme Court's mandate. In April 2008, the trial court ruled that certain defendants, including PM USA, lacked standing with respect to allocation of the funds escrowed under the May 2001 bond stipulation and would receive no credit at that time from the \$500 million paid by PM USA against any future punitive damages awards in cases brought by former Engle class members.

In May 2008, the trial court, among other things, decertified the limited class maintained for purposes of the May 2001 bond stipulation and, in July 2008, severed the remaining plaintiffs' claims except for those of Howard Engle. The only remaining plaintiff in the Engle case, Howard Engle, voluntarily dismissed his claims with prejudice.

Engle Progeny Cases

The deadline for filing Engle progeny cases, as required by the Florida Supreme Court's Engle decision, expired in January 2008. As of October 24, 2016, approximately 2,700 state court cases were pending against PM USA or Altria Group, Inc. asserting individual claims by or on behalf of approximately 3,600 state court plaintiffs. Because of a number of factors, including, but not limited to, docketing delays, duplicated filings and overlapping dismissal orders, these numbers are estimates. While the Federal Engle Agreement (discussed below) resolved nearly all Engle progeny cases pending in federal court, as of October 24, 2016, approximately 14 cases were pending against PM USA in federal court representing the cases excluded from that agreement.

Agreement to Resolve Federal Engle Progeny Cases

In February 2015, PM USA, R.J. Reynolds Tobacco Company ("R.J. Reynolds") and Lorillard Tobacco Company ("Lorillard") reached a tentative agreement to resolve approximately 415 pending federal Engle progeny cases (the "Federal Engle Agreement"). Under the terms of the Federal Engle Agreement, PM USA paid into escrow approximately \$43 million in March 2015. PM USA recorded a pre-tax provision of approximately \$43 million in the first quarter of 2015. Federal cases that were in trial as of February 25, 2015 and those that previously reached final verdict were not included in the Federal Engle Agreement. The Federal Engle Agreement was conditioned on approval by all federal court plaintiffs in the cases resolved by the Federal Engle Agreement or as the parties otherwise agree. The parties satisfied all conditions and, in December 2015, the cases subject to the Federal Engle Agreement were dismissed, and the escrow funds were moved to the plaintiffs' settlement fund.

Engle Progeny Trial Results

As of October 24, 2016, 102 federal and state Engle progeny cases involving PM USA have resulted in verdicts since the Florida Supreme Court Engle decision. Fifty-six verdicts were returned in favor of plaintiffs and three verdicts (Graham, Skolnick and Calloway) that were initially returned in favor of plaintiffs were reversed on appeal and

remain pending. Graham is now subject to en banc appellate review; Skolnick was remanded for a new trial; Calloway was reversed on an appellate finding that improper arguments by plaintiff's counsel deprived defendants of a fair trial.

Forty-three verdicts were returned in favor of PM USA, of which 34 were state cases (Gelep, Kalyvas, Gil de Rubio, Warrick, Willis, Russo (formerly Frazier), C. Campbell, Rohr, Espinosa, Oliva, Weingart, Junious, Szymanski, Hancock, D. Cohen, LaMotte, J. Campbell, Dombey, Haldeman, Blasco, Gonzalez, Banks, Surico, Baum, Bishop, Vila, McMannis, Collar, Suarez, Shulman, Ewing, E. Smith, Mooney and Chacon) and 9 were federal cases (Gollihue, McCray, Denton, Wilder, Jacobson, Reider, Davis, Starbuck and Sowers). In addition, there have been a number of mistrials, only some of which have resulted in new trials as of October 24, 2016. The juries in the Reider and Banks cases returned zero damages verdicts in favor of PM USA. The juries in the Weingart and Hancock cases returned verdicts against PM USA awarding no damages, but the trial court in each case granted an additur.

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The charts below list the verdicts and post-trial developments in certain Engle progeny cases in which verdicts were returned in favor of plaintiffs (including Hancock, where the verdict originally was returned in favor of PM USA). The first chart lists such cases that are pending as of October 24, 2016; the second chart lists such cases that were pending within the previous 12 months, but that are now concluded.

Currently-Pending Engle Cases

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Plaintiff: Oshinsky-Blacker  
Date: September 2016

Verdict:

A Broward County jury returned a verdict in favor of plaintiff and against PM USA and R.J. Reynolds awarding compensatory damages of \$6.155 million and allocating 60% of the fault to PM USA (an amount of \$3.7 million). The jury also awarded plaintiff \$1 million in punitive damages against PM USA. In October 2016, PM USA filed motions to set aside the verdict and for a directed verdict.

---

Plaintiff: Varner  
Date: July 2016

Verdict:

A Broward County jury returned a verdict in favor of plaintiff and against PM USA awarding compensatory damages of \$1.5 million and allocating 25% of the fault to PM USA (an amount of \$375,000).

Post-Trial Developments:

In July 2016, the trial court entered final judgment in favor of plaintiff with a deduction for plaintiff's comparative fault. In August 2016, PM USA filed motions to set aside the verdict and for a directed verdict, and plaintiff filed a motion for a new trial.

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Plaintiff: Sermons  
Date: July 2016

Verdict:

A Duval County jury returned a verdict in favor of plaintiff and against PM USA and R.J. Reynolds awarding compensatory damages of \$65,000 and allocating 15% of the fault to PM USA (an amount of \$9,750). The jury also awarded plaintiff \$51,225 in punitive damages against PM USA.

Post-Trial Developments:

In July 2016, plaintiff filed a motion for a new trial or, in the alternative, for an additur.

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Plaintiff: Purdo  
Date: April 2016

Verdict:

A Palm Beach County jury returned a verdict in favor of plaintiff and against PM USA and R.J. Reynolds awarding compensatory damages of \$21 million and allocating 12% of the fault to PM USA (an amount of \$2.52 million). The jury also awarded plaintiff \$6.25 million in punitive damages against each defendant.



Post-Trial Developments:

In May 2016, PM USA and R.J. Reynolds filed various post-trial motions, including motions to set aside the verdict and for a new trial, all of which the court denied and entered final judgment in favor of plaintiff with a deduction for plaintiff's comparative fault. In June 2016, defendants filed a notice of appeal to the Florida Fourth District Court of Appeal and PM USA posted a bond in the amount of approximately \$1.5 million.

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Plaintiff: McCall  
Date: March 2016

Verdict:  
A Broward County jury returned a verdict in favor of plaintiff and against PM USA awarding compensatory damages of \$350,000 and allocating 25% of the fault to PM USA (an amount of \$87,500).

Post-Trial Developments:  
In March 2016, PM USA filed a motion to set aside the verdict and to enter judgment in its favor, which the court denied in May 2016. Also in March 2016, plaintiff filed a motion for a new trial on punitive damages, citing the Soffer decision (allowing Engle progeny plaintiffs to seek punitive damages on their negligence and strict liability claims) discussed below under Engle Progeny Appellate Issues, which the court granted in May 2016. In June 2016, PM USA filed a notice of appeal to the Florida Fourth District Court of Appeal and plaintiff cross-appealed.

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Plaintiff: Ahrens  
Date: February 2016

Verdict:  
A Pinellas County jury returned a verdict in favor of plaintiff and against PM USA and R.J. Reynolds awarding \$9 million in compensatory damages and allocating 24% of the fault to PM USA. The jury also awarded plaintiff \$2.5 million in punitive damages against each defendant.

Post-Trial Developments:  
In February 2016, the trial court entered final judgment against PM USA and R.J. Reynolds without any deduction for plaintiff's comparative fault and defendants filed various post-trial motions, including motions to set aside the verdict and for a new trial. In March 2016, the trial court denied defendants' post-trial motions. In April 2016, defendants filed a notice of appeal to the Florida Second District Court of Appeal and PM USA posted a bond in the amount of \$2.5 million.

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Plaintiff: Ledoux  
Date: December 2015

Verdict:  
A Miami-Dade County jury returned a verdict in favor of plaintiff and against PM USA and R.J. Reynolds awarding \$10 million in compensatory damages and allocating 47% of the fault to PM USA. The jury also awarded plaintiff \$12.5 million in punitive damages against each defendant.

Post-Trial Developments:  
In January 2016, PM USA and R.J. Reynolds filed various post-trial motions, including motions to set aside the verdict and for a new trial, and the trial court entered final judgment against PM USA and R.J. Reynolds without any deduction for plaintiff's comparative fault. In February 2016, the trial court denied defendants' post-trial motions. In March 2016, defendants filed a notice of appeal to the Florida Third District Court of Appeal and PM USA posted a bond in the amount of \$2.5 million.

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Plaintiff: Barbose  
Date: November 2015

Verdict:

A Pasco County jury returned a verdict in favor of plaintiff and against PM USA and R.J. Reynolds awarding \$10 million in compensatory damages and allocating 42.5% of the fault to PM USA. The jury also awarded plaintiff \$500,000 in punitive damages against each defendant.

Post-Trial Developments:

In November 2015, the court entered final judgment in favor of plaintiff without any deduction for plaintiff's comparative fault and in December 2015, PM USA and R.J. Reynolds filed various post-trial motions, including motions to set aside the verdict and for a new trial, which the court denied in January 2016. In February 2016, PM USA posted a bond in the amount of \$2.5 million and filed a notice of appeal to the Florida Second District Court of Appeal.

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Plaintiff: Tognoli  
Date: November 2015

Verdict:  
A Broward County jury returned a verdict in favor of plaintiff and against PM USA awarding \$1.05 million in compensatory damages and allocating 15% of the fault to PM USA (an amount of \$157,500).

Post-Trial Developments:  
In December 2015, PM USA filed a motion to set aside the verdict and for judgment in accordance with its motion for directed verdict. In January 2016, the trial court entered final judgment against PM USA with a deduction for plaintiff's comparative fault and plaintiff filed an appeal to the Florida Fourth District Court of Appeal. Additionally, the trial court denied PM USA's post-trial motions and PM USA cross-appealed.

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Plaintiff: Danielson  
Date: November 2015

Verdict:  
An Escambia County jury returned a verdict in favor of plaintiff and against PM USA awarding \$325,000 in compensatory damages and allocating 49% of the fault to PM USA. The jury also awarded plaintiff \$325,000 in punitive damages.

Post-Trial Developments:  
In November 2015, plaintiff filed a motion to enforce the parties' pretrial stipulation of \$2.3 million in economic damages. The plaintiff also filed a motion for an additur or, in the alternative, for a new trial and PM USA filed post-trial motions, including a motion concerning the proper form of judgment and for a new trial. In December 2015, the trial court granted plaintiff's motion for a new trial on damages and denied PM USA's post-trial motions. In January 2016, PM USA filed a notice of appeal to the Florida First District Court of Appeal.

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Plaintiff: Marchese  
Date: October 2015

Verdict:  
A Broward County jury returned a verdict in favor of plaintiff and against PM USA and R.J. Reynolds awarding \$1 million in compensatory damages and allocating 22.5% of the fault to PM USA (an amount of \$225,000). The jury also awarded plaintiff \$250,000 in punitive damages against each defendant.

Post-Trial Developments:  
In October 2015, defendants filed various post-trial motions, including motions to set aside the verdict and for a new trial. In November 2015, the court entered final judgment in favor of plaintiff. In May 2016, the court denied defendants' post-trial motions and amended the final judgment to apply the comparative fault deduction. In June 2016, defendants filed a notice of appeal to the Florida Fourth District Court of Appeal and plaintiff cross-appealed. Also in June 2016, PM USA posted a bond in the amount of approximately \$475,000.

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Plaintiff: Duignan  
Date: September 2015

Verdict:

A Pinellas County jury returned a verdict in favor of plaintiff and against PM USA and R.J. Reynolds awarding \$6 million in compensatory damages and allocating 37% of the fault to PM USA. The jury also awarded plaintiff \$3.5 million in punitive damages against PM USA.

Post-Trial Developments:

In September 2015, the trial court entered final judgment without any deduction for plaintiff's comparative fault, and PM USA filed various post-trial motions, including motions to set aside the verdict and for a new trial, which the court denied in October 2015. In November 2015, PM USA and R.J. Reynolds filed a notice of appeal to the Florida Second District Court of Appeal and PM USA posted a bond in the amount of approximately \$2.7 million.

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Plaintiff: Cooper  
Date: September 2015

Verdict:  
A Broward County jury returned a verdict in favor of plaintiff and against PM USA and R.J. Reynolds awarding \$4.5 million in compensatory damages and allocating 10% of the fault to PM USA (an amount of \$450,000).

Post-Trial Developments:  
In September 2015, defendants filed various post-trial motions, including motions to set aside the verdict and for a directed verdict. In January 2016, the trial court denied PM USA's post-trial motions. In February 2016, the trial court entered final judgment in favor of plaintiff, reducing the compensatory damages award against PM USA to approximately \$300,000. In March 2016, PM USA and R.J. Reynolds filed a notice of appeal in the Florida Fourth District Court of Appeal and plaintiff cross-appealed. Also in March 2016, PM USA posted a bond in the amount of approximately \$300,000.

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Plaintiff: Jordan  
Date: August 2015

Verdict:  
A Duval County jury returned a verdict in favor of plaintiff and against PM USA awarding approximately \$7.8 million in compensatory damages and allocating 60% of the fault to PM USA. The jury also awarded approximately \$3.2 million in punitive damages.

Post-Trial Developments:  
In August 2015, the trial court entered final judgment without any deduction for plaintiff's comparative fault, but reduced the compensatory damages to approximately \$6.4 million. PM USA filed various post-trial motions, including motions to set aside the verdict and for a new trial, which the court denied in December 2015. PM USA subsequently filed a notice of appeal to the Florida First District Court of Appeal and plaintiff cross-appealed.

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Plaintiff: Merino  
Date: July 2015

Verdict:  
A Miami-Dade County jury returned a verdict in favor of plaintiff and against PM USA awarding \$8 million in compensatory damages and allocating 70% of the fault to PM USA. The jury also awarded \$6.5 million in punitive damages.

Post-Trial Developments:  
In August 2015, the trial court denied all post-trial motions, including motions to set aside the verdict and for a new trial, and entered final judgment without any deduction for plaintiff's comparative fault. In September 2015, PM USA filed a notice of appeal to the Florida Third District Court of Appeal and posted a bond in the amount of \$5 million.

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Plaintiff: McCoy  
Date: July 2015

Verdict:

A Broward County jury returned a verdict in favor of plaintiff and against PM USA, R.J. Reynolds and Lorillard awarding \$1.5 million in compensatory damages and allocating 20% of the fault to PM USA (an amount of \$300,000). The jury also awarded \$3 million in punitive damages against each defendant.

Post-Trial Developments:

In July 2015, defendants filed various post-trial motions, including motions to set aside the verdict and for a new trial. In August 2015, the trial court entered final judgment without any deduction for plaintiff's comparative fault. In January 2016, the trial court denied defendants' post-trial motions and amended the final judgment to apply the comparative fault deduction. Subsequently, defendants filed a notice of appeal to the Florida Fourth District Court of Appeal, PM USA posted a bond in the amount of approximately \$1.65 million and plaintiff filed a notice of cross-appeal.

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Plaintiff: M. Brown

Date: May 2015

Verdict:

In May 2015, a Duval County jury returned a verdict in favor of plaintiff and against PM USA in a partial retrial. In 2013, a jury returned a partial verdict against PM USA, but was deadlocked as to (i) the amount of compensatory damages, (ii) whether punitive damages should be awarded and, if so, (iii) the amount of punitive damages. In the partial retrial, the jury was asked to address these issues. In May 2015, the jury awarded \$6.375 million in compensatory damages, but did not award any punitive damages.

Post-Trial Developments:

In May 2015, the trial court entered final judgment without any deduction for plaintiff's comparative fault, and PM USA posted a bond in the amount of \$5 million. Additionally, PM USA filed post-trial motions, including motions to set aside the verdict and for a new trial, as well as filed a notice of appeal to the Florida First District Court of Appeal. In August 2015, the trial court denied the last of PM USA's post-trial motions and plaintiff cross-appealed.

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Plaintiff: Gore

Date: March 2015

Verdict:

An Indian River County jury returned a verdict in favor of plaintiff and against PM USA and R.J. Reynolds awarding \$2 million in compensatory damages and allocating 23% of the fault to PM USA (an amount of \$460,000).

Post-Trial Developments:

In April 2015, defendants filed post-trial motions, including motions to set aside the verdict and for a new trial. In September 2015, the trial court entered final judgment with a deduction for plaintiff's comparative fault. In October 2015, defendants filed a notice of appeal to the Florida Fourth District Court of Appeal and PM USA subsequently posted a bond in the amount of \$460,000.

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Plaintiff: Pollari

Date: March 2015

Verdict:

A Broward County jury returned a verdict in favor of plaintiff and against PM USA and R.J. Reynolds awarding \$10 million in compensatory damages and allocating 42.5% of the fault to PM USA (an amount of \$4.25 million). The jury also awarded \$1.5 million in punitive damages against each defendant.

Post-Trial Developments:

In April 2015, defendants filed post-trial motions, including motions to set aside the verdict and for a new trial, and the trial court entered final judgment without any deduction for plaintiff's comparative fault. In January 2016, the trial court denied defendants' post-trial motions and amended the final judgment to apply the comparative fault deduction. Also in January 2016, defendants filed a notice of appeal to the Florida Fourth District Court of Appeal and PM USA posted a bond in the amount of \$2.5 million. In February 2016, plaintiff cross-appealed.

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Plaintiff: Zamboni

Date: February 2015



Verdict:

A jury in the U.S. District Court for the Middle District of Florida returned a verdict in favor of plaintiff and against PM USA and R.J. Reynolds awarding \$340,000 in compensatory damages and allocating 10% of the fault to PM USA (an amount of \$34,000).

Post-Trial Developments:

In April 2015, PM USA and R.J. Reynolds filed a motion for judgment in defendants' favor in accordance with the Eleventh Circuit's decision in Graham. In June 2015, the trial court stayed the case pending the Eleventh Circuit's final disposition in the Graham case, discussed below under Engle Progeny Appellate Issues.

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Plaintiff: Caprio  
Date: February 2015

Verdict:

A Broward County jury returned a partial verdict in favor of plaintiff and against PM USA, R.J. Reynolds, Lorillard and Liggett Group LLC (“Liggett Group”). The jury found against defendants on class membership, allocating 25% of the fault to PM USA. The jury also found \$559,172 in economic damages. The jury deadlocked with respect to the intentional torts, certain elements of compensatory damages and punitive damages.

Post-Trial Developments:

In March 2015, PM USA filed post-trial motions, including motions to set aside the partial verdict and for a new trial. In May 2015, the court denied all of PM USA’s post-trial motions and defendants filed a notice of appeal to the Florida Fourth District Court of Appeal.

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Plaintiff: McKeever  
Date: February 2015

Verdict:

A Broward County jury returned a verdict in favor of plaintiff and against PM USA awarding approximately \$5.8 million in compensatory damages and allocating 60% of the fault to PM USA. The jury also awarded plaintiff approximately \$11.63 million in punitive damages. However, the jury found in favor of PM USA on the statute of repose defense to plaintiff’s intentional tort and punitive damages claims.

Post-Trial Developments:

In March 2015, PM USA filed various post-trial motions, including motions to set aside the verdict and motions for a new trial. In April 2015, the trial court entered final judgment without any deduction for plaintiff’s comparative fault. In June 2015, the trial court denied PM USA’s post-trial motions, and PM USA posted a bond in the amount of \$5 million. PM USA also filed a notice of appeal to the Florida Fourth District Court of Appeal in June 2015.

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Plaintiff: D. Brown  
Date: January 2015

Verdict:

A jury in the U.S. District Court for the Middle District of Florida returned a verdict against PM USA awarding plaintiff approximately \$8.3 million in compensatory damages and allocating 55% of the fault to PM USA. The jury also awarded plaintiff \$9 million in punitive damages.

Post-Trial Developments:

In February 2015, the trial court entered final judgment without any deduction for plaintiff’s comparative fault. In March 2015, PM USA filed various post-trial motions, including motions to alter or amend the judgment and for a new trial or, in the alternative, remittitur of the damages awards, all of which the court denied. In July 2015, PM USA filed a notice of appeal to the U.S. Court of Appeals for the Eleventh Circuit. In August 2015, the Court of Appeals granted PM USA’s motion to stay the appeal pending final disposition in the Graham case, discussed below under Engle Progeny Appellate Issues.

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Plaintiff: Allen

Date: November 2014

Verdict:

A Duval County jury returned a verdict against PM USA and R.J. Reynolds awarding plaintiff approximately \$3.1 million in compensatory damages and allocating 6% of the fault to PM USA. The jury also awarded approximately \$7.76 million in punitive damages against each defendant. This was a retrial of a 2011 trial that awarded plaintiff \$6 million in compensatory damages and \$17 million in punitive damages against each defendant.

Post-Trial Developments:

In December 2014, defendants filed various post-trial motions, including motions to set aside the verdict and motions for a new trial, which the court denied in July 2015. In August 2015, the trial court entered final judgment without any deduction for plaintiff's comparative fault. Defendants filed a notice of appeal to the Florida First District Court of Appeal in September

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2015 and PM USA posted a bond in the amount of approximately \$2.5 million.

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Plaintiff: Perrotto

Date: November 2014

Verdict:

A Palm Beach County jury returned a verdict against PM USA, R.J. Reynolds, Lorillard and Liggett Group awarding plaintiff approximately \$4.1 million in compensatory damages and allocating 25% of the fault to PM USA (an amount of approximately \$1.02 million).

Post-Trial Developments:

In December 2014, the trial court entered final judgment with a deduction for plaintiff's comparative fault, and plaintiff filed a motion for a new trial. In May 2016, the court granted plaintiff's motion for a new trial on punitive damages, citing the Soffer decision, discussed below under Engle Progeny Appellate Issues. In September 2016, the court denied defendants' post-trial motions.

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Plaintiff: Boatright

Date: November 2014

Verdict:

A Polk County jury returned a verdict against PM USA and Liggett Group awarding plaintiff \$15 million in compensatory damages and allocating 85% of the fault to PM USA (an amount of approximately \$12.75 million). In addition, in November 2014, the jury awarded plaintiff approximately \$19.7 million in punitive damages against PM USA and \$300,000 in punitive damages against Liggett Group.

Post-Trial Developments:

In November 2014, PM USA filed various post-trial motions and, in January 2015, the trial court denied PM USA's motions for a new trial and for remittitur, but entered final judgment with a deduction for plaintiff's comparative fault. In February 2015, defendants filed a notice of appeal to the Florida Second District Court of Appeal, and PM USA posted a bond in the amount of \$3.98 million.

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Plaintiff: Kerrivan

Date: October 2014

Verdict:

A jury in the U.S. District Court for the Middle District of Florida returned a verdict against PM USA and R.J. Reynolds awarding plaintiff \$15.8 million in compensatory damages and allocating 50% of the fault to PM USA. The jury also awarded plaintiff \$25.3 million in punitive damages and allocated \$15.7 million to PM USA.

Post-Trial Developments:

The trial court entered final judgment without any deduction for plaintiff's comparative fault. In December 2014, defendants filed various post-trial motions, including a renewed motion for judgment or for a new trial. Plaintiff agreed to waive the bond for the appeal. In May 2015, the trial court deferred further briefing on the post-trial motions pending the Eleventh Circuit's final disposition in the Graham and Searcy cases, discussed below under Engle Progeny Appellate Issues.

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Plaintiff: Lourie

Date: October 2014

Verdict:

A Hillsborough County jury returned a verdict against PM USA, R.J. Reynolds and Lorillard awarding plaintiff approximately \$1.37 million in compensatory damages and allocating 27% of the fault to PM USA (an amount of approximately \$370,000).

Post-Trial Developments:

In October 2014, defendants filed a motion for judgment and a motion for a new trial. In November 2014, the trial court denied defendants' post-trial motions and entered final judgment with a deduction for plaintiff's comparative fault. Later in November 2014, defendants filed a notice of appeal to the Florida Second District Court of Appeal, and PM USA posted a bond in the amount of \$370,318. In August 2016, the Florida Second District Court of Appeal affirmed the judgment entered in favor of

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the plaintiff. In September 2016, defendants filed a petition to invoke the discretionary jurisdiction of the Florida Supreme Court and the Florida Supreme Court stayed the proceedings pending final disposition in the Marotta case, discussed below under Engle Progeny Appellate Issues.

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Plaintiff: Berger  
Date: September 2014

Verdict:

A jury in the U.S. District Court for the Middle District of Florida returned a verdict against PM USA awarding plaintiff \$6.25 million in compensatory damages and allocating 60% of the fault to PM USA. The jury also awarded \$20.76 million in punitive damages.

Post-Trial Developments:

The trial court entered final judgment in September 2014 without any deduction for plaintiff's comparative fault. In October 2014, plaintiff agreed to waive the bond for the appeal. Also in October 2014, PM USA filed a motion for a new trial or, in the alternative, remittitur of the jury's damages awards. In April 2015, the trial court granted PM USA's post-verdict motion in part and vacated the punitive damages award. In November 2015, the court entered final judgment with a deduction for plaintiff's comparative fault. In April 2016, plaintiff filed a motion to reinstate the jury's punitive damages award or, alternatively, for a new trial on punitive damages, citing the Soffer decision, discussed below under Engle Progeny Appellate Issues. Also in April 2016, PM USA filed a motion to stay post-trial proceedings pending the Eleventh Circuit's final disposition in the Graham case, discussed below under Engle Progeny Appellate Issues. In May 2016, (i) the trial court denied PM USA's remaining post-trial motions and (ii) PM USA filed a notice of appeal to the U.S. Court of Appeals for the Eleventh Circuit and a motion to stay the appeal pending Graham, which the court granted in June 2016. In August 2016, the trial court denied plaintiff's motion to reinstate the jury's punitive damages or to order a new trial and, in September 2016, plaintiff cross-appealed.

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Plaintiff: Harris  
Date: July 2014

Verdict:

The U.S. District Court for the Middle District of Florida returned a verdict in favor of plaintiff and against PM USA, R.J. Reynolds and Lorillard awarding approximately \$1.73 million in compensatory damages and allocating 15% of the fault to PM USA.

Post-Trial Developments:

Defendants filed motions for a defense verdict because the jury's findings indicated that plaintiff was not a member of the Engle class. In December 2014, the trial court entered final judgment without any deduction for plaintiff's comparative fault and, in January 2015, defendants filed a renewed motion for judgment as a matter of law or, in the alternative, a motion for a new trial. Defendants also filed a motion to alter or amend the final judgment. In April 2015, the trial court stayed the post-trial proceedings pending the Eleventh Circuit's final disposition in the Graham case, discussed below under Engle Progeny Appellate Issues.

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Plaintiff: Griffin  
Date: June 2014

Verdict:

A jury in the U.S. District Court for the Middle District of Florida returned a verdict in favor of plaintiff and against PM USA awarding approximately \$1.27 million in compensatory damages and allocating 50% of the fault to PM USA (an amount of approximately \$630,000).

Post-Trial Developments:

The trial court entered final judgment against PM USA in July 2014 with a deduction for plaintiff's comparative fault. In August 2014, PM USA filed a motion to amend the judgment to reduce plaintiff's damages by the amount paid by collateral sources, which the court denied in September 2014. In October 2014, PM USA posted a bond in the amount of \$640,543 and filed a notice of appeal to the U.S. Court of Appeals for the Eleventh Circuit. In May 2015, the Eleventh Circuit stayed the appeal pending final disposition in the Graham case, discussed below under Engle Progeny Appellate Issues.

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Plaintiff: Burkhart

Date: May 2014

Verdict:

A jury in the U.S. District Court for the Middle District of Florida returned a verdict in favor of plaintiff and against PM USA, R.J. Reynolds and Lorillard awarding \$5 million in compensatory damages and allocating 15% of the fault to PM USA. The jury also awarded plaintiff \$2.5 million in punitive damages, allocating \$750,000 to PM USA.

Post-Trial Developments:

In July 2014, defendants filed post-trial motions, including a renewed motion for judgment or, alternatively, for a new trial or remittitur of the damages awards, which the court denied in September 2014. The trial court entered final judgment without any deduction for plaintiff's comparative fault. In October 2014, defendants filed a notice of appeal to the U.S. Court of Appeals for the Eleventh Circuit.

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Plaintiff: Skolnick

Date: June 2013

Verdict:

A Palm Beach County jury returned a verdict in favor of plaintiff and against PM USA and R.J. Reynolds. The jury awarded plaintiff \$2.555 million in compensatory damages and allocated 30% of the fault to each defendant (an amount of \$766,500).

Post-Trial Developments:

In June 2013, defendants and plaintiff filed post-trial motions. The trial court entered final judgment with a deduction for plaintiff's comparative fault. In November 2013, the trial court denied plaintiff's post-trial motion and, in December 2013, denied defendants' post-trial motions. Defendants filed a notice of appeal to the Florida Fourth District Court of Appeal, and plaintiff cross-appealed in December 2013. Also in December 2013, PM USA posted a bond in the amount of \$766,500. In July 2015, the District Court of Appeal reversed the compensatory damages award and ordered judgment in favor of defendants on the strict liability and negligence claims, but remanded plaintiff's conspiracy and concealment claims for a new trial. In August 2015, defendants filed a motion for rehearing, and plaintiff filed a motion for clarification, which the District Court of Appeal denied in September 2015.

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Plaintiff: Starr-Blundell

Date: June 2013

Verdict:

A Duval County jury returned a verdict in favor of plaintiff and against PM USA and R.J. Reynolds. The jury awarded plaintiff \$500,000 in compensatory damages and allocated 10% of the fault to each defendant (an amount of \$50,000).

Post-Trial Developments:

In June 2013, the defendants filed a motion to set aside the verdict and to enter judgment in accordance with their motion for directed verdict or, in the alternative, for a new trial, which was denied in October 2013. In November 2013, the trial court entered final judgment with a deduction for plaintiff's comparative fault. In December 2013, plaintiff filed a notice of appeal to the Florida First District Court of Appeal. Plaintiff agreed to waive the bond for the appeal. In May 2015, the Florida First District Court of Appeal affirmed the final judgment. In June 2015, plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court. In July 2015, the Florida Supreme



Court stayed the case pending the outcome of Soffer, discussed below under Engle Progeny Appellate Issues. In April 2016, the Florida Supreme Court ordered defendants to show cause as to why the case should not be remanded in light of the Soffer decision. In the first quarter of 2016, PM USA recorded a provision on its condensed consolidated balance sheet of approximately \$55,000 for the judgment plus interest and associated costs. In May 2016, the Florida Supreme Court accepted jurisdiction of plaintiff's petition for review and remanded the case for reconsideration in light of the Soffer decision. In September 2016, the Florida First District Court of Appeal further remanded the case in light of Soffer.

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Plaintiff: Graham  
Date: May 2013

Verdict:

A jury in the U.S. District Court for the Middle District of Florida returned a verdict in favor of plaintiff and against PM USA and R.J. Reynolds. The jury awarded \$2.75 million in compensatory damages and allocated 10% of the fault to PM USA (an amount of \$275,000).

Post-Trial Developments:

In June 2013, defendants filed several post-trial motions, including motions for judgment as a matter of law and for a new trial, which the trial court denied in September 2013. The trial court entered final judgment with a deduction for plaintiff's comparative fault. In October 2013, defendants filed a notice of appeal to the U.S. Court of Appeals for the Eleventh Circuit arguing that Engle progeny plaintiffs' product liability claims are impliedly preempted by federal law, and PM USA posted a bond in the amount of \$277,750. In April 2015, the U.S. Court of Appeals for the Eleventh Circuit found in favor of defendants on the basis of federal preemption, reversed the trial court's denial of judgment as a matter of law, and plaintiff filed a petition for rehearing en banc or panel rehearing. In January 2016, the Eleventh Circuit granted a rehearing en banc on both the preemption and due process issues.

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Plaintiff: Searcy  
Date: April 2013

Verdict:

A jury in the U.S. District Court for the Middle District of Florida returned a verdict in favor of plaintiff and against PM USA and R.J. Reynolds. The jury awarded \$6 million in compensatory damages (allocating 30% of the fault to each defendant) and \$10 million in punitive damages against each defendant.

Post-Trial Developments:

In June 2013, the trial court entered final judgment without any deduction for plaintiff's comparative fault. In July 2013, defendants filed various post-trial motions, including motions requesting reductions in damages. In September 2013, the district court reduced the compensatory damages award to \$1 million and the punitive damages award to \$1.67 million against each defendant. The district court denied all other post-trial motions. Plaintiff filed a motion to reconsider the district court's remittitur and, in the alternative, to certify the issue to the U.S. Court of Appeals for the Eleventh Circuit, both of which the court denied in October 2013. In November 2013, defendants filed a notice of appeal to the U.S. Court of Appeals for the Eleventh Circuit. In December 2013, defendants filed an amended notice of appeal after the district court corrected a clerical error in the final judgment, and PM USA posted a bond in the amount of approximately \$2.2 million.

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Plaintiff: Hancock  
Date: August 2012

Verdict:

A Broward County jury returned a verdict in the amount of zero damages and allocated 5% of the fault to each of the defendants (PM USA and R.J. Reynolds). The trial court granted an additur of approximately \$110,000, which is subject to the jury's comparative fault finding.

Post-Trial Developments:

In August 2012, defendants moved to set aside the verdict and to enter judgment in accordance with their motion for directed verdict. Defendants also moved to reduce damages, which motion the court granted. The trial court granted defendants' motion to set off the damages award by the amount of economic damages paid by third parties, which will reduce further any final award. In October 2012, the trial court entered final judgment with a deduction for plaintiff's comparative fault (PM USA's portion of the damages was approximately \$700) and PM USA filed a motion to amend the judgment to award PM USA attorneys' fees of approximately \$20,000. In November 2012, both sides filed notices of appeal to the Florida Fourth District Court of Appeal. Plaintiff agreed to waive the bond for the appeal. In April 2015, the Florida Fourth District Court of Appeal affirmed the trial court's verdict. In May 2015, plaintiff filed a motion for rehearing and for a written opinion and rehearing en banc, which the Court of Appeal denied in June 2015. PM USA's motion for a fee award remains pending.

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Plaintiff: Calloway

Date: May 2012

Verdict:

A Broward County jury returned a verdict in favor of plaintiff and against PM USA, R.J. Reynolds, Lorillard and Liggett Group. The jury awarded approximately \$21 million in compensatory damages and allocated 25% of the fault against PM USA. The jury also awarded approximately \$17 million in punitive damages against PM USA, approximately \$17 million in punitive damages against R.J. Reynolds, approximately \$13 million in punitive damages against Lorillard and approximately \$8 million in punitive damages against Liggett Group.

Post-Trial Developments:

In May and June 2012, defendants filed motions to set aside the verdict and for a new trial. In August 2012, the trial court denied the remaining post-trial motions, reduced the compensatory damages to \$16.1 million and entered final judgment without any deduction for plaintiff's comparative fault. In September 2012, PM USA posted a bond in an amount of \$1.5 million and defendants filed a notice of appeal to the Florida Fourth District Court of Appeal. In August 2013, plaintiff filed a motion to determine the sufficiency of the bond in the trial court on the ground that the bond cap statute is unconstitutional, which the court denied. In January 2016, a panel of the Florida Fourth District Court of Appeal vacated the punitive damages award and remanded the case for retrial on plaintiff's claims of concealment and conspiracy, and punitive damages. The court also found that the trial court should have applied the comparative fault deduction, reducing the compensatory damages against PM USA to \$4.025 million. In February 2016, defendants and plaintiff filed respective motions for rehearing and rehearing en banc. In March 2016, plaintiff filed a notice of supplemental authority citing the Soffer decision, discussed below under Engle Progeny Appellate Issues. In September 2016, the Florida Fourth District Court of Appeal, ruling en banc, reversed the judgment against PM USA and R.J. Reynolds in its entirety on the grounds that improper arguments by plaintiff's counsel deprived defendants of a fair trial, and ordered a new trial. In October 2016, plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court.

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Plaintiff: Putney

Date: April 2010

Verdict:

A Broward County jury returned a verdict in favor of plaintiff and against PM USA, R.J. Reynolds and Liggett Group. The jury awarded approximately \$15.1 million in compensatory damages and allocated 15% of the fault to PM USA (an amount of approximately \$2.3 million). The jury also awarded \$2.5 million in punitive damages against PM USA.

Post-Trial Developments:

In August 2010, the trial court entered final judgment with a deduction for plaintiff's comparative fault. PM USA filed its notice of appeal to the Florida Fourth District Court of Appeal and, in November 2010, posted a \$1.6 million bond. In June 2013, the Fourth District Court of Appeal reversed and remanded the case for further proceedings, holding that the trial court erred in (1) not reducing the compensatory damages award as excessive and (2) not instructing the jury on the statute of repose in connection with plaintiff's conspiracy claim that resulted in the \$2.5 million punitive damages award. In July 2013, plaintiff filed a motion for rehearing, which the Fourth District Court of Appeal denied in August 2013. In September 2013, both parties filed notices to invoke the discretionary jurisdiction of the Florida Supreme Court. In December 2013, the Florida Supreme Court stayed the appeal pending the outcome of the Hess case. In April 2015, the Florida Supreme Court rejected the statute of repose defense in Hess, and PM USA moved for a rehearing. In September 2015, the Florida Supreme Court denied PM USA's rehearing petition in Hess. In February

2016, the Florida Supreme Court upheld the trial court's decision in favor of plaintiff and, in March 2016, clarified that its February 2016 order reinstated the trial court's decision on the statute of repose only. In August 2016, the Florida Fourth District Court of Appeal reinstated the jury's punitive damages verdict and reaffirmed that the compensatory damages award was excessive, remanding the case to the trial court to reduce the compensatory damages.

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Plaintiff: Naugle

Date: November 2009

Verdict:

A Broward County jury returned a verdict in favor of plaintiff and against PM USA. The jury awarded approximately \$56.6 million in compensatory damages and \$244 million in punitive damages. The jury allocated 90% of the fault to PM USA.

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Post-Trial Developments:

In March 2010, the trial court entered final judgment reflecting a reduced award of approximately \$13 million in compensatory damages and \$26 million in punitive damages, but without any deduction for plaintiff's comparative fault. In April 2010, PM USA filed its notice of appeal and posted a \$5 million bond. In June 2012, the Fourth District Court of Appeal affirmed the final judgment (as amended to correct a clerical error) in the amount of approximately \$12.3 million in compensatory damages and approximately \$24.5 million in punitive damages. In December 2012, the Fourth District withdrew its prior decision, reversed the verdict as to compensatory and punitive damages and returned the case to the trial court for a new trial on the question of damages. Upon retrial, in October 2013, the new jury awarded approximately \$3.7 million in compensatory damages and \$7.5 million in punitive damages. PM USA filed post-trial motions, which the trial court denied in April 2014. In May 2014, PM USA filed a notice of appeal to the Fourth District Court of Appeal and plaintiff cross-appealed. Also in May 2014, PM USA filed a rider with the Florida Supreme Court to make the previously-posted Naugle bond applicable to the retrial judgment. In January 2016, the Fourth District Court of Appeal reversed the trial court's decision and remanded the case to the trial court to conduct a juror interview. In April 2016, PM USA moved for a new trial following the juror interview, which the court denied. In May 2016, PM USA filed a notice of appeal to the Fourth District Court of Appeal.

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Engle Cases Concluded Within Past 12 Months

Plaintiff: R. Cohen

Date: March 2010

Verdict:

A Broward County jury returned a verdict in favor of plaintiff and against PM USA and R.J. Reynolds. The jury awarded \$10 million in compensatory damages and allocated 33 1/3% of the fault to PM USA (an amount of approximately \$3.3 million). The jury also awarded a total of \$20 million in punitive damages, assessing separate \$10 million awards against each defendant.

Post-Trial Developments:

In July 2010, the trial court entered final judgment with a deduction for plaintiff's comparative fault. In August 2010, PM USA filed its notice of appeal. In October 2010, PM USA posted a \$2.5 million bond. In September 2012, the Florida Fourth District Court of Appeal affirmed the compensatory damages award but reversed and remanded the punitive damages verdict. The Fourth District returned the case to the trial court for a new jury trial on plaintiff's fraudulent concealment claim. In January 2013, plaintiff and defendants each filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court. In February 2013, the Fourth District granted defendants' motion to stay the mandate. In March 2013, plaintiff filed a motion for review of the stay order with the Florida Supreme Court, which was denied in April 2013. In June 2013, plaintiff moved to consolidate with Hess and Kayton, which defendants did not oppose, but in October 2013, plaintiff withdrew the motion for consolidation. In February 2014, the Florida Supreme Court stayed the appeal pending the outcome of the Hess case. In April 2015, the Florida Supreme Court rejected the statute of repose defense in Hess, and PM USA moved for a rehearing. In September 2015, the Florida Supreme Court denied PM USA's rehearing petition in Hess. In the third quarter of 2015, PM USA recorded a provision on its condensed consolidated balance sheet of approximately \$17.9 million for the judgment plus interest and associated costs. In January 2016, the Florida Supreme Court upheld the trial court's decision in favor of plaintiff. In February 2016, PM USA posted a rider increasing the amount of its bond to \$7.5 million. In April 2016, PM USA filed a motion in the trial court with regard to Florida's bond cap statute, seeking to confirm that the stay on executing the judgment remains in effect through the completion of United States Supreme Court writ of certiorari review or

until the time for moving for such review has expired, which the court granted. See additional discussion below under Florida Bond Statute. In June 2016, PM USA paid the judgment plus interest and associated costs in the amount of approximately \$19.1 million.

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Plaintiff: Buchanan

Date: December 2012

Verdict:

A Leon County jury returned a verdict in favor of plaintiff and against PM USA and Liggett Group. The jury awarded \$5.5 million in compensatory damages and allocated 37% of the fault to each of the defendants.

Post-Trial Developments:

In December 2012, defendants filed several post-trial motions, including motions for a new trial and to set aside the verdict. In March 2013, the trial court denied all motions and entered final judgment against PM USA and Liggett Group without any

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deduction for plaintiff's comparative fault. In April 2013, defendants filed a notice of appeal to the Florida First District Court of Appeal, and PM USA posted a bond in the amount of \$2.5 million. In July 2014, the Florida First District Court of Appeal affirmed the judgment, but certified to the Florida Supreme Court the issue of the statute of repose, which was before the court in Hess. In August 2014, defendants filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court. In September 2014, the Florida Supreme Court stayed the case pending the outcome of Hess. In April 2015, the Florida Supreme Court rejected the statute of repose defense in Hess, and PM USA moved for a rehearing. In September 2015, the Florida Supreme Court denied PM USA's rehearing petition in Hess. In the third quarter of 2015, PM USA recorded a provision on its condensed consolidated balance sheet of approximately \$4.1 million for the judgment plus interest and associated costs. In February 2016, the Florida Supreme Court declined to accept jurisdiction of PM USA's petition for review and PM USA posted a rider increasing the amount of its bond to \$5.5 million. In June 2016, PM USA paid the judgment plus interest and associated costs in the amount of approximately \$4.4 million.

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Plaintiff: Hallgren  
Date: January 2012

Verdict:

A Highland County jury returned a verdict in favor of plaintiff and against PM USA and R.J. Reynolds. The jury awarded approximately \$2 million in compensatory damages and allocated 25% of the fault to PM USA (an amount of approximately \$500,000). The jury also awarded \$750,000 in punitive damages against each of the defendants.

Post-Trial Developments:

The trial court entered final judgment in March 2012 with a deduction for plaintiff's comparative fault. In April 2012, PM USA posted a bond in an amount of approximately \$1.25 million. In May 2012, defendants filed a notice of appeal to the Florida Second District Court of Appeal. In October 2013, the Second District Court of Appeal affirmed the judgment. In November 2013, defendants filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court. In June 2014, the Florida Supreme Court stayed the case pending the outcome of Russo (presenting the same statute of repose issue as Hess). In April 2015, the Florida Supreme Court rejected the statute of repose defense in the Hess and Russo cases, and defendants moved for a rehearing. Additionally, in April 2015, the Florida Supreme Court stayed the case pending the outcome of Soffer, discussed below under Engle Progeny Appellate Issues. In September 2015, the Florida Supreme Court denied PM USA's rehearing petition in Hess and Russo. In October 2015, the Florida Supreme Court lifted its stay of the case and ordered defendants to show cause why the court should not decline to exercise jurisdiction, to which defendants responded. In January 2016, the Florida Supreme Court denied defendants' petition for discretionary review, and PM USA amended its bond to post an additional amount of approximately \$500,000. In the first quarter of 2016, PM USA recorded a provision on its condensed consolidated balance sheet of approximately \$2.2 million for the judgment plus interest and associated costs. In June 2016, PM USA paid the judgment plus interest and associated costs in the amount of approximately \$2.3 million.

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Plaintiff: Kayton (formerly Tate)  
Date: July 2010

Verdict:

A Broward County jury returned a verdict in favor of plaintiff and against PM USA. The jury awarded \$8 million in compensatory damages and allocated 64% of the fault to PM USA (an amount of approximately \$5.1 million). The jury also awarded approximately \$16.2 million in punitive damages against PM USA.



Post-Trial Developments:

In August 2010, the trial court entered final judgment with a deduction for plaintiff's comparative fault, and PM USA filed its notice of appeal and posted a \$5 million bond. In November 2012, the Florida Fourth District Court of Appeal reversed the punitive damages award and remanded the case for a new trial on plaintiff's conspiracy claim. PM USA filed a motion for rehearing, which was denied in January 2013. In January 2013, plaintiff and defendant each filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court. In June 2013, the Florida Supreme Court stayed the appeal pending the outcome of Hess. In April 2015, the Florida Supreme Court rejected the statute of repose defense in Hess, and PM USA moved for a rehearing. In September 2015, the Florida Supreme Court denied PM USA's rehearing petition in Hess. In the third quarter of 2015, PM USA recorded a provision on its condensed consolidated balance sheet of approximately \$28.2 million for the judgment plus interest and associated costs. In February 2016, the Florida Supreme Court upheld the trial court's decision in favor of plaintiff, and PM USA posted a rider increasing the amount of its bond to \$15 million. In April 2016, PM USA filed a motion in the trial court with regard to Florida's bond cap statute, seeking to confirm that the stay on executing the judgment

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remains in effect through the completion of United States Supreme Court writ of certiorari review or until the time for moving for such review has expired, which the court granted. See additional discussion below under Florida Bond Statute. In June 2016, PM USA paid the judgment plus interest and associated costs in the amount of approximately \$30.1 million.

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Plaintiff: Bowden  
Date: March 2014

Verdict:

A Duval County jury returned a verdict in favor of plaintiff and against PM USA and R.J. Reynolds. The jury awarded plaintiff \$5 million in compensatory damages and allocated 30% of the fault to PM USA (an amount of \$1.5 million).

Post-Trial Developments:

The trial court entered final judgment in March 2014 with a deduction for plaintiff's comparative fault. In April 2014, defendants filed post-trial motions, including motions for a new trial and to set aside the verdict. In May 2014, the court denied defendants' post-trial motions. In June 2014, defendants filed a notice of appeal to the Florida First District Court of Appeal, and PM USA posted a bond in the amount of \$1.5 million. In February 2016, the Florida First District Court of Appeal affirmed the trial court's decision in favor of plaintiff. In the first quarter of 2016, PM USA recorded a provision on its condensed consolidated balance sheet of approximately \$1.6 million for the judgment plus interest. In June 2016, PM USA paid the judgment plus interest and associated costs in the amount of approximately \$2.7 million.

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Plaintiff: Hess  
Date: February 2009

Verdict:

A Broward County jury found in favor of plaintiff and against PM USA. The jury awarded \$3 million in compensatory damages and allocated 42% of the fault to PM USA (an amount of approximately \$1.2 million). The jury also awarded \$5 million in punitive damages.

Post-Trial Developments:

In June 2009, the trial court entered final judgment with a deduction for plaintiff's comparative fault. PM USA filed a notice of appeal to the Florida Fourth District Court of Appeal and posted a \$7 million bond in July 2009. In May 2012, the Fourth District reversed and vacated the punitive damages award on the basis that it was barred by the statute of repose and affirmed the judgment in all other respects, upholding the compensatory damages award of \$1.26 million. In June 2012, both parties filed rehearing motions with the Fourth District, which were denied in September 2012. In October 2012, PM USA and plaintiff filed notices to invoke the Florida Supreme Court's discretionary jurisdiction. In the first quarter of 2013, PM USA recorded a provision on its condensed consolidated balance sheet of approximately \$3.2 million for the compensatory damages component of the judgment plus interest and associated costs. In June 2013, the Florida Supreme Court accepted jurisdiction of plaintiff's petition for review, but declined to accept jurisdiction of PM USA's petition. In April 2015, the Florida Supreme Court rejected the statute of repose defense and reinstated the punitive damages award against PM USA, and PM USA moved for a rehearing. In September 2015, the Florida Supreme Court denied PM USA's rehearing petition. In the third quarter of 2015, PM USA recorded an additional provision on its condensed consolidated balance sheet of approximately \$6.6 million for the punitive damages component of the judgment plus interest and associated costs. In February 2016, PM USA paid the judgment plus interest and associated costs in the amount of approximately \$10.6 million. In June 2016, PM USA

paid an additional \$843,261 in interest on the judgment, an amount that had been disputed between the parties.

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Plaintiff: Greene (formerly Rizzuto)

Date: August 2013

Verdict:

A Hernando County jury returned a verdict in favor of plaintiff and against PM USA and Liggett Group. The jury awarded plaintiff \$12.55 million in compensatory damages and allocated 55% of the fault to PM USA.

Post-Trial Developments:

In September 2013, defendants filed post-trial motions, including a motion to reduce damages. In September 2013, the trial court granted a remittitur in part on economic damages, which the court reduced from \$2.55 million to \$1.1 million for a total award of \$11.1 million in compensatory damages. The trial court entered final judgment without a deduction for plaintiff's comparative fault. In July 2015, the Florida Fifth District Court of Appeal found that the trial court should have applied the

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comparative fault deduction to the compensatory damages award. As a result, the judgment against PM USA was reduced to approximately \$6.1 million. In September 2015, the Fifth District Court of Appeal denied PM USA's motion for rehearing. In October 2015, PM USA posted a bond in the amount of \$6.1 million. In the third quarter of 2015, PM USA recorded a provision on its condensed consolidated balance sheet of approximately \$6.7 million for the judgment plus interest and associated costs. In February 2016, PM USA paid the judgment plus interest in the amount of approximately \$6.8 million. In April 2016, PM USA paid fees of approximately \$1.45 million.

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Engle Progeny Appellate Issues

Three Florida federal district courts (in the Merlob, B. Brown and Burr cases) ruled in 2008 that the findings in the first phase of the Engle proceedings cannot be used to satisfy elements of plaintiffs' claims, and two of those rulings (B. Brown and Burr) were certified by the trial court for interlocutory review. The certification in both cases was granted by the U.S. Court of Appeals for the Eleventh Circuit and the appeals were consolidated. The appeal in Burr was dismissed for lack of prosecution, and the case was ultimately dismissed on statute of limitations grounds.

In July 2010, the Eleventh Circuit ruled in B. Brown that, as a matter of Florida law, plaintiffs do not have an unlimited right to use the findings from the original Engle trial to meet their burden of establishing the elements of their claims at trial. The Eleventh Circuit did not reach the issue of whether the use of the Engle findings violates defendants' due process rights. Rather, the court held that plaintiffs may only use the findings to establish those specific facts, if any, that they demonstrate with a reasonable degree of certainty were actually decided by the original Engle jury. The Eleventh Circuit remanded the case to the district court to determine what specific factual findings the Engle jury actually made.

After the remand of B. Brown, several state appellate rulings superseded the Eleventh Circuit's ruling on Florida state law. These cases include Martin, a case against R.J. Reynolds in Escambia County, and J. Brown, a case against R.J. Reynolds in Broward County. In December 2011, petitions for writ of certiorari were filed with the United States Supreme Court by R.J. Reynolds in Campbell, Martin, Gray and Hall and by PM USA and Liggett Group in Campbell. The United States Supreme Court denied defendants' certiorari petitions in March 2012.

In Douglas, in March 2012, the Florida Second District Court of Appeal issued a decision affirming the judgment of the trial court in favor of the plaintiff and upholding the use of the Engle jury findings with respect to strict liability claims but certified to the Florida Supreme Court the question of whether granting res judicata effect to the Engle jury findings violates defendants' federal due process rights. In March 2013, the Florida Supreme Court affirmed the final judgment entered in favor of plaintiff upholding the use of the Engle jury findings with respect to strict liability and negligence claims. PM USA filed its petition for writ of certiorari with the United States Supreme Court in August 2013, which the court denied in October 2013.

Meanwhile, in the Waggoner case, the U.S. District Court for the Middle District of Florida ruled in December 2011 that application of the Engle findings to establish the wrongful conduct elements of plaintiffs' claims consistent with Martin or J. Brown did not violate defendants' due process rights. PM USA and the other defendants sought appellate review of the due process ruling. In February 2012, the district court denied the motion for interlocutory appeal, but did apply the ruling to all active pending federal Engle progeny cases. As a result, R.J. Reynolds appealed the rulings in the Walker and Duke cases to the Eleventh Circuit, which ultimately rejected the due process defense. In March 2014, R.J. Reynolds filed petitions for writ of certiorari to the United States Supreme Court in the Walker and Duke cases, as well as in J. Brown. Defendants filed petitions for writ of certiorari in eight other Engle progeny cases that

were tried in Florida state courts, including one case, Barbanell, in which PM USA was the defendant. In these eight petitions, defendants asserted questions similar to those in Walker, Duke and J. Brown. In June 2014, the United States Supreme Court denied defendants' petitions for writ of certiorari in all 11 cases.

In Graham, an Engle progeny case against PM USA and R.J. Reynolds on appeal to the U.S. Court of Appeals for the Eleventh Circuit, in April 2015 the court, found in favor of defendants on the basis of federal preemption, reversing the trial court's denial of judgment as a matter of law. Thereafter, plaintiff filed a petition for rehearing en banc, which the Eleventh Circuit granted in January 2016. The Eleventh Circuit directed the parties to file briefs and argue both the federal preemption and due process issues. Also in January 2016, in Marotta, a case against R.J. Reynolds on appeal to the Florida Fourth District Court of Appeal, the court rejected R.J. Reynolds's federal preemption defense, but noted the conflict with Graham and certified the preemption question to the Florida Supreme Court. In March 2016, the Florida Supreme Court accepted review of Marotta. Argument is currently scheduled for November 1, 2016.

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In Searcy, an Engle progeny case against PM USA and R.J. Reynolds on appeal to the Eleventh Circuit, defendants argued that application of the Engle findings to the Engle progeny plaintiffs' concealment and conspiracy claims violated defendants' due process rights. The appeal is pending.

In Soffer, an Engle progeny case against R.J. Reynolds, the Florida First District Court of Appeal held that Engle progeny plaintiffs can recover punitive damages only on their intentional tort claims. The Florida Supreme Court accepted jurisdiction over plaintiff's appeal from the Florida First District Court of Appeal's decision and, in March 2016, held that Engle progeny plaintiffs can recover punitive damages in connection with all of their claims. Plaintiffs have increasingly relied on this Florida Supreme Court decision at the trial and appellate court levels in seeking punitive damages in connection with all of their claims.

In Ciccone, an Engle progeny case against R.J. Reynolds, the Florida Fourth District Court of Appeal held that Engle progeny plaintiffs could establish class membership by showing that they developed symptoms during the Engle class period that could, in hindsight, be attributed to their smoking-related disease. The court certified a conflict with Castleman, a Florida First District Court of Appeal decision, which held that manifestation requires Engle progeny plaintiffs to have been aware during the class period that they had a disease caused by smoking in order to establish class membership. The Florida Supreme Court accepted jurisdiction in the Ciccone case and, in March 2016, ruled in favor of plaintiff, approving the Fourth District Court of Appeal's definition.

Florida Bond Statute

In June 2009, Florida amended its existing bond cap statute by adding a \$200 million bond cap that applies to all state Engle progeny lawsuits in the aggregate and establishes individual bond caps for individual Engle progeny cases in amounts that vary depending on the number of judgments in effect at a given time. Plaintiffs in three state Engle progeny cases against R.J. Reynolds in Alachua County, Florida (Alexander, Townsend and Hall) and one case in Escambia County (Clay) challenged the constitutionality of the bond cap statute. The Florida Attorney General intervened in these cases in defense of the constitutionality of the statute.

Trial court rulings were rendered in Clay, Alexander, Townsend and Hall rejecting the plaintiffs' bond cap statute challenges in those cases. The plaintiffs unsuccessfully appealed these rulings. In Alexander, Clay and Hall, the District Court of Appeal for the First District of Florida affirmed the trial court decisions and certified the decision in Hall for appeal to the Florida Supreme Court, but declined to certify the question of the constitutionality of the bond cap statute in Clay and Alexander. The Florida Supreme Court granted review of the Hall decision, but, in September 2012, the court dismissed the appeal as moot. In October 2012, the Florida Supreme Court denied the plaintiffs' rehearing petition. In August 2013, in Calloway, discussed further above, plaintiff filed a motion in the trial court to determine the sufficiency of the bond posted by defendants on the ground that the bond cap statute is unconstitutional, which was denied.

In February 2016, in the Sikes case against R.J. Reynolds, the trial court held that Florida's bond cap statute does not stay the execution of judgment after a case is final in the Florida judicial system and before the defendant files a petition for writ of certiorari in the United States Supreme Court. The District Court of Appeal for the First District of Florida issued an order staying execution of the judgment and requesting that plaintiff show cause why the stay should not remain in effect through the completion of United States Supreme Court writ of certiorari review or until the time for moving for such review has expired. In April 2016, the District Court of Appeal held that the bond cap applies to the period between a Florida Supreme Court ruling and completion of United States Supreme Court writ of certiorari review. In April 2016, PM USA filed motions in the trial court in the R. Cohen and Kayton cases seeking

confirmation that the stay on executing the judgment remains in effect through the completion of United States Supreme Court writ of certiorari review or until the time for moving for such review has expired, which the court granted.

No federal court has yet addressed the constitutionality of the bond cap statute or the applicability of the bond cap to Engle progeny cases tried in federal court.

#### Other Smoking and Health Class Actions

Since the dismissal in May 1996 of a purported nationwide class action brought on behalf of allegedly addicted smokers, plaintiffs have filed numerous putative smoking and health class action suits in various state and federal courts. In general, these cases purport to be brought on behalf of residents of a particular state or states (although a few cases purport to be nationwide in scope) and raise addiction claims and, in many cases, claims of physical injury as well.

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Class certification has been denied or reversed by courts in 60 smoking and health class actions involving PM USA in Arkansas (1), California (1), the District of Columbia (2), Florida (2), Illinois (3), Iowa (1), Kansas (1), Louisiana (1), Maryland (1), Michigan (1), Minnesota (1), Nevada (29), New Jersey (6), New York (2), Ohio (1), Oklahoma (1), Oregon (1), Pennsylvania (1), Puerto Rico (1), South Carolina (1), Texas (1) and Wisconsin (1).

As of October 24, 2016, PM USA and Altria Group, Inc. are named as defendants, along with other cigarette manufacturers, in seven class actions filed in the Canadian provinces of Alberta, Manitoba, Nova Scotia, Saskatchewan, British Columbia and Ontario. In Saskatchewan, British Columbia (two separate cases) and Ontario, plaintiffs seek class certification on behalf of individuals who suffer or have suffered from various diseases, including chronic obstructive pulmonary disease, emphysema, heart disease or cancer, after smoking defendants' cigarettes. In the actions filed in Alberta, Manitoba and Nova Scotia, plaintiffs seek certification of classes of all individuals who smoked defendants' cigarettes. See Guarantees and Other Similar Matters below for a discussion of the Distribution Agreement between Altria Group, Inc. and PMI that provides for indemnities for certain liabilities concerning tobacco products.

Medical Monitoring Class Actions

In medical monitoring actions, plaintiffs have sought to recover the cost for, or otherwise the implementation of, court-supervised programs for ongoing medical monitoring purportedly on behalf of a class of individual plaintiffs. Plaintiffs in these cases have sought to impose liability under various product-based causes of action and the creation of a court-supervised program providing members of the purported class Low Dose CT ("LDCT") scanning in order to identify and diagnose lung cancer. Plaintiffs in these cases have not sought punitive damages, although plaintiffs in Donovan sought permission from the court to seek to treble any damages awarded, which the court denied. The defense of any future medical monitoring cases may be negatively impacted by evolving medical standards and practice.

In Donovan, filed in December 2006 in the U.S. District Court for the District of Massachusetts, plaintiffs purportedly brought the action on behalf of the state's residents who are: age 50 or older; have smoked the Marlboro brand for 20 pack-years or more; and have neither been diagnosed with lung cancer nor are under investigation by a physician for suspected lung cancer. The Supreme Judicial Court of Massachusetts, in answering questions certified to it by the district court, held in October 2009 that under certain circumstances state law recognizes a claim by individual smokers for medical monitoring despite the absence of an actual injury. The court also ruled that whether or not the case is barred by the applicable statute of limitations is a factual issue to be determined at trial. The case was remanded to federal court for further proceedings. In June 2010, the district court granted in part the plaintiffs' motion for class certification, certifying the class as to plaintiffs' claims for breach of implied warranty and violation of the Massachusetts Consumer Protection Act, but denying certification as to plaintiffs' negligence claim. In July 2010, PM USA petitioned the U.S. Court of Appeals for the First Circuit for appellate review of the class certification decision. The petition was denied in September 2010. As a remedy, plaintiffs have proposed a 28-year medical monitoring program with a cost in excess of \$190 million. In October 2011, PM USA filed a motion for class decertification, which motion was denied in March 2012. In February 2013, the district court amended the class definition to extend to individuals who satisfy the class membership criteria through February 26, 2013, and to exclude any individual who was not a Massachusetts resident as of February 26, 2013.

In July 2015, both parties filed various motions, including motions for partial summary judgment and to exclude certain evidence. In October 2015, the district court granted PM USA's motion for partial summary judgment holding that e-vapor products may not be deemed an alternative design for ordinary cigarettes. In February 2016, the trial court



jury returned a verdict in favor of PM USA on the warranty claim. In March 2016, PM USA filed a motion for judgment on plaintiffs' Massachusetts Consumer Protection Act claim based on the jury's verdict, which the court denied in April 2016, ruling that it would function as the finder of fact with respect to the Massachusetts Consumer Protection Act. In September 2016, the U.S. District Court for the District of Massachusetts ruled in favor of PM USA on plaintiffs' Massachusetts Consumer Protection Act claim and entered final judgment in favor of PM USA. Plaintiff did not appeal the judgment, concluding this litigation.

#### Health Care Cost Recovery Litigation

##### Overview

In the health care cost recovery litigation, governmental entities seek reimbursement of health care cost expenditures allegedly caused by tobacco products and, in some cases, of future expenditures and damages. Relief sought by some but not all plaintiffs includes punitive damages, multiple damages and other statutory damages and penalties, injunctions prohibiting

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alleged marketing and sales to minors, disclosure of research, disgorgement of profits, funding of anti-smoking programs, additional disclosure of nicotine yields, and payment of attorney and expert witness fees.

The claims asserted include the claim that cigarette manufacturers were “unjustly enriched” by plaintiffs’ payment of health care costs allegedly attributable to smoking, as well as claims of indemnity, negligence, strict liability, breach of express and implied warranty, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under federal and state statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under federal and state anti-racketeering statutes.

Defenses raised include lack of proximate cause, remoteness of injury, failure to state a valid claim, lack of benefit, adequate remedy at law, “unclean hands” (namely, that plaintiffs cannot obtain equitable relief because they participated in, and benefited from, the sale of cigarettes), lack of antitrust standing and injury, federal preemption, lack of statutory authority to bring suit and statutes of limitations. In addition, defendants argue that they should be entitled to “set off” any alleged damages to the extent the plaintiffs benefit economically from the sale of cigarettes through the receipt of excise taxes or otherwise. Defendants also argue that these cases are improper because plaintiffs must proceed under principles of subrogation and assignment. Under traditional theories of recovery, a payor of medical costs (such as an insurer) can seek recovery of health care costs from a third party solely by “standing in the shoes” of the injured party. Defendants argue that plaintiffs should be required to bring any actions as subrogees of individual health care recipients and should be subject to all defenses available against the injured party.

Although there have been some decisions to the contrary, most judicial decisions in the United States have dismissed all or most health care cost recovery claims against cigarette manufacturers. Nine federal circuit courts of appeals and eight state appellate courts, relying primarily on grounds that plaintiffs’ claims were too remote, have ordered or affirmed dismissals of health care cost recovery actions. The United States Supreme Court has refused to consider plaintiffs’ appeals from the cases decided by five circuit courts of appeals.

Individuals and associations have also sued in purported class actions or as private attorneys general under the Medicare as Secondary Payer (“MSP”) provisions of the Social Security Act to recover from defendants Medicare expenditures allegedly incurred for the treatment of smoking-related diseases. Cases were brought in New York (2), Florida (2) and Massachusetts (1). All were dismissed by federal courts.

In addition to the cases brought in the United States, health care cost recovery actions have also been brought against tobacco industry participants, including PM USA and Altria Group, Inc., in Israel (dismissed), the Marshall Islands (dismissed) and Canada (10), and other entities have stated that they are considering filing such actions.

In September 2005, in the first of several health care cost recovery cases filed in Canada, the Canadian Supreme Court ruled that legislation passed in British Columbia permitting the lawsuit is constitutional, and, as a result, the case, which had previously been dismissed by the trial court, was permitted to proceed. PM USA’s and other defendants’ challenge to the British Columbia court’s exercise of jurisdiction was rejected by the Court of Appeals of British Columbia and, in April 2007, the Supreme Court of Canada denied review of that decision.

Since the beginning of 2008, the Canadian Provinces of British Columbia, New Brunswick, Ontario, Newfoundland and Labrador, Quebec, Alberta, Manitoba, Saskatchewan, Prince Edward Island and Nova Scotia have brought health care reimbursement claims against cigarette manufacturers. PM USA is named as a defendant in the British Columbia and Quebec cases, while both Altria Group, Inc. and PM USA are named as defendants in the New Brunswick, Ontario, Newfoundland and Labrador, Alberta, Manitoba, Saskatchewan, Prince Edward Island and Nova Scotia

cases. The Nunavut Territory and Northwest Territory have passed similar legislation. See Guarantees and Other Similar Matters below for a discussion of the Distribution Agreement between Altria Group, Inc. and PMI that provides for indemnities for certain liabilities concerning tobacco products.

#### Settlements of Health Care Cost Recovery Litigation

In November 1998, PM USA and certain other United States tobacco product manufacturers entered into the 1998 Master Settlement Agreement (the “MSA”) with 46 states, the District of Columbia, Puerto Rico, Guam, the United States Virgin Islands, American Samoa and the Northern Marianas to settle asserted and unasserted health care cost recovery and other claims. PM USA and certain other United States tobacco product manufacturers had previously entered into agreements to

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settle similar claims brought by Mississippi, Florida, Texas and Minnesota (together with the MSA, the “State Settlement Agreements”). The State Settlement Agreements require that the original participating manufacturers or “OPMs” (now PM USA and R.J. Reynolds and, with respect to the brands it acquired from R.J. Reynolds and Lorillard, ITG Brands, LLC (“ITG”)) make annual payments of approximately \$9.4 billion, subject to adjustments for several factors, including inflation, market share and industry volume. In addition, the OPMs are required to pay settling plaintiffs’ attorneys’ fees, subject to an annual cap of \$500 million. For the three months ended September 30, 2016 and 2015, the aggregate amount recorded in cost of sales with respect to the State Settlement Agreements was approximately \$1.2 billion and \$1.1 billion, respectively. For the nine months ended September 30, 2016 and 2015, the aggregate amount recorded in cost of sales with respect to the State Settlement Agreements was approximately \$3.6 billion and \$3.3 billion, respectively. The amount for the nine months ended September 30, 2016 included an increase to cost of sales of approximately \$12 million related to the Maryland NPM Adjustment discussed below. The amounts for the three and nine months ended September 30, 2015 included a reduction to cost of sales of approximately \$126 million related to the New York NPM Adjustment settlement discussed below.

The State Settlement Agreements also include provisions relating to advertising and marketing restrictions, public disclosure of certain industry documents, limitations on challenges to certain tobacco control and underage use laws, restrictions on lobbying activities and other provisions.

NPM Adjustment Disputes

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” or “PMs”) for 2003-2015. The NPM Adjustment is a reduction in MSA payments that applies if the PMs collectively lose at least a specified level of market share to non-participating manufacturers (“NPMs”) between 1997 and the year at issue, subject to certain conditions and defenses. The independent auditor appointed under the MSA calculates the maximum amount, if any, of the NPM Adjustment for any year in respect of which such NPM Adjustment is potentially applicable.

2003-2014 NPM Adjustment Disputes - Settlement with 24 States and Territories and Settlement with New York

PM USA has settled the NPM Adjustment disputes for the years 2003-2012 with 24 of the 52 MSA states and territories (these 24 states and territories are referred to as the “signatory states,” and the remaining MSA states and territories are referred to as the “non-signatory states”). Pursuant to the settlement with these 24 signatory states, PM USA has received a total of \$599 million for 2003-2012 in the form of reductions to its MSA payments in 2013, 2014 and 2015.

In addition, the settlement provides that the NPM Adjustment provision will be revised and streamlined as to the signatory states for the years after 2012. Under the revised provision, the 2013 and 2014 NPM Adjustments were “transition years,” for which the PMs received specified payments in settlement of the NPM Adjustments for those years. PM USA received \$38 million for the 2013 transition year and \$41 million for the 2014 transition year pursuant to this revised provision in the form of reductions to its MSA payments in 2014 and 2015, respectively.

The revised NPM Adjustment provision in the settlement provides that, for 2015 and subsequent years, there is a potential downward adjustment to the PMs’ MSA payment relating to NPM sales on which state excise tax (“SET”) is paid. Pursuant to such adjustment, each signatory state will pay an amount to the OPMs tied to the number of NPM cigarettes sold during the year at issue on which that state collected its SET (or, potentially, on which a comparable

tax was collected) but on which that state did not collect escrow (“non-compliant NPM sales”). These payments will be made in the form of future reductions to MSA payments by the OPMs. This adjustment for SET-paid NPM sales is subject to certain exceptions and to a “safe harbor” under which a state does not owe any payment if the number or percentage of non-compliant NPM sales is below certain stated benchmarks. In addition, the settlement further provides that the NPM Adjustment for 2015 and subsequent years will continue to apply to the signatory states, subject to certain defenses, but that those states will receive a partial liability reduction tied to the percentage of NPM sales nationwide during the year at issue on which either an MSA state has collected SET (or potentially a comparable tax is collected) or, potentially, Mississippi, Florida, Texas or Minnesota collected an equity fee (as defined in the settlement) on cigarettes sold by NPMs in those respective states. The amount (if any) of the potential adjustment relating to SET-paid NPM sales for 2015 and the amount of the partial liability reduction for 2015 have not yet been determined. In addition, proceedings to determine the availability of and defenses to the 2015 NPM Adjustment as to the signatory states will likely not take place for a considerable period of time. In the meantime, pursuant to the settlement, the OPMs and the signatory states have agreed to split the NPM Adjustment amount for 2015 and each subsequent year thereafter pending the ultimate outcome of the applicable proceedings. As a result, in the second quarter of 2016, approximately \$43 million was returned to

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PM USA related to the 2015 NPM Adjustment. This amount was included in other liabilities on the condensed consolidated balance sheet at June 30, 2016 and, once the proceedings to determine the amount of the 2015 NPM Adjustment are concluded, it will either be paid to the signatory states or retained by PM USA (in each case, without interest) as part of the ultimately determined amount payable. The OPMs have agreed that the amounts they receive under the settlement for the 2013-2014 transition years and for subsequent years from the signatory states will be allocated among them pursuant to a formula that modifies the MSA allocation formula in a manner favorable to PM USA. The extent to which it remains favorable to PM USA will depend upon future developments, as well as upon the resolution of certain disputes among the OPMs discussed below.

Many of the non-signatory states objected to the settlement before the arbitration panel hearing the 2003 NPM Adjustment dispute. In March 2013, the panel issued a stipulated partial settlement and award (the “Stipulated Award”) rejecting the objections and permitting the settlement to proceed. In the Stipulated Award, the arbitration panel also ruled that the total 2003 NPM Adjustment would be reduced pro rata by the aggregate allocable share of the signatory states to determine the maximum amount of the 2003 NPM Adjustment potentially available from the non-signatory states whose diligent enforcement claims the PMs continued to contest (the “pro rata judgment reduction”).

Fourteen of the non-signatory states filed motions in their state courts to vacate and/or modify the Stipulated Award in whole or part. Decisions by the Pennsylvania, Missouri, Maryland and New Mexico courts on such motions, and the subsequent appeals of those rulings, are discussed below. One state’s motion was denied without an appeal by the state. As for the remaining states, rulings rejecting their motions to vacate the Stipulated Award have been affirmed on appeal, or the motions have been voluntarily dismissed or stayed pending further state action.

In October 2015, PM USA, along with the other PMs, settled the 2004-2014 NPM Adjustment disputes with New York. The New York settlement is separate from the settlement with the 24 signatory states and is different from that settlement in certain respects. Pursuant to the New York settlement, PM USA received approximately \$126 million for 2004-2014 in the form of a reduction to its MSA payment in 2016. PM USA previously recorded \$126 million as a reduction to cost of sales in the third quarter of 2015 to reflect the New York settlement in its estimate of MSA expenses related to prior years. In addition, the New York settlement provides that the NPM Adjustment provision will be revised as to New York for the years after 2014. The revised provision with respect to NPM cigarettes on which New York SET is paid is largely similar to the revised provision in the settlement with the 24 signatory states with respect to an adjustment relating to SET-paid NPM sales. As to other NPM cigarettes, the New York settlement provides that, in lieu of the NPM Adjustment provision for years after 2014, New York will make annual payments to the PMs tied to the number of NPM cigarettes on which New York did not collect SET that were sold on or through Native American reservations located in New York (or otherwise met the standard in the settlement agreement) during the year at issue to New York consumers. These annual payments will be made in the form of reductions to future MSA payments by the PMs, beginning with the MSA payment in 2017. The OPMs have agreed that the amounts they receive under the New York settlement for the years after 2014 will be allocated among them pursuant to a formula that modifies the MSA allocation formula in a manner favorable to PM USA, although the extent to which it remains favorable to PM USA will depend upon future developments, as well as upon the resolution of certain disputes among the OPMs discussed below. Under the New York settlement, in return for the payments described above and other consideration described in the New York settlement, the PMs have released New York from the NPM Adjustment provision for all years except as provided in the New York settlement.

2003 and Subsequent NPM Adjustment Disputes - Continuing Disputes with Non-Signatory States other than New York

PM USA has continued to pursue the NPM Adjustments for 2003 and subsequent years with respect to the non-signatory states other than New York. Under the MSA, once all conditions for the NPM Adjustment for a particular year are met (including the condition that the disadvantages of the MSA were a “significant factor” contributing to the PMs’ collective loss of market share), each state may avoid an NPM Adjustment to its share of the PMs’ MSA payments for that year by establishing that it diligently enforced a qualifying escrow statute during the entirety of that year. Such a state’s share of the NPM Adjustment would then be reallocated to any states that are found not to have diligently enforced for that year. For 2003-2014, all conditions for the NPM Adjustment have been met, either by determination or agreement among the parties (although the parties’ agreement provides that the “significant factor” condition for 2014 will become effective in February 2017).

2003 NPM Adjustment. With one exception (Montana), the courts have ruled that the states’ claims of diligent enforcement are to be submitted to arbitration. PM USA and other PMs entered into an agreement with most of the MSA states and territories concerning the 2003 NPM Adjustment, under which such states and territories would receive a partial liability reduction of 20% for the 2003 NPM Adjustment in the event the arbitration panel determined

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that they did not diligently enforce during 2003. The Montana state courts ruled that Montana may litigate its diligent enforcement claims in state court, rather than in arbitration. In June 2012, the PMs and Montana entered a consent decree pursuant to which Montana would not be subject to the 2003 NPM Adjustment.

In September 2013, the arbitration panel issued rulings regarding the 15 states and territories whose diligent enforcement the PMs contested that had not as of that time joined the settlement, ruling that six of them (Indiana, Kentucky, Maryland, Missouri, New Mexico and Pennsylvania) did not diligently enforce during 2003 and that nine of them did. Based on this ruling, the PMs were entitled to receive from the six non-diligent states the entire 2003 NPM Adjustment remaining after the pro rata judgment reduction. PM USA believed it was entitled to receive an NPM Adjustment for 2003 based on this ruling, after reflecting the 20% partial liability reduction noted above, of approximately \$145 million. PM USA recorded this \$145 million as a reduction to cost of sales, which increased its reported pre-tax earnings in the third quarter of 2013. In addition, PM USA believed it would be entitled to interest on this amount of approximately \$89 million. PM USA recorded \$64 million of this amount as interest income, which reduced interest and other debt expense, net in the first quarter of 2014, but did not record the remaining \$25 million based on its assessment of certain disputes concerning interest discussed below.

After PM USA recorded these amounts, two of the six non-diligent states (Indiana and Kentucky) joined the settlement and became signatory states. Those two states account for (i) \$37 million of the \$145 million NPM Adjustment for 2003 that PM USA recorded and (ii) \$17 million of the interest that PM USA recorded. PM USA has retained those amounts from the two states, and has received additional amounts as part of the settlement recoveries for the 2003-2012 NPM Adjustment disputes described above. The remaining four states account for approximately (i) \$108 million of the \$145 million 2003 NPM Adjustment that PM USA recorded and (ii) \$66 million of the \$89 million of interest to which PM USA believed it would be entitled on the \$145 million (and \$47 million of the \$64 million of interest that PM USA recorded). Each of these four states filed a motion in its state court to (i) vacate the panel's ruling as to its diligence and (ii) modify the pro rata judgment reduction and to substitute a reduction method more favorable to the state. These four states also raised a dispute concerning the independent auditor's calculation of interest. In addition, another OPM has raised a dispute concerning the allocation of the interest and disputed payments account earnings among the OPMs.

In April 2014, a Pennsylvania state trial court denied Pennsylvania's motion to vacate the arbitration panel's ruling that Pennsylvania had not diligently enforced, but granted Pennsylvania's motion to modify, with respect to Pennsylvania, the pro rata judgment reduction. In April 2015, a Pennsylvania intermediate appellate court affirmed the trial court's modification, with respect to Pennsylvania, of the pro rata judgment reduction. In December 2015, the Supreme Court of Pennsylvania denied PM USA's petition for further judicial review of the Pennsylvania intermediate appellate court decision. Because the Pennsylvania state trial court ruling preceded PM USA's 2014 MSA payment date, the total 2014 MSA payment credit PM USA received on account of the 2003 NPM Adjustment from the four states was reduced from \$108 million to \$79 million, and the interest PM USA received from the four states was \$48 million rather than the \$66 million in interest to which PM USA believed it would be entitled from those four states. As a result of the denial by the Supreme Court of Pennsylvania of PM USA's petition for review of the intermediate appellate court ruling on the modification of the pro rata judgment reduction method, PM USA reversed \$29 million of the reduction to cost of sales and \$13 million of the interest income that had been previously recorded in respect of Pennsylvania for the 2003 NPM Adjustment, which reduced its reported pre-tax earnings by approximately \$42 million in the fourth quarter of 2015. In April 2016, PM USA filed a petition for writ of certiorari with the United States Supreme Court. In October 2016, the United States Supreme Court denied PM USA's petition.



In July 2014, a Maryland state trial court denied both Maryland's motion to vacate the arbitration panel's ruling that Maryland had not diligently enforced and Maryland's motion to vacate or modify the pro rata judgment reduction. Maryland appealed both decisions. In October 2015, a Maryland intermediate appellate court reversed the Maryland trial court's ruling on the pro rata judgment reduction method and applied a judgment reduction method that is more favorable to the state. PM USA sought further discretionary review of this decision in the Maryland Court of Appeals but, in February 2016, the Court of Appeals denied PM USA's petition. As a result, PM USA returned approximately \$12 million of the 2003 NPM Adjustment and \$7 million of the interest it received (plus interest on those amounts). In addition, PM USA recorded a corresponding reduction to its pre-tax earnings in the first quarter of 2016. In June 2016, PM USA filed a petition for writ of certiorari with the United States Supreme Court. In October 2016, the United States Supreme Court denied PM USA's petition.

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In May 2014, a Missouri state trial court denied Missouri's motion to vacate the arbitration panel's ruling that Missouri had not diligently enforced, but granted Missouri's motion to modify, with respect to Missouri, the pro rata judgment reduction. In September 2015, however, a Missouri intermediate appellate court reversed the Missouri state trial court's ruling that modified the pro rata judgment reduction, effectively reinstating the application of that reduction method to Missouri. The Supreme Court of Missouri granted Missouri's request for review of the intermediate appellate court decision. If Missouri is successful on further judicial review of the Missouri intermediate appellate court's ruling reversing the Missouri trial court ruling, 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, and would need to make corresponding reversals to amounts previously recorded. In connection with its appeal of the Missouri state trial court's ruling, PM USA posted a bond in the amount of \$22 million, which will remain in place despite the reversal of the Missouri state trial court's ruling by the intermediate appellate court until all appeals are exhausted. In February 2016, PM USA and other PMs entered into an agreement with the State of Missouri to settle the NPM Adjustment disputes, contingent upon Missouri's enactment by June 3, 2016 of certain amendments to its existing escrow statute. Because the Missouri state legislature failed to pass this legislation, the settlement did not become effective, and Missouri's appeal on the pro rata judgment reduction issue is now proceeding before the Supreme Court of Missouri.

In September 2016, a New Mexico state trial court denied New Mexico's motion to vacate the arbitration panel's ruling that New Mexico had not diligently enforced, but granted New Mexico's motion to modify, with respect to New Mexico, the pro rata judgment reduction. PM USA is appealing the New Mexico trial court's decision regarding the pro rata judgment reduction. If PM USA is not successful on further judicial review of the trial court's ruling on the judgment reduction issue, PM USA will have to return \$3 million of the 2003 NPM Adjustment and \$2 million of the interest it received (plus interest on those amounts) and would need to make corresponding revisions to amounts previously recorded. This and the other litigation and disputes discussed above could further reduce PM USA's recovery on the 2003 NPM Adjustment or recovery of interest and potentially require PM USA to return amounts previously received and/or reverse amounts previously recorded. No assurance can be given that the litigation and disputes discussed above will be resolved in a manner favorable to PM USA.

2004 and Subsequent NPM Adjustments. PM USA believes that the MSA requires the states' diligent enforcement claims for 2004 and thereafter to be determined in multi-state arbitrations, although a number of non-signatory states filed motions in their state courts contending that the claims are to be determined in separate arbitrations for individual states or that there is no arbitrable dispute for 2004. In September 2015, a Missouri intermediate appellate court ruled that Missouri was entitled to a single-state arbitration to determine whether Missouri diligently enforced for 2004. PM USA appealed this ruling, and the Supreme Court of Missouri granted review. No assurance can be given that the outcome of such appeal will be favorable to PM USA. In December 2015, a Wisconsin trial court ruled that Wisconsin must arbitrate its claim of diligent enforcement for 2004, and Wisconsin has since agreed to join the 2004 diligent enforcement arbitration.

In June 2015, PM USA entered into an agreement with 17 of the non-signatory states to form an arbitration panel to conduct an arbitration regarding the 2004 NPM Adjustment. Pursuant to that agreement, in July 2015 PM USA and the 17 states each appointed its respective side's arbitrator for that arbitration panel. In December 2015, the two appointed arbitrators selected the third arbitrator for a three-arbitrator panel required by the MSA. Other PMs declined to participate in appointing the arbitrators, and instead filed motions in courts in each of the 17 states seeking to compel these states to participate in an arbitration of the 2004 NPM Adjustment dispute between the states and the PMs that would also include disputes solely between the OPMs regarding the allocation of NPM Adjustments as between them (the "inter-company disputes"). Several of the 17 states and PM USA filed cross-motions objecting to the

motions filed by the other PMs and seeking to confirm the arbitrators selected by them in July 2015 as properly selected pursuant to the MSA to resolve the 2004 NPM Adjustment dispute between the 17 states and the PMs. PM USA, the 17 states and the other PMs resolved these disputes, and the 2004 diligent enforcement arbitration is underway before two separate arbitration panels, with certain states' claims of diligent enforcement to be decided by one panel and certain other states' claims of diligent enforcement decided by the other panel. These two arbitration panels have two arbitrators in common. In addition, Wisconsin, Pennsylvania and Maryland have agreed to join in the 2004 diligent enforcement arbitration. As part of the resolution of these disputes, the OPMs have agreed that the inter-company disputes will be heard by a separate arbitration panel.

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Proceedings regarding diligent enforcement claims for 2005 and subsequent years have not yet been scheduled. No assurance can be given as to when proceedings for 2005 and subsequent years will be scheduled or the precise form those proceedings will take.

The independent auditor has calculated that PM USA's share of the maximum potential NPM Adjustments for 2004-2015 is (exclusive of interest or earnings): \$388 million for 2004, \$181 million for 2005, \$154 million for 2006, \$185 million for 2007, \$250 million for 2008, \$211 million for 2009, \$218 million for 2010, \$166 million for 2011, \$210 million for 2012, \$218 million for 2013, \$241 million for 2014 and \$289 million for 2015. These maximum amounts will be reduced by a judgment reduction to reflect the settlement with the signatory states and the New York settlement. The judgment reduction for the 2004 and subsequent NPM Adjustments has not yet been determined. In addition, these maximum amounts may also be further reduced by other developments, including agreements that may be entered in the future, disputes that may arise or recalculation of the NPM Adjustment amounts by the independent auditor. Further, the maximum amount for 2004 may also be reduced due to a dispute raised by another OPM regarding the allocation of the maximum potential 2004 NPM Adjustment among the OPMs. In addition, as discussed below, PM USA believes that the amount shown above as PM USA's share of the maximum potential NPM Adjustment for 2015 was incorrectly calculated by the independent auditor, and that PM USA's correct share is higher. Finally, PM USA's recovery of these amounts, even as reduced, is dependent upon subsequent determinations of state diligent enforcement claims, and is subject (in the case of signatory states found non-diligent) to the partial liability reduction under the settlement. The availability and amount of any NPM Adjustment for 2004 and subsequent years will not be finally determined in the near term. There is no assurance that PM USA will ultimately receive any adjustment as a result of these proceedings. PM USA's receipt of amounts on account of the 2003 NPM Adjustment and interest from non-signatory states does not provide any assurance that PM USA will receive any NPM Adjustment amounts (or associated interest or earnings) for 2004 or any subsequent year. PM USA may enter into settlement discussions regarding the NPM Adjustment disputes with any state if PM USA believes it is in its best interests to do so.

Other Disputes Under the State Settlement Agreements

The payment obligations of the tobacco product manufacturers that are parties to the State Settlement Agreements, as well as the allocations of any NPM Adjustments received by them pursuant to the MSA or the settlements of NPM Adjustment disputes with certain states described above, as calculated by the independent auditor, have been and may continue to be affected by R.J. Reynolds's acquisition of Lorillard and the related divestiture of certain cigarette brands by R.J. Reynolds to ITG (the "RJR-Lorillard-ITG transaction"). In that regard, PM USA disputed several recent calculations made by the independent auditor. In particular, PM USA believes that the independent auditor's calculations incorrectly increased PM USA's payment for 2015 due to Mississippi, Florida, Texas and Minnesota under the separate agreements with those states. In addition, PM USA believes that the calculations by the independent auditor have resulted in an improper decrease of PM USA's share of the 2015 NPM Adjustment pursuant to the MSA and the settlements of the NPM Adjustment disputes, although the amount of such decrease depends on a number of factors that cannot be determined at this time. For future years, PM USA cannot predict the amount by which its payment obligations may be increased or its allocation of NPM Adjustments decreased as a result of the RJR-Lorillard-ITG transaction. PM USA cannot provide any assurance that it will be successful in any such dispute that it has raised or may raise.

Other MSA-Related Litigation

Since the MSA's inception, NPMs and/or their distributors or customers have filed a number of challenges to the MSA and related legislation. They have named as defendants the states and their officials, in an effort to enjoin enforcement of important parts of the MSA and related legislation, and/or participating manufacturers, in an effort to obtain damages. To date, no such challenge has been successful, and the U.S. Courts of Appeals for the Second, Third, Fourth, Fifth, Sixth, Eighth, Ninth and Tenth Circuits have affirmed judgments in favor of defendants in 16 such cases.

#### Federal Government's Lawsuit

In 1999, the United States government filed a lawsuit in the U.S. District Court for the District of Columbia against various cigarette manufacturers, including PM USA, and others, including Altria Group, Inc., asserting claims under three federal statutes, namely the Medical Care Recovery Act ("MCRA"), the MSP provisions of the Social Security Act and the civil provisions of RICO. Trial of the case ended in June 2005. The lawsuit sought to recover an unspecified amount of health care

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costs for tobacco-related illnesses allegedly caused by defendants' fraudulent and tortious conduct and paid for by the government under various federal health care programs, including Medicare, military and veterans' health benefits programs, and the Federal Employees Health Benefits Program. The complaint alleged that such costs total more than \$20 billion annually. It also sought what it alleged to be equitable and declaratory relief, including disgorgement of profits that arose from defendants' allegedly tortious conduct, an injunction prohibiting certain actions by defendants, and a declaration that defendants are liable for the federal government's future costs of providing health care resulting from defendants' alleged past tortious and wrongful conduct. The case ultimately proceeded only under the civil provisions of RICO.

The government alleged that disgorgement by defendants of approximately \$280 billion is an appropriate remedy and the trial court agreed. In February 2005, however, a panel of the U.S. Court of Appeals for the District of Columbia Circuit held that disgorgement is not a remedy available to the government under the civil provisions of RICO. In October 2005, the United States Supreme Court denied the government's petition for writ of certiorari.

In August 2006, the federal trial court entered judgment in favor of the government. The court held that certain defendants, including Altria Group, Inc. and PM USA, violated RICO and engaged in seven of the eight "sub-schemes" to defraud that the government had alleged. Specifically, the court found that:

defendants falsely denied, distorted and minimized the significant adverse health consequences of smoking;  
defendants hid from the public that cigarette smoking and nicotine are addictive;  
defendants falsely denied that they control the level of nicotine delivered to create and sustain addiction;  
defendants falsely marketed and promoted "low tar/light" cigarettes as less harmful than full-flavor cigarettes;  
defendants falsely denied that they intentionally marketed to youth;  
defendants publicly and falsely denied that ETS is hazardous to non-smokers; and  
defendants suppressed scientific research.

The court did not impose monetary penalties on defendants, but ordered the following relief: (i) an injunction against "committing any act of racketeering" relating to the manufacturing, marketing, promotion, health consequences or sale of cigarettes in the United States; (ii) an injunction against participating directly or indirectly in the management or control of the Council for Tobacco Research, the Tobacco Institute, or the Center for Indoor Air Research, or any successor or affiliated entities of each; (iii) an injunction against "making, or causing to be made in any way, any material false, misleading, or deceptive statement or representation or engaging in any public relations or marketing endeavor that is disseminated to the United States public and that misrepresents or suppresses information concerning cigarettes"; (iv) an injunction against conveying any express or implied health message or health descriptors on cigarette packaging or in cigarette advertising or promotional material, including "lights," "ultra lights" and "low tar," which the court found could cause consumers to believe one cigarette brand is less hazardous than another brand; (v) the issuance of "corrective statements" in various media regarding the adverse health effects of smoking, the addictiveness of smoking and nicotine, the lack of any significant health benefit from smoking "low tar" or "light" cigarettes, defendants' manipulation of cigarette design to ensure optimum nicotine delivery and the adverse health effects of exposure to environmental tobacco smoke; (vi) the disclosure on defendants' public document websites and in the Minnesota document repository of all documents produced to the government in the lawsuit or produced in any future court or administrative action concerning smoking and health until 2021, with certain additional requirements as to documents withheld from production under a claim of privilege or confidentiality; (vii) the disclosure of disaggregated marketing data to the government in the same form and on the same schedule as defendants now follow in disclosing such data to the Federal Trade Commission ("FTC") for a period of 10 years; (viii) certain restrictions on the sale or transfer by defendants of any cigarette brands, brand names, formulas or cigarette businesses within the United States; and

(ix) payment of the government's costs in bringing the action.

Defendants appealed and, in May 2009, a three judge panel of the Court of Appeals for the District of Columbia Circuit issued a per curiam decision largely affirming the trial court's judgment against defendants and in favor of the government. Although the panel largely affirmed the remedial order that was issued by the trial court, it vacated the following aspects of the order:

its application to defendants' subsidiaries;  
the prohibition on the use of express or implied health messages or health descriptors, but only to the extent of extraterritorial application;  
its point-of-sale display provisions; and

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its application to Brown & Williamson Holdings.

The Court of Appeals panel remanded the case for the trial court to reconsider these four aspects of the injunction and to reformulate its remedial order accordingly. Furthermore, the Court of Appeals panel rejected all of the government's and intervenors' cross-appeal arguments and refused to broaden the remedial order entered by the trial court. The Court of Appeals panel also left undisturbed its prior holding that the government cannot obtain disgorgement as a permissible remedy under RICO.

In July 2009, defendants filed petitions for a rehearing before the panel and for a rehearing by the entire Court of Appeals. Defendants also filed a motion to vacate portions of the trial court's judgment on the grounds of mootness because of the passage of the Family Smoking Prevention and Tobacco Control Act ("FSPTCA"), granting the U.S. Food and Drug Administration (the "FDA") broad authority over the regulation of tobacco products. In September 2009, the Court of Appeals entered three per curiam rulings. Two of them denied defendants' petitions for panel rehearing or for rehearing en banc. In the third per curiam decision, the Court of Appeals denied defendants' suggestion of mootness and motion for partial vacatur. In February 2010, PM USA and Altria Group, Inc. filed their certiorari petitions with the United States Supreme Court. In addition, the federal government and the intervenors filed their own certiorari petitions, asking the court to reverse an earlier Court of Appeals decision and hold that civil RICO allows the trial court to order disgorgement as well as other equitable relief, such as smoking cessation remedies, designed to redress continuing consequences of prior RICO violations. In June 2010, the United States Supreme Court denied all of the parties' petitions. In July 2010, the Court of Appeals issued its mandate lifting the stay of the trial court's judgment and remanding the case to the trial court. As a result of the mandate, except for those matters remanded to the trial court for further proceedings, defendants are now subject to the injunction discussed above and the other elements of the trial court's judgment.

In February 2011, the government submitted its proposed corrective statements and the trial court referred issues relating to a document repository to a special master. Defendants filed a response to the government's proposed corrective statements and filed a motion to vacate the trial court's injunction in light of the FSPTCA, which motion was denied in June 2011. Defendants appealed the trial court's ruling to the U.S. Court of Appeals for the District of Columbia Circuit. In July 2012, the Court of Appeals affirmed the district court's denial of defendants' motion to vacate the district court's injunction.

Remaining issues pending include: (i) the content of the court-ordered corrective communications and (ii) the requirements related to point-of-sale signage. In November 2012, the district court issued its order specifying the content of the corrective communications described above. The district court's order required the parties to engage in negotiations with the special master regarding implementation of the corrective communications remedy for television, newspapers, cigarette pack inserts and websites. In January 2013, defendants filed a notice of appeal from the order on the content and vehicles of the corrective communications and a motion to hold the appeal in abeyance pending completion of the negotiations, which the U.S. Court of Appeals granted in February 2013. In January 2014, the parties submitted a motion for entry of a consent order in the district court, setting forth their agreement on the implementation details of the corrective communications remedy. The agreement provides that the "trigger date" for implementation is after the appeal on the content of the communications has been exhausted. Also in January 2014, the district court convened a hearing and ordered further briefing. A number of amici who sought modification or rejection of the agreement for a variety of reasons were given leave to appear. In April 2014, the parties filed an amended proposed consent order and accompanying submission in the district court seeking entry of a revised agreement on the implementation details of the corrective communications remedy. In June 2014, the district court approved the April 2014 proposed consent order. Also in June 2014, defendants filed a notice of appeal of the consent



order solely for the purpose of perfecting the U.S. Court of Appeals' jurisdiction over the pending appeal relating to the content and vehicles of the corrective communications and, in July 2014, defendants moved to consolidate this appeal with the appeal filed in January 2013. The U.S. Court of Appeals granted the motion to consolidate in August 2014.

In May 2015, the U.S. Court of Appeals affirmed in part and reversed in part, concluding that certain portions of the statements exceeded the district court's jurisdiction under RICO, but upheld other portions challenged by defendants. The Court of Appeals remanded the case to the trial court for further proceedings. In July 2015, the government filed a petition for panel rehearing, which the U.S. Court of Appeals denied on August 2015. In October 2015, the district court ordered further briefing on the content of the corrective communications reversed by the U.S. Court of Appeals and any implementation changes the parties propose. In February 2016, the U.S. District Court for the District of Columbia issued an order on the content of the corrective communications and ordered the parties to submit proposed changes to the consent order on the implementation details, which the parties jointly submitted and the court approved in April 2016. Also in April 2016, defendants filed a notice of appeal to the U.S. Court of Appeals for the District of Columbia Circuit on the content of the corrective communications. In

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May 2016, defendants filed a notice of appeal of the consent order for the purpose of perfecting the appeal of the district court's February 2016 order on the content of the corrective communications.

In the second quarter of 2014, Altria Group, Inc. and PM USA recorded provisions on each of their respective balance sheets totaling \$31 million for the estimated costs of implementing the corrective communications remedy. This estimate is subject to change due to several factors, including the outcome of further proceedings, though Altria Group, Inc. and PM USA do not expect any change in this estimate to be material.

The consent order approved by the district court in June 2014 did not address the requirements related to point-of-sale signage. In May 2014, the district court ordered further briefing by the parties on the issue of corrective statements on point-of-sale signage, which was completed in June 2014.

In December 2011, the parties to the lawsuit entered into an agreement as to the issues concerning the document repository. Pursuant to this agreement, PM USA agreed to deposit an amount of approximately \$3.1 million into the district court in installments over a five-year period.

“Lights/Ultra Lights” Cases

Overview

Plaintiffs in certain pending matters seek certification of their cases as class actions and allege, among other things, that the uses of the terms “Lights” and/or “Ultra Lights” constitute deceptive and unfair trade practices, common law or statutory fraud, unjust enrichment or breach of warranty, and seek injunctive and equitable relief, including restitution and, in certain cases, punitive damages. These class actions have been brought against PM USA and, in certain instances, Altria Group, Inc. or its subsidiaries, on behalf of individuals who purchased and consumed various brands of cigarettes, including Marlboro Lights, Marlboro Ultra Lights, Virginia Slims Lights and Superslims, Merit Lights and Cambridge Lights. Defenses raised in these cases include lack of misrepresentation, lack of causation, injury and damages, the statute of limitations, non-liability under state statutory provisions exempting conduct that complies with federal regulatory directives, and the First Amendment. As of October 24, 2016, a total of 9 such cases are pending in various U.S. state courts.

The Good Case

In *Good*, a purported “Lights” class action, the United States Supreme Court ruled in December 2008 that plaintiffs’ claims are not preempted by the Federal Cigarette Labeling and Advertising Act (“FCLAA”). The case was returned to federal court in Maine and consolidated with other federal cases in the multidistrict litigation proceeding discussed below. In June 2011, the plaintiffs voluntarily dismissed the case without prejudice.

Federal Multidistrict Proceeding and Subsequent Developments

Since the December 2008 United States Supreme Court decision in *Good*, and through October 24, 2016, 26 purported “Lights” class actions were served upon PM USA and, in certain cases, Altria Group, Inc. These cases were filed in 15 states, the U.S. Virgin Islands and the District of Columbia. All of these cases either were filed in federal court or were removed to federal court by PM USA and were transferred and consolidated by the Judicial Panel on Multidistrict Litigation (“JPMDL”) before the U.S. District Court for the District of Maine for pretrial proceedings (“MDL proceeding”).

In November 2010, the district court in the MDL proceeding denied plaintiffs' motion for class certification in four cases, covering the jurisdictions of California, the District of Columbia, Illinois and Maine. These jurisdictions were selected by the parties as sample cases, with two selected by plaintiffs and two selected by defendants. Plaintiffs sought appellate review of this decision but, in February 2011, the U.S. Court of Appeals for the First Circuit denied plaintiffs' petition for leave to appeal. Later that year, plaintiffs in 13 cases voluntarily dismissed their cases without prejudice. In April 2012, the JPMDL remanded the remaining four cases back to the federal district courts in which the suits originated. These cases were ultimately resolved in a manner favorable to PM USA.

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“Lights” Cases Dismissed, Not Certified or Ordered De-Certified

As of October 24, 2016, in addition to the federal district court in the MDL proceeding, 20 courts in 21 “Lights” cases have refused to certify class actions, dismissed class action allegations, reversed prior class certification decisions or have entered judgment in favor of PM USA.

Trial courts in Arizona, Hawaii, Illinois, Kansas, New Jersey, New Mexico, Ohio, Oregon, Tennessee, Washington and Wisconsin have refused to grant class certification or have dismissed plaintiffs’ class action allegations. Plaintiffs voluntarily dismissed a case in Michigan after a trial court dismissed the claims plaintiffs asserted under the Michigan Unfair Trade and Consumer Protection Act. Several appellate courts have issued rulings that either affirmed rulings in favor of Altria Group, Inc. and/or PM USA or reversed rulings entered in favor of plaintiffs.

In Florida, an intermediate appellate court overturned an order by a trial court that granted class certification in Hines. The Florida Supreme Court denied review in January 2008. The Supreme Court of Illinois overturned a judgment that awarded damages to a certified class in the Price case. See The Price Case below for further discussion. In Louisiana, the U.S. Court of Appeals for the Fifth Circuit dismissed a purported “Lights” class action (Sullivan) on the grounds that plaintiffs’ claims were preempted by the FCLAA. In New York, the U.S. Court of Appeals for the Second Circuit overturned a trial court decision in Schwab that granted plaintiffs’ motion for certification of a nationwide class of all U.S. residents that purchased cigarettes in the United States that were labeled “Light” or “Lights.” In July 2010, plaintiffs in Schwab voluntarily dismissed the case with prejudice. In Ohio, the Ohio Supreme Court overturned class certifications in the Marrone and Phillips cases. Plaintiffs voluntarily dismissed both cases without prejudice in August 2009, but refiled in federal court as the Phillips case discussed above. The Supreme Court of Washington denied a motion for interlocutory review filed by the plaintiffs in the Davies case that sought review of an order by the trial court that refused to certify a class. Plaintiffs subsequently voluntarily dismissed the Davies case with prejudice. In August 2011, the U.S. Court of Appeals for the Seventh Circuit affirmed the Illinois federal district court’s dismissal of “Lights” claims brought against PM USA in the Cleary case. In Curtis, a certified class action, in May 2012, the Minnesota Supreme Court affirmed the trial court’s entry of summary judgment in favor of PM USA, concluding this litigation.

In Lawrence, in August 2012, the New Hampshire Supreme Court reversed the trial court’s order to certify a class and subsequently denied plaintiffs’ rehearing petition. In October 2012, the case was dismissed after plaintiffs filed a motion to dismiss the case with prejudice, concluding this litigation.

State Trial Court Class Certifications

State trial courts have certified classes against PM USA in several jurisdictions. Over time, several such cases have been dismissed by the courts at the summary judgment stage, but others remain pending. Significant developments in these pending cases include:

Aspinall: In August 2004, the Massachusetts Supreme Judicial Court affirmed the class certification order. In August 2006, the trial court denied PM USA’s motion for summary judgment and granted plaintiffs’ cross-motion for summary judgment on the defenses of federal preemption and a state law exemption to Massachusetts’ consumer protection statute. On motion of the parties, the trial court subsequently reported its decision to deny summary judgment to the appeals court for review and stayed further proceedings pending completion of the appellate review. In March 2009, the Massachusetts Supreme Judicial Court affirmed the order denying summary judgment to PM USA and granting the plaintiffs’ cross-motion. In January 2010, plaintiffs moved for partial summary judgment as to liability claiming

collateral estoppel from the findings in the case brought by the Department of Justice (see Health Care Cost Recovery Litigation - Federal Government's Lawsuit described above). In March 2012, the trial court denied plaintiffs' motion. In February 2013, the trial court, upon agreement of the parties, dismissed without prejudice plaintiffs' claims against Altria Group, Inc. PM USA is now the sole defendant in the case. In September 2013, the case was transferred to the Business Litigation Session of the Massachusetts Superior Court. Also in September 2013, plaintiffs filed a motion for partial summary judgment on the scope of remedies available in the case, which the Massachusetts Superior Court denied in February 2014, concluding that plaintiffs cannot obtain disgorgement of profits as an equitable remedy and that their recovery is limited to actual damages or \$25 per class member if they cannot prove actual damages greater than \$25. Plaintiffs filed a motion asking the trial court to report its February 2014 ruling to the Massachusetts Appeals Court for review, which the trial court denied. In March 2014, plaintiffs petitioned the Massachusetts Appeals Court for review of the ruling, which the appellate court denied. In August

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2015, the trial court denied various pre-trial motions filed by PM USA, including a motion for summary judgment on the ground that plaintiffs have no proof of injury. Trial began in October 2015 and concluded in November 2015. In December 2015, PM USA filed a motion to decertify the class. In February 2016, the trial court issued its “Findings of Fact and Conclusions of Law,” finding that (1) PM USA violated Massachusetts consumer protection laws in marketing Marlboro “Lights” and (2) plaintiffs proved that class members were economically injured, but did not prove a specific measure of damages. As a result, the court awarded statutory damages of \$25 per class member, for a total of \$4.9 million, plus interest, attorneys’ fees and costs. In April 2016, the parties agreed to settle all claims for approximately \$32 million. The agreement is subject to approval by the court. In the first quarter of 2016, PM USA recorded a provision on its condensed consolidated balance sheet of approximately \$32 million for the judgment plus interest and associated costs. In May 2016, PM USA paid approximately \$32 million to plaintiffs’ escrow agent. In September 2016, the court approved the settlement in which PM USA agreed to pay approximately \$15.3 million to the class and \$16.5 million in attorneys’ fees and costs, and dismissed the case with prejudice.

Larsen: In August 2005, a Missouri Court of Appeals affirmed the class certification order. In December 2009, the trial court denied plaintiffs’ motion for reconsideration of the period during which potential class members can qualify to become part of the class. The class period remains 1995-2003. In June 2010, PM USA’s motion for partial summary judgment regarding plaintiffs’ request for punitive damages was denied. In April 2010, plaintiffs moved for partial summary judgment as to an element of liability in the case, claiming collateral estoppel from the findings in the case brought by the Department of Justice (see Health Care Cost Recovery Litigation - Federal Government’s Lawsuit described above). The plaintiffs’ motion was denied in December 2010. In June 2011, PM USA filed various summary judgment motions challenging the plaintiffs’ claims. In August 2011, the trial court granted PM USA’s motion for partial summary judgment, ruling that plaintiffs could not present a damages claim based on allegations that Marlboro Lights are more dangerous than Marlboro Reds. The trial court denied PM USA’s remaining summary judgment motions. Trial in the case began in September 2011 and, in October 2011, the court declared a mistrial after the jury failed to reach a verdict. In January 2014, the trial court reversed its prior ruling granting partial summary judgment against plaintiffs’ “more dangerous” claim and allowed plaintiffs to pursue that claim. In October 2014, PM USA filed motions to decertify the class and for partial summary judgment on plaintiffs’ “more dangerous” claim, which the court denied in June 2015. Upon retrial, in April 2016, the jury returned a verdict in favor of PM USA. In May 2016, plaintiffs filed a motion for a new trial, which PM USA opposed in June 2016. In August 2016, the trial court denied plaintiffs’ motion for a new trial, plaintiffs filed a notice of appeal and PM USA cross-appealed.

Miner: In June 2007, the United States Supreme Court reversed the lower court rulings in Miner (formerly known as Watson) that denied plaintiffs’ motion to have the case heard in a state, as opposed to federal, trial court. The Supreme Court rejected defendants’ contention that the case must be tried in federal court under the “federal officer” statute. Following remand, the case was removed again to federal court in Arkansas and transferred to the MDL proceeding discussed above. In November 2010, the district court in the MDL proceeding remanded the case to Arkansas state court. In December 2011, plaintiffs voluntarily dismissed their claims against Altria Group, Inc. without prejudice. In March 2013, plaintiffs filed a class certification motion. In November 2013, the trial court granted class certification. The certified class includes those individuals who, from November 1, 1971 through June 22, 2010, purchased Marlboro Lights and Marlboro Ultra Lights for personal consumption in Arkansas. PM USA filed a notice of appeal of the class certification ruling to the Arkansas Supreme Court in December 2013. In February 2015, the Arkansas Supreme Court affirmed the trial court’s class certification order. In May 2015, PM USA filed a motion for partial summary judgment seeking to foreclose any recovery for cigarette purchases prior to 1999, when a private right of action was added to the consumer protection statute under which plaintiffs are suing. The trial court denied the motion in July 2015. In June 2016, the trial court granted PM USA’s motion for partial summary judgment to limit any damages claimed by the plaintiffs’ class to purchases made prior to May 2003. In July 2016, the parties agreed to settle

all claims for \$45 million. The settlement was preliminarily approved by the trial court in August 2016 and is subject to final approval by the court. In the third quarter of 2016, PM USA recorded a provision on its condensed consolidated balance sheet of \$45 million.

#### Other Developments

In Oregon (Pearson), a state court in October 2006 denied plaintiffs' motion for interlocutory review of the trial court's refusal to certify a class. The denial was ultimately affirmed on appeal and the case was remanded to the trial court to adjudicate the claims of the individual plaintiffs. In April 2016, the parties agreed to settle plaintiffs' individual claims for an aggregate

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amount of \$30,000 and, pursuant to that settlement, the parties filed a stipulation of voluntary dismissal with prejudice with the Circuit Court of Multnomah County. This litigation has concluded.

In December 2009, the state trial court in Carroll (formerly known as Holmes) (pending in Delaware) denied PM USA's motion for summary judgment based on an exemption provision in the Delaware Consumer Fraud Act. In January 2011, the trial court allowed the plaintiffs to file an amended complaint substituting class representatives and naming Altria Group, Inc. and PMI as additional defendants. In February 2013, the trial court approved the parties' stipulation to the dismissal without prejudice of Altria Group, Inc. and PMI, leaving PM USA as the sole defendant in the case. In March 2015, plaintiffs moved for class certification and, in July 2015, PM USA filed a summary judgment motion seeking to dismiss plaintiffs' claims in their entirety on preemption grounds.

The Price Case

Trial in Price commenced in state court in Illinois in January 2003 and, in March 2003, the judge found in favor of the plaintiff class and awarded \$7.1 billion in compensatory damages and \$3 billion in punitive damages against PM USA. In December 2005, the Illinois Supreme Court reversed the trial court's judgment in favor of the plaintiffs. In November 2006, the United States Supreme Court denied plaintiffs' petition for writ of certiorari and, in December 2006, the Circuit Court of Madison County dismissed the case with prejudice. In December 2008, plaintiffs filed with the trial court a petition for relief from the final judgment that was entered in favor of PM USA. In February 2012, plaintiffs filed an amended petition asking the trial court to reinstate the original judgment, which the court denied in December 2012. On appeal, in April 2014, the Fifth Judicial District reversed and ordered reinstatement of the original \$10.1 billion trial court judgment against PM USA. In September 2014, the Illinois Supreme Court granted PM USA's motion for leave to appeal. In November 2015, the Illinois Supreme Court vacated the Fifth Judicial District's decision and dismissed the cause of action without prejudice to plaintiffs to file a motion to recall the mandate in the Illinois Supreme Court. In November 2015, the plaintiffs filed a motion in the Illinois Supreme Court seeking to recall the 2005 mandate issued in PM USA's favor, which the court denied. The litigation concluded in June 2016 after the United States Supreme Court denied plaintiffs' petition for writ of certiorari.

Certain Other Tobacco-Related Litigation

Ignition Propensity Cases

PM USA and Altria Group, Inc. are currently facing litigation alleging that a fire caused by cigarettes led to individuals' deaths. In a Kentucky case (Walker), the federal district court denied plaintiffs' motion to remand the case to state court and dismissed plaintiffs' claims in February 2009. Plaintiffs subsequently filed a notice of appeal. In October 2011, the U.S. Court of Appeals for the Sixth Circuit reversed the portion of the district court decision that denied remand of the case to Kentucky state court and remanded the case to Kentucky state court. The Sixth Circuit did not address the merits of the district court's dismissal order. Defendants' petition for rehearing with the Sixth Circuit was denied in December 2011. Defendants filed a renewed motion to dismiss in state court in March 2013. Based on new evidence, in June 2013, defendants removed the case for a second time to the U.S. District Court for the Western District of Kentucky and re-filed their motion to dismiss in June 2013. In July 2013, plaintiffs filed a motion to remand the case to Kentucky state court, which was granted in March 2014.

False Claims Act Case



PM USA is a defendant in a qui tam action filed in the U.S. District Court for the District of Columbia (United States ex rel. Anthony Oliver) alleging violation of the False Claims Act in connection with sales of cigarettes to the U.S. military. The relator contends that PM USA violated “most favored customer” provisions in government contracts and regulations by selling cigarettes to non-military customers in overseas markets at more favorable prices than it sold to the U.S. military exchange services for resale on overseas military bases in those same markets. The relator has dropped Altria Group, Inc. as a defendant and has dropped claims related to post-MSA price increases on cigarettes sold to the U.S. military. In July 2012, PM USA filed a motion to dismiss, which was granted on jurisdictional grounds in June 2013, and the case was dismissed with prejudice. In July 2013, the relator appealed the dismissal to the U.S. Court of Appeals for the District of Columbia Circuit. In August 2014, the U.S. Court of Appeals reversed the jurisdictional issue and remanded the case to the district court for further proceedings, including consideration of PM USA’s alternative grounds for dismissal. In October 2014, PM USA filed a second motion to dismiss in the U.S. District Court for the District of Columbia for lack of subject matter jurisdiction based on issues left unresolved by the opinion of the U.S. Court of Appeals for the District of Columbia Circuit. In April 2015, the district court granted PM USA’s second motion to dismiss for lack of subject matter jurisdiction and again dismissed the case with prejudice.

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The relator appealed the latest dismissal to the U.S. Court of Appeals for the District of Columbia Circuit in May 2015. In June 2016, the U.S. Court of Appeals for the District of Columbia Circuit affirmed the dismissal of the case on jurisdictional grounds. In July 2016, the relator filed a petition for rehearing or rehearing en banc. In September 2016, the U.S. Court of Appeals for the District of Columbia Circuit denied the petition for rehearing.

Argentine Grower Cases

PM USA and Altria Group, Inc. were sued in six cases (Hupan, Chalanuk, Rodriguez Da Silva, Aranda, Taborda and Biglia) filed in Delaware state court against multiple defendants by the parents of Argentine children born with alleged birth defects. Plaintiffs in these cases allege that they grew tobacco in Argentina under contract with Tabacos Norte S.A., an alleged subsidiary of PMI, and that they and their infant children were exposed directly and in utero to Monsanto Company's ("Monsanto") Roundup herbicide during the production and cultivation of tobacco. Plaintiffs seek compensatory and punitive damages against all defendants. In December 2012, Altria Group, Inc. and certain other defendants were dismissed from the Hupan, Chalanuk and Rodriguez Da Silva cases. Altria Group, Inc. and certain other defendants were dismissed from Aranda, Taborda and Biglia in May 2013, October 2013 and February 2014, respectively. The three remaining defendants in the six cases were PM USA, Philip Morris Global Brands Inc. (a subsidiary of PMI) and Monsanto. Following discussions regarding indemnification for these cases pursuant to the Distribution Agreement between PMI and Altria Group, Inc., PMI and PM USA have agreed to resolve conflicting indemnity demands after final judgments are entered. See Guarantees and Other Similar Matters below for a discussion of the Distribution Agreement. In April 2014, all three defendants in the Hupan case filed motions to dismiss for failure to state a claim, and PM USA and Philip Morris Global Brands filed separate motions to dismiss based on the doctrine of forum non conveniens. All proceedings in the other five cases were stayed pending the court's resolution of the motions to dismiss filed in Hupan. In November 2015, the trial court granted PM USA's motion to dismiss on forum non conveniens grounds. Plaintiffs filed a motion for clarification or re-argument in December 2015, which the court denied in August 2016. Later in August 2016, PM USA and Philip Morris Global Brands moved for entry of final judgment in the Hupan case and also moved to lift the stays in the other five cases for the limited purpose of entering final judgment of dismissal in those cases as well based on the forum non conveniens decision in Hupan. The court granted those motions in September 2016, and entered final judgment of dismissal in all six cases.

UST Litigation

Claims related to smokeless tobacco products generally fall within the following categories:

First, UST and/or its tobacco subsidiaries have been named in certain actions in West Virginia (See In re: Tobacco Litigation above) brought by or on behalf of individual plaintiffs against cigarette manufacturers, smokeless tobacco manufacturers and other organizations seeking damages and other relief in connection with injuries allegedly sustained as a result of tobacco usage, including smokeless tobacco products. Included among the plaintiffs are three individuals alleging use of USSTC's smokeless tobacco products and alleging the types of injuries claimed to be associated with the use of smokeless tobacco products. USSTC, along with other non-cigarette manufacturers, has remained severed from such proceedings since December 2001.

Second, UST and/or its tobacco subsidiaries have been named in a number of other individual tobacco and health suits over time. Plaintiffs' allegations of liability in these cases are based on various theories of recovery, such as negligence, strict liability, fraud, misrepresentation, design defect, failure to warn, breach of implied warranty, addiction and breach of consumer protection statutes. Plaintiffs seek various forms of relief, including compensatory

and punitive damages, and certain equitable relief, including but not limited to disgorgement. Defenses raised in these cases include lack of causation, assumption of the risk, comparative fault and/or contributory negligence, and statutes of limitations. In July 2016, USSTC and Altria Group, Inc. were named as defendants, along with other named defendants, in one such case in California (Gwynn). In August 2016, defendants removed the case to federal court. In September 2016, plaintiffs filed a motion to remand the case back to state court.

#### Nu Mark Patent Litigation

In April 2016, Fontem Ventures B.V. and Fontem Holdings 1 B.V., both subsidiaries of Imperial Tobacco Group, sued Nu Mark for alleged patent infringement in the U.S. District Court for the Central District of California. The suit contends that Nu Mark's MarkTen, MarkTen XL and Green Smoke products infringe one or more claims under eight separate Fontem patents for e-vapor products. The suit seeks recovery of an unspecified amount of money damages for alleged past infringement and an

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Altria Group, Inc. and Subsidiaries

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injunction against future infringement, which injunction may result in Nu Mark being enjoined from marketing one or more of the products at issue in the suit. In June 2016, Nu Mark filed ten inter partes review petitions with the U.S. Patent Trial and Appeal Board challenging the validity of all patents and claims asserted against it in the lawsuit on multiple grounds.

In June 2016, the same Fontem entities filed a second lawsuit against Nu Mark in the U.S. District Court for the Central District of California asserting infringement of eight additional e-vapor patents that have issued since the filing of the first case in April 2016. The second case involves the same Nu Mark products as the first case, and likewise seeks recovery of an unspecified amount of money damages for alleged past infringement and an injunction against future infringement. In June 2016, Nu Mark filed a motion to transfer venue of both lawsuits from California to the Middle District of North Carolina, which the court granted in August 2016. In August and September 2016, Nu Mark filed inter partes review petitions with the U.S. Patent Trial and Appeal Board challenging the validity of all patents and claims asserted against it in the second lawsuit.

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.

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 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.

Guarantees and Other Similar Matters

In the ordinary course of business, certain subsidiaries of Altria Group, Inc. have agreed to indemnify a limited number of third parties in the event of future litigation. At September 30, 2016, Altria Group, Inc. and certain of its subsidiaries (i) had \$59 million of unused letters of credit obtained in the ordinary course of business; (ii) were contingently liable for \$24 million of guarantees, consisting primarily of surety bonds, related to their own performance; and (iii) had a redeemable noncontrolling interest of \$36 million recorded on its condensed consolidated balance sheet. In addition, from time to time, subsidiaries of Altria Group, Inc. issue lines of credit to affiliated entities. These items have not had, and are not expected to have, a significant impact on Altria Group, Inc.’s liquidity.

Under the terms of a distribution agreement between Altria Group, Inc. and PMI (the “Distribution Agreement”), entered into as a result of Altria Group, Inc.’s 2008 spin-off of its former subsidiary PMI, liabilities concerning tobacco

products will be allocated based in substantial part on the manufacturer. PMI will indemnify Altria Group, Inc. and PM USA for liabilities related to tobacco products manufactured by PMI or contract manufactured for PMI by PM USA, and PM USA will indemnify PMI for liabilities related to tobacco products manufactured by PM USA, excluding tobacco products contract manufactured for PMI. Altria Group, Inc. does not have a related liability recorded on its condensed consolidated balance sheet at September 30, 2016 as the fair value of this indemnification is insignificant.

As more fully discussed in Note 12. Condensed Consolidating Financial Information, PM USA has issued guarantees relating to Altria Group, Inc.'s obligations under its outstanding debt securities, borrowings under its \$3.0 billion senior unsecured 5-year revolving credit agreement (the "Credit Agreement") and amounts outstanding under its commercial paper program.

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Altria Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 12. Condensed Consolidating Financial Information:

PM USA, which is a 100% owned subsidiary of Altria Group, Inc., has guaranteed Altria Group, Inc.'s obligations under its outstanding debt securities, borrowings under its Credit Agreement and amounts outstanding under its commercial paper program (the "Guarantees"). Pursuant to the Guarantees, PM USA fully and unconditionally guarantees, as primary obligor, the payment and performance of Altria Group, Inc.'s obligations under the guaranteed debt instruments (the "Obligations"), subject to release under certain customary circumstances as noted below. The Guarantees provide that PM USA guarantees the punctual payment when due, whether at stated maturity, by acceleration or otherwise, of the Obligations. The liability of PM USA under the Guarantees is absolute and unconditional irrespective of: any lack of validity, enforceability or genuineness of any provision of any agreement or instrument relating thereto; any change in the time, manner or place of payment of, or in any other term of, all or any of the Obligations, or any other amendment or waiver of or any consent to departure from any agreement or instrument relating thereto; any exchange, release or non-perfection of any collateral, or any release or amendment or waiver of or consent to departure from any other guarantee, for all or any of the Obligations; or any other circumstance that might otherwise constitute a defense available to, or a discharge of, Altria Group, Inc. or PM USA. The obligations of PM USA under the Guarantees are limited to the maximum amount as will not result in PM USA's obligations under the Guarantees constituting a fraudulent transfer or conveyance, after giving effect to such maximum amount and all other contingent and fixed liabilities of PM USA that are relevant under Bankruptcy Law, the Uniform Fraudulent Conveyance Act, the Uniform Fraudulent Transfer Act or any similar federal or state law to the extent applicable to the Guarantees. For this purpose, "Bankruptcy Law" means Title 11, U.S. Code, or any similar federal or state law for the relief of debtors.

PM USA will be unconditionally released and discharged from the Obligations upon the earliest to occur of:

the date, if any, on which PM USA consolidates with or merges into Altria Group, Inc. or any successor;

the date, if any, on which Altria Group, Inc. or any successor consolidates with or merges into PM USA;

the payment in full of the Obligations pertaining to such Guarantees; and

the rating of Altria Group, Inc.'s long-term senior unsecured debt by Standard & Poor's of A or higher.

At September 30, 2016, the respective principal 100% owned subsidiaries of Altria Group, Inc. and PM USA 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.

The following sets forth the condensed consolidating balance sheets as of September 30, 2016 and December 31, 2015, condensed consolidating statements of earnings and comprehensive earnings for the nine and three months ended September 30, 2016 and 2015, and condensed consolidating statements of cash flows for the nine months ended September 30, 2016 and 2015 for Altria Group, Inc., PM USA and, collectively, Altria Group, Inc.'s other subsidiaries that are not guarantors of Altria Group, Inc.'s debt instruments (the "Non-Guarantor Subsidiaries"). The financial information is based on Altria Group, Inc.'s understanding of the Securities and Exchange Commission ("SEC") interpretation and application of Rule 3-10 of SEC Regulation S-X.

The financial information may not necessarily be indicative of results of operations or financial position had PM USA and the Non-Guarantor Subsidiaries operated as independent entities. Altria Group, Inc. and PM USA account for investments in their subsidiaries under the equity method of accounting.



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Altria Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Balance Sheets

September 30, 2016

(in millions of dollars)

	Altria Group, Inc.	PM USA	Non- Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
Assets					
Cash and cash equivalents	\$ 2,239	\$ 1	\$ 58	\$ —	\$ 2,298
Receivables	—	7	139	—	146
Inventories:					
Leaf tobacco	—	510	334	—	844
Other raw materials	—	114	60	—	174
Work in process	—	6	404	—	410
Finished product	—	133	419	—	552
	—	763	1,217	—	1,980
Due from Altria Group, Inc. and subsidiaries	—	3,673	1,453	(5,126)	) —
Deferred income taxes	—	1,277	9	(98)	) 1,188
Other current assets	573	238	50	(70)	) 791
Total current assets	2,812	5,959	2,926	(5,294)	) 6,403
Property, plant and equipment, at cost	—	2,983	1,837	—	4,820
Less accumulated depreciation	—	2,082	769	—	2,851
	—	901	1,068	—	1,969
Goodwill	—	—	5,285	—	5,285
Other intangible assets, net	—	2	12,040	—	12,042
Investment in SABMiller	5,826	—	—	—	5,826
Investment in consolidated subsidiaries	11,805	2,714	—	(14,519)	) —
Finance assets, net	—	—	1,046	—	1,046
Due from Altria Group, Inc. and subsidiaries	4,790	—	—	(4,790)	) —
Other assets	18	537	144	(336)	) 363
Total Assets	\$ 25,251	\$ 10,113	\$ 22,509	\$ (24,939)	) \$ 32,934





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Altria Group, Inc. and Subsidiaries  
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Condensed Consolidating Balance Sheets (Continued)  
September 30, 2016  
(in millions of dollars)

	Altria Group, Inc.	PM USA	Non- Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
<b>Liabilities</b>					
Accounts payable	\$ 3	\$ 86	\$ 207	\$ —	\$ 296
Accrued liabilities:					
Marketing	—	681	116	—	797
Employment costs	80	7	129	—	216
Settlement charges	—	3,422	7	—	3,429
Other	301	517	314	(168)	) 964
Dividends payable	1,193	—	—	—	1,193
Due to Altria Group, Inc. and subsidiaries	4,850	266	10	(5,126)	) —
Total current liabilities	6,427	4,979	783	(5,294)	) 6,895
Long-term debt	13,878	—	—	—	13,878
Deferred income taxes	1,694	—	4,249	(336)	) 5,607
Accrued pension costs	193	—	670	—	863
Accrued postretirement health care costs	—	1,459	837	—	2,296
Due to Altria Group, Inc. and subsidiaries	—	—	4,790	(4,790)	) —
Other liabilities	115	164	133	—	412
Total liabilities	22,307	6,602	11,462	(10,420)	) 29,951
Contingencies					
Redeemable noncontrolling interest	—	—	36	—	36
<b>Stockholders' Equity</b>					
Common stock	935	—	9	(9)	) 935
Additional paid-in capital	5,864	3,310	11,585	(14,895)	) 5,864
Earnings reinvested in the business	27,816	467	1,213	(1,680)	) 27,816
Accumulated other comprehensive losses	(3,278)	) (266)	) (1,799)	) 2,065	(3,278)
Cost of repurchased stock	(28,393)	) —	—	—	(28,393)
Total stockholders' equity attributable to Altria Group, Inc.	2,944	3,511	11,008	(14,519)	) 2,944
Noncontrolling interests	—	—	3	—	3
Total stockholders' equity	2,944	3,511	11,011	(14,519)	) 2,947
Total Liabilities and Stockholders' Equity	\$ 25,251	\$ 10,113	\$ 22,509	\$ (24,939)	) \$ 32,934



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Altria Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Balance Sheets

December 31, 2015

(in millions of dollars)

	Altria Group, Inc.	PM USA	Non- Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
Assets					
Cash and cash equivalents	\$ 2,313	\$—	\$ 56	\$—	\$ 2,369
Receivables	—	7	117	—	124
Inventories:					
Leaf tobacco	—	562	395	—	957
Other raw materials	—	123	58	—	181
Work in process	—	5	439	—	444
Finished product	—	121	328	—	449
	—	811	1,220	—	2,031
Due from Altria Group, Inc. and subsidiaries	—	3,821	1,807	(5,628)	) —
Deferred income taxes	—	1,268	7	(100)	) 1,175
Other current assets	284	65	112	(74)	) 387
Total current assets	2,597	5,972	3,319	(5,802)	) 6,086
Property, plant and equipment, at cost	—	3,102	1,775	—	4,877
Less accumulated depreciation	—	2,157	738	—	2,895
	—	945	1,037	—	1,982
Goodwill	—	—	5,285	—	5,285
Other intangible assets, net	—	2	12,026	—	12,028
Investment in SABMiller	5,483	—	—	—	5,483
Investment in consolidated subsidiaries	11,648	2,715	—	(14,363)	) —
Finance assets, net	—	—	1,239	—	1,239
Due from Altria Group, Inc. and subsidiaries	4,790	—	—	(4,790)	) —
Other assets	20	536	131	(327)	) 360
Total Assets	\$ 24,538	\$ 10,170	\$ 23,037	\$ (25,282)	) \$ 32,463



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Altria Group, Inc. and Subsidiaries  
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## Condensed Consolidating Balance Sheets (Continued)

December 31, 2015

(in millions of dollars)

	Altria Group, Inc.	PM USA	Non- Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
<b>Liabilities</b>					
Current portion of long-term debt	\$ —	\$ —	\$ 4	\$ —	\$ 4
Accounts payable	3	104	293	—	400
Accrued liabilities:					
Marketing	—	586	109	—	695
Employment costs	18	11	169	—	198
Settlement charges	—	3,585	5	—	3,590
Other	354	616	285	(174)	1,081
Dividends payable	1,110	—	—	—	1,110
Due to Altria Group, Inc. and subsidiaries	5,427	191	10	(5,628)	—
Total current liabilities	6,912	5,093	875	(5,802)	7,078
Long-term debt	12,831	—	12	—	12,843
Deferred income taxes	1,547	—	4,443	(327)	5,663
Accrued pension costs	215	—	1,062	—	1,277
Accrued postretirement health care costs	—	1,460	785	—	2,245
Due to Altria Group, Inc. and subsidiaries	—	—	4,790	(4,790)	—
Other liabilities	153	126	168	—	447
Total liabilities	21,658	6,679	12,135	(10,919)	29,553
<b>Contingencies</b>					
Redeemable noncontrolling interest	—	—	37	—	37
<b>Stockholders' Equity</b>					
Common stock	935	—	9	(9)	935
Additional paid-in capital	5,813	3,310	11,456	(14,766)	5,813
Earnings reinvested in the business	27,257	436	1,099	(1,535)	27,257
Accumulated other comprehensive losses	(3,280)	(255)	(1,692)	1,947	(3,280)
Cost of repurchased stock	(27,845)	—	—	—	(27,845)
Total stockholders' equity attributable to Altria Group, Inc.	2,880	3,491	10,872	(14,363)	2,880
Noncontrolling interests	—	—	(7)	—	(7)
Total stockholders' equity	2,880	3,491	10,865	(14,363)	2,873
Total Liabilities and Stockholders' Equity	\$ 24,538	\$ 10,170	\$ 23,037	\$ (25,282)	\$ 32,463

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Condensed Consolidating Statements of Earnings and Comprehensive Earnings  
For the Nine Months Ended September 30, 2016  
(in millions of dollars)

	Altria Group, Inc.	PM USA	Non- Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
Net revenues	\$ —	\$ 16,874	\$ 2,646	\$ (28 )	\$ 19,492
Cost of sales	—	5,084	785	(28 )	5,841
Excise taxes on products	—	4,723	165	—	4,888
Gross profit	—	7,067	1,696	—	8,763
Marketing, administration and research costs	113	1,435	323	—	1,871
Asset impairment and exit costs	5	96	22	—	123
Operating (expense) income	(118 )	5,536	1,351	—	6,769
Interest and other debt expense, net	393	13	165	—	571
Loss on early extinguishment of debt	823	—	—	—	823
Earnings from equity investment in SABMiller	(564 )	—	—	—	(564 )
Gain on derivative financial instruments	(205 )	—	—	—	(205 )
(Loss) earnings before income taxes and equity earnings of subsidiaries	(565 )	5,523	1,186	—	6,144
(Benefit) provision for income taxes	(269 )	2,023	424	—	2,178
Equity earnings of subsidiaries	4,259	217	—	(4,476 )	—
Net earnings	3,963	3,717	762	(4,476 )	3,966
Net earnings attributable to noncontrolling interests	—	—	(3 )	—	(3 )
Net earnings attributable to Altria Group, Inc.	\$ 3,963	\$ 3,717	\$ 759	\$ (4,476 )	\$ 3,963
Net earnings	\$ 3,963	\$ 3,717	\$ 762	\$ (4,476 )	\$ 3,966
Other comprehensive earnings (losses), net of deferred income taxes	2	(11 )	(107 )	118	2
Comprehensive earnings	3,965	3,706	655	(4,358 )	3,968
Comprehensive earnings attributable to noncontrolling interests	—	—	(3 )	—	(3 )
Comprehensive earnings attributable to Altria Group, Inc.	\$ 3,965	\$ 3,706	\$ 652	\$ (4,358 )	\$ 3,965

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Altria Group, Inc. and Subsidiaries  
Notes to Condensed Consolidated Financial Statements  
(Unaudited)

Condensed Consolidating Statements of Earnings and Comprehensive Earnings  
For the Nine Months Ended September 30, 2015  
(in millions of dollars)

	Altria Group, Inc.	PM USA	Non- Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
Net revenues	\$ —	\$ 16,743	\$ 2,405	\$ (32 )	\$ 19,116
Cost of sales	—	4,983	782	(32 )	5,733
Excise taxes on products	—	4,834	157	—	4,991
Gross profit	—	6,926	1,466	—	8,392
Marketing, administration and research costs	135	1,511	305	—	1,951
Reduction of PMI tax-related receivable	41	—	—	—	41
Asset impairment and exit costs	—	—	4	—	4
Operating (expense) income	(176 )	5,415	1,157	—	6,396
Interest and other debt expense, net	430	11	168	—	609
Loss on early extinguishment of debt	228	—	—	—	228
Earnings from equity investment in SABMiller	(546 )	—	—	—	(546 )
(Loss) earnings before income taxes and equity earnings of subsidiaries	(288 )	5,404	989	—	6,105
(Benefit) provision for income taxes	(200 )	1,959	351	—	2,110
Equity earnings of subsidiaries	4,082	197	—	(4,279 )	—
Net earnings	3,994	3,642	638	(4,279 )	3,995
Net earnings attributable to noncontrolling interests	—	—	(1 )	—	(1 )
Net earnings attributable to Altria Group, Inc.	\$ 3,994	\$ 3,642	\$ 637	\$ (4,279 )	\$ 3,994
Net earnings	\$ 3,994	\$ 3,642	\$ 638	\$ (4,279 )	\$ 3,995
Other comprehensive (losses) earnings, net of deferred income taxes	(475 )	11	102	(113 )	(475 )
Comprehensive earnings	3,519	3,653	740	(4,392 )	3,520
Comprehensive earnings attributable to noncontrolling interests	—	—	(1 )	—	(1 )
Comprehensive earnings attributable to Altria Group, Inc.	\$ 3,519	\$ 3,653	\$ 739	\$ (4,392 )	\$ 3,519



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(Unaudited)

Condensed Consolidating Statements of Earnings and Comprehensive Earnings  
For the Three Months Ended September 30, 2016  
(in millions of dollars)

	Altria Group, Inc.	PM USA	Non- Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
Net revenues	\$ —	\$ 5,964	\$ 950	\$ (9 )	\$ 6,905
Cost of sales	—	1,767	285	(9 )	2,043
Excise taxes on products	—	1,654	58	—	1,712
Gross profit	—	2,543	607	—	3,150
Marketing, administration and research costs	40	607	119	—	766
Asset impairment and exit costs	—	1	1	—	2
Operating (expense) income	(40 )	1,935	487	—	2,382
Interest and other debt expense (income), net	129	(4 )	54	—	179
Loss on early extinguishment of debt	823	—	—	—	823
Earnings from equity investment in SABMiller	(299 )	—	—	—	(299 )
Gain on derivative financial instruments	(48 )	—	—	—	(48 )
(Loss) earnings before income taxes and equity earnings of subsidiaries	(645 )	1,939	433	—	1,727
(Benefit) provision for income taxes	(232 )	707	158	—	633
Equity earnings of subsidiaries	1,506	77	—	(1,583 )	—
Net earnings	1,093	1,309	275	(1,583 )	1,094
Net earnings attributable to noncontrolling interests	—	—	(1 )	—	(1 )
Net earnings attributable to Altria Group, Inc.	\$ 1,093	\$ 1,309	\$ 274	\$ (1,583 )	\$ 1,093
Net earnings	\$ 1,093	\$ 1,309	\$ 275	\$ (1,583 )	\$ 1,094
Other comprehensive earnings, net of deferred income taxes	62	4	22	(26 )	62
Comprehensive earnings	1,155	1,313	297	(1,609 )	1,156
Comprehensive earnings attributable to noncontrolling interests	—	—	(1 )	—	(1 )
Comprehensive earnings attributable to Altria Group, Inc.	\$ 1,155	\$ 1,313	\$ 296	\$ (1,609 )	\$ 1,155

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Altria Group, Inc. and Subsidiaries  
Notes to Condensed Consolidated Financial Statements  
(Unaudited)

Condensed Consolidating Statements of Earnings and Comprehensive Earnings  
For the Three Months Ended September 30, 2015  
(in millions of dollars)

	Altria Group, Inc.	PM USA	Non- Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
Net revenues	\$ —	\$ 5,865	\$ 845	\$ (11 )	\$ 6,699
Cost of sales	—	1,671	272	(11 )	1,932
Excise taxes on products	—	1,670	51	—	1,721
Gross profit	—	2,524	522	—	3,046
Marketing, administration and research costs	46	552	100	—	698
Reduction of PMI tax-related receivable	41	—	—	—	41
Operating (expense) income	(87 )	1,972	422	—	2,307
Interest and other debt expense, net	138	11	56	—	205
Earnings from equity investment in SABMiller	(187 )	—	—	—	(187 )
(Loss) earnings before income taxes and equity earnings of subsidiaries	(38 )	1,961	366	—	2,289
(Benefit) provision for income taxes	(55 )	685	131	—	761
Equity earnings of subsidiaries	1,511	71	—	(1,582 )	—
Net earnings	1,528	1,347	235	(1,582 )	1,528
Net earnings attributable to noncontrolling interests	—	—	—	—	—
Net earnings attributable to Altria Group, Inc.	\$ 1,528	\$ 1,347	\$ 235	\$ (1,582 )	\$ 1,528
Net earnings	\$ 1,528	\$ 1,347	\$ 235	\$ (1,582 )	\$ 1,528
Other comprehensive (losses) earnings, net of deferred income taxes	(279 )	4	32	(36 )	(279 )
Comprehensive earnings	1,249	1,351	267	(1,618 )	1,249
Comprehensive earnings attributable to noncontrolling interests	—	—	—	—	—
Comprehensive earnings attributable to Altria Group, Inc.	\$ 1,249	\$ 1,351	\$ 267	\$ (1,618 )	\$ 1,249

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Altria Group, Inc. and Subsidiaries  
Notes to Condensed Consolidated Financial Statements  
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Condensed Consolidating Statements of Cash Flows  
For the Nine Months Ended September 30, 2016  
(in millions of dollars)

	Altria Group, Inc.	PM USA	Non- Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
<b>Cash Provided by Operating Activities</b>					
Net cash provided by operating activities	\$ 4,241	\$ 3,582	\$ 8	\$ (4,331 )	\$ 3,500
<b>Cash Provided by (Used in) Investing Activities</b>					
Capital expenditures	—	(23 )	(105 )	—	(128 )
Proceeds from finance assets	—	—	207	—	207
Other	(3 )	—	(41 )	—	(44 )
Net cash (used in) provided by investing activities	(3 )	(23 )	61	—	35
<b>Cash Provided by (Used in) Financing Activities</b>					
Long-term debt issued	1,976	—	—	—	1,976
Long-term debt repaid	(933 )	—	—	—	(933 )
Repurchases of common stock	(512 )	—	—	—	(512 )
Dividends paid on common stock	(3,321 )	—	—	—	(3,321 )
Changes in amounts due to/from Altria Group, Inc. and subsidiaries	(715 )	128	587	—	—
Premiums and fees related to early extinguishment of debt	(809 )	—	—	—	(809 )
Cash dividends paid to parent	—	(3,686 )	(645 )	4,331	—
Other	2	—	(9 )	—	(7 )
Net cash used in financing activities	(4,312 )	(3,558 )	(67 )	4,331	(3,606 )
<b>Cash and cash equivalents:</b>					
(Decrease) increase	(74 )	1	2	—	(71 )
Balance at beginning of period	2,313	—	56	—	2,369
Balance at end of period	\$ 2,239	\$ 1	\$ 58	\$ —	\$ 2,298



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Altria Group, Inc. and Subsidiaries  
Notes to Condensed Consolidated Financial Statements  
(Unaudited)

Condensed Consolidating Statements of Cash Flows  
For the Nine Months Ended September 30, 2015  
(in millions of dollars)

	Altria Group, Inc.	PM USA	Non- Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
Cash Provided by Operating Activities					
Net cash provided by operating activities	\$ 3,557	\$3,767	\$ 655	\$ (3,889 )	\$ 4,090
Cash Provided by (Used in) Investing Activities					
Capital expenditures	—	(37 )	(125 )	—	(162 )
Proceeds from finance assets	—	—	255	—	255
Other	—	10	(8 )	—	2
Net cash (used in) provided by investing activities	—	(27 )	122	—	95
Cash Provided by (Used in) Financing Activities					
Long-term debt repaid	(1,793 )	—	—	—	(1,793 )
Repurchases of common stock	(518 )	—	—	—	(518 )
Dividends paid on common stock	(3,071 )	—	—	—	(3,071 )
Changes in amounts due to/from Altria Group, Inc. and subsidiaries	611	(492 )	(119 )	—	—
Premiums and fees related to early extinguishment of debt	(226 )	—	—	—	(226 )
Cash dividends paid to parent	—	(3,249 )	(640 )	3,889	—
Other	17	—	(8 )	—	9
Net cash used in financing activities	(4,980 )	(3,741 )	(767 )	3,889	(5,599 )
Cash and cash equivalents:					
(Decrease) increase	(1,423 )	(1 )	10	—	(1,414 )
Balance at beginning of period	3,281	3	37	—	3,321
Balance at end of period	\$ 1,858	\$2	\$ 47	\$ —	\$ 1,907

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Altria Group, Inc. and Subsidiaries  
Notes to Condensed Consolidated Financial Statements  
(Unaudited)

## Note 13. Recent Accounting Guidance Not Yet Adopted:

The following table provides a description of the recently issued accounting guidance that Altria Group, Inc. has not yet adopted:

Standards	Description	Effective Date for Public Entity	Effect on financial statements and other significant matters
ASU Nos. 2014-09; 2015-14; 2016-08; 2016-10; 2016-12 Revenue from Contracts with Customers (Topic 606)	The guidance establishes principles for reporting information about the nature, amount, timing, and uncertainty of revenue and cash flows arising from an entity's contracts with customers.	The guidance is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period.	Altria Group, Inc. is in the process of evaluating the impact of this guidance on its consolidated financial statements and related disclosures.
ASU No. 2015-17 Balance Sheet Classification of Deferred Taxes (Topic 740)	The guidance simplifies the presentation of deferred income taxes by requiring that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. This guidance does not change the current requirement that deferred tax liabilities and assets for each tax-paying jurisdiction be offset and presented as a single amount. The guidance may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented.	The guidance is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is permitted.	Under the new guidance, at September 30, 2016, current deferred income tax assets of approximately \$1.2 billion would have been reclassified to noncurrent deferred income tax liabilities (\$1.0 billion) and noncurrent deferred income tax assets (\$0.2 billion). Altria Group, Inc. will adopt the new guidance by the first quarter of 2017.
ASU No. 2016-01 Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10)	The guidance addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments.	The guidance is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early adoption of the guidance is not permitted, except for a certain provision of the guidance.	Altria Group, Inc. is in the process of evaluating the impact of this guidance on its consolidated financial statements and related disclosures.
ASU No. 2016-02			

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Leases (Topic 842)	The guidance increases transparency and comparability among organizations by requiring entities to recognize lease assets and lease liabilities on the balance sheet and disclose key information about leasing arrangements.	The guidance is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period. Early adoption is permitted.	Altria Group, Inc. is in the process of evaluating the impact of this guidance on its consolidated financial statements and related disclosures.
ASU No. 2016-09 Improvements to Employee Share-Based Payment Accounting (Topic 718)	The guidance simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows.	The guidance is effective for annual reporting periods beginning after December 15, 2016, and interim periods within that reporting period. Early adoption is permitted in any interim or annual period.	The adoption of this guidance is not expected to have a material impact on Altria Group, Inc.'s consolidated financial statements. Altria Group, Inc. expects to adopt this guidance effective January 1, 2017.

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Altria Group, Inc. and Subsidiaries  
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Standards	Description	Effective Date for Public Entity	Effect on financial statements and other significant matters
ASU No. 2016-13 Measurement of Credit Losses on Financial Instruments (Topic 326)	The guidance replaces the current incurred loss impairment methodology for recognizing credit losses for financial assets with a methodology that reflects the entity's current estimate of all expected credit losses and requires consideration of a broader range of reasonable and supportable information for estimating credit losses.	The guidance is effective for annual reporting periods beginning after December 15, 2019, including interim periods within that reporting period. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period.	Altria Group, Inc. is in the process of evaluating the impact of this guidance on its consolidated financial statements and related disclosures.
ASU No. 2016-15 Classification of Certain Cash Receipts and Cash Payments (Topic 230)	The guidance addresses how eight specific cash flow issues are to be presented and classified in the statement of cash flows.	The guidance is effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period.	Altria Group, Inc. is in the process of evaluating the impact of this guidance on its consolidated financial statements and related disclosures.



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## Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

## Description of the Company

At September 30, 2016, Altria Group, Inc.’s wholly-owned subsidiaries included Philip Morris USA Inc. (“PM USA”), which is engaged predominantly 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. 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 September 30, 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. also 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 its previously-announced 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”), has become 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 at October 10, 2016 based on AB InBev’s shares outstanding. 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 October 24, 2016. For further discussion, see Note 4. Investment in SABMiller/AB InBev to the condensed consolidated financial statements in Part I, Item 1. Financial Statements of this Quarterly Report on Form 10-Q (“Item 1”).

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.

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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 for the Nine Months Ended September 30, 2016: The changes in Altria Group, Inc.'s net earnings and diluted earnings per share ("EPS") attributable to Altria Group, Inc. for the nine months ended September 30, 2016, from the nine months ended September 30, 2015, were due primarily to the following:

	Net Earnings (in millions, except per share data)	Diluted EPS
For the nine months ended September 30, 2015	\$3,994	\$2.03
2015 NPM Adjustment Items	(80 )	(0.04 )
2015 Tobacco and health litigation items	73	0.04
2015 SABMiller special items	62	0.03
2015 Loss on early extinguishment of debt	143	0.07
2015 Asset impairment, exit and integration costs	6	—
2015 Tax items	(17 )	—
Subtotal 2015 special items	187	0.10
2016 NPM Adjustment Items	(11 )	(0.01 )
2016 Asset impairment, exit, implementation and acquisition-related costs	(84 )	(0.04 )
2016 Tobacco and health litigation items	(56 )	(0.03 )
2016 SABMiller special items	(96 )	(0.05 )
2016 Gain on derivative financial instruments	129	0.07
2016 Loss on early extinguishment of debt	(541 )	(0.28 )
2016 Tax items	17	0.01
Subtotal 2016 special items	(642 )	(0.33 )
Fewer shares outstanding	—	0.01
Change in tax rate	(14 )	(0.01 )
Operations	438	0.22
For the nine months ended September 30, 2016	\$3,963	\$2.02

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.

Operations: The increase of \$438 million in operations shown in the table above was due primarily to the following: higher income from the smokeable products and smokeless products segments; higher earnings from Altria Group, Inc.'s equity investment in SABMiller; higher operating results from the financial services business; lower interest and other debt expense, net; and lower investment spending in the innovative tobacco products businesses.

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



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Consolidated Results of Operations for the Three Months Ended September 30, 2016: The changes in Altria Group, Inc.'s net earnings and diluted EPS attributable to Altria Group, Inc. for the three months ended September 30, 2016, from the three months ended September 30, 2015, were due primarily to the following:

	Net Earnings (in millions, except per share data)	Diluted EPS
For the three months ended September 30, 2015	\$1,528	\$0.78
2015 NPM Adjustment Items	(80 )	(0.04 )
2015 Tobacco and health litigation items	43	0.02
2015 SABMiller special items	4	—
2015 Integration costs	1	—
2015 Tax items	(21 )	(0.01 )
Subtotal 2015 special items	(53 )	(0.03 )
2016 Asset impairment, exit and implementation costs	(2 )	—
2016 Tobacco and health litigation items	(29 )	(0.01 )
2016 SABMiller special items	26	0.01
2016 Gain on derivative financial instruments	29	0.02
2016 Loss on early extinguishment of debt	(541 )	(0.28 )
2016 Tax items	1	—
Subtotal 2016 special items	(516 )	(0.26 )
Change in tax rate	(15 )	(0.01 )
Operations	149	0.08
For the three months ended September 30, 2016	\$1,093	\$0.56

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.

Operations: The increase of \$149 million in operations shown in the table above was due primarily to the following: higher income from the smokeable products and smokeless products segments; higher earnings from Altria Group, Inc.'s equity investment in SABMiller; and higher operating results from the financial services business.

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

2016 Forecasted Results: On October 11, 2016, to reflect the previously disclosed one-quarter lag in reporting Altria Group, Inc.'s share of AB InBev's results, Altria Group, Inc. revised its 2016 full-year forecast for adjusted diluted EPS growth rate to a range of 6.5% to 8.5% over 2015 full-year adjusted diluted EPS. Altria Group, Inc. reaffirmed this forecast on October 27, 2016. This forecasted growth rate excludes the income and expense items in the table below.

Altria Group, Inc.'s full-year adjusted diluted EPS guidance excludes 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, 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 11. Contingencies to the condensed consolidated financial statements in Item 1 (“Note 11”)).

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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 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.

In addition, the factors described in the Cautionary Factors That May Affect Future Results section of the following Discussion and Analysis represent continuing risks to this forecast and to the other forward-looking statements made in this Quarterly Report on Form 10-Q ("Form 10-Q").

(Income) Expense, Net Excluded from Adjusted Diluted EPS

	2016	2015
NPM Adjustment Items	\$0.01	\$(0.03)
Asset impairment, exit and implementation costs <sup>1</sup>	0.07	—
Tobacco and health litigation items	0.03	0.05
SABMiller special items	0.05	0.04
Loss on early extinguishment of debt	0.28	0.07
Gain on the Transaction <sup>2</sup>	(4.67 )	—
Tax items	(0.01 )	—
	\$(4.24)	\$0.13

<sup>1</sup> Includes restructuring charges of \$0.02 in connection with the facilities consolidation announced in October 2016. For further discussion, see Note 2. Asset Impairment, Exit and Implementation Costs to the condensed consolidated financial statements in Item 1 ("Note 2").

<sup>2</sup> Includes gain on derivative financial instruments of \$0.12.

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 sustainable results as they may be highly variable, are difficult to predict and can distort underlying business trends and results. 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 Altria Group, Inc.'s chief operating decision maker 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.

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## Discussion and Analysis

## Consolidated Operating Results

	For the Nine Months Ended September 30, 2016		For the Three Months Ended September 30, 2015	
	2016	2015	2016	2015
	(in millions)			
Net revenues:				
Smokeable products	\$17,398	\$17,235	\$6,147	\$6,040
Smokeless products	1,530	1,393	528	482
Wine	498	461	182	166
All other	66	27	48	11
Net revenues	\$19,492	\$19,116	\$6,905	\$6,699
Excise taxes on products:				
Smokeable products	\$4,769	\$4,876	\$1,671	\$1,682
Smokeless products	102	100	35	34
Wine	17	15	6	5
Excise taxes on products	\$4,888	\$4,991	\$1,712	\$1,721
Operating income:				
Operating companies income (loss):				
Smokeable products	\$5,955	\$5,831	\$2,086	\$2,121
Smokeless products	930	830	312	286
Wine	100	97	38	35
All other	(46 )	(139 )	8	(35 )
Amortization of intangibles	(15 )	(16 )	(5 )	(6 )
General corporate expenses	(150 )	(166 )	(57 )	(53 )
Reduction of PMI tax-related receivable	—	(41 )	—	(41 )
Corporate asset impairment and exit costs	(5 )	—	—	—
Operating income	\$6,769	\$6,396	\$2,382	\$2,307

As discussed further in Note 7. Segment Reporting to the condensed consolidated financial statements in Item 1, Altria Group, Inc.'s chief operating decision maker 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 the nine and three months ended September 30, 2016 and 2015 affected the comparability of statement of earnings amounts:

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NPM Adjustment Items: Pre-tax expense (income) for NPM Adjustment Items was recorded in Altria Group, Inc.'s condensed consolidated statements of earnings as follows:

	For the Nine Months Ended September 30, 2016	For the Three Months Ended September 30, 2015	For the Three Months Ended September 30, 2015
	(in millions)		
Smokeable products segment	\$12	\$(126)	\$-(126)
Interest and other debt expense, net	6	—	—
Total	\$18	\$(126)	\$-(126)

The amounts shown in the table above for the smokeable products segment were recorded by PM USA as increases (reductions) to cost 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 11.

Tobacco and Health Litigation Items: Pre-tax charges related to certain tobacco and health litigation items were recorded in Altria Group, Inc.'s condensed consolidated statements of earnings as follows:

	For the Nine Months Ended September 30, 2016	For the Three Months Ended September 30, 2015	For the Three Months Ended September 30, 2016	For the Three Months Ended September 30, 2015
	(in millions)			
Smokeable products segment	\$72	\$102	\$45	\$54
Interest and other debt expense, net	16	13	—	13
Total	\$88	\$115	\$45	\$67

During the third quarter of 2016, PM USA recorded a pre-tax charge related to the Miner case of \$45 million in marketing, administration and research costs. During the first quarter of 2016, PM USA recorded pre-tax charges, primarily related to the Aspinall case, of \$26 million in marketing, administration and research costs and \$12 million in interest costs. For further discussion, see "Lights/Ultra Lights" Cases - State Trial Court Class Certifications in Note 11.

During the third quarter of 2015, PM USA recorded pre-tax charges of \$54 million in marketing, administration and research costs related to tobacco and health judgments in six state Engle progeny lawsuits, as well as \$13 million in interest costs related to those cases. During the first quarter of 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, during the first quarter of 2015, 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 11.

Asset Impairment, Exit and Implementation Costs: 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 this initiative, Altria Group, Inc. expects to incur total pre-tax restructuring charges of approximately \$140 million, substantially all of which are expected to be recorded in 2016 and result in cash expenditures.



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Pre-tax asset impairment, exit and implementation costs in connection with the productivity initiative consisted of the following:

	For the Nine Months Ended September 30, 2016			For the Three Months Ended September 30, 2016		
	Asset Impairment and Exit Costs (in millions)	Implementation Costs	Total	Asset Impairment and Exit Costs (in millions)	Implementation Costs	Total
Smokeable products	\$99	\$ 6	\$105	\$1	\$ 3	\$ 4
Smokeless products	13	1	14	—	1	1
All other	6	—	6	1	—	1
General corporate	5	—	5	—	—	—
Total	\$123	\$ 7	\$130	\$2	\$ 4	\$ 6

For further discussion, see Note 2. Asset Impairment, Exit and Implementation Costs to the condensed consolidated financial statements in Item 1.

Loss on Early Extinguishment of Debt: During the third quarter of 2016 and the first quarter of 2015, Altria Group, Inc. completed debt tender offers to purchase for cash certain of its senior unsecured notes in aggregate principal amounts of \$933 million and \$793 million, respectively. As a result of the debt tender offers, Altria Group, Inc. recorded pre-tax losses on early extinguishment of debt in its condensed consolidated statements of earnings as follows:

	For the Nine Months Ended September 30, 2016		For the Three Months Ended September 30, 2015	
	2016	2015	2016	2015
Premiums and fees	\$809	\$226	\$ 809	\$ —
Write-off of unamortized debt discounts and debt issuance costs	14	2	14	—
Total	\$823	\$228	\$ 823	\$ —

For further discussion, see Note 9. Debt to the condensed consolidated financial statements in Item 1 (“Note 9”).

Gain on Derivative Financial Instruments: For the nine and three months ended September 30, 2016, Altria Group, Inc. recorded pre-tax gains of \$205 million and \$48 million, respectively, for the changes in the fair value of its derivative financial instruments entered into in connection with the Transaction. For further discussion, see Note 4.

Investment in SABMiller/AB InBev to the condensed consolidated financial statements in Item 1 (“Note 4”).

SABMiller Special Items: Altria Group, Inc.’s earnings from its equity investment in SABMiller for the nine months ended September 30, 2016 included net pre-tax charges of \$147 million, consisting primarily of Altria Group, Inc.’s share of SABMiller’s asset impairment charges and costs related to the Transaction, partially offset by gains on asset disposals. Altria Group, Inc.’s earnings from its equity investment in SABMiller for the three months ended September 30, 2016 included net pre-tax gains of \$40 million, consisting primarily of Altria Group, Inc.’s share of SABMiller’s gains on asset disposals, partially offset by costs related to the Transaction. For further discussion, see Note 4. Altria Group, Inc.’s earnings from its equity investment in SABMiller for the nine months ended September 30, 2015 included net pre-tax charges of \$96 million, consisting primarily of Altria Group, Inc.’s share of SABMiller’s asset impairment charges.

Tax Items: Tax items for the nine and three months ended September 30, 2016 relate primarily to the reversal of tax accruals no longer required. Tax items for the nine and three months ended September 30, 2015 primarily included the reversal in 2015 of tax reserves and associated interest due primarily to the closure in August 2015 of the Internal Revenue Service (“IRS”) audit of Altria Group, Inc. and its consolidated subsidiaries’ 2007-2009 tax years (“IRS 2007-2009 Audit”), partially offset by a reversal of foreign tax credits primarily associated with SABMiller dividends. For further discussion, see Note 10. Income Taxes to the condensed consolidated financial statements in Item 1 (“Note 10”).

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Consolidated Results of Operations for the Nine Months Ended September 30, 2016

The following discussion compares consolidated operating results for the nine months ended September 30, 2016 with the nine months ended September 30, 2015.

Net revenues, which include excise taxes billed to customers, increased \$376 million (2.0%), due primarily to higher net revenues in the smokeable products and smokeless products segments.

Cost of sales increased \$108 million (1.9%), due primarily to higher per unit settlement charges and NPM Adjustment Items in 2015, partially offset by lower manufacturing costs and lower shipment volume in the smokeable products segment.

Excise taxes on products decreased \$103 million (2.1%), due primarily to lower smokeable products shipment volume.

Marketing, administration and research costs decreased \$80 million (4.1%), due primarily to lower costs in the smokeable products segment (which included lower tobacco and health litigation items).

Operating income increased \$373 million (5.8%), 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 productivity initiative in 2016), higher operating results from the financial services business, lower investment spending in the innovative tobacco products businesses and a reduction of a Philip Morris International Inc. ("PMI") tax-related receivable in 2015.

Interest and other debt expense, net, decreased \$38 million (6.2%), due primarily to lower interest costs on debt as a result of a debt maturity and a debt tender offer in 2015, partially offset by the reversal of interest income in 2016 as a result of the NPM Adjustment Items.

Altria Group, Inc.'s income tax rate increased 0.8 percentage points to 35.4% due primarily to the reversal in 2015 of tax reserves and associated interest due primarily to the closure in August 2015 of the IRS 2007-2009 Audit and the resolution of various PMI tax matters in 2015, partially offset by a reversal of foreign tax credits primarily associated with SABMiller dividends during 2015. For further discussion, see Note 10.

Net earnings attributable to Altria Group, Inc. of \$3,963 million decreased \$31 million (0.8%), due primarily to a higher loss on early extinguishment of debt, partially offset by higher operating income and gain on derivative financial instruments. Diluted and basic EPS attributable to Altria Group, Inc. of \$2.02, each decreased by 0.5% due to lower net earnings attributable to Altria Group, Inc.

Consolidated Results of Operations for the Three Months Ended September 30, 2016

The following discussion compares consolidated operating results for the three months ended September 30, 2016 with the three months ended September 30, 2015.

Net revenues, which include excise taxes billed to customers, increased \$206 million (3.1%), due primarily to higher net revenues in the smokeable products and smokeless products segments.

Cost of sales increased \$111 million (5.7%), due primarily to NPM Adjustment Items in 2015 and higher per unit settlement charges, partially offset by lower manufacturing costs in the smokeable products segment.

Excise taxes on products decreased \$9 million (0.5%), due primarily to lower smokeable products shipment volume.

Marketing, administration and research costs increased \$68 million (9.7%), due primarily to higher costs in the smokeable products segment.

Operating income increased \$75 million (3.3%), due primarily to a reduction of a PMI tax-related receivable in 2015, higher operating results from the the financial services business, and higher operating results from the smokeless products segment, partially offset by lower operating results from the smokeable products segment.

Interest and other debt expense, net, decreased \$26 million (12.7%), due primarily to interest costs related to tobacco and health litigation items and a debt maturity in 2015.

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Earnings from Altria Group, Inc.'s equity investment in SABMiller, which increased \$112 million (59.9%), were positively affected by SABMiller special items.

Altria Group, Inc.'s income tax rate increased 3.5 percentage points to 36.7% due primarily to the reversal of tax reserves and associated interest due primarily to the closure in August 2015 of the IRS 2007-2009 Audit and the resolution of various PMI tax matters in 2015, partially offset by a reversal of foreign tax credits primarily associated with SABMiller dividends during 2015. For further discussion, see Note 10.

Net earnings attributable to Altria Group, Inc. of \$1,093 million decreased \$435 million (28.5%), due primarily to the loss on early extinguishment of debt in 2016, partially offset by higher earnings from Altria Group, Inc.'s equity investment in SABMiller, higher operating income and gain on derivative financial instruments. Diluted and basic EPS attributable to Altria Group, Inc. of \$0.56, each decreased by 28.2% due to lower net earnings attributable to Altria Group, Inc.

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 11 and in Cautionary Factors That May Affect Future Results below, 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 Family Smoking Prevention and Tobacco Control Act ("FSPTCA"), and restrictions and requirements (and related enforcement actions) that have been, and in the future will be, imposed by the U.S. Food and Drug Administration ("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

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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 all other tobacco products, including cigars, e-vapor products, pipe tobacco and oral tobacco-derived nicotine products (“Other Tobacco Products”). See FDA Regulatory Actions - Deeming Regulations below.

Among other measures, the FSPTCA or its implementing regulations:

- 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,



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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

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.

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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 - Debt and Liquidity - Payments Under State Settlement Agreements 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 Tobacco Company ("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

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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 (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.



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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 products currently marketed by PM USA and USSTC are provisional products. PM USA and USSTC submitted timely reports for these products. PM USA and USSTC 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 PM USA and USSTC 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 respective substantial equivalence reports or seek to enforce the law and regulations consistent with its guidance.

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.

The FDA began announcing its decisions on substantial equivalence reports for provisional cigarette, cigarette tobacco and smokeless tobacco products in 2013. However, there are a significant number of substantial equivalence reports for such products for which the FDA has not announced decisions, including reports submitted by PM USA and USSTC. At the request of the FDA, PM USA and USSTC 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 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



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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. PM USA and USSTC 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 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.

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.

## 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 ("FET") on cigarettes increased from \$0.39 per pack to approximately \$1.01 per

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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 October 24, 2016, the weighted-average state and certain local cigarette excise taxes increased from \$0.36 to \$1.61 per pack. As of October 24, 2016, Pennsylvania, Louisiana and West Virginia have enacted legislation to increase their cigarette excise taxes in 2016. There are also several states with proposed ballot initiatives to increase cigarette excise taxes. In California, for example, a ballot measure to increase the cigarette excise tax by \$2.00 per pack and impose corresponding increases on other tobacco products and e-vapor products has qualified for the November 2016 ballot. The Federal Budget released by the President in February 2016 proposes significant increases in the FET for all tobacco products. The proposed budget would increase the FET on a pack of cigarettes by \$0.94 per pack, raising the total FET to \$1.95 per pack, and would also increase the tax on other tobacco products by a proportionate amount. It is not possible to predict whether this proposed FET increase will be enacted.

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 October 24, 2016, 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 October 24, 2016, 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 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.

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### State Settlement Agreements

As discussed in Note 11, 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 - Debt and Liquidity - Payments Under State Settlement Agreements and FDA Regulation below and Note 11. 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

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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.

### 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 moist smokeless tobacco (“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 would materially adversely affect the business and volume of our tobacco subsidiaries and our consolidated results of operations and cash flows.

### 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 PM USA, USSTC or Middleton 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.



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## 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 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 discussion compares operating results for the smokeable products and smokeless products segments for the nine and three months ended September 30, 2016, with the nine and three months ended September 30, 2015.

	For the Nine Months Ended September 30,			
	Net Revenues		Operating Companies Income	
	2016	2015	2016	2015
	(in millions)			
Smokeable products	\$17,398	\$17,235	\$5,955	\$5,831
Smokeless products	1,530	1,393	930	830
Total smokeable and smokeless products	\$18,928	\$18,628	\$6,885	\$6,661

	For the Three Months Ended September 30,			
	Net Revenues		Operating Companies Income	
	2016	2015	2016	2015
	(in millions)			
Smokeable products	\$6,147	\$6,040	\$2,086	\$2,121
Smokeless products	528	482	312	286
Total smokeable and smokeless products	\$6,675	\$6,522	\$2,398	\$2,407



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## Smokeable products segment

The smokeable products segment's net revenues increased during the nine and three months ended September 30, 2016, due primarily to higher pricing. PM USA grew total cigarettes retail share by 0.1 percentage point for the nine and three months ended September 30, 2016.

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

	Shipment Volume					
	For the Nine Months Ended September 30, 2016			For the Three Months Ended September 30, 2015		
	2016	2015	Change	2016	2015	Change
	(sticks in millions)					
Cigarettes:						
Marlboro	80,446	82,007	(1.9 )%	28,152	28,392	(0.8 )%
Other premium	4,858	5,114	(5.0 )%	1,684	1,769	(4.8 )%
Discount	8,569	8,383	2.2 %	3,028	3,021	0.2 %
Total cigarettes	93,873	95,504	(1.7 )%	32,864	33,182	(1.0 )%
Cigars:						
Black & Mild	1,028	963	6.7 %	357	340	5.0 %
Other	19	24	(20.8)%	4	11	(63.6)%
Total cigars	1,047	987	6.1 %	361	351	2.8 %
Total smokeable products	94,920	96,491	(1.6 )%	33,225	33,533	(0.9 )%

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 Nine Months Ended September 30, 2016			For the Three Months Ended September 30, 2015		
	2016	2015	Percentage Point Change	2016	2015	Percentage Point Change
Cigarettes:						
Marlboro	44.0%	44.0%	—	44.0%	43.9%	0.1
Other premium	2.7	2.9	(0.2 )	2.7	2.8	(0.1 )
Discount	4.7	4.4	0.3	4.7	4.6	0.1
Total cigarettes	51.4%	51.3%	0.1	51.4%	51.3%	0.1
Cigars:						
Black & Mild	26.3%	27.4%	(1.1 )	26.8%	27.9%	(1.1 )
Other	0.4	0.4	—	0.3	0.5	(0.2 )
Total cigars	26.7%	27.8%	(1.1 )	27.1%	28.4%	(1.3 )

Retail share results for cigarettes are based on data from IRI/Management Science Associates, 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

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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 and 2015:

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.

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

Net revenues, which include excise taxes billed to customers, for the nine months ended September 30, 2016 increased \$163 million (0.9%), due primarily to higher pricing, which includes higher promotional investments, partially offset by lower shipment volume (\$296 million). Operating companies income for the nine months ended September 30, 2016 increased \$124 million (2.1%), due primarily to higher pricing, which includes higher promotional investments, and lower costs (due primarily to lower pension and benefit costs). These factors were partially offset by lower shipment volume (\$158 million), higher per unit settlement charges, NPM Adjustment Items in 2015 and costs in connection with the productivity initiative.

Net revenues, which include excise taxes billed to customers, for the three months ended September 30, 2016 increased \$107 million (1.8%), due primarily to higher pricing, which includes higher promotional investments, partially offset by lower shipment volume (\$49 million). Operating companies income for the three months ended September 30, 2016 decreased \$35 million (1.7%), driven primarily by NPM Adjustment Items in 2015, higher marketing, administration and research costs (due primarily to state excise tax ballot initiative spending), higher per unit settlement charges and lower shipment volume (\$25 million). These factors were partially offset by higher pricing, which includes higher promotional investments, and lower manufacturing costs (due primarily to lower pension and benefit costs).

Total smokeable products shipment volume for the nine and three months ended September 30, 2016 decreased 1.6% and 0.9%, respectively. PM USA's reported domestic cigarettes shipment volume decreased 1.7% for the the nine months ended September 30, 2016, driven primarily by the industry's rate of decline, partially offset by calendar differences and trade inventory movements. When adjusted for trade inventory movements and calendar differences, PM USA estimates that its domestic cigarettes shipment volume for the nine months ended September 30, 2016 decreased by approximately 2%, in line with its estimate for total industry cigarette volumes.

In the third quarter of 2016, PM USA's reported domestic cigarettes shipment volume decreased 1.0%, driven primarily by the industry's rate of decline, partially offset by trade inventory movements. When adjusted for trade inventory movements, PM USA estimates that its third-quarter domestic cigarettes shipment volume decreased by approximately 3%, in line with its estimate for total industry cigarette volumes.

PM USA's shipments of premium cigarettes accounted for 90.9% and 90.8% of its reported domestic cigarettes shipment volume for the nine and three months ended September 30, 2016, respectively, versus 91.2% and 90.9% for the nine and three months ended September 30, 2015, respectively.

Middleton's reported cigars shipment volume for the nine and three months ended September 30, 2016 increased 6.1% and 2.8%, respectively, driven primarily by Black & Mild in the tipped cigars segment.

Marlboro's retail share was unchanged for the nine months ended September 30, 2016 and grew 0.1 retail share point in the third quarter of 2016. PM USA grew its total retail share for the nine and three months ended September 30, 2016 by 0.1 share point in both periods.

In the machine-made large cigars category, Black & Mild's retail share declined 1.1 share points for both the nine and three months ended September 30, 2016.

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## Smokeless products segment

In both the nine and three months ended September 30, 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 during both periods.

The following table summarizes smokeless products segment shipment volume performance:

	Shipment Volume					
	For the Nine Months Ended September 30, 2016			For the Three Months Ended September 30, 2016		
	2016	2015	Change	2016	2015	Change
	(cans and packs in millions)					
Copenhagen	392.3	351.5	11.6 %	133.5	120.2	11.1 %
Skoal	197.3	200.5	(1.6) %	66.2	67.1	(1.3) %
Copenhagen and Skoal	589.6	552.0	6.8 %	199.7	187.3	6.6 %
Other	50.8	53.0	(4.2) %	16.7	17.6	(5.1) %
Total smokeless products	640.4	605.0	5.9 %	216.4	204.9	5.6 %

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. Other includes certain USSTC and PM USA smokeless 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. 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 Nine Months Ended September 30, 2016			For the Three Months Ended September 30, 2016		
	2016	2015	Percentage Change	2016	2015	Percentage Change
Copenhagen	33.6 %	31.4 %	2.2	34.4 %	31.7 %	2.7
Skoal	18.6	19.8	(1.2)	18.2	19.7	(1.5)
Copenhagen and Skoal	52.2	51.2	1.0	52.6	51.4	1.2
Other	3.4	3.7	(0.3)	3.3	3.6	(0.3)
Total smokeless products	55.6 %	54.9 %	0.7	55.9 %	55.0 %	0.9

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. Other includes certain USSTC and PM USA smokeless 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 and 2015:

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.



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

Net revenues, which include excise taxes billed to customers, for the nine months ended September 30, 2016 increased \$137 million (9.8%), due primarily to higher volume (\$89 million) and higher pricing, which includes higher promotional investments, partially offset by mix due to growth in popular price products. Operating companies income for the nine months ended September 30, 2016 increased \$100 million (12.0%), due primarily to higher shipment volume (\$78 million) and higher pricing, which includes higher promotional investments, partially offset by product mix, higher marketing, administration and research costs, and costs in connection with the productivity initiative.

Net revenues, which include excise taxes billed to customers, for the three months ended September 30, 2016 increased \$46 million (9.5%), due primarily to higher shipment volume (\$34 million) and higher pricing, which includes higher promotional investments, partially offset by mix due to growth in popular price products. Operating companies income for the three months ended September 30, 2016 increased \$26 million (9.1%), due primarily to higher shipment volume (\$31 million) and higher pricing, which includes higher promotional investments, partially offset by higher manufacturing costs, product mix and state excise tax ballot initiative spending.

The smokeless products segment's reported domestic shipment volume increased 5.9% and 5.6% for the nine and three months ended September 30, 2016, respectively, driven by Copenhagen, partially offset by declines in Skoal and Other portfolio brands. Copenhagen and Skoal's combined reported shipment volume for the nine and three months ended September 30, 2016 increased 6.8% and 6.6%, respectively.

After adjusting for trade inventory movements and other factors, USSTC estimates that its domestic smokeless products shipment volume grew approximately 5.5% and 6% for the nine and three months ended September 30, 2016, respectively. USSTC estimates that the smokeless products category volume grew approximately 3% over the six months ended September 30, 2016.

Copenhagen and Skoal's combined retail share for the nine and three months ended September 30, 2016 increased 1.0 and 1.2 share points, respectively. For the three months ended September 30, 2016, Copenhagen's retail share grew 2.7 share points benefiting from Copenhagen Mint's national retail expansion earlier this year, while Skoal's retail share declined 1.5 share points.

Total smokeless products retail share for the nine and three months ended September 30, 2016 increased 0.7 and 0.9 share points, respectively.

## 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.

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## Operating Results

Ste. Michelle increased its net revenues and shipment volume for the nine and three months ended September 30, 2016.

The following discussion compares wine segment results for the nine and three months ended September 30, 2016, with the nine and three months ended September 30, 2015.

	For the Nine Months Ended September 30, 2016		For the Three Months Ended September 30, 2015	
	2016	2015	2016	2015
	(in millions)			
Net revenues	\$498	\$461	\$182	\$166
Operating companies income	\$100	\$97	\$38	\$35

Net revenues, which include excise taxes billed to customers, for the nine and three months ended September 30, 2016 increased \$37 million (8.0%) and \$16 million (9.6%), respectively, due primarily to higher shipment volume.

Operating companies income for the nine months ended September 30, 2016 increased \$3 million (3.1%), due primarily to higher shipment volume, partially offset by higher costs. Operating companies income for the three months ended September 30, 2016 increased \$3 million (8.6%), due primarily to higher shipment volume.

For the nine and three months ended September 30, 2016, Ste. Michelle's reported wine shipment volume of 6,231 and 2,256 thousand cases, respectively, grew 5.8% and 6.3%, respectively, driven primarily by growth among its core premium brands.

## Financial Review

## Net Cash Provided by Operating Activities

During the first nine months of 2016, net cash provided by operating activities was \$3,500 million compared with \$4,090 million during the first nine months of 2015. This decrease was due primarily to voluntary contributions totaling \$500 million to Altria Group, Inc.'s pension plans and higher payments for tobacco and health litigation items during the first nine months of 2016.

Altria Group, Inc. had a working capital deficit at September 30, 2016 and December 31, 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 Investing Activities

During the first nine months of 2016, net cash provided by investing activities was \$35 million compared with \$95 million during the first nine months of 2015. This decrease was due primarily to lower proceeds from asset sales in the financial services business during the first nine months of 2016.

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## Net Cash Used in Financing Activities

During the first nine months of 2016, net cash used in financing activities was \$3,606 million compared with \$5,599 million during the first nine months of 2015. This decrease was due primarily to the following:

debt issuances of \$2.0 billion used in part to repurchase senior unsecured notes in connection with the 2016 debt tender offer, as more fully described in Note 9; and

\$1.0 billion repayment of Altria Group, Inc. senior unsecured notes at scheduled maturity during the third quarter of 2015;

partially offset by:

higher premiums and fees in connection with debt tender offers during the first nine months of 2016;

higher dividends paid during the first nine months of 2016; and

higher repayments of debt in connection with debt tender offers during the first nine months of 2016.

## 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 long-term 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 below regarding the potential adverse impact of certain events on Altria Group, Inc.'s credit ratings in Cautionary Factors That May Affect Future Results.

At September 30, 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 September 30, 2016 and 2015, and at December 31, 2015, Altria Group, Inc. had no short-term borrowings.

At September 30, 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 long-term senior unsecured 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 September 30, 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 September 30, 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

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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 September 30, 2016, the ratios of debt to consolidated EBITDA and consolidated EBITDA to consolidated interest expense, calculated in accordance with the Credit Agreement, were 1.5 to 1.0 and 13.0 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 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 12. Condensed Consolidating Financial Information to the condensed consolidated financial statements in Item 1 (“Note 12”).

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 the discussion below regarding access to debt capital markets in Cautionary Factors That May Affect Future Results for certain risk factors associated with the foregoing discussion.

Debt - At September 30, 2016 and December 31, 2015, Altria Group, Inc.’s total debt was \$13.9 billion and \$12.8 billion, respectively.

On September 16, 2016, Altria Group, Inc. issued \$0.5 billion aggregate principal amount of 2.625% senior unsecured long-term notes due 2026 and \$1.5 billion aggregate principal amount of 3.875% senior unsecured long-term notes due 2046. During the third quarter of 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. For further discussion, see Note 9.

On January 1, 2016, Altria Group, Inc. adopted Accounting Standards Update No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, which requires that debt issuance costs related to a recognized debt liability be presented on the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts, rather than as a deferred charge (an asset). For further discussion, see Note 1. Background and Basis of Presentation to the condensed consolidated financial statements in Item 1 (“Note 1”).

Guarantees and Other Similar Matters - As discussed in Note 11, 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 September 30, 2016. From time to time, subsidiaries of Altria Group, Inc. also issue lines of credit to affiliated entities. In addition, as discussed in Note 12, 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.

Payments Under State Settlement Agreements and FDA Regulation - As discussed previously and in Note 11, PM USA has entered into State Settlement Agreements with the states and territories of the United States that call for certain payments. 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 and FDA user fees

as a component of cost of sales. As a result of the State Settlement Agreements and FDA user fees, Altria Group, Inc.'s subsidiaries recorded approximately \$3.8 billion and \$3.5 billion of charges to cost of sales for the nine months ended September 30, 2016 and 2015, respectively, and approximately \$1.3 billion and \$1.1 billion of charges to cost of sales for the three months ended September 30, 2016 and 2015, respectively. The amount for the nine months ended September 30, 2016 included an increase to cost of sales of \$12 million for the NPM Adjustment Items. The 2015 amounts included reductions to cost of sales of approximately \$126 million for both the nine and three months ended September 30, 2015 for the NPM Adjustment Items.

In connection with the settlement with the 24 signatory states of certain NPM Adjustment disputes under the 1998 Master Settlement Agreement ("MSA"), the formula for allocating the revised NPM Adjustments applicable to the signatory states for 2013 and subsequent years among the tobacco product manufacturers that are original signatories to the MSA ("OPMs") has been modified in a manner favorable to PM USA, although the extent to which it remains favorable to PM USA will depend upon future developments. Similarly, in connection with the settlement with New York of certain NPM Adjustment disputes

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under the MSA, the formula for allocating among the OPMs the revised NPM Adjustments applicable to New York for years after 2014 has been modified in a manner favorable to PM USA, although the extent to which it remains favorable to PM USA will depend upon future developments. For a detailed discussion of settlements of, and determinations made in connection with, disputes with certain states and territories related to the NPM Adjustment provision under the MSA for the years 2003-2012, see Health Care Cost Recovery Litigation - NPM Adjustment Disputes in Note 11.

Based on current agreements, 2015 market share and historical annual industry volume decline rates, the estimated amounts that Altria Group, Inc.'s subsidiaries may charge to cost of sales for payments related to State Settlement Agreements and FDA user fees approximate \$4.9 billion in 2016 and each year thereafter. The increase in these amounts compared with approximately \$4.8 billion charged to cost of sales in 2015 reflects the impact of the NPM Adjustment Items recorded in 2015. These amounts exclude the potential impact of the NPM Adjustment provision applicable under the MSA and the revised NPM Adjustment provisions applicable under the settlements of the NPM Adjustment disputes with the 24 signatory states and with New York, respectively, for years after 2014 discussed above.

The estimated amounts due under the State Settlement Agreements charged to cost of sales in each year would generally be paid in the following year. The amounts charged to cost of sales for FDA user fees are generally paid in the quarter in which the fees are incurred. As previously stated, the payments due under the terms of the State Settlement Agreements and FDA user fees are subject to adjustment for several factors, including volume, operating income, inflation and certain contingent events and, in general, are allocated based on each manufacturer's market share. The future payment amounts discussed above are estimates, and actual payment amounts will differ to the extent underlying assumptions differ from actual future results.

Litigation-Related Deposits and Payments - With respect to certain adverse verdicts currently on appeal, to obtain stays of judgments pending appeals, as of September 30, 2016, PM USA had posted various forms of security totaling approximately \$72 million, the majority of which have been collateralized with cash deposits. These cash deposits are included in other assets on the condensed consolidated balance sheet.

Although litigation is subject to uncertainty and an adverse outcome or settlement of litigation could have a material adverse effect on the financial position, cash flows or results of operations of PM USA, UST or Altria Group, Inc. in a particular fiscal quarter or fiscal year, as more fully disclosed in Note 11 and in Cautionary Factors That May Affect Future Results, management expects cash flow from operations, together with Altria Group, Inc.'s access to capital markets, to provide sufficient liquidity to meet ongoing business needs.

Leases - PMCC's investment in leases is included in the line item finance assets, net, on Altria Group, Inc.'s condensed consolidated balance sheets as of September 30, 2016 and December 31, 2015. At September 30, 2016, PMCC's net finance receivables of approximately \$1.1 billion in leveraged leases, which are included in finance assets, net, on Altria Group, Inc.'s condensed consolidated balance sheet, consisted of rents receivable (\$1.7 billion) and the residual value of assets under lease (\$0.5 billion), reduced by third-party nonrecourse debt (\$0.8 billion) and unearned income (\$0.3 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 condensed consolidated balance sheets. Finance assets, net, of \$1.0 billion at September 30, 2016, also included an allowance for losses.

Equity and Dividends



On January 26, 2016, Altria Group, Inc. granted an aggregate of 0.9 million shares of restricted stock units to eligible employees. Restrictions on these shares lapse in the first quarter of 2019. The market value per share was \$59.03 on the date of grant.

During the nine months ended September 30, 2016, 1.3 million shares of restricted stock and restricted stock units vested. The total fair value of restricted stock and restricted stock units that vested during the nine months ended September 30, 2016 was \$78 million. The weighted-average grant date fair value per share of these awards was \$33.87.

Dividends paid during the first nine months of 2016 and 2015 were \$3,321 million and \$3,071 million, respectively, an increase of 8.1%, reflecting a higher dividend rate, partially offset by fewer shares outstanding as a result of shares repurchased by Altria Group, Inc. under its share repurchase programs.

During the third quarter of 2016, Altria Group, Inc.'s Board of Directors (the "Board of Directors") approved an 8.0% increase in the quarterly dividend rate to \$0.61 per common share versus the previous rate of \$0.565 per common share. Altria Group, Inc. expects to continue to maintain a dividend payout ratio target of approximately 80% of its adjusted diluted

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EPS. The current annualized dividend rate is \$2.44 per Altria Group, Inc. common share. Future dividend payments remain subject to the discretion of the Board of Directors.

In July 2015, the Board of Directors authorized a \$1.0 billion share repurchase program, of which approximately \$453 million was remaining at September 30, 2016. In October 2016, the Board of Directors authorized a \$2.0 billion expansion of this program from \$1.0 billion to \$3.0 billion, which Altria Group, Inc. expects to complete by the end of the second quarter of 2018.

For further discussion of Altria Group, Inc.'s share repurchase programs, see Note 1 and Part II, Item 2. Unregistered Sales of Equity Securities and Use of Proceeds of this Form 10-Q.

### Recent Accounting Guidance Not Yet Adopted

See Note 13. Recent Accounting Guidance Not Yet Adopted to the condensed consolidated financial statements in Item 1 for a discussion of recent accounting guidance issued but not yet adopted.

### Contingencies

See Note 11 for a discussion of contingencies.

### Cautionary Factors That May Affect Future Results

### Forward-Looking and Cautionary Statements

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 Securities and Exchange Commission ("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," "targets" and other words of similar 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 Form 10-Q, particularly in the "Business Environment" sections preceding our discussion of the operating results of our subsidiaries' businesses above. 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.

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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.

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Litigation is subject to uncertainty and it is possible that there 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 11, 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 11, 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 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 Note 11 and Exhibits 99.1 and 99.2 to this Form 10-Q 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 above, PM USA faces significant governmental and private sector actions, including efforts aimed at reducing the incidence of tobacco use and efforts seeking to hold PM USA 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 above, may impact the adult tobacco consumer acceptability of or access to tobacco products, 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,

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consolidated results of operations, cash flows or financial position of Altria Group, Inc. and its tobacco subsidiaries. See Tobacco Space - Business Environment above 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 above.

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.

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 above 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

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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 above.

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. 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.

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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 above.

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, 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

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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.

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Our tax treatment of the consideration that we received from the Transaction may be challenged.

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. It is also possible that the tax treatment of the dividends Altria Group, Inc. expects to receive from AB InBev may not be as favorable as that applied to the dividends we received from SABMiller.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in Altria Group, Inc.'s market risk during the nine months ended September 30, 2016. For additional information regarding quantitative and qualitative disclosures about market risk, see Part II, Item 7A. Quantitative and Qualitative Disclosures About Market Risk of Altria Group, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2015 (the "2015 Form 10-K").

Item 4. Controls and Procedures.

Altria Group, Inc. carried out an evaluation, with the participation of Altria Group, Inc.'s management, including Altria Group, Inc.'s Chief Executive Officer and Chief Financial Officer, of the effectiveness of Altria Group, Inc.'s disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based upon that evaluation, Altria Group, Inc.'s Chief Executive Officer and Chief Financial Officer concluded that Altria Group, Inc.'s disclosure controls and procedures are effective.

There have been no changes in Altria Group, Inc.'s internal control over financial reporting during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, Altria Group, Inc.'s internal control over financial reporting.

Part II – OTHER INFORMATION

Item 1. Legal Proceedings.

See Note 11 for a discussion of legal proceedings pending against Altria Group, Inc. and its subsidiaries. See also Exhibits 99.1 and 99.2 to this Form 10-Q.

Item 1A. Risk Factors.

Information regarding Risk Factors appears under Cautionary Factors That May Affect Future Results in Part I, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-Q ("Item 2") and in Part I, Item 1A. Risk Factors of the 2015 Form 10-K. Other than as set forth in Item 2, there have been no material changes from the risk factors previously disclosed in the 2015 Form 10-K.

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## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

In July 2015, the Board of Directors authorized a \$1.0 billion share repurchase program that it expanded to \$3.0 billion in October 2016. Altria Group, Inc. expects to complete the expanded program by the end of the second quarter of 2018. The timing of share repurchases under this 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 September 30, 2016, was as follows:

Period	Total Number of Shares Purchased <sup>(1)</sup>	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 <sup>(2)</sup>
July 1 - 31, 2016	153,227	\$ 68.00	150,000	\$613,593,252
August 1 - 31, 2016	1,171,433	\$ 66.63	1,170,000	\$535,634,540
September 1 - 30, 2016	1,272,294	\$ 65.65	1,266,200	\$452,500,410
For the Quarter Ended September 30, 2016	2,596,954	\$ 66.23	2,586,200	

The total number of shares purchased include (a) shares purchased under this program (which totaled 150,000 shares in July, 1,170,000 shares in August and 1,266,200 shares in September) and (b) shares withheld by Altria

<sup>(1)</sup> 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 3,227 shares in July, 1,433 shares in August and 6,094 shares in September).

<sup>(2)</sup> This chart provides information for each of the three months in the period ended September 30, 2016; therefore, it does not reflect the October 2016 expansion of Altria Group, Inc.'s share repurchase program discussed above.

## Item 5. Other Information.

## Facilities Consolidation

On October 27, 2016, Altria Group, Inc. announced the consolidation of certain 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. USSTC will transfer its Franklin Park, Illinois operations to its Nashville, Tennessee facility and the Manufacturing Center site in Richmond, Virginia. Employees affected by the consolidation will be offered the opportunity to transfer into available positions; those who do not do so will be offered separation benefits. 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 this consolidation, Altria Group, Inc. expects to record total pre-tax charges of approximately \$150 million, or \$0.05 per share. Of this amount, Altria Group, Inc. expects to record pre-tax charges of approximately \$60 million, or \$0.02 per share, in the fourth quarter of 2016, \$75 million in 2017 and the remainder in 2018. The estimated charges relate primarily to accelerated depreciation (\$55 million), employee separation costs (\$45 million) and other exit and implementation costs (\$50 million). Approximately \$90 million of the total pre-tax charges are

expected to result in cash expenditures. These estimated charges do not reflect the non-cash impact that may result from pension settlement and curtailment accounting.



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Item 6. Exhibits.

12 Statements regarding computation of ratios of earnings to fixed charges.

31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

99.1 Certain Litigation Matters.

99.2 Trial Schedule for Certain Cases.

Definitions of Terms Related to Financial Covenants included in Altria Group, Inc.'s Amended and Restated 99.35-Year Revolving Credit Agreement, dated as of August 19, 2013. Incorporated by reference to Altria Group, Inc.'s Quarterly Report on Form 10-Q for the period ended September 30, 2013 (File No. 1-08940).

101.INS XBRL Instance Document.

101.SCH XBRL Taxonomy Extension Schema.

101.CAL XBRL Taxonomy Extension Calculation Linkbase.

101.DEF XBRL Taxonomy Extension Definition Linkbase.

101.LAB XBRL Taxonomy Extension Label Linkbase.

101.PRE XBRL Taxonomy Extension Presentation Linkbase.

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Signature

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ALTRIA GROUP, INC.

/s/ WILLIAM F. GIFFORD, JR.

William F. Gifford, Jr.

Executive Vice President and

Chief Financial Officer

October 27, 2016