

"Tobacco Talk" -- Q4 U.S. Retailer Survey

No Reprieve For Marlboro As Pressure Persists

Tobacco

• Retailers Remain Cautious On Marlboro But Bullish On Newport & 4th Tier – Optimism Abounds For the Vapor/Reduced Risk Product (RRP) Categories Fueled By Anticipation Behind iQOS –

Based on results from our recent "Tobacco Talk" survey of retailers and wholesalers representing around 30,000 convenience stores in the U.S., the overall environment remains largely stable but Marlboro pressures continue. "Price confusion" and inroads by Newport, 4th tier brands & the vaping category have all "hurt" Marlboro as it aims to recover from the CA tax increase. **Winners:** Newport as it wins over younger adult smokers with effective promos; 4th tier brands as they get the price value equation right & JUUL as it captures the Millennial consumer interest with an "Apple-like" approach. Also, a vast majority of retailers (75%) are excited about iQOS and plan to carry it with 40% planning to increase shelf space for iQOS. **Losers:** Marlboro (recovery taking longer than we initially anticipated), ITG Brands & Skoal. Although Marlboro pressures are likely to continue n.t. and stabilization of the brand might take more time, we remain optimistic given easier comps, promo changes & new innovation. However, we trim our FY17/18 EPS ests by \$0.01 to \$4.15/\$4.44 but maintain our \$85 price target as we believe most of Marlboro's softness is priced into MO's valuation. **Bottom line** - We expect investors to be laser-focused on mgmt. comments about Marlboro's performance in/out of CA & efforts to restore momentum. L.T., we remain bullish on MO's outlook given: **(1)** accelerating cash flows & growth prospects with iQOS, **(2)** added financial flexibility from U.S. corp. tax reform, and **(3)** increased dividends & buybacks.

• Marlboro – Retailers Still Cautious N.T. on Marlboro Share Performance, But Excited about iQOS Prospects –

Over half of retailers expect Marlboro to lose 20bps of share in 2018 after a tough 2017 (~50bp decline). According to our contacts, Marlboro remains under pressure from: **(1)** Newport, **(2)** price confusion/ineffective promos, **(3)** deep discount/4th tier brands & **(4)** e-cigs/vape category. Two retailers noted, "the price value equation for Marlboro is broken" & "Altria is overthinking its strategy." **Bottom line** – We realistically expect MO's cig vol/share pressures to continue n.t. but stabilize in FY18. We est. Marlboro vol was down -4.6% in Q4 (comping a -4.8% decline in 4Q16) and down ~-3.5% (in line with the ind) for FY18. Importantly, MO's margins remain very strong and continue to expand.

• Newport - Retailers Remain Bullish on Newport but Largely Disappointed by Newport Platinum –

Retailers expect Newport to gain 50bps of share in 2018 driven, in part, by effective promos, success with younger adult demographics & customer "confusion" with Marlboro menthol offerings. Indeed, Newport's strong appeal to Millennials is similar to JUUL with both brands tapping into a demographic with strong disposable income growth. **Bottom line** - We believe Newport will continue to be a strong growth vehicle for Reynolds under BAT ownership, partially offset by continued Pall Mall weakness (-6.9% vol in 4-wks ended 12/30 per Nielsen).

• TPSAC Doesn't Derail iQOS Opportunity –

While disappointing, TPSAC's vote against PM's modified risk (MRTP) application as currently framed is not a deal-breaker, in our view, and certainly doesn't derail the huge commercialization opportunity ahead (even without MRTP approval). We review the TPSAC votes in detail on pg. 24 and reiterate that this is an iterative and necessarily involved process!

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Please see page 27 for rating definitions, important disclosures and required analyst certifications. All estimates/forecasts are as of 01/28/18 unless otherwise stated. 01/28/18 22:34:26 ET

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Key Takeaways from Q4 "Tobacco Talk" Retailer Survey

We recently reached out to several of our industry trade contacts to get a sense of cigarette, smokeless and OTP (other tobacco products) category trends during 4Q17 as well as current brand dynamics and the state of the overall U.S. tobacco industry. Below are some of the key takeaways from this survey including direct quotes from tobacco retailer/wholesaler contacts, representing around 30,000 U.S. retail locations.

Overall Combustible Cigarette Q4 Trends

- **Adult Tobacco Consumer Relatively Stable, But CA Price Hike & Category Confusion Weigh on Cig Volumes, However Tax Stimulus & Strengthening Economy Bode Well Going Fwd**
- **Retailers Expect Cig Volume Pressure to Persist in 2018 – We Expect Cig Industry Vol Declined -3.5% in FY17 & Will Be -3.3% in FY18**
- **Cig Manufacturers' Pricing Power Largely Intact**
- **Higher Prices From Tier 4 Brands Narrows the Relative Price Gap – However, "Premium Brands Not Seeming Premium in Price"**
- **Cig Competition Heats Up As Players Compete For Shrinking Volume - Promo Environment Largely Rational With An Effort From Mfrs To Be "More Focused"**
- **Most Retailers Expect Tax Reform to Have the Greatest Impact on Foot Traffic & Size of Basket Purchases**
- **Most Retailers Expect Altria/PM USA to Reinvest Tax Benefits Behind its Reduced Risk Portfolio (iQOS, Smokeless, Vapor) & RJRT Behind Newport – "No Benefit to Price War"**
- **FDA Regulation – Retailers Are Increasingly Concerned by the FDA's Nicotine Plan ("We Have to Be Prepared," "There Are Always Unintended Consequences")**

Marlboro, Newport & 4th Tier Cigarette Q4 Trends

- **Retailers Remain Cautious on Marlboro with the Majority of Retailers Expecting the Brand to Lose ~20bps of Share in 2018, Pressured By Newport's Strong Appeal to Millennials**
- **Retailers Don't See PM USA's Efforts to Shore Up Marlboro As Necessarily Effective - "Erratic Pricing Structure," "Too Many SKUs" & Growth of 4th Tier & Newport Drive Pressure on Marlboro**
- **Overall Retailers Are Not Too Thrilled By PM USA's Latest Innovations (Marlboro Ice and B&H Menthol) Although Some See Hope – "Both are Fresh Takes on Iconic Brands"**
- **Retailers Remain Bullish Overall on Newport, But Largely Disappointed By Newport Platinum – Expect Newport To Gain ~50bps of Incremental Share in 2018**
- **Retailers Are Broadly Pleased With the Performance & Outlook for 4th Tier Cig Brands – "Premium/Discount Gap Closing" – "Deep Discount Is Crushing It"**

Smokeless Tobacco & Vapor/E-Cig/RRP Q4 Trends

- **Retailers Expect Smokeless Tobacco Industry Vol to Increase ~3.4% in 2018 in Line With Our +3.5% Est. - We Expect Q4 Volume Picked Up Following A Slow Recall Recovery Post USSTC's Jan Recall**
- **Retailers Are Growing Increasingly Bullish on the E-Cig/Vapor Category ("Re-Birth") as Product Quality Rises Led By JUUL, VUSE & Optimism About iQOS Hitting Shelves in 2018**
- **Retailers Are Broadly Optimistic About RRP's With 75% Planning to Carry iQOS in Their Stores When Commercially Available & 33% Planning to Allocate Add'l Shelf Space To It**
- **JUUL Outperforming as it Captures Millennial Consumer Interest With "Apple-like Approach" - Vuse Vibe Seen Cannibalizing VUSE Sales – MarkTen Shows Limited Growth**
- **Retailers Are Most Excited About iQOS/RRP Opportunity Given FDA's New Nicotine Strategy; Most Concerned About Margin Compression & FDA Delaying RRP Approvals**

Key Quotes from Retailers/Wholesalers on Marlboro & Cig Category Trends

Overall Combustible Cigarette Q4 Trends

- *"Category confusion has never been higher."*
- *"A move from **cigarettes to moist** still seems to be the trend."*
- *"Customer count/traffic is weaker but...**spending above** the past average."*
- *"...the initial shock of the **price changes** from last year is over..."*

Marlboro Brand & Marlboro Promos

- *"**Price confusion** is hurting [Marlboro]. Altria needs to quit overthinking their strategy behind it."*
- *"Marlboro losing share and volume decreases have allowed competitors to know [they are weak and they're circling]"*
- *"Altria is beginning to see that **Marlboro has peaked**, and is declining in both volume and share. They are moving to a defensive position rather than offensive."*
- *"**Marlboro promos** increasing the most in 2018, they have doubled their loyalty plans to 32 weeks."*
- *"The **re-sealable foil** [of the new Marlboro Ice product] means nothing for the general smoker...These things never seem to be well thought out."*
- *"**Too many SKUs** have diluted the line."*
- *"**Newport's** growth, **fourth tier** brands, and the **growth of vaping** are all hurting Marlboro."*
- *"The **price value equation** for Marlboro is broken."*
- *"Consumers are looking for **cheaper alternatives**."*
- *"Marlboro has muddied the water with **too many Menthol offerings** over the past several years and continues this year with Marlboro Ice... this only **confuses customers** and makes purchase choice difficult."*
-

PM USA New Product Launches

- *"If they would focus on it and not **B&H Menthol** (not selling) that would be helpful."*
- *"**Marlboro Ice** is a differentiated line extension and does have some chance of being impactful."*
- *"**very confusing** to the customers"*
- *"...both products [Marlboro Ice & B&H Menthol] are **fresh takes** on iconic brands that will stimulate interest with **21 to 35 year age group**."*
- *"Ice may help if Altria can **communicate packing benefits** to the consumer."*

Newport Brand & Promos

- *"It's a menthol world among **younger adult smokers**..."*
- *"As they **promote better** they zap share from Marlboro Menthol brands."*
- *"The **pricing** for the Premium Menthol smoker is more favorable for Newport than in the past."*

Newport Platinum Performance

- *"Not setting the world on fire."*
- *"...having a hard time getting it started..."*
- *"One of the worst new item brand launches for tobacco in a long time."*

Discount Category / 4th Tier

- *"Premium and discount gap closing in."*
- *"Deep discount is crushing the big two companies."*

- "4th tier continues to decline in our market...as consumers seek premium brands due to lower unemployment and higher wages."

Reduced Risk Product (RRP) Opportunity

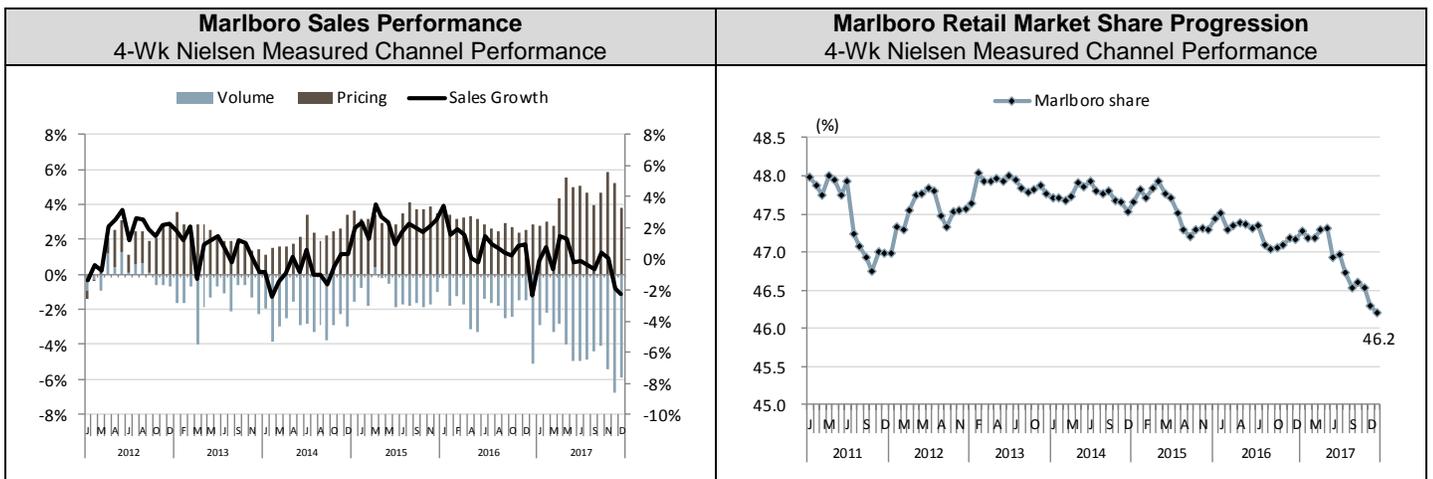
- "I believe this segment will eventually **replace cigarettes completely** in years to come."
- "PM needs to **find a way to simplify** the use of the products being developed so they can capture a **broader base** of folks....and **not only the Tech savvy** folks."
- "It will take time to educate customers..."

MarkTen, JUUL & Vuse

- "**JUUL** just keeps growing."
- "JUUL's growth appears to be due to growth with the **18 to 24 year old** age group. This group has disposable income and finds the product an attractive alternative to combustible cigarettes."
- "...limited movement on **Mark Ten**."
- "**Vuse** growth slowed down and **Vibe** cannibalized much of Vuse sales. We do not carry **JUUL** but it was the first of its kind with an "**Apple**" like approach to the category **catching fire with millennials**."

Trimming FY17/FY18 EPS Estimates on Continued Marlboro Concerns

We are trimming our FY17/FY18 EPS estimates for MO (Outperform, \$71.02) by \$0.01 to \$3.27/\$4.15 as we lower our expectations for Marlboro volume in 4Q17 to -4.6% vs -3.5% previously as our recent "Tobacco Talk" survey appears to confirm trends we're seeing in recent Nielsen measured channel data (see pages 22-23). These two sets of data points suggest stabilization of the Marlboro brand is not likely to materialize until 1Q18 at the earliest. While this is likely to weigh on investors' n.t. sentiment, we highlight the following potential mitigating factors: **(1)** Marlboro momentum improves in next quarter on an easy comp & reallocated marketing resources; **(2)** Relative to PM, MO faces substantially lower upfront costs for IQOS (i.e., only distribution/marketing) (see pg. 17 of "Multiple Positive Catalysts" MO 12/4 report); **(3)** MO should benefit from lower interest expense; and **(4)** MO will likely increase its dividend and share repurchase activity given benefits from corp tax reform as well as our expectation that MO could tap the debt capital markets given its low leverage (around 1.1x net debt/ebitda).



Note: In 1Q17, MO restated Marlboro retail market shares from 1Q16-4Q16 citing IRI's restatement of its cigarette database. Our chart reflects the % share restatement in 2016, but assumes no restatement for market shares in 2014 and 2015. **Source:** Nielsen Total US xAOC Including Convenience Database; Company reports; Wells Fargo Securities, LLC

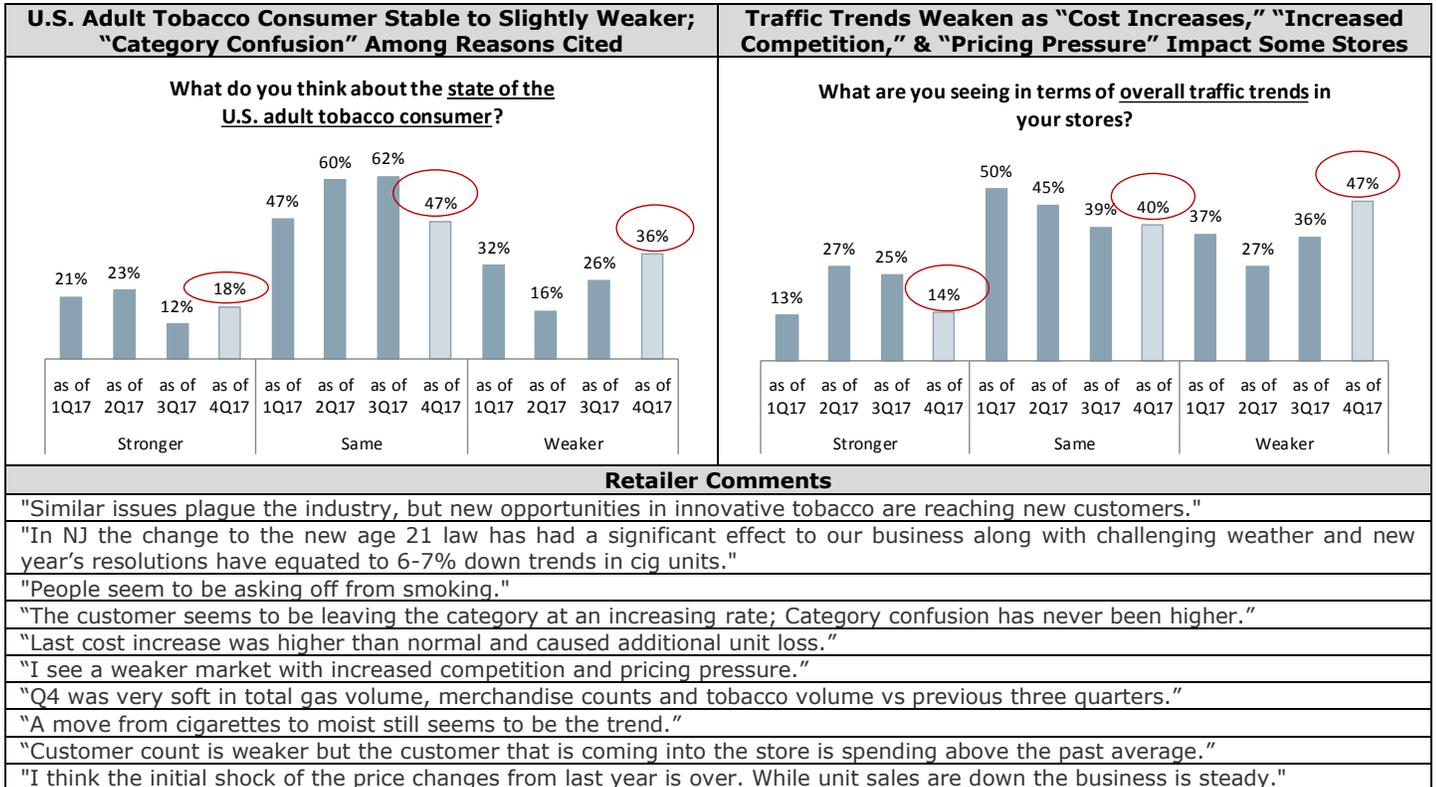
Our 4Q17 Volume and Pricing Estimates

	Cigarette Volume		Cigarette Pricing		Cigarette Net Revenue *	
	4Q17E	4Q16	4Q17E	4Q16	4Q17E	4Q16
Industry Volume	-4.4%	-4.2%				
Altria Group	-4.2%	-4.8%	5.6%	4.6%	1.2%	-0.4%
Marlboro	-4.6%	-4.8%	5.5%	4.5%		
Discount (incl. L&M)	-1.0%	-3.1%	6.0%	5.5%		
Reynolds American		-2.3%		6.0%		5.9%
	Smokeless Volume		Smokeless Pricing		Smokeless Net Rev	
	4Q17E	4Q16	4Q17E	4Q16	4Q17E	4Q16
Industry Volume	1.5%	2.5%				
Altria Group	-0.2%	2.2%	3.3%	5.3%	2.9%	7.7%
Copenhagen	3.0%	7.8%	3.3%	5.3%		
Skoal	-6.0%	-5.6%	3.5%	5.5%		
Reynolds American		-1.5%		3.8%		2.7%

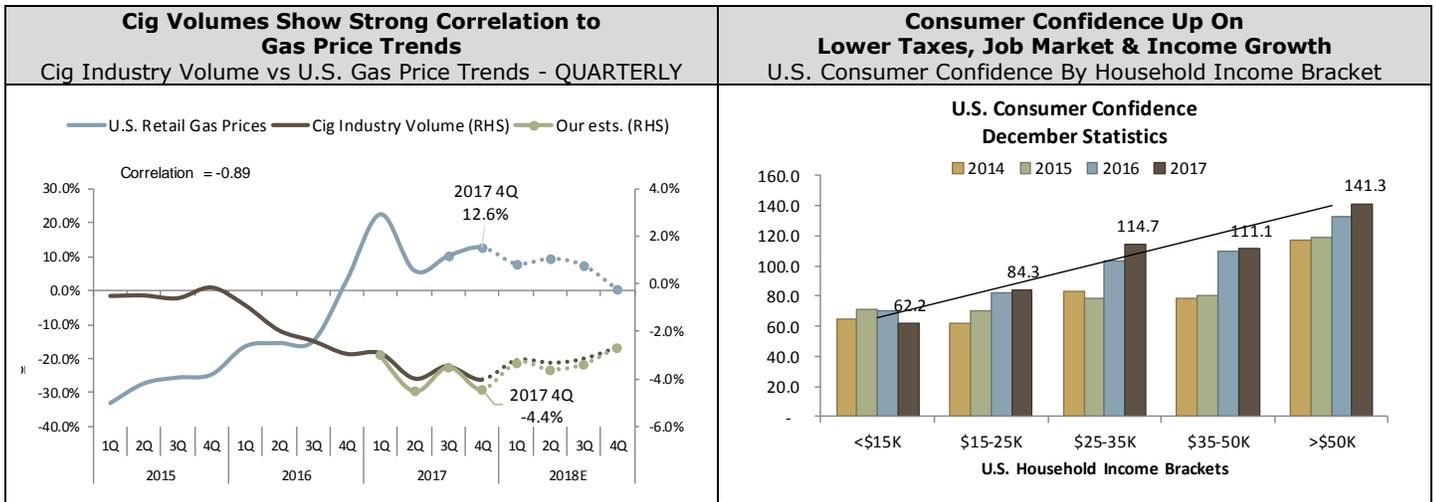
*For Altria, Cigarette Net Revenue is estimated as cigarette results are incorporated for the Smokeable Segment which includes cigars. **Source:** Company reports, Wells Fargo Securities, LLC estimates.

Overall Combustible Cigarette Q4 Trends

Adult Tobacco Consumer Relatively Stable, But CA Price Hike & Category Confusion Weigh on Cig Volumes - However Tax Stimulus & Strengthening Economy Bode Well Going Forward - Especially For Lower Income Tobacco Consumer

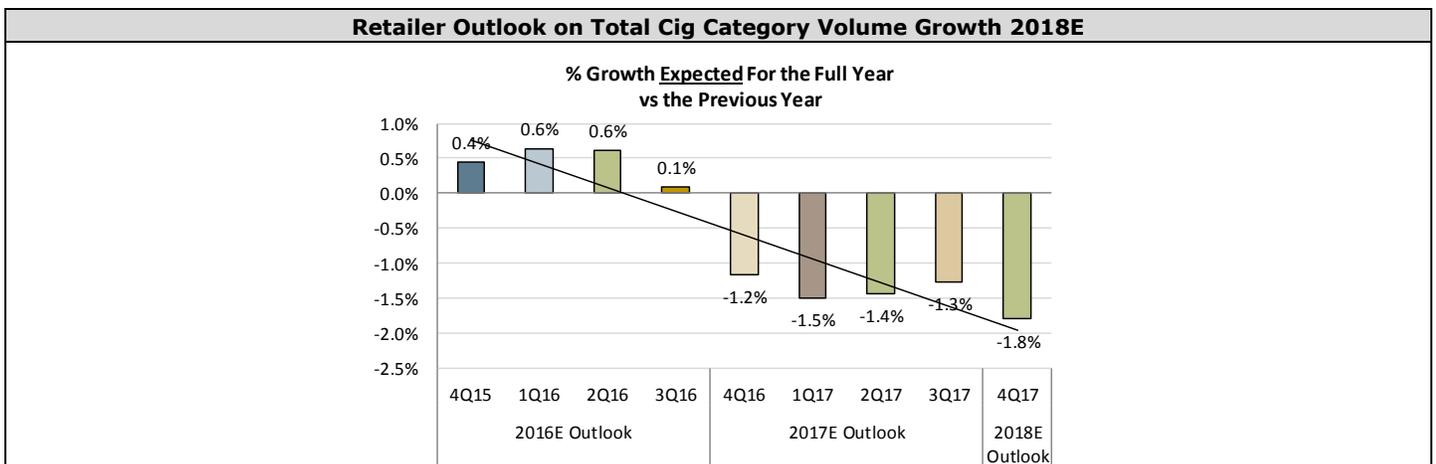


Source: Wells Fargo Securities, LLC



Note: See Wells Fargo food retail team's 1/23 report for a detailed look at the potential impact of U.S. tax reform on the spending power of lower income consumers, "Dollar Stores: Proprietary Work Suggests Tax Stimulus A Key Catalyst".
Source: U.S. Energy Information Administration (EIA), FactSet, Wells Fargo Securities, LLC

Retailers Expect Cig Volume Pressure to Persist in 2018 – We Expect Cig Industry Vol Declined 3.5% in FY17 & Will Be Down 3.3% in FY18

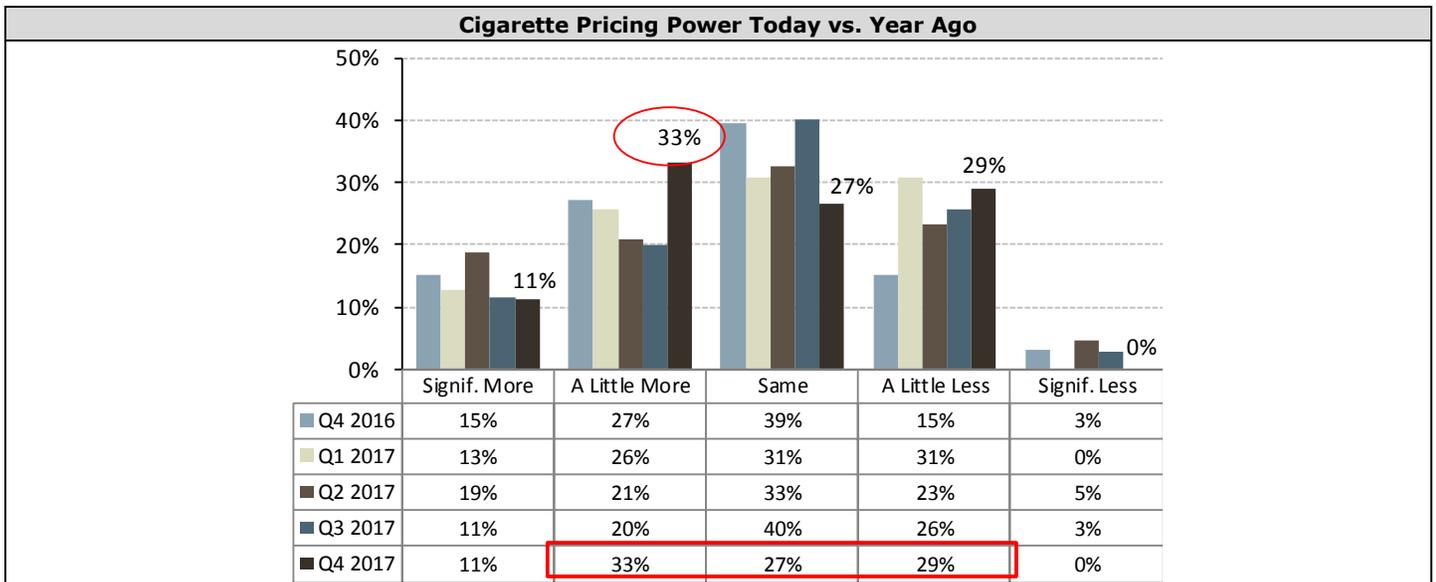


Please provide any additional color and what you think will impact the category in 2018.

- "High Tax States."
- "Cigarettes will continue to decline, with a slight lead up in sales dollars due to price increases."
- "We will see the cigarette customer continue to shift to other tobacco alternatives due mostly to price. Cigars and moist tobacco continue to grow in our market."
- "The age changing to 21 is my major concern."
- "Should PM follow the path that they recently advertised in the UK then that could change the game quickly, especially if they throw financial resources toward vape to get the customer to convert sooner in the USA."
- "Units will continue to deteriorate. This will be a direct result of 1.) Consumers as a whole being more health conscious. 2.) New availability of cessation products. 3.) Price increases creating further pressure on consumer affordability. 4.) Increased restrictions on consumption options and 5.) More geographies moving to 21 age minimums."
- "Of course the state tax rates hurt sales. The low end cheap cigarettes that some places sell, hurt sales. RJR EDLP with Pall Mall being signed on hurts when others are not... Altria's contracts aren't helpful... Also the amount of space for NEW cigarettes that RJR & PM take is way too much. When the new brands are brought out most fail... so giving 10-20 facings on a small set to a new brand is overdoing it."
- "Utilizing Altria rewards to get below state minimum in applicable states as well as being more prices aggressive to drive customers to stores."

Source: Wells Fargo Securities, LLC

Cig Manufacturers' Pricing Power Largely Intact



Do you feel cigarette manufacturers have more or less pricing power today vs last year?

"Buy downs are so heavily reflective of competitive responses that very little are coming in terms of true pricing to re-engage customers let down by one brand or another."

"They increase buy downs when they need to get market share. Price increases and regulations drive this."

"The volume does not lie. The decline curve is steepening. Mfg. margins must fall."

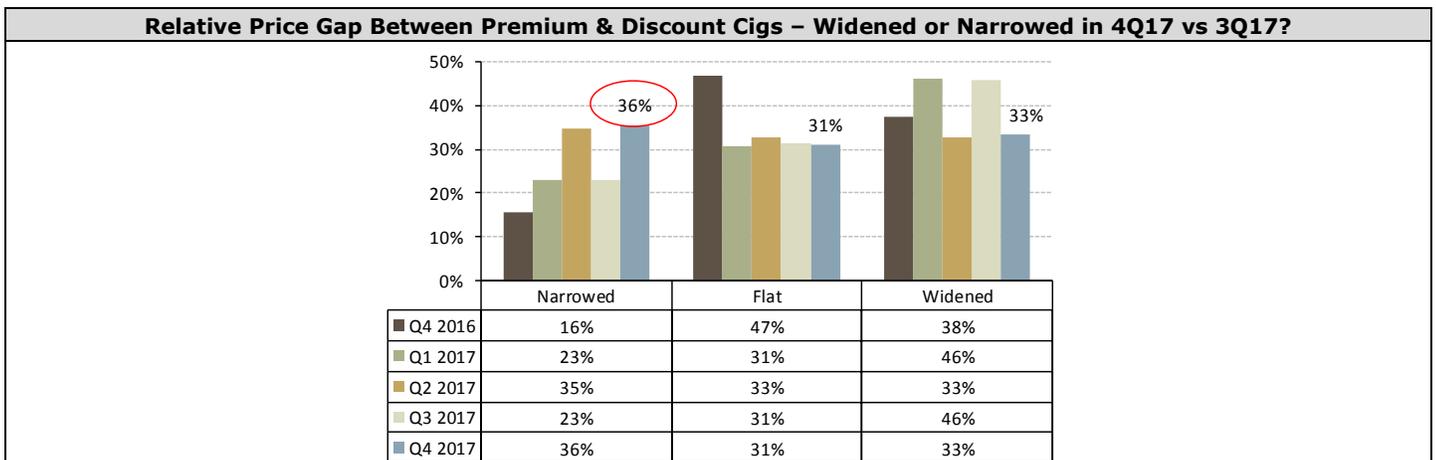
"Buy downs at retail are more frequent, which is driving down the retail price however it's not helping movement nor the wholesaler. It's just hurting margin."

"With Altria's new PDR program they are now controlling margin on Special Blend and Marlboro Black to be in line with Newport and Camel."

"MLP of course and the additional options offered from PM... Understandable to have parity for the other brands."

Source: Wells Fargo Securities, LLC

Higher Prices From Tier 4 Brands Narrows the Relative Price Gap – However, "Premium Brands Not Seeming Premium in Price"



If you think price gaps have widened, which brands have been the primary winners/losers in your opinion?

"Non EDLP growth."

"Altria Marlboro to an Eagles."

"Kwik Trip went on RJ Reynolds' EDLP which closed price gap in market. The more chains on EDLP = lower price gap vs. more chains NOT on EDLP."

"Liggett is the winner for us."

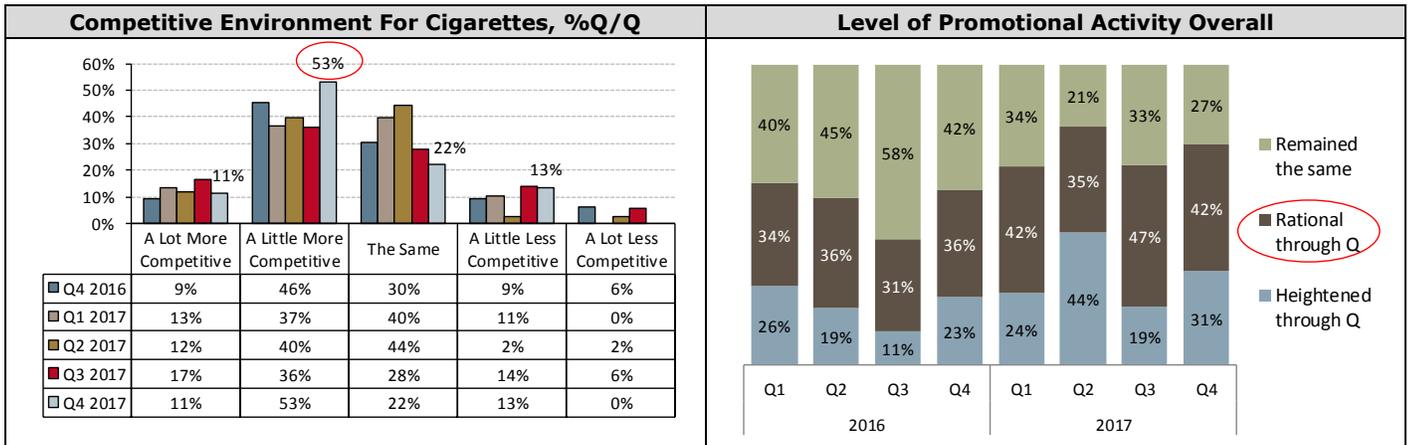
"Depending on what contract retailers signed up for, core brand funds narrowed the gap of select top share premium brands through the use of increased buy down funding. All other brands remained the same."

"The smart low end manufacturers did not take the same increases as the majors."

"Well considering cost increases and buy-down changes the "Premium Segment" vs the "Discount" prices are closer than ever to each other. With the new brands bringing out, deep discounts on those as well as the promos for the new brands that are premium but priced like a discount the tiers are not equating properly... With the Cigarette companies having Brands broken into separate buy-down rates it makes the so called premium not seem premium in price. Examples would be: Marlboro Special Blend, Black, 72s. Newport Non Menthol & Smooth. Camel Turkish, Camel Core, Camel Capsule. They are all dipping into the same Premium segment but discounting where some are almost the same price as Pall Mall Box (EDLP)..."

Source: Wells Fargo Securities, LLC

Cig Competition Heats Up As Players Compete For Shrinking Volume - Promo Environment Largely Rational With An Effort From Mfrs To Be "More Focused"



How would you characterize the overall competitive environment for cigarettes in 4Q17 compared to 3Q17?

- "Brands like Newport and Winston were revived with new ownership focus."
- "Due to Dollars Stores building all around d us."
- "Newport continues to gain share, Marlboro continues to lose in our market despite more promos and bigger buy downs."
- "Marlboro losing share and volume decreases have allowed competitors to know [they are weak and they're circling]."
- "The cigarette companies don't really compete much right now. They mostly just operate to hold share."
- "In our markets there are more organized competitors driving markets down with pricing."
- "Vape shops continue to use profits from vape to keep margins low on tobacco."
- "Altria is beginning to see that Marlboro has peaked, and is declining in both volume and share. They are moving to a defensive position rather than offensive."
- "With all of the new Loyalty Fund offers from the cigarette companies etc. the competition is getting a little heated. Especially with programs making that Loyalty Fund Offer be the only one in place at that time. And battling over space etc."

What is your sense of promotional activity overall? Which brands have been most promotional? What is your outlook on promotional activity in 2018?

- "Marlboro Menthol"
- "Marlboro and Camel."
- "Lagging sales have induced some heavy-termed promotions for 2018 with competitive responses aggressive, leading to a packed calendar year and forcing clarity on cross-promotional opportunities. Marlboro has increased promotions dramatically with USST stepping up to the game as well."
- "Promotions will increase in 2018 as the demand continues to fall and volume declines."
- "Marlboro by far and in 2018 they have doubled their loyalty plans to 32 weeks."
- "Winston big push In our market. Altria new items for 2018."
- "I wouldn't be surprised if Newport is promoted less in our area. Why promote it when it's doing well without it?"
- "PM continues to pull back on overall funding, diminish their support programs and change courses monthly. While they want to dump promo cigarettes on everyone, with their smaller discounts and much higher prices, they continue to drive customers away from their brands - particularly Marlboro."
- "Traditional promotions have been on the decline and are being replaced by promotions and coupons via social media platforms like store and Tobacco company web sites and App's."
- "It is getting ready to gear up in 2018 with expanded Loyalty Promotions and BEF's."
- "Buy downs have been lowered and promotional products taken from \$1.00 per pack to .50 per pack over the last year which has caused much less promotional activity."
- "Promotional activity from retailers has increased where the promotional activity from manufacturers has decreased with manufactures trying to be more focused with their promotions but at the retail level it becomes more confusing."
- "Menthol has been the pricing target with both Newport and Marlboro Menthol."
- "Marlboro"
- "Marlboro loyalty has changed and increased to 32 weeks in 2018 if you elect their leadership level."

"The number of VAP packages is crazy. Manufacturers believe that if they continue to push these items down the retailers' throat they will sell them to customers as an alternative to the brand\package that they ask for. This not happening, C-Store operators and sales associates know that if you ask for Marlboro you don't want a Pall Mall or Camel and likewise the other way."

"Newport has pushed out a 50 cent off pack promotion late in Q4. Altria is introducing new brands Marlboro Ice and B&H menthol with additional price promotions."

"I don't feel that any particular brand(s) are more promotional than others. Promotional activity appears to be about the same."

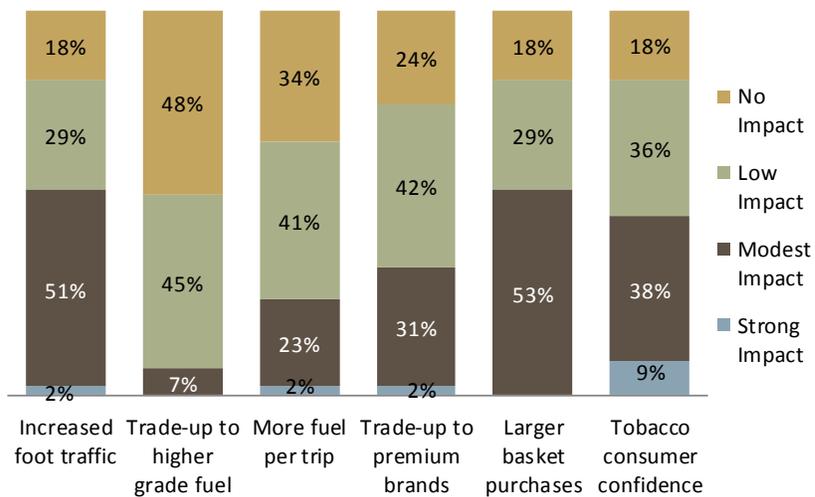
"There seems to be a lot of promos of brands that don't sell but of course increase share for certain companies with so many force-outs. And the new brands that make no sense but they are pushing and wanting everywhere. Marlboro Ice for instance that is pointless... Kamel no longer discounted so sitting on all this inventory of promos forced out etc."

"RJR has continued to over greater quantity of Promotional products."

Source: Wells Fargo Securities, LLC

Most Retailers Expect Tax Reform to Have the Greatest Impact on Foot Traffic & Size of Basket Purchases

In general, what impact, if any, do you expect U.S. tax reform will have on the following:



Retailer Comments

"One time buys with a tax return - large-value buys, specifically with no impact to C-Stores."

"It's hard to say until the consumer sees a difference in their earnings."

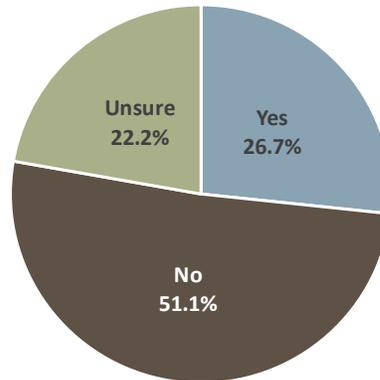
"The new tax reform will have little or no effect on the consumer."

"I really believe that lower Corp tax rates will help to increase capital spending and not serve to lower retail prices in general. I think fuel pricing will not be impacted much because retailers need to finish upgrading credit card processing systems. With respect to retail pricing in general I think the overall retail marketplace is going to continue to be very competitive as the big guys continue to fight it out."

Source: Wells Fargo Securities, LLC

Most Retailers Expect Altria/PM USA to Reinvest Tax Benefits Behind its Reduced Risk Portfolio (iQOS, Smokeless, Vapor) & RJRT Behind Newport – “No Benefit to Price War”

Given the presumably positive impact of corporate tax reform on the earnings power and free cash flow of tobacco manufacturers, do you anticipate PM USA/RJRT will invest more in promos (i.e., lower prices or possibly start a potential price war)?



Retailer Comments

- "Continued "more" investment in Alternatives."
- "In a dying industry, they need to redirect to a future - PM has revealed as much in the "quit smoking" comments this year. I'd guess they'll invest more in lobbying towards more glamorous FDA "safer" verbiage on the heat-not-burn innovations."
- "The price war is already here and has been for a long time. When Altria changes the others follow. However, as the volume declines and the customer base declines, we should see deeper discounts."
- "They traditionally have NOT done any type of price war seeing no benefit to either side."
- "Altria seems to be more Into OTP vs. cigarettes to me."
- "It's a constantly shrinking market. They will either bank the savings, or plow it into more and faster development of non-traditional products."
- "They're going to use that money for other ventures - i.e. IQOS, smokeless, etc."
- "I believe Altria will continue to selective price promote and while RJRT continues to grow Newport they will not over invest to start a "price war"."
- "They needed to anyway; this will soften the blow of doing so."
- "I think these companies will continue to test each other but I believe they like a healthy balance in the competitive marketplace."
- "They already battle each other constantly and follow what the other does. They continue to make it more difficult on the retailers with new sets that really don't do anything for the new brands they bring out. Promos will be forced out and probably a bunch of the ones that aren't great sellers so they sit and then retailer is stuck with them."
- "PM will continue to make the intense investments in IQOS and continue to return any additional profitability to shareholders. PM is also leveraging their profitability to ensure a high stock price when they merge with PMI.* RJRT has retracted some funding and promo support, but appears keen on capitalizing on PM weaknesses particularly with Marlboro record volume decreases."
- "I see any revenue derived for the tax cuts to be thrown against the development of modified risk products and the education of the customer as to why these products are a viable alternative to regular cigarettes."
- "I would hope so, Would be a great time to put some more of these dollars back in the retailers pockets to help off-set some of the unit losses and margin compression over the past several years. Needs to be in a way that retailers hang on to it versus placing it into their pricing."
- "Invest it in heat not burn product."
- "If they invest the tax windfall anywhere it will be in innovation, not in combustibles."
- "I also think they could take less of a price increase in 2018 since the last one took such a big hit on volume for all manufacturers."
- "PM & RJR are looking to strengthen their bottom line. They will try and convince the retailer to fund lower price."
- "Both will harvest some margin while utilizing funds to secure share in heavy combative markets. I expect additional money being invested into scan accounts."
- "There has been nothing I have read nor heard that would lead me to believe this."

*Note: A potential merger has been speculated in the media (Reuters & Bloomberg) with no comment from management
Source: Wells Fargo Securities, LLC

Retailers Remain Cautious on Marlboro with the Majority of Retailers Expecting the Brand to Lose ~20bps of Share in 2018, Pressured By Newport's Strong Appeal to Millennials

Select Retailer Comments on Marlboro

- **"Price confusion** is hurting [Marlboro]. Altria needs to quit overthinking their strategy behind it."
- "The re-sealable foil [of the new **Marlboro Ice** product] means nothing for the general smoker...These things never seem to be well thought out."
- "Marlboro has muddied the water with **too many Menthol offerings** over the past several years and continues this year with Marlboro Ice... only **confuses customers** and makes purchase choice difficult."

Select Retailer Comments on Newport

- "It's a menthol world among **younger adult smokers**..."
- "As they **promote better** they sap share from Marlboro Menthol brands."
- "The **pricing** for the Premium Menthol smoker is more favorable for Newport than in the past."

Anticipated Incremental Share Loss for Marlboro in '18 Wtd. Avg: ~20bp decline vs -50bps expected previously for '17	Is Newport Pressuring Marlboro?																												
<p>Mkt Share Expectations for Marlboro Brand</p> <table border="1"> <caption>Mkt Share Expectations for Marlboro Brand</caption> <thead> <tr> <th>Quarter</th> <th>Gain share</th> <th>Lose share</th> <th>No change</th> </tr> </thead> <tbody> <tr> <td>1Q17</td> <td>50%</td> <td>25%</td> <td>25%</td> </tr> <tr> <td>2Q17</td> <td>40%</td> <td>38%</td> <td>21%</td> </tr> <tr> <td>3Q17</td> <td>14%</td> <td>67%</td> <td>19%</td> </tr> <tr> <td>4Q17</td> <td>36%</td> <td>51%</td> <td>13%</td> </tr> </tbody> </table>	Quarter	Gain share	Lose share	No change	1Q17	50%	25%	25%	2Q17	40%	38%	21%	3Q17	14%	67%	19%	4Q17	36%	51%	13%	<p>Is Newport Pressuring Marlboro?</p> <table border="1"> <caption>Is Newport Pressuring Marlboro?</caption> <thead> <tr> <th>Response</th> <th>Percentage</th> </tr> </thead> <tbody> <tr> <td>Yes</td> <td>48%</td> </tr> <tr> <td>No</td> <td>39%</td> </tr> <tr> <td>Unsure</td> <td>12%</td> </tr> </tbody> </table>	Response	Percentage	Yes	48%	No	39%	Unsure	12%
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<p>"Confusing message on pricing/lost dime margin option."</p>																													
<p>"Additional pricing with loyalty should generate additional share pts."</p>																													
<p>"Due to lack of new products and required SKUs from RJRT to combat vs. 2017."</p>																													
<p>"Price confusion is hurting this brand. Altria needs to quit overthinking their strategy behind it."</p>																													
<p>"I see Altria investing heavily in Marlboro mainline to grow the share back."</p>																													
<p>"Black and Menthol will lead growth from buy downs and contract funding while Marlboro mainline will see a spike in share from incremental loyalty accounts in 2018."</p>																													
<p>"I think with the additional weeks they will offer their loyalty discount will help drive this increase."</p>																													
<p>"Primarily Marlboro Menthol. Marlboro Black may be insulated in 2018 with Altria's new promotional discount requirement."</p>																													
<p>"Marlboro's demographic has gotten to the point where it is more susceptible to losing consumers."</p>																													
<p>"With the lower price segment within the Marlboro family they continue to have more potential for growth. Then the new brands being forced out increases the share from a purchases side, not from retail sales side. The lower priced segments ex Marlboro special blend, Marlboro black & Marlboro 72s gives the consumer the Marlboro comparison they want for the lower price. Those are the type of consumers that will convert to those. The Marlboro Ice I don't see it doing well. The re-sealable foil means nothing for the general smoker as they don't have the cigarettes for that long and usually like to put their lighter in their cigarette pack when it gets lower. These things never seem to be well thought out."</p>																													
<p>Why is Newport pressuring Marlboro?</p>																													
<p>"The pricing for the Premium Menthol smoker is more favorable for Newport than in the past."</p>																													
<p>"Increased presence on the fixture."</p>																													
<p>"As they promote better they zap share from Marlboro Menthol brands."</p>																													
<p>"It's a menthol world among younger adult smokers, and Newport rules the menthol segment."</p>																													
<p>"Two different demographic groups."</p>																													
<p>"Marlboro has muddied the water with too many Menthol offerings over the past several years and continues this year with Marlboro Ice. Only confuses customers and makes purchase choice difficult. None of their menthol offerings have been very successful as a stand-alone; but have loaded up retailers with additional inventory on hand."</p>																													
<p>"Taking some volume and share from the menthol side of the business."</p>																													
<p>"Better positioned for the menthol Consumer!."</p>																													

"Primarily in the menthol category, to gain share and protect the Newport franchise."
"Just on the Menthol side."
"Unsure if this is the actual culprit or not although younger adult consumers do lean toward menthol vs non menthol at least in the markets where we operate."
"Newport is a strong recognized menthol cigarette. Marlboro is wanting more menthol share, but Newport is already a well-known Menthol cigarette. Newport hurt itself with packaging changes because the consumer see a pack looking different they assume it is counterfeit or something else changed so they waver on buying until they feel it is the same cigarette and they have the confidence in purchasing."
"New Marlboro Menthol products."

Source: Wells Fargo Securities, LLC

Retailers Don't See PM USA's Efforts to Shore Up Marlboro As Necessarily Effective - "Erratic Pricing Structure," "Too Many SKUs" & Growth of 4th Tier & Newport Drive Pressure on Marlboro - "Need to Refocus on the Basics"

Select Retailer Comments

- **"Too many SKUs** have diluted the line."
- "If they would focus on it and not **B&H Menthol** (not selling) that would be helpful."
- **"Newport's** growth, **fourth tier** brands, and the **growth of vaping** are all hurting Marlboro."
- "The **price value equation** for Marlboro is broken."
- "Consumers are looking for **cheaper alternatives**."

Note: Respondents voted CA's excise tax increase as least impactful among the choices as a driver of Marlboro pressure. We believe it's because the majority of our retailer participants have stores outside of CA, which makes sense given California accounts for just around 5% of industry cig volume.

<p>If you are seeing PM USA reallocate marketing resources around Marlboro, are you optimistic these actions will help to alleviate share pressure on the brand?</p>	<p>If you continue to see pressure on Marlboro's retail share in your stores, how important are the following in terms of driving that weakness?</p>
<p>A pie chart showing retailer sentiment regarding PM USA's marketing reallocation. The chart is divided into three segments: 'Yes' at 29% (blue), 'No' at 40% (dark brown, circled in red), and 'Unsure' at 31% (light green).</p>	<p>A stacked bar chart showing the importance of various factors driving weakness in Marlboro's retail share. The legend indicates four categories: Strong Driver (blue), Medium Driver (dark brown), Weak Driver (light green), and No Impact (yellow). The factors and their percentages are: Price Confusion (24.4% Strong, 36.6% Medium, 4.9% Weak, 34.2% No Impact), Ineffective Promo (11.9% Strong, 45.2% Medium, 2.4% Weak, 40.5% No Impact), Stronger Competitor Promos (4.8% Strong, 50.0% Medium, 2.4% Weak, 42.9% No Impact), Marlboro Losing Relevance (9.8% Strong, 43.9% Medium, 12.2% Weak, 34.2% No Impact), New Prod by Competitors (4.8% Strong, 26.2% Medium, 50.0% Weak, 19.1% No Impact), and CA Excise Tax Incr (12.2% Strong, 14.6% Medium, 14.6% Weak, 58.5% No Impact). The first four factors are highlighted with a red box.</p>
<p>What more should PM USA do to "fix" Marlboro?</p>	
<p>"Make pricing and contract easier for customer to see a value."</p>	
<p>"I sincerely believe PM USA letting sleeping dogs lie with regards to Marlboro in anticipation of marketing the heat not burn products in a wider market then its currently in. "</p>	
<p>"Lower prices."</p>	
<p>"They removed margin option in Jan."</p>	
<p>"Cut it down to two price tier at most. I mean 4 price tiers? Not even all the Marlboro Black items are the same price. Now Ice comes out at yet another price tier? Additionally keeping retail margins unnaturally low via MLP drives retail indifference. Profitability is to the point where why care about growing a loser category. With minimum wage increases and rent increases, Altria needs to not just look at but act on increasing retailer margins on MLP and not "down the road" but now."</p>	
<p>"They need to fix the erratic pricing structure and come to a more rational approach to pricing."</p>	
<p>"Reduce price on overall brand another Marlboro Friday. This is keeping the integrity of the overall brand instead of promotion a flavor a month. End user seems to be losing some brand loyalty but promo's help when it's their flavor. Too many SKUs have diluted the line."</p>	
<p>"Be more consistent in pricing and promotion. There are too many offers in the marketplace which is causing consumer confusion."</p>	
<p>"Not sure that it is broken."</p>	
<p>"If they would focus on it and not B&H Menthol (not selling) that would be helpful. And stop messing with all the brands and keep</p>	

the ones people want along with keeping their website for mobile coupons working properly etc. Need to refocus on the basics it seems. They don't work with the retailers as much as they should. It is more of a battle against. They want to force brands and share of fixtures in stores that their brands do not sell in, which then makes everything more difficult. Work together to create a win-win. Provide fixtures and other potential helpful resources for the store levels and maybe get where retailers can use the scan data collected to help with categories."

"Additional promotional product but also widen the Gap within their Marlboro brands and Special Marlboro family."

"The new promos will give them an advantage."

"I just think Marlboro has had a good long run at the top, and it's going to end at some point. Nobody stays #1 forever."

Do you continue to see pressure on Marlboro's retail share in your stores? What's driving that weakness?

"Going non-EDLP in our chain will add pressure."

"Marlboro is growing share."

"I believe the consumer is backing off of smoking and the Indiana Reservations is selling cartons at 22.50 a carton all over New York State."

"Newport's growth, fourth tier brands, and the growth of vaping are all hurting Marlboro."

"Continue to see that growth and pressure from 4th tier Cigs. Also, continue to see marginal promotion Cigs from Altria in our Markets."

"Lack of consistent promotional focus and marketing strategy through retail support. Their broker field team efforts may have produced additional cost savings but broker execution is horrible."

"Tier 4 product gap is starting to show up in share numbers. Considering the strong economy this is really odd. The price value equation for Marlboro is broken."

"Consumers are looking for cheaper alternatives and we are seeing very good growth with our private brand cigarette."

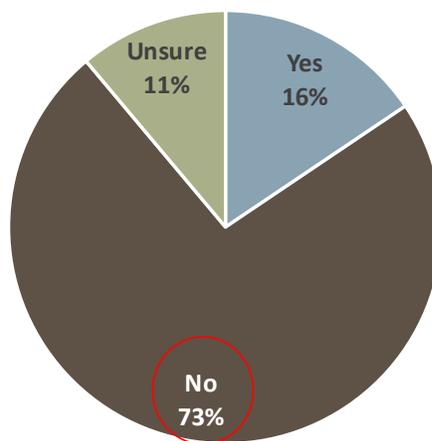
Source: Wells Fargo Securities, LLC

Overall, Retailers Are Not Too Thrilled By PM USA's Latest Innovations (Marlboro Ice and B&H Menthol) Although Some See Hope – "Both are Fresh Takes on Iconic Brands"

Select Retailer Comments

- "**Marlboro Ice** is a differentiated line extension and does have some chance of being impactful."
- "**very confusing** to the customers"
- "...both products are **fresh takes** on iconic brands that will stimulate interest with **21 to 35 year age group**."
- "Why on earth would you brand anything **B&H!**"
- "Ice may help if Altria can **communicate packing benefits** to the consumer."

Are you optimistic PM's new product launches? Do you expect them to help stabilize PM USA's share performance in the overall premium category over time?



Retailer Comments

"Low % menthol chain. Ice could get interesting though."

"B&H Menthol is a cheaper offering and the brand doesn't have a ton of leverage in our market currently. Marlboro Ice is a differentiated line extension and does have some chance of being impactful since its getting added into the main promotional offerings."

"Why on earth would you brand anything B&H! Very poor move we are in fact removing from all sets the entire family for lack of

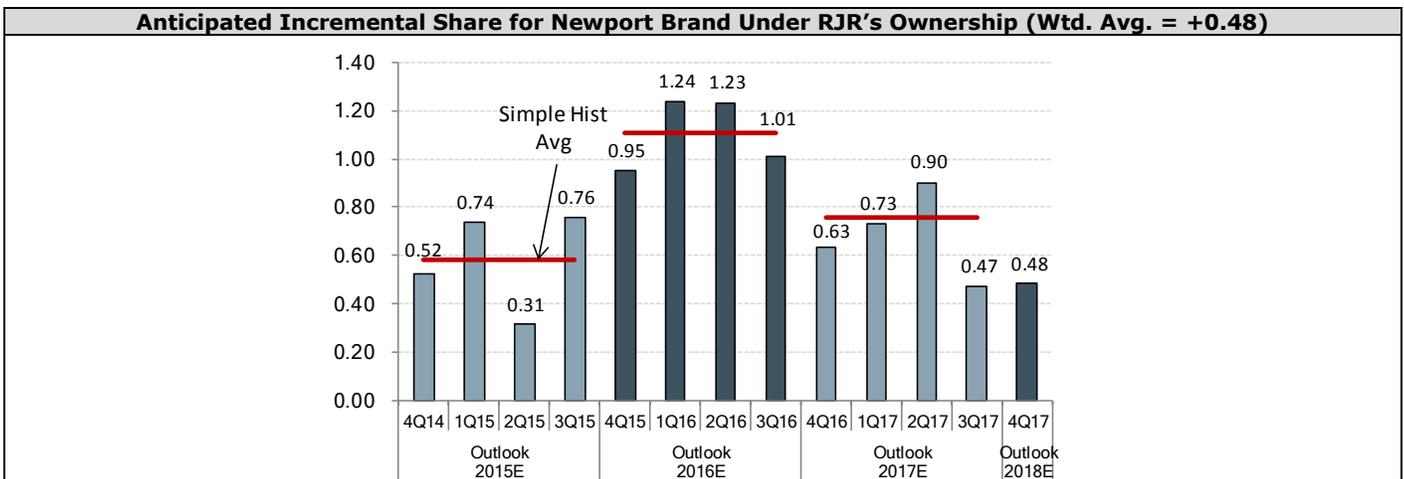
sales and Altria does not even put it with the other B&H brands when it launches."
"I think the way they are doing it is very confusing to the customers."
"Just two more menthol cigarettes in an over skewed Marlboro Menthol category."
"I think both products are fresh takes on iconic brands that will stimulate interest with 21 to 35 year age group."
"Time will tell. We plan to place and work into our sets day 1."
"Marlboro Ice probably HURTS Marlboro by further increasing confusion."
"Marlboro ICE should be a great new item, especially with the additional buy downs to help get it started. B&H will be a slow growth if any."
"This will have minimum effect. How are they going to communicate or educate the consumer about this new product?"
"I don't buy B&H will have any success in our market and Marlboro Ice will just be a menthol extension, I do not see this brand becoming a Marlboro segment of its own."
"PM is throwing old news against the wall to see if the newer generation will embrace and buy it."
"Ice may help if Altria can communicate packing benefits to the consumer. B&H is very high price even with an aggressive SPP."
"Come on, B&H doesn't sell now. Retailers got stuck with their inventory. Once again Altria is complicating pricing by having different prices and promotional offers within a same brand. If Altria was fully invested in this new B&H, they would remove all of the old B&H inventory from the market as to not confuse the consumer. Both of these brands are about pipeline fill for the manufacturer. Altria is throwing things at the wall, and hoping something sticks."
"Marlboro Ice will be a winner."
"First off B&H Menthol isn't doing anything at retail level. When looking at purchases it appears good because they force it out. They dedicate too much space to these brands that aren't gonna move. Marlboro Ice is just another one of the brands that they are all pumped about but not going to help with share. They cover fixtures with advertising of the one brand and focus too much on it when that isn't close to what the consumers even want."
"Benson and Hedges have limited availability and cartons in our Market."
"I feel this launch will be similar to Black and have a few trial but consumers will return to their usual."
"It will be interesting to see if the new packaging moves the needle on Marlboro Ice. Other than that it's just another menthol to throw out against Newport. They are rolling B&H Menthol out to even more states in Feb., and it's interesting they are pricing it like a Marlboro. I still think it's just grasping at straws."

Source: Wells Fargo Securities, LLC

Retailers Remain Bullish Overall on Newport, But Largely Disappointed By New Platinum Rollout – Expect Newport To Gain ~50bps of Incremental Share in 2018

Select Retailer Comments on Newport Platinum

- "Not setting the world on fire."
- "...having a hard time getting it started..."
- "One of the worst new item brand launches for tobacco in a long time."



How is Newport Platinum doing since its national rollout in July 2017?
"Really bad"
"OK."
"Not well."
"Very poorly and it likely will not make the sets this time next year it's so bad."
"Not setting the world on fire."
"Seems to get slower every month here."

"Newport Platinumreal slow."
"Horrible - forced out product with no sales from consumers."
"Not much traction yet. RJRT needs to get behind this product with more support."
"Newport is not as big in Hawaii as it is on the continent."
"Fair. Some stores doing well other are having a hard time getting it started."
"A total no seller. We are still sitting in the remainder of the non-pre-booked inventory."
"Terrible. One of the worst new item brand launches for tobacco in a long time. I hope they don't lose the true Newport smoker by spending money on launches like this."
"This rollout has been very soft. Have not even gone through the initial VAP distribution."
"Marlboro Menthol pricing plan will combat any share growth from Newport."
"Newport Platinum has underperformed."
"Failed"
"We have not seen any positive sales impact as of yet from this new product."
"Platinum is not the savior for anyone. RJR would be well served to drive the primary Newport to grab more market share THEN work to convert that customer to a new member of the Newport family."
"Platinum account for 2.2% share of Newport sales. Newport ended Q4 2017 +.012 and if you remove Newport VAP the brand would have been down 12%."
"Fair with some re ordering but not significant share."
"Platinum is a nothing. If I wasn't required to carry it, I wouldn't. I am still sitting on some of my introductory inventory."
"Newport Platinum is doing nothing but taking up space on our fixtures. The consumers don't seem to be interested in the new brands the come out because they are loyal brand smokers. If they want their Newport cigarettes that is what they want and no matter what is done they don't want to change that."

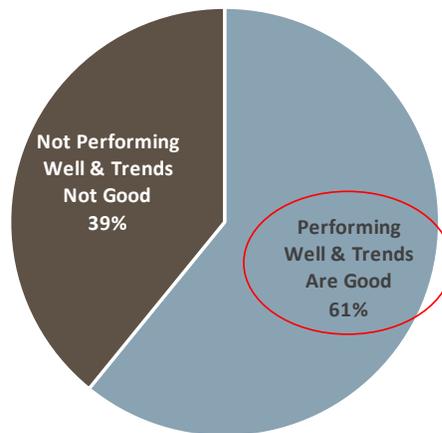
Source: Wells Fargo Securities, LLC

Retailers Are Broadly Pleased With the Performance & Outlook for 4th Tier Cig Brands – “Premium/Discount Gap Closing” – “Deep Discount Is Crushing It”

Select Retailer Comments on Discount Category / Downtrading

- "Premium and discount gap closing in."
- "Deep discount is crushing the big two companies."
- "4th tier continues to decline in our market...as consumers seek premium brands due to lower unemployment and higher wages."

How did the 4th tier/deep-discount cigarette category perform in 2017 & what’s your expectation for 2018?



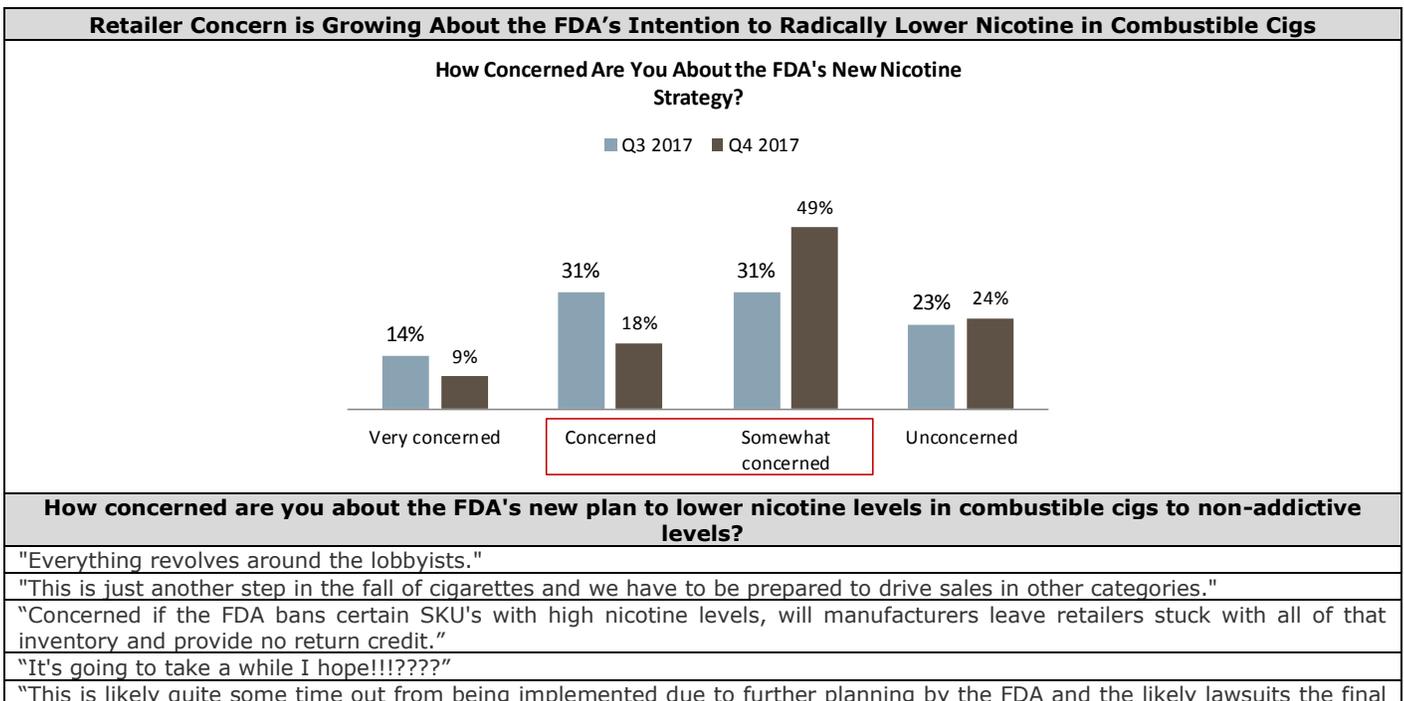
How did the 4th tier/deep-discount cigarette category perform in 2017 and how do you expect it to perform in 2018? Also, what trends are you seeing with private label cigarette brands?

"Good"
"Discontinued; currently RJR EDLP."
"None yet, but Q2 major role once contract changes."
"Poorly - trends are not good."
"Private label loses its sheen as consumer confidence rises - that alongside the consistently expanding private-label verse following the 2008 recession."
"Eagle 20 continues to grow well but only on a small base. RJRT's EDLP program limits the growth."

"Very low."
"More are coming into the market."
"It's the only cigarette we increase volume in. I believe there is no further for private label."
"I am seeing 4th tier on the rise again and expect the same in 2018."
"Increased slightly."
"Our private label continues to grow. Have had same private label brand for 12+ years."
"Market wise - it trending higher vs. PY. Looking to expand for 2018."
"It's down - 2018 the same."
"4th tier continues to decline in our market with share down 10% from last year as consumers seek premium brands due to lower unemployment and higher wages."
"Low end is doing well."
"Two things: one we changed contract levels last year so it impacted the 3rd and 4th tier brands so I'm probably not the right person answer for you."
"Some states private label brands are doing well for comp. Those are consumers that don't necessarily want because counting out change and not purchasing any other high margin items. Premium and discount gap closing in."
"4th tier has accelerated our overall cigarette volume, at a cost to premium market."
"Flat."
"Flat as a wholesaler we are restricted from driving deep discount. I expect pressure from key customers to provide deep discount in 2018."
"Flat to down. We do not carry private label."
"Weakness - which will continue."
"There is very little 4th tier product in the Hawaii Market. L&M, USA, & Pall Mall, is that tier."
"These items showed some growth even as we are on RJRT's EDLP Program."
"Deep discount cigarettes performed stronger than expected in 2017 and I expect the category will hold onto the gains of 2017 and possibly grow more in 2018."
"Gained nearly a full share point in 2017. If nothing changes another half a point is likely in 2018."
"Much slower than expected."
"We don't carry 4th tier cigs."
"About the same."
"All my growth is in the 4th tier. I expect it to keep growing."
"Deep discount is crushing the big two companies."
"Extremely well and I see this continuing in 2018."
"We don't stock any 4th tier products."

Source: Wells Fargo Securities, LLC

FDA Regulation – Retailers Are Increasingly Concerned by the FDA’s Nicotine Plan (“We Have to Be Prepared,” “There Are Always Unintended Consequences”)



plan will spawn."

"We are still a very long way away from FDA making any meaningful decisions."

"This would put a de facto ban on cigarettes which the FDA can't do. So this will be a long drawn out process that will most likely be decided in a similar fashion to the MSA funding which is set to expire in 5 years."

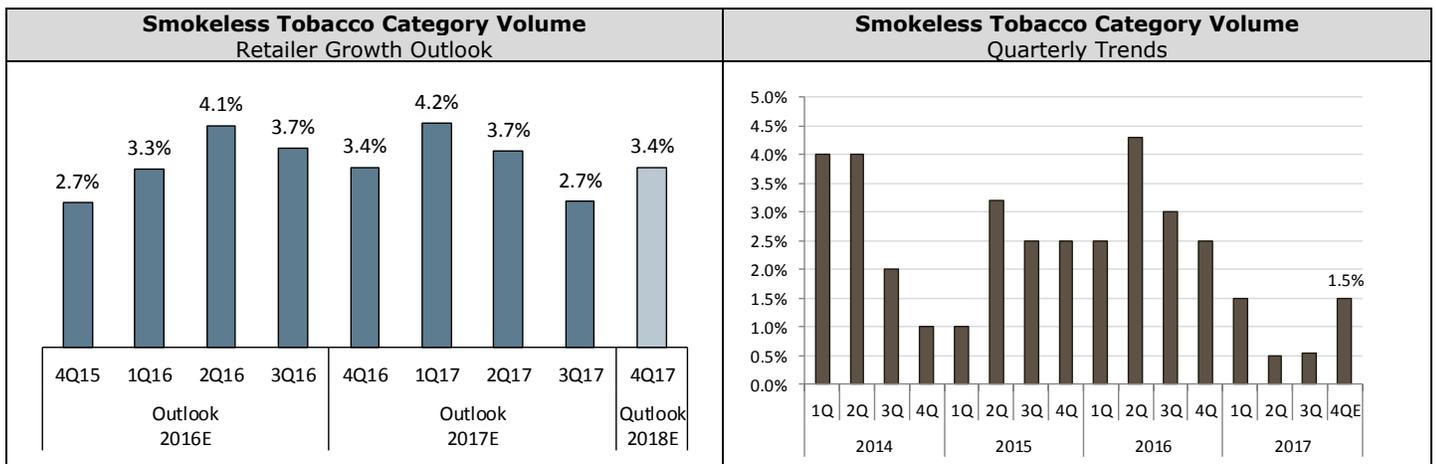
"When the FDA gets involved, there are always unintended consequences."

"Never know what the FDA will do. They know little to nothing and need to get out of tobacco business. They continue to state things and it doesn't follow through or work. They should stop policing people so much. Let them make their own choices. Why not go after alcohol more? Leave cigarettes alone for a little while."

Source: Wells Fargo Securities, LLC

Smokeless Tobacco Trends

Retailers Expect Smokeless Tobacco Industry Vol to Increase ~3.4% in 2018 in Line With Our Estimate of +3.5% - We Expect Q4 Volume Picked Up Following A Slow Recovery Post USSTC's Jan Recall



What is your expectation for total smokeless tobacco category volume growth for the full year of 2018?

"Cigar growth trends continue to be a positive category influence with manufacturers providing smart data to support line extensions and shelf decisions."

"Smokeless is capturing the existing cigarette customer and gaining any available new ones with alternative options."

"Comps of the Skoal recall should help for the first half of 2018."

"Still seeing a move from cigs to moist."

"See cigars increasing so when that is added in for the total tobacco category along with other potential growers it will increase."

Source: Wells Fargo Securities, LLC

Vapor/E-Cig Trends

Retailers Are Growing Increasingly Bullish on the E-Cig/Vapor Category (“Re-Birth,” “Outstanding”) as Product Quality Rises Led By JUUL, VUSE & Optimism About IQOS Hitting Shelves in 2018

Expected Annual Growth Rate of the U.S. Vapor Category (E-Cigs, VTMs, Personal Vaporizers)													
<table border="1" style="margin: auto;"> <caption>Expected Annual Growth Rate of the U.S. Vapor Category</caption> <thead> <tr> <th>Period</th> <th>Growth Rate</th> </tr> </thead> <tbody> <tr> <td>Q1</td> <td>6.9%</td> </tr> <tr> <td>Q2</td> <td>4.1%</td> </tr> <tr> <td>Q3</td> <td>6.7%</td> </tr> <tr> <td>Q4</td> <td>12.1%</td> </tr> <tr> <td>2018E Outlook</td> <td>16.8%</td> </tr> </tbody> </table>		Period	Growth Rate	Q1	6.9%	Q2	4.1%	Q3	6.7%	Q4	12.1%	2018E Outlook	16.8%
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2018E Outlook	16.8%												
Broadly Speaking, How Do You Think the Entire E-Cig/Vapor Category is Performing?													
"Good"													
"Declining - Vuse is the only driver."													
"Very well. Re-birth."													
"Outstandingly well."													
"Well!"													
"It is stable. RJRT continues to lead this category with VUSE although it remains a very small portion of the OTP Category. E-Liquids continue to fall."													
"Old pen styles of e-cigs are steadily decreasing sales."													
"Very poorly."													
"It is not. We reduce selling them in 211 stores down to 60 at this time."													
"Slow for us. Still too much uncertainty in the market."													
"Outstanding growth in this category. E-Cig growth driven by JUUL....sales are amazing!! Vapor continues to grow....open tank systems still king."													
"Growing well - look to see RJRT & Altria compete with JUUL by launching similar technology in near future."													
"Flat to up slightly."													
"Fair however, it appears that there are a number of new Blu items and JUUL is gaining traction."													
"Okay, If it wasn't for JUUL, the category would be down."													
"Vuse is doing well. Blu is so-so and Mark Ten not so good."													
"Leave these at Vape shops where there is time to explain and they know more about the product lines."													
"See strength within the Closed system. See a weak come back in the open systems in the State of Indiana. State law was recently changed to allow greater entry in this open system juices and devices."													
"Same."													
"JUUL driving the market in c-stores. Vuse following. Not much else going on, but some lift due to JUUL."													
"2-3 big players and hundreds of dwarfs."													
"It's flat but with resurgent pockets. We carry a private Vape line that does well. VUSE and VIBE do a good business and so does Logic in our stores."													
"Flat"													
"Responding well over the past several months. Still a very small piece of the overall business."													
"A total non-factor. I think the manufacturers invested a great deal of funds in the category and are trying to force no-selling products into wholesalers to appease investors."													
"2017 was a strong year for vaping and it looks like JUUL is poised to become number 1."													
"Very well"													
"Strong."													
"It performed very well in 2017 on the back of Vuse. It will be difficult to have those results in 2018 unless there is a break through new product."													
"The category stabilized in 2017. With new lines of Vuse Ciro, MyBlue and IQOS I think the category is in store for a significant sales and share jump in 2018."													
"Badly"													
"Above my best estimate."													

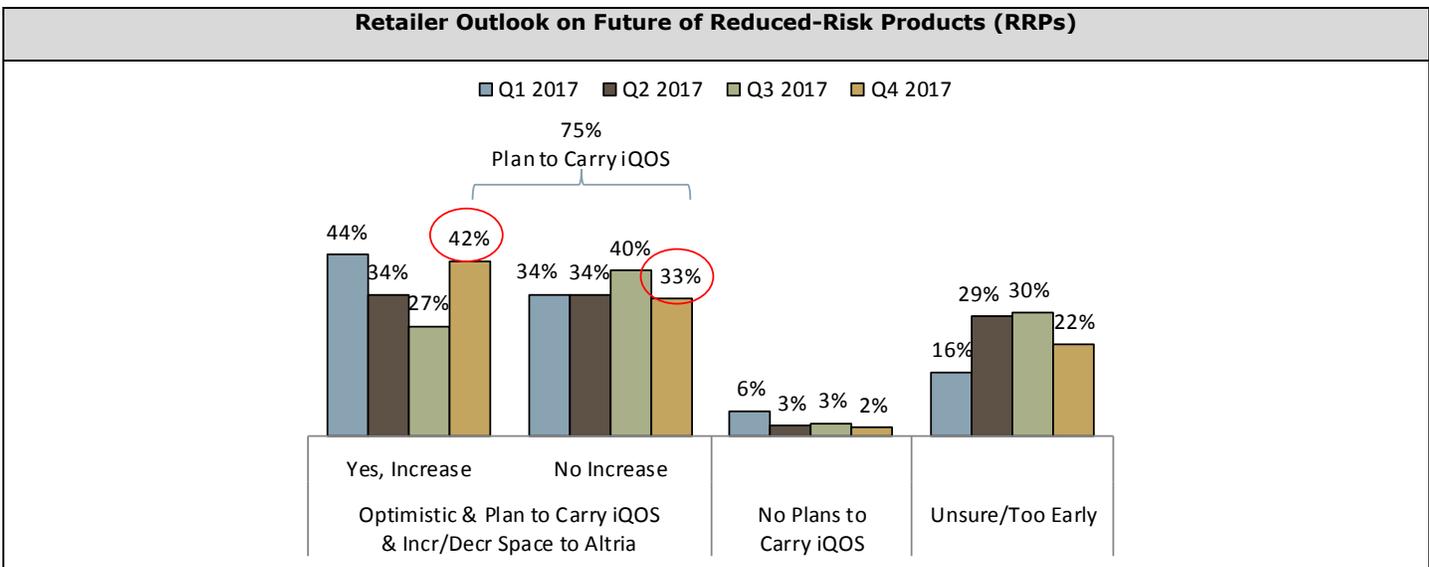
"Not living up to the hype so far."
"Flat"
"Fairly well. However, we are not seeing the large increase I would have expected."
"Under performing thus far. Giving it additional space in 2018 to better position it for future growth and the opportunity to become the combustible of the future generations."
"Small sub-category but growing."

Source: Wells Fargo Securities, LLC

Retailers Are Broadly Optimistic About RRP's With 75% Planning to Carry IQOS in Their Stores When Commercially Available (We Think as Early as Feb 2018) & 33% Planning to Allocate Additional Shelf Space To It

Select Retailer Comments

- "I believe this segment will eventually **replace cigarettes completely** in years to come."
- "PM needs to **find a way of simplify** the use of the products being developed so they can capture a **broader base** of folks...and **not only the Tech savvy** folks."
- "It will take time to educate customers..."



Are you optimistic or pessimistic about the future of reduced-risk products (RRPs)? What do you think of the opportunity for PM's IQOS heat-not-burn platform in the U.S. (Altria has commercialization rights in the U.S. pending FDA approval)? Has your Altria sales rep talked to you about IQOS yet? Will you carry IQOS? If so, will you give Altria incremental space?

"Altria needs to really display a concrete roadmap on the product since sales say one thing but the product use needing a coach and the physical unit buy at a pop up mall shop makes it seem a little too much an obstacle at the moment."
"I believe this segment has a positive future. I also believe it will not require additional space and only take away from existing cigarette space. The space allocation will be determined by how Altria and their competitors develop and market products. Initial introduction of these products will likely be merchandised within Altria's existing space and same for other manufacturers. I believe this segment will eventually replace cigarettes completely in years to come."
"Altria gave us 1 foot racks to place our e cigs and other tobacco at the end of last year. I believe they will Place these on these racks."
"I believe there will be many benefits to the product. However, much will depend how Altria communicates these benefits to consumers and can show them how to use the device and product."
"RRP's are a great addition to the category. IQOS will gain trial and a base, however it is being way over sold by analysts and the hype by the media. Take it down a notch guys."
"These products don't sell well in areas our stores are located. They take up too much room, too much inventory money and don't move. Just like the MarkTen failed because it was horrible."
"We've seen strong demand for Altria's Green Smoke brand, somewhat less optimistic on their Mark Ten brand. Customers haven't seen to adapt well to the MarkTen or requested this product, despite wider distribution."
"Unsure if we will carry; dependent upon price and ROI. Also dependent if they force this into their cigarette contracts. IQOS appears to be an expensive product. PM could be playing a very shrewd hand, by passing along such large and early cost increases in cigarettes during 2017 to narrow the gap between premium combustible cigarettes and IQOS."

"This is an exciting development that I think has great upside potential. PM needs to find a way of simplify the use of the products being developed so they can capture a broader base of folks who are looking at alternatives to traditional products and not only the Tech savvy folks."

"It will take time to educate customers so it will have little impact at first."

"We have not had any specific conversations regarding this product. However, when and if we carry this Altria will need to work this into their existing space."

Source: Wells Fargo Securities, LLC

JUUL Outperforming as it Captures Millennial Consumer Interest With "Apple-like Approach" - Vuse Vibe May Be Cannibalizing VUSE Sales – MarkTen Seeing Limited Growth

Select Retailer Comments

- **"JUUL just keeps growing."**
- **"JUUL's growth appears to be due to growth with the 18 to 24 year old age group. This group has disposable income and finds the product an attractive alternative to combustible cigarettes."**
- **"...limited movement on Mark Ten."**
- **"Vuse growth slowed down and Vibe cannibalized much of Vuse sales. We do not carry JUUL but it was the first of its kind with an "Apple" like approach to the category catching fire with millennials."**
- **"Thinking about eliminating BLU"**

How are MarkTen, VUSE and JUUL performing? What do you think accounts for JUUL's strong recent performance and do you expect that to continue? What other trends are you seeing in this category?
"Good"
"Vuse performs well; MarkTen still stagnant; Not carrying JUUL but considering."
"Vuse well. Adding JUUL now. Some lower priced JUUL knock offs may do well. Or a "like" trendy product."
"Customer interest in MarkTen has been little to none. VUSE remains competitive and JUUL growth end is at least outside of Q1."
"JUUL is doing great."
"We do not carry JUUL and Mark Ten was only recently reintroduced in WV I have seen some limited movement on Mark Ten while VUSE holds to top share spot by a long shot."
"These brands are not growing in our stores. We did a Major cut back because of the slow sales we had I this category."
"I think JUUL will be a fad and will end at some point. At this time still gaining traction if they can keep up with distribution demand."
"JUUL is doing great when we can get it, and it looks like their supply chain issues are easing."
"JUUL is driving e-cig category in our stores! Mark Ten showing small growth. Vuse/Vibe declining sales. Thinking about eliminating BLU....maybe new BLU (JUUL copycat item) my help them."
"Don't have JUUL in stores yet - rolling out in 2018. MarkTen & Vuse are stagnant."
"Progressing. It's a better fit for most consumers."
"Mark Ten is flat however, seeing some growth in new flavors. Vuse is growing due to new Vibe and expansion of Ciro. JUUL's growth appears to be due to growth with the 18 to 24 year old age group. This group has disposable income and finds the product an attractive alternative to combustible cigarettes."
"MarkTen was horrible VUSE not much better but RJR continues to push it. JUUL actually not bad but not in our stores. They seem very popular in stores that carry them but limited in where located."
"JUUL continues to grow strong--based on increased availability of product. Mark Ten--sales remain sluggish. Vuse--double sales of Mark Ten Logic--strong sales, outsells Mark Ten and Vuse CUE, --outsells all devices in closed system category. Njoy---great sales with limited distribution within our stores, planning on additional roll out. Green Smoke--Great sales with no support from Altria (concerned about this brand fading away, with the strong sales originally as a "test market".'
"JUUL strong Vuse flat Mark Ten down."
"MarkTen not a player. VUSE & Blu doing well. Do not carry JUUL."
"We don't carry JUUL but VUSE is doing well with Mark Ten making some noise."
"The items are performing fine, still seeing steady growth. We are just now planning to add JUUL in some locations to measure guest interest. We are also considering Kian from CB Distributors. This is a new nicotine salts Pod system."
"We have not sold a unit in over two months of either."
"MarkTen and Vuse had solid growth while JUUL exploded with 600% growth. All others were flat to declining. I expect JUUL growth to be more in line with Vuse in 2018."
"JUUL is the clear winner still."
"JUUL is trending better than the other two. Mainly driven by younger adults. Vuse Ciro is much better than Mark Ten and sales show it."
"Mark Ten is only doing OK not a big player. Vuse continues to have the majority of the market. We are just getting into JUUL."

Will see if this is the new break through item for us."
"Mark Ten has been consistent performer this year right alongside Blue. Vuse growth slowed down and Vibe cannibalized much of Vuse sales. We do not carry JUUL but it was the first of its kind with an "Apple" like approach to the category catching fire with millennials. I see all others copying this and making JUUL less relevant the next two years."
"Very poorly on Mark Ten and Vuse."
"JUUL just keeps growing."
"Vuse is our best seller as we have not been able to get distribution of the JUUL products."
"Not carrying jewel. They have some major production and distribution issues. Mark 10 +56%, Vuse +16%. However, Vuse sales are 3 times higher than Mark 10."

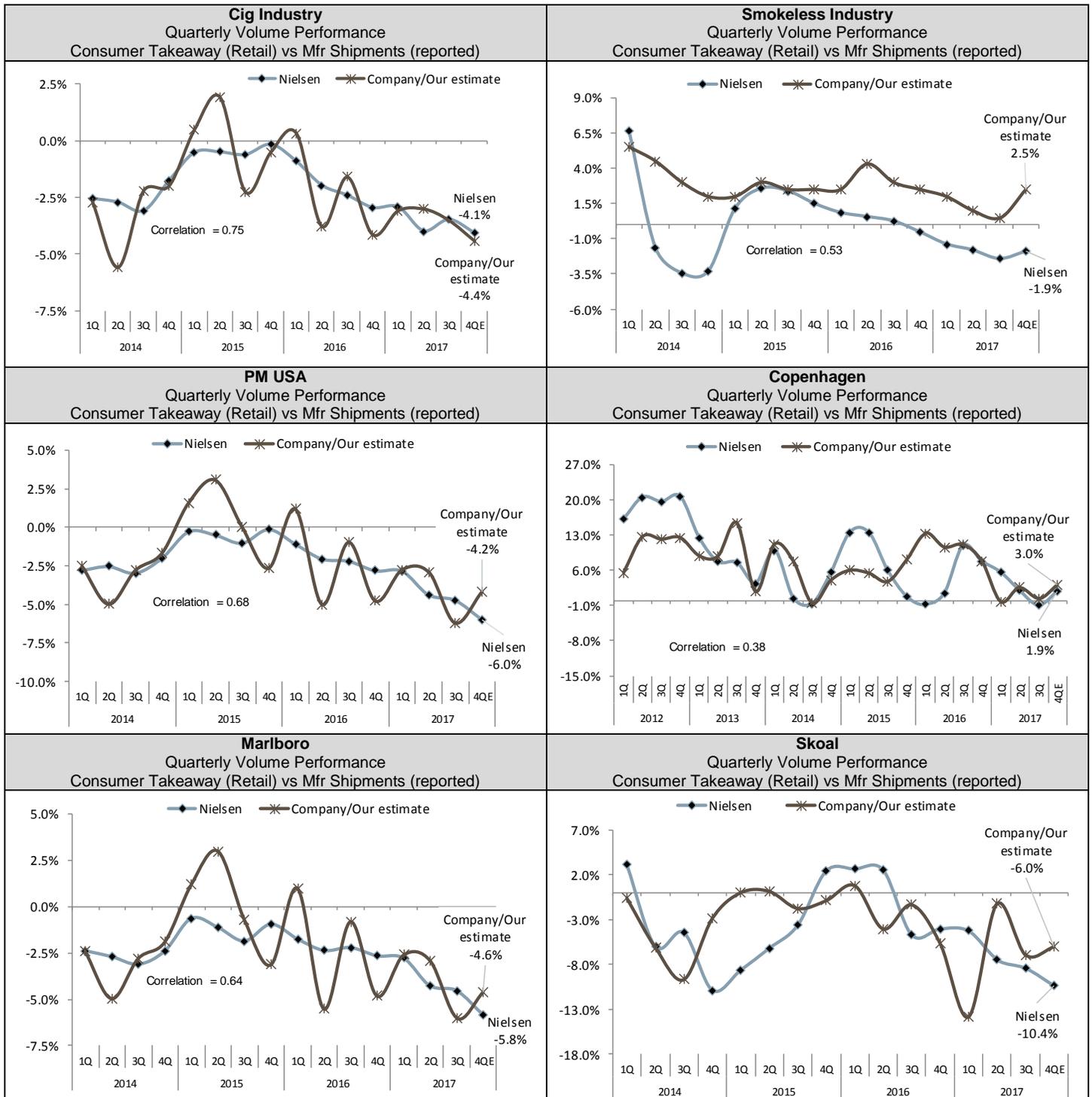
Source: Wells Fargo Securities, LLC

Retailers Are Most Excited About iQOS/RRP Opportunity Especially Given FDA’s New Nicotine Strategy; Most Concerned About Margin Compression & FDA Delaying RRP Approvals

What are you most excited about and concerned by for the entire tobacco/reduced-risk industry? What are your big predictions?
"How will consumers react? Am I exposed to non-turning inventory risk? Viable manufacturers - think impact of Njoy on the industry."
"Once labeled reduced-great growth, Zyn/ON! type of products will be big."
"Big tobacco companies will continue to fill ranks with marijuana and heat-not-burn experts in order to have a direct fill for the industry shift."
"None."
"Excited about the increased margin opportunity vs cigarettes. Concerned about proper merchandising and space availability and manufacturers driving price and margin opportunity down competing for sales."
"Less tobacco/cigarette focus and more focus on items that have a higher margin. (non-tobacco)."
"Most excited about other tobacco offers. Concerns age change to 21. Lost in sales big concerns."
"I think we may finally see iQOS this year. I'm not sure it is going to live up to the hype."
"Consumers quitting because they do not like the vapor options - especially gen X & baby boomers."
"iQOS."
"FDA regulation and the FDA taking too long to review and approve applications for reduced risk products."
"Excited about new products. They are the bright light in non-cigarette categories. Predictions - Blu, Vuse, MarkTen will all decline in volume. E-cig consumers will move to newer yet to be released products."
"Closed Systems continue to grow and be strong. Open systems; maintain acceptance, but moderate growth and perhaps elimination/ consolidation of some manufacturers."
"Not optimistic."
"FDA delays roll out of reduced risk."
"The reduced risk category product line is the most exciting development and trend this year and in the year to come. I like the stability of the traditional products keeping the category viable. Cigars and Moist continue to be positive."
"Concerned with continued city and communities attacking tobacco, going after age 21 laws, and restricting programs. Indiana is of main concern since the state has banned Loyalty Programs and Business Enhancement Funds. We need to work together to get this fixed."
"Total failure in the long run, some experimental growth in the short term."
"I expect continued solid growth but will need further innovation to sustain the growth long term."
"Items getting better and cost less."
"PM will introduce the iQOS system in late 2018 to selected markets. Introduction will be slow but consumers will begin to catch on."
"Most excited about the new innovation. The new lines are much different than their predecessors, however with this much innovation comes the death of certain lines which will require more hands on category management getting old product out of stores quick and having buttoned up merchandising plans to get these lines into stores as soon as they launch."
"Financial strength of the wholesale / middle man."
"Bring on iQOS"
"It will be interesting to see what impact the govt. may have with their involvement and I think the heat not burn product is too early in the stages to know what impact this may have on the category."
"iQOS"

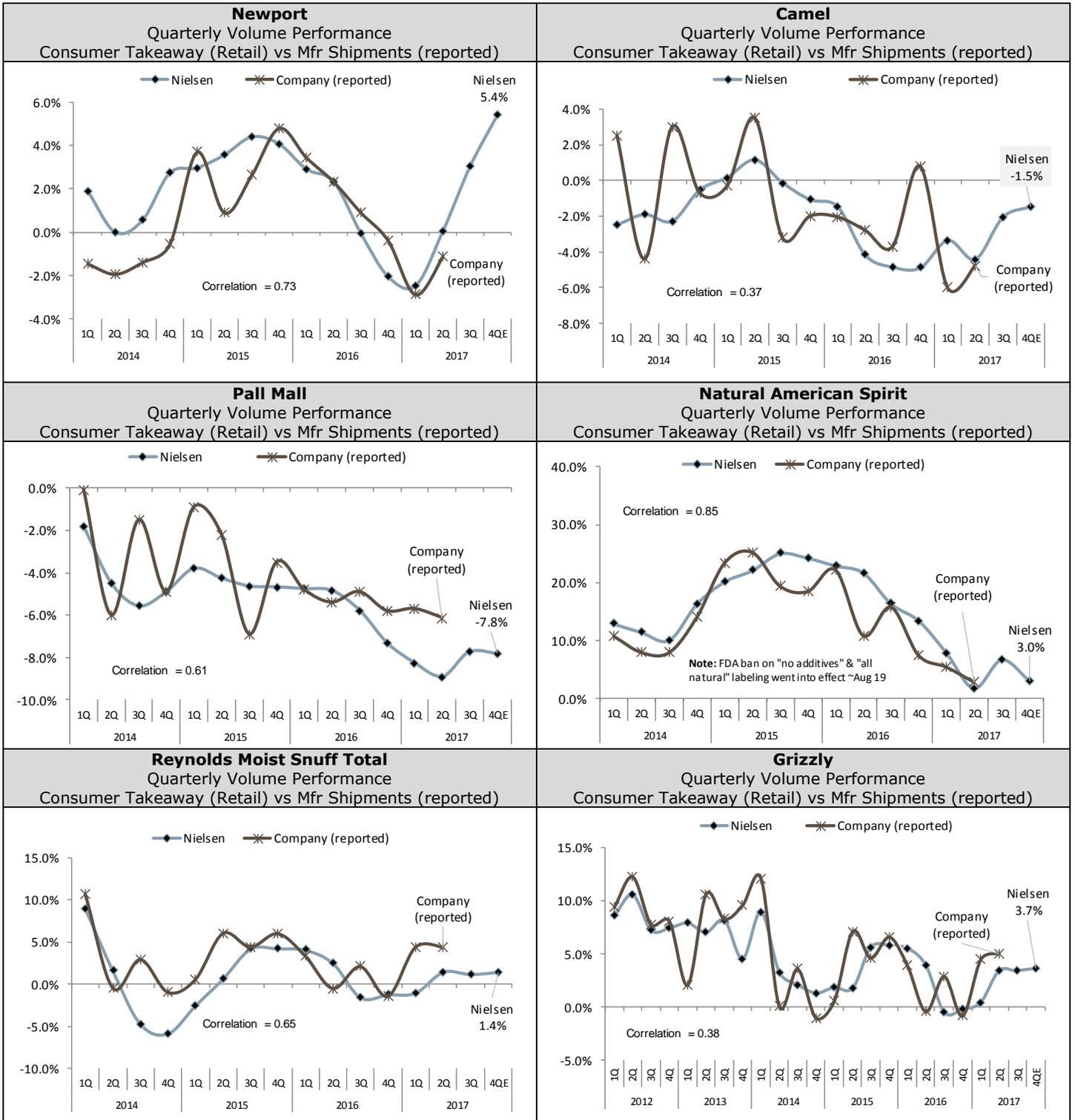
Source: Wells Fargo Securities, LLC

Consumption vs Shipment – MO Vol Trends at Retail (Consumer) Based on Nielsen Scanner Data vs Wholesale (Mfr) Reported



Source: Nielsen AOC+C Database and Wells Fargo Securities, LLC

Consumption vs Shipment – Reynolds Vol Trends at Retail (Consumer) Based on Nielsen Scanner Data vs Wholesale (Mfr) Reported



Source: Nielsen AOC+C Database and Wells Fargo Securities, LLC

Post TPSAC Briefing – Now What? Understanding the Standard for PMTA Approval

The TPSAC vote on 1/25 ended with a recommendation that the FDA deny PM's modified-risk (MRTP) application as currently framed for iQOS. While disappointing, we knew going into it that the bar for a slate of "Yes" votes from the Panel was high given the relative nascence of iQOS and, therefore, limits on the kind of data available for analysis – particularly at the epidemiological level which favors long term data which is simply non-existent for iQOS/heat-not-burn technology (iQOS has been around only since 2014/15). However, in our view all is not lost for PM's MRTP application as the road to FDA approval is very much an iterative process. In other words, there is still time for PM to strengthen its case by addressing the concerns of the committee via more evidence or by working with the FDA to arrive at something more acceptable, such as through modifying the wording of the claims being sought.

We still expect MRTP approval, but it could realistically take more time (perhaps early 2019 vs 2H18)

Ultimately, we still think the FDA's ambitious plan to dramatically lower nicotine levels in conventional cigs requires the development first of a healthy, thriving market of satisfying, lower risk alternatives. Through this lens, PM and the FDA's objectives are not conflicted leading us to expect iQOS will ultimately be approved as a modified risk product - it just may take longer than we originally anticipated as we don't see any reason the FDA would rush the process given its standard-setting importance. Therefore, we now think it possible that the MRTP application is approved in early 2019 or late 2018 at the earliest.

What about PMTA Approval?

PMTA approval is subject to a much lower standard than the MRTP. Approval is dependent on submission/review of scientific level data and that data must be able to demonstrate that the product (iQOS) doesn't raise any new issues of public health and cannot be more harmful than what is already on the market. In other words, the product must "benefit" public health from an initiation/cessation standpoint (see the FDA's definition below). Also a TPSAC review is not required for PMTAs like it is for MRTPAs.

From the FDA's website ([link](#)):

"Premarket Tobacco Applications must provide scientific data to demonstrate that the new tobacco product is beneficial to the population as a whole including users and non-users. This demonstration shall take into account the increased or decreased likelihood that existing tobacco users will stop using such products, and the increased or decreased likelihood that those who do not use tobacco products will start using them."

PMTA approval timing?

Under the 180-day guideline review period, a decision on PM's premarket application (PMTA) could theoretically come as soon as Feb. However, recognizing that the "clock" can stop/restart at any point along the way, a decision could feasibly come later. To be clear, however, the PMTA and MRTP application reviews run on separate tracks and are reviewed by different teams within the FDA. That said, it's reasonable and likely there is some level of information sharing between the assigned FDA teams and therefore it's possible PMTA reviewers will want to digest some of the information discussed at the TPSAC event. But ultimately, the approval of one application is not contingent on approval of the other. Likewise, the timing of the MRTP review process or conclusions drawn by the TPSAC (i.e., how they voted on any of the FDA questions) should not impact the PMTA review process or outcome. We continue to believe the probability is very high (over 90% chance) that PM's PMTA will be approved and iQOS will be commercialized in the U.S. via MO with no modified risk claims (until its MRTP is approved). We remain optimistic that PM's PMTA could be approved in the next few months.

TPSAC Votes – So what happened?

The TPSAC voted against PM in 4 out of 5 questions it was tasked to answer with a "Yes" or "No" vote by the FDA (see below for the final tally, by question). We review our key takeaways from the first four votes as we think they were the most critical. A summary of the final tally of votes is at the end.

On **Question 1**, the Panel simply did not find enough evidence in PM's data to be able to "conclusively" state that iQOS reduces smokers' risk of tobacco-related disease (8 "No" votes, 1 "Abstained"). This was a very tough question to answer in the affirmative given its wording and limited epidemiological evidence. Indeed, some of the Panel's comments following the vote revealed where the fault lines were in the wording of the question itself: "potential to reduce yes, but scientific evidence in humans not there;" "the science doesn't warrant the bottom line;" "problem with linking 'science' to human disease referenced in the claim;" "tremendous potential, but uncomfortable with language;" and "abstained because great potential, but [the modified risk labeling] doesn't communicate it."

Vote Question 1: "Scientific studies have shown that switching completely from cigarettes to the IQOS system can reduce the risks of tobacco-related diseases."?

The Panel similarly voted down **Question 2** regarding iQOS' ability to lower the risk of "harm," however, here the Panel was much more split (5 "No" votes, 4 "Yes") as the language was less ambiguous and some Panel members felt it was easier to get behind iQOS under the premise that smoking conventional cigarettes "is the greatest harm." Some panel comments: "The totality of evidence supports [this] less specific statement;" "Continuing to smoke cigarettes is greatest harm;" "Less wiggle room in the statement, so [I] support;" "Uncertain there aren't other harms from iQOS not attributable to smoking;" and "Concerned about other risks; premature to make such a claim."

Vote Question 2: "Switching completely to IQOS presents less risk of harm than continuing to smoke cigarettes."?

Encouragingly, the Panel voted "Yes" to **Question 3**, recognizing that smoking iQOS reduces exposure to harmful or potentially harmful chemicals (8 "Yes" votes, 1 "No"). This was presumably easier to affirm as "exposure" is something that is more easily measured (as in 'exposure to a chemical') than a reduction in actual morbidity/mortality rates which was **Question 4** (e.g., cancer studies are conducted over 20-30 years since cancer needs time to develop).

Vote Question 3: "Scientific studies have shown that switching completely from cigarettes to the IQOS system significantly reduces your body's exposure to harmful or potentially harmful chemicals."?

Panel comments: "Yes, biomarkers of exposure compelling;" "Data compelling on exposure;" "data compelling on exposure, but don't know full possibilities of harmful/potential harmful chemicals"

Vote Question 4: If the answer to above is "yes", has the applicant demonstrated that the reductions in exposure are reasonably likely to translate to a measurable and substantial reduction in morbidity and/or mortality?

Panel comments: "No, statistics didn't show 'substantial', need more data/time;" "No, not statistically significant although in right direction, so can't say 'reasonably likely';" "No, reduction & exposure not equivalent for all ethnic populations;" "abstained, but leaned closer to yes [vote]"

Final TPSAC Votes - 1/25

I. Health Risks of IQOS & Advertising - Has the applicant demonstrated that the following statement in their proposed modified risk labeling and advertising is true:

- Vote Question: "Scientific studies have shown that switching completely from cigarettes to the IQOS system can reduce the risks of tobacco-related diseases."? **NO (8/1, 90/10%)**
- Vote Question: "Switching completely to IQOS presents less risk of harm than continuing to smoke cigarettes."? **NO (5/4, 56/44%)**

II. Human Exposure to Harmful/Potentially Harmful Chemicals - Has the applicant demonstrated that the following statement in their proposed modified risk labeling and advertising is true:

- Vote Question: "Scientific studies have shown that switching completely from cigarettes to the IQOS system significantly reduces your body's exposure to harmful or potentially harmful chemicals."? **YES (8/1, 90/10%)**
- Vote Question: If the answer to above is "yes", has the applicant demonstrated that the reductions in exposure are reasonably likely to translate to a measurable and substantial reduction in morbidity and/or mortality? **NO (5/2/1, 63/25/13%)**

III. iQOS Conversion: Likelihood of Initiating Use, Complete Switch & Dual-Usage

- Non-Vote Question: What is the likelihood that that U.S. smokers would completely switch to use of the IQOS system? (High/Medium/Low) **LOW (78%) vs 22% Medium**
- Non-Vote Question: What is the likelihood that U.S. smokers would become long-term dual users of IQOS and combusted cigarettes? (High/Medium/Low) **MED (56%) vs 33% High and 11% Low**

IV. Attracting New Users to the Category

- Non-Vote Question: What is the likelihood that U.S. never smokers, particularly youth, will become established users of the IQOS system? (High/Medium/Low) **LOW** (57%) vs 29% High and 14% Medium
- Non-Vote Question: What is the likelihood that former smokers will re-initiate tobacco use with the IQOS system? (High/Medium/Low) **LOW** (100%)

V. Consumer Comprehension & Perceptions of Modified-Risk Labeling & Advertising

- Vote Question: Has the applicant demonstrated that, after viewing the proposed modified risk labeling and advertising, consumers accurately understand the risks of IQOS use as conveyed in the modified risk information? **NO** (100%)

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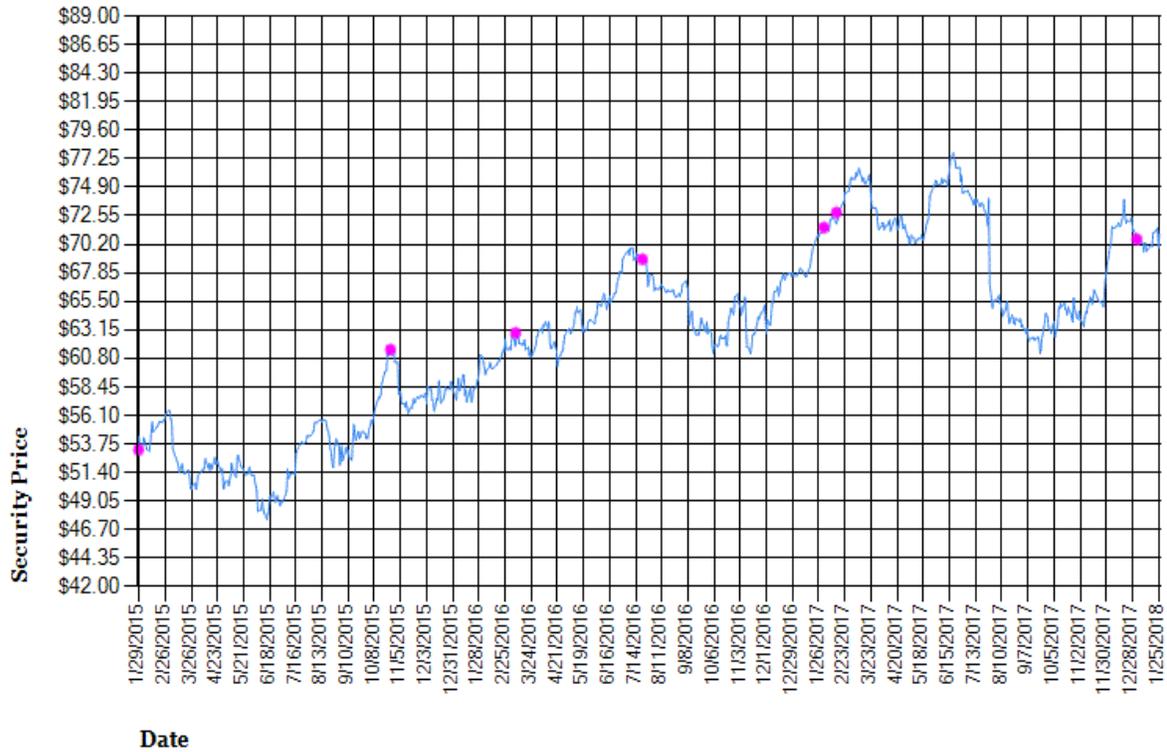
MO Thesis: We believe Altria is achieving a better balance between stabilizing Marlboro market share and growing profitably. We see further potential upside from strong pricing trends and potential of vapor/iQOS that isn't currently reflected in the stock.

Price Target Information:

MO Basis and Risks: Our price target of \$85 is based on a 15.5x forward EV/EBITDA multiple and a 20.4x forward P/E multiple—both premiums to historical averages, which we believe are justified given MO's total tobacco strategy and potential upside from iQOS. Risks include increased price competition and increased downtrading by consumers.

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Altria Group, Inc. (MO) 3-yr. Price Performance



Date	Published Price (\$)	Rating Code	Price Target	Val. Rng. Low	Val. Rng. High	Close Price (\$)	
1/27/2015		Herzog					
1/27/2015	NA	1	NE	56.00	58.00	54.56	
1/30/2015	53.10	1	NE	59.00	61.00	53.10	
10/26/2015	61.05	1	NE	64.00	66.00	61.40	
3/9/2016	62.30	1	NE	69.00	71.00	62.81	
7/22/2016	68.86	1	NE	73.00	75.00	68.86	
2/1/2017	71.39	1	NE	76.00	78.00	71.39	
2/16/2017	72.71	1	NE	79.00	81.00	72.71	
1/3/2018	70.48	1	85	NE	NE	70.48	

Source: Wells Fargo Securities, LLC estimates and Reuters data

Symbol Key

- ▼ Rating Downgrade
- ▲ Rating Upgrade
- Price Target/Val Range Change
- ◆ Initiation, Resumption, Drop or Suspend
- Analyst Change
- Split Adjustment

Rating Code Key

- 1 Outperform/Buy
- 2 Market Perform/Hold
- 3 Underperform/Sell
- SR Suspended
- NR Not Rated
- NE No Estimate

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M=Market Weight: Industry expected to perform in-line with the relevant broad market benchmark over the next 12 months.

U=Underweight: Industry expected to underperform the relevant broad market benchmark over the next 12 months.

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