We have designed this website to share information about the Altria family of companies, our growth and development, and issues of interest to our stakeholders. Therefore, although we are very proud of our tobacco companies, we have not included any cigarette brand advertising in this online version of the 2005 Annual Report, because it is not our intention to market, advertise or promote their cigarette brands on this site.

Altria

Altria Group, Inc. 2005 Annual Report

SOLID RESULTS IN 2005

Building Our Businesses

- Philip Morris USA produced solid income gains and achieved total retail share of 50%, driven by *Marlboro*.
- Philip Morris International posted strong income growth and increased its share of the world cigarette market (excluding the U.S. and worldwide duty-free) to an estimated 15%, benefiting from the acquisition of Sampoerna in Indonesia.
- Kraft Foods made continued progress in a challenging environment, with new product revenues of approximately $1.5 billion and solid top-line growth.

Improving Litigation Environment

- The litigation climate continued to evolve favorably, with greater clarity emerging as a result of key decisions.

Committed to Responsibility

- Philip Morris USA broke ground on a new Center for Research and Technology in Virginia, and continued to distribute QuitAssist™ resource guides to help smokers who have decided to quit.
- Philip Morris International continued to engage with governments and health authorities to achieve comprehensive regulation that combines fiscal policy, consumer information, licensing requirements and other measures to help reduce the harm caused by smoking.
- Kraft Foods introduced the *Sensible Solution*™ labeling program to help consumers easily identify better-for-you choices, and adopted an approach to advertising to children that addresses consumers' concerns.

Delivering Shareholder Value

- Total shareholder return was 27.7%, and Altria's market capitalization grew to more than $150 billion at year-end.
- The quarterly dividend was raised 9.6% in August 2005 to $0.80 per common share, for an annualized dividend rate of $3.20 per share.




Altria

The Family of Companies

Philip Morris USA Inc.
(100% Ownership)

Philip Morris International Inc.
(100% Ownership)

Kraft Foods Inc.
(87.2% Ownership)

Philip Morris Capital Corporation
(100% Ownership)

Other Interest:
ALG holds a 28.7% economic and voting interest in SABMiller plc

(Ownership percentages as of 12/31/05)

Table of Contents

FINANCIAL HIGHLIGHTS

Consolidated Results (in millions of dollars, except per share data)

	2005	2004	% Change
Net revenues	**$97,854**	$89,610	9.2%
Operating income	**16,592**	15,180	9.3%
Earnings from continuing operations	**10,668**	9,420	13.2%
Net earnings	**10,435**	9,416	10.8%
Basic earnings per share:			
Continuing operations	**5.15**	4.60	12.0%
Net earnings	**5.04**	4.60	9.6%
Diluted earnings per share:			
Continuing operations	**5.10**	4.57	11.6%
Net earnings	**4.99**	4.56	9.4%
Dividends declared per share	**3.06**	2.82	8.5%

Results by Business Segment

	2005	2004	% Change
Tobacco			
Domestic			
Net revenues	**$18,134**	$17,511	3.6%
Operating companies income*	**4,581**	4,405	4.0%
International			
Net revenues	**45,288**	39,536	14.5%
Operating companies income*	**7,825**	6,566	19.2%
Food			
North American			
Net revenues	**$23,293**	$22,060	5.6%
Operating companies income*	**3,831**	3,870	(1.0%)
International			
Net revenues	**10,820**	10,108	7.0%
Operating companies income*	**1,122**	933	20.3%
Financial Services			
Net revenues	**$ 319**	$ 395	(19.2%)
Operating companies income*	**31**	144	(78.5%)

* Altria Group, Inc.'s management reviews operating companies income, which is defined as operating income before corporate expenses and amortization of intangibles, to evaluate segment performance and allocate resources. For a reconciliation of operating companies income to operating income, see Note 15. *Segment Reporting*.

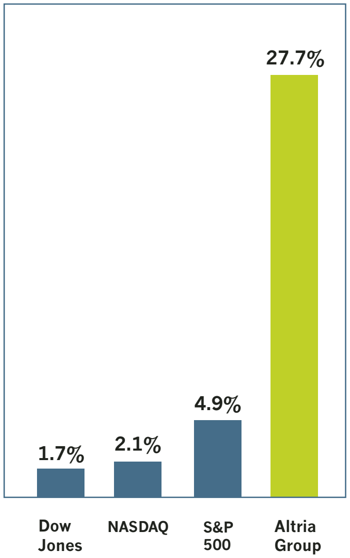
DEAR SHAREHOLDER

I am pleased to report that Altria had another successful year in 2005, and we enter 2006 confident in our ability to deliver the superior returns to our shareholders envisaged by our long-term plan.

Key accomplishments and developments last year included:

- Diluted earnings per share from continuing operations rose 11.6% to $5.10.
- Philip Morris USA (PM USA) and Philip Morris International (PMI) posted solid financial results, more than offsetting a weaker than expected performance at Kraft Foods (Kraft).
- Strategically, the highlights of 2005 were the acquisition by PMI of Sampoerna in Indonesia for $4.8 billion, followed by the announcement of a long-term alliance with the China National Tobacco Corporation (CNTC).
- In the *Engle* class action case, we are awaiting the Florida Supreme Court's decision regarding the Third District Court of Appeal's opinion, issued in May 2003, which reversed the trial court's judgment, overturned the nearly $145 billion punitive damages award and ordered decertification of the class. Oral argument before the Florida Supreme Court occurred in November 2004.
- In the *Price* case, PM USA was gratified when, in December 2005, the Illinois Supreme Court reversed the trial court's judgment of $10.1 billion for compensatory and punitive damages.
- In the *United States Government* case, the United States Court of Appeals for the District of Columbia ruled in February 2005 that disgorgement is not a remedy available in a civil RICO claim. In October 2005, the United States Supreme Court denied the government's request for a review at that time. The trial concluded in June 2005 and post-trial briefing concluded in September. We are awaiting a decision by the federal district court judge.
- Altria increased its regular quarterly dividend by 9.6% to $0.80 per common share in August 2005, representing an annualized rate of $3.20 per common share.
- Total shareholder return for our stock was 27.7% in 2005, exceeding that of the Standard & Poor's 500 Index and nearly all of Altria's peers in the consumer packaged goods industry.

2005 Total Return
Dividends and Price Appreciation



Potential Restructuring

Our solid financial performance, coupled with an improving litigation environment, has garnered the attention of the investment community and resulted in our strong stock price appreciation during 2005.

However, our stock price appreciation has trailed that of several other tobacco companies, and we continue to trade at a multiple discount to a number of them. While this has been a source of some frustration, it clearly demonstrates the significant upside potential that remains to reward our shareholders.

We have emphasized that any potential restructuring will proceed on our own timeline and that we will not act prematurely. We advanced our preparations during 2005 for a potential restructuring of the company into two, or possibly three, stand-alone entities. Continuing improvements in the entire litigation environment are a prerequisite to any restructuring. As I have previously said, the timing and chronology of events are uncertain.

2005 Results

Net revenues for the full year 2005 increased 9.2% to $97.9 billion, including favorable currency, the impact of acquisitions and the benefit of an extra shipping week at Kraft versus 2004.

Operating income increased 9.3% to $16.6 billion, reflecting favorable currency, the impact of acquisitions, the absence of the upfront expense related to the 2004 agreement PMI entered into with the European Community (E.C.), lower charges for asset impairment, implementation and exit costs, gains on sales of businesses, the reversal of a 2004 accrual related to tobacco quota buy-out legislation, higher results from operations for domestic and international tobacco, and the impact of the extra week at Kraft. These were partially offset by a larger provision in 2005 for airline industry exposure at Philip Morris Capital Corporation, a charge for PM USA's portion of the losses incurred by the federal government on the disposition of its pool tobacco stock and lower results at Kraft.

Earnings from continuing operations increased 13.2% to $10.7 billion, reflecting the items mentioned above and a lower tax rate, partially offset by higher minority interest and lower equity income from SABMiller.

Net earnings, including discontinued operations, increased 10.8% to $10.4 billion. Diluted earnings per share, including discontinued operations, increased 9.4% to $4.99.

Domestic Tobacco

In our domestic tobacco business, PM USA delivered another solid year in 2005 as it benefited from continued improvement in the U.S. cigarette industry's fundamental dynamics, principally characterized by a lack of vitality in the deep-discount segment and reductions in illegal imports.

Net revenues increased 3.6% to $18.1 billion and operating companies income increased 4.0% to $4.6 billion, primarily driven by lower wholesale promotional allowance rates and aided by reversal of a 2004 accrual related to tobacco quota buy-out legislation, partially offset by lower volume, charges for disposition of pool tobacco stock, higher R&D expenses and the accrual for the *Boeken* case.

Marlboro achieved a record retail market share of 40% in 2005, supported by numerous special events around its year-long 50th anniversary celebration and 72mm line extensions. The revamped Retail Leaders merchandising program was successfully launched, while PM USA continued at the same time to reduce costs with improved manufacturing systems and higher productivity.

PM USA took a number of actions to preserve and protect the legitimate cigarette market in the United States. These include specific actions, many in support of law enforcement and regulatory agency efforts, to address illegal sales of cigarettes over the Internet, as well as efforts to reduce the incidence of counterfeit and contraband cigarettes.

PM USA also continues to invest in developing reduced-exposure products, and to support the enactment of federal legislation to grant the Food and Drug Administration (FDA) regulatory authority over all tobacco products. Legislation was reintroduced in both the House of Representatives and the Senate in 2005, but regrettably has not been acted upon.

As it pursues its commitment to balance market share and income growth over the long term, I am confident that PM USA has the human, financial and brand wherewithal necessary to drive growth in a highly competitive industry, while exploring expansion into adjacent tobacco categories.

International Tobacco

2005 was a very good year for PMI in a challenging global environment. Its cigarette shipment volume increased by 5.7% to 804.5 billion units. Gains in many markets, particularly Egypt, France, Mexico, the Philippines, Russia, Thailand, Turkey and Ukraine, coupled with acquisitions in Indonesia and Colombia, were partially offset by lower shipments in the European Union. Excluding the impact of acquisitions, PMI's cigarette shipment volume increased 0.7% versus 2004. PMI's total

Corporate Officers

Front (left to right): **Louis C. Camilleri,** Chairman of the Board and Chief Executive Officer; **Dinyar S. Devitre,** Senior Vice President and Chief Financial Officer

Middle (left to right): **Nancy J. De Lisi,** Senior Vice President, Mergers and Acquisitions; **Steven C. Parrish,** Senior Vice President, Corporate Affairs; **G. Penn Holsenbeck,** Vice President, Associate General Counsel and Corporate Secretary; **David I. Greenberg,** Senior Vice President and Chief Compliance Officer; **Amy J. Engel,** Vice President and Treasurer

Back (left to right): **Walter V. Smith,** Vice President, Taxes; **Charles R. Wall,** Senior Vice President and General Counsel; **Joseph A. Tiesi,** Vice President and Controller tobacco volume, which included 7.1 billion cigarette equivalent units of other tobacco products (OTPs), grew 6.1% versus 2004, and 1.2% excluding acquisitions.

Operating companies income rose 19.2%, or $1.3 billion, to $7.8 billion, due primarily to higher pricing, as well as the impact of acquisitions, positive currency, higher income from the return of the *Marlboro* license in Japan, the impact of a one-time inventory sale in Italy and a favorable comparison with 2004 when PMI recorded a charge for the E.C. agreement. These were partially offset by unfavorable volume/mix, higher R&D, manufacturing, distribution, trade and selling expenses, and higher asset impairment and exit costs.

PMI continued to outperform its principal competitors in terms of both volume and income. Its share of the world market (excluding the U.S. and worldwide duty-free) reached an estimated 15%, up 0.5 share points versus 2004, driven by its superior brand portfolio and leadership in key growth segments such as premium and menthol.

Excise tax increases undoubtedly present PMI with a significant challenge. It is not just a question of tax incidence, but tax structure. Inappropriate structures distort markets by providing consumers with incentives to switch to substitute products or trade down to cheap and marginally profitable cigarette products.

PMI had considerable success in 2005 in advocating fair tax structures as several key countries adopted either absolute minimum reference price (MRP) or minimum excise tax (MET) levels. Most noteworthy was the adoption of an MRP in both Italy and Belgium, and the reform of taxes in Turkey. In Spain, an MET was introduced in February 2006, though it remains to be seen if its level is sufficient to achieve the government's health and fiscal objectives.

In fact, 20 of PMI's top 25 markets currently have in place either an MET, MRP or single-tier specific tax regime, up from 15 in 2004. In addition, some progress was achieved in securing equal tax treatment of all tobacco products, particularly in Germany, where tobacco portions will be taxed at the same rate as cigarettes for products manufactured as of April 1, 2006.

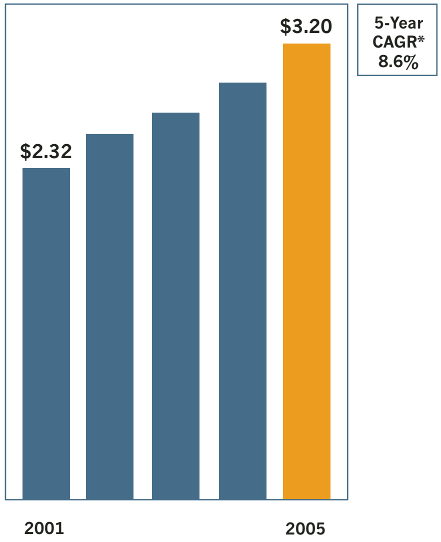
Less than 5% of PMI's income today is derived from markets that account for combined cigarette consumption of 3.1 trillion cigarettes, or about 60% of the total international market of more than five trillion cigarettes. PMI has strategies in place that focus on expanding in those markets, either organically or through acquisitions.

The Sampoerna and Coltabaco acquisitions in 2005 are the most recent examples, offering PMI market share leadership in both Indonesia and Colombia, with aggregate consumption of 240 billion units.

Another example is PMI's late-2005 announcement of a strategic alliance with the CNTC, which sets the stage for long-term growth in China through the licensed manufacture and sale of *Marlboro* in China and the formation of an international joint venture, equally owned by PMI and the CNTC. The joint venture will offer a portfolio of Chinese heritage brands globally and pursue other business development opportunities.

Looking ahead, I remain confident in PMI's ability to generate strong results while successfully confronting the inevitable surprises, both good and bad, based on its unparalleled global infrastructure, outstanding brand portfolio and talented workforce.

Altria Group, Inc.
Annualized Dividend Rate
Per Share



*Compound Annual Growth Rate

Food

Kraft's 2005 results were a source of disappointment. The principal culprit was the surge in commodity costs, which increased $800 million in 2005, on top of a $900 million increase in 2004, for a total of $1.7 billion over a two-year period.

For the full year 2005, Kraft's net revenues were up 6.0% to $34.1 billion, reflecting pricing, positive mix, favorable currency and the impact of an extra shipping week versus 2004.

Ongoing volume was up approximately 2%, but was essentially flat on a comparable 52-week basis. Operating income increased 3.0% to $4.8 billion, driven by positive mix, productivity and restructuring savings, lower restructuring and impairment costs, favorable currency, gains on sales of businesses and brands, and the extra week. These were partially offset by higher commodity costs, and increased benefit costs and marketing support.

New products such as the *South Beach Diet* line helped drive the top line at Kraft, with new products generating record revenues of approximately $1.5 billion in 2005. Importantly, new products are generating margin levels that are significantly higher than the Kraft average and have suffered from significantly less cannibalization than in the past. In addition, developing market revenues were very strong in 2005, with a particularly robust performance in Russia.

Kraft's restructuring program, originally announced in early 2004, remains on track and achieved cumulative cost savings of approximately $260 million through 2005. An expansion of the program was announced by Kraft early in 2006, which includes further organizational streamlining, facility closures and other simplification initiatives. The expanded plan anticipates total cumulative annualized cost savings of $1.15 billion and total estimated costs of $3.7 billion by 2009.

I believe that the flawless execution of Kraft's growth strategies, combined with its expanded restructuring program, will achieve the desired results.

Philip Morris Capital Corporation and SABMiller

The troubled airline industry cast a shadow once again on otherwise strong progress and good income performance at Philip Morris Capital Corporation. Operating companies income was $31 million for the full year 2005, versus $144 million for 2004. Results for 2005 include a $200 million increase to the provision for losses related to the airline industry in the third quarter and lower gains from asset sales, partially offset by lower interest expense.

SABMiller continues to perform strongly, despite ferocious competition in the U.S. domestic beer market. The global stock market has reacted favorably to SABMiller's acquisition of Bavaria, which holds the lion's share of the brewing industry in Colombia, Ecuador and Peru. As a result of this transaction, Altria's equity stake in the enlarged company was reduced to 28.7% from 33.9%, while our voting interest increased to 28.7% from 24.9%. Altria's economic interest in SABMiller is currently valued on a pre-tax basis at approximately $8.5 billion.

Improving Litigation Environment

Recent trends reinforce our belief that the litigation climate continues to evolve favorably and that greater clarity is slowly, but surely, emerging.

In addition to the favorable development in the *Price* case mentioned earlier, we were encouraged by developments during 2005 in other "Lights" cases.

In August 2005, the United States Court of Appeals for the Eighth Circuit, in the *Watson* case, affirmed removal of this "Lights" case from state to federal court, because the court found that PM USA was acting under the direction and control of the Federal Trade Commission (FTC) in relation to tar and nicotine testing, measurement and disclosures. While plaintiffs have indicated that they intend to seek United States Supreme Court review of this decision, we believe that this ruling has important ramifications going forward.

In October 2005, a state court in Oregon in the *Pearson* case, also involving PM USA, refused to certify this "Lights" case as a class action. As is true in the vast majority of smoking and health personal injury class actions, the court in *Pearson* found that individual issues predominate over common ones, upholding a view we believe is fundamental to all "Lights" class actions, and renders class certification inappropriate.

And, shortly before and after the favorable *Pearson* decision, federal district courts in Michigan and Louisiana, in "Lights" cases called *Flanagan* and *Sullivan*, dismissed the plaintiffs' major claims based on those states' Consumer Protection Statutes because those statutes exempt claims based upon conduct specifically authorized by or in compliance with FTC action. Both courts found that plaintiffs' claims were based on conduct governed by the FTC's decades-long regulatory activity involving low tar and "Lights" cigarettes, and thus fell within the statutory exemptions. This general type of statutory exemption exists in most states, including Illinois.

Of the 24 pending "Lights" cases, five are presently certified as class actions, three of which are on appeal, with the remaining two subject to pre-trial motions. Of the remaining 19, including *Schwab*, a purported nationwide class action pending before the Federal District Court for the Eastern District of New York, all are in various pre-trial stages in the trial courts, with decisions on class certification and other issues to come.

While we are pleased with the recent positive trend in these cases, they remain an important part of the evolving litigation environment, as well as a particular focus of our attention and resources.

Although the litigation record in 2005 was very positive, it was not totally unblemished. PM USA lost the *Rose* case in New York, one of five individual cases tried during the year, and this case is now on appeal. With regard to appeals in other individual cases, the United States Supreme Court denied PM USA's request for review in the *Henley* case in California and the judgment of $17 million (which includes $6.4 million in interest) was paid to the plaintiff. In the *Boeken* case, the California Supreme Court denied PM USA's appeal. A petition for review has been filed with the United States Supreme Court and an accrual was recorded by PM USA. In the *Williams-Branch* case, PM USA will seek review by the United States Supreme Court after the Oregon Supreme Court affirmed a $79.5 million punitive damages jury verdict.

As we await further developments this year, I urge you to have patience, remembering that the legal system in the United States moves at a deliberate pace. I believe that our litigation history teaches that patience and perseverance will ultimately be rewarded. For a more complete review of litigation, I refer you to Note 19 to the Consolidated Financial Statements in this report.

Corporate Governance and Board Developments

The 2006 proxy statement contains a comprehensive description of your Board of Directors and its committees, as well as the nominees for election to the Board at the 2006 Annual Meeting of Shareholders. I urge you to read the full statement and return your proxy card as soon as possible with your vote.

I want to express my heartfelt gratitude to Carlos Slim Helú, who will not be standing for re-election to the Board of Directors in April 2006. Since joining the Board in 1997, he has made many invaluable contributions to Altria, as we examined strategic opportunities and planned our future course. We will sorely miss his tremendous insight and acumen, particularly in the realm of international business, and thank him for his service as a Director.

Our operating companies and corporate departments are governed by a strong, comprehensive set of explicit, enterprise-wide standards that make it clear that nothing is more important than compliance and integrity. I suggest that you review the Responsibility section of this report, as well as our corporate website, for additional information on these topics.

Outlook

Looking ahead, we expect the considerable momentum evident in our 2005 results to continue. However, the current strength of the U.S. dollar and circumstances affecting some of PMI's key markets, most notably Spain, dictate a cautious earnings outlook at this point. In addition, Kraft's restructuring costs and the inclusion of an extra week of results at Kraft in 2005 will make for difficult comparisons.

Despite these short-term challenges, I am confident that strategic actions by our individual businesses and continued improvement in the litigation and legislative environment will move us toward our long-term goals.

Overall, I believe that Altria Group is well positioned and equipped to seize the opportunities that will arise, and to overcome the inevitable challenges that we will confront. Most importantly, all our operating companies are investing in innovation, and each has an impressive pipeline of new products to drive future growth.

Of course, none of our achievements would have been possible without the personal commitment, passion, resilience and determination of our employees. I salute and thank them, along with our shareholders, for their continued support.

Louis C. Camilleri
Chairman of the Board and
Chief Executive Officer
March 10, 2006

PHILIP MORRIS USA INC.

2005 Business Review

We have designed this website to share information about the Altria family of companies, our growth and development, and issues of interest to our stakeholders. Therefore, although we are very proud of our tobacco companies, we have not included any cigarette brand advertising in this online version of the 2005 Annual Report, because it is not our intention to market, advertise or promote their cigarette brands on this site.

Michael E. Szymanczyk
Chairman and
Chief Executive Officer

Domestic Tobacco

Philip Morris USA Inc. (PM USA) achieved a record 50.0% total retail share in a highly competitive environment during 2005, and produced solid income gains for the year. **Shipment volume was down 0.8% to 185.5 billion units,** but was estimated to be essentially flat when adjusted for the timing of promotional shipments and trade inventory changes, and two fewer shipping days versus 2004. Premium mix increased 0.2 percentage points to 91.6%.

Operating companies income increased 4.0% to $4.6 billion, primarily driven by lower wholesale promotional allowance rates and aided by the reversal of a 2004 accrual related to tobacco quota buy-out legislation, partially offset by lower volume, charges for the disposition of pool tobacco stock, higher R&D expenses and a $56 million accrual for the *Boeken* case.

Total retail share for PM USA increased 0.2 share points to a record 50.0%, driven by *Marlboro*. Retail share for *Marlboro* increased 0.5 share points to a record 40.0% in 2005, while retail share was essentially stable for PM USA's other focus premium brands. *Parliament* held a 1.7% retail share in 2005, while *Virginia Slims'* retail share was down 0.1 share point to 2.3%.

The premium category increased 0.4 share points to 73.6% of the total U.S. cigarette industry in 2005, led by *Marlboro.*

Parliament and *Virginia Slims* performed well in a highly competitive environment.

PM USA's retail share of the premium category was stable at 62.1%, while its share of the declining discount category increased 0.2 share points to 16.3%, reflecting the performance of *Basic*, its major discount brand. Retail share was flat at 11.8% for the deep-discount segment of the industry, which includes both major manufacturers' private label brands and all other manufacturers' discount brands. Retail share amounts and records mentioned above are based on the IRI/Capstone Total Retail Panel, which was developed to measure market share in retail stores selling cigarettes. It is not designed to capture Internet or direct-mail sales.

During 2005, a number of efforts contributed to a decline in illegal cigarette sales over the Internet, which historically has been a conduit for federal and state excise tax avoidance and illegal imports. Importantly, major credit card and package delivery companies agreed to take steps to prohibit the use of their services for illegal Internet cigarette sales. PM USA continued to support criminal prosecution of counterfeit importer and distributor networks by law enforcement agencies, and pursued civil litigation against counterfeiters of its *Marlboro* brand. Additionally, it supported federal and state legislation aimed at stopping the illegal trade in cigarettes. During 2005, 17 states passed legislation that takes positive steps to curb this illegal activity. In early 2006, PM USA joined with 37 attorneys general to establish protocols aimed at combating illegal sales of its cigarettes over the Internet or by mail, telephone or fax.

PM USA continued to invest for the future and to explore opportunities for growth. Several new cigarette products that incorporate novel filter technology, including *Marlboro* UltraSmooth, were introduced into test markets during 2005 to gauge adult smoker acceptance of their taste. In addition, PM USA announced a tobacco category adjacency growth strategy to develop new revenue and income sources for the future. It will make significant investments in product development, consumer research and other areas to develop this strategy. For example, it is investing an estimated $350 million for a Center for Research and Technology in Richmond, Virginia. The Center will be dedicated to enhancing scientific research, new product development and commercialization of products that might help address the harm caused by smoking.

PM USA continued to address societal concerns about smoking by, among other things, communicating about the health effects of cigarette smoking, helping to prevent youth smoking and helping to connect adult smokers who have decided to quit smoking with expert quitting information. More information and resources are available in both English and Spanish at www.philipmorrisusa.com. PM USA's website also includes the Parent Resource Center and QuitAssist™. The Parent Resource Center provides parents with tips and tools to help them talk to their kids about not smoking. QuitAssist™ is an information resource designed to help connect smokers who have decided to quit with expert quitting information from public health authorities and others.

PHILIP MORRIS INTERNATIONAL INC.

We have designed this website to share information about the Altria family of companies, our growth and development, and issues of interest to our stakeholders. Therefore, although we are very proud of our tobacco companies, we have not included any cigarette brand advertising in this online version of the 2005 Annual Report, because it is not our intention to market, advertise or promote their cigarette brands on this site.

André Calantzopoulos
President and
Chief Executive Officer

International Tobacco

Philip Morris International Inc. (PMI) achieved record financial results in 2005, aided by positive currency and income from acquisitions, and increased its share in numerous markets.

Cigarette shipment volume increased 5.7% to 804.5 billion units, with widespread gains in many markets, and acquisitions in Indonesia and Colombia, partially offset by lower shipments in the European Union. Total *Marlboro* cigarette shipments increased 2.0% to 322.1 billion units, with gains in Eastern Europe, the Middle East & Africa, as well as higher inventories in Japan following the expiration of the *Marlboro* license with Japan Tobacco in May and the one-time inventory sale to a new distributor in Italy, partially offset by declines in Germany and worldwide duty-free. Share gains for *Marlboro* were achieved in the top income markets of Egypt, France, Japan, Mexico, Portugal, Russia, Turkey, Ukraine and the United Kingdom.

Operating companies income rose 19.2% to $7.8 billion, due primarily to higher pricing, as well as the impact of acquisitions, positive currency, higher income following the expiration of the *Marlboro* license in Japan, the impact of the one-time inventory sale in Italy and a favorable comparison with 2004 when PMI recorded a $250 million charge for the E.C. agreement. These were partially offset by unfavorable volume/mix, higher R&D, manufacturing, distribution, trade and selling expenses, and higher asset impairment and exit costs.

In the EU region, cigarette volume was down 2.7%, primarily due to Germany, where tax-advantaged tobacco portions replaced a significant volume of cigarettes in the market. During the fourth quarter of 2005, the European Court of Justice issued a mandate that requires the German government to equalize the tax burden between cigarettes and tobacco portions. As a result, consumption of lower-priced portions is expected to decline once high stock levels are depleted. For the full year, PMI's cigarette market share was down 0.2 share points to 36.6%, while its share of the tobacco portions market increased 9.1 share points to 16.9%.

In France, PMI's volume and share performance in 2005 were robust, reflecting an improved pricing environment and moderate price gaps. Shipments rose 2.5%, and share grew from 39.8% to 41.7%, based on strong performances by *Marlboro* and the *Philip Morris* brand.

In Italy, PMI's cigarette shipment volume increased 2.7%, due primarily to the one-time inventory sale to PMI's new distributor. Excluding the one-time inventory sale of 3.0 billion units, shipment volume in Italy was down 3.2%, reflecting a decline in the total cigarette market of 6.1% in 2005, largely due to tax-driven pricing and the impact of indoor smoking restrictions in public places. PMI's share improved to 52.6%, driven by *Diana*.

In Spain, PMI's shipments were down 2.2%, reflecting increased consumer down-trading to the deep-discount segment, which expanded to 20% for the full year 2005, double its 2004 share, and surged to a 31.2% share in the fourth quarter. As a result of growing price gaps, PMI's share declined 1.1 share points to 34.5% for the full year, and declined 3.4 share points to 31.5% in the fourth quarter. In January 2006, PMI reduced its cigarette prices to restore the competitiveness of its brands following an excise tax increase. In February 2006, PMI announced a return to previous price levels for its major brands, subsequent to the introduction of a minimum excise tax.

In Eastern Europe, the Middle East & Africa, volume was up 6.4%, due mainly to increases in Egypt, Russia, Turkey and Ukraine. Shipments in Russia were up 2.7%, and market share rose 0.7 share points to 27.0%, due to the continued success of *Marlboro*, *Muratti*, *Parliament*, *Next* and *Chesterfield*. In Turkey, volume was up 8.6%, and market share increased 4.4 share points to 41.4%, fueled by the growth of *Marlboro*, *Parliament*, *Lark* and *Bond Street*. Improved economic conditions and continued up-trading to *Marlboro*, *Chesterfield*, *L&M* and *Bond Street* drove the increase in Ukraine.

In Asia, volume increased 21.3%, primarily due to the acquisition of Sampoerna in Indonesia. Excluding Sampoerna, volume was essentially stable. PMI achieved a full-year 26.1% share in Indonesia, driven by *A Mild*, *Dji Sam Soe* and *A Hijau*. In Japan, PMI's shipments were down slightly in a total market that declined 2.8%. Market share rose 0.3 share points to a record 24.8%, driven by *Marlboro* and *Virginia Slims*. In Korea, PMI's shipments declined 11.8% in a total market that declined more than 20%. PMI's market share in Korea grew 0.9 share points to 8.3%, driven by *Marlboro* and *Parliament*.

In Latin America, PMI's volume increased 5.5%, reflecting the acquisition of Coltabaco in Colombia and higher shipments in Mexico, partially offset by declines in Argentina and Brazil. Excluding the impact of acquisitions, volume was down 3.8%. In Mexico, PMI's shipments increased 1.0%, and its market share rose 1.9 share points to 62.1%, driven by *Marlboro*'s continued momentum, while the total cigarette industry declined 1.5%. In Argentina, PMI's shipments were down 7.0% versus a total market decline of 1.4%. PMI's share declined 3.7 share points to 61.4% in Argentina, due to a surge in the ultra-low-price segment.

PMI supports meaningful and effective tobacco regulation in every country where it does business. It is marketing its products responsibly and communicating with consumers regarding important tobacco issues. More information on PMI's business and responsibility initiatives is available at www.philipmorrisinternational.com.

Strong performance by *Marlboro* helped drive PMI's market share in France to 41.7%, up nearly two share points.

In Russia, PMI's market share rose 0.7 share points to 27% fueled by its superb international brand portfolio.

In Indonesia, PMI's market share reached 26.1% with the acquisition of Sampoerna and its leading local kretek brands, including *Dji Sam Soe*.

KRAFT FOODS INC.

A separate Kraft Foods Inc. Annual Report is available at www.kraft.com.

Roger K. Deromedi
Chief Executive Officer

Kraft Foods Inc. (Kraft), the world's second-largest packaged food and beverage company, achieved higher revenues and operating income in a challenging environment in 2005.

Net revenues increased 6.0% to $34.1 billion for the full year, reflecting pricing, positive mix, favorable currency and the impact of an extra shipping week in 2005. Ongoing constant-currency revenues were up approximately 3% on a 52-week basis, and increased approximately 8% in developing markets, with particularly strong growth in Russia. Ongoing volume was up approximately 2%, but was essentially flat on a comparable 52-week basis, including a 0.7 point benefit from acquisitions. Factors contributing to the volume softness included Kraft's focus on mix improvement, its stock keeping unit (SKU) reduction program and the impact of pricing.

Strong new product results produced revenues of approximately $1.5 billion in 2005. Launch of the *South Beach Diet* line exceeded Kraft's expectations and achieved revenues of approximately $170 million in 2005.

Operating income increased 3.0% to $4.8 billion, driven by positive mix, productivity and restructuring savings, lower restructuring and impairment costs, favorable currency, gains on sales of businesses and brands, and the extra week. These were partially offset by significantly higher commodity costs (net of pricing), increased benefit costs and increased consumer marketing support.

Commodity costs increased more than $800 million in 2005, with pricing actions only partially offsetting the impact of higher costs. Kraft expects many of the cost pressures faced in 2005 to continue, and in January 2006 announced plans to expand its cost restructuring program. Additional organizational streamlining and facility closures will continue to build on the success of the program. The expanded initiatives are expected to add approximately $700 million in cumulative annualized cost savings by 2009, for a total of $1.15 billion. The expanded program will add approximately $2.5 billion in costs for total estimated costs of $3.7 billion by 2009.




Kraft is focusing on new product ideas that address large, unmet consumer needs and offer the potential for geographic expansion. It also is investing in leadership initiatives including product reformulations to enhance nutrition and reduce fat, and an approach to advertising to children that addresses consumers' concerns.

North American Food

Kraft North America Commercial (KNAC) net revenues grew 5.6% to $23.3 billion, reflecting positive mix, net pricing, the benefit of the extra week and favorable currency. Ongoing volume increased 2.8%, or approximately 1% adjusted for the extra week, with market shares up across several of Kraft's top 25 U.S. categories. Operating companies income declined 1.0% to $3.8 billion, with increased post-employment benefit costs, higher commodity costs, net of pricing, and increased marketing spending, partially offset by productivity and restructuring savings, volume growth, positive mix, lower restructuring and impairment charges, the benefit of the extra week and favorable currency.

International Food

Kraft International Commercial (KIC) net revenues increased 7.0% to $10.8 billion, reflecting growth in both Europe, Middle East & Africa, and Latin America & Asia Pacific, as well as favorable currency and the extra week. Ongoing volume was down 0.6%, or approximately 3% adjusted for the impact of the extra week. Operating companies income increased 20.3% to $1.1 billion, benefiting from lower restructuring and impairment charges, a gain on sale of brands and related assets, positive mix, favorable currency and the extra week, partially offset by higher commodity costs, net of pricing, increased developing market infrastructure costs and lost income from divestitures.

In 2005, Kraft invested in launching the *Tassimo* hot beverage system in Germany, Switzerland, the United Kingdom and the U.S.

New products such as the *South Beach Diet* line helped drive solid top-line growth at Kraft.

RESPONSIBILITY

Responsibility is a top priority at the Altria family of companies. It is integral to the way we do business and build trust with society.

Compliance and Integrity

At Altria, we are determined to conduct business with integrity, and in full compliance with the letter and spirit of the law. Our efforts are guided by Altria's Standards for Compliance and Integrity, and the Altria Code of Conduct. In 2005, each operating company developed unique programs to continue to embed compliance and integrity into its business. For example, Kraft implemented a "speaking up" policy, reinforcing employees' obligations to ask legal and ethical questions and report misconduct. PMI developed a global compliance infrastructure, and PM USA created the PM USA Compliance Institute to educate employees and enhance its culture of responsibility. Altria and our operating companies strive to foster ethical environments in which all employees understand the right thing to do, know how and where to get help, and feel empowered to take action should they encounter a compliance issue. We are continually working to improve upon our existing initiatives to help ensure that we are meeting the requirements of the law and the needs of our employees.

People

We recognize that diverse and talented employees are key to our success. Each of our operating companies is committed to employee development and providing a workplace that promotes fairness, safety and inclusion.

Altria ranked Number One in DiversityInc's "Top 50 Companies for Diversity," and received the National Minority Business Council's "Outstanding Corporate Supplier Diversity Award" for 2005. Kraft received a top score on the Human Rights Campaign Foundation's Corporate Equality Index. Both PMI and PM USA are members of the Eliminating Child Labour in Tobacco-Growing Foundation, while Kraft supports the International Cocoa Initiative to eliminate child labor and forced labor.

Environment

In 2005, our operating companies continued efforts to reduce the environmental impact of their activities, promote sustainable natural resources and enhance environmental awareness. PM USA supported the Keep America Beautiful® Cigarette Litter Prevention Program, and both PMI and PM USA helped tobacco farmers manage resources and improve efficiency. Kraft purchased more than 13 million pounds of Rainforest Alliance-certified coffee and received its "Corporate Green Globe Award" for the company's commitment to sustainable coffee production.

Communities

Altria companies contribute major support to not-for-profit organizations around the world. In 2005, we aided people and communities recovering from natural disasters, helped feed the hungry, assisted victims of domestic violence and supported the arts. By working closely with leaders in the field, we addressed existing and emerging service gaps, and supported collaborative long-term strategies to improve services and programs.

> When hurricanes devastated New Orleans and the Gulf Coast, Altria donated almost $5 million toward relief and reconstruction.

Left: Kraft employee, Jiyun Song, helps preschoolers learn the alphabet on Kraft Cares Day.

Right: Altria Group supported hunger relief programs including the Food Bank for New York City.

Following the unprecedented hurricane season of 2005 and the devastation caused by Katrina, we committed nearly $5 million for relief and reconstruction efforts, particularly on the Gulf Coast. We partnered with disaster relief organizations including the American Red Cross and AmeriCares. Internationally, PMI provided support for victims of the earthquake in Pakistan and flooding in Mexico, El Salvador and Guatemala.

As part of our commitment to address the issue of hunger, the Altria companies supported more than 500 organizations that provide food and nutrition services. Grants totaled over $12.8 million in 2005. These included local meals-on-wheels deliveries and initiatives to improve programs for people living with HIV/AIDS and other critical illnesses. Kraft funded community-based nutrition programs worldwide, including Salsa, Sabor y Salud in the U.S., partnering with the National Latino Children's Institute to promote healthy lifestyles for Latino families. Kraft also supported Health 4 Schools, an initiative in the United Kingdom to encourage life-long healthy eating habits. PMI supported programs around the world to improve food security, reforestation and irrigation.

Since establishing its groundbreaking domestic violence prevention program in 1998, the Altria family of companies has awarded over $45 million to organizations that provide critical services. In 2005, in partnership with the National Network to End Domestic Violence, Altria granted almost $4.5 million to support legal advocacy and shelter services that help victims become survivors. In Europe, PMI supported domestic violence response training and shelter programs.

Altria continued its long-time support of the arts, providing more than 700 grants to dance, theatre and visual arts organizations across the country. Major sponsorships included the *Visual Music* exhibition at the Smithsonian Institution's Hirshhorn Museum and Sculpture Garden in Washington, D.C., and the national tour of the Mark Morris Dance Group. In Richmond, Virginia, PM USA supported the ArtsFund, whose mission is to promote business support for arts and cultural organizations.

Employee Involvement

Our commitment to strengthening and improving communities is much more than the sum of our grant-making at Altria. Our employees continue to be involved in the communities where they live and work, giving generously of their time and money. Through our Employee Funds, Matching Gifts, Dollars for Doers and other initiatives, more than $8.5 million was granted to not-for-profit organizations in 2005.

More information is available at www.altria.com/responsibility.

FINANCIAL REVIEW

Financial Contents

Guide to Select Disclosures

For easy reference, areas that may be of interest to investors are highlighted in the index below.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Description of the Company

Throughout Management's Discussion and Analysis of Financial Condition and Results of Operations, the term "Altria Group, Inc." refers to the consolidated financial position, results of operations and cash flows of the Altria family of companies and the term "ALG" refers solely to the parent company. ALG's wholly-owned subsidiaries, Philip Morris USA Inc. ("PM USA") and Philip Morris International Inc. ("PMI"), and its majority-owned (87.2% as of December 31, 2005) subsidiary, Kraft Foods Inc. ("Kraft"), are engaged in the manufacture and sale of various consumer products, including cigarettes and other tobacco products, packaged grocery products, snacks, beverages, cheese and convenient meals. Philip Morris Capital Corporation ("PMCC"), another wholly-owned subsidiary, maintains a portfolio of leveraged and direct finance leases. In addition, ALG had a 28.7% economic and voting interest in SABMiller plc ("SABMiller") at December 31, 2005. ALG's access to the operating cash flows of its subsidiaries consists of cash received from the payment of dividends and interest, and the repayment of amounts borrowed from ALG by its subsidiaries.

As previously communicated, for significant business reasons, the Board of Directors is looking at a number of restructuring alternatives, including the possibility of separating Altria Group, Inc. into two, or potentially three, independent entities. Continuing improvements in the entire litigation environment are a prerequisite to such action by the Board of Directors, and the timing and chronology of events are uncertain.

In June 2005, Kraft sold substantially all of its sugar confectionery business for pre-tax proceeds of approximately $1.4 billion. Altria Group, Inc. has reflected the results of Kraft's sugar confectionery business prior to the closing date as discontinued operations on the consolidated statements of earnings for all years presented. The assets related to the sugar confectionery business were reflected as assets of discontinued operations held for sale on the consolidated balance sheet at December 31, 2004.

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

Sampoerna's financial position and results of operations have been fully consolidated with PMI as of June 1, 2005. From March 2005 to May 2005, PMI recorded equity earnings in Sampoerna. Sampoerna contributed $315 million of operating income and $128 million of net earnings since March 2005.

Kraft's operating subsidiaries generally report year-end results as of the Saturday closest to the end of each year. This resulted in fifty-three weeks of operating results for Kraft in the consolidated statement of earnings for the year ended December 31, 2005, versus fifty-two weeks for the years ended December 31, 2004 and 2003.

Executive Summary

The following executive summary is intended to provide significant highlights of the Discussion and Analysis that follows.

■ **Consolidated Operating Results**—The changes in Altria Group, Inc.'s earnings from continuing operations and diluted earnings per share ("EPS") from continuing operations for the year ended December 31, 2005, from the year ended December 31, 2004, were due primarily to the following:

(in millions, except per share data)	Earnings from Continuing Operations	Diluted EPS from Continuing Operations
For the year ended December 31, 2004	$ 9,420	$ 4.57
2004 Domestic tobacco headquarters relocation charges	20	0.01
2004 International tobacco E.C. agreement	161	0.08
2004 Asset impairment, exit and implementation costs	446	0.21
2004 Loss on sales of businesses	2	—
2004 Investment impairment	26	0.01
2004 Provision for airline industry exposure	85	0.04
2004 Tax items	(419)	(0.20)
2004 Gains from investments at SABMiller	(111)	(0.05)
Subtotal 2004 items	210	0.10
2005 Domestic tobacco headquarters relocation charges	(2)	—
2005 Domestic tobacco loss on U.S. tobacco pool	(87)	(0.04)
2005 Domestic tobacco quota buy-out	72	0.03
2005 Asset impairment, exit and implementation costs	(426)	(0.21)
2005 Tax items	521	0.25
2005 Gains on sales of businesses, net	60	0.03
2005 Provision for airline industry exposure	(129)	(0.06)
Subtotal 2005 items	9	—
Currency	272	0.13
Change in effective tax rate	332	0.16
Higher shares outstanding		(0.07)
Operations (including the impact of Kraft's 53rd week)	425	0.21
For the year ended December 31, 2005	$10,668	$ 5.10

See discussion of events affecting the comparability of statement of earnings amounts in the Consolidated Operating Results section of the following Discussion and Analysis. Amounts shown above that relate to Kraft are reported net of the related minority interest impact.

■ **Domestic Tobacco Loss on U.S. Tobacco Pool**—As further discussed in Note 19. *Contingencies*, in October 2004, the Fair and Equitable Tobacco Reform Act of 2004 ("FETRA") was signed into law. Under the provisions of FETRA, PM USA was obligated to cover its share of potential losses that the government may incur on the disposition of pool tobacco stock accumulated under the previous tobacco price support program. In 2005, PM USA recorded a $138 million pre-tax expense for its share of the loss.

■ **Domestic Tobacco Quota Buy-Out**—The provisions of FETRA require PM USA, along with other manufacturers and importers of tobacco products, to make quarterly payments that will be used to compensate tobacco growers and quota holders affected by the legislation. Payments made by PM USA under FETRA will offset amounts due under the provisions of the National Tobacco Grower Settlement Trust ("NTGST"), a trust formerly established to compensate tobacco growers and quota holders. Disputes arose as to the applicability of FETRA to 2004 NTGST payments. During the third quarter of 2005, a North Carolina Supreme Court ruling determined that FETRA enactment had not triggered the offset provisions during 2004 and that tobacco companies were required to make full payment to the NTGST for the full year of 2004. The ruling, along with FETRA billings from the United States Department of Agriculture ("USDA"), established that FETRA was effective beginning in 2005. Accordingly, during the third quarter of 2005, PM USA reversed a prior year pre-tax accrual for FETRA payments in the amount of $115 million.

■ **Asset Impairment, Exit and Implementation Costs** — In January 2004, Kraft announced a three-year restructuring program. During the years ended December 31, 2005 and 2004, Kraft recorded pre-tax charges of $297 million ($178 million after taxes and minority interest) and $633 million ($356 million after taxes and minority interest), respectively, for the restructuring plan, including pre-tax implementation costs of $87 million and $50 million, respectively. In addition, in January 2006, Kraft announced plans to expand its restructuring efforts beyond those originally contemplated. Additional pre-tax charges are anticipated to be $2.5 billion from 2006 to 2009, reflecting additional organizational streamlining and facility closures. The entire program is expected to ultimately result in $3.7 billion in pre-tax charges, the closure of up to 40 facilities and the elimination of approximately 14,000 positions. Approximately $2.3 billion of the $3.7 billion in pre-tax charges are expected to require cash payments.

During 2005, Kraft incurred pre-tax asset impairment charges of $269 million ($151 million after taxes and minority interest), relating to the sale of its fruit snacks assets and the pending sales of certain assets in Canada and a small biscuit brand in the United States. In addition, during 2005, PMI and Altria Group, Inc. recorded pre-tax asset impairment and exit costs of $139 million ($97 million after taxes). *For further details on the restructuring program or asset impairment, exit and implementation costs, see Note 3 to the Consolidated Financial Statements and the Food Business Environment section of the following Discussion and Analysis.*

■ **International Tobacco E.C. Agreement** — In July 2004, PMI entered into an agreement with the European Commission ("E.C.") and 10 member states of the European Union that provides for broad cooperation with European law enforcement agencies on anti-contraband and anti-counterfeit efforts. Under the terms of the agreement, PMI will make 13 payments over 12 years, including an initial payment of $250 million, which was recorded as a pre-tax charge against its earnings in 2004.

■ **Gains on Sales of Businesses, net** — The favorable impact is due primarily to the gain on sale of Kraft's U.K. desserts assets in 2005.

■ **Provision for Airline Industry Exposure** — As discussed in Note 8. *Finance Assets, net,* during 2005, PMCC increased its allowance for losses by $200 million, reflecting its exposure to the troubled airline industry, particularly to Delta Air Lines, Inc. ("Delta") and Northwest Airlines, Inc. ("Northwest"), both of which filed for bankruptcy protection during 2005. During 2004, in recognition of the economic downturn in the airline industry, PMCC increased its allowance for losses by $140 million.

■ **Currency** — The favorable currency impact on earnings from continuing operations and diluted EPS from continuing operations is due primarily to the weakness of the U.S. dollar versus the euro, Japanese yen and Central and Eastern European currencies.

■ **Income taxes** — Altria Group, Inc.'s effective tax rate decreased by 2.5 percentage points to 29.9%. The 2005 effective tax rate includes a $372 million benefit related to dividend repatriation under the American Jobs Creation Act in 2005, the reversal of $82 million of tax accruals no longer required at Kraft, as well as other benefits, including the impact of the domestic manufacturers' deduction under the American Jobs Creation Act and lower repatriation costs. The 2004 effective tax rate includes the reversal of $355 million of tax accruals that are no longer required due to foreign tax events that were resolved during 2004, and an $81 million favorable resolution of an outstanding tax item at Kraft.

■ **Shares Outstanding** — Higher shares outstanding during 2005 primarily reflects exercises of employee stock options and the impact of stock options outstanding.

■ **Continuing Operations** — The increase in results from continuing operations was due primarily to the following:

- Higher international tobacco income, reflecting higher pricing, the impact of acquisitions in Indonesia and Colombia, higher income from the return of the *Marlboro* license in Japan and the impact of a one-time inventory sale in Italy, partially offset by unfavorable volume/mix, expenses related to the E.C. agreement and higher marketing, administration and research costs.

- Higher domestic tobacco income, reflecting lower wholesale promotional allowance rates, partially offset by lower volume, a pre-tax provision of $56 million for the *Boeken* individual smoking case, and higher research and development expenses.

These increases were partially offset by:

- Lower North American food income, reflecting higher commodity and benefit costs, and increased marketing spending, partially offset by higher pricing and favorable volume/mix (including the impact of the extra week of shipments in 2005).

- Lower international food income, reflecting higher commodity and developing market infrastructure costs, partially offset by higher pricing and favorable volume/mix (including the impact of the extra week of shipments in 2005).

- Lower financial services income, reflecting lower lease portfolio revenues and lower gains from asset sales, partially offset by lower interest expense.

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

■ **2006 Forecasted Results** — In January 2006, Altria Group, Inc. announced that it expects forecasted 2006 full-year diluted EPS from continuing operations in a range of $4.85 to $4.95. This forecast includes approximately $0.36 per share in charges associated with the Kraft restructuring program, unfavorable currency of $0.14 per share at current exchange rates, about $0.10 per share for lower tobacco income in Spain, $0.05 per share due to higher shares outstanding, and $0.04 per share as a result of a higher base income tax rate of 33.9% versus a corresponding rate of 33.4% in 2005. It does not include any future acquisitions or divestitures, or the benefit of potential tax accrual reversals following the completion of audits in certain jurisdictions. 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.

Discussion and Analysis

Critical Accounting Policies and Estimates

Note 2 to the consolidated financial statements includes a summary of the significant accounting policies and methods used in the preparation of Altria Group, Inc.'s consolidated financial statements. In most instances, Altria Group, Inc. must use an accounting policy or method because it is the only policy or method permitted under accounting principles generally accepted in the United States of America ("U.S. GAAP").

The preparation of financial statements includes the use of estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities at the dates of the financial statements and the reported amounts of net revenues and expenses during the reporting periods. If actual amounts are ultimately different from previous estimates, the revisions are included in Altria Group, Inc.'s consolidated results of operations for the period in which the actual amounts become known. Historically, the aggregate differences, if any, between Altria Group, Inc.'s estimates and actual amounts in any year, have not had a significant impact on its consolidated financial statements.

The selection and disclosure of Altria Group, Inc.'s critical accounting policies and estimates have been discussed with Altria Group, Inc.'s Audit Committee. The following is a review of the more significant assumptions and estimates, as well as the accounting policies and methods used in the preparation of Altria Group, Inc.'s consolidated financial statements:

■ **Consolidation**—The consolidated financial statements include ALG, as well as its wholly-owned and majority-owned subsidiaries. Investments in which ALG exercises significant influence (20%—50% ownership interest), are accounted for under the equity method of accounting. Investments in which ALG has an ownership interest of less than 20%, or does not exercise significant influence, are accounted for with the cost method of accounting. All intercompany transactions and balances have been eliminated.

■ **Revenue Recognition**—As required by U.S. GAAP, Altria Group, Inc.'s consumer products businesses recognize revenues, net of sales incentives and including shipping and handling charges billed to customers, upon shipment or delivery of goods when title and risk of loss pass to customers. ALG's tobacco subsidiaries also include excise taxes billed to customers in revenues. Shipping and handling costs are classified as part of cost of sales.

■ **Depreciation, Amortization and Goodwill Valuation**—Altria Group, Inc. depreciates property, plant and equipment and amortizes its definite life intangible assets using the straight-line method over the estimated useful lives of the assets.

Altria Group, Inc. is required to conduct an annual review of goodwill and intangible assets for potential impairment. Goodwill impairment testing requires a comparison between the carrying value and fair value of each reporting unit. If the carrying value exceeds the fair value, goodwill is considered impaired. The amount of impairment loss is measured as the difference between the carrying value and implied fair value of goodwill, which is determined using discounted cash flows. Impairment testing for non-amortizable intangible assets requires a comparison between the fair value and carrying value of the intangible asset. If the carrying value exceeds fair value, the intangible asset is considered impaired and is reduced to fair value. These calculations may be affected by interest rates, general economic conditions and projected growth rates. During 2005, Altria Group, Inc. completed its annual review of goodwill and intangible assets, and no charges resulted from this review. However, as part of the sale or pending sale of certain Canadian assets and two brands, Kraft recorded total non-cash pre-tax asset impairment charges of $269 million in 2005, which included impairment of goodwill and intangible assets of $13 million and $118 million, respectively, as well as $138 million of asset write-downs. The 2004 review of goodwill and intangible assets resulted in a $29 million non-cash pre-tax charge at Kraft related to an intangible asset impairment for a small confectionery business in the United States and certain brands in Mexico. A portion of this charge, $17 million, was reclassified to (loss) earnings from discontinued operations on the consolidated statement of earnings in the fourth quarter of 2004. The remaining charge was recorded as asset impairment and exit costs on the consolidated statement of earnings.

■ **Marketing and Advertising Costs**—As required by U.S. GAAP, Altria Group, Inc. records marketing costs as an expense in the year to which such costs relate. Altria Group, Inc. does not defer amounts on its year-end consolidated balance sheets with respect to marketing costs. Altria Group, Inc. expenses advertising costs in the year incurred. Consumer incentive and trade promotion activities are recorded as a reduction of revenues based on amounts estimated as being due to customers and consumers at the end of a period, based principally on historical utilization and redemption rates. Such programs include, but are not limited to, discounts, coupons, rebates, in-store display incentives and volume-based incentives. For interim reporting purposes, advertising and certain consumer incentive expenses are charged to operations as a percentage of sales, based on estimated sales and related expenses for the full year.

■ **Contingencies**—As discussed in Note 19 to the consolidated financial statements ("Note 19"), legal proceedings covering a wide range of matters are pending or threatened in various United States and foreign jurisdictions against ALG, its subsidiaries and affiliates, including PM USA and PMI, as well as their respective indemnitees. In 1998, PM USA and certain other United States tobacco product manufacturers entered into the Master Settlement Agreement (the "MSA") with 46 states and various other governments and jurisdictions to settle asserted and unasserted health care cost recovery and other claims. PM USA and certain other United States tobacco product manufacturers had previously settled similar claims brought by Mississippi, Florida, Texas and Minnesota (together with the MSA, the "State Settlement Agreements"). PM USA's portion of ongoing adjusted payments and legal fees is based on its relative share of the settling manufacturers' domestic cigarette shipments, including roll-your-own cigarettes, in the year preceding that in which the payment is due. PM USA records its portion of ongoing settlement payments as part of cost of sales as product is shipped. During the years ended December 31, 2005, 2004 and 2003, PM USA recorded expenses of $5.0 billion, $4.6 billion and $4.4 billion, respectively, as part of cost of sales for the payments under the State Settlement Agreements and payments for tobacco growers and quota holders.

ALG and its subsidiaries record provisions in the 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. Except as discussed in Note 19: (i) management has not concluded that it is probable that a loss has been incurred in any of the pending tobacco-related litigation; (ii) management is unable to make a meaningful estimate of the amount or range of loss that could result from an unfavorable outcome of pending tobacco-related litigation; and (iii) accordingly, management has not provided any amounts in the consolidated financial statements for unfavorable outcomes, if any.

■ **Employee Benefit Plans** — As discussed in Note 16. *Benefit Plans* ("Note 16") of the notes to the consolidated financial statements, Altria Group, Inc. provides a range of benefits to its employees and retired employees, including pensions, postretirement health care and postemployment benefits (primarily severance). Altria Group, Inc. records annual amounts relating to these plans based on calculations specified by U.S. GAAP, which include various actuarial assumptions, such as discount rates, assumed rates of return on plan assets, compensation increases, turnover rates and health care cost trend rates. Altria Group, Inc. reviews its actuarial assumptions on an annual basis and makes modifications to the assumptions based on current rates and trends when it is deemed appropriate to do so. As permitted by U.S. GAAP, any effect of the modifications is generally amortized over future periods. Altria Group, Inc. believes that the assumptions utilized in recording its obligations under its plans, which are presented in Note 16, are reasonable based on advice from its actuaries.

In December 2003, the United States enacted into law the Medicare Prescription Drug, Improvement and Modernization Act of 2003, establishing a prescription drug benefit known as "Medicare Part D," and a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D.

In May 2004, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position No. 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" ("FSP 106-2"). FSP 106-2 requires companies to account for the effect of the subsidy on benefits attributable to past service as an actuarial experience gain and as a reduction of the service cost component of net postretirement health care costs for amounts attributable to current service, if the benefit provided is at least actuarially equivalent to Medicare Part D.

Altria Group, Inc. adopted FSP 106-2 in the third quarter of 2004. The impact of FSP 106-2 for 2005 and 2004 was a reduction of pre-tax net postretirement health care costs and an increase in net earnings of $67 million (including $55 million related to Kraft) and $28 million (including $24 million related to Kraft), respectively. In addition, as of July 1, 2004, Altria Group, Inc. reduced its accumulated postretirement benefit obligation for the subsidy related to benefits attributed to past service by $375 million and decreased its unrecognized actuarial losses by the same amount.

At December 31, 2005, for its U.S. pension and postretirement plans, Altria Group, Inc. reduced its discount rate assumption to 5.64% and modified its health care cost trend rate assumption. Altria Group, Inc. presently anticipates that these and other less significant assumption changes, coupled with the amortization of deferred gains and losses, will result in an increase in 2006 pre-tax benefit expense of approximately $130 million (including $80 million related to Kraft). A fifty basis point decrease (increase) in Altria Group, Inc.'s discount rate would increase (decrease) Altria Group, Inc.'s pension and postretirement expense by approximately $123 million. Similarly, a fifty basis point decrease (increase) in the expected return on plan assets would increase (decrease) Altria Group, Inc.'s pension expense by approximately $56 million.

See Note 16 for a sensitivity discussion of the assumed health care cost trend rates.

■ **Income Taxes** — Altria Group, Inc. accounts for income taxes in accordance with Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes." Under SFAS No. 109, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse. The provision for income taxes is based on domestic and international statutory income tax rates and tax planning opportunities available in the jurisdictions in which Altria Group, Inc. operates. Significant judgment is required in determining income tax provisions and in evaluating tax positions. ALG and its subsidiaries establish additional provisions for income taxes when, despite the belief that their tax positions are fully supportable, there remain certain positions that are likely to be challenged and that may not be sustained on review by tax authorities. Upon the closure of current and future tax audits in various jurisdictions, significant income tax accrual reversals could continue to occur in 2006. ALG and its subsidiaries evaluate and potentially adjust these accruals in light of changing facts and circumstances. The consolidated tax provision includes the impact of changes to accruals that are considered appropriate.

In October 2004, the American Jobs Creation Act ("the Jobs Act") was signed into law. The Jobs Act includes a deduction for 85% of certain foreign earnings that are repatriated. In 2005, Altria Group, Inc. repatriated $6.0 billion of earnings under the provisions of the Jobs Act. Deferred taxes had previously been provided for a portion of the dividends remitted. The reversal of the deferred taxes more than offset the tax costs to repatriate the earnings and resulted in a net tax reduction of $372 million in the 2005 consolidated income tax provision. This reduction was included in the consolidated statement of earnings as an estimated benefit of $209 million in the second quarter and was subsequently revised to $168 million in the fourth quarter. Altria Group, Inc. recorded an additional $204 million tax benefit, which resulted from a favorable foreign tax law ruling that was received in the third quarter of 2005 related to the repatriation of earnings under the Jobs Act.

The Jobs Act also provides tax relief to U.S. domestic manufacturers by providing a tax deduction related to a percentage of the lesser of "qualified production activities income" or taxable income. The deduction, which was 3% in 2005, increases to 9% by 2010. In accordance with SFAS No. 109, Altria Group, Inc. will recognize these benefits in the year earned. The tax benefit in 2005 was approximately $60 million.

The tax provision in 2005 includes the $372 million benefit related to dividend repatriation under the Jobs Act in 2005, and the reversal of $82 million of tax accruals no longer required at Kraft, as well as other benefits, including the impact of the domestic manufacturers' deduction under the Jobs Act and lower repatriation costs. The tax provision in 2004 includes the reversal of $355 million of tax accruals that are no longer required due to foreign tax events that were resolved during the first quarter of 2004 ($35 million) and the second quarter of 2004 ($320 million), and an $81 million favorable resolution of an outstanding tax item at Kraft, the majority of which occurred in the third quarter.

Altria Group, Inc. is regularly audited by federal, state and foreign tax authorities, and these audits are at various stages at any given time. Altria Group, Inc. anticipates several domestic and foreign audits will close in 2006 with expected favorable settlements. Any tax contingency reserves in excess of additional assessed liabilities will be reversed at the time the audits close.

■ **Hedging** — As discussed below in "Market Risk," Altria Group, Inc. uses derivative financial instruments principally to reduce exposures to market risks resulting from fluctuations in foreign exchange rates and commodity prices by creating offsetting exposures. Altria Group, Inc. conforms with the requirements of U.S. GAAP in order to account for a substantial portion of its derivative financial instruments as hedges. As a result, gains and losses on these derivatives are deferred in accumulated other comprehensive earnings (losses) and recognized in the consolidated statement of earnings in the periods when the related hedged transaction is also recognized in operating results. If Altria Group, Inc. had elected not to use and comply with the hedge accounting provisions permitted under U.S. GAAP, gains (losses) deferred as of December 31, 2005, 2004 and 2003, would have been recorded in net earnings. Deferred gains (losses) from hedging activities included in other comprehensive earnings (losses), including the impact of currency hedges recorded as cumulative translation adjustments, were deferred gains of $393 million at December 31, 2005, and deferred losses of $358 million and $369 million at December 31, 2004 and 2003, respectively.

■ **Impairment of Long-Lived Assets** — Altria Group, Inc. reviews long-lived assets, including amortizable intangible assets, for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable. Altria Group, Inc. performs undiscounted operating cash flow analyses to determine if an impairment exists. These analyses are affected by interest rates, general economic conditions and projected growth rates. For purposes of recognition and measurement of an impairment for assets held for use, Altria Group, Inc. groups assets and liabilities at the lowest level for which cash flows are separately identifiable. If an impairment is determined to exist, any related impairment loss is calculated based on fair value. Impairment losses on assets to be disposed of, if any, are based on the estimated proceeds to be received, less costs of disposal.

■ **Leasing** — Approximately 95% of PMCC's net revenues in 2005 related to leveraged leases. Income relating to leveraged leases is recorded initially as unearned income, which is included in the line item finance assets, net, on Altria Group, Inc.'s consolidated balance sheets, and is subsequently recorded as net revenues over the life of the related leases at a constant after-tax rate of return. The remainder of PMCC's net revenues consist primarily of amounts related to direct finance leases, with income initially recorded as unearned and subsequently recognized in net revenues over the life of the leases at a constant pre-tax rate of return. As discussed further in Note 8. *Finance Assets, net*, PMCC leases certain aircraft and other assets that were affected by bankruptcy filings.

PMCC's investment in leases is included in the line item finance assets, net, on the consolidated balance sheets as of December 31, 2005 and 2004. At December 31, 2005, PMCC's net finance receivable of $7.2 billion in leveraged leases, which is included in the line item on Altria Group, Inc.'s consolidated balance sheet of finance assets, net, consists of rents receivables ($25.0 billion) and the residual value of assets under lease ($1.8 billion), reduced by third-party nonrecourse debt ($16.7 billion) and unearned income ($2.9 billion). The payment 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 the line item finance assets, net, in Altria Group, Inc.'s consolidated balance sheets. Finance assets, net, at December 31, 2005, also includes net finance receivables for direct finance leases of ($0.6 billion) and an allowance for losses ($0.6 billion).

Estimated residual values represent PMCC's estimate at lease inception as to the fair value of assets under lease at the end of the lease term. The estimated residual values are reviewed annually by PMCC's management based on a number of factors and activity in the relevant industry. If necessary, revisions to reduce the residual values are recorded. Such reviews resulted in no adjustments in 2005 or 2003, and a decrease of $25 million to PMCC's net revenues and results of operations in 2004. To the extent that lease receivables due PMCC may be uncollectible, PMCC records an allowance for losses against its finance assets. During 2005 and 2004, PMCC increased this allowance by $200 million and $140 million, respectively, in consideration of the continuing downturn in the airline industry. PMCC's aggregate finance asset balance related to aircraft was approximately $2.1 billion at December 31, 2005. It is possible that adverse developments in the airline and other industries may require PMCC to increase its allowance for losses in future periods.

Consolidated Operating Results

See pages 39–40 for a discussion of Cautionary Factors That May Affect Future Results.

(in millions)	2005	2004	2003
Net Revenues			
Domestic tobacco	**$18,134**	$17,511	$17,001
International tobacco	**45,288**	39,536	33,389
North American food	**23,293**	22,060	20,937
International food	**10,820**	10,108	9,561
Financial services	**319**	395	432
Net revenues	**$97,854**	$89,610	$81,320

(in millions)	2005	2004	2003
Operating Income			
Operating companies income:			
Domestic tobacco	**$ 4,581**	$ 4,405	$ 3,889
International tobacco	**7,825**	6,566	6,286
North American food	**3,831**	3,870	4,658
International food	**1,122**	933	1,393
Financial services	**31**	144	313
Amortization of intangibles	**(28)**	(17)	(9)
General corporate expenses	**(770)**	(721)	(771)
Operating income	**$16,592**	$15,180	$15,759

As discussed in Note 15. *Segment Reporting*, management reviews operating companies income, which is defined as operating income before general corporate expenses and amortization of intangibles, to evaluate segment performance and allocate resources. 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 2005, 2004 and 2003 affected the comparability of statement of earnings amounts.

■ **Domestic Tobacco Headquarters Relocation Charges** — PM USA has substantially completed the move of its corporate headquarters from New York City to Richmond, Virginia, for which pre-tax charges of $4 million, $31 million and $69 million were recorded in the operating companies income of the domestic tobacco segment for the years ended December 31, 2005, 2004 and 2003, respectively. At December 31, 2005, a liability of $6 million remains on the consolidated balance sheet.

■ **Domestic Tobacco Loss on U.S. Tobacco Pool** — As further discussed in Note 19. *Contingencies*, in October 2004, FETRA was signed into law. Under the provisions of FETRA, PM USA was obligated to cover its share of potential losses that the government may incur on the disposition of pool tobacco stock accumulated under the previous tobacco price support program. In 2005, PM USA recorded a $138 million expense for its share of the loss.

■ **Domestic Tobacco Quota Buy-Out** — The provisions of FETRA require PM USA, along with other manufacturers and importers of tobacco products, to make quarterly payments that will be used to compensate tobacco growers and quota holders affected by the legislation. Payments made by PM USA under FETRA will offset amounts due under the provisions of the NTGST, a trust formerly established to compensate tobacco growers and quota holders. Disputes arose as to the applicability of FETRA to 2004 NTGST payments. During the third quarter of 2005, a North Carolina Supreme Court ruling determined that FETRA enactment had not triggered the offset provisions during 2004 and that tobacco companies were required to make full payment to the NTGST for the full year of 2004. The ruling, along with FETRA billings from the USDA, established that FETRA was effective beginning in 2005. Accordingly during the third quarter of 2005, PM USA reversed a prior year accrual for FETRA payments in the amount of $115 million.

■ **Domestic Tobacco Legal Settlement** — During 2003, PM USA and certain other defendants reached an agreement with a class of U.S. tobacco growers and quota holders to resolve a lawsuit related to tobacco leaf purchases. During 2003, PM USA recorded pre-tax charges of $202 million for its obligations under the agreement. The pre-tax charges are included in the operating companies income of the domestic tobacco segment.

■ **International Tobacco E.C. Agreement** — In July 2004, PMI entered into an agreement with the E.C. and 10 member states of the European Union that provides for broad cooperation with European law enforcement agencies on anti-contraband and anti-counterfeit efforts. The agreement resolves all disputes between the parties relating to these issues. Under the terms of the agreement, PMI will make 13 payments over 12 years, including an initial payment of $250 million, which was recorded as a pre-tax charge against its earnings in 2004. The agreement calls for additional payments of approximately $150 million on the first anniversary of the agreement (this payment was made in July 2005), approximately $100 million on the second anniversary and approximately $75 million each year thereafter for 10 years, each of which is to be adjusted based on certain variables, including PMI's market share in the European Union in the year preceding payment. Because future additional payments are subject to these variables, PMI records charges for them as an expense in cost of sales when product is shipped.

■ **Inventory Sale in Italy** — During the first quarter of 2005, PMI made a one-time inventory sale of 4.0 billion units to its new distributor in Italy, resulting in a $96 million pre-tax operating companies income benefit for the international tobacco segment. During the second quarter of 2005, the new distributor reduced its inventories by approximately 1.0 billion units, resulting in lower shipments for PMI. The net impact of these actions was a benefit to PMI's pre-tax operating companies income of approximately $70 million for the year ended December 31, 2005.

■ **Asset Impairment and Exit Costs** — For the years ended December 31, 2005, 2004 and 2003, pre-tax asset impairment and exit costs consisted of the following:

(in millions)		**2005**	2004	2003
Separation program	Domestic tobacco	**$ —**	$ 1	$13
Separation program	International tobacco*	**55**	31	
Separation program	General corporate**	**49**	56	26
Restructuring program	North American food	**66**	383	
Restructuring program	International food	**144**	200	
Asset impairment	International tobacco*	**35**	13	
Asset impairment	North American food	**269**	8	
Asset impairment	International food		12	6
Asset impairment	General corporate**		10	41
Lease termination	General corporate**		4	
Asset impairment and exit costs		**$618**	$718	$86

* During 2005, PMI recorded pre-tax charges of $90 million, primarily related to the write-off of obsolete equipment, severance benefits and impairment charges associated with the closure of a factory in the Czech Republic, and the streamlining of various operations. During 2004, PMI recorded pre-tax charges of $44 million for severance benefits and impairment charges related to the closure of its Eger, Hungary facility and a factory in Belgium, and the streamlining of its Benelux operations.

** In 2005, 2004 and 2003, Altria Group, Inc. recorded pre-tax charges of $49 million, $70 million and $26 million, respectively, primarily related to the streamlining of various corporate functions in each year, and the write-off of an investment in an e-business consumer products purchasing exchange in 2004. In addition, during 2004, Altria Group, Inc. sold its office facility in Rye Brook, New York. In connection with this sale, Altria Group, Inc. recorded a pre-tax charge in 2003 of $41 million to write down the facility and the related fixed assets to fair value.

■ **(Gains)/Losses on Sales of Businesses, net** — During 2005, operating companies income of the international food segment included pre-tax gains on sales of businesses of $109 million, primarily related to the sale of Kraft's desserts assets in the U.K. During 2004, Kraft sold a Brazilian snack nuts business and trademarks associated with a candy business in Norway, and recorded aggregate pre-tax losses of $3 million. During 2003, Kraft sold a European rice business and a branded fresh cheese business in Italy and recorded aggregate pre-tax gains of $31 million.

■ **Provision for Airline Industry Exposure** — As discussed in Note 8. *Finance Assets, net*, during 2005 PMCC increased its allowance for losses by $200 million, reflecting its exposure to the troubled airline industry, particularly Delta and Northwest, both of which filed for bankruptcy protection during September 2005. In addition, during 2004 and 2002, in recognition of the economic downturn in the airline industry, PMCC increased its allowance for losses by $140 million and $290 million, respectively.

■ **Discontinued Operations** — As more fully discussed in Note 4. *Divestitures,* in June 2005, Kraft sold substantially all of its sugar confectionery business. Altria Group, Inc. has reflected the results of Kraft's sugar confectionery business prior to the closing date as discontinued operations on the consolidated statements of earnings for all years presented.

2005 compared with 2004

The following discussion compares consolidated operating results for the year ended December 31, 2005, with the year ended December 31, 2004.

Net revenues, which include excise taxes billed to customers, increased $8.2 billion (9.2%). Excluding excise taxes, net revenues increased $5.0 billion (7.7%), due primarily to increases from both the tobacco and food businesses (including the impact of acquisitions at international tobacco and the extra week of shipments at Kraft), and favorable currency.

Operating income increased $1.4 billion (9.3%), due primarily to higher operating results from the tobacco businesses, the favorable impact of currency, the 2004 charge for the international tobacco E.C. agreement, lower asset impairment and exit costs in 2005, primarily related to the Kraft restructuring program, gains on sales of food businesses and the reversal of a 2004 accrual related to tobacco quota buy-out legislation. These items were partially offset by an increase in the provision for airline industry exposure at PMCC, a charge for PM USA's portion of the losses incurred by the federal government on disposition of its pool tobacco stock and lower operating results from the food and financial services businesses.

Currency movements increased net revenues by $2.0 billion ($1.1 billion, after excluding the impact of currency movements on excise taxes) and operating income by $421 million. Currency related increases in net revenues and operating income were due primarily to the weakness versus prior year of the U.S. dollar against the euro, Japanese yen and Central and Eastern European currencies.

Altria Group, Inc.'s effective tax rate decreased by 2.5 percentage points to 29.9%. The 2005 effective tax rate includes a $372 million benefit related to dividend repatriation under the Jobs Act in 2005, the reversal of $82 million of tax accruals no longer required at Kraft, as well as other benefits, including the impact of the domestic manufacturers' deduction under the Jobs Act and lower repatriation costs. The 2004 effective tax rate includes the reversal of $355 million of tax accruals that are no longer required due to foreign tax events that were resolved during 2004 and an $81 million favorable resolution of an outstanding tax item at Kraft.

Minority interest in earnings from continuing operations, and equity earnings, net, was $149 million of expense for 2005, compared with $44 million of expense for 2004. The change primarily reflected ALG's share of SABMiller's gains from sales of investments in 2004.

Earnings from continuing operations of $10.7 billion increased $1.2 billion (13.2%), due primarily to higher operating income and a lower effective tax rate, partially offset by lower equity earnings from SABMiller. Diluted and basic EPS from continuing operations of $5.10 and $5.15, respectively, increased by 11.6% and 12.0%, respectively.

Loss from discontinued operations, net of income taxes and minority interest, was $233 million for 2005, compared with a loss of $4 million for 2004, due primarily to the recording of a loss on sale of Kraft's sugar confectionery business in the second quarter of 2005.

Net earnings of $10.4 billion increased $1.0 billion (10.8%). Diluted and basic EPS from net earnings of $4.99 and $5.04, respectively, increased by 9.4% and 9.6%, respectively.

2004 compared with 2003

The following discussion compares consolidated operating results for the year ended December 31, 2004, with the year ended December 31, 2003.

Net revenues, which include excise taxes billed to customers, increased $8.3 billion (10.2%). Excluding excise taxes, net revenues increased $3.8 billion (6.3%), due primarily to increases from the tobacco and North American food businesses and favorable currency.

Operating income decreased $579 million (3.7%), due primarily to asset impairment and exit costs, primarily related to the Kraft restructuring program, the 2004 pre-tax charges for the international tobacco E.C. agreement and the provision for airline industry exposure, and lower operating results from the food businesses. These decreases were partially offset by the favorable impact of currency, 2003 pre-tax charges for the domestic tobacco legal settlement and higher operating results from the tobacco businesses.

Currency movements increased net revenues by $3.3 billion ($1.9 billion, after excluding the impact of currency movements on excise taxes) and operating income by $638 million. Increases in net revenues and operating income were due primarily to the weakness versus prior year of the U.S. dollar, primarily against the euro, Japanese yen and Russian ruble.

Altria Group, Inc.'s effective tax rate decreased by 2.5 percentage points to 32.4%. This decrease was due primarily to the reversal of $355 million of tax accruals that are no longer required due to foreign tax events that were resolved during the year and the $81 million favorable resolution of an outstanding tax item at Kraft.

Minority interest in earnings from continuing operations, and equity earnings, net, was $44 million of expense for 2004, compared with $391 million of expense for 2003. The change from 2003 was due to lower 2004 net earnings at Kraft and higher equity earnings from SABMiller, which included $111 million of gains from the sales of investments.

Earnings from continuing operations of $9.4 billion increased $299 million (3.3%), due primarily to the favorable impact of currency, a lower effective tax rate, 2003 pre-tax charges for the domestic tobacco legal settlement, higher equity earnings from SABMiller and higher operating income from the tobacco businesses, partially offset by the 2004 pre-tax charges for asset impairment and exit costs, primarily related to the Kraft restructuring program, the international tobacco E.C. agreement and a provision for airline industry exposure, and lower operating income from the food businesses. Diluted and basic EPS from continuing operations of $4.57 and $4.60, respectively, increased by 2.0% and 2.2%, respectively.

(Loss) earnings from discontinued operations, net of income taxes and minority interest, was a loss of $4 million for 2004 compared to earnings of $83 million for 2003, due primarily to a pre-tax non-cash asset impairment charge of $107 million in 2004.

Net earnings of $9.4 billion increased $212 million (2.3%). Diluted and basic EPS from net earnings of $4.56 and $4.60, respectively, increased by 0.9% and 1.3%, respectively.

Operating Results by Business Segment

Tobacco

Business Environment

Taxes, Legislation, Regulation and Other Matters Regarding Tobacco and Smoking

The tobacco industry, both in the United States and abroad, faces a number of challenges that may continue to adversely affect the business, volume, results of operations, cash flows and financial position of PM USA, PMI and ALG. These challenges, which are discussed below and in *Cautionary Factors That May Affect Future Results*, include:

- the civil lawsuit, filed by the United States government against various cigarette manufacturers and others, including PM USA and ALG, discussed in Note 19. *Contingencies* ("Note 19");
- a $74 billion punitive damages judgment against PM USA in the *Engle* smoking and health class action, which has been overturned by a Florida district court of appeal and is currently on appeal to the Florida Supreme Court;
- a compensatory and punitive damages judgment totaling approximately $10.1 billion against PM USA in the *Price* Lights/Ultra Lights class action. The Illinois Supreme Court has reversed the trial court's judgment in favor of the plaintiffs in the *Price* case and remanded the case to the trial court with instructions that the case be dismissed. However, plaintiffs have filed a motion for rehearing with the Illinois Supreme Court;
- punitive damages verdicts against PM USA in other smoking and health cases discussed in Note 19;
- pending and threatened litigation and bonding requirements as discussed in Note 19;
- competitive disadvantages related to price increases in the United States attributable to the settlement of certain tobacco litigation;
- actual and proposed excise tax increases worldwide as well as changes in tax structures in foreign markets;
- 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 the collection of applicable taxes;
- price gaps and changes in price gaps between premium and lowest price brands;
- diversion into one market of products intended for sale in another;
- the outcome of proceedings and investigations, and the potential assertion of claims, relating to contraband shipments of cigarettes;
- governmental investigations;
- actual and proposed requirements regarding the use and disclosure of cigarette ingredients and other proprietary information;
- actual and proposed restrictions on imports in certain jurisdictions outside the United States;
- actual and proposed restrictions affecting tobacco manufacturing, marketing, advertising and sales;
- governmental and private bans and restrictions on smoking;
- the diminishing prevalence of smoking and increased efforts by tobacco control advocates to further restrict smoking;
- governmental regulations setting ignition propensity standards for cigarettes; and
- other actual and proposed tobacco legislation both inside and outside the United States.

In the ordinary course of business, PM USA and PMI 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.

■ **Excise Taxes:** Cigarettes are subject to substantial excise taxes in the United States and to substantial taxation abroad. Significant increases in cigarette-related taxes or fees have been proposed or enacted and are likely to continue to be proposed or enacted within the United States, the European Union (the "EU") and in other foreign jurisdictions. In addition, in certain jurisdictions, PMI's products are subject to discriminatory tax structures and inconsistent rulings and interpretations on complex methodologies to determine excise and other tax burdens.

Tax increases are expected to continue to have an adverse impact on sales of cigarettes by PM USA and PMI, due to lower consumption levels and to a shift in 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.

■ **Tar and Nicotine Test Methods and Brand Descriptors:** A number of governments and public health organizations throughout the world have determined that the existing standardized machine-based methods for measuring tar and nicotine yields do not provide useful information about tar and nicotine deliveries and that such results are misleading to smokers. For example, in the 2001 publication of Monograph 13, the U.S. National Cancer Institute ("NCI") concluded that measurements based on the Federal Trade Commission ("FTC") standardized method "do not offer smokers meaningful information on the amount of tar and nicotine they will receive from a cigarette" or "on the relative amounts of tar and nicotine exposure likely to be received from smoking different brands of cigarettes." Thereafter, the FTC issued a press release indicating that it would be working with the NCI to determine what changes should be made to its testing method to "correct the limitations" identified in Monograph 13. In 2002, PM USA petitioned the FTC to promulgate new rules governing the use of existing standardized machine-based methodologies for measuring tar and nicotine yields and descriptors. That petition remains pending. In addition, the World Health Organization ("WHO") has concluded that these standardized measurements are "seriously flawed" and that measurements based upon the current standardized methodology "are misleading and should not be displayed." The International Organization for Standardization ("ISO") has set up a working group, chaired by the WHO, to develop a new measurement method which more accurately reflects human smoking behavior. The working group is scheduled to report to ISO in mid-2006.

In light of these conclusions, governments and public health organizations have increasingly challenged the use of descriptors — such as "light," "mild," and "low tar" — that are based on measurements produced by the standardized test methodologies. For example, the European Commission has concluded that descriptors based on standardized tar and nicotine yield measurements "may mislead the consumer" and has prohibited the use of descriptors. Public health organizations have also urged that descriptors be banned. For example, the Scientific Advisory Committee of the WHO concluded that descriptors such as "light, ultra-light, mild and low tar" are "misleading terms" and should be banned. In 2003, the WHO proposed the Framework Convention on Tobacco Control ("FCTC"), a treaty that requires signatory nations to adopt and implement measures to ensure that descriptive terms do not create "the false impression that a particular tobacco product is less harmful than other tobacco products." Such terms "may include 'low tar,' 'light,' 'ultra-light,' or 'mild.'" For a discussion of the FCTC, see below under the heading "The WHO's Framework Convention on Tobacco Control." In addition, public health organizations in Canada and the United States have advocated "a complete prohibition of the use of deceptive descriptors such as 'light' and 'mild.'" In July 2005, PMI's Australian affiliates agreed to refrain from using descriptors in Australia on cigarettes, cigarette packaging and on material intended to be disseminated to the general public in Australia in relation to the marketing, advertising or sale of cigarettes.

See Note 19, which describes pending litigation concerning the use of brand descriptors.

■ **Food and Drug Administration ("FDA") Regulations:** ALG and PM USA endorsed federal legislation introduced in May 2004 in the Senate and the House of Representatives, known as the Family Smoking Prevention and Tobacco Control Act, which would have granted the FDA the authority to regulate the design, manufacture and marketing of cigarettes and disclosures of related information. The legislation also would have granted the FDA the authority to combat counterfeit and contraband tobacco products and would have imposed fees to pay for the cost of regulation and other matters. The legislation was passed by the Senate, but Congress adjourned in October 2004 without enacting it. In March 2005, bipartisan legislation was reintroduced in the Senate and House of Representatives that, if enacted, would grant the FDA the authority to broadly regulate tobacco products as described above. ALG and PM USA support this legislation. Whether Congress will grant the FDA authority over tobacco products in the future cannot be predicted.

■ **Tobacco Quota Buy-Out:** In October 2004, the Fair and Equitable Tobacco Reform Act of 2004 ("FETRA") was signed into law. FETRA provides for the elimination of the federal tobacco quota and price support program through an industry-funded buy-out of tobacco growers and quota holders. The cost of the buy-out is approximately $9.6 billion and will be paid over 10 years by manufacturers and importers of each kind of tobacco product. The cost will be allocated based on the relative market shares of manufacturers and importers of each kind of tobacco product. The quota buy-out payments will offset already scheduled payments to the National Tobacco Grower Settlement Trust (the "NTGST"), a trust fund established in 1999 by four of the major domestic tobacco product manufacturers to provide aid to tobacco growers and quota holders. Manufacturers and importers of tobacco products are also obligated to cover any losses (up to $500 million) that the government may incur on the disposition of tobacco pool stock accumulated under the previous tobacco price support program. In September and December 2005, PM USA was billed a total of $138 million for its share of tobacco pool stock losses and recorded the amount as an expense. For a discussion of the NTGST, see Note 19. Altria Group, Inc. does not currently anticipate that the quota buy-out will have a material adverse impact on its consolidated results in 2006 and beyond.

Following the enactment of FETRA, the trustee of the NTGST and the state entities conveying NTGST payments to tobacco growers and quota holders sued tobacco product manufacturers, alleging that the offset provisions did not apply to payments due in 2004. In December 2004, a North Carolina trial court ruled that FETRA's enactment had triggered the offset provisions and that the tobacco product manufacturers, including PM USA, were entitled to receive a refund of amounts paid to the NTGST during the first three quarters of 2004 and were not required to make the payments that would otherwise have been due during the fourth quarter of 2004. Plaintiffs appealed, and in August 2005, the North Carolina Supreme Court reversed the trial court's ruling and remanded the case to the lower court for additional proceedings. In October 2005, the trial court ordered that the trustee could distribute the amounts that the tobacco companies had already paid to the NTGST during the first three quarters of 2004. PM USA's portion of these payments was approximately $174 million. The trial court also ruled that the manufacturers must make the payment originally scheduled to be made to the NTGST in December 2004, with interest. PM USA's portion of the principal was approximately $58 million, which PM USA paid in October 2005. In November 2005, PM USA paid $2 million in interest on the December 2004 payment.

■ **Ingredient Disclosure Laws:** Jurisdictions inside and outside the United States have enacted or proposed legislation or regulations that would require cigarette manufacturers to disclose the ingredients used in the manufacture of cigarettes and, in certain cases, to provide toxicological information. In some jurisdictions, governments have prohibited the use of certain ingredients, and proposals have been discussed to further prohibit the use of ingredients. Under an EU tobacco product directive, tobacco companies are now required to disclose ingredients and toxicological information to each Member State. In implementing the EU tobacco product directive, the Netherlands has issued a decree that would require tobacco companies to disclose the ingredients used in each brand of cigarettes, including quantities used. PMI and others are challenging this decree on the grounds of a lack of appropriate protection of proprietary information. Concurrently, PMI is discussing with the relevant authorities the appropriate implementation of the EU tobacco product directive.

■ **Health Effects of Smoking and Exposure to Environmental Tobacco Smoke ("ETS"):** Reports with respect to the health risks of cigarette smoking have been publicized for many years, and the sale, promotion, and use of cigarettes continue to be subject to increasing governmental regulation. Most regulation of ETS exposure to date has been done at the local level through bans in public establishments. However, the state of California is in the process of regulating ETS exposure in the ambient air at the state level. In January 2006, the California Air Resources Board ("CARB") listed ETS as a toxic contaminant under state law. CARB is now required to consider the adoption of appropriate control measures utilizing "best available control technology" in order to reduce public exposure to ETS in outdoor air to the "lowest level achievable."

It is the policy of PM USA and PMI to support a single, consistent public health message on the health effects of cigarette smoking in the development of diseases in smokers, and on smoking and addiction, and on exposure to ETS. It is also their policy to defer to the judgment of public health authorities as to the content of warnings in advertisements and on product packaging regarding the health effects of smoking, addiction and exposure to ETS.

PM USA and PMI each have established websites that include, among other things, the views of public health authorities on smoking, disease causation in smokers, addiction and ETS. These sites reflect PM USA's and PMI's agreement with the medical and scientific consensus that cigarette smoking is addictive, and causes lung cancer, heart disease, emphysema and other serious diseases in smokers. The websites advise smokers, and those considering smoking, to rely on the messages of public health authorities in making all smoking-related decisions. The website addresses are www.philipmorrisusa.com and www.philipmorrisinternational.com. The information on PMI's and PM USA's websites is not, and shall not be deemed to be, a part of this document or incorporated into any filings ALG makes with the Securities and Exchange Commission.

■ **The WHO's Framework Convention on Tobacco Control ("FCTC"):** The FCTC entered into force on February 27, 2005. As of December 31, 2005, the FCTC had been signed by 168 countries and the EU, ratified by 115 countries and confirmed by the EU. The FCTC is the first treaty to establish a global agenda for tobacco regulation. The treaty recommends (and in certain instances, requires) signatory nations to enact legislation that would, among other things, establish specific actions to prevent youth smoking; restrict and gradually eliminate tobacco product advertising and promotion; inform the public about the health consequences of smoking and the benefits of quitting; regulate the ingredients of tobacco products; impose new package warning requirements that may include the use of pictures or graphic images; adopt measures that would eliminate cigarette smuggling and counterfeit cigarettes; restrict smoking in public places; increase cigarette taxes; adopt and implement measures that ensure that descriptive terms do not create the false impression that one brand of cigarettes is safer than another; phase out duty-free tobacco sales; and encourage litigation against tobacco product manufacturers.

Each country that ratifies the treaty must implement legislation reflecting the treaty's provisions and principles. While not agreeing with all of the provisions of the treaty, such as a complete ban on tobacco advertising, excessive excise tax increases and regulation through litigation, PM USA and PMI have expressed hope that the treaty will lead to the implementation of meaningful, effective and coherent regulation of tobacco products around the world.

■ **Reduced Cigarette Ignition Propensity Legislation:** Effective June 28, 2004, all cigarettes sold or offered for sale in New York are required to meet certain reduced ignition propensity standards established in regulations issued by the New York State Office of Fire Prevention and Control. California and Vermont have each enacted legislation requiring cigarettes sold in their state to meet the same reduced cigarette ignition propensity standard. The Vermont law takes effect on May 1, 2006 and the California law is effective on January 1, 2007. Reduced cigarette ignition propensity legislation is being considered in several states, at the federal level, and in jurisdictions outside the United States. Similar legislation has been passed in Canada and took effect on October 1, 2005.

■ **Other Legislation and Legislative Initiatives:** Legislative and regulatory initiatives affecting the tobacco industry have been adopted or are being considered in a number of countries and jurisdictions. In 2001, the EU adopted a directive on tobacco product regulation requiring EU Member States to implement regulations that reduce maximum permitted levels of tar, nicotine and carbon monoxide yields; require manufacturers to disclose ingredients and toxicological data; and require cigarette packs to carry health warnings covering no less than 30% of the front panel and no less than 40% of the back panel. The directive also gives Member States the option of introducing graphic warnings as of 2005; requires tar, nicotine and carbon monoxide data to cover at least 10% of the side panel; and prohibits the use of texts, names, trademarks and figurative or other signs suggesting that a particular tobacco product is less harmful than others.

All 25 EU Member States have implemented these regulations. The European Commission has issued guidelines for optional graphic warnings on cigarette packaging that Member States may apply as of 2005. Graphic warning requirements have also been proposed or adopted in a number of other jurisdictions. In 2003, the EU adopted a new directive prohibiting radio, press and Internet tobacco marketing and advertising, which has now been implemented in most EU Member States. Tobacco control legislation addressing the manufacture, marketing and sale of tobacco products has been proposed or adopted in numerous other jurisdictions.

In the United States in recent years, various members of federal and state governments have introduced legislation that would: subject cigarettes to various regulations; establish educational campaigns relating to tobacco consumption or tobacco control programs, or provide additional funding for governmental tobacco control activities; further restrict the advertising of cigarettes; require additional warnings, including graphic warnings, on packages and in advertising; eliminate or reduce the tax deductibility of tobacco advertising; provide that the Federal Cigarette Labeling and Advertising Act and the Smoking Education Act not be used as a defense against liability under state statutory or common law; and allow state and local governments to restrict the sale and distribution of cigarettes.

It is not possible to predict what, if any, additional governmental legislation or regulations will be adopted relating to the manufacturing, advertising, sale or use of cigarettes, or the tobacco industry generally. If, however, any of the proposals were to be implemented, the business, volume, results of operations, cash flows and financial position of PM USA, PMI and their parent, ALG, could be materially adversely affected.

■ **Governmental Investigations:** From time to time, ALG and its subsidiaries are subject to governmental investigations on a range of matters, including those discussed below.

- Canada: ALG believes that Canadian authorities are contemplating a legal proceeding based on an investigation of ALG entities relating to allegations of contraband shipments of cigarettes into Canada in the early to mid-1990s.
- Greece: In 2003, the competition authorities in Greece initiated an investigation into cigarette price increases in that market. PMI's Greek affiliates have responded to the authorities' request for information.

ALG and its subsidiaries cannot predict the outcome of these investigations or whether additional investigations may be commenced.

■ **Cooperation Agreement between PMI and the European Commission:** In July 2004, PMI entered into an agreement with the European Commission (acting on behalf of the European Community) and 10 Member States of the EU that provides for broad cooperation with European law enforcement agencies on anti-contraband and anti-counterfeit efforts. Subsequently, 8 additional Member States have signed the agreement. The agreement resolves all disputes between the European Community and the 18 Member States that signed the agreement, on the one hand, and PMI and certain affiliates, on the other hand, relating to these issues. Under the terms of the agreement, PMI will make 13 payments over 12 years. In the second quarter of 2004, PMI recorded a pre-tax charge of $250 million for the initial payment. The agreement calls for payments of approximately $150 million on the first anniversary of the agreement (this payment was made in July 2005), approximately $100 million on the second anniversary, and approximately $75 million each year thereafter for 10 years, each of which is to be adjusted based on certain variables, including PMI's market share in the EU in the year preceding payment. PMI will record these payments as an expense in cost of sales when product is shipped.

■ **State Settlement Agreements:** As discussed in Note 19, during 1997 and 1998, PM USA and other major domestic tobacco product manufacturers entered into agreements with states and various United States jurisdictions settling asserted and unasserted health care cost recovery and other claims. These settlements require PM USA to make substantial annual payments. The settlements also place numerous restrictions on PM USA's business operations, including prohibitions and restrictions on the advertising and marketing of cigarettes. 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.

Operating Results

	Net Revenues			Operating Companies Income		
(in millions)	**2005**	2004	2003	**2005**	2004	2003
Domestic tobacco	**$18,134**	$17,511	$17,001	**$ 4,581**	$ 4,405	$ 3,889
International tobacco	**45,288**	39,536	33,389	**7,825**	6,566	6,286
Total tobacco	**$63,422**	$57,047	$50,390	**$12,406**	$10,971	$10,175

2005 compared with 2004

The following discussion compares tobacco operating results for 2005 with 2004.

■ **Domestic tobacco:** PM USA's net revenues, which include excise taxes billed to customers, increased $623 million (3.6%). Excluding excise taxes, net revenues increased $658 million (4.8%), due primarily to lower wholesale promotional allowance rates ($837 million), partially offset by lower volume ($189 million).

Operating companies income increased $176 million (4.0%), due primarily to the previously discussed lower wholesale promotional allowance rates, net of expenses related to the quota buy-out legislation and ongoing resolution costs (aggregating $419 million), the reversal of a 2004 accrual related to tobacco quota buy-out legislation ($115 million), and lower charges for the domestic tobacco headquarters relocation ($27 million), partially offset by a charge for PM USA's portion of the losses incurred by the federal government on disposition of its pool tobacco stock ($138 million), lower volume ($137 million) and higher marketing, administration and research costs ($133 million, due primarily to a pre-tax provision of $56 million for the *Boeken* individual smoking case, and an increase in research and development expenses).

Marketing, administration and research costs include PM USA's cost of administering and litigating product liability claims. Litigation defense costs are influenced by a number of factors, as more fully discussed in Note 19. Principal among these factors are the number and types of cases filed, the number of cases tried annually, the results of trials and appeals, the development of the law controlling relevant legal issues, and litigation strategy and tactics. For the years ended December 31, 2005, 2004 and 2003, product liability defense costs were $258 million, $268 million and $307 million, respectively. The factors that have influenced past product liability defense costs are expected to continue to influence future costs. While PM USA does not expect that product liability defense costs will increase significantly in the future, it is possible that adverse developments among the factors discussed above could have a material adverse effect on PM USA's operating companies income.

PM USA's shipment volume was 185.5 billion units, a decrease of 0.8%, but was estimated to be essentially flat when adjusted for the timing of promotional shipments and trade inventory changes, and two less shipping days versus 2004. In the premium segment, PM USA's shipment volume decreased 0.6%. *Marlboro* shipment volume increased 0.1 billion units (0.1%) to 150.5 billion units. In the discount segment, PM USA's shipment volume decreased 3.2%, while *Basic* shipment volume was down 2.7% to 15.2 billion units.

The following table summarizes PM USA's retail share performance, based on data from the IRI/Capstone Total Retail Panel, which was developed to measure market share in retail stores selling cigarettes, but was not designed to capture Internet or direct mail sales:

For the Years Ended December 31,	**2005**	2004
Marlboro	**40.0%**	39.5%
Parliament	**1.7**	1.7
Virginia Slims	**2.3**	2.4
Basic	**4.3**	4.2
Focus on Four Brands	**48.3**	47.8
Other	**1.7**	2.0
Total PM USA	**50.0%**	49.8%

PM USA reduced its wholesale promotional allowance on its Focus on Four brands by $0.50 per carton, from $5.50 to $5.00, effective December 19, 2005. In addition, effective December 27, 2005, PM USA increased the price of its other brands by $2.50 per thousand cigarettes or $0.50 per carton.

PM USA reduced its wholesale promotional allowance on its Focus on Four brands by $1.00 per carton, from $6.50 to $5.50, effective December 12, 2004. In addition, effective January 16, 2005, PM USA increased the price of its other brands by $5.00 per thousand cigarettes or $1.00 per carton.

In April 2005, PM USA announced the construction of a research and technology center in Richmond, Virginia, which is estimated to cost $350 million. When completed in 2007, the facility will nearly double PM USA's research space and will house more than 500 scientists, engineers and support staff.

PM USA cannot predict future changes or rates of change in domestic tobacco industry volume, the relative sizes of the premium and discount segments or its shipment or retail market share; however, it believes that its results may be materially adversely affected by price increases related to increased excise taxes and tobacco litigation settlements, as well as by the other items discussed under the caption *Tobacco—Business Environment*.

■ **International tobacco:** International tobacco net revenues, which include excise taxes billed to customers, increased $5.8 billion (14.5%). Excluding excise taxes, net revenues increased $2.4 billion (13.8%), due primarily to price increases ($1.0 billion), the impact of acquisitions ($796 million) and favorable currency ($576 million).

Operating companies income increased $1.3 billion (19.2%), due primarily to price increases ($1.0 billion, including the benefit from the return of the *Marlboro* license in Japan), favorable currency ($331 million), the 2004 charge related to the international tobacco E.C. agreement ($250 million) and the impact of acquisitions ($341 million, which includes Sampoerna equity income earned from March to May of 2005), partially offset by higher marketing, administration and research costs ($246 million, due primarily to higher marketing, and research and development expenses), unfavorable volume/mix ($198 million, reflecting favorable volume but unfavorable mix), expenses related to the international tobacco E.C. agreement ($61 million), higher fixed manufacturing costs ($63 million) and higher pre-tax charges for asset impairment and exit costs ($46 million).

During the third quarter of 2005, PMI refined its organizational structure to bring greater focus to the enlarged European Union and the Asia region. Accordingly, in place of Western Europe and Central Europe regions, PMI now reports results for a European Union region, which includes the original European Union countries and the Baltic States, Cyprus, Czech Republic, Hungary, Malta, Norway, Poland, Slovak Republic and Switzerland. Other regions remain essentially unchanged. The region commentary throughout PMI's section of this Management's Discussion and Analysis of Financial Condition and Results of Operations reflects the revised organizational structure, with prior-year results restated for comparability.

PMI's cigarette volume of 804.5 billion units increased 43.1 billion units (5.7%), due primarily to acquisition volumes in Indonesia and Colombia, and higher volume in Italy as a result of the one-time inventory sale to PMI's new distributor. Excluding the volume related to acquisitions and the one-time inventory sale to the new distributor in Italy, shipments increased 0.3%. PMI's total tobacco volume, which includes 7.1 billion cigarette equivalent units of other tobacco products, grew 6.1% overall, and 0.8% excluding acquisitions and the one-time inventory sale to the new distributor in Italy.

In the European Union, PMI's cigarette volume decreased 2.7%, due primarily to declines in Germany, Portugal, Switzerland and Spain, partially offset by the 2005 inventory sale in Italy and higher shipments in France. Excluding the inventory sale in Italy, PMI's volume decreased 3.8% in the European Union.

In Germany, PMI's cigarette volume declined 15.9% and market share was down 0.2 share points to 36.6%, reflecting tax-driven price increases in March and December 2004, which accelerated down-trading to low-priced tobacco portions that currently are subject to favorable excise tax treatment compared with cigarettes. PMI captured a 16.9% share of the German tobacco portions segment, driven by *Marlboro, Next,* and *f6* tobacco portions. During the fourth quarter of 2005, the European Court of Justice issued a mandate that requires the German government to equalize the tax burden between cigarettes and tobacco portions. As a result of this ruling, tobacco portions in Germany will be taxed at the same rate as cigarettes for products manufactured as of April 1, 2006. Nevertheless, lower-priced tobacco portions are expected to remain available at retail for some time due to anticipated high stock levels.

In Spain, PMI's shipment volume decreased 2.2%, reflecting increased consumer down-trading to the deep-discount segment. As a result of growing price gaps, PMI's market share in Spain declined 1.1 share points to 34.5%, with a pronounced product mix deterioration. On January 21, 2006, the Spanish government raised excise taxes on cigarettes, which would have resulted in even larger price gaps if the tax increase had been passed on to consumers. Accordingly, PMI reduced its cigarette prices on January 26, 2006 to restore the competitiveness of its brands. PMI expects that the price reduction will significantly reduce its income in Spain in 2006. Late in February the Spanish government again raised the level of excise taxes, but also established a minimum excise tax, following which PMI raised its prices back to prior levels. While the introduction of a minimum excise tax effectively raises the floor price of the cheapest brands, it still permits these brands to maintain sizeable price gaps. Accordingly, PMI must await further developments before being able to make a more accurate assessment of its 2006 volume and income projections from the Spanish market.

In Italy, the total cigarette market declined 6.1% in 2005, largely reflecting tax-driven pricing and the impact of indoor smoking restrictions in public places. PMI's shipment volume in Italy increased 2.7%, mainly reflecting the one-time inventory sale to its new distributor. Excluding the one-time inventory sale, cigarette shipment volume in Italy declined 3.2%. However, market share in Italy increased 1.1 share points to 52.6%, driven by *Diana*.

In France, shipment volume increased 2.5% and market share increased 1.9 share points to 41.7%, reflecting the strong performance of *Marlboro* and the *Philip Morris* brands.

In Eastern Europe, Middle East and Africa, volume increased 6.4%, due to gains in Egypt, Russia, North Africa, Turkey and Ukraine. Higher shipments in Ukraine and Egypt reflect improved economic conditions. In Turkey, shipment volume increased 8.6% and market share increased 4.4 points to 41.4%, fueled by the growth of *Marlboro, Parliament, Lark* and *Bond Street.*

In Asia, volume increased 21.3%, due primarily to the acquisition in Indonesia, the strong performance of *Marlboro* in the Philippines and *L&M* growth in Thailand, partially offset by lower volumes in Korea and Japan. Excluding the acquisition in Indonesia, volume in Asia was essentially flat.

In Latin America, volume increased 5.5%, due primarily to the acquisition in Colombia, and higher shipments in Mexico, partially offset by declines in Argentina and Brazil. Excluding the acquisition in Colombia, volume in Latin America declined 3.8%.

PMI achieved market share gains in a number of important markets, including Egypt, France, Italy, Japan, Korea, Mexico, the Netherlands, the Philippines, Russia, Thailand, Turkey, Ukraine and the United Kingdom. In addition, in Indonesia, Sampoerna's share in 2005 was significantly higher than the prior year.

Volume for *Marlboro* cigarettes grew 2.0%, due primarily to gains in Eastern Europe, the Middle East and Africa, higher inventories in Japan following the return of the *Marlboro* license in May 2005, and the one-time inventory sale in Italy, partially offset by lower volumes in Germany and worldwide duty-free. Excluding the one-time gains in Italy and Japan, *Marlboro* cigarette volume was essentially flat. *Marlboro* market share increased in many important markets, including Egypt, France, Japan, Mexico, Portugal, Russia, Turkey, Ukraine and the United Kingdom.

As discussed in Note 5. *Acquisitions*, during 2005, PMI acquired 98% of the outstanding shares of Sampoerna, an Indonesian tobacco company, and a 98.2% stake in Coltabaco, the largest tobacco company in Colombia.

During 2004, PMI purchased a tobacco business in Finland for a cost of approximately $42 million. During 2004, PMI also increased its ownership interest in a tobacco business in Serbia from 74.2% to 85.2%.

PMI's license agreement with Japan Tobacco Inc. for the manufacture and sale of *Marlboro* cigarettes in Japan was not renewed when the agreement expired in April 2005. PMI has undertaken the manufacture and merchandising of *Marlboro* and has expanded its field force and vending machine infrastructure in Japan.

In December 2005, the China National Tobacco Corporation ("CNTC") and PMI reached agreement on the licensed production in China of *Marlboro* and the establishment of an international joint venture between China National Tobacco Import and Export Group Corporation ("CNTIEGC"), a wholly owned subsidiary of CNTC, and PMI. PMI and CNTIEGC will each hold 50% of the shares of the joint venture company, which will be based in Lausanne, Switzerland. Following its establishment, the joint venture company will offer consumers a comprehensive portfolio of Chinese heritage brands globally, expand the export of tobacco products and tobacco materials from China, and explore other business development opportunities. It is expected that the production and sale of *Marlboro* cigarettes under license in China and the sale of Chinese style brands in selected international markets through the joint venture company will commence in the first half of 2006. The agreements will not result in a material impact on PMI's financial results.

2004 compared with 2003

The following discussion compares tobacco operating results for 2004 with 2003.

■ **Domestic tobacco:** PM USA's net revenues, which include excise taxes billed to customers, increased $510 million (3.0%). Excluding excise taxes, net revenues increased $514 million (3.9%), due primarily to savings resulting from changes to the 2004 trade programs, including PM USA's returned goods policy and lower Wholesale Leaders program discounts.

Operating companies income increased $516 million (13.3%), due primarily to savings resulting from changes to trade programs in 2004, including PM USA's returned goods policy and lower Wholesale Leaders program discounts, net of increased costs including the State Settlement Agreements (aggregating $197 million), the 2003 pre-tax charges for the domestic tobacco legal settlement ($202 million), lower marketing, administration and research costs ($67 million), lower pre-tax charges for the domestic tobacco headquarters relocation ($38 million) and lower asset impairment and exit costs ($12 million).

PM USA's shipment volume was 187.1 billion units, a decrease of 0.1%. In the premium segment, PM USA's shipment volume increased 0.1%, as gains in *Marlboro* were essentially offset by declines in other premium brands. *Marlboro* shipment volume increased 2.5 billion units (1.7%) to 150.4 billion units with gains across the brand portfolio and the introduction of *Marlboro* Menthol 72mm. In the discount segment, PM USA's shipment volume decreased 1.9%, while *Basic* shipment volume was down 0.7% to 15.6 billion units.

The following table summarizes PM USA's retail share performance, based on data from the IRI/Capstone Total Retail Panel, which was developed to measure market share in retail stores selling cigarettes, but was not designed to capture Internet or direct mail sales:

For the Years Ended December 31,	2004	2003
Marlboro	39.5%	38.0%
Parliament	1.7	1.7
Virginia Slims	2.4	2.4
Basic	4.2	4.2
Focus on Four Brands	47.8	46.3
Other	2.0	2.4
Total PM USA	49.8%	48.7%

■ **International tobacco:** International tobacco net revenues, which include excise taxes billed to customers, increased $6.1 billion (18.4%). Excluding excise taxes, net revenues increased $1.6 billion (10.2%), due primarily to favorable currency ($1.0 billion), price increases ($538 million) and the impact of acquisitions ($285 million), partially offset by lower volume/mix ($300 million), reflecting lower volume in France, Germany and Italy.

Operating companies income increased $280 million (4.5%), due primarily to favorable currency ($540 million), price increases ($538 million) and the impact of acquisitions ($71 million), partially offset by higher marketing, administration and research costs ($373 million), the 2004 pre-tax charges for the international tobacco E.C. agreement ($250 million), unfavorable volume/mix ($201 million), reflecting lower volume in the higher-margin markets of France, Germany and Italy, and asset impairment and exit costs for the closures of facilities in Hungary and Belgium, as well as the streamlining of PMI's Benelux operations ($44 million).

PMI's cigarette volume of 761.4 billion units increased 25.6 billion units (3.5%), due primarily to incremental volume from acquisitions made during 2003. Excluding acquisition volume, shipments increased 9.1 billion units (1.2%).

In the European Union, PMI's cigarette volume declined 4.8%, due primarily to decreases in France, Germany and Italy, partially offset by higher volume in Poland and an acquisition in Greece. Shipment volume decreased 19.5% in France, due to tax-driven price increases since January 1, 2003, that continued to drive an overall market decline. PMI's market share in France increased 0.7 share points to 39.9%. In Italy, volume decreased 6.4% and market share fell 2.6 share points to 51.5%, as PMI's brands were adversely impacted by low-price competitive brands and a lower total market. In Germany, volume declined, reflecting a lower total cigarette market due mainly to tax-driven price increases and the resultant consumer shifts to low-price tobacco products, particularly tobacco portions which benefit from lower excise taxes than cigarettes. PMI entered the tobacco portions market during the second quarter of 2004 with the *Marlboro* and *Next* brands.

In Eastern Europe, Middle East and Africa, volume increased due to gains in Kazakhstan, Romania, Russia, Saudi Arabia, Turkey and Ukraine, and an acquisition in Serbia. In worldwide duty-free, volume increased, reflecting the global recovery in travel and a favorable comparison to the prior year, which was depressed by the effects of SARS and the Iraq war.

In Asia, volume grew, due primarily to increases in Korea, Malaysia, Thailand and the Philippines. In Japan, PMI's volume was up slightly, while the total market was down due to the adverse impact of the July 2003 tax-driven retail price increase and a lower incidence of smoking.

In Latin America, volume decreased, driven mainly by declines in Argentina, partially offset by an increase in Mexico.

PMI achieved market share gains in a number of important markets, including Austria, Belgium, Egypt, France, Greece, Japan, Mexico, the Netherlands, Poland, Russia, Saudi Arabia, Spain, Turkey and Ukraine.

Volume for *Marlboro* declined 1.3%, as lower volume in the European Union, mainly France and Germany, was partially offset by gains in Eastern Europe, Middle East and Africa, and Asia. *Marlboro* market share increased in many important markets, including Argentina, Belgium, Japan, Mexico, Poland, Portugal, Russia, Spain, Turkey, Ukraine and the United Kingdom.

During 2004, PMI purchased a tobacco business in Finland for a cost of approximately $42 million. During 2003, PMI purchased approximately 74.2% of a tobacco business in Serbia for a cost of approximately $486 million, and in 2004, PMI increased its ownership interest to 85.2%. During 2003, PMI also purchased 99% of a tobacco business in Greece for approximately $387 million and increased its ownership interest in its affiliate in Ecuador from less than 50% to approximately 98% for a cost of $70 million.

Food

Business Environment

Kraft manufactures and markets packaged food products, consisting principally of beverages, cheese, snacks, convenient meals and various packaged grocery products. Kraft manages and reports operating results through two units, Kraft North America Commercial ("KNAC") and Kraft International Commercial ("KIC"). KNAC represents the North American food segment (United States and Canada) and KIC represents the international food segment.

KNAC and KIC are subject to a number of challenges that may adversely affect their businesses. These challenges, which are discussed below and in the *Cautionary Factors That May Affect Future Results* section include:

- fluctuations in commodity prices;
- movements of foreign currencies;
- competitive challenges in various products and markets, including price gaps with competitor products and the increasing price-consciousness of consumers;
- a rising cost environment and the limited ability to increase prices;
- a trend toward increasing consolidation in the retail trade and consequent pricing pressure and inventory reductions;
- a growing presence of discount retailers, primarily in Europe, with an emphasis on private label products;
- changing consumer preferences, including diet trends;
- competitors with different profit objectives and less susceptibility to currency exchange rates; and
- concerns and/or regulations regarding food safety, quality and health, including genetically modified organisms, trans-fatty acids and obesity. Increased government regulation of the food industry could result in increased costs to Kraft.

Fluctuations in commodity costs can lead to retail price volatility and intense price competition, and can influence consumer and trade buying patterns. During 2005, Kraft's commodity costs on average have been higher than those incurred in 2004 (most notably coffee, nuts, energy and packaging), and have adversely affected earnings. For 2005, Kraft had a negative pre-tax earnings impact from all commodities of approximately $800 million as compared with 2004, following an increase of approximately $900 million for 2004 compared with 2003.

In the ordinary course of business, Kraft is subject to many influences that can impact the timing of sales to customers, including the timing of holidays and other annual or special events, seasonality of certain products, significant weather conditions, timing of Kraft or customer incentive programs and pricing actions, customer inventory programs, Kraft's initiatives to improve supply chain efficiency, including efforts to align product shipments more closely with consumption by shifting some of its customer marketing programs to a consumption based approach, the financial condition of customers and general economic conditions. Kraft's operating subsidiaries generally report year-end results as of the Saturday closest to the end of each year. This resulted in fifty-three weeks of operating results for Kraft in the consolidated statement of earnings for the year ended December 31, 2005, versus fifty-two weeks for the years ended December 31, 2004 and 2003.

In January 2004, Kraft announced a three-year restructuring program with the objectives of leveraging Kraft's global scale, realigning and lowering its cost structure, and optimizing capacity utilization. As part of this program (which is discussed further in Note 3. *Asset Impairment and Exit Costs*), Kraft anticipated the closure or sale of up to 20 plants and the elimination of approximately 6,000 positions. From 2004 through 2006, Kraft expects to incur approximately $1.2 billion in pre-tax charges, reflecting asset disposals, severance and other implementation costs, including $297 million and $641 million incurred in 2005 and 2004, respectively. Total pre-tax charges for the program incurred through December 31, 2005 were $938 million. Approximately 60% of the pre-tax charges are expected to require cash payments.

In addition, Kraft expects to incur approximately $170 million in capital expenditures from 2004 through 2006 to implement the restructuring program. From January 2004 through December 31, 2005, Kraft spent $144 million, including $98 million spent in 2005, in capital to implement the restructuring program. Cost savings as a result of the restructuring program were approximately $131 million in 2005 and $127 million in 2004, and were anticipated to reach cumulative annualized cost savings of approximately $450 million by 2006, all of which were expected to be used to support brand-building initiatives.

In January 2006, Kraft announced plans to expand its restructuring efforts beyond those originally contemplated. Additional pre-tax charges are anticipated to be $2.5 billion from 2006 to 2009, of which approximately $1.6 billion are expected to require cash payments. These charges will result in the anticipated closure of up to 20 additional facilities and the elimination of approximately 8,000 additional positions. Initiatives under the expanded program include additional organizational streamlining and facility closures. The expanded initiatives are expected to add approximately $700 million in annualized cost savings by 2009. Capitalized expenditures required for the expanded restructuring program will be included within Kraft's overall capital spending budget, which is expected to remain flat in 2006 versus 2005 at $1.2 billion. The entire restructuring program is expected to ultimately result in $3.7 billion in pre-tax charges, the closure of up to 40 facilities, the elimination of approximately 14,000 positions and cumulative annualized cost savings at the completion of the program of approximately $1.15 billion. Approximately $2.3 billion of the $3.7 billion in pre-tax charges are expected to require cash payments.

One element of Kraft's growth strategy is to strengthen its brand portfolio through a disciplined program of selective acquisitions and divestitures. Kraft is constantly reviewing potential acquisition candidates and from time to time sells businesses that are outside its core categories or that do not meet its growth or profitability targets. The impact of any future acquisition or divestiture could have a material impact on Altria Group, Inc.'s consolidated financial position, results of operations or cash flows, and future sales of businesses could in some cases result in losses on sale.

As previously discussed, Kraft sold substantially all of its sugar confectionery business in June 2005, for pre-tax proceeds of approximately $1.4 billion. The sale included the *Life Savers*, *Creme Savers*, *Altoids*, *Trolli* and *Sugus* brands. Altria Group, Inc. has reflected the results of Kraft's sugar confectionery business prior to the closing date as discontinued operations on the consolidated statements of earnings for all years presented. The assets related to the sugar confectionery business were reflected as assets of discontinued operations held for sale on the consolidated balance sheet at December 31, 2004. Kraft recorded a net loss on sale of discontinued operations of $297 million in the second quarter of 2005, related largely to taxes on the transaction. ALG's share of the loss, net of minority interest, was $255 million.

During 2005, Kraft sold its fruit snacks assets and incurred a pre-tax asset impairment charge of $93 million in recognition of this sale. Additionally, during 2005, Kraft sold its U.K. desserts assets and its U.S. yogurt brand. The aggregate proceeds received from the sales of other businesses during 2005 were $238 million, on which pre-tax gains of $108 million were recorded. In December 2005, Kraft announced the sales of certain Canadian assets and a small U.S. biscuit brand and incurred pre-tax asset impairment charges of $176 million in recognition of these sales. These transactions closed in the first quarter of 2006.

During 2004, Kraft sold a Brazilian snack nuts business and trademarks associated with a candy business in Norway. The aggregate proceeds received from the sales of these businesses were $18 million, on which pre-tax losses of $3 million were recorded.

During 2004, Kraft acquired a U.S.-based beverage business for a total cost of $137 million. During 2003, Kraft acquired trademarks associated with a small U.S.-based natural foods business and also acquired a biscuits business in Egypt. The total cost of these and other smaller businesses purchased by Kraft during 2003 was $98 million.

During 2003, Kraft sold a European rice business and a branded fresh cheese business in Italy. The aggregate proceeds received from the sales of businesses in 2003 were $96 million, on which pre-tax gains of $31 million were recorded.

The operating results of businesses acquired and sold, excluding Kraft's sugar confectionery business, in the aggregate, were not material to Altria Group, Inc.'s consolidated financial position, results of operations or cash flows in any of the years presented.

Operating Results

	Net Revenues			Operating Companies Income		
(in millions)	**2005**	2004	2003	**2005**	2004	2003
North American food	**$23,293**	$22,060	$20,937	**$3,831**	$3,870	$4,658
International food	**10,820**	10,108	9,561	**1,122**	933	1,393
Total food	**$34,113**	$32,168	$30,498	**$4,953**	$4,803	$6,051

2005 compared with 2004

The following discussion compares food operating results for 2005 with 2004.

■ **North American food:** North American food included 53 weeks of operating results in 2005 compared with 52 weeks in 2004. Kraft estimates that this extra week positively impacted net revenues and operating companies income in 2005 by approximately $435 million and $80 million, respectively.

Net revenues increased $1.2 billion (5.6%), due primarily to higher volume/mix ($873 million, including the benefit of the 53rd week), higher net pricing ($239 million, primarily reflecting commodity-driven price increases on coffee, nuts, cheese and meats, partially offset by increased promotional spending), favorable currency ($172 million) and the impact of acquisitions ($41 million), partially offset by the impact of divestitures ($97 million).

Operating companies income decreased $39 million (1.0%), due primarily to higher marketing, administration and research costs ($367 million, including higher benefit and marketing costs, as well as costs associated with the 53rd week), higher fixed manufacturing costs ($94 million), the net impact of higher implementation costs associated with the restructuring program ($15 million), the impact of divestitures ($9 million) and unfavorable costs, net of higher pricing ($3 million, including higher commodity costs and increased promotional spending), partially offset by favorable volume/mix ($364 million, including the benefit of the 53rd week), lower pre-tax charges for asset impairment and exit costs ($56 million) and favorable currency ($31 million).

Volume increased 2.0%, including the benefit of 53 weeks in 2005 results. Excluding acquisitions and divestitures, and the 53rd week of shipments, volume was essentially flat. In U.S. Beverages, volume increased, driven primarily by an acquisition in 2004, partially offset by volume declines in coffee due to the impact of commodity-driven price increases on category consumption. In U.S. Snacks & Cereals, volume increased, due primarily to higher biscuit shipments, and new product introductions and expanded distribution in cereals, partially offset by lower snack nut shipments, due to commodity-driven price increases and increased competitive activity. Volume increased in U.S. Convenient Meals, due primarily to new product introductions and higher shipments of cold cuts, and higher shipments of pizza and meals due primarily to the impact of the 53rd week. In U.S. Grocery, volume increased due primarily to the 53rd week of shipments. In U.S. Cheese, Canada & North America Foodservice, volume decreased, due primarily to the impact of divestitures and lower volume in Canada.

■ **International food:** International food included 53 weeks of operating results in 2005 compared with 52 weeks in 2004. Kraft estimates that this extra week positively impacted net revenues and operating companies income in 2005 by approximately $190 million and $20 million, respectively.

Net revenues increased $712 million (7.0%), due primarily to favorable currency ($361 million), higher pricing ($214 million, including higher commodity-driven pricing) and favorable volume/mix ($213 million, including the benefit of the 53rd week), partially offset by the impact of divestitures ($77 million). Net revenues were up in developing markets, driven by significant growth in Russia, Ukraine and the Middle East. In addition, net revenues increased in several Western European markets, partially offset by a decline in volume, particularly in Germany.

Operating companies income increased $189 million (20.3%), due primarily to favorable volume/mix ($115 million, including the benefit of the 53rd week), net gains on the sale of businesses ($112 million), lower pre-tax charges for asset impairment and exit costs ($68 million), favorable currency ($59 million) and a 2004 equity investment impairment charge related to a joint venture in Turkey ($47 million), partially offset by unfavorable costs and increased promotional spending, net of higher pricing ($99 million, including higher commodity costs), higher marketing, administration and research costs ($53 million, including higher marketing and benefit costs, and costs associated with the 53rd week, partially offset by a $16 million recovery of receivables previously written off), the impact of divestitures ($24 million), the net impact of higher implementation costs associated with the Kraft restructuring program ($22 million) and higher fixed manufacturing costs ($16 million).

Volume decreased 1.2%, including the benefit of 53 weeks in 2005 results. Excluding the 53rd week of shipments in 2005 and the impact of divestitures, volume decreased approximately 2%, due primarily to higher commodity-driven pricing.

In Europe, Middle East and Africa, volume decreased, due primarily to lower volume in Germany and the divestiture of the U.K. desserts assets in the first quarter of 2005, partially offset by growth in developing markets, including

Russia, Ukraine and the Middle East. In grocery, volume declined, due to the divestiture of the U.K. desserts assets in the first quarter of 2005 and lower results in Egypt and Germany. Beverages volume decreased, driven by lower coffee shipments in Germany, due to commodity-driven price increases, partially offset by higher shipments of refreshment beverages in the Middle East and higher shipments of coffee in Russia and Ukraine. Convenient meals volume declined, due primarily to lower category performance in the U.K. and lower promotions in Germany. Cheese volume increased due to higher shipments in the U.K., Italy and the Middle East. In snacks, volume increased, as gains in confectionery, benefiting from growth in Russia and Ukraine, were partially offset by lower biscuits volume in Egypt.

Volume decreased in Latin America & Asia Pacific, due primarily to lower shipments in China, partially offset by growth in Southeast Asia. Grocery volume declined, due primarily to lower shipments in Brazil and Central America. Snacks volume also declined, impacted by increased biscuit competition in China and resizing of biscuit products in Latin America, partially offset by higher shipments in Venezuela. In beverages, volume increased, due primarily to refreshment beverage gains in the Philippines, Argentina and Puerto Rico.

2004 compared with 2003

The following discussion compares food operating results for 2004 with 2003.

- **North American food:** Net revenues increased $1.1 billion (5.4%), due primarily to higher volume/mix ($537 million), higher net pricing ($312 million, reflecting commodity-driven price increases, partially offset by increased promotional spending), favorable currency ($164 million) and the impact of acquisitions ($117 million). Higher net revenues were driven by cheese, meats and nuts due to higher volume in response to consumer nutrition trends and higher commodity-driven pricing net of increased promotional spending.

Operating companies income decreased $788 million (16.9%), due primarily to the 2004 pre-tax charges for asset impairment and exit costs ($391 million), cost increases, net of higher pricing ($356 million, including higher commodity costs and increased promotional spending), higher marketing, administration and research costs ($214 million, including higher benefit costs), and the 2004 implementation costs associated with the Kraft restructuring program ($40 million), partially offset by higher volume/mix ($197 million) and favorable currency ($29 million).

Volume increased 4.3%, of which 2.6% was due to acquisitions. In U.S. Beverages, volume increased, driven primarily by an acquisition in beverages, growth in coffee and new product introductions. Volume gains were achieved in U.S. Cheese, Canada & North America Foodservice, due primarily to promotional reinvestment spending in cheese and higher volume in Foodservice, due to the impact of an acquisition and higher shipments to national accounts. In U.S. Convenient Meals, volume increased, due primarily to higher cold cuts shipments and new product introductions in pizza, partially offset by lower shipments of meals. In U.S. Grocery, volume increased, due primarily to growth in enhancers, partially offset by declines in desserts. In U.S. Snacks & Cereals, volume increased, due primarily to higher snack nuts and biscuits shipments, partially offset by lower cereals volumes.

- **International food:** Net revenues increased $547 million (5.7%), due primarily to favorable currency ($674 million), favorable volume/mix ($23 million) and the impact of acquisitions ($23 million), partially offset by the impact of divestitures ($126 million) and increased promotional spending, net of higher pricing ($47 million). Lower pricing and higher promotional spending on coffee in Europe and lower shipments of refreshment beverages in Mexico negatively impacted net revenues.

Operating companies income decreased $460 million (33.0%), due primarily to the pre-tax charges for asset impairment and exit costs ($206 million), cost increases and increased promotional spending, net of higher pricing ($113 million), higher marketing, administration and research costs ($92 million, including higher benefit costs and infrastructure investment in developing markets), an investment impairment charge relating to a joint venture in Turkey ($47 million), the 2004 loss and 2003 gain on sales of businesses (aggregating $34 million) and the impact of divestitures, partially offset by favorable currency ($69 million).

Volume decreased 1.1%, due primarily to the impact of the divestitures of a rice business and a branded fresh cheese business in Europe in 2003, as well as price competition and trade inventory reductions in several markets, partially offset by the impact of acquisitions.

In Europe, Middle East and Africa, volume decreased, impacted by divestitures, price competition in France and trade inventory reductions in Russia, partially offset by growth in Germany, Austria, Italy and Romania, and the impact of acquisitions. Beverages volume declined, impacted by price competition in coffee in France and lower shipments of refreshment beverages in the Middle East. In cheese, volume decreased, due primarily to the divestiture of a branded fresh cheese business in Italy, partially offset by higher shipments of cream cheese in Germany, Italy and the United Kingdom, and higher process cheese shipments in the United Kingdom. In convenient meals, volume declined, due primarily to the divestiture of a European rice business. In grocery, volume declined across several markets, including Germany and Italy, partially offset by an acquisition in Egypt. Snacks volume increased, benefiting from acquisitions and new product introductions across the region, partially offset by trade inventory reductions in Russia.

Volume decreased in Latin America & Asia Pacific, due primarily to declines in Mexico, Peru, and Venezuela, partially offset by gains in Brazil and China. Snacks volume decreased, impacted by price competition and trade inventory reductions in Peru and Venezuela. In grocery, volume decreased across several markets, including Peru, Australia and the Philippines. In beverages, volume increased, impacted by gains in Brazil and China, partially offset by price competition in Mexico. Cheese volume increased, with gains across several markets, including Japan, Australia and the Philippines.

Financial Services

Business Environment

In 2003, PMCC shifted its strategic focus and is no longer making new investments but is instead focused on managing its existing portfolio of finance assets in order to maximize gains and generate cash flow from asset sales and related activities. Accordingly, PMCC's operating companies income will fluctuate over time as investments mature or are sold. During 2005, 2004 and 2003, PMCC received proceeds from asset sales and maturities of $476 million, $644 million and $507 million, respectively, and recorded gains of $72 million, $112 million and $45 million respectively, in operating companies income.

Among its leasing activities, PMCC leases a number of aircraft, predominantly to major United States passenger carriers. At December 31, 2005, $2.1 billion of PMCC's finance asset balance related to aircraft. Two of PMCC's aircraft lessees, Delta Air Lines, Inc. ("Delta") and Northwest Airlines, Inc. ("Northwest") are currently under bankruptcy protection and a third lessee, United

Air Lines, Inc. ("United") exited bankruptcy on February 1, 2006. In addition, PMCC leases various natural gas-fired power plants to indirect subsidiaries of Calpine Corporation ("Calpine"), also currently under bankruptcy protection. PMCC is not recording income on any of these leases.

PMCC leases 24 Boeing 757 aircraft to United with an aggregate finance asset balance of $541 million at December 31, 2005. PMCC has entered into an agreement with United to amend 18 direct finance leases and United has assumed the 18 amended leases. There is no third-party debt associated with these leases. United remains current on lease payments due to PMCC on these 18 amended leases. PMCC continues to monitor the situation at United with respect to the six remaining aircraft financed under leveraged leases, in which PMCC has an aggregate finance asset balance of $92 million. United and the public debtholders have a court approved agreement that calls for the public debtholders to foreclose on PMCC's interests in these six aircraft and transfer them to United. The foreclosure, expected to occur in 2006, subsequent to United's emergence from bankruptcy, would result in the write-off of the $92 million finance asset balance against PMCC's allowance for losses and the acceleration of tax payments in the amount of approximately $55 million on these leases.

In addition, PMCC has an aggregate finance asset balance of $257 million at December 31, 2005, relating to six Boeing 757, nine Boeing 767 and four McDonnell Douglas (MD-88) aircraft leased to Delta under leveraged leases. In November 2004, PMCC, along with other aircraft lessors, entered into restructuring agreements with Delta on all 19 aircraft. As a result of its agreement, PMCC recorded a charge to the allowance for losses of $40 million in the fourth quarter of 2004. As a result of Delta's bankruptcy filing in September 2005, the restructuring agreement is no longer in effect and PMCC is at risk of having its interest in these aircraft foreclosed upon by the senior lenders under the leveraged leases. Should a foreclosure occur, it would also result in the write-off of the finance asset balance against PMCC's allowance for losses and the acceleration of tax payments on these leases, and may require further provisions to increase the allowance for losses.

PMCC also leases three Airbus A-320 aircraft and five British Aerospace RJ85 aircraft to Northwest financed under leveraged leases with an aggregate finance asset balance of $62 million at December 31, 2005. Northwest filed for bankruptcy protection in September 2005. As a result of Northwest's bankruptcy filing, PMCC is at risk of having its interest in these aircraft foreclosed upon by the senior lenders under the leveraged leases. Should a foreclosure occur, it would also result in the write-off of the finance asset balance against PMCC's allowance for losses and the acceleration of tax payments on these leases.

In addition, PMCC's leveraged leases for ten Airbus A-319 aircraft with Northwest have been rejected in the bankruptcy. As a result of the lease rejection, PMCC, as owner of the aircraft, recorded these assets on its consolidated balance sheet at the lower of net book value or fair market value. The adjustment to fair market value resulted in a $100 million charge against the allowance for losses in the fourth quarter of 2005. The assets are classified as held for sale and reflected in Financial Services other assets on the consolidated balance sheet until such time as the assets are either sold or foreclosed upon by the lenders. In addition, the related nonrecourse debt is reflected in Financial Services other liabilities on the consolidated balance sheet until such time as the underlying assets are either sold or foreclosed upon by the senior lenders. Should a foreclosure occur, it would result in the acceleration of tax payments on these aircraft of approximately $57 million.

In addition, PMCC leases 16 Airbus A-319 aircraft to US Airways, Inc. ("US Airways") financed under leveraged leases with an aggregate finance asset balance of $150 million at December 31, 2005. In September 2005, US Airways emerged from bankruptcy protection and assumed the leases on PMCC's aircraft without any changes. Also in September 2005, US Airways and America West Holdings Corp. ("America West") completed a merger. PMCC leases five Airbus A-320 aircraft and three engines to America West with an aggregate finance asset balance of $44 million at December 31, 2005.

PMCC also leases two 265 megawatt ("MW") natural gas-fired power plants (located in Tiverton, Rhode Island, and Rumford, Maine) and one 750 MW natural gas-fired power plant (located in Pasadena, Texas) to indirect subsidiaries of Calpine financed under leveraged leases with an aggregate finance asset balance of $206 million at December 31, 2005. On December 20, 2005, Calpine filed for bankruptcy protection. In the initial bankruptcy filing, PMCC's lessees of the Tiverton and Rumford projects were included. On February 6, 2006, these leases were rejected. The Pasadena lessee did not file for bankruptcy but could file at a future date. Should a foreclosure on any of these projects occur, it would result in the write-off of the finance asset balance against PMCC's allowance for losses and the acceleration of tax payments on these leases, and may require further provisions to increase the allowance for losses.

Due to continuing uncertainty within its airline portfolio and bankruptcy filings by Delta and Northwest, PMCC recorded a provision for losses of $200 million in September 2005. As a result of this provision, PMCC's fixed charges coverage ratio did not meet its 1.25:1 requirement under a support agreement with ALG. Accordingly, as required by the support agreement, a support payment of $150 million was made by ALG to PMCC in September 2005.

Previously, PMCC recorded provisions for losses of $140 million in the fourth quarter of 2004 and $290 million in the fourth quarter of 2002 for its airline industry exposure. At December 31, 2005, PMCC's allowance for losses, which includes the provisions recorded by PMCC for its airline industry exposure, was $596 million. It is possible that adverse developments in the airline or other industries may require PMCC to increase its allowance for losses.

Operating Results

	Net Revenues			Operating Companies Income		
(in millions)	**2005**	2004	2003	**2005**	2004	2003
Financial Services	**$319**	$395	$432	**$31**	$144	$313

PMCC's net revenues for 2005 decreased $76 million (19.2%) from 2004, due primarily to the previously discussed change in strategy which resulted in lower lease portfolio revenues and lower gains from asset management activity. PMCC's operating companies income for 2005 decreased $113 million (78.5%) from 2004. Operating companies income for 2005 includes a $200 million increase to the provision for airline industry exposure as discussed above, an increase of $60 million over the prior year's provision, and lower gains from asset sales, partially offset by lower interest expense.

PMCC's net revenues for 2004 decreased $37 million (8.6%) from 2003, due primarily to the previously discussed change in strategy which resulted in lower lease portfolio revenues, partially offset by an increase of $66 million from gains on asset sales. PMCC's operating companies income for 2004 decreased $169 million (54.0%) from 2003, due primarily to the 2004 provision for airline industry exposure discussed above, and the decrease in net revenues.

■ **Net Cash Provided by Operating Activities:** During 2005, net cash provided by operating activities was $11.1 billion, compared with $10.9 billion during 2004. The increase in cash provided by operating activities was due primarily to higher earnings from continuing operations and lower escrow bond deposits related to the *Price* domestic tobacco case, partially offset by a higher use of cash to fund working capital and increased pension plan contributions.

During 2004, net cash provided by operating activities was $10.9 billion, compared with $10.8 billion during 2003. The increase of $74 million was due primarily to higher net earnings in 2004, partially offset by higher escrow deposits for the *Price* domestic tobacco case and lower cash from the financial services business.

■ **Net Cash Used in Investing Activities:** One element of the growth strategy of ALG's subsidiaries is to strengthen their brand portfolios through active programs of selective acquisitions and divestitures. These subsidiaries are constantly investigating potential acquisition candidates and from time to time Kraft sells businesses that are outside its core categories or that do not meet its growth or profitability targets. The impact of future acquisitions or divestitures could have a material impact on Altria Group, Inc.'s consolidated cash flows, and future sales of businesses could in some cases result in losses on sale.

During 2005, 2004 and 2003, net cash used in investing activities was $4.9 billion, $1.4 billion and $2.4 billion, respectively. The increase in 2005 primarily reflects the purchase of 98% of the outstanding shares of Sampoerna in 2005, partially offset by proceeds from the sales of businesses (primarily Kraft's sugar confectionery business) in 2005. The decrease in 2004 primarily reflects lower amounts used for the purchase of businesses. The discontinuation of finance asset investments, as well as the increased proceeds from finance asset sales also contributed to a lower level of cash used in investing activities.

Capital expenditures for 2005 increased 15.3% to $2.2 billion. Approximately 44% related to tobacco operations and approximately 53% related to food operations; the expenditures were primarily for modernization and consolidation of manufacturing facilities, and expansion of certain production capacity. In 2006, capital expenditures are expected to be approximately 20% above 2005 expenditures and are expected to be funded by operating cash flows.

■ **Net Cash Used in Financing Activities:** During 2005, net cash used in financing activities was $5.1 billion, compared with $8.0 billion in 2004 and $5.5 billion in 2003. The decrease of $2.9 billion from 2004 was due primarily to increased borrowings in 2005, which were primarily related to the acquisition of Sampoerna, partially offset by higher dividends paid on Altria Group, Inc. common stock and an increase in share repurchases at Kraft. The increase of $2.5 billion over 2003 was due primarily to the repayment of debt in 2004, as compared with 2003 when ALG and Kraft borrowed against their revolving credit facilities, while their access to commercial paper markets was temporarily eliminated following a $10.1 billion judgment against PM USA.

■ **Debt and Liquidity:**

Credit Ratings: Following a $10.1 billion judgment on March 21, 2003, against PM USA in the *Price* litigation, which is discussed in Note 19, the three major credit rating agencies took a series of ratings actions resulting in the lowering of ALG's short-term and long-term debt ratings. During 2003, Moody's lowered ALG's short-term debt rating from "P-1" to "P-3" and its long-term debt rating from "A2" to "Baa2." Standard & Poor's lowered ALG's short-term debt rating from "A-1" to "A-2" and its long-term debt rating from "A-" to "BBB." Fitch Rating Services lowered ALG's short-term debt rating from "F-1" to "F-2" and its long-term debt rating from "A" to "BBB."

While Kraft is not a party to, and has no exposure to, this litigation, its credit ratings were also lowered, but to a lesser degree. As a result of the rating agencies' actions, borrowing costs for ALG and Kraft have increased. None of ALG's or Kraft's debt agreements require accelerated repayment as a result of a decrease in credit ratings. The credit rating downgrades by Moody's, Standard & Poor's, and Fitch Rating Services had no impact on any of ALG's or Kraft's other existing third-party contracts.

Credit Lines: ALG and Kraft each maintain separate revolving credit facilities that they have historically used to support the issuance of commercial paper. However, as a result of the rating agencies' actions discussed above, ALG's and Kraft's access to the commercial paper market was temporarily eliminated in 2003. Subsequently, in April 2003, ALG and Kraft began to borrow against existing credit facilities to repay maturing commercial paper and to fund normal working capital needs. By the end of May 2003, Kraft regained its access to the commercial paper market. ALG's access to the commercial paper market has improved since it regained limited access in November 2003, but not to the levels achieved prior to the ratings downgrades.

As discussed in Note 5. *Acquisitions*, the purchase price of the Sampoerna acquisition was primarily financed through a euro 4.5 billion bank credit facility arranged for PMI and its subsidiaries in May 2005, consisting of a euro 2.5 billion three-year term loan facility and a euro 2.0 billion five-year revolving credit facility. These facilities, which are not guaranteed by ALG, require PMI to maintain an earnings before interest, taxes, depreciation and amortization ("EBITDA") to interest ratio of not less than 3.5 to 1.0. At December 31, 2005, PMI exceeded this ratio by a significant amount and is expected to continue to exceed it.

In April 2005, ALG negotiated a 364-day revolving credit facility in the amount of $1.0 billion and a new multi-year credit facility in the amount of $4.0 billion, which expires in April 2010. In addition, ALG terminated its existing $5.0 billion multi-year credit facility, which was due to expire in July 2006. The new ALG facilities require the maintenance of an earnings to fixed charges ratio, as defined by the agreements, of 2.5 to 1.0. At December 31, 2005, the ratio calculated in accordance with the agreements was 10.0 to 1.0.

In April 2005, Kraft negotiated a new multi-year revolving credit facility to replace both its $2.5 billion 364-day facility that was due to expire in July 2005 and its $2.0 billion multi-year facility that was due to expire in July 2006. The new Kraft facility, which is for the sole use of Kraft, in the amount of $4.5 billion, expires in April 2010 and requires the maintenance of a minimum net worth of $20.0 billion. At December 31, 2005, Kraft's net worth was $29.6 billion.

ALG, PMI and Kraft expect to continue to meet their respective covenants. These facilities do not include any credit rating triggers or any provisions that could require the posting of collateral. The multi-year facilities enable the respective companies to reclassify short-term debt on a long-term basis.

At December 31, 2005, $2.4 billion of short-term borrowings that PMI expects to remain outstanding at December 31, 2006 were reclassified as long-term debt.

At December 31, 2005, credit lines for ALG, Kraft and PMI, and the related activity were as follows:

ALG

Type (in billions of dollars)	Credit Lines	Amount Drawn	Commercial Paper Outstanding	Lines Available
364-day	**$1.0**	**$—**	**$—**	**$1.0**
Multi-year	**4.0**			**4.0**
	$5.0	**$—**	**$—**	**$5.0**

Kraft

Type (in billions of dollars)	Credit Lines	Amount Drawn	Commercial Paper Outstanding	Lines Available
Multi-year	**$4.5**	**$—**	**$0.4**	**$4.1**

PMI

Type (in billions of dollars)	Credit Lines	Amount Drawn	Lines Available
euro 2.5 billion, 3-year term loan	**$3.0**	**$3.0**	**$ —**
euro 2.0 billion, 5-year revolving credit	**2.3**	**0.8**	**1.5**
	$5.3	**$3.8**	**$1.5**

In addition to the above, certain international subsidiaries of ALG and Kraft maintain credit lines to meet their respective working capital needs. These credit lines, which amounted to approximately $2.2 billion for ALG subsidiaries (other than Kraft) and approximately $1.3 billion for Kraft subsidiaries, are for the sole use of these international businesses. Borrowings on these lines amounted to approximately $1.0 billion at December 31, 2005.

Debt: Altria Group, Inc.'s total debt (consumer products and financial services) was $23.9 billion and $23.0 billion at December 31, 2005 and 2004, respectively. Total consumer products debt was $21.9 billion and $20.8 billion at December 31, 2005 and 2004, respectively. Total consumer products debt includes third-party debt in Kraft's consolidated balance sheet of $10.5 billion and $12.3 billion, at December 31, 2005 and 2004, respectively, and PMI third-party debt of $4.9 billion and $0.7 billion at December 31, 2005 and 2004, respectively. At December 31, 2005 and 2004, Altria Group, Inc.'s ratio of consumer products debt to total equity was 0.61 and 0.68, respectively. The ratio of total debt to total equity was 0.67 and 0.75 at December 31, 2005 and 2004, respectively. Fixed-rate debt constituted approximately 75% and 90% of total consumer products debt at December 31, 2005 and 2004, respectively. The weighted average interest rate on total consumer products debt, including the impact of swap agreements, was approximately 5.4% at December 31, 2005 and 2004.

In November 2004, Kraft issued $750 million of 5-year notes bearing interest at 4.125%. The net proceeds of the offering were used by Kraft to refinance maturing debt. Kraft has a Form S-3 shelf registration statement on file with the SEC, under which Kraft may sell debt securities and/or warrants to purchase debt securities in one or more offerings. At December 31, 2005, Kraft had $3.5 billion of capacity remaining under its shelf registration.

At December 31, 2005, ALG had approximately $2.8 billion of capacity remaining under its existing shelf registration statement.

ALG does not guarantee the debt of Kraft or PMI.

Taxes: The IRS is examining the consolidated tax returns for Altria Group, Inc., which includes PMCC, for years 1996 through 1999. Recently, the IRS has proposed to disallow certain transactions, and may in the future challenge and disallow several more, of PMCC's leveraged leases based on recent Revenue Rulings and a recent IRS Notice addressing specific types of leveraged leases (lease-in/lease-out transactions, qualified technological equipment transactions, and sale-in/lease-out transactions). Altria Group, Inc. is expecting an assessment regarding these transactions for the years 1996 to 1999. PMCC believes that the position and supporting case law described in the Revenue Rulings and the IRS Notice as well as those asserted in the proposed adjustments, are incorrectly applied to PMCC's transactions and that its leveraged leases are factually and legally distinguishable in material respects from the IRS's position. PMCC and ALG intend to vigorously defend against any challenges based on that position through administrative appeals and litigation, if necessary, and ALG believes that, given the strength of PMCC's position, it should ultimately prevail. However, litigation is subject to many uncertainties and an adverse outcome could have a material adverse effect on Altria Group, Inc.'s consolidated results of operations, cash flows or financial position.

■ **Off-Balance Sheet Arrangements and Aggregate Contractual Obligations:** Altria Group, Inc. has no off-balance sheet arrangements, including special purpose entities, other than guarantees and contractual obligations that are discussed below.

Guarantees: As discussed in Note 19, at December 31, 2005, Altria Group, Inc.'s third-party guarantees, which are primarily related to excise taxes, and acquisition and divestiture activities, approximated $328 million, of which $296 million have no specified expiration dates. The remainder expire through 2023, with $17 million expiring during 2006. Altria Group, Inc. is required to perform under these guarantees in the event that a third party fails to make contractual payments or achieve performance measures. Altria Group, Inc. has a liability of $41 million on its consolidated balance sheet at December 31, 2005, relating to these guarantees. In the ordinary course of business, certain subsidiaries of ALG have agreed to indemnify a limited number of third parties in the event of future litigation. At December 31, 2005, subsidiaries of ALG were also contingently liable for $1.8 billion of guarantees related to their own performance, consisting of the following:

- $1.5 billion of guarantees of excise tax and import duties related primarily to international shipments of tobacco products. In these agreements, a financial institution provides a guarantee of tax payments to the respective governments. PMI then issues a guarantee to the respective financial institution for the payment of the taxes. These are revolving facilities that are integral to the shipment of tobacco products in international markets, and the underlying taxes payable are recorded on Altria Group, Inc.'s consolidated balance sheet.
- $0.3 billion of other guarantees related to the tobacco and food businesses.

Although Altria Group, Inc.'s guarantees of its own performance are frequently short-term in nature, the short-term guarantees are expected to be replaced, upon expiration, with similar guarantees of similar amounts. These items have not had, and are not expected to have, a significant impact on Altria Group, Inc.'s liquidity.

Aggregate Contractual Obligations: The following table summarizes Altria Group, Inc.'s contractual obligations at December 31, 2005:

	Payments Due				
(in millions)	Total	2006	2007-2008	2009-2010	2011 and Thereafter
Long-term debt(1):					
Consumer products	$16,738	$ 3,430	$4,864	$1,052	$7,392
Financial services	2,014	943	572	499	
	18,752	4,373	5,436	1,551	7,392
Operating leases(2)	1,619	436	561	278	344
Purchase obligations(3):					
Inventory and production costs	5,868	3,170	1,682	533	483
Other	5,273	2,912	1,346	689	326
	11,141	6,082	3,028	1,222	809
Other long-term liabilities(4)	158	6	107	21	24
	$31,670	$10,897	$9,132	$3,072	$8,569

(1) Amounts represent the expected cash payments of Altria Group, Inc.'s long-term debt and do not include short-term borrowings reclassified as long-term debt, bond premiums or discounts, or nonrecourse debt issued by PMCC. Amounts include capital lease obligations, primarily associated with the expansion of PMI's vending machine distribution in Japan.

(2) Amounts represent the minimum rental commitments under non-cancelable operating leases.

(3) Purchase obligations for inventory and production costs (such as raw materials, indirect materials and supplies, packaging, co-manufacturing arrangements, storage and distribution) are commitments for projected needs to be utilized in the normal course of business. Other purchase obligations include commitments for marketing, advertising, capital expenditures, information technology and professional services. Arrangements are considered purchase obligations if a contract specifies all significant terms, including fixed or minimum quantities to be purchased, a pricing structure and approximate timing of the transaction. Most arrangements are cancelable without a significant penalty, and with short notice (usually 30 days). Any amounts reflected on the consolidated balance sheet as accounts payable and accrued liabilities are excluded from the table above.

(4) Other long-term liabilities primarily consist of specific severance and incentive compensation arrangements. The following long-term liabilities included on the consolidated balance sheet are excluded from the table above: accrued pension, postretirement health care and postemployment costs, income taxes, minority interest, insurance accruals and other accruals. Altria Group, Inc. is unable to estimate the timing of payments for these items. Currently, Altria Group, Inc. anticipates making U.S. pension contributions of approximately $410 million in 2006 and non-U.S. pension contributions of approximately $216 million in 2006, based on current tax law (as discussed in Note 16. *Benefit Plans*).

The State Settlement Agreements and related legal fee payments, and payments for tobacco growers, as discussed below and in Note 19, are excluded from the table above, as the payments are subject to adjustment for several factors, including inflation, market share and industry volume. In addition, the international tobacco E.C. agreement payments discussed below are excluded from the table above, as the payments are subject to adjustment based on certain variables including PMI's market share in the European Union. Litigation escrow deposits, as discussed below and in Note 19. *Contingencies*, are also excluded from the table above since these deposits will be returned to PM USA should it prevail on appeal.

International Tobacco E.C. Agreement: In July 2004, PMI entered into an agreement with the E.C. and 10 member states of the European Union that provides for broad cooperation with European law enforcement agencies on anti-contraband and anti-counterfeit efforts. This agreement resolves all disputes between the parties relating to these issues. Under the terms of the agreement, PMI will make 13 payments over 12 years, including an initial payment of $250 million, which was recorded as a pre-tax charge against its earnings in 2004. The agreement calls for additional payments of approximately $150 million on the first anniversary of the agreement (this payment was made in July 2005), approximately $100 million on the second anniversary and approximately $75 million each year thereafter for 10 years, each of which is to be adjusted based on certain variables, including PMI's market share in the European Union in the year preceding payment. Because the additional payments are subject to these variables, PMI records charges for them as an expense in cost of sales when product is shipped. During the third quarter of 2004, PMI began accruing for payments due on the first anniversary of the agreement.

Payments Under State Settlement and Other Tobacco Agreements: As discussed previously and in Note 19, PM USA has entered into State Settlement Agreements with the states and territories of the United States and had entered into agreements for the benefit of United States tobacco growers which have now been replaced by obligations imposed by FETRA. During 2004, PMI entered into a cooperation agreement with the European Community. Each of these agreements calls for payments that are based on variable factors, such as cigarette volume, market shares and inflation. PM USA and PMI account for the cost of these agreements as a component of cost of sales as product is shipped.

As a result of these agreements, PM USA and PMI recorded the following amounts in cost of sales for the years ended December 31, 2005, 2004 and 2003:

(in billions)	PM USA	PMI	Total
2005	$5.0	$0.1	$5.1
2004	4.6	0.1	4.7
2003	4.4		4.4

In addition, during 2004, PMI recorded a pre-tax charge of $250 million at the signing of the cooperation agreement with the European Community, and PM USA recorded a one-time pre-tax charge of $202 million in 2003 related to the settlement of litigation with tobacco growers.

Based on current agreements and current estimates of volume and market share, the estimated amounts that PM USA and PMI may charge to cost of sales under these agreements will be approximately as follows:

(in billions)	PM USA	PMI	Total
2006	$5.1	$0.1	$5.2
2007	5.6	0.1	5.7
2008	5.8	0.1	5.9
2009	5.8	0.1	5.9
2010	5.9	0.1	6.0
2011 to 2016	5.9 annually	0.1 annually	6.0 annually
Thereafter	6.1 annually		6.1 annually

The estimated amounts charged to cost of sales in each of the years above would generally be paid in the following year. As previously stated, the payments due under the terms of these agreements are subject to adjustment for several factors, including cigarette volume, inflation and certain contingent events and, in general, are allocated based on each manufacturer's market share. The amounts shown in the table above are estimates, and actual amounts will differ as underlying assumptions differ from actual future results.

Litigation Escrow Deposits: As discussed in Note 19, in connection with obtaining a stay of execution in May 2001 in the *Engle* class action, PM USA placed $1.2 billion into an interest-bearing escrow account. The $1.2 billion escrow account and a deposit of $100 million related to the bonding requirement are included in the December 31, 2005 and 2004 consolidated balance sheets as other assets. These amounts will be returned to PM USA should it prevail in its appeal of the case. Interest income on the $1.2 billion escrow account is paid to PM USA quarterly and is being recorded as earned in interest and other debt expense, net, in the consolidated statements of earnings.

In addition, in connection with obtaining a stay of execution in the *Price* case, PM USA placed a pre-existing 7.0%, $6 billion long-term note from ALG to PM USA into an escrow account with an Illinois financial institution. Since this note is the result of an intercompany financing arrangement, it does not appear on the consolidated balance sheet of Altria Group, Inc. In addition, PM USA agreed to make cash deposits with the clerk of the Madison County Circuit Court in the following amounts: beginning October 1, 2003, an amount equal to the interest earned by PM USA on the ALG note ($210 million every six months), an additional $800 million in four equal quarterly installments between September 2003 and June 2004 and the payments of the principal of the note which are due in equal installments in April 2008, 2009 and 2010. Through December 31, 2005, PM USA made $1.85 billion in cash deposits due under the judge's order. Cash deposits into the account are included in other assets on the consolidated balance sheet. If PM USA prevails on appeal, the escrowed note and all cash deposited with the court will be returned to PM USA, with accrued interest less administrative fees payable to the court.

With respect to certain adverse verdicts and judicial decisions currently on appeal, other than the *Engle* and the *Price* cases discussed above, as of December 31, 2005, PM USA has posted various forms of security totaling approximately $329 million, the majority of which have been collateralized with cash deposits, to obtain stays of judgments pending appeals. In addition, as discussed in Note 19, PMI placed 51 million euro in an escrow account pending appeal of an adverse administrative court decision in Italy. These cash deposits are included in other assets on the consolidated balance sheets.

As discussed above under *Tobacco—Business Environment*, the present legislative and litigation environment is substantially uncertain and could result in material adverse consequences for the business, financial condition, cash flows or results of operations of ALG, PM USA and PMI. Assuming there are no material adverse developments in the legislative and litigation environment, Altria Group, Inc. expects its cash flow from operations to provide sufficient liquidity to meet the ongoing needs of the business.

■ **Equity and Dividends**: Following the rating agencies' actions in the first quarter of 2003, discussed above in "Credit Ratings," ALG suspended its share repurchase program.

During December 2004, Kraft completed its $700 million share repurchase program and began a $1.5 billion two-year share repurchase program. During 2005 and 2004, Kraft repurchased 39.2 million and 21.5 million shares, respectively, of its Class A common stock at a cost of $1.2 billion and $700 million, respectively. As of December 31, 2005, Kraft had repurchased 40.6 million shares of its Class A common stock, under its $1.5 billion authority, at an aggregate cost of $1.25 billion.

As discussed in Note 12. *Stock Plans,* in January 2005 and January 2004, Altria Group, Inc. granted approximately 1.2 million and 1.4 million shares of restricted stock, respectively, to eligible U.S.-based employees and Directors of Altria Group, Inc. and also issued to eligible non-U.S. employees and Directors rights to receive approximately 1.0 million equivalent shares each year. Restrictions on the stock and rights granted in 2005 and 2004 lapse in the first quarter of 2008 and the first quarter of 2007, respectively.

At December 31, 2005, the number of shares to be issued upon exercise of outstanding stock options and vesting of non-U.S. rights to receive equivalent shares was 54.8 million, or 2.6% of shares outstanding.

Dividends paid in 2005 and 2004 were $6.2 billion and $5.7 billion, respectively, an increase of 9.2%, primarily reflecting a higher dividend rate in 2005. During the third quarter of 2005, Altria Group, Inc.'s Board of Directors approved a 9.6% increase in the quarterly dividend rate to $0.80 per share. As a result, the annualized dividend rate increased to $3.20 from $2.92.

Market Risk

ALG's subsidiaries operate globally, with manufacturing and sales facilities in various locations around the world. ALG and its subsidiaries utilize certain financial instruments to manage foreign currency and commodity exposures. Derivative financial instruments are used by ALG and its subsidiaries, principally to reduce exposures to market risks resulting from fluctuations in foreign exchange rates and commodity prices, by creating offsetting exposures. Altria Group, Inc. is not a party to leveraged derivatives and, by policy, does not use derivative financial instruments for speculative purposes.

A substantial portion of Altria Group, Inc.'s derivative financial instruments are effective as hedges. Hedging activity affected accumulated other comprehensive earnings (losses), net of income taxes, during the years ended December 31, 2005, 2004 and 2003, as follows:

(in millions)	**2005**	2004	2003
Loss as of January 1	**$ (14)**	$(83)	$(77)
Derivative (gains) losses transferred to earnings	**(95)**	86	(42)
Change in fair value	**133**	(17)	36
Gain (loss) as of December 31	**$ 24**	$(14)	$(83)

The fair value of all derivative financial instruments has been calculated based on market quotes.

■ **Foreign exchange rates:** Altria Group, Inc. uses forward foreign exchange contracts and foreign currency options to mitigate its exposure to changes in exchange rates from third-party and intercompany actual and forecasted transactions. The primary currencies to which Altria Group, Inc. is exposed include the Japanese yen, Swiss franc and the euro. At December 31, 2005 and 2004, Altria Group, Inc. had foreign exchange option and forward contracts with aggregate notional amounts of $4.8 billion and $9.7 billion, respectively. In addition, Altria Group, Inc. uses foreign currency swaps to mitigate its exposure to changes in exchange rates related to foreign currency denominated debt. These swaps typically convert fixed-rate foreign currency denominated debt to fixed-rate debt denominated in the functional currency of the borrowing entity. A substantial portion of the foreign currency swap agreements is accounted for as cash flow hedges. The unrealized gain (loss) relating to foreign currency swap agreements that do not qualify for hedge accounting treatment under U.S. GAAP was insignificant as of December 31, 2005 and 2004. At December 31, 2005 and 2004, the notional amounts of foreign currency swap agreements aggregated $2.3 billion and $2.7 billion, respectively. Aggregate maturities of foreign currency swap agreements at December 31, 2005, were $1.0 billion in 2006 and $1.3 billion in 2008.

Altria Group, Inc. also designates certain foreign currency denominated debt as net investment hedges of foreign operations. During the year ended

December 31, 2005, these hedges of net investments resulted in a gain, net of income taxes, of $369 million, and in the years ended December 31, 2004 and 2003, resulted in losses, net of income taxes, of $344 million and $286 million, respectively. These gains and losses were reported as a component of accumulated other comprehensive earnings (losses) within currency translation adjustments.

■ **Commodities:** Kraft is exposed to price risk related to forecasted purchases of certain commodities used as raw materials. Accordingly, Kraft uses commodity forward contracts as cash flow hedges, primarily for coffee and cocoa. Commodity futures and options are also used to hedge the price of certain commodities, including milk, coffee, cocoa, wheat, corn, sugar and soybean oil. At December 31, 2005 and 2004, Kraft had net long commodity positions of $521 million and $443 million, respectively. In general, commodity forward contracts qualify for the normal purchase exception under U.S. GAAP, and are therefore not subject to the provisions of SFAS No. 133. The effective portion of unrealized gains and losses on commodity futures and option contracts is deferred as a component of accumulated other comprehensive earnings (losses) and is recognized as a component of cost of sales when the related inventory is sold. Unrealized gains or losses on net commodity positions were immaterial at December 31, 2005 and 2004.

■ **Value at Risk:** Altria Group, Inc. uses a value at risk ("VAR") computation to estimate the potential one-day loss in the fair value of its interest rate-sensitive financial instruments and to estimate the potential one-day loss in pre-tax earnings of its foreign currency and commodity price-sensitive derivative financial instruments. The VAR computation includes Altria Group, Inc.'s debt; short-term investments; foreign currency forwards, swaps and options; and commodity futures, forwards and options. Anticipated transactions, foreign currency trade payables and receivables, and net investments in foreign subsidiaries, which the foregoing instruments are intended to hedge, were excluded from the computation.

The VAR estimates were made assuming normal market conditions, using a 95% confidence interval. Altria Group, Inc. used a "variance/co-variance" model to determine the observed interrelationships between movements in interest rates and various currencies. These interrelationships were determined by observing interest rate and forward currency rate movements over the preceding quarter for the calculation of VAR amounts at December 31, 2005 and 2004, and over each of the four preceding quarters for the calculation of average VAR amounts during each year. The values of foreign currency and commodity options do not change on a one-to-one basis with the underlying currency or commodity, and were valued accordingly in the VAR computation.

The estimated potential one-day loss in fair value of Altria Group, Inc.'s interest rate-sensitive instruments, primarily debt, under normal market conditions and the estimated potential one-day loss in pre-tax earnings from foreign currency and commodity instruments under normal market conditions, as calculated in the VAR model, were as follows:

	Pre-Tax Earnings Impact			
(in millions)	At 12/31/05	Average	High	Low
Instruments sensitive to:				
Foreign currency rates	**$23**	**$21**	**$24**	**$19**
Commodity prices	**7**	**6**	**12**	**3**

	Fair Value Impact			
(in millions)	At 12/31/05	Average	High	Low
Instruments sensitive to:				
Interest rates	**$43**	**$63**	**$75**	**$43**

	Pre-Tax Earnings Impact			
(in millions)	At 12/31/04	Average	High	Low
Instruments sensitive to:				
Foreign currency rates	$16	$21	$35	$16
Commodity prices	4	6	8	4

	Fair Value Impact			
(in millions)	At 12/31/04	Average	High	Low
Instruments sensitive to:				
Interest rates	$72	$96	$113	$72

The VAR computation is a risk analysis tool designed to statistically estimate the maximum probable daily loss from adverse movements in interest rates, foreign currency rates and commodity prices under normal market conditions. The computation does not purport to represent actual losses in fair value or earnings to be incurred by Altria Group, Inc., nor does it consider the effect of favorable changes in market rates. Altria Group, Inc. cannot predict actual future movements in such market rates and does not present these VAR results to be indicative of future movements in such market rates or to be representative of any actual impact that future changes in market rates may have on its future results of operations or financial position.

New Accounting Standards

See Note 2 to the consolidated financial statements for a discussion of new accounting standards.

Contingencies

See Note 19 to the consolidated financial statements for a discussion of contingencies.

Cautionary Factors That May Affect Future Results

Forward-Looking and Cautionary Statements

We* may from time to time make written or oral forward-looking statements, including statements contained in filings with the Securities and Exchange Commission, in reports to stockholders and in 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," "intends," "projects," "goals," "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 inaccurate assumptions. 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. Investors should bear this in mind as they 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 document, particularly in the "Business Environment" sections preceding our discussion of operating results of our subsidiaries' businesses. 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.

- **Tobacco-Related Litigation:** There is substantial litigation related to tobacco products in the United States and certain foreign jurisdictions. We anticipate that new cases will continue to be filed. Damages claimed in some of the tobacco-related litigation range into the billions of dollars. There are presently 12 cases on appeal in which verdicts were returned against PM USA, including a compensatory and punitive damages verdict totaling approximately $10.1 billion in the *Price* case in Illinois, which was reversed by the Illinois Supreme Court in December 2005. Generally, in order to prevent a plaintiff from seeking to collect a judgment while the verdict is being appealed, the defendant must post an appeal bond or negotiate an alternative arrangement with plaintiffs. In the event of future losses at trial, we may not always be able to obtain the required bond or to negotiate an acceptable alternative arrangement.

The present litigation environment is substantially uncertain, and it is possible that our business, volume, results of operations, cash flows or financial position could be materially affected by an unfavorable outcome of pending litigation, including certain of the verdicts against us that are on appeal. We intend to continue vigorously defending all tobacco-related litigation, although we may enter into settlement discussions in particular cases if we believe it is in the best interest of our stockholders to do so. The entire litigation environment may not improve sufficiently to enable the Board of Directors to implement any contemplated restructuring alternatives. Please see Note 19 for a discussion of pending tobacco-related litigation.

- **Anti-Tobacco Action in the Public and Private Sectors:** Our tobacco subsidiaries face significant governmental action aimed at reducing the incidence of smoking and seeking to hold us responsible for the adverse health effects associated with both smoking and exposure to environmental tobacco smoke. Governmental actions, combined with the diminishing social acceptance of smoking and private actions to restrict smoking, have resulted in reduced industry volume, and we expect this decline to continue.

- **Excise Taxes:** Cigarettes are subject to substantial excise taxes in the United States and to substantial taxation abroad. Significant increases in cigarette-related taxes have been proposed or enacted and are likely to continue to be proposed or enacted within the United States, the EU and in other foreign jurisdictions. In addition, in certain jurisdictions, PMI's products are subject to discriminatory tax structures, and inconsistent rulings and interpretations on complex methodologies to determine excise and other tax burdens.

Tax increases are expected to continue to have an adverse impact on sales of cigarettes by our tobacco subsidiaries, due to lower consumption levels and to a shift in 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 or contraband products.

- **Increased Competition in the Domestic Tobacco Market:** Settlements of certain tobacco litigation in the United States have resulted in substantial cigarette price increases. PM USA faces competition from lowest-priced brands sold by certain domestic and foreign manufacturers that have cost advantages because they are not parties to these settlements. These manufacturers may fail to comply with related state escrow legislation or may take advantage of certain provisions in the legislation that permit the non-settling manufacturers to concentrate their sales in a limited number of states and thereby avoid escrow deposit obligations on the majority of their sales. 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 increased imports of foreign lowest-priced brands.

- **Governmental Investigations:** From time to time, ALG and its tobacco subsidiaries are subject to governmental investigations on a range of matters. Ongoing investigations include allegations of contraband shipments of cigarettes and allegations of unlawful pricing activities within certain international markets. We cannot predict the outcome of those investigations or whether additional investigations may be commenced, and it is possible that our business could be materially affected by an unfavorable outcome of pending or future investigations.

- **New Tobacco Product Technologies:** Our tobacco subsidiaries continue to seek ways to develop and to commercialize new product technologies that have the objective of reducing constituents in tobacco smoke identified by public health authorities as harmful while continuing to offer adult smokers products that meet their taste expectations. We cannot guarantee that our tobacco subsidiaries will succeed in these efforts. If they do not succeed, but one or more of their competitors do, our tobacco subsidiaries may be at a competitive disadvantage.

* This section uses the terms "we," "our" and "us" when it is not necessary to distinguish among ALG and its various operating subsidiaries or when any distinction is clear from the context.

■ **Foreign Currency:** Our international food and tobacco subsidiaries conduct their businesses in local currency and, for purposes of financial reporting, their results are translated into U.S. dollars based on average exchange rates prevailing during a reporting period. During times of a strengthening U.S. dollar, our reported net revenues and operating income will be reduced because the local currency will translate into fewer U.S. dollars.

■ **Competition and Economic Downturns:** Each of our consumer products subsidiaries is subject to intense competition, changes in consumer preferences and local economic conditions. To be successful, they must continue to:

- promote brand equity successfully;
- anticipate and respond to new consumer trends;
- develop new products and markets and to broaden brand portfolios in order to compete effectively with lower-priced products;
- improve productivity; and
- respond effectively to changing prices for their raw materials.

The willingness of consumers to purchase premium cigarette brands and premium food and beverage brands depends in part on local economic conditions. In periods of economic uncertainty, consumers tend to purchase more private label and other economy brands, and the volume of our consumer products subsidiaries could suffer accordingly.

Our finance subsidiary, PMCC, holds investments in finance leases, principally in transportation (including aircraft), power generation and manufacturing equipment and facilities. Its lessees are also subject to intense competition and economic conditions. If counterparties 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 profitability.

■ **Grocery Trade Consolidation:** As the retail grocery trade continues to consolidate and retailers grow larger and become more sophisticated, they demand lower pricing and increased promotional programs. Further, these customers are reducing their inventories and increasing their emphasis on private label products. If Kraft fails to use its scale, marketing expertise, branded products and category leadership positions to respond to these trends, its volume growth could slow or it may need to lower prices or increase promotional support of its products, any of which would adversely affect our profitability.

■ **Continued Need to Add Food and Beverage Products in Faster-Growing and More Profitable Categories:** The food and beverage industry's growth potential is constrained by population growth. Kraft's success depends in part on its ability to grow its business faster than populations are growing in the markets that it serves. One way to achieve that growth is to enhance its portfolio by adding products that are in faster-growing and more profitable categories. If Kraft does not succeed in making these enhancements, its volume growth may slow, which would adversely affect our profitability.

■ **Strengthening Brand Portfolios Through Acquisitions and Divestitures:** One element of the growth strategy of our consumer products subsidiaries is to strengthen their brand portfolios through active programs of selective acquisitions and divestitures. These subsidiaries are constantly investigating potential acquisition candidates and from time to time Kraft sells businesses that are outside its core categories or that do not meet its growth or profitability targets. 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 continue to acquire attractive businesses on favorable terms or that all future acquisitions will be quickly accretive to earnings.

■ **Food Raw Material Prices:** The raw materials used by our food businesses are largely commodities that experience price volatility caused by external conditions, commodity market fluctuations, currency fluctuations and changes in governmental agricultural programs. Commodity price changes may result in unexpected increases in raw material and packaging costs (which are significantly affected by oil costs), and our operating subsidiaries may be unable to increase their prices to offset these increased costs without suffering reduced volume, net revenues and operating companies income. We do not fully hedge against changes in commodity prices and our hedging strategies may not work as planned.

■ **Food Safety, Quality and Health Concerns:** We could be adversely affected if consumers in Kraft's principal markets lose confidence in the safety and quality of certain food products. Adverse publicity about these types of concerns, whether or not valid, may discourage consumers from buying Kraft's products or cause production and delivery disruptions. Recent publicity concerning the health implications of obesity and trans-fatty acids could also reduce consumption of certain of Kraft's products. In addition, Kraft may need to recall some of its products if they become adulterated or misbranded. Kraft may also be liable if the consumption of any of its products causes injury. A widespread product recall or a significant product liability judgment could cause products to be unavailable for a period of time and a loss of consumer confidence in Kraft's food products and could have a material adverse effect on Kraft's business and results.

■ **Limited Access to Commercial Paper Market:** As a result of actions by credit rating agencies during 2003, ALG currently has limited access to the commercial paper market, and may have to rely on its revolving credit facilities.

■ **Asset Impairment:** We periodically calculate the fair value of our goodwill and intangible assets to test for impairment. This calculation may be affected by the market conditions noted above, as well as interest rates and general economic conditions. If an impairment is determined to exist, we will incur impairment losses, which will reduce our earnings.

■ **IRS Challenges to PMCC Leases:** Recently, the IRS has proposed to disallow certain transactions, and may in the future challenge and disallow several more, of PMCC's leveraged leases based on recent Revenue Rulings and a recent IRS Notice addressing specific types of leveraged leases (lease-in/lease-out transactions, qualified technological equipment transactions, and sale-in/lease-out transactions). PMCC believes that the position and supporting case law described in the Revenue Rulings and the IRS Notice, as well as those asserted in the proposed adjustments, are incorrectly applied to PMCC's transactions and that its leveraged leases are factually and legally distinguishable in material respects from the IRS's position. PMCC and ALG intend to vigorously defend against any challenges based on that position through administrative appeals and litigation, if necessary, and ALG believes that, given the strength of PMCC's position, it should ultimately prevail. However, should PMCC's position not be upheld, PMCC may have to accelerate the payment of significant amounts of federal income tax and lower its earnings to reflect the recalculation of the income from the affected leveraged leases.

Selected Financial Data—Five-Year Review

(in millions of dollars, except per share data)

	2005	2004	2003	2002	2001
Summary of Operations:					
Net revenues	**$ 97,854**	$ 89,610	$81,320	$79,933	$80,376
United States export sales	**3,630**	3,493	3,528	3,654	3,866
Cost of sales	**36,764**	33,959	31,573	32,491	33,644
Federal excise taxes on products	**3,659**	3,694	3,698	4,229	4,418
Foreign excise taxes on products	**25,275**	21,953	17,430	13,997	12,791
Operating income	**16,592**	15,180	15,759	16,448	15,535
Interest and other debt expense, net	**1,157**	1,176	1,150	1,134	1,418
Earnings from continuing operations before income taxes, minority interest, equity earnings, net, and cumulative effect of accounting change	**15,435**	14,004	14,609	17,945	14,117
Pre-tax profit margin from continuing operations	**15.8%**	15.6%	18.0%	22.5%	17.6%
Provision for income taxes	**4,618**	4,540	5,097	6,368	5,326
Earnings from continuing operations before minority interest, equity earnings, net, and cumulative effect of accounting change	**10,817**	9,464	9,512	11,577	8,791
Minority interest in earnings from continuing operations, and equity earnings, net	**149**	44	391	556	302
Earnings from continuing operations before cumulative effect of accounting change	**10,668**	9,420	9,121	11,021	8,489
(Loss) earnings from discontinued operations, net of income taxes and minority interest	**(233)**	(4)	83	81	77
Cumulative effect of accounting change					(6)
Net earnings	**10,435**	9,416	9,204	11,102	8,560
Basic earnings per share —continuing operations	**5.15**	4.60	4.50	5.22	3.89
—discontinued operations	**(0.11)**		0.04	0.04	0.04
—cumulative effect of accounting change					(0.01)
—net earnings	**5.04**	4.60	4.54	5.26	3.92
Diluted earnings per share—continuing operations	**5.10**	4.57	4.48	5.18	3.84
—discontinued operations	**(0.11)**	(0.01)	0.04	0.03	0.04
—cumulative effect of accounting change					(0.01)
—net earnings	**4.99**	4.56	4.52	5.21	3.87
Dividends declared per share	**3.06**	2.82	2.64	2.44	2.22
Weighted average shares (millions)—Basic	**2,070**	2,047	2,028	2,111	2,181
Weighted average shares (millions)—Diluted	**2,090**	2,063	2,038	2,129	2,210
Capital expenditures	**2,206**	1,913	1,974	2,009	1,922
Depreciation	**1,647**	1,590	1,431	1,324	1,323
Property, plant and equipment, net (consumer products)	**16,678**	16,305	16,067	14,846	15,137
Inventories (consumer products)	**10,584**	10,041	9,540	9,127	8,923
Total assets	**107,949**	101,648	96,175	87,540	84,968
Total long-term debt	**17,667**	18,683	21,163	21,355	18,651
Total debt—consumer products	**21,919**	20,759	22,329	21,154	20,098
—financial services	**2,014**	2,221	2,210	2,166	2,004
Stockholders' equity	**35,707**	30,714	25,077	19,478	19,620
Common dividends declared as a % of Basic EPS	**60.7%**	61.3%	58.1%	46.4%	56.6%
Common dividends declared as a % of Diluted EPS	**61.3%**	61.8%	58.4%	46.8%	57.4%
Book value per common share outstanding	**17.13**	14.91	12.31	9.55	9.11
Market price per common share—high/low	**78.68-60.40**	61.88-44.50	55.03-27.70	57.79-35.40	53.88-38.75
Closing price of common share at year end	**74.72**	61.10	54.42	40.53	45.85
Price/earnings ratio at year end—Basic	**15**	13	12	8	12
Price/earnings ratio at year end—Diluted	**15**	13	12	8	12
Number of common shares outstanding at year end (millions)	**2,084**	2,060	2,037	2,039	2,153
Number of employees	**199,000**	156,000	165,000	166,000	175,000

Consolidated Balance Sheets

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

at December 31,	2005	2004
Assets		
Consumer products		
Cash and cash equivalents	**$ 6,258**	$ 5,744
Receivables (less allowances of $112 in 2005 and $139 in 2004)	**5,361**	5,754
Inventories:		
Leaf tobacco	**4,060**	3,643
Other raw materials	**2,232**	2,170
Finished product	**4,292**	4,228
	10,584	10,041
Assets of discontinued operations held for sale		1,458
Other current assets	**3,578**	2,904
Total current assets	**25,781**	25,901
Property, plant and equipment, at cost:		
Land and land improvements	**989**	889
Buildings and building equipment	**7,428**	7,366
Machinery and equipment	**20,050**	19,566
Construction in progress	**1,489**	1,266
	29,956	29,087
Less accumulated depreciation	**13,278**	12,782
	16,678	16,305
Goodwill	**31,219**	28,056
Other intangible assets, net	**12,196**	11,056
Other assets	**14,667**	12,485
Total consumer products assets	**100,541**	93,803
Financial services		
Finance assets, net	**7,189**	7,827
Other assets	**219**	18
Total financial services assets	**7,408**	7,845
Total Assets	**$107,949**	$101,648

See notes to consolidated financial statements.

at December 31,	2005	2004
Liabilities		
Consumer products		
Short-term borrowings	**$ 2,836**	$ 2,546
Current portion of long-term debt	**3,430**	1,751
Accounts payable	**3,645**	3,466
Accrued liabilities:		
Marketing	**2,382**	2,516
Taxes, except income taxes	**2,871**	2,909
Employment costs	**1,296**	1,325
Settlement charges	**3,503**	3,501
Other	**3,130**	3,072
Income taxes	**1,393**	983
Dividends payable	**1,672**	1,505
Total current liabilities	**26,158**	23,574
Long-term debt	**15,653**	16,462
Deferred income taxes	**8,492**	8,295
Accrued postretirement health care costs	**3,412**	3,285
Minority interest	**4,141**	4,764
Other liabilities	**6,260**	6,238
Total consumer products liabilities	**64,116**	62,618
Financial services		
Long-term debt	**2,014**	2,221
Non-recourse debt	**201**	112
Deferred income taxes	**5,737**	5,876
Other liabilities	**174**	107
Total financial services liabilities	**8,126**	8,316
Total liabilities	**72,242**	70,934
Contingencies (Note 19)		
Stockholders' Equity		
Common stock, par value $0.33⅓ per share (2,805,961,317 shares issued)	**935**	935
Additional paid-in capital	**6,061**	5,176
Earnings reinvested in the business	**54,666**	50,595
Accumulated other comprehensive losses (including currency translation of ($1,317) in 2005 and ($610) in 2004)	**(1,853)**	(1,141)
Cost of repurchased stock (721,696,918 shares in 2005 and 746,433,841 shares in 2004)	**(24,102)**	(24,851)
Total stockholders' equity	**35,707**	30,714
Total Liabilities and Stockholders' Equity	**$107,949**	$101,648

Consolidated Statements of Earnings

(in millions of dollars, except per share data)

for the years ended December 31,	**2005**	2004	2003
Net revenues	**$97,854**	$89,610	$81,320
Cost of sales	**36,764**	33,959	31,573
Excise taxes on products	**28,934**	25,647	21,128
Gross profit	**32,156**	30,004	28,619
Marketing, administration and research costs	**14,799**	13,665	12,525
Domestic tobacco headquarters relocation charges	**4**	31	69
Domestic tobacco loss on U.S. tobacco pool	**138**		
Domestic tobacco quota buy-out	**(115)**		
Domestic tobacco legal settlement			202
International tobacco E.C. agreement		250	
Asset impairment and exit costs	**618**	718	86
(Gains) losses on sales of businesses, net	**(108)**	3	(31)
Provision for airline industry exposure	**200**	140	
Amortization of intangibles	**28**	17	9
Operating income	**16,592**	15,180	15,759
Interest and other debt expense, net	**1,157**	1,176	1,150
Earnings from continuing operations before income taxes, minority interest, and equity earnings, net	**15,435**	14,004	14,609
Provision for income taxes	**4,618**	4,540	5,097
Earnings from continuing operations before minority interest, and equity earnings, net	**10,817**	9,464	9,512
Minority interest in earnings from continuing operations, and equity earnings, net	**149**	44	391
Earnings from continuing operations	**10,668**	9,420	9,121
(Loss) earnings from discontinued operations, net of income taxes and minority interest	**(233)**	(4)	83
Net earnings	**$10,435**	$ 9,416	$ 9,204
Per share data:			
Basic earnings per share:			
Continuing operations	**$ 5.15**	$ 4.60	$ 4.50
Discontinued operations	**(0.11)**		0.04
Net earnings	**$ 5.04**	$ 4.60	$ 4.54
Diluted earnings per share:			
Continuing operations	**$ 5.10**	$ 4.57	$ 4.48
Discontinued operations	**(0.11)**	(0.01)	0.04
Net earnings	**$ 4.99**	$ 4.56	$ 4.52

See notes to consolidated financial statements.

Consolidated Statements of Stockholders' Equity

(in millions of dollars, except per share data)

	Common Stock	Additional Paid-in Capital	Earnings Reinvested in the Business	Accumulated Other Comprehensive Earnings (Losses): Currency Translation Adjustments	Other	Total	Cost of Repurchased Stock	Total Stockholders' Equity
Balances, January 1, 2003	$935	$4,642	$43,259	$(2,951)	$(1,005)	$(3,956)	$(25,402)	$19,478
Comprehensive earnings:								
Net earnings			9,204					9,204
Other comprehensive earnings (losses), net of income taxes:								
Currency translation adjustments				1,373		1,373		1,373
Additional minimum pension liability					464	464		464
Change in fair value of derivatives accounted for as hedges					(6)	(6)		(6)
Total other comprehensive earnings								1,831
Total comprehensive earnings								11,035
Exercise of stock options and issuance of other stock awards		171	(93)				537	615
Cash dividends declared ($2.64 per share)			(5,362)					(5,362)
Stock repurchased							(689)	(689)
Balances, December 31, 2003	935	4,813	47,008	(1,578)	(547)	(2,125)	(25,554)	25,077
Comprehensive earnings:								
Net earnings			9,416					9,416
Other comprehensive earnings (losses), net of income taxes:								
Currency translation adjustments				968		968		968
Additional minimum pension liability					(53)	(53)		(53)
Change in fair value of derivatives accounted for as hedges					69	69		69
Total other comprehensive earnings								984
Total comprehensive earnings								10,400
Exercise of stock options and issuance of other stock awards		363	(39)				703	1,027
Cash dividends declared ($2.82 per share)			(5,790)					(5,790)
Balances, December 31, 2004	935	5,176	50,595	(610)	(531)	(1,141)	(24,851)	30,714
Comprehensive earnings:								
Net earnings			**10,435**					**10,435**
Other comprehensive earnings (losses), net of income taxes:								
Currency translation adjustments				**(707)**		**(707)**		**(707)**
Additional minimum pension liability					**(54)**	**(54)**		**(54)**
Change in fair value of derivatives accounted for as hedges					**38**	**38**		**38**
Other					**11**	**11**		**11**
Total other comprehensive losses								**(712)**
Total comprehensive earnings								**9,723**
Exercise of stock options and issuance of other stock awards		**519**	**(6)**				**749**	**1,262**
Cash dividends declared ($3.06 per share)			**(6,358)**					**(6,358)**
Other		**366**						**366**
Balances, December 31, 2005	**$935**	**$6,061**	**$54,666**	**$(1,317)**	**$ (536)**	**$(1,853)**	**$(24,102)**	**$35,707**

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

(in millions of dollars)

for the years ended December 31,	2005	2004	2003
Cash Provided by (Used in) Operating Activities			
Net earnings — Consumer products	**$10,418**	$ 9,330	$ 8,934
— Financial services	**17**	86	270
Net earnings	**10,435**	9,416	9,204
Adjustments to reconcile net earnings to operating cash flows:			
Consumer products			
Depreciation and amortization	**1,675**	1,607	1,440
Deferred income tax (benefit) provision	**(863)**	381	717
Minority interest in earnings from continuing operations, and equity earnings, net	**149**	44	405
Domestic tobacco legal settlement, net of cash paid		(57)	57
Domestic tobacco headquarters relocation charges, net of cash paid	**(9)**	(22)	35
Domestic tobacco quota buy-out	**(115)**		
Escrow bond for *Price* domestic tobacco case	**(420)**	(820)	(610)
Integration costs, net of cash paid	**(1)**	(1)	(26)
Asset impairment and exit costs, net of cash paid	**382**	510	62
Impairment loss on discontinued operations		107	
Loss on sale of discontinued operations	**32**		
(Gains) losses on sales of businesses, net	**(108)**	3	(31)
Cash effects of changes, net of the effects from acquired and divested companies:			
Receivables, net	**253**	(193)	295
Inventories	**(524)**	(140)	251
Accounts payable	**27**	49	(220)
Income taxes	**203**	(502)	(119)
Accrued liabilities and other current assets	**(555)**	785	(588)
Domestic tobacco accrued settlement charges	**(30)**	(31)	497
Pension plan contributions	**(1,234)**	(1,078)	(1,183)
Pension provisions and postretirement, net	**793**	425	278
Other	**874**	314	33
Financial services			
Deferred income tax (benefit) provision	**(126)**	7	267
Provision for airline industry exposure	**200**	140	
Other	**22**	(54)	52
Net cash provided by operating activities	**11,060**	10,890	10,816
Cash Provided by (Used in) Investing Activities			
Consumer products			
Capital expenditures	**(2,206)**	(1,913)	(1,974)
Purchase of businesses, net of acquired cash	**(4,932)**	(179)	(1,041)
Proceeds from sales of businesses	**1,668**	18	96
Other	**112**	24	125
Financial services			
Investments in finance assets	**(3)**	(10)	(140)
Proceeds from finance assets	**476**	644	507
Net cash used in investing activities	**(4,885)**	(1,416)	(2,427)

See notes to consolidated financial statements.

for the years ended December 31,	2005	2004	2003
Cash Provided by (Used in) Financing Activities			
Consumer products			
Net issuance (repayment) of short-term borrowings	**$ 3,114**	$(1,090)	$ (419)
Long-term debt proceeds	**69**	833	3,077
Long-term debt repaid	**(1,779)**	(1,594)	(1,871)
Financial services			
Long-term debt repaid		(189)	(147)
Repurchase of Altria Group, Inc. common stock			(777)
Repurchase of Kraft Foods Inc. common stock	**(1,175)**	(688)	(372)
Dividends paid on Altria Group, Inc. common stock	**(6,191)**	(5,672)	(5,285)
Issuance of Altria Group, Inc. common stock	**985**	827	443
Other	**(157)**	(409)	(108)
Net cash used in financing activities	**(5,134)**	(7,982)	(5,459)
Effect of exchange rate changes on cash and cash equivalents	**(527)**	475	282
Cash and cash equivalents:			
Increase	**514**	1,967	3,212
Balance at beginning of year	**5,744**	3,777	565
Balance at end of year	**$ 6,258**	$ 5,744	$ 3,777
Cash paid: Interest — Consumer products	**$ 1,628**	$ 1,397	$ 1,336
— Financial services	**$ 106**	$ 97	$ 120
Income taxes	**$ 5,397**	$ 4,448	$ 4,158

NOTE 1.

Background and Basis of Presentation:

■ **Background:** Throughout these financial statements, the term "Altria Group, Inc." refers to the consolidated financial position, results of operations and cash flows of the Altria family of companies, and the term "ALG" refers solely to the parent company. ALG's wholly-owned subsidiaries, Philip Morris USA Inc. ("PM USA") and Philip Morris International Inc. ("PMI"), and its majority-owned (87.2% as of December 31, 2005) subsidiary, Kraft Foods Inc. ("Kraft"), are engaged in the manufacture and sale of various consumer products, including cigarettes and other tobacco products, packaged grocery products, snacks, beverages, cheese and convenient meals. Philip Morris Capital Corporation ("PMCC"), another wholly-owned subsidiary, maintains a portfolio of leveraged and direct finance leases. In addition, ALG had a 28.7% economic interest in SABMiller plc ("SABMiller") as of December 31, 2005. ALG's access to the operating cash flows of its subsidiaries consists of cash received from the payment of dividends and interest, and the repayment of amounts borrowed from ALG by its subsidiaries.

In June 2005, Kraft sold substantially all of its sugar confectionery business for pre-tax proceeds of approximately $1.4 billion. Altria Group, Inc. has reflected the results of Kraft's sugar confectionery business prior to the closing date as discontinued operations on the consolidated statements of earnings for all years presented. The assets related to the sugar confectionery business were reflected as assets of discontinued operations held for sale on the consolidated balance sheet at December 31, 2004.

■ **Basis of presentation:** The consolidated financial statements include ALG, as well as its wholly-owned and majority-owned subsidiaries. Investments in which ALG exercises significant influence (20%-50% ownership interest), are accounted for under the equity method of accounting. Investments in which ALG has an ownership interest of less than 20%, or does not exercise significant influence, are accounted for with the cost method of accounting. All intercompany transactions and balances have been eliminated.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities at the dates of the financial statements and the reported amounts of net revenues and expenses during the reporting periods. Significant estimates and assumptions include, among other things, pension and benefit plan assumptions, lives and valuation assumptions of goodwill and other intangible assets, marketing programs, income taxes, and the allowance for loan losses and estimated residual values of finance leases. Actual results could differ from those estimates.

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

Kraft's operating subsidiaries generally report year-end results as of the Saturday closest to the end of each year. This resulted in fifty-three weeks of operating results for Kraft in the consolidated statement of earnings for the year ended December 31, 2005, versus fifty-two weeks for the years ended December 31, 2004 and 2003.

As discussed in Note 14. *Income Taxes*, classification of certain prior years' amounts have been revised to conform with the current year's presentation.

NOTE 2.

Summary of Significant Accounting Policies:

■ **Cash and cash equivalents:** Cash equivalents include demand deposits with banks and all highly liquid investments with original maturities of three months or less.

■ **Depreciation, amortization and goodwill valuation:** Property, plant and equipment are stated at historical cost and depreciated by the straight-line method over the estimated useful lives of the assets. Machinery and equipment are depreciated over periods ranging from 3 to 20 years, and buildings and building improvements over periods up to 50 years.

Definite life intangible assets are amortized over their estimated useful lives. Altria Group, Inc. is required to conduct an annual review of goodwill and intangible assets for potential impairment. Goodwill impairment testing requires a comparison between the carrying value and fair value of each reporting unit. If the carrying value exceeds the fair value, goodwill is considered impaired. The amount of impairment loss is measured as the difference between the carrying value and implied fair value of goodwill, which is determined using discounted cash flows. Impairment testing for non-amortizable intangible assets requires a comparison between the fair value and carrying value of the intangible asset. If the carrying value exceeds fair value, the intangible asset is considered impaired and is reduced to fair value. During 2005, Altria Group, Inc. completed its annual review of goodwill and intangible assets, and no charges resulted from this review. However, as part of the sale or pending sale of certain Canadian assets and two brands, Kraft recorded total non-cash pre-tax asset impairment charges of $269 million in 2005, which included impairment of goodwill and intangible assets of $13 million and $118 million, respectively, as well as $138 million of asset write-downs. The 2004 review of goodwill and intangible assets resulted in a $29 million non-cash pre-tax charge at Kraft related to an intangible asset impairment for a small confectionery business in the United States and certain brands in Mexico. A portion of this charge, $12 million, was recorded as asset impairment and exit costs on the consolidated statement of earnings. The remainder of the charge, $17 million, was included in discontinued operations.

Goodwill by segment was as follows:

(in millions)	**December 31, 2005**	December 31, 2004
International tobacco	**$ 5,571**	$ 2,222
North American food	**20,803**	20,511
International food	**4,845**	5,323
Total goodwill	**$31,219**	$28,056

Intangible assets were as follows:

(in millions)	December 31, 2005 Gross Carrying Amount	December 31, 2005 Accumulated Amortization	December 31, 2004 Gross Carrying Amount	December 31, 2004 Accumulated Amortization
Non-amortizable intangible assets	**$11,867**		$10,901	
Amortizable intangible assets	**410**	**$81**	212	$57
Total intangible assets	**$12,277**	**$81**	$11,113	$57

Non-amortizable intangible assets substantially consist of brand names from Kraft's acquisition of Nabisco Holdings Corp. ("Nabisco") in 2000 and PMI's 2005 acquisition in Indonesia. Amortizable intangible assets consist primarily of certain trademark licenses and non-compete agreements. Pre-tax amortization expense for intangible assets during the years ended December 31, 2005, 2004 and 2003, was $28 million, $17 million and $9 million, respectively. Amortization expense for each of the next five years is estimated to be $30 million or less, assuming no additional transactions occur that require the amortization of intangible assets.

The movement in goodwill and gross carrying amount of intangible assets is as follows:

(in millions)	2005 Goodwill	2005 Intangible Assets	2004 Goodwill	2004 Intangible Assets
Balance at January 1	**$28,056**	**$11,113**	$27,742	$11,842
Changes due to:				
Divestitures	**(18)**			
Acquisitions	**3,707**	**1,346**	90	74
Reclassification to assets held for sale			(814)	(485)
Currency	**(866)**	**(64)**	640	3
Asset impairment	**(13)**	**(118)**		(29)
Other	**353**		398	(292)
Balance at December 31	**$31,219**	**$12,277**	$28,056	$11,113

As a result of Kraft's common stock repurchases, ALG's ownership percentage of Kraft has increased from 85.4% at December 31, 2004 to 87.2% at December 31, 2005, thereby resulting in an increase in goodwill. Other, above, includes this additional goodwill, as well as the 2004 reclassification to goodwill of certain amounts previously classified as indefinite life intangible assets, and 2004 tax adjustments related to the Nabisco acquisition. The increase in goodwill and intangible assets from acquisitions during 2005 is related to preliminary allocations of purchase price for PMI's acquisitions in Indonesia and Colombia. The allocations are based upon preliminary estimates and assumptions and are subject to revision when appraisals are finalized, which will be in the first half of 2006.

■ **Environmental costs:** Altria Group, Inc. is subject to laws and regulations relating to the protection of the environment. 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.

While it is not possible to quantify with certainty the potential impact of actions regarding environmental remediation and compliance efforts that Altria Group, Inc. may undertake in the future, in the opinion of management, environmental remediation and compliance costs, before taking into account any recoveries from third parties, will not have a material adverse effect on Altria Group, Inc.'s consolidated financial position, results of operations or cash flows.

■ **Finance leases:** Income attributable to leveraged leases is initially recorded as unearned income and subsequently recognized as revenue over the terms of the respective leases at constant after-tax rates of return on the positive net investment balances. Investments in leveraged leases are stated net of related nonrecourse debt obligations.

Income attributable to direct finance leases is initially recorded as unearned income and subsequently recognized as revenue over the terms of the respective leases at constant pre-tax rates of return on the net investment balances.

Finance leases include unguaranteed residual values that represent PMCC's estimates at lease inception as to the fair values of assets under lease at the end of the non-cancelable lease terms. The estimated residual values are reviewed annually by PMCC's management based on a number of factors and activity in the relevant industry. If necessary, revisions are recorded to reduce the residual values. Such reviews resulted in no adjustments in 2005 and a decrease of $25 million to PMCC's net revenues and results of operations in 2004. There were also no adjustments in 2003.

■ **Foreign currency translation:** Altria Group, Inc. translates the results of operations of its foreign subsidiaries using average exchange rates during each period, whereas balance sheet accounts are translated using exchange rates at the end of each period. Currency translation adjustments are recorded as a component of stockholders' equity. Transaction gains and losses are recorded in the consolidated statements of earnings and were not significant for any of the periods presented.

■ **Guarantees:** Altria Group, Inc. accounts for guarantees in accordance with Financial Accounting Standards Board ("FASB") Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." Interpretation No. 45 requires the disclosure of certain guarantees and requires the recognition of a liability for the fair value of the obligation of qualifying guarantee activities. See Note 19. *Contingencies* for a further discussion of guarantees.

■ **Hedging instruments:** Derivative financial instruments are recorded at fair value on the consolidated balance sheets as either assets or liabilities. Changes in the fair value of derivatives are recorded each period either in accumulated other comprehensive earnings (losses) or in earnings, depending on whether a derivative is designated and effective as part of a hedge transaction and, if it is, the type of hedge transaction. Gains and losses on derivative instruments reported in accumulated other comprehensive earnings (losses) are reclassified to the consolidated statements of earnings in the periods in which operating results are affected by the hedged item. Cash flows from hedging instruments are classified in the same manner as the affected hedged item in the consolidated statements of cash flows.

■ **Impairment of long-lived assets:** Altria Group, Inc. reviews long-lived assets, including amortizable intangible assets, for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable. Altria Group, Inc. performs undiscounted operating cash flow analyses to determine if an impairment exists. For purposes of recognition and measurement of an impairment for assets held for use, Altria Group, Inc. groups assets and liabilities at the lowest level for which cash flows are separately identifiable. If an impairment is determined to exist, any related impairment loss is calculated based on fair value. Impairment losses on assets to be disposed of, if any, are based on the estimated proceeds to be received, less costs of disposal.

■ **Income taxes:** Altria Group, Inc. accounts for income taxes in accordance with Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes." Under SFAS No. 109, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse. Significant judgment is required in determining income tax provisions and in evaluating tax positions. ALG and its subsidiaries establish additional provisions for income taxes when, despite the belief that their tax positions are fully supportable, there remain certain positions that are likely to be challenged and that may not be sustained on review by tax authorities. Upon the closure of current and future tax audits in various jurisdictions, significant income tax accrual reversals could continue to occur in 2006. ALG and its subsidiaries evaluate and potentially adjust these accruals in light of changing facts and circumstances. The consolidated tax provision includes the impact of changes to accruals that are considered appropriate.

■ **Inventories:** Inventories are stated at the lower of cost or market. The last-in, first-out ("LIFO") method is used to cost substantially all domestic inventories. The cost of other inventories is principally determined by the average cost method. It is a generally recognized industry practice to classify leaf tobacco inventory as a current asset although part of such inventory, because of the duration of the aging process, ordinarily would not be utilized within one year.

In 2004, the FASB issued SFAS No. 151, "Inventory Costs." SFAS No. 151 requires that abnormal idle facility expense, spoilage, freight and handling costs be recognized as current-period charges. In addition, SFAS No. 151 requires that allocation of fixed production overhead costs to inventories be based on the normal capacity of the production facility. Altria Group, Inc. is required to adopt the provisions of SFAS No. 151 prospectively as of January 1, 2006, but the effect of adoption will not have a material impact on its consolidated results of operations, financial position or cash flows.

■ **Marketing costs:** ALG's subsidiaries promote their products with advertising, consumer incentives and trade promotions. Such programs include, but are not limited to, discounts, coupons, rebates, in-store display incentives and volume-based incentives. Advertising costs are expensed as incurred. Consumer incentive and trade promotion activities are recorded as a reduction of revenues based on amounts estimated as being due to customers and consumers at the end of a period, based principally on historical utilization and redemption rates. For interim reporting purposes, advertising and certain consumer incentive expenses are charged to operations as a percentage of sales, based on estimated sales and related expenses for the full year.

■ **Revenue recognition:** The consumer products businesses recognize revenues, net of sales incentives and including shipping and handling charges billed to customers, upon shipment or delivery of goods when title and risk of loss pass to customers. ALG's tobacco subsidiaries also include excise taxes billed to customers in revenues. Shipping and handling costs are classified as part of cost of sales.

■ **Software costs:** Altria Group, Inc. capitalizes certain computer software and software development costs incurred in connection with developing or obtaining computer software for internal use. Capitalized software costs are included in property, plant and equipment on the consolidated balance sheets and are amortized on a straight-line basis over the estimated useful lives of the software, which do not exceed five years.

■ **Stock-based compensation:** Altria Group, Inc. accounts for employee stock compensation plans in accordance with the intrinsic value-based method permitted by SFAS No. 123, "Accounting for Stock-Based Compensation," which has not resulted in compensation cost for stock options. The market value at date of grant of restricted stock and rights to receive shares of stock is recorded as compensation expense over the period of restriction, which is generally three years.

At December 31, 2005, Altria Group, Inc. had stock-based employee compensation plans, which are described more fully in Note 12. *Stock Plans*. Altria Group, Inc. applies the recognition and measurement principles of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations in accounting for stock options within those plans. No compensation expense for employee stock options is reflected in net earnings, as all stock options granted under those plans had an exercise price not less than the market value of the common stock on the date of the grant. Net earnings, as reported, includes pre-tax compensation expense related to restricted stock and rights to receive shares of stock of $263 million, $185 million and $99 million for the years ended December 31, 2005, 2004 and 2003, respectively. The following table illustrates the effect on net earnings and earnings per share ("EPS") if Altria Group, Inc. had applied the fair value recognition provisions of SFAS No. 123 to measure compensation expense for outstanding stock option awards for the years ended December 31, 2005, 2004 and 2003:

(in millions, except per share data)	2005	2004	2003
Net earnings, as reported	$10,435	$9,416	$9,204
Deduct:			
Total stock-based employee compensation expense determined under fair value method for all stock option awards, net of related tax effects	15	12	19
Pro forma net earnings	$10,420	$9,404	$9,185
Earnings per share:			
Basic — as reported	$ 5.04	$ 4.60	$ 4.54
Basic — pro forma	$ 5.03	$ 4.59	$ 4.53
Diluted — as reported	$ 4.99	$ 4.56	$ 4.52
Diluted — pro forma	$ 4.98	$ 4.56	$ 4.51

Altria Group, Inc. has not granted stock options to employees since 2002. The amounts shown above as stock-based compensation expense in 2005 and 2004 relate primarily to Executive Ownership Stock Options ("EOSOs"). Under certain circumstances, senior executives who exercise outstanding stock options, using shares to pay the option exercise price and taxes, receive EOSOs equal to the number of shares tendered. During the years ended December 31, 2005, 2004 and 2003, Altria Group, Inc. granted 2.0 million, 1.7 million and 1.3 million EOSOs, respectively.

In 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123R"). SFAS No. 123R requires companies to measure compensation cost for share-based payments at fair value. Altria Group, Inc. will adopt this new standard prospectively, on January 1, 2006, and it will not have a material impact on Altria Group, Inc.'s consolidated financial position, results of operations or cash flows.

NOTE 3.

Asset Impairment and Exit Costs:

For the years ended December 31, 2005, 2004 and 2003, pre-tax asset impairment and exit costs consisted of the following:

(in millions)		**2005**	2004	2003
Separation program	Domestic tobacco	**$ —**	$ 1	$13
Separation program	International tobacco*	**55**	31	
Separation program	General corporate**	**49**	56	26
Restructuring program	North American food	**66**	383	
Restructuring program	International food	**144**	200	
Asset impairment	International tobacco*	**35**	13	
Asset impairment	North American food	**269**	8	
Asset impairment	International food		12	6
Asset impairment	General corporate**		10	41
Lease termination	General corporate**		4	
Asset impairment and exit costs		**$618**	$718	$86

* During 2005, PMI recorded pre-tax charges of $90 million, primarily related to the write-off of obsolete equipment, severance benefits and impairment charges associated with the closure of a factory in the Czech Republic, and the streamlining of various operations. During 2004, PMI recorded pre-tax charges of $44 million for severance benefits and impairment charges related to the closure of its Eger, Hungary facility and a factory in Belgium, and the streamlining of its Benelux operations.

** In 2005, 2004 and 2003, Altria Group, Inc. recorded pre-tax charges of $49 million, $70 million and $26 million, respectively, primarily related to the streamlining of various corporate functions in each year, and the write-off of an investment in an e-business consumer products purchasing exchange in 2004. In addition, during 2004, Altria Group, Inc. sold its office facility in Rye Brook, New York. In connection with this sale, Altria Group, Inc. recorded a pre-tax charge in 2003 of $41 million to write down the facility and the related fixed assets to fair value.

Kraft Restructuring Program

In January 2004, Kraft announced a multi-year restructuring program with the objectives of leveraging Kraft's global scale, realigning and lowering its cost structure, and optimizing capacity utilization. As part of this program, Kraft anticipates the closing or sale of up to twenty plants and the elimination of approximately six thousand positions. From 2004 through 2006, Kraft expects to incur approximately $1.2 billion in pre-tax charges for the program, reflecting asset disposals, severance and other implementation costs, including $297 million and $641 million incurred in 2005 and 2004, respectively. Approximately sixty percent of the pre-tax charges are expected to require cash payments. In addition, in January 2006, Kraft announced plans to continue its restructuring efforts beyond those originally contemplated. Additional pre-tax charges are anticipated to be $2.5 billion from 2006 to 2009, of which approximately $1.6 billion are expected to require cash payments. These charges will result in the anticipated closure of up to 20 additional facilities and the elimination of approximately 8,000 additional positions. Initiatives under the expanded program include additional organizational streamlining and facility closures. The entire restructuring program is expected to ultimately result in $3.7 billion in pre-tax charges, the closure of up to 40 facilities and the elimination of approximately 14,000 positions. Approximately $2.3 billion of the $3.7 billion in pre-tax charges are expected to require cash payments.

During 2005, Kraft recorded $479 million of asset impairment and exit costs on the consolidated statement of earnings. These pre-tax charges were composed of $210 million of costs under the restructuring program, and $269 million of asset impairment charges related to the sale of Kraft's fruit snacks assets in 2005 and Kraft's pending sale of certain assets in Canada and a small biscuit brand in the United States. The 2005 pre-tax restructuring charges reflect the announcement of the closing of 6 plants, for a total of 19 since January 2004, and the continuation of a number of workforce reduction programs. Approximately $170 million of the pre-tax charges incurred in 2005 will require cash payments. During 2004, Kraft recorded $603 million of asset impairment and exit costs in the consolidated statement of earnings. These pre-tax charges were composed of $583 million of costs under the restructuring program, $12 million of impairment charges relating to intangible assets and $8 million of impairment charges related to the sale of Kraft's yogurt brand. The 2004 restructuring charges resulted from the 2004 announcement of the closing of 13 plants, the termination of co-manufacturing agreements and the commencement of a number of workforce reduction programs.

Pre-tax restructuring liability activity for 2005 and 2004 was as follows:

(in millions)	Severance	Asset Write-downs	Other	Total
Liability balance, January 1, 2004	$ —	$ —	$ —	$ —
Charges	176	363	44	583
Cash spent	(84)		(26)	(110)
Charges against assets	(5)	(363)		(368)
Currency	4		1	5
Liability balance, December 31, 2004	91	—	19	110
Charges	154	30	26	210
Cash spent	(114)		(50)	(164)
Charges against assets	(12)	(30)		(42)
Currency/other	(5)		6	1
Liability balance, December 31, 2005	**$ 114**	**$ —**	**$ 1**	**$ 115**

Severance costs in the above schedule, which relate to the workforce reduction programs, include the cost of related benefits. Specific programs announced during 2004 and 2005, as part of the overall restructuring program, will result in the elimination of approximately 5,500 positions. At December 31, 2005, approximately 4,900 of these positions have been eliminated. Asset write-downs relate to the impairment of assets caused by the plant closings and related activity. Other costs incurred relate primarily to contract termination costs associated with the plant closings and the termination of co-manufacturing and leasing agreements. Severance charges taken against assets relate to incremental pension costs, which reduce prepaid pension assets.

During 2005 and 2004, Kraft recorded pre-tax implementation costs associated with the restructuring program. These costs include the discontinuance of certain product lines and incremental costs related to the integration and streamlining of functions and closure of facilities. Substantially all implementation costs incurred in 2005 will require cash payments. These costs were recorded on the consolidated statements of earnings as follows:

(in millions)	2005	2004
Net revenues	$ 2	$ 7
Cost of sales	56	30
Marketing, administration and research costs	29	13
Total—continuing operations	87	50
Discontinued operations		8
Total implementation costs	$87	$58

Kraft Asset Impairment Charges

During 2005, Kraft sold its fruit snacks assets for approximately $30 million and incurred a pre-tax asset impairment charge of $93 million in recognition of the sale. During December 2005, Kraft reached agreements to sell certain assets in Canada and a small biscuit brand in the United States. These transactions are expected to close in the first quarter of 2006. Kraft incurred pre-tax asset impairment charges of $176 million in recognition of these pending sales. These charges, which include the write-off of all associated intangible assets, were recorded as asset impairment and exit costs on the consolidated statement of earnings.

During 2004, Kraft recorded a $29 million non-cash pre-tax charge related to an intangible asset impairment for a small confectionery business in the United States and certain brands in Mexico. A portion of this charge, $17 million, was reclassified to earnings from discontinued operations on the consolidated statement of earnings in the fourth quarter of 2004.

In November 2004, following discussions between Kraft and its joint venture partner in Turkey, and an independent valuation of its equity investment, it was determined that a permanent decline in value had occurred. This valuation resulted in a $47 million non-cash pre-tax charge. This charge was recorded as marketing, administration and research costs on the consolidated statement of earnings. During 2005, Kraft's interest in the joint venture was sold.

In 2004, as a result of the anticipated sale of the sugar confectionery business in 2005, Kraft recorded non-cash asset impairments totaling $107 million. This charge was included in loss from discontinued operations on the consolidated statement of earnings.

In 2004, as a result of the anticipated sale of a yogurt brand in 2005, Kraft recorded asset impairments totaling $8 million. This charge was recorded as asset impairment and exit costs on the consolidated statement of earnings.

NOTE 4.

Divestitures:

Discontinued Operations

In June 2005, Kraft sold substantially all of its sugar confectionery business for pre-tax proceeds of approximately $1.4 billion. The sale included the *Life Savers*, *Creme Savers*, *Altoids*, *Trolli* and *Sugus* brands. Altria Group, Inc. has reflected the results of Kraft's sugar confectionery business prior to the closing date as discontinued operations on the consolidated statements of earnings for all years presented. Pursuant to the sugar confectionery sale agreement, Kraft has agreed to provide certain transition and supply services to the buyer. These service arrangements are primarily for terms of one year or less, with the exception of one supply arrangement with a term of not more than three years. The expected cash flow from this supply arrangement is not significant.

Summary results of operations for the sugar confectionery business for the years ended December 31, 2005, 2004 and 2003, were as follows:

(in millions)	2005	2004	2003
Net revenues	$ 228	$ 477	$512
Earnings before income taxes and minority interest	$ 41	$ 103	$151
Impairment loss on assets of discontinued operations held for sale		(107)	
Provision for income taxes	(16)		(54)
Loss on sale of discontinued operations	(297)		
Minority interest in loss (earnings) from discontinued operations	39		(14)
(Loss) earnings from discontinued operations, net of income taxes and minority interest	$(233)	$ (4)	$ 83

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

The assets of the sugar confectionery business, which were reflected as assets of discontinued operations held for sale on the consolidated balance sheet at December 31, 2004, were as follows:

(in millions)	
Inventories	$ 65
Property, plant and equipment, net	201
Goodwill	814
Other intangible assets, net	485
Impairment loss on assets of discontinued operations held for sale	(107)
Assets of discontinued operations held for sale	$1,458

Other

During 2005, Kraft sold its fruit snacks assets and incurred a pre-tax asset impairment charge of $93 million in recognition of this sale. Additionally, during 2005, Kraft sold its desserts assets in the U.K. and its U.S. yogurt brand. The aggregate proceeds received from other divestitures during 2005 were $238 million, on which pre-tax gains of $108 million were recorded. In December 2005, Kraft announced the sale of certain Canadian assets and a small U.S. biscuit brand, incurring pre-tax asset impairment charges of $176 million in recognition of these sales. These transactions are expected to close in the first quarter of 2006.

During 2004, Kraft sold a Brazilian snack nuts business and trademarks associated with a candy business in Norway. The aggregate proceeds received from the sales of these businesses were $18 million, on which pre-tax losses of $3 million were recorded.

During 2003, Kraft sold a European rice business and a branded fresh cheese business in Italy. The aggregate proceeds received from the sales of businesses in 2003 were $96 million, on which pre-tax gains of $31 million were recorded.

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

NOTE 5.

Acquisitions:

Sampoerna

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

The acquisition of Sampoerna allowed PMI to enter the profitable kretek cigarette segment in Indonesia. Sampoerna's financial position and results of operations have been fully consolidated with PMI as of June 1, 2005. From March 2005 to May 2005, PMI recorded equity earnings in Sampoerna. Sampoerna contributed $315 million of operating income and $128 million of net earnings since March 2005.

Assets purchased consist primarily of goodwill of $3.5 billion, other intangible assets of $1.3 billion, inventories of $0.5 billion and property, plant and equipment of $0.4 billion. Liabilities assumed in the acquisition consist principally of long-term debt of $0.2 billion and accrued liabilities. These amounts represent the preliminary allocation of purchase price and are subject to revision when appraisals are finalized, which will be in the first half of 2006.

Other

During 2005, PMI acquired a 98.2% stake in Coltabaco, the largest tobacco company in Colombia, with a 48% market share, for approximately $300 million.

During 2004, Kraft purchased a U.S.-based beverage business, and PMI purchased a tobacco business in Finland. The total cost of acquisitions during 2004 was $179 million.

During 2003, PMI purchased approximately 74.2% of a tobacco business in Serbia for a cost of $486 million and purchased 99% of a tobacco business in Greece for approximately $387 million. PMI also increased its ownership interest in its affiliate in Ecuador from less than 50% to approximately 98% for a cost of $70 million. In addition, Kraft acquired a biscuits business in Egypt and acquired trademarks associated with a small U.S.-based natural foods business. The total cost of acquisitions during 2003 was $1.0 billion.

The effects of these other acquisitions were not material to Altria Group, Inc.'s consolidated financial position, results of operations or operating cash flows in any of the periods presented.

NOTE 6.

Inventories:

The cost of approximately 34% and 35% of inventories in 2005 and 2004, respectively, was determined using the LIFO method. The stated LIFO amounts of inventories were approximately $0.6 billion and $0.8 billion lower than the current cost of inventories at December 31, 2005 and 2004, respectively.

NOTE 7.

Investment in SABMiller:

At December 31, 2005, ALG had a 28.7% economic and voting interest in SABMiller. ALG's ownership interest in SABMiller is being accounted for under the equity method. Accordingly, ALG's investment in SABMiller of approximately $3.4 billion and $2.5 billion is included in other assets on the consolidated balance sheets at December 31, 2005 and 2004, respectively. In October 2005, SABMiller purchased a 71.8% interest in Bavaria SA, the second-largest brewer in South America, in exchange for the issuance of 225 million SABMiller ordinary shares. The ordinary shares had a value of approximately $3.5 billion. The remaining shares of Bavaria SA were acquired via a cash tender offer. Following the completion of the share issuance, ALG's economic ownership interest in SABMiller was reduced from 33.9% to approximately 28.7%. In addition, ALG elected to convert all of its non-voting shares into voting shares, and as a result increased its voting interest from 24.9% to 28.7%. The issuance of SABMiller ordinary shares in exchange for a controlling interest in Bavaria SA resulted in a change of ownership gain for ALG of $402 million, net of income taxes, that was recorded in stockholders' equity in the fourth quarter of 2005. ALG records its share of SABMiller's net earnings, based on its economic ownership percentage, in minority interest in earnings from continuing operations and equity earnings, net, on the consolidated statements of earnings.

NOTE 8.

Finance Assets, net:

In 2003, PMCC shifted its strategic focus and is no longer making new investments but is instead focused on managing its existing portfolio of finance assets in order to maximize gains and generate cash flow from asset sales and related activities. Accordingly, PMCC's operating companies income will fluctuate over time as investments mature or are sold. During 2005, 2004 and 2003, PMCC received proceeds from asset sales and maturities of $476 million, $644 million and $507 million, respectively, and recorded gains of $72 million, $112 million and $45 million, respectively, in operating companies income.

At December 31, 2005, finance assets, net, of $7,189 million were comprised of investments in finance leases of $7,737 million and other receivables of $48 million, reduced by allowance for losses of $596 million. At December 31, 2004, finance assets, net, of $7,827 million were comprised of investments in finance leases of $8,266 million and other receivables of $58 million, reduced by allowance for losses of $497 million.

A summary of the net investment in finance leases at December 31, before allowance for losses, was as follows:

	Leveraged Leases		Direct Finance Leases		Total	
(in millions)	**2005**	2004	**2005**	2004	**2005**	2004
Rentals receivable, net	**$ 8,237**	$ 8,726	**$ 628**	$ 747	**$ 8,865**	$ 9,473
Unguaranteed residual values	**1,846**	2,139	**101**	110	**1,947**	2,249
Unearned income	**(2,878)**	(3,237)	**(159)**	(177)	**(3,037)**	(3,414)
Deferred investment tax credits	**(38)**	(42)			**(38)**	(42)
Investment in finance leases	**7,167**	7,586	**570**	680	**7,737**	8,266
Deferred income taxes	**(5,666)**	(5,739)	**(320)**	(351)	**(5,986)**	(6,090)
Net investments in finance leases	**$ 1,501**	$ 1,847	**$ 250**	$ 329	**$ 1,751**	$ 2,176

For leveraged leases, rentals receivable, net, represent unpaid rentals, net of principal and interest payments on third-party nonrecourse debt. PMCC's rights to rentals receivable are subordinate to the third-party nonrecourse debtholders, and the leased equipment is pledged as collateral to the debtholders. The payment 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 of $16.7 billion and $18.3 billion at December 31, 2005 and 2004, respectively, has been offset against the related rentals receivable. There were no leases with contingent rentals in 2005, 2004 and 2003.

At December 31, 2005, PMCC's investment in finance leases was principally comprised of the following investment categories: aircraft (27%), electric power (26%), surface transport (21%), manufacturing (13%), real estate (11%) and energy (2%). Investments located outside the United States, which are primarily dollar-denominated, represent 20% and 19% of PMCC's investments in finance leases in 2005 and 2004, respectively.

Among its leasing activities, PMCC leases a number of aircraft, predominantly to major United States passenger carriers. At December 31, 2005, $2.1 billion of PMCC's finance asset balance related to aircraft. Two of PMCC's aircraft lessees, Delta Air Lines, Inc. ("Delta") and Northwest Airlines, Inc. ("Northwest") are currently under bankruptcy protection, and a third lessee, United Air Lines, Inc. ("United"), exited bankruptcy on February 1, 2006. PMCC is not recording income on these leases. In addition, PMCC leases various natural gas-fired power plants to indirect subsidiaries of Calpine Corporation ("Calpine"), also currently under bankruptcy protection. PMCC is not recording income on these leases.

PMCC leases 24 Boeing 757 aircraft to United with an aggregate finance asset balance of $541 million at December 31, 2005. PMCC has entered into an agreement with United to amend 18 direct finance leases and United has assumed the 18 amended leases. There is no third-party debt associated with these leases. United remains current on lease payments due to PMCC on these 18 amended leases. PMCC continues to monitor the situation at United with respect to the six remaining aircraft financed under leveraged leases, in which PMCC has an aggregate finance asset balance of $92 million. United and the public debtholders have a court approved agreement that calls for the public debtholders to foreclose on PMCC's interests in these six aircraft and transfer them to United. The foreclosure, expected to occur in 2006, subsequent to United's emergence from bankruptcy, would result in the write-off of the $92 million finance asset balance against PMCC's allowance for losses and the acceleration of tax payments in the amount of approximately $55 million on these leases.

In addition, PMCC has an aggregate finance asset balance of $257 million at December 31, 2005, relating to six Boeing 757, nine Boeing 767 and four McDonnell Douglas (MD-88) aircraft leased to Delta under leveraged leases. In November 2004, PMCC, along with other aircraft lessors, entered into restructuring agreements with Delta on all 19 aircraft. As a result of its agreement, PMCC recorded a charge to the allowance for losses of $40 million in the fourth quarter of 2004. As a result of Delta's bankruptcy filing in September 2005, the restructuring agreement is no longer in effect and PMCC is at risk of having its interest in these aircraft foreclosed upon by the senior lenders under the leveraged leases. Should a foreclosure occur, it would also result in the write-off of the finance asset balance against PMCC's allowance for losses and the acceleration of tax payments on these leases, and may require further provisions to increase the allowance for losses.

PMCC also leases three Airbus A-320 aircraft and five British Aerospace RJ85 aircraft to Northwest financed under leveraged leases with an aggregate finance asset balance of $62 million at December 31, 2005. Northwest filed for bankruptcy protection in September 2005. As a result of Northwest's bankruptcy filing, PMCC is at risk of having its interest in these aircraft foreclosed upon by the senior lenders under the leveraged leases. Should a foreclosure occur, it would also result in the write-off of the finance asset balance against PMCC's allowance for losses and the acceleration of tax payments on these leases.

In addition, PMCC's leveraged leases for ten Airbus A-319 aircraft with Northwest have been rejected in the bankruptcy. As a result of the lease rejection, PMCC, as owner of the aircraft, recorded these assets on its consolidated balance sheet at the lower of net book value or fair market value. The adjustment to fair market value resulted in a $100 million charge against the allowance for losses in the fourth quarter of 2005. The assets are classified as held for sale and reflected in other assets on the consolidated balance sheet until such time as the assets are either sold or foreclosed upon by the lenders. In addition, the related nonrecourse debt is reflected in other liabilities on the consolidated balance sheet until such time as the underlying assets are either sold or foreclosed upon by the senior lenders. Should a foreclosure occur, it would result in the acceleration of tax payments on these aircraft of approximately $57 million.

In addition, PMCC leases 16 Airbus A-319 aircraft to US Airways, Inc. ("US Airways") financed under leveraged leases with an aggregate finance asset balance of $150 million at December 31, 2005. In September 2005, US Airways emerged from bankruptcy protection and assumed the leases on PMCC's aircraft without any changes. Also in September 2005, US Airways and America West Holdings Corp. ("America West") completed a merger. PMCC leases five Airbus A-320 aircraft and three engines to America West with an aggregate finance asset balance of $44 million at December 31, 2005.

PMCC also leases two 265 megawatt ("MW") natural gas-fired power plants (located in Tiverton, Rhode Island, and Rumford, Maine) and one 750 MW natural gas-fired power plant (located in Pasadena, Texas) to indirect subsidiaries of Calpine financed under leveraged leases with an aggregate finance asset balance of $206 million at December 31, 2005. On December 20, 2005, Calpine filed for bankruptcy protection. In the initial bankruptcy filing, PMCC's lessees of the Tiverton and Rumford projects were included. On February 6, 2006, these leases were rejected. The Pasadena lessee did not file for bankruptcy but could file at a future date. Should a foreclosure on any of these projects occur, it would result in the write-off of the finance asset balance against PMCC's allowance for losses and the acceleration of tax payments on these leases, and may require further provisions to increase the allowance for losses.

Due to continuing uncertainty within its airline portfolio and bankruptcy filings by Delta and Northwest, PMCC recorded a provision for losses of $200 million in September 2005. As a result of this provision, PMCC's fixed charges coverage ratio did not meet its 1.25:1 requirement under a support agreement with ALG. Accordingly, as required by the support agreement, a support payment of $150 million was made by ALG to PMCC in September 2005.

Previously, PMCC recorded provisions for losses of $140 million in the fourth quarter of 2004 and $290 million in the fourth quarter of 2002 for its airline industry exposure. At December 31, 2005, PMCC's allowance for losses, which includes the provisions recorded by PMCC for its airline industry exposure, was $596 million. It is possible that adverse developments in the airline or other industries may require PMCC to increase its allowance for losses.

Rentals receivable in excess of debt service requirements on third-party nonrecourse debt related to leveraged leases and rentals receivable from direct finance leases at December 31, 2005, were as follows:

(in millions)	Leveraged Leases	Direct Finance Leases	Total
2006	$ 233	$ 48	$ 281
2007	209	32	241
2008	329	19	348
2009	298	19	317
2010	348	17	365
2011 and thereafter	6,820	493	7,313
Total	$8,237	$628	$8,865

Included in net revenues for the years ended December 31, 2005, 2004 and 2003, were leveraged lease revenues of $303 million, $351 million and $333 million, respectively, and direct finance lease revenues of $11 million, $38 million and $90 million, respectively. Income tax expense on leveraged lease revenues for the years ended December 31, 2005, 2004 and 2003, was $108 million, $136 million and $120 million, respectively.

Income from investment tax credits on leveraged leases and initial direct costs and executory costs on direct finance leases were not significant during the years ended December 31, 2005, 2004 and 2003.

NOTE 9.

Short-Term Borrowings and Borrowing Arrangements:

At December 31, 2005 and 2004, Altria Group, Inc.'s short-term borrowings and related average interest rates consisted of the following:

	2005		2004	
(in millions)	**Amount Outstanding**	**Average Year-End Rate**	Amount Outstanding	Average Year-End Rate
Consumer products:				
Bank loans	**$ 4,809**	**4.2%**	$ 878	4.9%
Commercial paper	**407**	**4.3**	1,668	2.4
Amount reclassified as long-term debt	**(2,380)**			
	$ 2,836		$2,546	

The fair values of Altria Group, Inc.'s short-term borrowings at December 31, 2005 and 2004, based upon current market interest rates, approximate the amounts disclosed above.

Following a $10.1 billion judgment on March 21, 2003, against PM USA in the *Price* litigation, which is discussed in Note 19. *Contingencies*, the three major credit rating agencies took a series of ratings actions resulting in the lowering of ALG's short-term and long-term debt ratings. During 2003, Moody's lowered ALG's short-term debt rating from "P-1" to "P-3" and its long-term debt rating from "A2" to "Baa2." Standard & Poor's lowered ALG's short-term debt rating from "A-1" to "A-2" and its long-term debt rating from "A–" to "BBB." Fitch Rating Services lowered ALG's short-term debt rating from "F-1" to "F-2" and its long-term debt rating from "A" to "BBB."

While Kraft is not a party to, and has no exposure to, this litigation, its credit ratings were also lowered, but to a lesser degree. As a result of the rating agencies' actions, borrowing costs for ALG and Kraft have increased. None of ALG's or Kraft's debt agreements require accelerated repayment as a result of a decrease in credit ratings. The credit rating downgrades by Moody's, Standard & Poor's and Fitch Rating Services had no impact on any of ALG's or Kraft's other existing third-party contracts.

As discussed in Note 5. *Acquisitions*, the purchase price of the Sampoerna acquisition was primarily financed through a euro 4.5 billion bank credit facility arranged for PMI and its subsidiaries in May 2005, consisting of a euro 2.5 billion three-year term loan facility and a euro 2.0 billion five-year revolving credit facility. These facilities, which are not guaranteed by ALG, require PMI to maintain an earnings before interest, taxes, depreciation and amortization ("EBITDA") to interest ratio of not less than 3.5 to 1.0. At December 31, 2005, PMI exceeded this ratio by a significant amount and is expected to continue to exceed it.

In April 2005, ALG negotiated a 364-day revolving credit facility in the amount of $1.0 billion and a new multi-year credit facility in the amount of $4.0 billion, which expires in April 2010. In addition, ALG terminated the existing $5.0 billion multi-year credit facility, which was due to expire in July 2006. The new ALG facilities require the maintenance of an earnings to fixed charges ratio, as defined by the agreement, of 2.5 to 1.0. At December 31, 2005, the ratio calculated in accordance with the agreement was 10.0 to 1.0.

In April 2005, Kraft negotiated a new multi-year revolving credit facility to replace both its $2.5 billion 364-day facility that was due to expire in July 2005 and its $2.0 billion multi-year facility that was due to expire in July 2006. The new Kraft facility, which is for the sole use of Kraft, in the amount of $4.5 billion, expires in April 2010 and requires the maintenance of a minimum net worth of $20.0 billion. At December 31, 2005, Kraft's net worth was $29.6 billion.

ALG, PMI and Kraft expect to continue to meet their respective covenants. These facilities do not include any credit rating triggers or any provisions that could require the posting of collateral. The multi-year facilities enable the respective companies to reclassify short-term debt on a long-term basis.

At December 31, 2005, approximately $2.4 billion of short-term borrowings that PMI expects to remain outstanding at December 31, 2006 were reclassified as long-term debt.

At December 31, 2005, credit lines for ALG, Kraft and PMI, and the related activity, were as follows:

ALG

Type (in billions of dollars)	Credit Lines	Amount Drawn	Commercial Paper Outstanding	Lines Available
364-day	$1.0	$—	$—	$1.0
Multi-year	4.0			4.0
	$5.0	$—	$—	$5.0

Kraft

Type (in billions of dollars)	Credit Lines	Amount Drawn	Commercial Paper Outstanding	Lines Available
Multi-year	$4.5	$—	$0.4	$4.1

PMI

Type (in billions of dollars)	Credit Lines	Amount Drawn	Lines Available
euro 2.5 billion, 3-year term loan	$3.0	$3.0	$ —
euro 2.0 billion, 5-year revolving credit	2.3	0.8	1.5
	$5.3	$3.8	$1.5

In addition to the above, certain international subsidiaries of ALG and Kraft maintain credit lines to meet their respective working capital needs. These credit lines, which amounted to approximately $2.2 billion for ALG subsidiaries (other than Kraft) and approximately $1.3 billion for Kraft subsidiaries, are for the sole use of these international businesses. Borrowings on these lines amounted to approximately $1.0 billion and $0.9 billion at December 31, 2005 and 2004, respectively.

ALG does not guarantee the debt of Kraft or PMI.

NOTE 10.

Long-Term Debt:

At December 31, 2005 and 2004, Altria Group, Inc.'s long-term debt consisted of the following:

(in millions)	2005	2004
Consumer products:		
Short-term borrowings, reclassified as long-term debt	$ 2,380	$ —
Notes, 4.00% to 7.65% (average effective rate 5.82%), due through 2031	12,721	14,443
Debentures, 7.00% to 8.38% (average effective rate 8.39%), $1,016 million face amount, due through 2027	981	911
Foreign currency obligations:		
Euro, 4.50% to 5.63% (average effective rate 5.07%), due through 2008	2,387	2,670
Other foreign	448	15
Other	166	174
	19,083	18,213
Less current portion of long-term debt	(3,430)	(1,751)
	$15,653	$16,462
Financial services:		
Eurodollar bonds, 7.50%, due 2009	$ 499	$ 499
Swiss franc, 4.00%, due 2006 and 2007	1,336	1,521
Euro, 6.88%, due 2006	179	201
	$ 2,014	$ 2,221

The increase in other foreign debt primarily reflects debt assumed as part of PMI's acquisition of Sampoerna and capital lease obligations associated with the expansion of PMI's vending machine distribution in Japan.

Aggregate maturities of long-term debt are as follows:

(in millions)	Consumer Products	Financial Services
2006	$3,430	$943
2007	2,039	572
2008	2,825	
2009	1,037	499
2010	15	
2011-2015	5,891	
2016-2020	1	
Thereafter	1,500	

Based on market quotes, where available, or interest rates currently available to Altria Group, Inc. for issuance of debt with similar terms and remaining maturities, the aggregate fair value of consumer products and financial services long-term debt, including the current portion of long-term debt, at December 31, 2005 and 2004 was $21.7 billion.

ALG does not guarantee the debt of Kraft or PMI.

NOTE 11.

Capital Stock:

Shares of authorized common stock are 12 billion; issued, repurchased and outstanding shares were as follows:

	Shares Issued	Shares Repurchased	Shares Outstanding
Balances, January 1, 2003	2,805,961,317	(766,701,765)	2,039,259,552
Exercise of stock options and issuance of other stock awards		16,675,270	16,675,270
Repurchased		(18,671,400)	(18,671,400)
Balances, December 31, 2003	2,805,961,317	(768,697,895)	2,037,263,422
Exercise of stock options and issuance of other stock awards		22,264,054	22,264,054
Balances, December 31, 2004	2,805,961,317	(746,433,841)	2,059,527,476
Exercise of stock options and issuance of other stock awards		**24,736,923**	**24,736,923**
Balances, December 31, 2005	**2,805,961,317**	**(721,696,918)**	**2,084,264,399**

At December 31, 2005, 104,294,075 shares of common stock were reserved for stock options and other stock awards under Altria Group, Inc.'s stock plans, and 10 million shares of Serial Preferred Stock, $1.00 par value, were authorized, none of which have been issued.

Following the rating agencies' actions discussed in Note 9. *Short-Term Borrowings and Borrowing Arrangements*, ALG suspended its share repurchase program. During 2005, 2004 and 2003, Kraft repurchased 39.2 million, 21.5 million and 12.5 million shares of its Class A common stock at a cost of $1.2 billion, $700 million and $380 million, respectively.

NOTE 12.

Stock Plans:

In 2005, Altria Group, Inc.'s Board of Directors adopted, and the stockholders approved, the Altria Group, Inc. 2005 Performance Incentive Plan (the "2005 Plan"). The 2005 Plan replaced the 2000 Performance Incentive Plan when it expired in May 2005. Under the 2005 Plan, Altria Group, Inc. may grant to eligible employees stock options, stock appreciation rights, restricted stock, restricted and deferred stock units, and other stock-based awards, as well as cash-based annual and long-term incentive awards. Up to 50 million shares of common stock may be issued under the 2005 Plan. Also, in 2005, Altria Group, Inc.'s Board of Directors adopted, and the stockholders approved, the 2005 Stock Compensation Plan for Non-Employee Directors (the "2005 Directors Plan"). The 2005 Directors Plan replaced the 2000 Stock Compensation Plan for Non-Employee Directors. Under the 2005 Directors Plan, Altria Group, Inc. may grant up to one million shares of common stock to members of the Board of Directors who are not employees of Altria Group, Inc. Shares available to be granted under the 2005 Plan and the 2005 Directors Plan at December 31, 2005, were 48,527,341 and 998,158, respectively.

In addition, Kraft may grant stock options, stock appreciation rights, restricted stock, restricted and deferred stock units, and other awards of its Class A common stock to its employees under the terms of the Kraft 2005 Performance Incentive Plan (the "Kraft Plan"). Up to 150 million shares of Kraft's Class A common stock may be issued under the Kraft Plan, of which no more than 45 million shares may be awarded as restricted stock. At December 31, 2005, Kraft's employees held options to purchase 15,145,840 shares of Kraft's Class A common stock.

Concurrent with Kraft's Initial Public Offering ("IPO") in June 2001, certain Altria Group, Inc. employees received a one-time grant of options to purchase shares of Kraft's Class A common stock held by Altria Group, Inc. at the IPO price of $31.00 per share. At December 31, 2005, employees held options to purchase approximately 1.4 million shares of Kraft's Class A common stock from Altria Group, Inc. In order to completely satisfy the obligation, Altria Group, Inc. purchased 1.6 million shares of Kraft's Class A common stock in open market transactions during 2002.

Altria Group, Inc. and Kraft apply the intrinsic value-based methodology in accounting for the various stock plans. Accordingly, no compensation expense has been recognized other than for restricted stock awards. In 2004, the FASB issued SFAS No. 123R, which requires companies to measure compensation cost for share-based payments at fair value. Altria Group, Inc. will adopt this new standard prospectively, on January 1, 2006.

Altria Group, Inc. has not granted stock options to employees since 2002. The amount included below as stock-based compensation expense in 2005 and 2004 relates primarily to EOSOs. Under certain circumstances, senior executives who exercise outstanding stock options using shares to pay the option exercise price and taxes, receive EOSOs equal to the number of shares tendered. During the years ended December 31, 2005, 2004 and 2003, Altria Group, Inc. granted 2.0 million, 1.7 million and 1.3 million EOSOs, respectively. EOSOs are granted at an exercise price of not less than fair value on the date of the grant.

Had compensation cost for stock option awards been determined by using the fair value at the grant date, Altria Group, Inc.'s net earnings and basic and diluted EPS would have been $10,420 million, $5.03 and $4.98, respectively, for the year ended December 31, 2005; $9,404 million, $4.59 and $4.56, respectively, for the year ended December 31, 2004; and $9,185 million, $4.53 and $4.51, respectively, for the year ended December 31, 2003. The foregoing impact of compensation cost was determined using a modified Black-Scholes methodology and the following assumptions for Altria Group, Inc. common stock:

	Risk-Free Interest Rate	Weighted Average Expected Life	Expected Volatility	Expected Dividend Yield	Fair Value at Grant Date
2005 Altria Group, Inc.	**3.97%**	**4 years**	**32.66%**	**4.39%**	**$14.41**
2004 Altria Group, Inc.	2.96	4	37.01	5.22	11.09
2003 Altria Group, Inc.	2.72	4	37.33	6.26	8.20

Altria Group, Inc. stock option activity was as follows for the years ended December 31, 2003, 2004 and 2005:

	Shares Subject to Option	Weighted Average Exercise Price	Options Exercisable
Balance at January 1, 2003	114,323,340	$37.62	105,145,417
Options granted	1,317,224	42.72	
Options exercised	(15,869,797)	28.57	
Options canceled	(3,072,139)	47.91	
Balance at December 31, 2003	96,698,628	38.85	95,229,316
Options granted	1,678,420	53.32	
Options exercised	(22,810,009)	36.26	
Options canceled	(275,956)	43.75	
Balance at December 31, 2004	75,291,083	39.93	74,548,371
Options granted	2,026,474	68.88	
Options exercised	(25,636,420)	38.44	
Options canceled	(23,940)	38.91	
Balance at December 31, 2005	**51,657,197**	**41.82**	**50,837,246**

The weighted average exercise prices of Altria Group, Inc. stock options exercisable at December 31, 2005, 2004 and 2003, were $41.32, $39.82 and $38.78, respectively.

The following table summarizes the status of Altria Group, Inc. stock options outstanding and exercisable as of December 31, 2005, by range of exercise price:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$21.34 – $22.09	6,993,231	4 years	$21.35	6,993,231	$21.35
33.94 – 50.72	39,957,250	4	43.13	39,957,250	43.13
51.04 – 75.71	4,706,716	4	61.08	3,886,765	58.60
	51,657,197			50,837,246	

Altria Group, Inc. and Kraft may grant shares of restricted stock and rights to receive shares of stock to eligible employees, giving them in most instances all of the rights of stockholders, except that they may not sell, assign, pledge or otherwise encumber such shares and rights. Such shares and rights are subject to forfeiture if certain employment conditions are not met. During 2005, 2004 and 2003, Altria Group, Inc. granted 1,246,970; 1,392,380; and 2,327,320 shares, respectively, of restricted stock to eligible U.S.-based employees and Directors, and during 2005, 2004 and 2003, also issued to eligible non-U.S. employees and Directors rights to receive 955,682; 1,011,467; and 1,499,920 equivalent shares, respectively. The market value per restricted share or right was $61.99, $55.42 and $36.61 on the respective dates of the 2005, 2004 and 2003 grants. At December 31, 2005, restrictions on such stock and rights, net of forfeitures, lapse as follows: 2006 – 3,001,130 shares; 2007 – 2,261,060 shares; 2008 – 2,386,760 shares; and 2011 and thereafter – 190,849 shares. During 2005, 2004 and 2003, Kraft granted 4,230,625; 4,129,902; and 3,659,751 restricted Class A shares to eligible U.S.-based employees and issued rights to receive 1,783,711; 1,939,450; and 1,651,717 restricted Class A equivalent shares to eligible non-U.S. employees, respectively. Restrictions on the Kraft Class A shares lapse as follows: 2006 – 4,140,552 shares; 2007 – 5,079,097 shares; 2008 – 5,596,297 shares; 2009 – 100,000 shares; 2010 – 69,170 shares; and 2012 – 100,000 shares.

The fair value of the restricted shares and rights at the date of grant is amortized to expense ratably over the restriction period, which is generally three years. Altria Group, Inc. recorded pre-tax compensation expense related to restricted stock and other stock awards of $263 million (including $148 million related to Kraft awards), $185 million (including $106 million related to Kraft awards) and $99 million (including $57 million related to Kraft awards) for the years ended December 31, 2005, 2004 and 2003, respectively. The unamortized portion of restricted stock and rights awards to employees of Altria Group, Inc. and Kraft, which is reported as a reduction of stockholders' equity, was $348 million at December 31, 2005. This amount included $202 million related to Kraft and $146 million related to Altria Group, Inc.

NOTE 13.

Earnings per Share:

Basic and diluted EPS from continuing and discontinued operations were calculated using the following:

(in millions) For the Years Ended December 31,	2005	2004	2003
Earnings from continuing operations	**$10,668**	$9,420	$9,121
(Loss) earnings from discontinued operations	**(233)**	(4)	83
Net earnings	**$10,435**	$9,416	$9,204
Weighted average shares for basic EPS	**2,070**	2,047	2,028
Plus incremental shares from assumed conversions:			
Restricted stock and stock rights	**6**	3	2
Stock options	**14**	13	8
Weighted average shares for diluted EPS	**2,090**	2,063	2,038

Incremental shares from assumed conversions are calculated as the number of shares that would be issued, net of the number of shares that could be purchased in the marketplace with the cash received upon stock option exercise or, in the case of restricted stock and rights, the number of shares corresponding to the unamortized compensation expense. For the 2005 computation, the number of stock options excluded from the calculation of weighted average shares for diluted EPS because their effects were antidilutive (i.e., the cash that would be received upon exercise is greater than the average market price of the stock during the year) was immaterial. For the 2004 and 2003 computations, 2 million and 43 million stock options, respectively, were excluded from the calculation of weighted average shares for diluted EPS because their effects were antidilutive.

NOTE 14.

Income Taxes:

Earnings from continuing operations before income taxes and minority interest, and provision for income taxes consisted of the following for the years ended December 31, 2005, 2004 and 2003:

(in millions)	2005	2004	2003
Earnings from continuing operations before income taxes, minority interest, and equity earnings, net:			
United States	**$ 8,062**	$ 7,414	$ 8,062
Outside United States	**7,373**	6,590	6,547
Total	**$15,435**	$14,004	$14,609
Provision for income taxes:			
United States federal:			
Current	**$ 2,909**	$ 2,106	$ 1,926
Deferred	**(765)**	450	742
	2,144	2,556	2,668
State and local	**355**	398	377
Total United States	**2,499**	2,954	3,045
Outside United States:			
Current	**2,179**	1,605	1,810
Deferred	**(60)**	(19)	242
Total outside United States	**2,119**	1,586	2,052
Total provision for income taxes	**$ 4,618**	$ 4,540	$ 5,097

The loss from discontinued operations for the year ended December 31, 2005, includes additional tax expense of $280 million from the sale of Kraft's sugar confectionery business, prior to any minority interest impact. The loss from discontinued operations for the year ended December 31, 2004, included a deferred income tax benefit of $43 million.

At December 31, 2005, applicable United States federal income taxes and foreign withholding taxes have not been provided on approximately $9.3 billion of accumulated earnings of foreign subsidiaries that are expected to be permanently reinvested.

In October 2004, the American Jobs Creation Act ("the Jobs Act") was signed into law. The Jobs Act includes a deduction for 85% of certain foreign earnings that are repatriated. In 2005, Altria Group, Inc. repatriated $6.0 billion of earnings under the provisions of the Jobs Act. Deferred taxes had previously been provided for a portion of the dividends remitted. The reversal of the deferred taxes more than offset the tax costs to repatriate the earnings and resulted in a net tax reduction of $372 million in the 2005 consolidated income tax provision. This reduction was included in the consolidated statement of earnings as an estimated benefit of $209 million in the second quarter and was subsequently revised to $168 million in the fourth quarter. Altria Group, Inc. recorded an additional $204 million tax benefit, which resulted from a favorable foreign tax law ruling that was received in the third quarter of 2005 related to the repatriation of earnings under the Jobs Act.

The Jobs Act also provides tax relief to U.S. domestic manufacturers by providing a tax deduction related to a percentage of the lesser of "qualified production activities income" or taxable income. The deduction, which was 3% in 2005, increases to 9% by 2010. In accordance with SFAS No. 109, Altria Group, Inc. will recognize these benefits in the year earned. The tax benefit in 2005 was approximately $60 million.

The effective income tax rate on pre-tax earnings differed from the U.S. federal statutory rate for the following reasons for the years ended December 31, 2005, 2004 and 2003:

	2005	2004	2003
U.S. federal statutory rate	**35.0%**	35.0%	35.0%
Increase (decrease) resulting from:			
State and local income taxes, net of federal tax benefit	**1.4**	1.8	1.8
Benefit related to dividend repatriation under the Jobs Act	**(2.4)**		
Reversal of taxes no longer required	**(0.9)**	(3.1)	(0.5)
Foreign rate differences	**(3.3)**	(3.6)	(4.1)
Foreign dividend repatriation cost		2.2	3.7
Other	**0.1**	0.1	(1.0)
Effective tax rate	**29.9%**	32.4%	34.9%

The tax provision in 2005 includes a $372 million benefit related to dividend repatriation under the Jobs Act in 2005, the reversal of $82 million of tax accruals no longer required at Kraft, the majority of which was in the first quarter, as well as other benefits, including the impact of the domestic manufacturers' deduction under the Jobs Act and lower repatriation costs. The tax provision in 2004 includes the reversal of $355 million of tax accruals that are no longer required due to foreign tax events that were resolved during the first quarter of 2004 ($35 million) and the second quarter of 2004 ($320 million), and an $81 million favorable resolution of an outstanding tax item at Kraft, the majority of which occurred in the third quarter. The tax provision in 2003 reflects reversals of $74 million of state tax liabilities, net of federal tax benefit, that were no longer required.

Altria Group, Inc. is regularly audited by federal, state and foreign tax authorities, and these audits are at various stages at any given time. Altria Group, Inc. anticipates several domestic and foreign audits will close in 2006 with favorable settlements. Any tax contingency reserves in excess of additional assessed liabilities will be reversed at the time the audits close.

The tax effects of temporary differences that gave rise to consumer products deferred income tax assets and liabilities consisted of the following at December 31, 2005 and 2004:

(in millions)	2005	2004
Deferred income tax assets:		
Accrued postretirement and postemployment benefits	**$ 1,534**	$1,506
Settlement charges	**1,228**	1,229
Other	**9**	231
Total deferred income tax assets	**2,771**	2,966
Deferred income tax liabilities:		
Trade names	**(4,341)**	(4,010)
Unremitted earnings	**(250)**	(971)
Property, plant and equipment	**(2,404)**	(2,547)
Prepaid pension costs	**(1,519)**	(1,485)
Total deferred income tax liabilities	**(8,514)**	(9,013)
Net deferred income tax liabilities	**$(5,743)**	$(6,047)

To conform with the current year's presentation, the amounts shown above at December 31, 2004 have been revised from previously reported amounts to reflect state deferred tax amounts that were previously included in other liabilities on the consolidated balance sheet. As a result, deferred income tax liabilities on the December 31, 2004 consolidated balance sheet increased $618 million from $7,677 million to $8,295 million, with a corresponding reduction in other liabilities.

Financial services deferred income tax liabilities are primarily attributable to temporary differences relating to net investments in finance leases.

NOTE 15.

Segment Reporting:

The products of ALG's subsidiaries include cigarettes and other tobacco products, and food (consisting principally of a wide variety of snacks, beverages, cheese, grocery products and convenient meals). Another subsidiary of ALG, PMCC, maintains a portfolio of leveraged and direct finance leases. The products and services of these subsidiaries constitute Altria Group, Inc.'s reportable segments of domestic tobacco, international tobacco, North American food, international food and financial services.

Altria Group, Inc.'s management reviews operating companies income to evaluate segment performance and allocate resources. Operating companies income for the segments excludes general corporate expenses and amortization of intangibles. Interest and other debt expense, net (consumer products), and provision for income taxes are centrally managed at the ALG 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 management. Altria Group, Inc.'s assets are managed on a worldwide basis by major products and, accordingly, asset information is reported for the tobacco, food and financial services segments. As described in Note 2. *Summary of Significant Accounting Policies*, intangible assets and related amortization are principally attributable to the food and international tobacco businesses. Other assets consist primarily of cash and cash equivalents and the investment in SABMiller. The accounting policies of the segments are the same as those described in Note 2.

Segment data were as follows:

(in millions) For the Years Ended December 31,	2005	2004	2003
Net revenues:			
Domestic tobacco	**$18,134**	$17,511	$17,001
International tobacco	**45,288**	39,536	33,389
North American food	**23,293**	22,060	20,937
International food	**10,820**	10,108	9,561
Financial services	**319**	395	432
Net revenues	**$97,854**	$89,610	$81,320
Earnings from continuing operations before income taxes, minority interest, and equity earnings, net:			
Operating companies income:			
Domestic tobacco	**$ 4,581**	$ 4,405	$ 3,889
International tobacco	**7,825**	6,566	6,286
North American food	**3,831**	3,870	4,658
International food	**1,122**	933	1,393
Financial services	**31**	144	313
Amortization of intangibles	**(28)**	(17)	(9)
General corporate expenses	**(770)**	(721)	(771)
Operating income	**16,592**	15,180	15,759
Interest and other debt expense, net	**(1,157)**	(1,176)	(1,150)
Earnings from continuing operations before income taxes, minority interest, and equity earnings, net	**$15,435**	$14,004	$14,609

Items affecting the comparability of results from continuing operations were as follows:

■ ***Domestic Tobacco Headquarters Relocation Charges***—PM USA has substantially completed the move of its corporate headquarters from New York City to Richmond, Virginia, for which pre-tax charges of $4 million, $31 million and $69 million were recorded in the operating companies income of the domestic tobacco segment for the years ended December 31, 2005, 2004 and 2003, respectively. At December 31, 2005, a liability of $6 million remains on the consolidated balance sheet.

■ ***Domestic Tobacco Loss on U.S. Tobacco Pool***—As further discussed in Note 19. *Contingencies*, in October 2004, the Fair and Equitable Tobacco Reform Act of 2004 ("FETRA") was signed into law. Under the provisions of FETRA, PM USA was obligated to cover its share of potential losses that the government may incur on the disposition of pool tobacco stock accumulated under the previous tobacco price support program. In 2005, PM USA recorded a $138 million expense for its share of the loss.

■ ***Domestic Tobacco Quota Buy-Out***—The provisions of FETRA require PM USA, along with other manufacturers and importers of tobacco products, to make quarterly payments that will be used to compensate tobacco growers and quota holders affected by the legislation. Payments made by PM USA under FETRA will offset amounts due under the provisions of the National Tobacco Grower Settlement Trust ("NTGST"), a trust formerly established to compensate tobacco growers and quota holders. Disputes arose as to the applicability of FETRA to 2004 NTGST payments. During the third quarter of 2005, a North Carolina Supreme Court ruling determined that FETRA enactment had not triggered the offset provisions during 2004 and that tobacco companies were required to make full payment to the NTGST for the full year of 2004. The ruling, along with FETRA billings from the United States Department of Agriculture ("USDA"), brought clarity to the fact that FETRA is effective beginning in 2005. Accordingly, during the third quarter of 2005, PM USA reversed a prior year accrual for FETRA payments applicable to 2004 in the amount of $115 million.

■ ***Domestic Tobacco Legal Settlement***—During 2003, PM USA and certain other defendants reached an agreement with a class of U.S. tobacco growers and quota holders to resolve a lawsuit related to tobacco leaf purchases. During 2003, PM USA recorded pre-tax charges of $202 million for its obligations under the agreement. The pre-tax charges are included in the operating companies income of the domestic tobacco segment.

■ ***International Tobacco E.C. Agreement***—In July 2004, PMI entered into an agreement with the European Commission ("E.C.") and 10 member states of the European Union that provides for broad cooperation with European law enforcement agencies on anti-contraband and anti-counterfeit efforts. The agreement resolves all disputes between the parties relating to these issues. Under the terms of the agreement, PMI will make 13 payments over 12 years, including an initial payment of $250 million, which was recorded as a pre-tax charge against its earnings in 2004. The agreement calls for additional payments of approximately $150 million on the first anniversary of the agreement (this payment was made in July 2005), approximately $100 million on the second anniversary and approximately $75 million each year thereafter for 10 years, each of which is to be adjusted based on certain variables, including PMI's market share in the European Union in the year preceding payment. Because future additional payments are subject to these variables, PMI will record charges for them as an expense in cost of sales when product is shipped.

■ ***Inventory Sale in Italy***—During the first quarter of 2005, PMI made a one-time inventory sale to its new distributor in Italy, resulting in a $96 million pre-tax operating companies income benefit for the international tobacco segment. During the second quarter of 2005, the new distributor reduced its inventories by approximately 1.0 billion units, resulting in lower shipments for PMI. The net impact of these actions was a benefit to PMI's pre-tax operating companies income of approximately $70 million for the year ended December 31, 2005.

■ ***Asset Impairment and Exit Costs***—See Note 3. *Asset Impairment and Exit Costs*, for a breakdown of these charges by segment.

■ ***(Gains)/Losses on Sales of Businesses, net***—During 2005, operating companies income of the international food segment included pre-tax gains on sales of businesses of $109 million, primarily related to the sale of Kraft's desserts assets in the U.K. During 2004, Kraft sold a Brazilian snack nuts business and trademarks associated with a candy business in Norway, and recorded aggregate pre-tax losses of $3 million. During 2003, Kraft sold a European rice business and a branded fresh cheese business in Italy and recorded aggregate pre-tax gains of $31 million.

■ ***Provision for Airline Industry Exposure***—As discussed in Note 8. *Finance Assets, net*, during 2005, PMCC increased its allowance for losses by $200 million, reflecting its exposure to the troubled airline industry, particularly to Delta and Northwest, both of which filed for bankruptcy protection during September 2005. In addition, during 2004 and 2002, in recognition of the economic downturn in the airline industry, PMCC increased its allowance for losses by $140 million and $290 million, respectively.

See Notes 4 and 5, respectively, regarding divestitures and acquisitions.

(in millions) For the Years Ended December 31,	2005	2004	2003
Depreciation expense from continuing operations:			
Domestic tobacco	**$ 208**	$ 203	$ 194
International tobacco	**509**	453	370
North American food	**551**	555	533
International food	**316**	309	266
	1,584	1,520	1,363
Other	**61**	66	63
Total depreciation expense from continuing operations	**1,645**	1,586	1,426
Depreciation expense from discontinued operations	**2**	4	5
Total depreciation expense	**$ 1,647**	$ 1,590	$ 1,431
Assets:			
Tobacco	**$ 32,370**	$ 27,472	$23,298
Food	**58,626**	60,760	59,735
Financial services	**7,408**	7,845	8,540
	98,404	96,077	91,573
Other	**9,545**	5,571	4,602
Total assets	**$107,949**	$101,648	$96,175
Capital expenditures from continuing operations:			
Domestic tobacco	**$ 228**	$ 185	$ 154
International tobacco	**736**	711	586
North American food	**720**	613	667
International food	**451**	389	402
	2,135	1,898	1,809
Other	**71**	11	149
Total capital expenditures from continuing operations	**2,206**	1,909	1,958
Capital expenditures from discontinued operations		4	16
Total capital expenditures	**$ 2,206**	$ 1,913	$ 1,974

Altria Group, Inc.'s operations outside the United States, which are principally in the tobacco and food businesses, are organized into geographic regions within each segment, with Europe being the most significant. Total tobacco and food segment net revenues attributable to customers located in Germany, Altria Group, Inc.'s largest European market, were $9.3 billion, $9.0 billion and $8.5 billion for the years ended December 31, 2005, 2004 and 2003, respectively.

Geographic data for net revenues and long-lived assets (which consist of all financial services assets and non-current consumer products assets, other than goodwill and other intangible assets, net) were as follows:

(in millions) For the Years Ended December 31,	2005	2004	2003
Net revenues:			
United States — domestic	**$39,273**	$37,729	$36,312
— export	**3,630**	3,493	3,528
Europe	**39,880**	36,163	30,813
Other	**15,071**	12,225	10,667
Total net revenues	**$97,854**	$89,610	$81,320
Long-lived assets:			
United States	**$27,793**	$26,347	$25,825
Europe	**6,716**	6,829	6,048
Other	**4,244**	3,459	3,375
Total long-lived assets	**$38,753**	$36,635	$35,248

NOTE 16.

Benefit Plans:

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

The plan assets and benefit obligations of Altria Group, Inc.'s U.S. and Canadian pension plans are measured at December 31 of each year, and all other non-U.S. pension plans are measured at September 30 of each year. The benefit obligations of Altria Group, Inc.'s postretirement plans are measured at December 31 of each year.

Pension Plans

Obligations and Funded Status

The benefit obligations, plan assets and funded status of Altria Group, Inc.'s pension plans at December 31, 2005 and 2004, were as follows:

	U.S. Plans		Non-U.S. Plans	
(in millions)	**2005**	2004	**2005**	2004
Benefit obligation at January 1	**$10,896**	$ 9,683	**$ 6,201**	$5,156
Service cost	**277**	247	**206**	180
Interest cost	**616**	613	**283**	254
Benefits paid	**(778)**	(677)	**(274)**	(315)
Termination, settlement and curtailment	**50**	36	**(5)**	
Actuarial losses	**268**	988	**727**	175
Currency			**(392)**	546
Acquisitions			**71**	8
Other	**21**	6	**69**	197
Benefit obligation at December 31	**11,350**	10,896	**6,886**	6,201
Fair value of plan assets at January 1	**10,569**	9,555	**4,476**	3,433
Actual return on plan assets	**686**	1,044	**759**	361
Contributions	**737**	659	**497**	419
Benefits paid	**(767)**	(686)	**(189)**	(139)
Termination, settlement, and curtailment			**(11)**	
Currency			**(257)**	392
Actuarial (losses) gains	**(3)**	(3)	**(3)**	10
Acquisitions			**24**	
Fair value of plan assets at December 31	**11,222**	10,569	**5,296**	4,476
Funded status (plan assets less than benefit obligations) at December 31	**(128)**	(327)	**(1,590)**	(1,725)
Unrecognized actuarial losses	**4,469**	4,350	**1,875**	1,727
Unrecognized prior service cost	**123**	120	**93**	108
Additional minimum liability	**(177)**	(206)	**(787)**	(663)
Unrecognized net transition obligation			**8**	9
Net prepaid pension asset (liability) recognized	**$ 4,287**	$ 3,937	**$ (401)**	$ (544)

The combined U.S. and non-U.S. pension plans resulted in a net prepaid pension asset of $3.9 billion and $3.4 billion at December 31, 2005 and 2004, respectively. These amounts were recognized in Altria Group, Inc.'s consolidated balance sheets at December 31, 2005 and 2004, as other assets of $5.7 billion and $5.2 billion, respectively, for those plans in which plan assets exceeded their accumulated benefit obligations, and as other liabilities of $1.8 billion at December 31, 2005 and 2004 for those plans in which the accumulated benefit obligations exceeded their plan assets.

For U.S. and non-U.S. pension plans, the change in the additional minimum liability in 2005 and 2004 was as follows:

	U.S. Plans		Non-U.S. Plans	
(in millions)	**2005**	2004	**2005**	2004
(Increase) decrease in minimum liability included in other comprehensive earnings (losses), net of tax	**$19**	$(5)	**$(73)**	$(48)

The accumulated benefit obligation, which represents benefits earned to date, for the U.S. pension plans was $10.1 billion and $9.5 billion at December 31, 2005 and 2004, respectively. The accumulated benefit obligation for non-U.S. pension plans was $6.1 billion and $5.5 billion at December 31, 2005 and 2004, respectively.

For U.S. plans with accumulated benefit obligations in excess of plan assets, the projected benefit obligation, accumulated benefit obligation and fair value of plan assets were $488 million, $384 million and $18 million, respectively, as of December 31, 2005, and $584 million, $415 million and $15 million, respectively, as of December 31, 2004. At December 31, 2005, the majority of these relate to plans for salaried employees that cannot be funded under I.R.S. regulations. For non-U.S. plans with accumulated benefit obligations in excess of plan assets, the projected benefit obligation, accumulated benefit obligation and fair value of plan assets were $4,583 million, $4,052 million and $2,956 million, respectively, as of December 31, 2005, and $3,689 million, $3,247 million and $2,013 million, respectively, as of December 31, 2004.

The following weighted-average assumptions were used to determine Altria Group, Inc.'s benefit obligations under the plans at December 31:

	U.S. Plans		Non-U.S. Plans	
	2005	2004	**2005**	2004
Discount rate	**5.64%**	5.75%	**4.04%**	4.75%
Rate of compensation increase	**4.20**	4.20	**3.13**	3.28

Altria Group, Inc.'s 2005 year-end U.S. and Canadian plans discount rates were developed from a model portfolio of high-quality, fixed-income debt instruments with durations that match the expected future cash flows of the benefit obligations. The 2005 year-end discount rates for Altria Group, Inc.'s non-U.S. plans were developed from local bond indices that match local benefit obligations as closely as possible.

Components of Net Periodic Benefit Cost

Net periodic pension cost consisted of the following for the years ended December 31, 2005, 2004 and 2003:

	U.S. Plans			Non-U.S. Plans		
(in millions)	**2005**	2004	2003	**2005**	2004	2003
Service cost	**$ 277**	$ 247	$ 234	**$ 206**	$ 180	$ 140
Interest cost	**616**	613	579	**283**	254	217
Expected return on plan assets	**(870)**	(932)	(936)	**(352)**	(318)	(257)
Amortization:						
Unrecognized net loss from experience differences	**271**	157	46	**70**	50	29
Prior service cost	**19**	16	16	**14**	14	11
Termination, settlement and curtailment	**92**	48	68	**27**	3	
Net periodic pension cost	**$ 405**	$ 149	$ 7	**$ 248**	$ 183	$ 140

During 2005, 2004 and 2003, employees left Altria Group, Inc. under voluntary early retirement and workforce reduction programs. These events resulted in settlement losses, curtailment losses and termination benefits for the U.S. plans in 2005, 2004 and 2003 of $19 million, $7 million and $17 million, respectively. In addition, retiring employees of Kraft North America Commercial ("KNAC") elected lump-sum payments, resulting in settlement losses of $73 million, $41 million and $51 million in 2005, 2004 and 2003, respectively. During 2005 and 2004, non-U.S. plant closures and early retirement benefits resulted in curtailment and settlement losses of $27 million and $3 million, respectively.

The following weighted-average assumptions were used to determine Altria Group, Inc.'s net pension cost for the years ended December 31:

	U.S. Plans			Non-U.S. Plans		
	2005	2004	2003	**2005**	2004	2003
Discount rate	**5.75%**	6.25%	6.50%	**4.75%**	4.87%	4.99%
Expected rate of return on plan assets	**8.00**	9.00	9.00	**7.54**	7.82	7.81
Rate of compensation increase	**4.20**	4.20	4.20	**3.28**	3.40	3.30

Altria Group, Inc.'s expected rate of return on plan assets is determined by the plan assets' historical long-term investment performance, current asset allocation and estimates of future long-term returns by asset class.

ALG and certain of its subsidiaries sponsor deferred profit-sharing plans covering certain salaried, non-union and union employees. Contributions and costs are determined generally as a percentage of pre-tax earnings, as defined by the plans. Certain other subsidiaries of ALG also maintain defined contribution plans. Amounts charged to expense for defined contribution plans totaled $256 million, $244 million and $235 million in 2005, 2004 and 2003, respectively.

Plan Assets

The percentage of fair value of pension plan assets at December 31, 2005 and 2004, was as follows:

	U.S. Plans		Non-U.S. Plans	
Asset Category	**2005**	2004	**2005**	2004
Equity securities	**74%**	72%	**60%**	59%
Debt securities	**25**	27	**35**	35
Real estate			**3**	4
Other	**1**	1	**2**	2
Total	**100%**	100%	**100%**	100%

Altria Group, Inc.'s investment strategy is based on an expectation that equity securities will outperform debt securities over the long term. Accordingly, the composition of Altria Group, Inc.'s U.S. plan assets is broadly characterized as a 70%/30% allocation between equity and debt securities. The strategy utilizes indexed U.S. equity securities, actively managed international equity securities and actively managed investment grade debt securities (which constitute 80% or more of debt securities) with lesser allocations to high-yield and international debt securities.

For the plans outside the U.S., the investment strategy is subject to local regulations and the asset/liability profiles of the plans in each individual country. These specific circumstances result in a level of equity exposure that is typically less than the U.S. plans. In aggregate, the actual asset allocations of the non-U.S. plans are virtually identical to their respective asset policy targets.

Altria Group, Inc. attempts to mitigate investment risk by rebalancing between equity and debt asset classes as Altria Group, Inc.'s contributions and monthly benefit payments are made.

Altria Group, Inc. presently makes, and plans to make, contributions, to the extent that they do not generate an excise tax liability, in order to maintain plan assets in excess of the accumulated benefit obligation of its funded U.S. and non-U.S. plans. Currently, Altria Group, Inc. anticipates making contributions of approximately $410 million in 2006 to its U.S. plans and approximately $216 million in 2006 to its non-U.S. plans, based on current tax law. These amounts include approximately $140 million and $106 million that Kraft anticipates making to its U.S. and non-U.S. plans, respectively. However, these estimates are subject to change as a result of changes in tax and other benefit laws, as well as asset performance significantly above or below the assumed long-term rate of return on pension assets, or significant changes in interest rates.

The estimated future benefit payments from the Altria Group, Inc. pension plans at December 31, 2005, were as follows:

(in millions)	U.S. Plans	Non-U.S. Plans
2006	$ 576	$ 273
2007	650	280
2008	615	292
2009	672	306
2010	729	318
2011–2015	4,472	1,716

Postretirement Benefit Plans

Net postretirement health care costs consisted of the following for the years ended December 31, 2005, 2004 and 2003:

(in millions)	2005	2004	2003
Service cost	$ 96	$ 85	$ 80
Interest cost	280	280	270
Amortization:			
Unrecognized net loss from experience differences	82	57	47
Unrecognized prior service cost	(29)	(25)	(27)
Other expense	2	1	7
Net postretirement health care costs	$431	$398	$377

During 2005, 2004 and 2003, Altria Group, Inc. instituted early retirement programs. These actions resulted in special termination benefits and curtailment losses of $2 million, $1 million and $7 million in 2005, 2004 and 2003, respectively, which are included in other expense, above.

In December 2003, the United States enacted into law the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act"). The Act establishes a prescription drug benefit under Medicare, known as "Medicare Part D," and a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D.

In May 2004, the FASB issued FASB Staff Position No. 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" ("FSP 106-2"). FSP 106-2 requires companies to account for the effect of the subsidy on benefits attributable to past service as an actuarial experience gain and as a reduction of the service cost component of net postretirement health care costs for amounts attributable to current service, if the benefit provided is at least actuarially equivalent to Medicare Part D.

Altria Group, Inc. adopted FSP 106-2 in the third quarter of 2004. The impact for 2005 and 2004 was a reduction of pre-tax net postretirement health care costs and an increase in net earnings, which is included above as a reduction of the following:

(in millions)	2005	2004
Service cost	$10	$ 4
Interest cost	28	11
Amortization of unrecognized net loss from experience differences	29	13
Reduction of pre-tax net postretirement health care costs and an increase in net earnings	$67	$28
Reduction related to Kraft included above	$55	$24

In addition, as of July 1, 2004, Altria Group, Inc. reduced its accumulated postretirement benefit obligation for the subsidy related to benefits attributed to past service by $375 million and decreased its unrecognized actuarial losses by the same amount.

The following weighted-average assumptions were used to determine Altria Group, Inc.'s net postretirement cost for the years ended December 31:

	U.S. Plans			Canadian Plans		
	2005	2004	2003	2005	2004	2003
Discount rate	5.75%	6.25%	6.50%	5.75%	6.50%	6.75%
Health care cost trend rate	8.00	8.90	8.00	9.50	8.00	7.00

Altria Group, Inc.'s postretirement health care plans are not funded. The changes in the accumulated benefit obligation and net amount accrued at December 31, 2005 and 2004, were as follows:

(in millions)	2005	2004
Accumulated postretirement benefit obligation at January 1	$ 4,819	$ 4,599
Service cost	96	85
Interest cost	280	280
Benefits paid	(291)	(305)
Curtailments	2	1
Plan amendments	19	(43)
Medicare Prescription Drug, Improvement and Modernization Act of 2003		(375)
Currency	2	10
Assumption changes	352	474
Actuarial losses	116	93
Accumulated postretirement benefit obligation at December 31	5,395	4,819
Unrecognized actuarial losses	(1,857)	(1,466)
Unrecognized prior service cost	173	221
Accrued postretirement health care costs	$ 3,711	$ 3,574

The current portion of Altria Group, Inc.'s accrued postretirement health care costs of $299 million and $289 million at December 31, 2005 and 2004, respectively, is included in other accrued liabilities on the consolidated balance sheets.

The following weighted-average assumptions were used to determine Altria Group, Inc.'s postretirement benefit obligations at December 31:

	U.S. Plans		Canadian Plans	
	2005	2004	2005	2004
Discount rate	5.64%	5.75%	5.00%	5.75%
Health care cost trend rate assumed for next year	8.00	8.00	9.00	9.50
Ultimate trend rate	5.00	5.00	6.00	6.00
Year that the rate reaches the ultimate trend rate	2009	2008	2012	2012

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects as of December 31, 2005:

	One-Percentage-Point Increase	One-Percentage-Point Decrease
Effect on total of service and interest cost	13.8%	(11.2)%
Effect on postretirement benefit obligation	10.0	(8.2)

Altria Group, Inc.'s estimated future benefit payments for its postretirement health care plans at December 31, 2005, were as follows:

(in millions)	U.S. Plans	Canadian Plans
2006	$ 292	$ 7
2007	307	7
2008	315	8
2009	323	8
2010	330	8
2011–2015	1,774	48

Postemployment Benefit Plans

ALG and certain of its subsidiaries sponsor postemployment benefit plans covering substantially all salaried and certain hourly employees. The cost of these plans is charged to expense over the working life of the covered employees. Net postemployment costs consisted of the following for the years ended December 31, 2005, 2004 and 2003:

(in millions)	**2005**	2004	2003
Service cost	**$ 18**	$ 18	$ 24
Amortization of unrecognized net loss	**9**	10	11
Other expense	**219**	226	69
Net postemployment costs	**$246**	$254	$104

As discussed in Note 3. *Asset Impairment and Exit Costs*, certain employees left Kraft under the restructuring program and certain salaried employees left Altria Group, Inc. under separation programs. These programs resulted in incremental postemployment costs, which are included in other expense, above.

Altria Group, Inc.'s postemployment plans are not funded. The changes in the benefit obligations of the plans at December 31, 2005 and 2004, were as follows:

(in millions)	**2005**	2004
Accumulated benefit obligation at January 1	**$ 457**	$ 480
Service cost	**18**	18
Kraft restructuring program	**139**	167
Benefits paid	**(318)**	(280)
Actuarial losses	**237**	72
Accumulated benefit obligation at December 31	**533**	457
Unrecognized experience (loss) gain	**(86)**	30
Accrued postemployment costs	**$ 447**	$ 487

The accumulated benefit obligation was determined using an assumed ultimate annual turnover rate of 0.5% and 0.4% in 2005 and 2004, respectively, assumed compensation cost increases of 4.3% and 4.2% in 2005 and 2004, respectively, and assumed benefits as defined in the respective plans. Postemployment costs arising from actions that offer employees benefits in excess of those specified in the respective plans are charged to expense when incurred.

NOTE 17.

Additional Information:

The amounts shown below are for continuing operations.

(in millions) For the Years Ended December 31,	**2005**	2004	2003
Research and development expense	**$ 943**	$ 809	$ 756
Advertising expense	**$1,784**	$1,763	$1,623
Interest and other debt expense, net:			
Interest expense	**$1,556**	$1,417	$1,367
Interest income	**(399)**	(241)	(217)
	$1,157	$1,176	$1,150
Interest expense of financial services operations included in cost of sales	**$ 107**	$ 106	$ 108
Rent expense	**$ 748**	$ 738	$ 709

Minimum rental commitments under non-cancelable operating leases in effect at December 31, 2005, were as follows:

(in millions)	
2006	$ 436
2007	329
2008	232
2009	157
2010	121
Thereafter	344
	$1,619

NOTE 18.

Financial Instruments:

■ **Derivative financial instruments:** ALG's subsidiaries operate globally, with manufacturing and sales facilities in various locations around the world. ALG and its subsidiaries utilize certain financial instruments to manage its foreign currency and commodity exposures. Derivative financial instruments are used by ALG and its subsidiaries, principally to reduce exposures to market risks resulting from fluctuations in foreign exchange rates and commodity prices, by creating offsetting exposures. Altria Group, Inc. is not a party to leveraged derivatives and, by policy, does not use derivative financial instruments for speculative purposes. Financial instruments qualifying for hedge accounting must maintain a specified level of effectiveness between the hedging instrument and the item being hedged, both at inception and throughout the hedged period. Altria Group, Inc. formally documents the nature and relationships between the hedging instruments and hedged items, as well as its risk-management objectives, strategies for undertaking the various hedge transactions and method of assessing hedge effectiveness. Additionally, for hedges of forecasted transactions, the significant characteristics and expected terms of the forecasted transaction must be specifically identified, and it must be probable that each forecasted transaction will occur. If it were deemed probable that the forecasted transaction will not occur, the gain or loss would be recognized in earnings currently.

Altria Group, Inc. uses forward foreign exchange contracts and foreign currency options to mitigate its exposure to changes in exchange rates from third-party and intercompany actual and forecasted transactions. The primary currencies to which Altria Group, Inc. is exposed include the Japanese yen, Swiss franc and the euro. At December 31, 2005 and 2004, Altria Group, Inc. had foreign exchange option and forward contracts with aggregate notional amounts of $4.8 billion and $9.7 billion, respectively. The effective portion of unrealized gains and losses associated with forward contracts and option contracts is deferred as a component of accumulated other comprehensive earnings (losses) until the underlying hedged transactions are reported on Altria Group, Inc.'s consolidated statement of earnings.

In addition, Altria Group, Inc. uses foreign currency swaps to mitigate its exposure to changes in exchange rates related to foreign currency denominated debt. These swaps typically convert fixed-rate foreign currency denominated debt to fixed-rate debt denominated in the functional currency of the borrowing entity. A substantial portion of the foreign currency swap agreements is accounted for as cash flow hedges. The unrealized gain (loss) relating to foreign currency swap agreements that do not qualify for hedge accounting treatment under U.S. GAAP was insignificant as of December 31, 2005 and 2004. At December 31, 2005 and 2004, the notional amounts of foreign currency swap agreements aggregated $2.3 billion and $2.7 billion, respectively. Aggregate maturities of foreign currency swap agreements at December 31, 2005, were $1.0 billion in 2006 and $1.3 billion in 2008.

Altria Group, Inc. also designates certain foreign currency denominated debt as net investment hedges of foreign operations. During the year ended December 31, 2005, these hedges of net investments resulted in a gain, net of income taxes, of $369 million, and in the years ended December 31, 2004 and 2003, resulted in losses, net of income taxes, of $344 million and $286 million, respectively. These gains and losses were reported as a component of accumulated other comprehensive earnings (losses) within currency translation adjustments.

Kraft is exposed to price risk related to forecasted purchases of certain commodities used as raw materials. Accordingly, Kraft uses commodity forward contracts as cash flow hedges, primarily for coffee and cocoa. Commodity futures and options are also used to hedge the price of certain commodities, including milk, coffee, cocoa, wheat, corn, sugar and soybean oil. At December 31, 2005 and 2004, Kraft had net long commodity positions of $521 million and $443 million, respectively. In general, commodity forward contracts qualify for the normal purchase exception under U.S. GAAP. The effective portion of unrealized gains and losses on commodity futures and option contracts is deferred as a component of accumulated other comprehensive earnings (losses) and is recognized as a component of cost of sales when the related inventory is sold. Unrealized gains or losses on net commodity positions were immaterial at December 31, 2005 and 2004.

During the years ended December 31, 2005, 2004 and 2003, ineffectiveness related to fair value hedges and cash flow hedges was not material. Altria Group, Inc. is hedging forecasted transactions for periods not exceeding the next fifteen months. At December 31, 2005, Altria Group, Inc. estimates that an insignificant amount of derivative gains, net of income taxes, reported in accumulated other comprehensive earnings (losses) will be reclassified to the consolidated statement of earnings within the next twelve months.

Derivative gains or losses reported in accumulated other comprehensive earnings (losses) are a result of qualifying hedging activity. Transfers of gains or losses from accumulated other comprehensive earnings (losses) to earnings are offset by the corresponding gains or losses on the underlying hedged item. Hedging activity affected accumulated other comprehensive earnings (losses), net of income taxes, during the years ended December 31, 2005, 2004 and 2003, as follows:

(in millions)	**2005**	2004	2003
Loss as of January 1	**$ (14)**	$(83)	$(77)
Derivative (gains) losses transferred to earnings	**(95)**	86	(42)
Change in fair value	**133**	(17)	36
Gain (loss) as of December 31	**$ 24**	$(14)	$(83)

■ **Credit exposure and credit risk:** Altria Group, Inc. is exposed to credit loss in the event of nonperformance by counterparties. Altria Group, Inc. does not anticipate nonperformance within its consumer products businesses. However, see Note 8. *Finance Assets, net* regarding certain aircraft and other leases.

■ **Fair value:** The aggregate fair value, based on market quotes, of Altria Group, Inc.'s total debt at December 31, 2005, was $24.6 billion, as compared with its carrying value of $23.9 billion. The aggregate fair value of Altria Group, Inc.'s total debt at December 31, 2004, was $24.2 billion, as compared with its carrying value of $23.0 billion.

The fair value, based on market quotes, of Altria Group, Inc.'s equity investment in SABMiller at December 31, 2005, was $7.8 billion, as compared with its carrying value of $3.4 billion. The fair value of Altria Group, Inc.'s equity investment in SABMiller at December 31, 2004, was $7.1 billion, as compared with its carrying value of $2.5 billion.

See Notes 9 and 10 for additional disclosures of fair value for short-term borrowings and long-term debt.

NOTE 19.

Contingencies:

Legal proceedings covering a wide range of matters are pending or threatened in various United States and foreign jurisdictions against ALG, its subsidiaries and affiliates, including PM USA and PMI, as well as their respective indemnitees. Various types of claims are raised in these proceedings, including product liability, consumer protection, antitrust, tax, contraband shipments, patent infringement, employment matters, claims for contribution and claims of competitors and distributors.

Overview of Tobacco-Related Litigation

■ **Types and Number of Cases:** Pending 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 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) and non-governmental 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 fraud, or violations of the Racketeer Influenced and Corrupt Organizations Act ("RICO"), and (v) other tobacco-related litigation. Other tobacco-related litigation includes suits by foreign governments seeking to recover damages resulting from the allegedly illegal importation of cigarettes into various jurisdictions, suits by former asbestos manufacturers seeking contribution or reimbursement for amounts expended in connection with the defense and payment of asbestos claims that were allegedly caused in whole or in part by cigarette smoking, and various antitrust suits. Damages claimed in some of the tobacco-related litigation range into the billions of dollars. Plaintiffs' theories of recovery and the defenses raised in the 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 and, in some instances, ALG or PMI, as of December 31, 2005, December 31, 2004 and December 31, 2003, and a page reference to further discussions of each type of case.

Type of Case	Number of Cases Pending as of December 31, 2005	Number of Cases Pending as of December 31, 2004	Number of Cases Pending as of December 31, 2003	Page References
Individual Smoking and Health Cases(1)	228	222	423	71
Smoking and Health Class Actions and Aggregated Claims Litigation(2)	9	9	12	71
Health Care Cost Recovery Actions	4	10	13	72-74
Lights/Ultra Lights Class Actions	24	21	21	74
Tobacco Price Cases	2	2	28	75
Cigarette Contraband Cases	0	2	5	75-76
Asbestos Contribution Cases	1	1	7	76

(1) Does not include 2,640 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, which was settled in 1997. The terms of the court-approved settlement in that case allow class members to file individual lawsuits seeking compensatory damages, but prohibit them from seeking punitive damages. Also, does not include nine individual smoking and health cases brought against certain retailers that are indemnitees of PM USA.

(2) Includes as one case the aggregated claims of 928 individuals that are proposed to be tried in a single proceeding in West Virginia. In December 2005, the West Virginia Supreme Court of Appeals ruled that the United States Constitution does not preclude a trial in two phases in this case. Issues related to defendants' conduct, entitlement to punitive damages and a punitive damages multiplier, if any, would be determined in the first phase. The second phase would consist of individual trials to determine liability, if any, and compensatory damages.

There are also a number of other tobacco-related actions pending outside the United States against PMI and its affiliates and subsidiaries, including an estimated 132 individual smoking and health cases (Argentina (59), Australia (2), Brazil (54), Chile (3), Colombia (1), Israel (2), Italy (4), the Philippines (1), Poland (1), Scotland (1), Spain (2), Turkey (1) and Venezuela (1)), compared with approximately 121 such cases on December 31, 2004, and approximately 99 such cases on December 31, 2003. In addition, in Italy, 23 cases are pending in the Italian equivalent of small claims court where damages are limited to €2,000 per case, and four cases are pending in Finland and one in Israel against defendants that are indemnitees of a subsidiary of PMI.

In addition, as of December 31, 2005, there were three smoking and health putative class actions pending outside the United States against PMI in Brazil (1), Israel (1), and Poland (1) compared with three such cases on December 31, 2004, and six such cases on December 31, 2003. Four health care cost recovery actions are pending in Israel (1), Canada (1), France (1) and Spain (1) against PMI or its affiliates, and two Lights/Ultra Lights class actions are pending in Israel.

■ **Pending and Upcoming Trials:** Trial in one individual smoking and health case in which PM USA is a defendant began in a Missouri state court in January 2006. An estimated nine additional smoking and health cases against PM USA are scheduled for trial in 2006. Cases against other tobacco companies are also scheduled for trial through the end of 2006. Trial dates are subject to change.

■ **Recent Trial Results:** Since January 1999, verdicts have been returned in 43 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 27 of the 43 cases. These 27 cases were tried in California (4), Florida (9), Mississippi (1), Missouri (1), New Hampshire (1), New Jersey (1), New York (3), Ohio (2), Pennsylvania (1), Rhode Island (1), Tennessee (2), and West Virginia (1). Plaintiffs' appeals or post-trial motions challenging the verdicts are pending in California, Florida, Missouri, and Pennsylvania. A motion for a new trial has been granted in one of the cases in Florida. In addition, in December 2002, a court dismissed an individual smoking and health case in California at the end of trial. Also, in July 2005, a jury in Tennessee returned a verdict in favor of PM USA in a case in which plaintiffs had challenged PM USA's retail promotional and merchandising programs under the Robinson-Patman Act.

Of the 16 cases in which verdicts were returned in favor of plaintiffs, four have reached final resolution. A $17.8 million verdict against defendants in a health care cost recovery case (including $6.8 million against PM USA) was reversed, and all claims were dismissed with prejudice in February 2005 (*Blue Cross/Blue Shield*). In October 2004, after exhausting all appeals, PM USA paid $3.3 million (including interest of $285,000) in an individual smoking and health case in Florida (*Eastman*). In March 2005, after exhausting all appeals, PM USA paid $17 million (including interest of $6.4 million) in an individual smoking and health case in California (*Henley*). In December 2005, after exhausting all appeals, PM USA paid $328,759 (including interest of $78,259) as its share of the judgment amount and interest in a flight attendant ETS case in Florida (*French*) and will pay attorneys' fees yet to be determined.

The chart below lists the verdict and post-trial developments in the remaining 12 pending cases that have gone to trial since January 1999 in which verdicts were returned in favor of plaintiffs.

Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
March 2005	New York/*Rose*	Individual Smoking and Health	$3.42 million in compensatory damages against two defendants, including PM USA, and $17.1 million in punitive damages against PM USA.	In December 2005, PM USA's post-trial motions challenging the verdict were denied by the trial court. PM USA has appealed.
October 2004	Florida/*Arnitz*	Individual Smoking and Health	$240,000 against PM USA.	PM USA's appeal is pending.
May 2004	Louisiana/*Scott*	Smoking and Health Class Action	Approximately $590 million, against all defendants including PM USA, jointly and severally, to fund a 10-year smoking cessation program.	In June 2004, the state trial court entered judgment in the amount of the verdict of $590 million, plus prejudgment interest accruing from the date the suit commenced. As of December 31, 2005, the amount of prejudgment interest was approximately $390 million. PM USA's share of the verdict and prejudgment interest has not been allocated. Defendants, including PM USA, have appealed. See "*Scott Class Action*" below.
November 2003	Missouri/*Thompson*	Individual Smoking and Health	$2.1 million in compensatory damages against all defendants, including $837,403 against PM USA.	PM USA's appeal is pending.
March 2003	Illinois/*Price*	Lights/Ultra Lights Class Action	$7.1005 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 and remanded the case to the trial court with instructions to dismiss the case against PM USA. See the discussion of the *Price* case under the heading "Lights/Ultra Lights Cases."
October 2002	California/*Bullock*	Individual Smoking and Health	$850,000 in compensatory damages and $28 billion in punitive damages against PM USA.	In December 2002, the trial court reduced the punitive damages award to $28 million; PM USA and plaintiff have appealed.
June 2002	Florida/*Lukacs*	Individual Smoking and Health	$37.5 million in compensatory damages against all defendants, including PM USA.	In March 2003, the trial court reduced the damages award to $24.86 million. PM USA's share of the damages award is approximately $6 million. The court has not yet entered the judgment on the jury verdict. If a judgment is entered in this case, PM USA intends to appeal.
March 2002	Oregon/*Schwarz*	Individual Smoking and Health	$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; PM USA and plaintiff have appealed.

Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
June 2001	California/*Boeken*	Individual Smoking and Health	$5.5 million in compensatory damages and $3 billion in punitive damages against PM USA.	In August 2001, the trial court reduced the punitive damages award to $100 million. In September 2004, the California Second District Court of Appeal reduced the punitive damages award to $50 million but otherwise affirmed the judgment entered in the case. Plaintiff and PM USA each sought rehearing. In April 2005, the Court of Appeal reaffirmed the award amount set in its September 2004 ruling. In August 2005, the California Supreme Court refused to hear the petitions of PM USA and plaintiff for further review. Following the California Supreme Court's refusal to hear the parties' appeal, PM USA recorded a provision in the 2005 statement of earnings of approximately $80 million (including interest) in connection with this case. Plaintiff and PM USA have petitioned the United States Supreme Court for further review.
July 2000	Florida/*Engle*	Smoking and Health Class Action	$145 billion in punitive damages against all defendants, including $74 billion against PM USA.	In May 2003, the Florida Third District Court of Appeal reversed the judgment entered by the state trial court and instructed the trial court to order the decertification of the class. Plaintiffs' motion for reconsideration was denied in September 2003, and plaintiffs petitioned the Florida Supreme Court for further review. In May 2004, the Florida Supreme Court agreed to review the case, and the Supreme Court heard oral arguments in November 2004. See "*Engle Class Action*" below.
March 2000	California/*Whiteley*	Individual Smoking and Health	$1.72 million in compensatory damages against PM USA and another defendant, and $10 million in punitive damages against each of PM USA and the other defendant.	In April 2004, the California First District Court of Appeal entered judgment in favor of defendants on plaintiff's negligent design claims, and reversed and remanded for a new trial on plaintiff's fraud-related claims. Defendants' motion to transfer venue is pending.
March 1999	Oregon/*Williams*	Individual Smoking and Health	$800,000 in compensatory damages, $21,500 in medical expenses and $79.5 million in punitive damages against PM USA.	The trial court reduced the punitive damages award to $32 million, and PM USA and plaintiff appealed. In June 2002, the Oregon Court of Appeals reinstated the $79.5 million punitive damages award. Following the Oregon Supreme Court's refusal to hear PM USA's appeal, PM USA recorded a provision of $32 million in connection with this case and petitioned the United States Supreme Court for further review. In October 2003, the United States Supreme Court set aside the Oregon appellate court's ruling, and directed the Oregon court to reconsider the case in light of the 2003 *State Farm* decision by the United States Supreme Court, which limited punitive damages. In June 2004, the Oregon Court of Appeals reinstated the $79.5 million punitive damages award. On February 2, 2006, the Oregon Supreme Court affirmed the Court of Appeals' decision. PM USA intends to petition the United States Supreme Court for further review and pursue other avenues of relief.

In addition to the cases discussed above, in October 2003, a three-judge panel of an appellate court in Brazil reversed a lower court's dismissal of an individual smoking and health case and ordered PMI's Brazilian affiliate to pay plaintiff approximately $256,000 and other unspecified damages. PMI's Brazilian affiliate appealed. In December 2004, the three-judge panel's decision was vacated by an *en banc* panel of the appellate court, which upheld the trial court's dismissal of the case. Also, in April 2005, a labor court trial judge entered judgment against PMI's Venezuelan affiliate in favor of a former employee plaintiff in the amount of approximately $150,000 in connection with an individual claim involving smoking and health issues. PMI's Venezuelan affiliate appealed. In August 2005, the appellate court reversed the lower court's decision. Plaintiff has appealed to the Supreme Court.

With respect to certain adverse verdicts currently on appeal, excluding amounts relating to the *Engle* and *Price* cases, as of December 31, 2005, PM USA has posted various forms of security totaling approximately $329 million, the majority of which have been collateralized with cash deposits, to obtain stays of judgments pending appeals. The cash deposits are included in other assets on the consolidated balance sheets.

■ **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 posted a bond in the amount of $100 million and 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 a separate interest-bearing escrow account that, regardless of the outcome of the appeal, will be paid to the court and the court will determine how to allocate or distribute it consistent with Florida Rules of Civil Procedure. In July 2001, PM USA also placed $1.2 billion into an interest-bearing escrow account, which will be returned to PM USA should it prevail in its appeal of the case. (The $1.2 billion escrow account is included in the December 31, 2005 and 2004 consolidated balance sheets as other assets. Interest income on the $1.2 billion escrow account is paid to PM USA quarterly and is being recorded as earned, in interest and other debt expense, net, in the consolidated statements of earnings.) In connection with the stipulation, PM USA recorded a $500 million pre-tax charge in its consolidated statement of earnings for the quarter ended March 31, 2001. 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 and, in May 2004, the Florida Supreme Court agreed to review the case. Oral arguments were heard in November 2004.

■ **Scott Class Action:** In July 2003, following the first phase of the trial in the *Scott* class action, in which plaintiffs sought creation of a fund to pay for medical monitoring and smoking cessation programs, a Louisiana jury returned a verdict in favor of defendants, including PM USA, in connection with plaintiffs' medical monitoring claims, but also found that plaintiffs could benefit from smoking cessation assistance. The jury also found that cigarettes as designed are not defective but that the defendants failed to disclose all they knew about smoking and diseases and marketed their products to minors. In May 2004, in the second phase of the trial, the jury awarded plaintiffs approximately $590 million, against all defendants jointly and severally, to fund a 10-year smoking cessation program. In June 2004, the court entered judgment, which awarded plaintiffs the approximately $590 million jury award plus prejudgment interest accruing from the date the suit commenced. As of December 31, 2005, the amount of prejudgment interest was approximately $390 million. PM USA's share of the jury award and prejudgment interest has not been allocated. Defendants, including PM USA, have appealed. Pursuant to a stipulation of the parties, the trial court entered an order setting the amount of the bond at $50 million for all defendants in accordance with an article of the Louisiana Code of Civil Procedure, and a Louisiana statute (the "bond cap law") fixing the amount of security in civil cases involving a signatory to the MSA (as defined below). Under the terms of the stipulation, plaintiffs reserve the right to contest, at a later date, the sufficiency or amount of the bond on any grounds including the applicability or constitutionality of the bond cap law. In September 2004, defendants collectively posted a bond in the amount of $50 million.

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, 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. In certain of these cases, plaintiffs claim that cigarette smoking exacerbated the injuries caused by their exposure to asbestos. Plaintiffs in the smoking and health actions 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.

■ **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.

Class certification has been denied or reversed by courts in 56 smoking and health class actions involving PM USA in Arkansas (1), the District of Columbia (2), Florida (1), Illinois (2), Iowa (1), Kansas (1), Louisiana (1), Maryland (1), Michigan (1), Minnesota (1), Nevada (29), New Jersey (6), New York (2), Ohio (1), Oklahoma (1), Pennsylvania (1), Puerto Rico (1), South Carolina (1), Texas (1) and Wisconsin (1). A class remains certified in the *Scott* class action discussed above.

A purported smoking and health class action is pending in Brazil. In that case, the trial court has issued an order finding that the action was valid under the Brazilian Consumer Defense Code. The order contemplates a second stage of the case in which individuals are to file their claims. The trial court awarded the equivalent of approximately $350 per smoker per year of smoking for moral damages and has indicated that material damages will be assessed in a second phase of the case. Defendants have appealed. The trial court has granted defendants' motion to stay its decision while the appeal is pending.

Health Care Cost Recovery Litigation

■ **Overview:** In health care cost recovery litigation, domestic and foreign governmental entities and non-governmental plaintiffs seek reimbursement of health care cost expenditures allegedly caused by tobacco products and, in some cases, of future expenditures and damages as well. Relief sought by some but not all plaintiffs includes punitive damages, multiple damages and other statutory damages and penalties, injunctions prohibiting 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 have dismissed all or most health care cost recovery claims against cigarette manufacturers. Nine federal circuit courts of appeals and six 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.

A number of foreign governmental entities have filed health care cost recovery actions in the United States. Such suits have been brought in the United States by 13 countries, a Canadian province, 11 Brazilian states and 11 Brazilian cities. Of these 36 cases, 34 have been dismissed, and the two cases brought by the Republic of Panama and the Brazilian State of São Paulo remain pending. In addition to the cases brought in the United States, health care cost recovery actions have also been brought in Israel (1), the Marshall Islands (1) (dismissed), Canada (1), France (1; dismissed, but on appeal) and Spain (1; dismissed, but on appeal), and other entities have stated that they are considering filing such actions. In September 2005, in the case in Canada, the Canadian Supreme Court ruled that legislation permitting the lawsuit is constitutional, and, as a result, the case which had previously been dismissed by the trial court will now proceed.

In March 1999, in the first health care cost recovery case to go to trial, an Ohio jury returned a verdict in favor of defendants on all counts. In addition, a \$17.8 million verdict against defendants (including \$6.8 million against PM USA) was reversed in a health care cost recovery case in New York, and all claims were dismissed with prejudice in February 2005 (*Blue Cross/Blue Shield*). The health care cost recovery case brought by the City of St. Louis, Missouri and approximately 50 Missouri hospitals, in which PM USA and ALG are defendants, remains pending without a trial date.

■ **Settlements of Health Care Cost Recovery Litigation:** In November 1998, PM USA and certain other United States tobacco product manufacturers entered into the 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 settled similar claims brought by Mississippi, Florida, Texas and Minnesota (together with the MSA, the "State Settlement Agreements"). The State Settlement Agreements require that the domestic tobacco industry make substantial annual payments in the following amounts (excluding future annual payments under the agreement with the tobacco grower states discussed below), subject to adjustments for several factors, including inflation, market share and industry volume: 2006 through 2007, \$8.4 billion each year; and thereafter, \$9.4 billion each year. In addition, the domestic tobacco industry is required to pay settling plaintiffs' attorneys' fees, subject to an annual cap of \$500 million. Pursuant to the provisions of the MSA, domestic tobacco product manufacturers, including PM USA, who are original signatories to the MSA ("OPMs") are participating in a proceeding that may result in a downward adjustment to the amounts paid by the OPMs to the states and territories that are parties to the MSA for the year 2003. The availability and the precise amount of that adjustment depend on a number of factors and will likely not be determined until some time in 2006 or later. If the adjustment does become available, it may be applied as a credit against future payments due from the OPMs.

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.

As part of the MSA, the settling defendants committed to work cooperatively with the tobacco-growing states to address concerns about the potential adverse economic impact of the MSA on tobacco growers and quota holders. To that end, in 1999, four of the major domestic tobacco product manufacturers, including PM USA, and the grower states, established the National Tobacco Grower Settlement Trust ("NTGST"), a trust fund to provide aid to tobacco growers and quota holders. The trust was to be funded by these four manufacturers over 12 years with payments, prior to application of various adjustments, scheduled to total \$5.15 billion. Remaining industry payments (2006 through 2008, \$500 million each year; 2009 and 2010, \$295 million each year) were to be subject to adjustment for several factors, including inflation, United States cigarette volume and certain contingent events, and, in general, were to be allocated based on each manufacturer's relative market share. Provisions of the NTGST allow for offsets to the extent that payments are made to growers and quota holders as part of a legislated end to the federal tobacco quota and price support program.

In October 2004, the Fair and Equitable Tobacco Reform Act of 2004 ("FETRA") was signed into law. FETRA provides for the elimination of the federal tobacco quota and price support program through an industry-funded buy-out of tobacco growers and quota holders. The cost of the buy-out is estimated at approximately $9.6 billion and will be paid over 10 years by manufacturers and importers of all tobacco products. The cost will be allocated based on the relative market shares of manufacturers and importers of all tobacco products. The quota buy-out payments will offset already scheduled payments to the NTGST. Manufacturers and importers of tobacco products are also obligated to cover any losses (up to $500 million) that the government may incur on the disposition of tobacco pool stock accumulated under the previous tobacco price support program. In September 2005, PM USA was billed $138 million for its share of tobacco pool stock losses and recorded the amount as an expense. Altria Group, Inc. does not currently anticipate that the quota buy-out will have a material adverse impact on its consolidated results in 2006 and beyond.

Following the enactment of FETRA, the trustee of the NTGST and the state entities conveying NTGST payments to tobacco growers and quota holders sued tobacco product manufacturers alleging that the offset provisions did not apply to payments due in 2004. In December 2004, a North Carolina trial court ruled that FETRA's enactment had triggered the offset provisions and that the tobacco product manufacturers, including PM USA, were entitled to receive a refund of amounts paid to the NTGST during the first three quarters of 2004 and were not required to make the payments that would otherwise have been due during the fourth quarter of 2004. Plaintiffs appealed, and in August 2005, the North Carolina Supreme Court reversed the trial court's ruling and remanded the case to the lower court for additional proceedings. In October 2005, the trial court ordered that the trustee could distribute the amounts that the tobacco companies had already paid to the NTGST during the first three quarters of 2004. PM USA's portion of these payments was approximately $174 million. The trial court also ruled that the manufacturers must make the payment originally scheduled to be made to the NTGST in December 2004, with interest. PM USA's portion of the principal was approximately $58 million, which PM USA paid in October 2005. In November 2005, PM USA paid $2 million in interest on the December 2004 payment.

The State Settlement Agreements have materially adversely affected the volumes of PM USA, and ALG believes that they may also materially adversely affect the results of operations, cash flows or financial position of PM USA and Altria Group, Inc. in future periods. The degree of the adverse impact will depend on, among other things, the rate of decline in United States cigarette sales in the premium and discount segments, PM USA's share of the domestic premium and discount cigarette segments, and the effect of any resulting cost advantage of manufacturers not subject to the MSA and the other State Settlement Agreements.

In April 2004, a lawsuit was filed in state court in Los Angeles, California, on behalf of all California residents who purchased cigarettes in California from April 2000 to the present, alleging that the MSA enabled the defendants, including PM USA and ALG, to engage in unlawful price fixing and market sharing agreements. The complaint sought damages and also sought to enjoin defendants from continuing to operate under those provisions of the MSA that allegedly violate California law. In June 2004, plaintiffs dismissed this case and refiled a substantially similar complaint in federal court in San Francisco, California. The new complaint is brought on behalf of the same purported class but differs in that it covers purchases from June 2000 to the present, names the Attorney General of California as a defendant, and does not name ALG as a defendant. In March 2005, the trial court granted defendants' motion to dismiss the case. Plaintiffs have appealed.

There is a suit pending against New York state officials, in which importers of cigarettes allege that the MSA and certain New York statutes enacted in connection with the MSA violate federal antitrust law. Neither ALG nor PM USA is a defendant in this case. In September 2004, the court denied plaintiffs' motion to preliminarily enjoin the MSA and certain related New York statutes, but the court issued a preliminary injunction against an amendment repealing the "allocable share" provision of the New York Escrow Statute. In addition, similar lawsuits have been brought in other states, including Kentucky, Arkansas, Kansas, Louisiana, Nebraska, Tennessee and Oklahoma, and a similar proceeding has been brought under the provisions of the North American Free Trade Agreement in the United Nations. Neither ALG nor PM USA is a defendant in these cases.

■ **Federal Government's Lawsuit:** In 1999, the United States government filed a lawsuit in the United States District Court for the District of Columbia against various cigarette manufacturers, including PM USA, and others, including ALG, asserting claims under three federal statutes, the Medical Care Recovery Act ("MCRA"), the Medicare Secondary Payer ("MSP") provisions of the Social Security Act and the civil provisions of RICO. Trial of the case ended in June 2005, and post-trial briefings were completed in September 2005. The lawsuit seeks to recover an unspecified amount of health care 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 alleges that such costs total more than $20 billion annually. It also seeks what it alleges to be equitable and declaratory relief, including disgorgement of profits which arose from defendants' allegedly tortious conduct, an injunction prohibiting certain actions by the defendants, and a declaration that the defendants are liable for the federal government's future costs of providing health care resulting from defendants' alleged past tortious and wrongful conduct. In September 2000, the trial court dismissed the government's MCRA and MSP claims, but permitted discovery to proceed on the government's claims for relief under the civil provisions of RICO.

The government alleged that disgorgement by defendants of approximately $280 billion is an appropriate remedy. In May 2004, the trial court issued an order denying defendants' motion for partial summary judgment limiting the disgorgement remedy. In February 2005, a panel of the United States 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 and entered summary judgment in favor of defendants, with respect to the disgorgement claim. In April 2005, the Court of Appeals denied the government's motion for rehearing. In July 2005, the government petitioned the United States Supreme Court for further review of the Court of Appeals' ruling that disgorgement is not an available remedy, and in October 2005, the Supreme Court denied the petition.

In June 2005, the government filed with the trial court its proposed final judgment seeking remedies of approximately $14 billion, including $10 billion over a five-year period to fund a national smoking cessation program and $4 billion over a ten-year period to fund a public education and counter-marketing campaign. Further, the government's proposed remedy would require defendants to pay additional monies to these programs if targeted reductions in the smoking rate of those under 21 are not achieved according to a prescribed timetable. In July 2005, the court granted the motion of six organizations to intervene in the case for the limited purpose of being heard on the issue of permissible and appropriate remedies. Those organizations argued that because the government's proposed final judgment sought remedies more limited than what had been sought earlier in the case, the government no longer adequately represents the interests of those organizations. In September 2005, the trial court granted six motions filed by various organizations for leave to file *amicus curiae* briefs. Two additional motions remain pending, including a motion for leave to file an *amicus curiae* brief advocating that as part of any relief granted in the case, the court direct more than $14 billion over the next ten years to various purposes specified in their brief.

Lights/Ultra Lights Cases

■ **Overview:** Plaintiffs in these class actions (some of which have not been certified as such), allege, among other things, that the uses of the terms "Lights" and/or "Ultra Lights" constitute deceptive and unfair trade practices, common law fraud, or RICO violations, 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, ALG and PMI 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, express preemption by the Federal Cigarette Labeling and Advertising Act and implied preemption by the policies and directives of the Federal Trade Commission, non-liability under state statutory provisions exempting conduct that complies with federal regulatory directives, and the First Amendment. Twenty-four cases are pending in Arkansas (2), Delaware (1), Florida (1), Georgia (1), Illinois (2), Kansas (1), Louisiana (1), Maine (1), Massachusetts (1), Minnesota (1), Missouri (1), New Hampshire (1), New Mexico (1), New Jersey (1), New York (1), Ohio (2), Oregon (1), Tennessee (1), Washington (1), and West Virginia (2). In addition, there are two cases pending in Israel. Other entities have stated that they are considering filing such actions against ALG, PMI, and PM USA.

To date, trial courts in Arizona and Oregon have refused to certify a class, an appellate court in Florida has overturned class certification by a trial court and the Supreme Court of Illinois has overturned a judgment in favor of a plaintiff class in the *Price* case, which is discussed below. Plaintiffs in the Florida case have petitioned the Florida Supreme Court for further review, and the Supreme Court has stayed further proceedings pending its decision in the *Engle* case discussed above.

Trial courts have certified classes against PM USA in Massachusetts (*Aspinall*), Ohio (*Marrone* and *Philipps*), Minnesota (*Curtis*) and Missouri (*Craft*). PM USA has appealed or otherwise challenged these class certification orders. In August 2004, the Massachusetts Judicial Supreme Court affirmed the class certification order in the *Aspinall* case. In September 2004, an appellate court affirmed the class certification orders in the *Marrone* and *Philipps* cases in Ohio, and PM USA sought review by the Ohio Supreme Court. In February 2005, the Ohio Supreme Court accepted the cases for review to determine whether a prior determination has been made by the State of Ohio that the conduct at issue is deceptive such that plaintiffs may pursue claims. In April 2005, the Minnesota Supreme Court denied PM USA's petition for interlocutory review of the trial court's class certification order in the *Curtis* case; however, the trial court has stayed the *Curtis* case pending the outcome of the appeal of the dismissal of an unrelated Lights case. In September 2005, PM USA removed *Curtis* to federal court based on the Eighth Circuit's decision in *Watson*, which upheld the removal of a Lights case to federal court based on the federal officer jurisdiction of the Federal Trade Commission. Plaintiffs' motion to remand the case to the state court is pending. In August 2005, a Missouri Court of Appeals affirmed the class certification order in the *Craft* case. In September 2005, PM USA removed *Craft* to federal court based on the Eighth Circuit's decision in *Watson.* Plaintiffs' motion to remand the case to the state court is pending.

In addition to these cases, plaintiffs' motion for certification of a nationwide class is pending in a case in the United States District Court for the Eastern District of New York (*Schwab*). In September 2005, the trial court hearing the *Schwab* case granted in part defendants' motion for partial summary judgment dismissing plaintiffs' claims for equitable relief, and denied a number of plaintiffs' motions for summary judgment. In November, the trial court hearing the *Schwab* case ruled that the plaintiffs would be permitted to calculate damages on an aggregate basis and use "fluid recovery" theories to allocate them among class members. Also, in December 2005, in the *Miner* case pending in the United States District Court for the Western District of Arkansas, plaintiffs moved for certification of a class composed of individuals who purchased *Marlboro Lights* or *Cambridge Lights* brands in Arkansas, California, Colorado, and Michigan. In December, defendants filed a motion to stay plaintiffs' motion for class certification until the court rules on PM USA's pending motion to transfer venue to the United States District Court for the Eastern District of Arkansas. This motion to transfer was granted in January 2006. In addition, plaintiffs' motions for class certification are pending in the cases in New Jersey and Georgia.

■ **The Price Case:** Trial in the *Price* case commenced in state court in Illinois in January 2003, and in March 2003, the judge found in favor of the plaintiff class and awarded approximately $7.1 billion in compensatory damages and $3 billion in punitive damages against PM USA. In April 2003, the judge reduced the amount of the appeal bond that PM USA must provide and ordered PM USA to place a pre-existing 7.0%, $6 billion long-term note from ALG to PM USA in an escrow account with an Illinois financial institution. (Since this note is the result of an intercompany financing arrangement, it does not appear on the consolidated balance sheets of Altria Group, Inc.) The judge's order also required PM USA to make cash deposits with the clerk of the Madison County Circuit Court in the following amounts: beginning October 1, 2003, an amount equal to the interest earned by PM USA on the ALG note ($210 million every six months), an additional $800 million in four equal quarterly installments between September 2003 and June 2004 and the payments of principal of the note, which are due in April 2008, 2009 and 2010. Through December 31, 2005, PM USA paid $1.85 billion of the cash payments due under the judge's order. (Cash payments into the account are included in other assets on Altria Group, Inc.'s consolidated balance sheets at December 31, 2005 and 2004.) Plaintiffs appealed the judge's order reducing the bond. In July 2003, the Illinois Fifth District Court of Appeals ruled that the trial court had exceeded its authority in reducing the bond. In September 2003, the Illinois Supreme Court upheld the reduced bond set by the trial court and announced it would hear PM USA's appeal on the merits without the need for intermediate appellate court review. In December 2005, the Illinois Supreme Court reversed the trial court's judgment in favor of the plaintiffs and remanded the case to the trial court with instructions that the case be dismissed. In January 2006, plaintiffs filed a motion seeking a rehearing from the Illinois Supreme Court. If PM USA prevails on appeal, the escrowed note and all cash deposited with the court will be returned to PM USA, with accrued interest less administrative fees payable to the court.

Certain Other Tobacco-Related Litigation

■ **Tobacco Price Cases:** As of December 31, 2005, two cases were pending in Kansas and New Mexico in which plaintiffs allege that defendants, including PM USA, conspired to fix cigarette prices in violation of antitrust laws. ALG and PMI are defendants in the case in Kansas. Plaintiffs' motions for class certification have been granted in both cases. In February 2005, the New Mexico Court of Appeals affirmed the class certification decision. PM USA's motion for summary judgment is pending in the New Mexico case.

■ **Wholesale Leaders Cases:** In June 2003, certain wholesale distributors of cigarettes filed suit in Tennessee against PM USA seeking to enjoin the PM USA "2003 Wholesale Leaders" ("WL") program that became available to wholesalers in June 2003. The complaint alleges that the WL program constitutes unlawful price discrimination and is an attempt to monopolize. In addition to an injunction, plaintiffs seek unspecified monetary damages, attorneys' fees, costs and interest. The states of Tennessee and Mississippi intervened as plaintiffs in this litigation. In August 2003, the trial court issued a preliminary injunction, subject to plaintiffs' posting a bond in the amount of $1 million, enjoining PM USA from implementing certain discount terms with respect to the sixteen wholesale distributor plaintiffs, and PM USA appealed. In September 2003, the United States Court of Appeals for the Sixth Circuit granted PM USA's motion to stay the injunction pending PM USA's expedited appeal. In January 2004, Tennessee filed a motion to dismiss its complaint, and its complaint was dismissed without prejudice in March 2004. In August 2005, the trial court granted PM USA's motion for summary judgment, dismissed the case, and dissolved the preliminary injunction. Plaintiffs have appealed. In December 2003, a tobacco manufacturer filed a similar lawsuit against PM USA in Michigan seeking unspecified monetary damages in which it alleges that the WL program constitutes unlawful price discrimination and is an attempt to monopolize. Plaintiff voluntarily dismissed its claims alleging price discrimination, and in July 2004, the court granted defendants' motion to dismiss the attempt-to-monopolize claim. Plaintiff appealed, but dismissed its appeal in September 2005.

■ **Consolidated Putative Punitive Damages Cases:** In September 2000, a putative class action (*Simon, et al. v. Philip Morris Incorporated, et al. (Simon II)*) was filed in the federal district court in the Eastern District of New York that purported to consolidate punitive damages claims in ten tobacco-related actions then pending in federal district courts in New York and Pennsylvania. In September 2002, the court granted plaintiffs' motion seeking certification of a punitive damages class of persons residing in the United States who smoke or smoked defendants' cigarettes, and who have been diagnosed by a physician with an enumerated disease from April 1993 through the date notice of the certification of this class is disseminated. The following persons are excluded from the class: (1) those who have obtained judgments or settlements against any defendants; (2) those against whom any defendant has obtained judgment; (3) persons who are part of the *Engle* class; (4) persons who should have reasonably realized that they had an enumerated disease prior to April 9, 1993; and (5) those whose diagnosis or reasonable basis for knowledge predates their use of tobacco. Defendants petitioned the United States Court of Appeals for the Second Circuit for review of the trial court's ruling. In May 2005, the Second Circuit vacated the trial court's class certification order and remanded the case to the trial court for further proceedings. Plaintiffs' motion for reconsideration was denied, and the time for plaintiffs to petition the United States Supreme Court for further review has expired.

■ **Cases Under the California Business and Professions Code:** In June 1997 and July 1998, two suits (*Brown* and *Daniels*), were filed in California state court alleging that domestic cigarette manufacturers, including PM USA and others, have violated California Business and Professions Code Sections 17200 and 17500 regarding unfair, unlawful and fraudulent business practices. Class certification was granted in both cases as to plaintiffs' claims that class members are entitled to reimbursement of the costs of cigarettes purchased during the class periods and injunctive relief. In September 2002, the court granted defendants' motion for summary judgment as to all claims in one of the cases, and plaintiffs appealed. In October 2004, the California Fourth District Court of Appeal affirmed the trial court's ruling, and also denied plaintiffs' motion for rehearing. In February 2005, the California Supreme Court agreed to hear plaintiffs' appeal. In September 2004, the trial court in the other case granted defendants' motion for summary judgment as to plaintiffs' claims attacking defendants' cigarette advertising and promotion and denied defendants' motion for summary judgment on plaintiffs' claims based on allegedly false affirmative statements. Plaintiffs' motion for rehearing was denied. In March 2005, the court granted defendants' motion to decertify the class based on a recent change in California law. Plaintiffs' motion for reconsideration of the order that decertified the class was denied, and plaintiffs have appealed.

In May 2004, a lawsuit (*Gurevitch*) was filed in California state court on behalf of a purported class of all California residents who purchased the *Merit* brand of cigarettes since July 2000 to the present alleging that defendants, including PM USA, violated California's Business and Professions Code Sections 17200 and 17500 regarding unfair, unlawful and fraudulent business practices, including false and misleading advertising. The complaint also alleges violations of California's Consumer Legal Remedies Act. Plaintiffs seek injunctive relief, disgorgement, restitution, and attorneys' fees. In July 2005, defendants' motion to dismiss was granted; however, plaintiffs' motion for leave to amend the complaint was also granted, and plaintiffs filed an amended complaint in September 2005. In October 2005, the court stayed this action pending the California Supreme Court's rulings on two cases not involving PM USA, the resolution of which may impact the adjudication of this case.

■ **Cigarette Contraband Cases:** In May 2000 and August 2001, various departments of Colombia and the European Community and 10 Member States, filed suits in the United States against ALG and certain of its subsidiaries, including PM USA and PMI, and other cigarette manufacturers and their affiliates, alleging that defendants sold to distributors cigarettes that would be illegally imported into various jurisdictions. The claims asserted in these cases include negligence, negligent misrepresentation, fraud, unjust enrichment, violations of RICO and its state-law equivalents and conspiracy. Plaintiffs in these cases seek actual damages, treble damages and unspecified injunctive relief. In February 2002, the federal district court granted defendants' motions to dismiss the actions. Plaintiffs in each case appealed. In January 2004, the United States Court of Appeals for the Second Circuit affirmed the dismissals of the cases based on the common law Revenue Rule, which bars a foreign government from bringing civil claims in U.S. courts for the recovery of lost taxes. In April 2004, plaintiffs petitioned the United States Supreme Court for further review. In July 2004, the European Community and the 10 Member States entered into a cooperation agreement with PMI, the terms of which provide for broad cooperation between PMI and European law enforcement agencies on anti-contraband and anti-counterfeit efforts and resolve all disputes between the parties on these issues. Pursuant to this agreement, the European Community and the 10 Member States withdrew their suit as it relates to the ALG, PM USA and PMI defendants.

In May 2005, the United States Supreme Court, in a summary order, granted the plaintiffs' petitions for review, vacated the judgment of the Court of Appeals for the Second Circuit and remanded the cases to that court for further review in light of the Supreme Court's April 2005 decision in *U.S. v. Pasquantino*. In *Pasquantino*, a criminal case brought by the United States government, the Supreme Court upheld the convictions of the defendants in that case for violating the U.S. wire fraud statute based on a scheme to smuggle alcohol into Canada without paying Canadian taxes, while expressing no opinion as to the question of whether the Revenue Rule barred a foreign government from bringing a civil action in U.S. courts for a scheme to defraud it of taxes, as the Second Circuit had earlier held in distinguishing those civil claims from a U.S. criminal prosecution as in *Pasquantino*. In September 2005, the Second Circuit reinstated its original decision affirming the dismissal of the cases based on the common law Revenue Rule, concluding that the *Pasquantino* decision cast no doubt on the reasoning and result of the original January 2004 decision. The Second Circuit acknowledged that the claims of the European Community and 10 Member States against ALG, PM USA, and PMI had previously been dismissed. In October 2005, the plaintiffs in the two cases petitioned the United States Supreme Court for further review. In January 2006, the Supreme Court denied plaintiffs' petition for review. It is possible that future litigation related to cigarette contraband issues may be brought.

■ **Vending Machine Case:** In February 1999, plaintiffs filed a lawsuit in the United States District Court in Tennessee as a purported nationwide class of cigarette vending machine operators, and alleged that PM USA violated the Robinson-Patman Act in connection with its promotional and merchandising programs available to retail stores and not available to cigarette vending machine operators. The initial complaint was amended to bring the total number of plaintiffs to 211 but, by stipulated orders, all claims were stayed, except those of ten plaintiffs that proceeded to pre-trial discovery. Plaintiffs requested actual damages, treble damages, injunctive relief, attorneys' fees and costs, and other unspecified relief. In August 2001, the trial court granted PM USA's motion for summary judgment and dismissed, with prejudice, the claims of the ten plaintiffs. In October 2001, the court certified its decision for appeal to the United States Court of Appeals for the Sixth Circuit following the stipulation of all plaintiffs that the district court's dismissal would, if affirmed, be binding on all plaintiffs. In January 2004, the Sixth Circuit reversed the lower court's grant of summary judgment with respect to plaintiffs' claim that PM USA violated Robinson-Patman Act provisions regarding promotional services and with respect to the discriminatory pricing claim of plaintiffs who bought cigarettes directly from PM USA. The claims of eight plaintiffs were tried in July 2005 (one plaintiff was granted a continuance and another voluntarily dismissed its claims with prejudice). The jury returned a verdict in favor of PM USA on the Robinson-Patman Act claims and awarded PM USA approximately $110,000 on counterclaims PM USA made against three plaintiffs. Following completion of the trial, the district court lifted the stay on the remaining claims and directed the magistrate judge to establish a schedule for the disposition of those claims. In October 2005, on agreement of the parties, all claims in this matter were dismissed with prejudice.

■ **Asbestos Contribution Cases:** These cases, which have been brought on behalf of former asbestos manufacturers and affiliated entities against PM USA and other cigarette manufacturers, seek, among other things, contribution or reimbursement for amounts expended in connection with the defense and payment of asbestos claims that were allegedly caused in whole or in part by cigarette smoking. Currently, one case is pending in California.

Certain Other Actions

■ **Italian Tax Matters:** In recent years, approximately two hundred tax assessments alleging nonpayment of taxes in Italy were served upon certain affiliates of PMI. All of these assessments were resolved in 2003 and the second quarter of 2004, with the exception of certain assessments which were duplicative of other assessments. In July 2005, the tax obligations underlying the duplicative assessments were declared fully satisfied, thereby rendering unnecessary any further litigation with respect to such assessments.

■ **Italian Antitrust Case:** During 2001, the competition authority in Italy initiated an investigation into the pricing activities of participants in that cigarette market. In March 2003, the authority issued its findings and imposed fines totaling 50 million euro on certain affiliates of PMI. PMI's affiliates appealed to the administrative court, which rejected the appeal in July 2003. PMI believes that its affiliates have numerous grounds for appeal, and in February 2004, its affiliates appealed to the supreme administrative court. The appeal was heard on November 8, 2005. However, under Italian law, if fines are not paid within certain specified time periods, interest and eventually penalties will be applied to the fines. Accordingly, in December 2003, pending final resolution of the case, PMI's affiliates paid 51 million euro representing the fines and any applicable interest to the date of payment. The 51 million euro will be returned to PMI's affiliates if they prevail on appeal. Accordingly, the payment has been included in other assets on Altria Group, Inc.'s consolidated balance sheets.

■ **PMCC Federal Income Tax Matter:** The IRS is examining the consolidated tax returns for Altria Group, Inc., which includes PMCC, for years 1996 through 1999. Recently, the IRS has proposed to disallow certain transactions, and may in the future challenge and disallow several more, of PMCC's leveraged leases based on recent Revenue Rulings and a recent IRS Notice addressing specific types of leveraged leases (lease-in/lease-out transactions, qualified technological equipment transactions, and sale-in/lease-out transactions). Altria Group, Inc. is expecting an assessment regarding these transactions for the years 1996 to 1999. PMCC believes that the position and supporting case law described in the Revenue Rulings and the IRS Notice, as well as those asserted in the proposed adjustments, are incorrectly applied to PMCC's transactions and that its leveraged leases are factually and legally distinguishable in material respects from the IRS's position. PMCC and ALG intend to vigorously defend against any challenges based on that position through administrative appeals and litigation, if necessary, and ALG believes that, given the strength of PMCC's position, it should ultimately prevail. However, litigation is subject to many uncertainties and an adverse outcome could have a material adverse effect on Altria Group, Inc.'s consolidated results of operations, cash flows or financial position.

It is not possible to predict the outcome of the litigation pending against ALG and its subsidiaries. Litigation is subject to many uncertainties. As discussed above under "Recent Trial Results," unfavorable verdicts awarding substantial damages against PM USA have been returned in 16 cases since 1999. Of the 16 cases in which verdicts were returned in favor of plaintiffs, four have reached final resolution. A verdict against defendants in a health care cost recovery case has been reversed and all claims were dismissed with prejudice, and after exhausting all appeals, PM USA paid $3.3 million (including interest of $285,000) in an individual smoking and health case in Florida, $17 million (including interest of $6.4 million) in an individual smoking and health case in California and $328,759 (including interest of $78,259) in a flight attendant ETS case in Florida. The remaining 12 cases are in various post-trial stages. It is possible that there could be further adverse developments in these cases and that additional cases could be decided unfavorably. In the event of an adverse trial result in certain pending litigation, the defendant may not be able to obtain a required bond or obtain relief from bonding requirements in order to prevent a plaintiff from seeking to collect a judgment while an adverse verdict is being appealed. An unfavorable outcome or settlement of pending tobacco-related litigation could encourage the commencement of additional litigation. There have also been a number of adverse legislative, regulatory, political and other developments concerning cigarette smoking and the tobacco industry that have received widespread media attention. These developments may negatively affect the perception of judges and jurors with respect to the tobacco industry, possibly to the detriment of certain pending litigation, and may prompt the commencement of additional similar litigation.

ALG and its subsidiaries record provisions in the 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. Except as discussed elsewhere in this Note 19. *Contingencies*: (i) management has not concluded that it is probable that a loss has been incurred in any of the pending tobacco-related litigation; (ii) management is unable to make a meaningful estimate of the amount or range of loss that could result from an unfavorable outcome of pending tobacco-related litigation; and (iii) accordingly, management has not provided any amounts in the consolidated financial statements for unfavorable outcomes, if any.

The present legislative and litigation environment is substantially uncertain, and it is possible that the business and volume of ALG's subsidiaries, as well as Altria Group, Inc.'s consolidated results of operations, cash flows or financial position could be materially affected by an unfavorable outcome or settlement of certain pending litigation or by the enactment of federal or state tobacco legislation. ALG 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 a number of valid defenses to the litigation pending against it, as well as valid bases for appeal of adverse verdicts against it. All such cases are, and will continue to be, vigorously defended. However, ALG and its subsidiaries may enter into settlement discussions in particular cases if they believe it is in the best interests of ALG's stockholders to do so.

Third-Party Guarantees

At December 31, 2005, Altria Group, Inc.'s third-party guarantees, which are primarily related to excise taxes, and acquisition and divestiture activities, approximated $328 million, of which $296 million have no specified expiration dates. The remainder expire through 2023, with $17 million expiring during 2006. Altria Group, Inc. is required to perform under these guarantees in the event that a third party fails to make contractual payments or achieve performance measures. Altria Group, Inc. has a liability of $41 million on its consolidated balance sheet at December 31, 2005, relating to these guarantees. In the ordinary course of business, certain subsidiaries of ALG have agreed to indemnify a limited number of third parties in the event of future litigation.

NOTE 20.

Quarterly Financial Data (Unaudited):

(in millions, except per share data)	2005 Quarters 1st	2nd	3rd	4th
Net revenues	**$23,618**	**$24,784**	**$24,962**	**$24,490**
Gross profit	**$ 7,791**	**$ 8,191**	**$ 8,224**	**$ 7,950**
Earnings from continuing operations	**$ 2,584**	**$ 2,912**	**$ 2,883**	**$ 2,289**
Earnings (loss) from discontinued operations	**12**	**(245)**		
Net earnings	**$ 2,596**	**$ 2,667**	**$ 2,883**	**$ 2,289**
Per share data:				
Basic EPS:				
Continuing operations	**$ 1.25**	**$ 1.41**	**$ 1.39**	**$ 1.10**
Discontinued operations	**0.01**	**(0.12)**		
Net earnings	**$ 1.26**	**$ 1.29**	**$ 1.39**	**$ 1.10**
Diluted EPS:				
Continuing operations	**$ 1.24**	**$ 1.40**	**$ 1.38**	**$ 1.09**
Discontinued operations	**0.01**	**(0.12)**		
Net earnings	**$ 1.25**	**$ 1.28**	**$ 1.38**	**$ 1.09**
Dividends declared	**$ 0.73**	**$ 0.73**	**$ 0.80**	**$ 0.80**
Market price — high	**$ 68.50**	**$ 69.68**	**$ 74.04**	**$ 78.68**
— low	**$ 60.40**	**$ 62.70**	**$ 63.60**	**$ 68.60**

(in millions, except per share data)	2004 Quarters 1st	2nd	3rd	4th
Net revenues	$21,721	$22,894	$22,615	$22,380
Gross profit	$ 7,392	$ 7,761	$ 7,517	$ 7,334
Earnings from continuing operations	$ 2,185	$ 2,608	$ 2,637	$ 1,990
Earnings (loss) from discontinued operations	9	19	11	(43)
Net earnings	$ 2,194	$ 2,627	$ 2,648	$ 1,947
Per share data:				
Basic EPS:				
Continuing operations	$ 1.07	$ 1.27	$ 1.29	$ 0.97
Discontinued operations		0.01		(0.02)
Net earnings	$ 1.07	$ 1.28	$ 1.29	$ 0.95
Diluted EPS:				
Continuing operations	$ 1.06	$ 1.26	$ 1.28	$ 0.96
Discontinued operations	0.01	0.01	0.01	(0.02)
Net earnings	$ 1.07	$ 1.27	$ 1.29	$ 0.94
Dividends declared	$ 0.68	$ 0.68	$ 0.73	$ 0.73
Market price — high	$ 58.96	$ 57.20	$ 50.30	$ 61.88
— low	$ 52.49	$ 44.75	$ 44.50	$ 45.88

Basic and diluted EPS are computed independently for each of the periods presented. Accordingly, the sum of the quarterly EPS amounts may not agree to the total for the year.

During 2005 and 2004, Altria Group, Inc. recorded the following pre-tax charges or (gains) in earnings from continuing operations:

	2005 Quarters			
(in millions)	**1st**	**2nd**	**3rd**	**4th**
Domestic tobacco headquarters relocation charges	**$ 1**	**$ 2**	**$ —**	**$ 1**
Domestic tobacco loss on U.S. tobacco pool			**138**	
Domestic tobacco quota buy-out			**(115)**	
Provision for airline industry exposure			**200**	
(Gains) losses on sales of businesses	**(116)**	**1**		**7**
Asset impairment and exit costs	**171**	**70**	**61**	**316**
	$ 56	**$73**	**$ 284**	**$324**

	2004 Quarters			
(in millions)	1st	2nd	3rd	4th
Domestic tobacco headquarters relocation charges	$ 10	$ 10	$ 5	$ 6
International tobacco E.C. agreement		250		
Provision for airline industry exposure				140
Losses (gains) on sales of businesses			8	(5)
Asset impairment and exit costs	308	160	62	188
	$318	$420	$75	$329

As discussed in Note 14. *Income Taxes*, Altria Group, Inc. and Kraft have each recognized income tax benefits in the consolidated statements of earnings during 2005 and 2004 as a result of various tax events, including the benefits earned under the provisions of the American Jobs Creation Act.

NOTE 21.

Subsequent Event:

In January 2006, Kraft announced plans to continue its restructuring efforts beyond those originally contemplated (see Note 3. *Asset Impairment and Exit Costs*). Additional pre-tax charges are anticipated to be $2.5 billion from 2006 to 2009, of which approximately $1.6 billion are expected to require cash payments. These charges will result in the anticipated closure of up to 20 additional facilities and the elimination of approximately 8,000 additional positions. Initiatives under the expanded program include additional organizational streamlining and facility closures. The entire restructuring program is expected to ultimately result in $3.7 billion in pre-tax charges, the closure of up to 40 facilities and the elimination of approximately 14,000 positions. Approximately $2.3 billion of the $3.7 billion in pre-tax charges are expected to require cash payments.

The principal stock exchange, on which Altria Group, Inc.'s common stock (par value $0.33⅓ per share) is listed, is the New York Stock Exchange. At January 31, 2006, there were approximately 106,300 holders of record of Altria Group, Inc.'s common stock.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and
Stockholders of Altria Group, Inc.:

We have completed integrated audits of Altria Group, Inc.'s 2005 and 2004 consolidated financial statements and of its internal control over financial reporting as of December 31, 2005, and an audit of its 2003 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions on Altria Group, Inc.'s 2005, 2004, and 2003 consolidated financial statements and on its internal control over financial reporting as of December 31, 2005, based on our audits, are presented below.

Consolidated financial statements

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of earnings, stockholders' equity, and cash flows, present fairly, in all material respects, the financial position of Altria Group, Inc. and its subsidiaries at December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of Altria Group, Inc.'s management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Internal control over financial reporting

Also, in our opinion, management's assessment, included in the Report of Management on Internal Control Over Financial Reporting dated February 7, 2006, that Altria Group, Inc. maintained effective internal control over financial reporting as of December 31, 2005 based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, Altria Group, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control—Integrated Framework* issued by the COSO. Altria Group, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of Altria Group, Inc.'s internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP

New York, New York
February 7, 2006

Report of Management on Internal Control Over Financial Reporting

Management of Altria Group, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. Altria Group, Inc.'s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Internal control over financial reporting includes those written policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of Altria Group, Inc.;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America;
- provide reasonable assurance that receipts and expenditures of Altria Group, Inc. are being made only in accordance with authorization of management and directors of Altria Group, Inc.; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the consolidated financial statements.

Internal control over financial reporting includes the controls themselves, monitoring and internal auditing practices and actions taken to correct deficiencies as identified.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of Altria Group, Inc.'s internal control over financial reporting as of December 31, 2005. Management based this assessment on criteria for effective internal control over financial reporting described in "*Internal Control—Integrated Framework*" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Management's assessment included an evaluation of the design of Altria Group, Inc.'s internal control over financial reporting and testing of the operational effectiveness of its internal control over financial reporting. Management reviewed the results of its assessment with the Audit Committee of our Board of Directors.

Based on this assessment, management determined that, as of December 31, 2005, Altria Group, Inc. maintained effective internal control over financial reporting.

PricewaterhouseCoopers LLP, independent registered public accounting firm, who audited and reported on the consolidated financial statements of Altria Group, Inc. included in this report, has audited our management's assessment of the effectiveness of Altria Group, Inc.'s internal control over financial reporting as of December 31, 2005 and issued an attestation report on management's assessment of internal control over financial reporting.

February 7, 2006

BOARD OF DIRECTORS

Dr. Elizabeth E. Bailey [1,3,4,5,6]
John C. Hower Professor of Business and Public Policy, The Wharton School of the University of Pennsylvania
Director since 1989

Dr. Harold Brown [2,6]
Partner, Warburg Pincus,
Counselor, Center for Strategic and International Studies
Director 1983–2003
Re-elected December 2004

Mathis Cabiallavetta [2]
Vice Chairman, Marsh & McLennan Companies, Inc.
Director since 2002

Louis C. Camilleri [1,2]
Chairman of the Board and Chief Executive Officer
Director since 2002

*Not standing for re-election in April 2006.

J. Dudley Fishburn [2,3,4,5,6]
Chairman, HFC Bank (UK)
Director since 1999

Robert E. R. Huntley [1,2,3,4,6]
Retired lawyer, educator and businessman
Director since 1976

Thomas W. Jones [2,5]
Senior Partner, TWJ Capital LLC
Director since 2002

George Muñoz [3,4]
Principal, Muñoz Investment Banking Group, LLC
Partner, Tobin, Petkus & Muñoz
Director since 2004

Lucio A. Noto [1,2,3,6]
Managing Partner, Midstream Partners, LLC
Director since 1998

John S. Reed [1,2,3,5,6]
Former Chairman, New York Stock Exchange and retired Chairman and Co-CEO, Citigroup Inc.
Director 1975–2003
Re-elected April 2004

Carlos Slim Helú [1,2*]
Chairman Emeritus, Grupo Carso, S.A. de C.V., Chairman, Teléfonos de México, S.A. de C.V. and Chairman, Carso Global Telecom, S.A. de C.V.
Director since 1997

Stephen M. Wolf [1,3,4,5,6]
Chairman, R.R. Donnelley & Sons Company
Chairman, Lehman Brothers Private Equity Advisory Board
Managing Partner, Alpilles LLC
Director since 1993

Committees

Presiding Director
Robert E. R. Huntley

1 Member of Executive Committee
Louis C. Camilleri, Chair

2 Member of Finance Committee
Mathis Cabiallavetta, Chair

3 Member of Audit Committee
Lucio A. Noto, Chair

4 Member of Public Affairs and Social Responsibility Committee
Dr. Elizabeth E. Bailey, Chair

5 Member of Nominating and Corporate Governance Committee
Stephen M. Wolf, Chair

6 Member of Compensation Committee
John S. Reed, Chair

OFFICERS

Altria Group, Inc.

Louis C. Camilleri
Chairman of the Board and Chief Executive Officer

Nancy J. De Lisi
Senior Vice President, Mergers and Acquisitions

Dinyar S. Devitre
Senior Vice President and Chief Financial Officer

David I. Greenberg
Senior Vice President and Chief Compliance Officer

Kenneth F. Murphy†
Senior Vice President, Human Resources and Administration

Steven C. Parrish
Senior Vice President, Corporate Affairs

Charles R. Wall
Senior Vice President and General Counsel

Amy J. Engel
Vice President and Treasurer

G. Penn Holsenbeck
Vice President, Associate General Counsel and Corporate Secretary

Walter V. Smith
Vice President, Taxes

Joseph A. Tiesi
Vice President and Controller

Philip Morris USA Inc.

Michael E. Szymanczyk
Chairman and Chief Executive Officer

Philip Morris International Inc.

André Calantzopoulos
President and Chief Executive Officer

Kraft Foods Inc.

Roger K. Deromedi
Chief Executive Officer

Philip Morris Capital Corporation

John J. Mulligan
President and Chief Executive Officer

†Resigned effective March 6, 2006.

Additional information on the Board of Directors and our Corporate Governance principles is available at www.altria.com/governance.

SHAREHOLDER INFORMATION

Altria

Mailing Addresses:

Altria Group, Inc.
120 Park Avenue
New York, NY 10017-5592
1-917-663-4000
www.altria.com

Philip Morris USA Inc.
P.O. Box 26603
Richmond, VA 23261-6603
www.philipmorrisusa.com

Philip Morris International Management SA (Philip Morris International Inc.)
Avenue de Cour 107
Case Postale 1171
CH-1001 Lausanne
Switzerland
www.philipmorrisinternational.com

Kraft Foods Inc.
Three Lakes Drive
Northfield, IL 60093-2753
www.kraft.com

Philip Morris Capital Corporation
225 High Ridge Road
Suite 300 West
Stamford, CT 06905-3000
www.philipmorriscapitalcorp.com

Independent Auditors:
PricewaterhouseCoopers LLP
300 Madison Avenue
New York, NY 10017-6204

Transfer Agent and Registrar:
Computershare Trust Company, N.A.
P.O. Box 43075
Providence, RI 02940-3075

Shareholder Response Center:
Computershare Trust Company, N.A., our transfer agent, will be happy to answer questions about your accounts, certificates, dividends or the Direct Stock Purchase and Dividend Reinvestment Plan.
U.S. and Canadian shareholders may call toll-free: **1-800-442-0077.**
From outside the U.S. or Canada, shareholders may call:
1-781-575-3572.
Postal address:
Computershare Trust Company, N.A.
P.O. Box 43075
Providence, RI 02940-3075
E-mail address:
altria@computershare.com

To eliminate duplicate mailings, please contact Computershare (if you are a registered shareholder) or your broker (if you hold your stock through a brokerage firm).

Direct Stock Purchase and Dividend Reinvestment Plan:
Altria Group, Inc. offers a Direct Stock Purchase and Dividend Reinvestment Plan, administered by Computershare. For more information, or to purchase shares directly through the Plan, please contact Computershare.

Shareholder Publications:
Altria Group, Inc. makes a variety of publications and reports available. These include the Annual Report, news releases and other publications. For copies, please visit our website at: **www.altria.com/investors.**
Altria Group, Inc. makes available free of charge its filings (proxy statement and Reports on Form 10-K, 10-Q and 8-K) with the Securities and Exchange Commission. For copies, please visit:
www.altria.com/SECfilings.

If you do not have Internet access, you may call our Shareholder Publications Center toll-free:
1-800-367-5415.

Internet Access Helps Reduce Costs
As a convenience to shareholders and an important cost-reduction measure, you can register to receive future shareholder materials (i.e., Annual Report and proxy statement) via the Internet. Shareholders also can vote their proxies via the Internet. For complete instructions, visit: **www.altria.com/investors.**

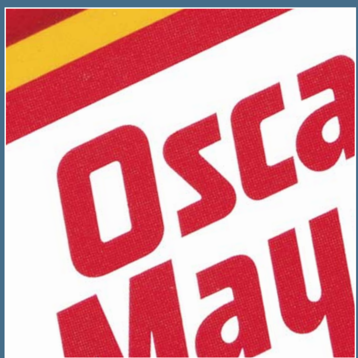
Trademarks:
Trademarks and service marks in this report are the registered property of or licensed by the subsidiaries of Altria Group, Inc., and are italicized or shown in their logo form.

2006 Annual Meeting:
The Altria Group, Inc. Annual Meeting of Shareholders will be held at 9:00 a.m. EDT on Thursday, April 27, 2006, at Kraft Foods Inc.,
Robert M. Schaeberle Technology Center,
188 River Road,
East Hanover, NJ 07936.
For further information, call toll-free: **1-800-367-5415.**

Stock Exchange Listings:
MO LISTED **NYSE** Altria Group, Inc. is listed on the New York Stock Exchange (ticker symbol "MO"). The company is also listed on the following exchanges: Amsterdam, Australia, Brussels, Frankfurt, London, Luxembourg, Paris, Swiss and Vienna.

Our Chief Executive Officer is required to make, and has made, an annual certification to the New York Stock Exchange ("NYSE") stating that he was not aware of any violation by us of the corporate governance listing standards of the NYSE. Our Chief Executive Officer made an annual certification to that effect to the NYSE as of May 24, 2005.

We have filed and/or furnished with the Securities and Exchange Commission, as exhibits to our Annual Reports on Form 10-K, the principal executive officer and principal financial officer certifications required under Sections 302 and 906 of the Sarbanes-Oxley Act of 2002 regarding the quality of our public disclosure.



Design: RWI (Robert Webster Inc) **Photography:** Kevin Fujii/Houston Chronicle/WorldPictureNetwork, Daniel Root, Todd Rosenberg, Deniek Sukarya, Vickers & Beechler, Ed Wheeler, David White **Typography:** Grid Typographic Services, Inc. **Printer:** Earth Color, USA

Altria

Altria Group, Inc.
120 Park Avenue
New York, NY 10017-5592

www.altria.com