MORGAN-DEMPSEY
CAPITAL MANAGEMENT, LLC

Altria (MO): Eliminate Position 0% **June 2022**

We have thrown in the towel on Altria. As many already know, we have three reasons that will cause us to eliminate a stock from the portfolio 1) Valuation: stock price does not justify earning power 2) Catalyst: the original catalyst has become impaired, or we have lost faith in the execution 3) Fundamentals: the business model has changed or the ability of the company to control their own destiny becomes questionable.

We eliminated Altria due to lost faith in the catalyst and concerns about the fundamentals.

Altria has made some positive steps in its transition of the business towards lower-risk, non-combustible products specifically the acquisition of On! nicotine pouches. Unfortunately, this strategy has been hampered by some recent events:

- Inability to import IQOS, Philip Morris International's successful heat-not-burn tobacco product, due to patent issues
- US FDA's ruling that JUUL, Altria's primary vaping product, can no longer be sold in the US

These products were considered important vehicles for future growth, particularly in the reduced risk categories.

The JUUL news was particularly disappointing because it seems to be based on JUUL's marketing strategy before Altria's investment in the company. The inability of Altria to convince the agency that things have changed under Altria's direction was surprising due to the historical strength of its lobbying arm.

We had been willing to give Altria significant leeway due to its strength in the US tobacco market, its ownership of Marlboro (a dominant premium brand), significant non-tobacco assets (approximately 10% interest in global beer company ABInBev), and focus on growing non-combustible products through partnerships (IQOS), external investment (vaping and cannabis) and acquisition (on! Nicotine pouches). However, the recent FDA ruling on JUUL and the current absence of IQOS has hurt the company's growth prospects in non-combustible nicotine products.

Altria has traditionally been a lower-risk holding that generated a lot of cash flow underpinning a high dividend yield. It traditionally has been a good place to be during periods of market declines and weak (or negative) economic growth. **What finally made us decide to exit the position is that it has not acted like a lower risk holding over the last couple of months.** The stock's volatile reaction to negative news despite its high yield and low valuation (based on price-to-cashflow and price-to-next-year's earnings) has made it difficult to consider this to be a lower-risk holding in the portfolio. This is the kind of stock that you hold to help protect your clients' portfolios during stressful times. It has not been providing as much support as we expected during the current downturn.

The proceeds from Altria combined with some cash have been invested in the following existing holdings:

- Cisco Systems 3.5% dividend yield; Forward PE 12.57
- Citigroup 4.31% dividend yield; Forward PE 6.98
- Rio Tinto Group 11% dividend yield excluding special dividend payout; Forward PE 5.4

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