

UNIVERSAL CORP /VA/
Form 10-Q
August 04, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (D) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2010

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (D) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM TO

Commission File Number: 001-00652

UNIVERSAL CORPORATION
(Exact name of registrant as specified in its charter)

Virginia
(State or other jurisdiction of
incorporation or organization)

54-0414210
(I.R.S. Employer
Identification Number)

9201 Forest Hill Avenue,
Richmond, Virginia
(Address of principal executive offices)

23235
(Zip Code)

804-359-9311
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes No

As of August 1, 2010, the total number of shares of common stock outstanding was 24,155,405.

UNIVERSAL CORPORATION
FORM 10-Q
TABLE OF CONTENTS

Item No.		Page
PART I - FINANCIAL INFORMATION		
1.	Financial Statements	3
2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	23
3.	Quantitative and Qualitative Disclosures About Market Risk	27
4.	Controls and Procedures	28
PART II - OTHER INFORMATION		
1.	Legal Proceedings	29
1A.	Risk Factors	31
2.	Unregistered Sales of Equity Securities and Use of Proceeds	31
4.	(Removed and Reserved)	31
6.	Exhibits	32
	Signatures	33

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

UNIVERSAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS
(In thousands of dollars, except per share data)

	Three Months Ended	
	June 30,	
	2010	2009
	(Unaudited)	
Sales and other operating revenues	\$ 538,916	\$ 616,112
Costs and expenses		
Cost of goods sold	436,679	476,748
Selling, general and administrative expenses	60,183	69,592
Restructuring costs	949	—
Operating income	41,105	69,772
Equity in pretax earnings of unconsolidated affiliates	378	3,641
Interest income	444	565
Interest expense	5,126	8,155
Income before income taxes and other items	36,801	65,823
Income taxes:	12,383	22,019
Net income	24,418	43,804
Less: net (income) loss attributable to noncontrolling interests in subsidiaries	902	(59)
Net income attributable to Universal Corporation	25,320	43,745
Dividends on Universal Corporation convertible perpetual preferred stock	(3,712)	(3,712)
Earnings available to Universal Corporation common shareholders	\$ 21,608	\$ 40,033
Earnings per share attributable to Universal Corporation common shareholders:		
Basic	\$ 0.89	\$ 1.60
Diluted	\$ 0.87	\$ 1.47
Retained earnings - beginning of year	\$ 767,213	\$ 686,960
Net income attributable to Universal Corporation	25,320	43,745
Cash dividends declared:		
Series B 6.75% Convertible Perpetual Preferred Stock	(3,712)	(3,712)
Common stock (2010 - \$0.47 per share; 2009 - \$0.46 per share)	(11,347)	(11,461)
Dividend equivalents on restricted stock units	(97)	(75)
Repurchase of common stock - cost in excess of stated capital amount	(8,605)	(2,773)
Retained earnings - end of period	\$ 768,772	\$ 712,684

See accompanying notes.

UNIVERSAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands of dollars)

	June 30, 2010 (Unaudited)	June 30, 2009 (Unaudited)	March 31, 2010
ASSETS			
Current			
Cash and cash equivalents	\$ 61,781	\$ 131,167	\$ 245,953
Accounts receivable, net	221,053	229,764	266,960
Advances to suppliers, net	122,878	141,383	167,400
Accounts receivable - unconsolidated affiliates	42,403	15,654	11,670
Inventories - at lower of cost or market:			
Tobacco	1,152,427	886,232	812,186
Other	66,183	66,851	52,952
Prepaid income taxes	14,062	14,238	13,514
Deferred income taxes	46,058	43,385	47,074
Other current assets	72,042	80,031	75,367
Total current assets	1,798,887	1,608,705	1,693,076
Property, plant and equipment			
Land	15,740	16,002	16,036
Buildings	262,468	254,846	266,350
Machinery and equipment	535,480	507,681	532,824
	813,688	778,529	815,210
Less accumulated depreciation	(486,576)	(462,266)	(485,723)
	327,112	316,263	329,487
Other assets			
Goodwill and other intangibles	105,409	106,030	105,561
Investments in unconsolidated affiliates	95,494	112,781	106,336
Deferred income taxes	28,627	20,393	30,073
Other noncurrent assets	101,870	91,297	106,507
	331,400	330,501	348,477
Total assets	\$ 2,457,399	\$ 2,255,469	\$ 2,371,040

See accompanying notes.

UNIVERSAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands of dollars)

	June 30, 2010 (Unaudited)	June 30, 2009 (Unaudited)	March 31, 2010
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current			
Notes payable and overdrafts	\$ 298,899	\$ 171,125	\$ 177,013
Accounts payable and accrued expenses	239,451	281,336	259,576
Accounts payable - unconsolidated affiliates	977	100	6,464
Customer advances and deposits	144,477	57,288	107,858
Accrued compensation	17,978	20,818	30,097
Income taxes payable	13,958	8,839	18,991
Current portion of long-term obligations	5,000	79,500	15,000
Total current liabilities	720,740	619,006	614,999
Long-term obligations	418,547	329,596	414,764
Pensions and other postretirement benefits	98,686	94,219	96,888
Other long-term liabilities	65,412	81,639	69,886
Deferred income taxes	38,627	51,226	46,128
Total liabilities	1,342,012	1,175,686	1,242,665
Shareholders' equity			
Universal Corporation:			
Preferred stock:			
Series A Junior Participating Preferred Stock, no par value, 500,000 shares authorized, none issued or outstanding	—	—	—
Series B 6.75% Convertible Perpetual Preferred Stock, no par value, 5,000,000 shares authorized, 219,999 shares issued and outstanding (219,999 at June 30, 2009, and March 31, 2010)	213,023	213,023	213,023
Common stock, no par value, 100,000,000 shares authorized, 24,155,316 shares issued and outstanding (24,901,506 at June 30, 2009, and 24,325,228 at March 31, 2010)	194,960	195,437	195,001
Retained earnings	768,772	712,684	767,213
Accumulated other comprehensive loss	(66,242)	(45,207)	(52,667)
Total Universal Corporation shareholders' equity	1,110,513	1,075,937	1,122,570
Noncontrolling interests in subsidiaries	4,874	3,846	5,805
Total shareholders' equity	1,115,387	1,079,783	1,128,375
Total liabilities and shareholders' equity	\$ 2,457,399	\$ 2,255,469	\$ 2,371,040

See accompanying notes.

5

UNIVERSAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands of dollars)

	Three Months Ended June 30,	
	2010	2009
	(Unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 24,418	\$ 43,804
Adjustments to reconcile net income to net cash used by operating activities:		
Depreciation	10,823	9,902
Amortization	412	504
Provisions for losses on advances and guaranteed loans to suppliers	2,991	583
Foreign currency remeasurement loss (gain), net	1,876	6,261
Restructuring costs	949	—
Other, net	(1,023)	13,825
Changes in operating assets and liabilities, net	(303,270)	(126,603)
Net cash used by operating activities	(262,824)	(51,724)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property, plant and equipment	(13,154)	(11,158)
Proceeds from sale of property, plant and equipment, and other	945	1,813
Net cash used by investing activities	(12,209)	(9,345)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Issuance (repayment) of short-term debt, net	127,985	(3,124)
Repayment of long-term obligations	(10,000)	—
Repurchase of common stock	(10,933)	(2,981)
Dividends paid on convertible perpetual preferred stock	(3,712)	(3,712)
Dividends paid on common stock	(11,427)	(11,461)
Net cash provided (used) by financing activities	91,913	(21,278)
Effect of exchange rate changes on cash	(1,052)	888
Net decrease in cash and cash equivalents	(184,172)	(81,459)
Cash and cash equivalents at beginning of year	245,953	212,626
Cash and cash equivalents at end of period	\$ 61,781	\$ 131,167

See accompanying notes.

UNIVERSAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION

Universal Corporation, with its subsidiaries ("Universal" or the "Company"), is the world's leading leaf tobacco merchant and processor. Because of the seasonal nature of the Company's business, the results of operations for any fiscal quarter will not necessarily be indicative of results to be expected for other quarters or a full fiscal year. All adjustments necessary to state fairly the results for the period have been included and were of a normal recurring nature. Certain amounts in prior year statements have been reclassified to conform to the current year presentation. This Form 10-Q should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2010.

NOTE 2. ACCOUNTING PRONOUNCEMENTS

Recent Pronouncements Adopted Through June 30, 2010

In June 2009, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles - a replacement of FASB Statement No. 162" ("SFAS 168"). This Statement established the newly-developed FASB Accounting Standards Codification ("Codification") as the single source of authoritative U.S. generally accepted accounting principles ("GAAP") for all nongovernmental entities. All guidance in the Codification carries the same level of authority, and all changes or additions to U.S. generally accepted accounting principles are now issued as Accounting Standards Updates ("ASU's"). In addition to the Codification, rules and interpretive releases of the U.S. Securities and Exchange Commission ("SEC") under federal securities laws remain sources of authoritative GAAP for SEC registrants. Universal was required to adopt SFAS 168 effective September 30, 2009. SFAS 168 did not make any changes to existing accounting guidance that impacted the Company's accounting and financial reporting.

During the fiscal year ended March 31, 2010 and through the quarter ended June 30, 2010, Universal adopted the following key accounting pronouncements:

- FASB Accounting Standards Update 2010-06, "Improving Disclosures about Fair Value Measurements" ("ASU 2010-06"), which was issued by the FASB in January 2010 and is effective for interim and annual financial statements for fiscal years beginning after December 15, 2010. ASU 2010-06 expands and clarifies the disclosure requirements related to fair value measurements. It requires companies to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 of the fair value hierarchy and describe the reasons for the transfers. In addition, information about purchases, sales, issuances, and settlements on a gross basis is required in the reconciliation of Level 3 fair-value measurements. ASU 2010-06 also clarifies existing fair value measurement disclosure guidance related to level of disaggregation, fair value inputs, and valuation techniques. Universal was required to apply most provisions of the new guidance effective April 1, 2010, the beginning of the current fiscal year. The adoption of ASU 2010-06 did not have a material effect on the Company's financial statements.
- FASB Staff Position No. 132(R)-1, "Employers' Disclosures about Postretirement Benefit Plan Assets" ("FSP 132(R)-1"), adopted effective March 31, 2010. This pronouncement, which is now a part of Topic 715 of the Codification, requires expanded disclosures about plan assets of defined benefit pension or other postretirement benefit plans. The new disclosures include information about investment allocation decisions, categories of plan assets, the inputs and valuation techniques used to measure the fair value of those assets, and significant

concentrations of credit risk. The disclosures required by FSP 132(R)-1 were included in the Company's annual financial statements at March 31, 2010 and did not have a material effect on those financial statements.

- FASB Statement of Financial Accounting Standards No. 165, "Subsequent Events" ("SFAS 165"), adopted effective June 30, 2009. SFAS 165, which is now set forth under Topic 855 of the Codification, establishes standards for accounting and disclosure for events occurring after the balance sheet date but before financial statements are issued. It defines the period after the balance sheet date during which events or transactions should be evaluated for potential recognition or disclosure, and it provides guidance on recognition and disclosure of actual transactions or events occurring after the balance sheet date. The adoption of SFAS 165 did not have a material effect on the Company's financial statements.

- FASB Statement of Financial Accounting Standards No. 160, "Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51" ("SFAS 160"), adopted effective April 1, 2009. SFAS 160, which is now set forth in Topic 810 of the Codification, requires that noncontrolling interests in subsidiaries that are included in a company's consolidated financial statements, previously referred to as "minority interests," be reported as a component of shareholders' equity in the balance sheet. It also requires that a company's consolidated net income and comprehensive income include the amounts attributable to both the company's interest and the noncontrolling interest in the subsidiary, identified separately in the financial statements. Finally, the new guidance requires certain disclosures about noncontrolling interests in the consolidated financial statements. Adoption of this guidance did not have a material impact on the Company's financial statements.
- FASB Statement of Financial Accounting Standards No. 141(R), "Business Combinations" ("SFAS 141(R)"), adopted effective April 1, 2009. SFAS 141(R) requires that companies record assets acquired, liabilities assumed, and noncontrolling interests in business combinations at fair value, separately from goodwill, as of the acquisition date. This approach differs from the cost allocation approach outlined under previous accounting guidance and can result in recognition of a gain at acquisition date if the cost to acquire a business is less than the net fair value of the assets acquired, liabilities assumed, and noncontrolling interests. SFAS 141(R), which is now set forth under Topic 805 of the Codification, also provides new guidance on recording assets and liabilities that arise from contingencies in a business combination, and it requires that transaction costs associated with business combinations be charged to expense instead of being recorded as part of the cost of the acquired business. Universal will apply the guidance to any future business combinations.

Pronouncements to be Adopted in Future Periods

In addition to the above accounting pronouncements adopted through June 30, 2010, the following pronouncement has been issued and will become effective in fiscal year 2012:

- FASB Accounting Standards Update 2009-13, "Multiple-Deliverable Revenue Arrangements" ("ASU 2009-13"), which was issued by the FASB in October 2009. ASU 2009-13 establishes a selling price hierarchy for determining the selling price of a deliverable in a multiple-deliverable arrangement. It also requires additional disclosures about the methods and assumptions used to evaluate multiple-deliverable arrangements and to identify the significant deliverables within those arrangements. ASU 2009-13 is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, which means that Universal will be required to adopt the guidance effective April 1, 2011, the beginning of its fiscal year 2012. The Company will be evaluating the potential impact of ASU 2009-13, but does not currently expect that it will have a material effect on its financial statements.

NOTE 3. GUARANTEES AND OTHER CONTINGENT LIABILITIES

Guarantees and Other Contingent Liabilities

Guarantees of bank loans to growers for crop financing and construction of curing barns or other tobacco producing assets are industry practice in Brazil and support the farmers' production of tobacco there. At June 30, 2010, the Company's total exposure under guarantees issued by its operating subsidiary in Brazil for banking facilities of farmers in that country was approximately \$46 million (\$62 million face amount including unpaid accrued interest, less \$16 million recorded for the fair value of the guarantees). About 60% of these guarantees expire within one year, and all of the remainder expire within five years. The subsidiary withholds payments due to the farmers on delivery of tobacco and forwards those payments to the third-party banks. Failure of farmers to deliver sufficient quantities of tobacco to the subsidiary to cover their obligations to the third-party banks could result in a liability for the subsidiary under the related guarantees; however, in that case, the subsidiary would have recourse against the farmers. The maximum potential amount of future payments that the Company's subsidiary could be required to make at June 30, 2010, was the face amount, \$62 million including unpaid accrued interest (\$82 million as of June 30, 2009, and \$112 million at March 31, 2010). The fair value of the guarantees was a liability of approximately \$16 million at June 30, 2010 (\$36 million at June 30, 2009, and \$26 million at March 31, 2010). In addition to these guarantees, the Company has other contingent liabilities totaling approximately \$47 million, primarily related to a bank guarantee that bonds an appeal of a 2006 fine in the European Union, as discussed below.

European Commission Fines and Other Legal Matters

European Commission Fines in Spain

In October 2004, the European Commission (the "Commission") imposed fines on "five companies active in the raw Spanish tobacco processing market" totaling €20 million for "colluding on the prices paid to, and the quantities bought from, the tobacco growers in Spain." Two of the Company's subsidiaries, Tabacos Espanoles S.A. ("TAES"), a purchaser and processor of raw tobacco in Spain, and Deltafina, S.p.A. ("Deltafina"), an Italian subsidiary, were among the five companies assessed fines. In its decision, the Commission imposed a fine of €108,000 on TAES and a fine of €11.88 million on Deltafina. Deltafina did not and does not purchase or process raw tobacco in the Spanish market, but was and is a significant buyer of tobacco from some of the Spanish processors. The Company recorded a charge of about €12 million (approximately \$14.9 million at the September 2004 exchange rate) in the second quarter of fiscal year 2005 to accrue the full amount of the fines assessed against the Company's subsidiaries.

In January 2005, Deltafina filed an appeal in the General Court of the European Union. Although a hearing on the matter was held in June 2009, the outcome of the appeal is uncertain. The General Court is scheduled to issue its decision in September 2010; however, an ultimate resolution to the matter could take several years. The Company has deposited funds in an escrow account with the Commission in the amount of the fine in order to stay execution during the appeal process. This deposit is accounted for as a non-current asset.

European Commission Fines in Italy

In 2002, the Company reported that it was aware that the Commission was investigating certain aspects of the leaf tobacco markets in Italy. Deltafina buys and processes tobacco in Italy. The Company reported that it did not believe that the Commission investigation in Italy would result in penalties being assessed against it or its subsidiaries that would be material to the Company's earnings. The reason the Company held this belief was that it had received conditional immunity from the Commission because Deltafina had voluntarily informed the Commission of the activities that were the basis of the investigation.

On December 28, 2004, the Company received a preliminary indication that the Commission intended to revoke Deltafina's immunity for disclosing in April 2002 that it had applied for immunity. Neither the Commission's Leniency Notice of February 19, 2002, nor Deltafina's letter of provisional immunity, contains a specific requirement of confidentiality. The potential for such disclosure was discussed with the Commission in March 2002, and the Commission never told Deltafina that disclosure would affect Deltafina's immunity. On November 15, 2005, the Company received notification from the Commission that the Commission had imposed fines totaling €30 million (about \$37 million at the June 30, 2010 exchange rate) on Deltafina and the Company jointly for infringing European Union antitrust law in connection with the purchase and processing of tobacco in the Italian raw tobacco market.

The Company does not believe that the decision can be reconciled with the Commission's Statement of Objections and the facts. In January 2006, the Company and Deltafina each filed appeals in the General Court of the European Union. For strategic reasons related to the defense of the Deltafina appeal, Universal recently withdrew its appeal. Based on consultation with outside legal counsel, the Company believes it is probable that Deltafina will prevail in the appeals process and has not accrued a charge for the fine. If the Company and Deltafina were ultimately found liable for the full amount of the fine, then accumulated interest on the fine would also be due and payable. Accumulated interest totaled approximately €4.7 million (about \$5.7 million) at June 30, 2010. Deltafina has provided a bank guarantee to the Commission in the amount of the fine plus accumulated interest in order to stay execution during the appeals process.

U.S. Foreign Corrupt Practices Act

As a result of a posting to the Company's Ethics Complaint hotline alleging improper activities that involved or related to certain of its tobacco subsidiaries, the Audit Committee of the Company's Board of Directors engaged an outside law firm to conduct an investigation of the alleged activities. That investigation revealed that there have been payments that may have violated the U.S. Foreign Corrupt Practices Act. The payments involved approximated \$2 million over a seven-year period. In addition, the investigation revealed activities in foreign jurisdictions that may have violated the competition laws of such jurisdictions, but the Company believes those activities did not violate U.S. antitrust laws. The Company voluntarily reported these activities to the Department of Justice ("DOJ") and Securities and Exchange Commission ("SEC") in March 2006. On June 6, 2006, the SEC notified the Company that a formal order of investigation had been issued.

Since voluntarily reporting, the Company has cooperated with and assisted the DOJ and SEC in their investigations, and for the past year the Company has engaged in settlement discussions with both authorities to resolve the matter. Those negotiations have resulted in agreements in principle being reached with representatives of the DOJ and the staff of the SEC. The final resolution of this matter remains subject to the completion of definitive agreements and the approval and execution of those agreements by the DOJ and the SEC. In addition, each settlement is subject to the approval of a federal district court with jurisdiction over the matter. Based on the agreements in principle that have been reached to date, the resolution of this matter with the DOJ and the SEC is expected to include injunctive relief, disgorgement and prejudgment interest, fines, penalties, and the retention of an independent compliance monitor. Based in part on the progress of the matter and consultation with outside counsel, the Company has recorded accruals from time to time since the matter arose that are adequate to satisfy the estimated financial settlement the Company expects with the resolution of the matter. The financial settlement is not expected to have a material effect on the Company's financial condition or results of operations.

Other Legal Matters

In addition to the above-mentioned matters, various subsidiaries of the Company are involved in other litigation and tax examinations incidental to their business activities. While the outcome of these matters cannot be predicted with certainty, management is vigorously defending these matters and does not currently expect that any of them will have a material adverse effect on the Company's financial position. However, should one or more of these matters be resolved in a manner adverse to management's current expectation, the effect on the Company's results of operations for a particular fiscal reporting period could be material.

NOTE 4. RESTRUCTURING COSTS

During the quarter ended June 30, 2010, the Company recorded restructuring costs totaling approximately \$950,000, representing special termination benefits associated with actions taken to adjust operations and reduce costs in certain areas of its U.S. operations. Those operations are part of the Company's North America reportable segment. The

restructuring costs reflected termination benefits to be paid to management employees who accepted voluntary early retirement offers. The majority of the termination benefits will be paid immediately following the employees' retirement during the quarter ending September 30, 2010.

NOTE 5. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share:

(in thousands, except per share data)	Three Months Ended June 30,	
	2010	2009
Basic Earnings Per Share		
Numerator for basic earnings per share		
Net income attributable to Universal Corporation	\$ 25,320	\$ 43,745
Less: Dividends on convertible perpetual preferred stock	(3,712)	(3,712)
Earnings available to Universal Corporation common shareholders for calculation of basic earnings per share	21,608	40,033
Denominator for basic earnings per share		
Weighted average shares outstanding	24,213	24,985
Basic earnings per share	\$ 0.89	\$ 1.60