

UNIVERSAL CORP /VA/  
Form 10-Q  
November 06, 2008  
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**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 September 30, 2008

or

**Transition Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**  
For the Transition Period From \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 1-652

**UNIVERSAL CORPORATION**

(Exact name of registrant as specified in its charter)

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**Virginia**  
(State or other jurisdiction of  
incorporation or organization)

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

**1501 North Hamilton Street,**

**Richmond, Virginia**  
(Address of principal executive offices)

**23230**  
(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 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 November 1, 2008, the total number of shares of common stock outstanding was 24,987,055.

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**UNIVERSAL CORPORATION**

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**Table of Contents****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 September 30, 2008      2007 (Unaudited)		Six Months Ended September 30, 2008      2007 (Unaudited)	
Sales and other operating revenues	\$ 785,590	\$ 655,330	\$ 1,291,877	\$ 1,105,547
Costs and expenses				
Cost of goods sold	630,447	512,614	1,033,700	878,663
Selling, general and administrative expenses	83,948	66,569	148,795	117,676
Restructuring costs				3,304
Operating income	71,195	76,147	109,382	105,904
Equity in pretax earnings (loss) of unconsolidated affiliates	7,583	(2,389)	7,533	(1,246)
Interest income	417	4,576	1,367	8,864
Interest expense	10,113	10,569	17,779	21,960
Income before income taxes and other items	69,082	67,765	100,503	91,562
Income taxes	23,115	24,577	33,396	33,733
Minority interests, net of income taxes	4,185	2,715	4,214	(822)
Income from continuing operations	41,782	40,473	62,893	58,651
Income from discontinued operations, net of income taxes		(675)		(145)
<b>Net income</b>	<b>41,782</b>	<b>39,798</b>	<b>62,893</b>	<b>58,506</b>
Dividends on convertible perpetual preferred stock	(3,713)	(3,712)	(7,425)	(7,425)
Earnings available to common shareholders	\$ 38,069	\$ 36,086	\$ 55,468	\$ 51,081
Basic earnings per common share:				
From continuing operations	\$ 1.50	\$ 1.34	\$ 2.12	\$ 1.88
From discontinued operations		(0.02)		(0.01)
Net income	\$ 1.50	\$ 1.32	\$ 2.12	\$ 1.87
Diluted earnings per common share:				
From continuing operations	\$ 1.38	\$ 1.25	\$ 2.02	\$ 1.81
From discontinued operations		(0.02)		(0.01)
Net income	\$ 1.38	\$ 1.23	\$ 2.02	\$ 1.80
Retained earnings beginning of year			\$ 711,655	\$ 682,232
Net income			62,893	58,506
Cash dividends declared:				
Series B 6.75% Convertible Perpetual Preferred Stock			(7,425)	(7,425)
Common stock (2008 \$0.90 per share; 2007 \$0.88 per share)			(23,615)	(24,103)

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Repurchase of common stock cost in excess of stated capital amount	(90,106)	
Adoption of Financial Accounting Standards Board Interpretation 48 (FIN 48) as of April 1, 2007		(10,870)
Retained earnings end of period	\$ 653,402	\$ 698,340

See accompanying notes.

**Table of Contents****UNIVERSAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(In thousands of dollars)

	September 30, 2008 (Unaudited)	September 30, 2007 (Unaudited)	March 31, 2008
<b>ASSETS</b>			
Current			
Cash and cash equivalents	\$ 40,765	\$ 381,094	\$ 186,070
Short-term investments	15,950		58,889
Accounts receivable, net	284,107	229,687	231,107
Advances to suppliers, net	149,096	100,347	149,376
Accounts receivable unconsolidated affiliates	34,403	51,559	43,718
Inventories at lower of cost or market:			
Tobacco	778,053	638,214	602,945
Other	80,095	47,524	42,562
Prepaid income taxes	10,058	9,227	17,696
Deferred income taxes	32,979	24,739	22,737
Other current assets	90,503	65,632	61,960
Current assets of discontinued operations		4,564	
<b>Total current assets</b>	<b>1,516,009</b>	<b>1,552,587</b>	<b>1,417,060</b>
Property, plant and equipment			
Land	16,133	16,684	16,460
Buildings	255,875	245,788	254,737
Machinery and equipment	504,568	509,791	519,695
	776,576	772,263	790,892
Less accumulated depreciation	(450,946)	(432,222)	(456,059)
	325,630	340,041	334,833
Other assets			
Goodwill and other intangibles	106,267	104,493	106,647
Investments in unconsolidated affiliates	108,137	105,228	116,185
Deferred income taxes	33,512	79,528	49,632
Other noncurrent assets	96,767	126,243	109,755
	344,683	415,492	382,219
<b>Total assets</b>	<b>\$ 2,186,322</b>	<b>\$ 2,308,120</b>	<b>\$ 2,134,112</b>

See accompanying notes.

**Table of Contents****UNIVERSAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(In thousands of dollars)

	September 30, 2008 (Unaudited)	September 30, 2007 (Unaudited)	March 31, 2008
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Current			
Notes payable and overdrafts	\$ 260,511	\$ 117,173	\$ 126,229
Accounts payable and accrued expenses	200,310	195,320	210,354
Accounts payable - unconsolidated affiliates	320	125	10,343
Customer advances and deposits	60,326	109,432	21,030
Accrued compensation	17,632	14,733	25,484
Income taxes payable	9,891	13,537	8,886
Current portion of long-term obligations	79,500	154,000	
Current liabilities of discontinued operations		1,642	
<b>Total current liabilities</b>	<b>628,490</b>	<b>605,962</b>	<b>402,326</b>
Long-term obligations	321,617	399,272	402,942
Pensions and other postretirement benefits	91,562	104,764	88,278
Other long-term liabilities	72,906	77,239	84,958
Deferred income taxes	35,335	39,989	36,795
<b>Total liabilities</b>	<b>1,149,910</b>	<b>1,227,226</b>	<b>1,015,299</b>
Minority interests	7,288	5,119	3,182
Shareholders' equity			
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 September 30, 2007, and March 31, 2008)	213,023	213,023	213,023
Common stock, no par value, 100,000,000 shares authorized, 25,026,040 shares issued and outstanding (27,374,956 at September 30, 2007, and 27,162,150 at March 31, 2008)	193,643	198,086	206,436
Retained earnings	653,402	698,340	711,655
Accumulated other comprehensive loss	(30,944)	(33,674)	(15,483)
<b>Total shareholders' equity</b>	<b>1,029,124</b>	<b>1,075,775</b>	<b>1,115,631</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 2,186,322</b>	<b>\$ 2,308,120</b>	<b>\$ 2,134,112</b>

See accompanying notes.

**Table of Contents****UNIVERSAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands of dollars)

	<b>Six Months Ended September 30, 2008                      2007 (Unaudited)</b>	
<b>CASH FLOWS FROM OPERATING ACTIVITIES OF CONTINUING OPERATIONS:</b>		
Net income	\$ 62,893	\$ 58,506
Adjustments to reconcile net income to net cash provided (used) by operating activities of continuing operations:		
Net loss from discontinued operations		145
Depreciation	22,000	20,585
Amortization	493	1,324
Provisions for losses on advances and guaranteed loans to suppliers	9,972	9,217
Remeasurement loss (gain), net	24,603	(2,907)
Restructuring costs		3,304
Other, net	12,671	10,572
Changes in operating assets and liabilities, net	(321,938)	(56,531)
<b>Net cash provided (used) by operating activities of continuing operations</b>	<b>(189,306)</b>	<b>44,215</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES OF CONTINUING OPERATIONS:</b>		
Purchase of property, plant and equipment	(21,748)	(13,365)
Purchases of short-term investments	(9,658)	
Maturities and sales of short-term investments	52,740	
Proceeds from sale of business, less cash of business sold		25,156
Proceeds from sale of property, plant and equipment, and other	14,298	15,923
<b>Net cash provided by investing activities of continuing operations</b>	<b>35,632</b>	<b>27,714</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES OF CONTINUING OPERATIONS:</b>		
Issuance (repayment) of short-term debt, net	144,884	(23,236)
Repayment of long-term debt		(10,000)
Issuance of common stock	37	16,051
Repurchase of common stock	(105,689)	
Dividends paid on convertible perpetual preferred stock	(7,425)	(7,425)
Dividends paid on common stock	(22,962)	(24,103)
Other		(907)
<b>Net cash provided (used) by financing activities of continuing operations</b>	<b>8,845</b>	<b>(49,620)</b>
<b>Net cash provided (used) by continuing operations</b>	<b>(144,829)</b>	<b>22,309</b>
<b>CASH FLOWS FROM DISCONTINUED OPERATIONS:</b>		
Net cash provided by operating activities of discontinued operations		6,495
Net cash used by investing activities of discontinued operations		(17)
Net cash used by financing activities of discontinued operations		(4,957)
<b>Net cash provided by discontinued operations</b>		<b>1,521</b>



Effect of exchange rate changes on cash	(476)	147
Net increase (decrease) in cash and cash equivalents	(145,305)	23,977
Cash and cash equivalents of continuing operations at beginning of year	186,070	358,236
Cash and cash equivalents of discontinued operations at beginning of year		239
Less: Cash and cash equivalents of discontinued operations at end of period		1,358
<b>Cash and cash equivalents at end of period</b>	<b>\$ 40,765</b>	<b>\$ 381,094</b>

See accompanying notes.

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**UNIVERSAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1. BASIS OF PRESENTATION**

Universal Corporation, with its subsidiaries ( Universal or the Company ), is one of the world's leading leaf tobacco merchants and processors. The Company previously had non-tobacco operations, but sold most of them in fiscal year 2007. The remaining non-tobacco businesses, or the assets of those businesses, were sold during fiscal year 2008. Those operations are reported as discontinued operations for all periods in the Company's financial statements.

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, 2008.

**NOTE 2. ACCOUNTING PRONOUNCEMENTS**

*Recent Pronouncements Adopted Through September 30, 2008*

Effective April 1, 2008, Universal adopted Financial Accounting Standards Board ( FASB ) Statement of Financial Accounting Standards No. 157, Fair Value Measurements ( SFAS 157 ) as it applies to financial assets and financial liabilities. SFAS 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and expands disclosures about fair value measurements. As originally issued, SFAS 157 also applied to nonfinancial assets and nonfinancial liabilities; however, the FASB subsequently issued additional guidance that delayed the effective date for those items until fiscal years beginning after November 15, 2008, except where they are currently required to be recognized or disclosed at fair value in the financial statements on at least an annual basis. Universal does not have any nonfinancial assets or nonfinancial liabilities that are required to be recognized or disclosed at fair value on at least an annual basis. The FASB also issued subsequent guidance to exclude fair value measurements related to leases from the scope of SFAS 157, except where they relate to leases assumed in a business combination. The adoption of SFAS 157 with respect to the Company's financial assets and liabilities did not have a material effect on the Company's operating results or financial position. The required disclosures about fair value measurements are provided in Note 10. The Company is continuing to evaluate the impact of adopting SFAS 157 for its nonfinancial assets and liabilities.

Effective April 1, 2008, the Company also adopted FASB Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 ( SFAS 159 ). SFAS 159 gives companies the option to report certain financial instruments and other items at fair value on an item-by-item basis (the fair value option) with changes in fair value reported in earnings. The Company did not elect the fair value option for any financial assets or liabilities that were not already being measured and reported at fair value; therefore, the adoption of SFAS 159 had no impact on its financial statements.

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Universal adopted FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes* ( FIN 48 ), effective April 1, 2007. FIN 48 clarified the accounting for uncertainty in income taxes recognized in the financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. It requires that positions taken or expected to be taken in tax returns meet a more-likely-than-not threshold based solely on their technical merit in order to be recognized in the financial statements. It also provides guidance on measuring the amount of a tax position that meets the more-likely-than-not criterion. As a result of adopting FIN 48, the Company recognized a net increase of approximately \$10.9 million in its liability related to uncertain tax positions, which was accounted for as a decrease in the April 1, 2007, balance of retained earnings.

### *Pronouncements to be Adopted in Future Periods*

In addition to the above accounting pronouncements adopted through September 30, 2008, the following pronouncements or specific provisions of pronouncements have been issued and will become effective in future periods:

The measurement timing provisions of FASB Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* an amendment of FASB Statements No. 87, 88, 106, and 132(R) ( SFAS 158 ). These provisions are effective for fiscal years ending after December 15, 2008, and require that the funded status of defined benefit plans be measured as of the balance sheet date, thereby eliminating the option allowed under the prior guidance, and previously used by the Company, to measure funded status at a date up to three months before the balance sheet date. Universal will adopt these measurement timing provisions in fiscal year 2009 by next measuring its plans at March 31, 2009. Upon adoption, the Company expects to record a direct adjustment to reduce retained earnings by approximately \$2 million (\$3 million before income taxes), reflecting the expense attributable to the intervening three-month transition period. Changes in the fair value of plan assets and benefit obligations for the full fifteen-month period between the fiscal year 2008 and 2009 measurement dates will be recognized in other comprehensive income for fiscal year 2009.

FASB Statement of Financial Accounting Standards No. 141R, *Business Combinations* ( SFAS 141R ), which 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 provided under current 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 141R 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. It is effective for fiscal years beginning after December 15, 2008, which means that Universal will apply the guidance to any business combinations occurring on or after April 1, 2009.

FASB Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements* an amendment of ARB No. 151 ( SFAS 160 ). SFAS 160 requires that noncontrolling interests in subsidiaries that are included in a

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company's consolidated financial statements, commonly 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. SFAS 160 is effective for fiscal years beginning after December 15, 2008. Universal has various subsidiaries with noncontrolling interests and will begin applying the new guidance in fiscal year 2010. Adoption of SFAS 160 is not expected to have a material impact on the Company's financial statements.

FASB Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities (SFAS 161). SFAS 161 amends FASB Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities and several other accounting pronouncements to require enhanced disclosures about derivatives and hedging activities that are aimed at improving the transparency and understanding of those activities for financial statement users. It requires additional disclosures explaining the objectives and strategies for using derivative instruments, how those instruments and the related hedged items are accounted for, and how they affect the company's financial position, results of operations, and cash flows. SFAS 161 is effective for interim periods and fiscal years beginning after November 15, 2008, which means that Universal will be initially required to make the disclosures in its financial statements for the fiscal year ending March 31, 2009, although earlier application is permitted. Universal uses interest rate swaps and forward foreign currency exchange contracts from time to time to minimize interest rate and foreign currency risk, and will make the required additional disclosures upon adoption of SFAS 161.

**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 September 30, 2008, the Company's total exposure under guarantees issued by its operating subsidiary in Brazil for banking facilities of farmers in that country was approximately \$135 million. About 50% 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 third-party banks could result in a liability for the subsidiary under the related guarantee; 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 is the face amount including unpaid accrued interest, or \$135 million (\$200 million as of September 30, 2007, and \$218 million at March 31, 2008). The accrual recorded for the fair value of the guarantees was approximately \$8 million and \$10 million at September 30, 2008 and 2007, respectively, and approximately \$13 million at March 31, 2008. The accrual was increased by approximately \$1.3 million in the quarter ended June 30, 2008, due to the adoption of SFAS 157 (see Notes 1 and 10). In addition to these guarantees, the Company has other contingent liabilities totaling approximately \$52 million, primarily related to a bank guarantee that bonds an appeal of a 2006 fine in the European Union, as discussed below.

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### **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 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 11.988 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 Court of First Instance of the European Communities. The outcome of the appeal is uncertain, and 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 \$42 million at the September 30, 2008 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.

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The Company does not believe that the decision can be reconciled with the Commission's Statement of Objections and the facts. The Company and Deltafina each have appealed the decision to the Court of First Instance of the European Communities. Based on consultation with outside legal counsel, the Company believes it is probable that it will prevail in the appeals process and has not accrued a charge for the fine. Deltafina has provided a bank guarantee to the Commission in the amount of the fine plus accrued interest in order to stay execution during the appeal 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 the Company's 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. These payments approximated \$1 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 appropriate U.S. authorities. On June 6, 2006, the Securities and Exchange Commission notified the Company that a formal order of investigation had been issued.

If the U.S. authorities determine that there have been violations of the Foreign Corrupt Practices Act, or if the U.S. authorities or the authorities in foreign jurisdictions determine there have been violations of other laws, they may seek to impose sanctions on the Company or its subsidiaries that may include injunctive relief, disgorgement, fines, penalties, and modifications to business practices. It is not possible to predict at this time what sanctions the U.S. authorities may seek to impose. It is also not possible to predict how the government's investigation or any resulting sanctions may impact the Company's business, financial condition, results of operations, or financial performance, although such sanctions, if imposed, could be material to its results of operations in any quarter. The Company will continue to cooperate with the authorities in this matter.

### *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 the claims 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. DISCONTINUED OPERATIONS**

As discussed in Note 1, Universal implemented actions during fiscal years 2007 and 2008 to divest its non-tobacco businesses, which included lumber and building products operations and agri-product operations. The lumber and building products businesses and a portion of the agri-products operations were sold during fiscal year 2007. The remaining agri-product businesses, or the assets of those businesses, were sold during fiscal year 2008. For the quarter and six months ended September 30, 2007, the Company reported a loss from discontinued operations, net of income taxes, of \$675,000 and \$145,000, respectively, most of which represented the net results from operating two of the agri-product

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businesses prior to sale. At September 30, 2007, the Company reported current assets of discontinued operations of approximately \$4.6 million and current liabilities of discontinued operations of approximately \$1.6 million. These balances reflected assets and liabilities of one agri-products business that was subsequently sold in October 2007, and primarily consisted of trade accounts receivable, inventories, and trade accounts payable.

**NOTE 5. RESTRUCTURING COSTS**

During the quarter ended June 30, 2007, the Company recorded restructuring costs totaling \$3.3 million, representing one-time and special termination benefits associated with actions taken in certain areas of its worldwide operations. Approximately \$1.1 million of the costs related to a restructuring and downsizing of the Company's operations in Canada in response to declining tobacco production in that country. In addition, the Company's decision to exit certain flue-cured growing projects in Africa accounted for approximately \$1.7 million of costs, as actions to release farm managers and workers were implemented during the quarter. The remaining \$0.5 million of the charge related to reorganizations in several smaller locations. The restructuring costs reflected termination benefits paid, or to be paid, to 40 management and administrative employees, plus small remuneration payments to approximately 10,500 seasonal workers released from the growing projects in Africa.

In addition to the restructuring costs recorded during the quarter ended June 30, 2007, Universal recorded other restructuring costs during the fiscal years ended March 31, 2006, and March 31, 2008, associated with various other actions taken to streamline, restructure, or exit various activities and functions in certain areas of its worldwide operations. A significant portion of the restructuring costs were paid prior to the end of fiscal year 2008, and nearly all of the remainder will be paid by the end of fiscal year 2009. During the six months ended September 30, 2008, payments of employee termination benefits were made to 33 employees. The activity in the Company's liability for restructuring costs for fiscal year 2008 and the first six months of fiscal year 2009 was as follows:

(in thousands of dollars)	Employee Termination Benefits	Other Costs	Total
Balance at March 31, 2007	\$ 1,331	\$ 190	\$ 1,521
Costs charged to expense during fiscal year 2008:			
Quarter ended June 30, 2007	3,304		3,304
Quarter ended March 31, 2008	3,413		3,413
Payments during fiscal year 2008:			
Quarter ended June 30, 2007	(786)	(52)	(838)
Quarter ended September 30, 2007	(2,359)	(35)	(2,394)
Quarter ended December 31, 2007	(441)	(34)	(475)
Quarter ended March 31, 2008	(1,376)	(69)	(1,445)
Balance at March 31, 2008	3,086		3,086
Payments during fiscal year 2009:			
Quarter ended June 30, 2008	(642)		(642)
Quarter ended September 30, 2008	(229)		(229)
Balance at September 30, 2008	\$ 2,215	\$	\$ 2,215

**Table of Contents****NOTE 6. STOCK-BASED COMPENSATION**

Universal's shareholders have approved Executive Stock Plans under which officers, directors, and employees of the Company may receive grants and awards of common stock, restricted stock, restricted stock units (RSUs), performance share awards (PSAs), stock appreciation rights (SARs), incentive stock options, and non-qualified stock options. The Company's practice is to award grants of stock-based compensation to officers on an annual basis at the first regularly-scheduled meeting of the Executive Compensation, Nominating and Corporate Governance Committee of the Board of Directors (the Compensation Committee) in the fiscal year. Awards of restricted stock, RSUs, PSAs, SARs, and non-qualified stock options are currently outstanding under the Plans. The non-qualified stock options and SARs have an exercise price equal to the market price of a share of common stock on the grant date. All stock options currently outstanding are fully vested and exercisable, and they expire ten years after the grant date. The SARs are settled in shares of common stock, vest in equal one-third tranches one, two, and three years after the grant date, and expire ten years after the grant date, except that SARs granted after fiscal year 2007 expire on the earlier of three years after the grantee's retirement date or ten years after the grant date. The RSUs vest five years from the grant date and are then paid out in shares of common stock. Under the terms of the RSU awards, grantees receive dividend equivalents in the form of additional RSUs that vest and are paid out on the same date as the original RSU grant. The PSAs vest three years from the grant date, are paid out in shares of common stock at the vesting date, and do not carry rights to dividends or dividend equivalents prior to vesting. Shares ultimately paid out under PSA grants are dependent on the achievement of predetermined performance measures established by the Compensation Committee and can range from zero to 150% of the stated award. The Company's outside directors automatically receive shares of restricted stock following each annual meeting of shareholders. These shares vest upon the individual's retirement from service as a director.

During the six months ended September 30, 2008 and 2007, Universal issued the following stock-based awards, representing the regular annual grants to officers and outside directors of the Company:

	<b>Six Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>
<b>SARs:</b>		
Number granted	132,000	272,800
Exercise price	\$ 51.32	\$ 62.66
Grant date fair value	\$ 11.65	\$ 14.64
<b>RSUs:</b>		
Number granted	36,500	68,200
Grant date fair value	\$ 51.32	\$ 62.66
<b>PSAs:</b>		
Number granted	31,600	
Grant date fair value	\$ 45.96	\$
<b>Restricted Shares:</b>		
Number granted	14,500	11,500
Grant date fair value	\$ 54.38	\$ 49.78



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The grant date fair value of the SARs was estimated using the Black-Scholes pricing model and the following assumptions:

	2008	2007
Expected term	5.0 years	5.0 years
Expected volatility	31.3%	26.1%
Expected dividend yield	3.50%	2.81%
Risk-free interest rate	3.32%	5.00%

Fair value expense for stock-based compensation is recognized ratably over the period from grant date to the earlier of: (1) the vesting date of the award, or (2) the date the grantee is eligible to retire without forfeiting the award. For employees who are already eligible to retire at the date an award is granted, the total fair value of all non-forfeitable awards is recognized as expense at the date of grant. As a result, Universal typically incurs higher stock compensation expense in the first quarter of each fiscal year when grants are awarded than in the other three quarters. For PSAs, the Company generally recognizes fair value expense ratably over the performance and vesting period based on management's judgment of the ultimate award that is likely to be paid out based on the achievement of the predetermined performance measures. For the six months ended September 30, 2008 and 2007, the Company recorded total stock-based compensation expense of approximately \$2.8 million and \$5.6 million, respectively. The significant decline in expense compared to the prior year period was due in part to retirements of several senior officers during fiscal year 2008 and in part to reduced award levels and related fair values for the awards granted to officers during the first quarter of fiscal year 2009. The Company expects to recognize stock-based compensation expense of approximately \$2 million during the remaining six months of fiscal year 2009.

**NOTE 7. COMPREHENSIVE INCOME**

Comprehensive income for each period presented in the consolidated statements of income and retained earnings was as follows:

(in thousands of dollars - all amounts net of income taxes)	Three Months Ended September 30,		Six Months Ended September 30,	
	2008	2007	2008	2007
From continuing operations:				
Income from continuing operations	\$ 41,782	\$ 40,473	\$ 62,893	\$ 58,651
Foreign currency translation adjustment	(11,777)	4,762	(10,047)	6,796
Foreign currency hedge adjustment	(7,009)	167	(5,414)	506
Comprehensive income from continuing operations	22,996	45,402	47,432	65,953
From discontinued operations:				
Income (loss) from discontinued operations		(675)		(145)
Comprehensive income (loss) from discontinued operations		(675)		(145)
Total comprehensive income	\$ 22,996	\$ 44,727	\$ 47,432	\$ 65,808

**Table of Contents****NOTE 8. 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 September 30,		Six Months Ended September 30,	
	2008	2007	2008	2007
<b>Basic Earnings Per Share</b>				
<b>Numerator for basic earnings per share</b>				
From continuing operations:				
Income from continuing operations	\$ 41,782	\$ 40,473	\$ 62,893	\$ 58,651
Less: Dividends on convertible perpetual preferred stock	(3,713)	(3,712)	(7,425)	(7,425)
Earnings available to common shareholders from continuing operations	38,069	36,761	55,468	51,226
From discontinued operations:				
Earnings (loss) available to common shareholders from discontinued operations		(675)		(145)
Net income available to common shareholders	\$ 38,069	\$ 36,086	\$ 55,468	\$ 51,081
<b>Denominator for basic earnings per share</b>				
Weighted average shares outstanding	25,404	27,370	26,146	27,249
<b>Basic earnings per share:</b>				
From continuing operations	\$ 1.50	\$ 1.34	\$ 2.12	\$ 1.88
From discontinued operations		(0.02)		(0.01)
Net income per share	\$ 1.50	\$ 1.32	\$ 2.12	\$ 1.87
<b>Diluted Earnings Per Share</b>				
<b>Numerator for diluted earnings per share</b>				
From continuing operations:				
Earnings available to common shareholders from continuing operations	\$ 38,069	\$ 36,761	\$ 55,468	\$ 51,226
Add: Dividends on convertible perpetual preferred stock (if conversion assumed)	3,713	3,712	7,425	7,425
Earnings available to common shareholders from continuing operations for calculation of diluted earnings per share	41,782	40,473	62,893	58,651
From discontinued operations:				
Earnings (loss) available to common shareholders from discontinued operations		(675)		(145)
Net income available to common shareholders	\$ 41,782	\$ 39,798	\$ 62,893	\$ 58,506
<b>Denominator for diluted earnings per share:</b>				
Weighted average shares outstanding	25,404	27,370	26,146	27,249
Effect of dilutive securities (if conversion or exercise assumed)				
Convertible perpetual preferred stock	4,716	4,710	4,715	4,710
Employee share-based awards	229	350	224	391
Denominator for diluted earnings per share	30,349	32,430	31,085	32,350

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<b>Diluted earnings per share:</b>					
From continuing operations	\$	1.38	\$	1.25	\$ 2.02 \$ 1.81
From discontinued operations			(0.02)		(0.01)
Net income per share	\$	1.38	\$	1.23	\$ 2.02 \$ 1.80

**Table of Contents****NOTE 9. OPERATING SEGMENTS**

The principal approach used by management to evaluate the Company's performance is by geographic region, although some components of the business are evaluated on the basis of their worldwide operations. The Company evaluates the performance of its segments based on operating income after allocated overhead expenses (excluding significant non-recurring charges or credits), plus equity in pretax earnings of unconsolidated affiliates.

Operating results for the Company's reportable segments for each period presented in the consolidated statements of income and retained earnings were as follows:

(in thousands of dollars)	Three Months Ended September 30,		Six Months Ended September 30,	
	2008	2007	2008	2007
<b>SALES AND OTHER OPERATING REVENUES</b>				
Flue-cured and burley leaf tobacco operations:				
North America	\$ 54,866	\$ 53,921	\$ 103,293	\$ 88,685
Other regions (1)	686,276	534,576	1,087,761	877,863
Subtotal	741,142	588,497	1,191,054	966,548
Other tobacco operations (2)	44,448	66,833	100,823	138,999
Consolidated sales and other operating revenues	\$ 785,590	\$ 655,330	\$ 1,291,877	\$ 1,105,547
<b>OPERATING INCOME (LOSS)</b>				
Flue-cured and burley leaf tobacco operations:				
North America	\$ 3,750	\$ 4,154	\$ 3,324	\$ (1,031)
Other regions (1)	62,453	63,654	97,638	95,912
Subtotal	66,203	67,808	100,962	94,881
Other tobacco operations (2)	12,575	5,950	15,953	13,081
Segment operating income	78,778	73,758	116,915	107,962
Less:				
Equity in pretax earnings (loss) of unconsolidated affiliates (3)	7,583	(2,389)	7,533	(1,246)
Restructuring costs (4)				3,304
Consolidated operating income	\$ 71,195	\$ 76,147	\$ 109,382	\$ 105,904

(1) Includes South America, Africa, Europe, and Asia regions, as well as inter-region eliminations.

(2) Includes Dark Air-Cured, Special Services, and Oriental, as well as inter-company eliminations. Sales and other operating revenues for this reportable segment include limited amounts for Oriental because its financial results consist principally of equity in the pretax earnings of an unconsolidated affiliate.

(3) Item is included in segment operating income, but not included in consolidated operating income.

(4) Item is not included in segment operating income, but is included in consolidated operating income.

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**NOTE 10. FAIR VALUE MEASUREMENTS**

As discussed in Note 2, Universal adopted SFAS 157, Fair Value Measurements, and SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115, effective April 1, 2008.

*SFAS 157 and Related Disclosures*

SFAS 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and expands disclosures about fair value measurements. The application of SFAS 157 is generally limited to financial assets and liabilities at this time because application to most nonfinancial assets and liabilities was deferred one year by subsequent guidance issued by the FASB. The adoption of SFAS 157 resulted in an increase of approximately \$1.3 million in the fair value liability associated with the Company's guarantees of bank loans to tobacco growers in Brazil (see Note 3).

Under SFAS 157, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The framework for measuring fair value under the guidance is based on a fair value hierarchy that distinguishes between observable inputs (i.e., inputs that are based on market data obtained from independent sources) and unobservable inputs (i.e., inputs that require the Company to make its own assumptions about market participant assumptions because little or no market data exists). There are three levels within the fair value hierarchy:

<b>Level</b>	<b>Description</b>
1	quoted prices in active markets for identical assets or liabilities that the Company has the ability to access as of the reporting date;
2	quoted prices in active markets for similar assets or liabilities, or quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability;
3	unobservable inputs for the asset or liability.

In measuring the fair value of liabilities, the Company considers the risk of non-performance in determining fair value.

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At September 30, 2008, the Company had certain financial assets and financial liabilities that were required to be measured and reported at fair value on a recurring basis. These assets and liabilities are listed in the table below and classified based on how their values were determined under the fair value hierarchy:

(in thousands of dollars)	Level 1	Level 2	Level 3	Total
<b>Assets:</b>				
Available-for-sale securities	\$ 11,018	\$ 5,040	\$	\$ 16,058
Trading securities associated with deferred compensation plans	19,977			19,977
Interest rate swaps		2,891		2,891
Forward foreign currency exchange contracts		101		101
<b>Total assets</b>	<b>\$ 30,995</b>	<b>\$ 8,032</b>	<b>\$</b>	<b>\$ 39,027</b>
<b>Liabilities:</b>				
Guarantees of bank loans to tobacco growers	\$	\$	\$ 8,158	\$ 8,158
Interest rate swaps		696		696
Forward foreign currency exchange contracts		5,878		5,878
<b>Total liabilities</b>	<b>\$</b>	<b>\$ 6,574</b>	<b>\$ 8,158</b>	<b>\$ 14,732</b>

**Available-for-sale securities**

Available-for-sale securities primarily include commercial paper, bank certificates of deposit, corporate bonds, and government bonds. Quoted market prices (Level 1) are used to determine the fair values of corporate bonds and government bonds. The fair values of commercial paper and bank certificates of deposit are determined by outside brokers through a combination of their knowledge of the current pricing environment and market flows (Level 2). The fair values of the Company's available-for-sale securities approximate cost due to the short-term maturities of the instruments and the high credit quality of the issuers.

**Trading securities associated with deferred compensation plans**

Trading securities represent mutual fund investments that are matched to employee deferred compensation obligations. These investments are bought and sold as employees defer compensation, receive distributions, or make changes in the funds underlying their accounts. Quoted market prices (Level 1) are used to determine the fair values of the mutual funds and their underlying securities.

**Interest rate swaps**

The fair values of interest rate swap contracts are determined based on dealer quotes using a discounted cash flow model matched to the contractual terms of each instrument. Since inputs to the model are observable and significant judgment is not required in determining the fair values, interest rate swaps are classified within Level 2 of the fair value hierarchy.

**Forward foreign currency exchange contracts**

The fair values of forward foreign currency exchange contracts are also determined based on dealer quotes using a discounted cash flow model matched to the contractual terms of each instrument. Since inputs to the model are observable and significant judgment is not required in determining the fair values, forward foreign currency exchange contracts are classified within Level 2 of the fair value hierarchy.

**Table of Contents****Guarantees of bank loans to tobacco growers**

The fair values of the Company's guarantees of bank loans to tobacco growers are determined by using internally-tracked historical loss data for such loans to develop an estimate of future losses under the guarantees outstanding at the measurement date. The present value of the cash flows associated with those estimated losses is then calculated at a risk-adjusted interest rate. This approach is sometimes referred to as the contingent claims valuation method. Although historical loss data is an observable input, significant judgment is required in applying this information to the portfolio of guaranteed loans outstanding at each measurement date and in selecting a risk-adjusted interest rate. The guarantees of bank loans to tobacco growers are therefore classified within Level 3 of the fair value hierarchy.

A reconciliation of the change in the balance of the financial liability for guarantees of bank loans to tobacco growers (Level 3) for the six months ended September 30, 2008, is as follows:

<b>(in thousands of dollars)</b>	
Balance at April 1, 2008	\$ 13,924
Favorable experience in collection of 2007-08 crop year loans	(1,974)
Decrease in aggregate guaranteed loan balance due to removal of 2007-08 crop year loans from the portfolio and addition of 2008-09 crop year loans	(4,386)
Change in discount rate and estimated collection period	998
Currency remeasurement	(404)
 Balance at September 30, 2008	 \$ 8,158

***SFAS 159***

SFAS 159 gives companies the option to report at fair value certain financial instruments and other items not otherwise required to be reported at fair value under current accounting guidance. Under SFAS 159, this reporting choice (the fair value option) is made on an item-by-item basis, and changes in fair value following initial application are reported in earnings. Universal did not elect the fair value option for any financial instruments or other items; therefore, the adoption of SFAS 159 had no impact on the Company's financial statements.

**NOTE 11. PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS**

The Company has several defined benefit pension plans covering U.S. salaried employees and certain foreign and other employee groups. These plans provide retirement benefits based primarily on employee compensation and years of service. The Company also provides postretirement health and life insurance benefits for eligible U.S. employees attaining specific age and service levels.

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The components of the Company's net periodic benefit cost for its continuing operations were as follows:

(in thousands of dollars)	Pension Benefits		Other Postretirement Benefits	
	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007
Service cost	\$ 1,446	\$ 1,430	\$ 216	\$ 270
Interest cost	3,438	3,255	640	715
Expected return on plan assets	(3,338)	(3,044)	(37)	(40)
Settlement cost	961			
Net amortization and deferral	69	884	(12)	(12)
Net periodic benefit cost	\$ 2,576	\$ 2,525	\$ 807	\$ 933

(in thousands of dollars)	Pension Benefits		Other Postretirement Benefits	
	Six Months Ended September 30, 2008	Six Months Ended September 30, 2007	Six Months Ended September 30, 2008	Six Months Ended September 30, 2007
Service cost	\$ 2,899	\$ 2,858	\$ 456	\$ 541
Interest cost	6,894	6,494	1,395	1,523
Expected return on plan assets	(6,680)	(6,088)	(78)	(81)
Curtailement loss	815			
Settlement cost	3,302			
Net amortization and deferral	639	1,695	(24)	(24)
Net periodic benefit cost	\$ 7,869	\$ 4,959	\$ 1,749	\$ 1,959

During the six months ended September 30, 2008, the Company made contributions of \$13 million to its qualified and non-qualified pension plans. Additional contributions of approximately \$10 million are expected during the remaining six months of the fiscal year.

As discussed in Note 2, the Company will adopt the measurement timing provisions of SFAS 158 during the fourth quarter of fiscal year 2009, and will change the annual measurement date for its defined benefit pension and other postretirement benefit plans to coincide with its fiscal year end. Upon adoption, the Company expects to record a direct adjustment to reduce retained earnings by approximately \$2 million (\$3 million before income taxes) in the fourth quarter, reflecting the expense attributable to the intervening three-month transition period.

**NOTE 12. INCOME TAXES**

The Company's consolidated effective income tax rate on pre-tax earnings from continuing operations for the quarter and six months ended September 30, 2008, and expected for the full fiscal year 2009, was approximately 33%. The rate was lower than the 35% U.S. federal statutory rate, primarily due to anticipated utilization in the current fiscal year of foreign tax credit carryforwards, for which a valuation allowance had previously been established. This anticipated utilization is due to the impact on the Company's overall tax position of the weakness



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of the U.S. dollar relative to the Brazilian currency over recent reporting periods and expected effects of tax planning. Under the accounting guidance for income taxes, the reversal of the valuation allowance is treated as an adjustment to the effective tax rate for the year in which the determination is made to the extent the change is due to current fiscal year income. The impact of reversing the allowance is a reduction in income tax expense for the year of approximately \$3 million. Another important factor contributing to the lower effective tax rate is the expected improvement in earnings in the African region where income tax rates are generally below the U.S. rate because of the structure of the ownership of the region. This factor more than offsets the impact of state taxes on income projected to be earned in the United States.

For the quarter and six months ended September 30, 2007, the effective income tax rates were approximately 36% and 37%, respectively. The rates were higher than the U.S. federal statutory income tax rate primarily because of excess foreign taxes recorded in countries where the tax rates exceed the U.S. rate, as well as state taxes on income earned in the U.S. In addition, the restructuring charges provided tax benefits at a rate that was lower than the statutory rate, which increased the effective tax rate for the quarter.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*This Quarterly Report on Form 10-Q and the following Management's Discussion and Analysis of Financial Condition and Results of Operations contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Among other things, these statements relate to the Company's financial condition, results of operation, and future business plans, operations, opportunities, and prospects. In addition, the Company and its representatives may from time to time make written or oral forward-looking statements, including statements contained in other filings with the Securities and Exchange Commission and in reports to shareholders. These forward-looking statements are generally identified by the use of words such as we expect, believe, anticipate, could, should, may, plan, will, predict, estimate, and similar expressions or words of similar import. These forward-looking statements are based upon management's current knowledge and assumptions about future events and involve risks and uncertainties that could cause actual results, performance, or achievements to be materially different from any anticipated results, prospects, performance, or achievements expressed or implied by such forward-looking statements. Such risks and uncertainties include: anticipated levels of demand for and supply of its products and services; costs incurred in providing these products and services; timing of shipments to customers; changes in market structure; changes in exchange rates; and general economic, political, market, and weather conditions. For a further description of factors that may cause actual results to differ materially from such forward-looking statements, see Item 1A, Risk Factors of our Annual Report on Form 10-K for the fiscal year ended March 31, 2008. We caution investors not to place undue reliance on any forward-looking statements as these statements speak only as of the date when made, and we undertake no obligation to update any forward-looking statements made in this report. This Form 10-Q should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended March 31, 2008.*

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### **Liquidity and Capital Resources**

#### **Overview**

The first half of the fiscal year is generally a period of significant working capital investment in both Brazil and Africa as crops come to market. In fiscal year 2009, we funded those requirements using cash on hand, short-term bank borrowings, customer funds, and operating cash flows. In addition, we continued our share repurchase program, which is based on free cash flow generated in prior years and an assessment of our future capital needs.

Our liquidity and capital resource requirements are predominantly short term in nature and primarily relate to working capital required for tobacco crop purchases. Working capital needs are seasonal within each geographic region. The geographic dispersion and the timing of working capital needs permit us to predict our general level of cash requirements, although crop size, prices paid to farmers, and currency fluctuations affect requirements each year. The marketing of the crop in each geographic area is heavily influenced by weather conditions and follows the cycle of buying, processing, and shipping of the tobacco crop. The timing of individual customer shipping requirements may change the level or the duration of crop financing. Despite a predominance of short-term needs, we maintain a relatively large portion of our total debt as long-term to reduce liquidity risk.

#### **Operations**

We used \$189 million to fund our operating activities during the first six months of fiscal year 2009. Tobacco inventory increased by about \$175 million since March 31, 2008, to \$778 million, reflecting our normal seasonal pattern, which was inflated this year by the weakness of the U.S. dollar and higher local currency prices paid to farmers. Other inventory, which includes packing supplies and agricultural materials, such as fertilizer, increased by about \$38 million, also reflecting higher prices for those commodities and earlier purchasing in some origins. Inventory is usually financed with a mix of cash, notes payable, and customer deposits, depending on our borrowing capabilities, interest rates, and exchange rates, as well as those of our customers. During the six months ended September 30, 2008, accounts receivable increased by \$53 million, primarily due to later shipments of higher priced South American tobacco. Although we do not present quarterly cash flows, it is important to note that, due to second quarter shipments, inventories have been reduced by \$187 million from their June balances, which reached \$965 million, and customer deposits that financed some of that inventory have been reduced by \$100 million.

We generally do not purchase material quantities of tobacco on a speculative basis. At September 30, 2008, our uncommitted inventories were \$74 million, or about 9% of total tobacco inventory, compared to \$89 million, or about 15% of our March 31, 2008, inventory, and \$78 million, or about 12% of our September 30, 2007, inventory. The effect of decreased volumes of uncommitted inventories was partially offset by higher local currency prices paid to farmers and the weak U.S. dollar during the quarter.

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Compared to balances at September 30, 2007, inventories were about \$140 million higher reflecting higher leaf costs as well as much larger African crops this year. Customer deposits were almost \$50 million lower this year as customers reduced prepayment programs, and accounts receivable increased by \$54 million due to higher selling prices this year as well as lower customer deposits. Advances to suppliers increased by \$49 million, primarily because of delayed supplier deliveries in South America.

Conditions in worldwide financial markets changed dramatically near the end of the quarter. The U.S. dollar strengthened significantly against many currencies, which has the effect of reducing the U.S. dollar cost of future tobacco purchases in local currency. Most of our inventory had been purchased before that change and thus reflects the higher costs. In addition, agricultural materials for next year's crops were purchased before the U.S. dollar strengthened. If the U.S. dollar remains at current exchange levels, we and our customers would expect to see a benefit from the recent exchange movements in future crop purchases.

## **Investment**

During the six months ended September 30, 2008, we invested about \$21.7 million in our fixed assets, which was slightly less than our depreciation expense of \$22.0 million. Our intent is to limit maintenance capital spending to a level below depreciation expense in order to maintain strong cash flow. In the first six months of last year, capital spending was \$13.4 million. The increase was primarily caused by the replacement of aircraft in Africa.

## **Financing**

Total debt and customer advances, less cash, cash equivalents, and short-term investments, increased by about \$360 million to \$665 million during the six months ended September 30, 2008, primarily due to seasonal working capital requirements and the use of prior year cash flows for share repurchases. That total as a percentage of capitalization (including total debt, customer advances, minority interests, and shareholders equity less cash, cash equivalents, and short-term investments) was approximately 39% at September 30, 2008, up from approximately 21% at March 31, 2008, and 27% at September 30, 2007. Net of cash, cash equivalents, and short-term investments, total debt and customer deposits has increased by about \$266 million since September 30, 2007, as we utilized the cash balances and issued new short-term debt to fund higher seasonal working capital requirements.

Pension assets have declined, reflecting the current state of financial markets. Depending on their status on January 1, 2009, we may have additional funding requirements.

As of September 30, 2008, we were in compliance with the covenants of our debt agreements. We had \$255 million available under a committed revolving credit facility that will expire on August 31, 2012, and \$57 million in cash, cash equivalents, and short-term

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investments. Our short-term debt and current maturities of long-term debt totaled \$340 million. In addition, we had about \$400 million in unused, uncommitted credit lines. Thus, we believe that our liquidity and capital resources at September 30, 2008, remained adequate to support our foreseeable operating needs.

On November 7, 2007, we announced that our Board of Directors had approved the purchase of up to \$150 million of our common stock through November 2009. The purchases are carried out from time to time on the open market or in privately negotiated transactions at prices not exceeding prevailing market rates. During the six months ended September 30, 2008, we purchased 2.1 million shares of common stock at an aggregate cost of \$107 million (average price per share of \$49.64), which brought our total purchases under the program to 2.5 million shares at an aggregate cost of \$124 million (average price per share of \$50.10). As of September 30, 2008, we had approximately 25.0 million common shares outstanding.

## **Results of Operations**

We reported a 12% increase in earnings per diluted share to \$1.38 for our second fiscal quarter, which ended on September 30, 2008. These results represented net income of \$41.8 million compared to \$39.8 million, or \$1.23 per diluted share, last year. The quarter reflected very strong operations in all of our operating segments, but it also included the negative effects of currency remeasurement related to Brazilian net monetary assets that reduced operating income by \$25 million. Revenues increased by 20% to \$785.6 million, primarily due to increased costs of green leaf that were passed through in sales prices as well as to increased volumes after the very low African crops last year. Similar factors affected the six-month results. Net income for the first half of the year was \$62.9 million, or \$2.02 per diluted share, up from \$58.5 million, or \$1.80 per diluted share, reported last year. Revenues increased by 17% during the period.

Results for the flue-cured and burley operations were nearly flat for the quarter at about \$67 million, although revenues increased by 25%. North America's revenues and operating income were consistent with last year, although U.S. crop deliveries were later this year and that delay reduced processing volumes. The unit was able to offset that impact with cost savings and sales of old crop tobacco in both Canada and the United States. Operating income for the Other Regions segment was flat for the quarter despite increases in volume from the larger African burley crops and higher shipments in Europe that had been delayed from the first quarter. These improved earnings were offset by lower results from our South American operations due to continued shipment delays and currency remeasurement losses in Brazil, where the local currency weakened by approximately 20% during the quarter. Some of the remeasurement losses were attributable to advances to farmers for crop inputs for the upcoming growing season. Crop inputs were more expensive this year due to increased fertilizer prices and the weaker U.S. dollar at the time they were purchased. Although they are related to production of 2008-09 crop leaf that will be sold next year, these advances are remeasured in U.S. dollars along with all other monetary assets and liabilities each reporting period, and the related remeasurement loss affects operating income this year when the prior 2007-08 crop is being sold. Asian operations saw improved earnings on higher volumes. Revenues for Other Regions increased by 27%, to \$686 million.

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For the six months, results for flue-cured and burley operations increased by more than 7%, to over \$100 million. A significant portion of the improvement was due to stronger performance in North America where cost savings and sales of old crop tobacco boosted income and revenues. In Other Regions, stronger results were driven by better volumes across the African region, as well as reduced charges and write downs there. Results of European operations were higher as well, primarily due to shipment timing benefits and higher volumes in the region's tobacco sheet business. South American results were hampered by shipment delays and the effect of the previously mentioned remeasurement losses. The currency devalued by almost 9% over the six-month period, compared to an 11% strengthening last year. Revenues for this segment were up by 23% to \$1.1 billion for the six months.

Results for Other Tobacco Operations more than doubled due to improved performance by the oriental tobacco joint venture reflecting higher volumes, which included one-time trading opportunities, as well as currency gains. Dark tobacco operations also improved, primarily due to increased domestic crop volumes. Special Services, where sales were accelerated last year, showed the expected decline related to the shift of business to the origins, and that change also caused the 33% decline in segment revenue in the quarter. The same factors caused six-month results to improve by over 20%.

Net interest expense increased by \$3.7 million in the quarter compared to last year, primarily because of increased cash requirements to fund crop purchases. We also made substantial progress on our share repurchase program, spending about \$107 million to purchase 2.15 million shares during the six months. The effective tax rate remained near 33% compared to last year's rate of over 36% as we expect to utilize more of our foreign tax credits, which caused the reduction of a valuation allowance for those credits.

Selling, general and administrative expenses are included in segment operating income and are discussed as part of segment performance. Those costs increased by about \$17 million in the second quarter and about \$31 million for the first half of fiscal year 2009. The increase was largely driven by currency remeasurement and exchange losses of about \$25 million during both periods. Last year, currency remeasurement produced a loss of about \$1.9 million for the quarter and a gain of \$2.9 million for the six months. The losses in the current year were mainly attributable to the effect of the weakening Brazilian currency on net monetary assets there. The Brazilian currency weakened by approximately 20% in the quarter. In addition, we had mark-to-market gains on forward currency contracts totaling \$6 million in the first half of fiscal year 2008, but none in the current year. The total currency remeasurement and exchange losses in fiscal year 2009 were \$25.8 million in the second quarter and \$22.8 million for the first six months, compared to last year's loss of \$2.4 million and gain of \$9.9 million, respectively. Gains on fixed asset sales this year, totaling about \$7 million, partially offset these currency-related expenses.

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We are pleased with the performance of our operations during this first half of the fiscal year. The devaluation of the Brazilian currency unfortunately occurred at a time when our net monetary asset position in local currency was at a seasonal peak, hurting a quarter that otherwise showed significant improvement over last year. We continued to strengthen customer relationships, and we reduced the level of our uncommitted inventories. Each region has delivered operating improvements as a result of hard work as well as careful attention to costs. They have done so despite the escalating cost of green leaf as all areas worked to ensure sustainability of supply in the face of competing crops. Volumes recovered in Africa this year, and signs are beginning to point to a very large burley crop there next year. Those expected crop levels could cause world production to approach or exceed the recent peak levels produced in 2004, which would replenish inventories and move worldwide supply to a balanced position or perhaps even a slight oversupply. Flue-cured tobacco supply is also expected to increase and could reach levels produced in the 2005 crop. The overall flue-cured supply is expected to remain mostly balanced, but the increased supply could lead to excess in the market. We continue to work to maintain future production of the type of quality tobacco that our customers require. We have been successfully navigating the current storm in financial markets. We have reached what is normally a peak working capital period during the year, and we believe that our financial resources are adequate to meet our needs.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

#### **Interest Rates**

Interest rate risk is limited in the tobacco business because major customers usually pre-finance purchases or pay market rates of interest for inventory purchased for their accounts. Our tobacco customers pay interest on tobacco purchased for their order. That interest is paid at rates based on current markets for variable-rate debt. If we fund our committed tobacco inventory with fixed-rate debt, we may not be able to recover interest at that fixed rate if current market interest rates were to fall. As of September 30, 2008, tobacco inventory of \$778 million included about \$704 million in inventory that was committed for sale to customers and about \$74 million that was not committed. Committed inventory, after deducting \$60 million in customer deposits, represents our net exposure of \$644 million. We maintain a portion of our debt at variable interest rates either directly or through interest rate exchange agreements in order to mitigate interest rate risk related to carrying fixed-rate debt. Debt carried at variable interest rates was about \$430 million at September 30, 2008. A hypothetical 1% change in short-term interest rates would result in a change in annual interest expense of approximately \$4 million, and all of that amount should be offset with changes in customer charges. Approximately \$230 million of fixed-rate debt with an average interest rate of 5.66% remains.

#### **Currency**

The international tobacco trade generally is conducted in U.S. dollars, thereby limiting foreign exchange risk to that which is related to production costs, overhead, and income taxes in the source country. Most of the operations are accounted for using the U.S. dollar as the

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functional currency. Because there are no forward foreign exchange markets in many of our major countries of tobacco origin, we generally manage our foreign exchange risk by matching funding for inventory purchases with the currency of sale, which is usually the U.S. dollar, and by minimizing our net investment in individual countries. In these countries, we are vulnerable to currency gains and losses to the extent that any local currency monetary balances do not offset each other. In fiscal year 2009, we had a larger balance of net monetary assets in Brazil when the currency devalued by approximately 20% during the second fiscal quarter. With continued devaluation since September 30, 2008, we could see an additional remeasurement loss in the third quarter. In addition, changes in local currency exchange rates make tobacco more or less attractive in U.S. dollar terms. In some situations where customer contracts have fixed dollar pricing and forward foreign exchange markets exist, we may enter forward contracts to mitigate the risk of currency exchange rate changes.

In certain tobacco markets that are primarily domestic, we use the local currency as the functional currency. Examples of these domestic markets are Canada, Hungary, and Poland. In each case, reported earnings are affected by the translation of the local currency into the U.S. dollar.

## **Derivatives Policies**

Hedging interest rate exposure using swaps and hedging foreign exchange exposure using forward contracts are specifically contemplated to manage risk in keeping with management's policies. We may use derivative instruments, such as swaps, forwards, or futures, which are based directly or indirectly upon interest rates and currencies to manage and reduce the risks inherent in interest rate and currency fluctuations.

We do not utilize derivatives for speculative purposes, and we do not enter into market risk-sensitive instruments for trading purposes. Derivatives are transaction specific so that a specific debt instrument, contract, or invoice determines the amount, maturity, and other specifics of the hedge. Counterparty risk is limited to institutions with long-term debt ratings of A or better.

## **ITEM 4. CONTROLS AND PROCEDURES**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in reports we file under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. Our Chief Executive Officer and Chief Financial Officer evaluated, with the participation of other members of management, the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)), as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, management concluded that our disclosure controls and procedures were effective. There were no changes in our internal

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controls over financial reporting identified in connection with this evaluation that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

## **PART II. OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

#### **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 our 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. We 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 our subsidiaries.

In January 2005, Deltafina filed an appeal in the Court of First Instance of the European Communities. The outcome of the appeal is uncertain, and an ultimate resolution to the matter could take several years. Deltafina 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, we reported that we were aware that the Commission was investigating certain aspects of the leaf tobacco markets in Italy. Deltafina buys and processes tobacco in Italy. We reported that we did not believe that the Commission investigation in Italy would result in penalties being assessed against us or our subsidiaries that would be material to our earnings. The reason we held this belief was that we 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, we 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, we received notification that the Commission had imposed fines totaling 30 million (about \$42 million



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at the September 30, 2008 exchange rate) on Deltafina and Universal Corporation jointly for infringing European Union antitrust law in connection with the purchase and processing of tobacco in the Italian raw tobacco market.

We do not believe that the decision can be reconciled the Commission's Statement of Objections and the facts. Both Deltafina and Universal Corporation have appealed the decision to the Court of First Instance of the European Communities. Based on consultation with outside legal counsel, we believe it is probable that we will prevail in the appeals process, and we have not accrued a charge for the fine. Deltafina has provided a bank guarantee to the Commission in the amount of the fine plus accrued interest in order to stay execution during the appeal process.

### **U.S. Foreign Corrupt Practices Act**

As a result of a posting to our Ethics Complaint hotline alleging improper activities that involved or related to certain of our tobacco subsidiaries, the Audit Committee of our 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. These payments approximated \$1 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 we believe those activities did not violate U.S. antitrust laws. We voluntarily reported these activities to the appropriate U.S. authorities. On June 6, 2006, the Securities and Exchange Commission notified us that a formal order of investigation had been issued.

If the U.S. authorities determine that there have been violations of the Foreign Corrupt Practices Act, or if the U.S. authorities or the authorities in foreign jurisdictions determine there have been violations of other laws, they may seek to impose sanctions on us or our subsidiaries that may include injunctive relief, disgorgement, fines, penalties, and modifications to business practices. It is not possible to predict at this time what sanctions the U.S. authorities may seek to impose. It is also not possible to predict how the government's investigation or any resulting sanctions may impact our business, financial condition, results of operations, or financial performance, although such sanctions, if imposed, could be material to its results of operations in any quarter. We will continue to cooperate with the authorities in this matter.

### **Other Legal Matters**

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

**Table of Contents****ITEM 1A. RISK FACTORS**

As of the date of this report, there are no material changes to the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended March 31, 2008. In evaluating our risks, readers should carefully consider the risk factors discussed in our Annual Report on Form 10-K, which could materially affect our business, financial condition or operating results, in addition to the other information set forth in this report and in our other filings with the Securities and Exchange Commission.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

The following table summarizes our repurchases of equity securities for the three-month period ended September 30, 2008:

Period (1)	Total Number of Shares Repurchased	Average Price Paid Per Share(2)	Total Number of Shares Repurchased as Part of Publicly Announced Plan or Program(3)	Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs(3)
July 1, 2008 to July 31, 2008	620,600	\$ 46.78	620,600	\$ 49,888,560
August 1, 2008 to August 31, 2008	222,600	\$ 52.71	222,600	\$ 38,156,222
September 1, 2008 to September 30, 2008	241,600	\$ 51.05	241,600	\$ 25,821,618
Total	1,084,800	\$ 48.95	1,084,800	\$ 25,821,618

- (1) Repurchases are based on the date the shares were traded. This presentation differs from the consolidated statement of cash flows, where the cost of share repurchases is based on the date the transactions were settled.
- (2) Amounts listed for average price paid per share includes broker commissions paid in the transactions.
- (3) The stock repurchase plan, which was authorized by our Board of Directors, became effective and was publicly announced on November 7, 2007. The stock repurchase plan authorizes the purchase of up to \$150 million in common stock in open market or privately negotiated transactions, subject to market conditions and other factors. The stock repurchase plan will expire on the earlier of November 15, 2009, or when we have repurchased all shares authorized for repurchase thereunder.

**Table of Contents****ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

The Annual Meeting of Shareholders of the Company (the Meeting ) was held on August 5, 2008.

At the Meeting, the shareholders elected three directors to serve three-year terms. The Company had outstanding, as of June 17, 2008, 26,575,840 shares of Common Stock, each of which was entitled to one vote. The majority of the shares entitled to vote constituted a quorum. Each of the three directors received more than an 89% majority of the votes of the outstanding shares. The voting with respect to each nominee was as follows:

Nominee	Votes For	Votes Withheld
George C. Freeman, III	23,778,302	252,898
Eddie N. Moore, Jr.	23,655,106	376,094
Hubert R. Stallard	23,774,457	256,743

The terms of office of the following directors continued after the Meeting: John B. Adams, Jr., Chester A. Crocker, Joseph C. Farrell, Charles H. Foster, Jr., Thomas H. Johnson, Jeremiah J. Sheehan, Walter A. Stosch, and Eugene P. Trani.

No other matters were voted upon at the Meeting or during the quarter for which this report is filed.

**ITEM 6. EXHIBITS**

- 12 Ratio of Earnings to Fixed Charges, and Ratio of Earnings to Combined Fixed Charges and Preference Dividends.\*
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002.\*
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002.\*
- 32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350.\*
- 32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350.\*

\* Filed herewith

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**SIGNATURES**

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

Date: November 6, 2008

UNIVERSAL CORPORATION  
(Registrant)

/s/ David C. Moore  
David C. Moore, Senior Vice President

and Chief Financial Officer

/s/ Robert M. Peebles  
Robert M. Peebles, Controller  
(Principal Accounting Officer)