UNIVERSAL CORP /VA/
Form 10-Q
November 05, 2010

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

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (D) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 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 x 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 x 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 x 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 x

As of November 1, 2010, the total number of shares of common stock outstanding was 23,793,065.

UNIVERSAL CORPORATION
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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,		Six Months Ended September 30,	
	2010	2009	2010	2009
	(Unaudited)		(Unaudited)	
Sales and other operating revenues	$ 664,188	$ 647,918	$ 1,203,104	$ 1,264,030
Costs and expenses				
Cost of goods sold	530,914	500,575	967,593	977,323
Selling, general and administrative expenses	51,649	71,478	111,832	141,070
Restructuring costs	2,020	—	2,969	—
Operating income	79,605	75,865	120,710	145,637
Equity in pretax earnings of unconsolidated affiliates	2,014	5,605	2,392	9,246
Interest income	1,416	231	1,860	796
Interest expense	5,862	6,694	10,988	14,849
Income before income taxes and other items	77,173	75,007	113,974	140,830
Income taxes	23,390	20,335	35,773	42,354
Net income	53,783	54,672	78,201	98,476
Less: net (income) loss attributable to noncontrolling interests in subsidiaries	(1,952)	(2,157)	(1,050)	(2,216)
Net income attributable to Universal Corporation	51,831	52,515	77,151	96,260
Dividends on Universal Corporation convertible perpetual preferred stock	(3,713)	(3,713)	(7,425)	(7,425)
Earnings available to Universal Corporation common shareholders	$ 48,118	$ 48,802	$ 69,726	$ 88,835
Earnings per share attributable to Universal Corporation common shareholders:				
Basic	$ 2.00	$ 1.97	$ 2.89	$ 3.57
Diluted	$ 1.78	$ 1.77	$ 2.65	$ 3.23
Retained earnings - beginning of year			$ 767,213	$ 686,960
Net income attributable to Universal Corporation			77,151	96,260
Cash dividends declared:				
Series B 6.75% Convertible Perpetual Preferred Stock			(7,425)	(7,425)
Common stock (2010 - $0.94 per share; 2009 - $0.92 per share)			(22,583)	(22,821)
Dividend equivalents on restricted stock units			(202)	(179)
Repurchase of common stock - cost in excess of stated capital amount			(15,885)	(8,873)
Retained earnings - end of period			$ 798,269	$ 743,922

See accompanying notes.

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

	September 30, 2010 (Unaudited)	September 30, 2009 (Unaudited)	March 31, 2010
ASSETS			
Current			
Cash and cash equivalents	$ 43,816	$ 61,991	$ 245,953
Accounts receivable, net	315,290	293,985	266,960
Advances to suppliers, net	128,923	89,169	167,400
Accounts receivable - unconsolidated affiliates	68,493	39,199	11,670
Inventories - at lower of cost or market:			
Tobacco	1,076,984	919,842	812,186
Other	64,792	66,039	52,952
Prepaid income taxes	11,075	23,544	13,514
Deferred income taxes	47,342	48,503	47,074
Other current assets	74,227	74,236	75,367
Total current assets	1,830,942	1,616,508	1,693,076
Land	15,866	16,188	16,036
Buildings	266,298	259,596	266,350
Machinery and equipment	551,551	523,380	532,824
	833,715	799,164	815,210
Less accumulated depreciation	(503,859)	(476,256)	(485,723)
	329,856	322,908	329,487
Other assets			
Goodwill and other intangibles	105,444	106,036	105,561
Investments in unconsolidated affiliates	107,588	120,608	106,336
Deferred income taxes	30,177	15,080	30,073
Other noncurrent assets	90,431	115,342	106,507
	333,640	357,066	348,477
Total assets	$ 2,494,438	$ 2,296,482	$ 2,371,040

See accompanying notes.

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

	September 30, 2010 (Unaudited)	September 30, 2009 (Unaudited)	March 31, 2010
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current			
Notes payable and overdrafts	$ 372,727	$ 301,376	$ 177,013
Accounts payable and accrued expenses	214,339	214,729	259,576
Accounts payable - unconsolidated affiliates	140	6,988	6,464
Customer advances and deposits	86,628	70,089	107,858
Accrued compensation	17,559	22,581	30,097
Income taxes payable	15,656	11,574	18,991
Current portion of long-term obligations	100,000	—	15,000
Total current liabilities	807,049	627,337	614,999
Long-term obligations	326,466	331,905	414,764
Pensions and other postretirement benefits	100,899	86,888	96,888
Other long-term liabilities	52,936	73,845	69,886
Deferred income taxes	45,459	55,035	46,128
Total liabilities	1,332,809	1,175,010	1,242,665
Shareholders' equity			
Universal Corporation:			
Preferred stock:			
Series A Junior Participating Preferred Stock, no par value, 5,000,000 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, 2009, and March 31, 2010)	213,023	213,023	213,023
Common stock, no par value, 100,000,000 shares authorized, 23,908,085 shares issued and outstanding (24,715,901 at September 30, 2009, and 24,325,228 at March 31, 2010)	194,523	195,227	195,001
Retained earnings	798,269	743,922	767,213
Accumulated other comprehensive loss	(51,122)	(36,745)	(52,667)
Total Universal Corporation shareholders' equity	1,154,693	1,115,427	1,122,570
Noncontrolling interests in subsidiaries	6,936	6,045	5,805

Total shareholders' equity	1,161,629	1,121,472	1,128,375
Total liabilities and shareholders' equity	$ 2,494,438	$ 2,296,482	$ 2,371,040

See accompanying notes.

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

	Six Months Ended September 30, 2010	Six Months Ended September 30, 2009
	(Unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 78,201	$ 98,476
Adjustments to reconcile net income to net cash used by operating activities:		
Depreciation	21,516	20,524
Amortization	814	1,020
Provisions for losses on advances and guaranteed loans to suppliers	7,363	8,827
Foreign currency remeasurement loss (gain), net	(183)	8,562
Restructuring costs	2,969	—
Other, net	(15,239)	8,562
Changes in operating assets and liabilities, net	(410,647)	(279,720)
Net cash used by operating activities	(315,206)	(133,749)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property, plant and equipment	(23,345)	(26,429)
Proceeds from sale of property, plant and equipment, and other	5,684	2,134
Net cash used by investing activities	(17,661)	(24,295)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Issuance (repayment) of short-term debt, net	190,000	125,997
Repayment of long-term obligations	(10,000)	(79,500)
Issuance of common stock	—	72
Repurchase of common stock	(19,540)	(10,947)
Dividends paid on convertible perpetual preferred stock	(7,425)	(7,425)
Dividends paid on common stock	(22,779)	(22,950)
Net cash provided by financing activities	130,256	5,247
Effect of exchange rate changes on cash	474	2,162
Net decrease in cash and cash equivalents	(202,137)	(150,635)
Cash and cash equivalents at beginning of year	245,953	212,626
Cash and cash equivalents at end of period	$ 43,816	$ 61,991

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 September 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 GAAP 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.

Through September 30, 2010, Universal adopted the following recent 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, 2009. 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.

Pronouncements to be Adopted in Future Periods

In addition to the above accounting pronouncements adopted through September 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 is 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, OTHER CONTINGENT LIABILITIES, AND OTHER MATTERS

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, 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 $87 million ($108 million face amount including unpaid accrued interest, less $21 million recorded for the fair value of the guarantees). About 75% 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 September 30, 2010, was the face amount, $108 million including unpaid accrued interest ($132 million as of September 30, 2009, and $112 million at March 31, 2010). The fair value of the guarantees was a liability of approximately $21 million at September 30, 2010 ($22 million at September 30, 2009, and $26 million at March 31, 2010). In addition to these guarantees, the Company has other contingent liabilities totaling approximately $53 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. A hearing was held in June 2009, and on September 8, 2010, the General Court issued its decision, in which it reduced the amount of the Deltafina fine to €6.12 million. The General Court held in part that the Commission erred in finding Deltafina acted as the leader of the Spanish cartel, and that the Commission's corresponding increase of the underlying fine by 50% was not justified. If either Deltafina or the Commission chooses to appeal the decision of the General Court, such appeal must be filed by November 22, 2010. If the decision is appealed, an ultimate resolution to the matter could take several years. The Company had deposited funds in an escrow account with the Commission in February 2005 in an amount equal to the original fine. The Company has since received funds from escrow in an amount equal to the reduction by the General Court plus interest that had accrued thereon. As a result of the General Court's decision in the appeal, during the quarter ended September 30, 2010, the Company reversed €5.76 million (approximately $7.4 million) of the charge previously recorded to accrue the fine and recognized approximately $1.2 million of interest income returned on the escrow funds. The reversal of the fine is included in selling, general and administrative expense in the consolidated statement of income.

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 $41 million at the September 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 either the Commission's Statement of Objections or the facts. In January 2006, the Company and Deltafina each filed appeals in the General Court of the European Union. Deltafina's appeal was held on September 28, 2010. For strategic reasons related to the defense of the Deltafina appeal, Universal 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 are 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 €4.9 million (about $6.7 million) at September 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.

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.

Assignment of Farmer Contracts in Brazil

In October 2010, Universal's operating subsidiary in Brazil completed the assignment of tobacco production contracts with approximately 8,100 farmers to a subsidiary of Philip Morris International ("PMI"). As part of the transaction, the PMI subsidiary acquired various related assets and hired certain employees who previously worked for the Company in agronomy and leaf procurement functions. The farmer contracts assigned represent approximately 20% of the annual volume handled by the Company in Brazil during the most recent crop year. The Company expects to continue to supply processed leaf and provide processing services in Brazil to PMI and its subsidiaries. The assignment of the farmer contracts and related assets will be reflected in the Company's operating results in the quarter ending December 31, 2010. Total proceeds of approximately $34 million received in the transaction exceeded the net book value of the assets conveyed.

NOTE 4. RESTRUCTURING COSTS

Universal continually reviews its business for opportunities to realize efficiencies, reduce costs, and realign its operations in response to business changes. During the six months ended September 30, 2010, the Company recorded restructuring costs associated with initiatives taken to adjust various operations and reduce costs. Most of the restructuring costs represent employee termination benefits associated with voluntary early retirement offers and involuntary separations that affected 34 positions through September 2010. A summary of the restructuring costs and related payments through September 30, 2010, is as follows:

(in thousands of dollars)	Employee Termination Benefits	Other Costs	Total
Costs charged to expense during fiscal year 2011:			
Quarter ended June 30, 2010	$ 949	$ —	$ 949
Quarter ended September 30, 2010	1,980	40	2,020
Payments during fiscal year 2011:			
Quarter ended September 30, 2010	(1,701)	(40)	(1,741)
Restructuring liability at September 30, 2010	$ 1,228	$ —	$ 1,228

The majority of the restructuring costs relate to operations that are part of the Company's North America and Other Regions reportable segments. Most of the restructuring liability at September 30, 2010, will be paid before the end of the current fiscal year. The Company expects to incur additional restructuring costs and may also incur asset impairment charges in future periods as additional cost savings initiatives are implemented.

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 September 30, 2010	Three Months Ended September 30, 2009	Six Months Ended September 30, 2010	Six Months Ended September 30, 2009
Basic Earnings Per Share				
Numerator for basic earnings per share				
Net income attributable to Universal Corporation	$ 51,831	$ 52,515	$ 77,151	$ 96,260
Less: Dividends on convertible perpetual preferred stock	(3,713)	(3,713)	(7,425)	(7,425)
Earnings available to Universal Corporation common shareholders for calculation of basic earnings per share	48,118	48,802	69,726	88,835
Denominator for basic earnings per share				
Weighted average shares outstanding	24,081	24,801	24,147	24,892
Basic earnings per share	$ 2.00	$ 1.97	$ 2.89	$ 3.57
Diluted Earnings Per Share				
Numerator for diluted earnings per share				
Earnings available to Universal Corporation common shareholders	$ 48,118	$ 48,802	$ 69,726	$ 88,835
Add: Dividends on convertible perpetual preferred stock (if conversion assumed)	3,713	3,713	7,425	7,425
Earnings available to Universal Corporation common shareholders for calculation of diluted earnings per share	51,831	52,515	77,151	96,260
Denominator for diluted earnings per share:				
Weighted average shares outstanding	24,081	24,801	24,147	24,892
Effect of dilutive securities (if conversion or exercise assumed)				
Convertible perpetual preferred stock	4,747	4,732	4,745	4,730
Employee share-based awards	225	162	242	147
Denominator for diluted earnings per share	29,053	29,695	29,134	29,769
Diluted earnings per share	$ 1.78	$ 1.77	$ 2.65	$ 3.23

For the six months ended September 30, 2010 and 2009, certain employee share-based awards were not included in the computation of diluted earnings per share because their effect would have been anti-dilutive. These awards included stock appreciation rights and stock options totaling 725,401 shares at a weighted-average exercise price of $51.15 for the period ended September 30, 2010, and 725,201 shares at a weighted-average exercise price of $50.33 for the period ended September 30, 2009.

NOTE 6. 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, 2010	Three Months Ended September 30, 2009	Six Months Ended September 30, 2010	Six Months Ended September 30, 2009
Net income	$ 53,783	$ 54,672	$ 78,201	$ 98,476
Foreign currency translation adjustment	12,567	5,448	1,161	13,592
Foreign currency hedge adjustment	2,663	3,056	465	14,268
Total comprehensive income	69,013	63,176	79,827	126,336
Less: comprehensive income attributable to noncontrolling interests in subsidiaries (including foreign currency translation adjustment)	(2,062)	(2,199)	(1,131)	(2,274)
Comprehensive income attributable to Universal Corporation	$ 66,951	$ 60,977	$ 78,696	$ 124,062

NOTE 7. INCOME TAXES

The Company is subject to the tax laws of many jurisdictions. Changes in tax laws or the interpretation of tax laws can affect the Company's earnings, as can the resolution of pending and contested tax issues. The consolidated income tax rate is affected by a number of factors, including the mix of domestic and foreign earnings and investments, local tax rates of subsidiaries, repatriation of foreign earnings, and the Company's ability to utilize foreign tax credits.

The Company’s consolidated effective income tax rates on pre-tax earnings were approximately 30% and 31% for the quarter and six months ended September 30, 2010, respectively. The rates were lower than the 35% U.S. statutory rate primarily due to continued earnings of subsidiaries in the Company’s African region, which allowed the recognition of foreign tax credits. For the quarter and six months ended September 30, 2009, the effective income tax rates were approximately 27% and 30%, respectively. In addition to the recognition of foreign tax credits related to subsidiaries in the African region, the effective rates for the periods ended September 2009 benefited from the reversal of income taxes recorded for uncertain tax positions due to the expiration of the statute of limitations for the related tax years.

NOTE 8. DERIVATIVES AND HEDGING ACTIVITIES

Universal is exposed to various risks in its worldwide operations and uses derivative financial instruments to manage two specific types of risks – interest rate risk and foreign currency exchange rate risk. Interest rate risk has been managed by entering into interest rate swap agreements, and foreign currency exchange rate risk has been managed by entering into forward foreign currency exchange contracts. However, the Company’s policy also permits other instruments. In addition, management works to manage foreign currency exchange rate risk by minimizing net monetary positions in non-functional currencies, which may include using local borrowings. The disclosures below provide additional information about the Company’s hedging strategies, the derivative instruments used, and the effects of these activities on the consolidated statements of income and the consolidated balance sheets. In the consolidated statements of cash flows, the cash flows associated with all of these activities are reported in net cash provided (used) by operating activities.

Fair Value Hedging Strategy for Interest Rate Risk

The Company has entered into interest rate swap agreements to manage its exposure to interest rate risk, with a strategy of maintaining a level of floating rate debt that approximates the interest rate exposure on its committed inventories. The strategy is implemented by borrowing at floating interest rates and converting a portion of the Company's fixed-rate debt to floating rates. The interest rate swap agreements allow the Company to receive amounts equal to the fixed interest payments it is obligated to make on the underlying debt instruments in exchange for making floating-rate interest payments that adjust semi-annually based on changes in the benchmark interest rate.

The Company's interest rate swap agreements are designated and qualify as hedges of the exposure to changes in the fair value of the underlying debt instruments created by fluctuations in prevailing market interest rates. In all cases, the critical terms of each interest rate swap agreement match the terms of the underlying debt instrument, and there is no hedge ineffectiveness. The total notional amount of the Company's receive-fixed/pay-floating interest rate swaps was $245 million at September 30, 2010 and March 31, 2010, and $170 million at September 30, 2009.

Cash Flow Hedging Strategy for Foreign Currency Exchange Rate Risk Related to Forecast Purchases of Tobacco and Related Processing Costs

The majority of the tobacco production in most countries outside the United States where Universal operates is sold in export markets at prices denominated in U.S. dollars. However, purchases of tobacco from farmers and most processing costs (such as labor and energy) in those countries are usually denominated in the local currency. Changes in exchange rates between the U.S. dollar and the local currencies where tobacco is grown and processed affect the ultimate U.S. dollar cost of the processed tobacco and therefore can adversely impact the gross profit earned on the sale of that tobacco. Since the Company is able to reasonably forecast the volume, timing, and local currency cost of its tobacco purchases and processing costs, it has routinely entered into forward contracts to sell U.S. dollars and buy the local currency at future dates that coincide with the expected timing of a portion of those purchases and costs. This strategy contemplates the Company's pricing arrangements with key customers and substantially eliminates the variability of future U.S. dollar cash flows for tobacco purchases and processing costs for the foreign currency notional amount hedged. The hedging strategy has been used mainly for tobacco purchases and processing costs in Brazil, where the large crops, the terms of sale to customers, and the availability of derivative markets make it particularly desirable to manage the related foreign exchange rate risk.

For the crops bought, processed, and sold in fiscal years 2010 and 2011, all contracts related to tobacco purchases in Brazil were designated and qualify as hedges of the future cash flows associated with the forecast purchases of tobacco. As a result, except for insignificant amounts related to any ineffective portion of the hedging strategy, changes in fair values of the forward contracts have been recognized in comprehensive income as they occurred, but only recognized in earnings upon sale of the related tobacco to third-party customers. Forward contracts related to processing costs have not been designated as hedges, and gains and losses on those contracts have been recognized in earnings on a mark-to-market basis.

From March through July 2010, the Company hedged approximately $109 million U.S. dollar notional amount related to 2009-2010 crop tobacco purchases in Brazil. Additional forward contracts totaling approximately $58 million U.S. dollar notional amount were entered to mitigate currency exposure on processing costs related to that crop. Purchases of the 2009-2010 crop were completed in July 2010, and all forward contracts to hedge those purchases matured and were settled by that time. All hedge gains and losses recorded in accumulated other comprehensive loss were recognized in cost of goods sold with the sale of tobacco by September 30, 2010. As noted above, changes in the fair values of forward contracts related to processing costs were recognized in earnings each quarter on a mark-to-market basis.

From September 2008 through July 2009, the Company hedged approximately $241 million U.S. dollar notional amount related to 2008-2009 crop tobacco purchases in Brazil, primarily related to customer contractual requirements. Purchases of that crop were completed in July 2009, and all forward contracts related to the crop matured and were settled by that time. Sales of the 2008-2009 crop began during the first quarter of fiscal year 2010 and were completed by the end of the fiscal year. As that tobacco was sold, all hedge gains and losses previously recorded in accumulated other comprehensive loss were reclassified to cost of goods sold.

Hedging Strategy for Foreign Currency Exchange Rate Risk Related to Net Local Currency Monetary Assets and Liabilities of Foreign Subsidiaries

Most of the Company's foreign subsidiaries transact the majority of their sales in U.S. dollars and finance the majority of their operating requirements with U.S. dollar borrowings, and therefore use the U.S. dollar as their functional currency. These subsidiaries normally have certain monetary assets and liabilities on their balance sheets that are denominated in the local currency. Those assets and liabilities can include cash and cash equivalents, accounts receivable and accounts payable, advances to farmers and suppliers, deferred income tax assets and liabilities, recoverable value-added taxes, and other items. Net monetary assets and liabilities denominated in the local currency are remeasured into U.S. dollars each reporting period, generating gains and losses that the Company records in earnings as a component of selling, general and administrative expenses. The level of net monetary assets or liabilities denominated in the local currency normally fluctuates throughout the year based on the operating cycle, but it is most common for monetary assets to exceed monetary liabilities at most times of the year, sometimes by a significant amount. When this situation exists and the local currency weakens against the U.S. dollar, remeasurement losses are generated. Conversely, remeasurement gains are generated on a net monetary asset position when the local currency strengthens against the U.S. dollar. Due to the size of its operations and the fact that it provides significant financing to farmers for crop production, the Company's subsidiary in Brazil has significant exposure to currency remeasurement gains and losses due to fluctuations in exchange rates at certain times of the year. To manage a portion of its exposure to currency remeasurement gains and losses in Brazil during fiscal year 2011, the Company entered into forward contracts to sell the Brazilian currency and buy U.S. dollars at future dates coinciding with expected changes in the overall net local currency monetary asset position of the subsidiary. Gains and losses on the forward contracts were recorded in earnings as a component of selling, general, and administrative expenses as they occurred, and thus directly offset the related remeasurement losses or gains for the notional amount hedged in the consolidated statements of income. Accordingly, the Company did not designate these contracts as hedges for accounting purposes. The notional amount of these contracts totaled approximately $60 million in U.S. dollars. All of the contracts were entered and settled during the quarter ended June 30, 2010. No contracts were entered for this purpose in fiscal year 2010. To further mitigate currency remeasurement exposure, some of the Company's foreign subsidiaries have obtained short-term local currency financing during certain periods. This strategy, while not involving the use of derivative instruments, is intended to minimize the subsidiary's net monetary position by financing a portion of the local currency monetary assets with local currency monetary liabilities and thus hedging a portion of the overall position.

The Company has several foreign subsidiaries that transact the majority of their sales and finance the majority of their operating requirements in their local currency, and therefore use their respective local currencies as the functional currency for reporting purposes. From time to time, these subsidiaries sell tobacco to customers in transactions that are not denominated in the functional currency. In those situations, the subsidiaries routinely enter into forward exchange contracts to offset currency risk for the period of time that a fixed-price order and the related trade account receivable are outstanding with the customer. The contracts are not designated as hedges for accounting purposes.

Effect of Derivative Financial Instruments on the Consolidated Statements of Income

The table below outlines the effects of the Company's use of derivative financial instruments on the consolidated statements of income for the quarters ended September 30, 2010 and 2009.

	Three Months Ended September 30,		Six Months Ended September 30,	
(in thousands of dollars)	2010	2009	2010	2009
Fair Value Hedges - Interest Rate Swap Agreements				
Derivative				
Gain (loss) recognized in earnings	$ 2,919	$ 2,309	$ 6,701	$ 97
Location of gain (loss) recognized in earnings				Interest expense
Hedged Item				
Description of hedged item				Fixed rate long-term debt
Gain (loss) recognized in earnings	$ (2,919)	$ (2,309)	$ (6,701)	$ (97)
Location of gain (loss) recognized in earnings				Interest expense
Cash Flow Hedges - Forward Foreign Currency Exchange Contracts				
Derivative				
Effective Portion of Hedge				
Gain (loss) recorded in accumulated other comprehensive loss	$ 459	$ 777	$ 88	$ 7,162
Gain (loss) reclassified from accumulated other comprehensive loss into earnings	$ 143	$ (3,584)	$ 100	$ (13,218)
Location of gain (loss) reclassified from accumulated other comprehensive loss into earnings				Cost of goods sold
Ineffective Portion and Early De-designation of Hedges				
Gain (loss) recognized in earnings	$ 2	$ (428)	$ 101	$ 1,444
Location of gain (loss) recognized in earnings				Selling, general and administrative expenses
Hedged Item				
Description of hedged item				Forecast purchases of tobacco in Brazil
Derivatives Not Designated as Hedges - Forward Foreign Currency Exchange Contracts				
Contracts related to forecast processing costs and forecast purchases of tobacco, primarily in Brazil				
Gain (loss) recognized in earnings	$ 1,015	$ —	$ 1,202	$ —
Location of gain (loss) recognized in earnings				Selling, general and administrative expenses
Contracts related to net local currency monetary assets and liabilities of subsidiary in Brazil				
Gain (loss) recognized in earnings	$ —	$ —	$ 661	$ —

Location of gain (loss) recognized in earnings	Selling, general and administrative expenses			
Contracts related to fixed-price orders and accounts receivable of non-U.S. dollar subsidiaries				
Gain (loss) recognized in earnings	$ 1,086	$ (18)	$ 342	$ 335
Location of gain (loss) recognized in earnings	Selling, general and administrative expenses			
Total gain (loss) recognized in earnings for forward foreign currency exchange contracts not designated as hedges	$ 2,101	$ (18)	$ 2,205	$ 335

For the interest rate swap agreements designated as fair value hedges, since the hedges have no ineffectiveness, the gain or loss recognized in earnings on the derivative is offset by a corresponding loss or gain on the underlying hedged debt. For the forward foreign currency exchange contracts designated as cash flow hedges of tobacco purchases in Brazil, no hedge gain or loss remained in accumulated other comprehensive loss at September 30, 2010.

Effect of Derivative Financial Instruments on the Consolidated Balance Sheets

The table below outlines the effects of the Company's derivative financial instruments on the consolidated balance sheets at September 30, 2010 and 2009, and March 31, 2010:

	Derivatives in a Fair Value Asset Position				Derivatives in a Fair Value Liability Position			
	Balance	Fair Value as of			Balance	Fair Value as of		
(in thousands of dollars)	Sheet Location	Sept. 30, 2010	Sept. 30, 2009	March 31, 2010	Sheet Location	Sept. 30, 2010	Sept. 30, 2009	March 31, 2010
Derivatives Designated as Hedging Instruments								
Interest rate swap agreements	Other non-current assets	$ 16,466	$ 11,905	$ 10,358	Long-term obligations	$ —	$ —	$ 593
Forward foreign currency exchange contracts	Other current assets	—	—	84	Accounts payable and accrued expenses	—	—	73
Total		$ 16,466	$ 11,905	$ 10,442		$ —	$ —	$ 666
Derivatives Not Designated as Hedging Instruments								
Forward foreign currency exchange contracts	Other current assets	$ 579	$ 741	$ 740	Accounts payable and accrued expenses	$ 400	$ 10	$ 512
Total		$ 579	$ 741	$ 740		$ 400	$ 10	$ 512

NOTE 9. FAIR VALUE MEASUREMENTS

Universal measures certain financial and nonfinancial assets and liabilities at fair value based on applicable accounting guidance. The financial assets and liabilities measured at fair value include money market funds, trading securities associated with deferred compensation plans, interest rate swap agreements, forward foreign currency exchange contracts, and guarantees of bank loans to tobacco growers. The application of the fair value guidance to nonfinancial assets and liabilities primarily includes assessments of goodwill and long-lived assets for potential impairment.

Under the accounting guidance, 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:

Level	Description
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; and
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.

At September 30, 2010, 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:

	September 30, 2010			
(in thousands of dollars)	Level 1	Level 2	Level 3	Total
Assets:				
Trading securities associated with deferred compensation plans	$ 19,337	$ —	$ —	$ 19,337
Interest rate swaps	—	16,466	—	16,466
Forward foreign currency exchange contracts	—	579	—	579
Total assets	$ 19,337	$ 17,045	$ —	$ 36,382
Liabilities:				
Guarantees of bank loans to tobacco growers	$ —	$ —	$ 21,224	$ 21,224
Forward foreign currency exchange contracts	—	400	—	400
Total liabilities	$ —	$ 400	$ 21,224	$ 21,624

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.

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, 2010, is as follows:

(in thousands of dollars)		Six Months Ended September 30, 2010
Balance at beginning of year	$	25,997
Transfer to allowance for loss on direct loans to farmers (removal of prior crop year loans from portfolio and addition of current crop year loans)		(6,288)
Change in discount rate and estimated collection period		674
Currency remeasurement		841
Balance at end of period	$	21,224

The effects of currency remeasurement and the change in discount rate and estimated collection period are recorded in earnings and reported in selling, general, and administrative expense. Universal has not elected to report at fair value

any financial instruments or other items not otherwise required to be reported at fair value under current accounting guidance.

NOTE 10. 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.

The components of the Company's net periodic benefit cost were as follows:

	Pension Benefits Three Months Ended September 30,		Other Postretirement Benefits Three Months Ended September 30,	
(in thousands of dollars)	2010	2009	2010	2009
Service cost	$ 1,242	$ 1,026	$ 204	$ 164
Interest cost	3,556	3,698	625	706
Expected return on plan assets	(3,703)	(3,455)	(36)	(38)
Net amortization and deferral	997	244		