UNIVERSAL CORP /VA/
Form 10-K
May 30, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended March 31, 2007.

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)

Virginia	**54-0414210**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification Number)**
1501 North Hamilton Street,	**23230**

Richmond, Virginia
(Address of principal executive offices) **(Zip Code)**
Registrant s telephone number, including area code: 804-359-9311

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, no par value	**New York Stock Exchange**
Preferred Share Purchase Rights	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes x No ¨

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

The aggregate market value of the registrant s common stock held by non-affiliates was approximately $708 million at September 30, 2006.

As of May 25, 2007, the total number of shares of common stock outstanding was 27,026,971.

DOCUMENTS INCORPORATED BY REFERENCE

Certain information contained in the 2007 Proxy Statement for the Annual Meeting of Shareholders of the registrant is incorporated by reference into Part III hereof.

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PART I

General

This Form 10-K, which we refer to herein as our Annual Report, contains 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 Universal Corporation s financial condition, results of operations and future business plans, operations, opportunities, and prospects. In addition, Universal Corporation 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 sim 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 our 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 description of factors that may cause actual results to differ materially from such forward-looking statements, see Item 1A, Risk Factors. 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. In addition, the discussion of the impact of current trends on our business in Management s Discussion and Analysis of Financial Condition and Results of Operations Other Information Regarding Trends and Management s Actions should be read carefully in connection with evaluating our business and the forward-looking statements contained in this Annual Report.

This Annual Report uses the terms Universal , the Company, we , us , and our to refer to Universal Corporation and its subsidiaries when it is necessary to distinguish among Universal Corporation and its various operating subsidiaries or when any distinction is clear from context.

Item 1. Business
A. The Company

Overview

We are one of the world s leading leaf tobacco merchants and processors, based on volumes handled by our subsidiaries and affiliates. Previously, we also had lumber and building products and agri-products operations; however, we sold the lumber and building product operations, along with a portion of our agri-products operations, on September 1, 2006. In December 2006, we adopted a plan to sell the remaining agri-products operations. One of those agri-products businesses was sold in January 2007, and one was sold in May 2007. The remaining agri-product operations are held for sale. We report the assets and liabilities of the lumber and building products and agri-products businesses as discontinued operations for all periods in the accompanying financial statements. Our worldwide tobacco business, which has been our principal focus since our founding in 1918, now represents our continuing operations. The reportable segments for our flue-cured and burley tobacco operations are North America and Other Regions. Our third reportable segment is Other Tobacco Operations, which comprises our dark tobacco business, our oriental tobacco joint venture, and certain services. We generated approximately $2.0 billion in consolidated revenues and earned approximately $208.7 million in total segment operating income in fiscal year 2007. Universal Corporation is a holding company that operates through numerous directly and indirectly owned subsidiaries. Universal Corporation s primary subsidiary is Universal Leaf Tobacco Company, Incorporated. See Exhibit 21, Subsidiaries of the Registrant, for additional subsidiary information.

Key Operating Principles

We believe that by following several key operating principles we will continue to produce strong results and enhance shareholder value. These key operating principles are:

Low-cost quality producer. Our goal is to be the low-cost producer of quality products and services for our customers. We focus on producing a quality product in a cost-effective manner. We sponsor programs in good agricultural practices, reduction of non-tobacco related materials, and social responsibility, among other programs.

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Strong local management. We operate with strong local management in major leaf tobacco markets. We believe that by having strong local management we can react quickly to changes in market conditions to ensure that we continue to deliver the high quality, reasonably priced products our customers expect.

Strategic alliances. We foster strategic alliances with our major customers to the benefit of all parties. These alliances with major manufacturers are, in our opinion, especially appropriate to the leaf tobacco industry where volume at an appropriate price is a key factor in long-term profitability. However, the need for adequate factory volumes must be balanced with the cost of sourcing incremental volumes in markets where we provide financing to farmers. Alliances permit the optimization of our inventory levels to reduce risk of loss during market downturns by enabling us to target our tobacco purchases against customer purchase indications.

Diversified sources. We strive to maintain diversified sources of leaf tobacco to minimize reliance on any one area so long as customers are willing to support such diversity. Historically, North America, South America, and Africa each have provided between 20% and 30% of the aggregate volume of flue-cured and burley tobacco that we handle. However, because of the decline in Zimbabwe crops in Africa, the South American share increased to about 33% of the aggregate volume that we handled from the 2006 crop. We are ending our direct involvement in the production of flue-cured tobacco in Africa as we have experienced unsatisfactory results from our flue-cured growing projects. We are taking the necessary steps to reduce our costs there.

Financial strength. We believe that our financial strength is important, because it enables us to fund our business efficiently and make investments in our business when an appropriate opportunity is identified. We continually work to improve our credit worthiness.

Additional Information

Our website address is www.universalcorp.com. We post regulatory filings and other documents on this website as soon as reasonably practicable after they are electronically filed with or furnished to the Securities and Exchange Commission. These filings include annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, Section 16 reports on Forms 3, 4, and 5, and any amendments to those reports filed with or furnished to the Securities and Exchange Commission. All such filings on our website are available free of charge. Information on our website is not deemed to be incorporated by reference into this Form 10-K.

In addition, our Corporate Governance Guidelines, Business Ethics Policy, and charters for the Audit Committee, the Executive Committee, the Executive Compensation, Nominating, and Corporate Governance Committee, the Pension Investment Committee, and the Finance Committee are available free of charge to shareholders and the public through the Investors/Corporate Governance section of our website. Printed copies of the foregoing are available to any shareholder upon written request to our Treasurer at the address set forth on the first page of this Annual Report.

B. Description of Business

General

Our business involves selecting, buying, processing, packing, storing, shipping, and financing leaf tobacco for sale to, or for the account of, manufacturers of consumer tobacco products throughout the world. We do not manufacture cigarettes or other consumer tobacco products. Through various operating subsidiaries and unconsolidated affiliates located in tobacco-growing countries around the world, we process and/or sell flue-cured and burley tobaccos, dark air-cured tobaccos, and oriental tobaccos. Flue-cured, burley, and oriental tobaccos are used principally in the manufacture of cigarettes, and dark air-cured tobaccos are used mainly in the manufacture of cigars, pipe tobacco, and smokeless tobacco products. We generate our revenues from product sales, processing fees, and fees for other services. About 80% of our volume is derived from sales to a limited number of large, multinational cigarette manufacturers.

Our sales consist primarily of flue-cured and burley tobaccos. For the fiscal year ended March 31, 2007, our flue-cured and burley operations accounted for 86% of our revenues and 82% of our segment operating income. Flue-cured and burley tobaccos, along with oriental tobaccos, are the major ingredients in American-blend cigarettes. According to industry sources, worldwide cigarette consumption increased, on average, about 0.4% per year during the ten years that ended in 2006. We believe that future increases in worldwide cigarette consumption will have little or no effect on demand for the tobacco we process because of increasing efficiencies in our customers use of leaf. This may mean that demand for flue-cured, burley, and oriental leaf tobacco has peaked and will not grow with current levels of growth in cigarette consumption. Industry data also shows, on average, a 0.2% decrease per year during the ten years ended in 2006 in consumption of American-blend cigarettes, which could indicate a further dampening of demand for burley and oriental tobacco.

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Because unprocessed, or green tobacco, is a perishable product, processing of leaf tobacco is an essential service to our customers. Our processing of leaf tobacco includes grading in the factories, blending, quality picking, separation of leaf lamina from the stems, drying, and packing to precise moisture targets for proper aging. Accomplishing these tasks generally requires investment in plants and machinery in areas where the tobacco is grown. Processed tobacco that has been properly aged can be stored by customers for a number of years prior to use, but most processed tobacco is used within two to three years.

We are a major purchaser and processor in the chief exporting regions for flue-cured and burley tobacco. We estimate that we usually purchase between 25% and 30% of the annual production of such tobaccos in Brazil and between 35% and 45% in Africa. These percentages can change from year to year based on the size, price, and quality of the crops. We also have a major processing facility in the United States, which normally handles between 35% and 45% of U.S. flue-cured and burley tobacco production. In the United States, we sell processed U.S. tobacco to several cigarette manufacturers, and we process U.S. flue-cured and burley tobacco on a fee basis, which we also refer to as toll processing . We participate in the procurement, processing, and sale of oriental tobacco through ownership of a 49% equity interest in what we believe to be the largest oriental leaf tobacco merchant in the world, Socotab, L.L.C. In addition, we maintain a presence, and in certain cases, a leading presence, in virtually all other major tobacco growing regions in the world. We believe that our leading position in the leaf tobacco industry is based on our operations in all of the major source areas, our development of processing equipment and technologies, our financial position, our ability to meet customer demand, and our long-standing relationships with customers. We also have a leading position in worldwide dark tobacco markets. Our dark tobacco operations are located in most of the major producing countries (i.e., the United States, the Dominican Republic, Indonesia, Italy, Nicaragua, Paraguay, the Philippines, and Brazil) as well as other markets. Dark tobaccos are typically used in the manufacture of cigars, pipe tobacco, smokeless tobacco products, and components of certain roll-your-own products.

Sales are made by our sales force and, to a lesser degree, through the use of commissioned agents. Most customers are long-established tobacco product manufacturers.

We conduct our business in varying degrees in a number of countries, including Argentina, Bangladesh, Belgium, Brazil, Canada, the Dominican Republic, France, Germany, Guatemala, Hungary, India, Indonesia, Italy, Malawi, Mexico, Mozambique, the Netherlands, Nicaragua, Paraguay, the People s Republic of China, the Philippines, Poland, Russia, Singapore, South Africa, Spain, Switzerland, Tanzania, the United States, Zambia, and Zimbabwe. In addition, Socotab, L.L.C. has oriental tobacco operations in Bulgaria, Greece, Macedonia, and Turkey.

In the majority of countries where we operate, including Argentina, Brazil, Guatemala, Hungary, Indonesia, Italy, Malawi, Mexico, Mozambique, Philippines, Poland, Tanzania, the United States, Zambia, and Zimbabwe, we contract directly with tobacco farmers or tobacco farmer cooperatives, in most cases before harvest, and thereby take the risk that the delivered quality and quantity may not meet market requirements. Outside the United States, we also provide agronomy services and crop advances of, or for, seed, fertilizer, and other supplies. Tobacco in Canada, and to a certain extent, India, Malawi, the United States, and Zimbabwe, is purchased under an auction system.

We have substantial capital investments in Brazil, and in southern Africa, and the performance of our operations in these regions can materially affect our earnings. For example, in fiscal year 2006, poor crops due to adverse weather conditions and high costs caused by the strong currency in Brazil caused a significant decline in tobacco earnings. See Management s Discussion and Analysis of Financial Condition and Results of Operations Factors that May Affect Future Results, and Risk Factors.

Our foreign operations are subject to international business risks, including unsettled political conditions, expropriation, import and export restrictions, exchange controls, and currency fluctuations. During the tobacco season in many of the countries listed above, we advance funds and guarantee local loans, each in substantial amounts, for the purchase of tobacco. The preponderance of these seasonal advances and loan guarantees terminate in one year or less. Most tobacco sales are denominated in U.S. dollars, thereby reducing our foreign currency exchange risk. See Risk Factors.

For a discussion of recent developments and trends in, and factors that may affect, our business, see Management s Discussion and Analysis of Financial Condition and Results of Operations, and Risk Factors.

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Seasonality

Our operations are seasonal in nature. Tobacco in Brazil is usually purchased from January through July, while the markets in Malawi generally open around April and continue into the fall. Farmers begin to sell U.S. flue-cured tobacco in late July and the marketing season lasts for approximately four months. U.S. burley tobacco farmers deliver their crop from mid-November through mid-February. These different marketing periods reduce the overall seasonality of our business.

We normally operate our processing plants for approximately seven to nine months of the year. During this period, inventories of green tobacco, inventories of redried tobacco, and trade accounts receivable normally reach peak levels in succession. Cash and current liabilities, particularly short-term notes payable to banks and customer advances, are means of financing this expansion of current assets and normally reach their peak usage during this processing period. Our balance sheet at our fiscal year end normally reflects seasonal expansions in working capital in South America, Central America, and Western Europe. However, in recent years later crops in South America have moved South American working capital expansion into the first quarter.

Customers

A material part of our business is dependent upon a few customers. For the year ended March 31, 2007, each of Altria Group, Inc. and Japan Tobacco Inc., including its respective affiliates, accounted for more than 10% of our revenues from continuing operations. The loss of, or substantial reduction in business from, either of these customers or any other significant customer would have a material adverse effect on our results. We have long-standing relationships with these customers.

We had orders from customers for approximately $475 million of our tobacco inventories at March 31, 2007. Based upon historical experience, we expect that at least 90% of such orders will be delivered during the following twelve months. Delays in the delivery of orders can result from such factors as changing customer requirements for shipment, container availability, and port access.

We recognize sales and revenue at the time that title to the tobacco and risk of loss passes to our customer. Individual shipments may be large, and since the customer typically specifies shipping dates, our financial results may vary significantly between reporting periods due to timing of sales.

Competition

The leaf tobacco industry is highly competitive. Competition among leaf tobacco merchants is based on the ability to satisfy customer specifications in the buying, processing, and financing of tobacco, as well as the price charged for products and services. Competition varies depending on the market or country involved. The number of competitors varies from country to country, but there is competition in most areas to buy the available tobacco. Our principal competitor is Alliance One International, Inc. (Alliance One). Alliance One operates in many of the countries where we operate. We believe that we hold the larger worldwide market share based on volume handled by our subsidiaries and affiliates. However, the market shares do not differ substantially between the two companies. British American Tobacco p.l.c., a multinational tobacco product manufacturer, has subsidiaries that also compete with us in some markets. In most major markets, smaller competitors are very active. These competitors typically have lower overhead requirements and provide less support to farmers. Due to their lower cost structures, they can often offer a price on products that is lower than our price. However, we believe that we provide quality controls that are necessary for our customers and make our products highly competitive.

Reportable Segments

We evaluate the performance of our business by geographic region, although the dark air-cured and oriental tobacco businesses are each evaluated on the basis of their worldwide operations. Performance of the oriental tobacco operations is evaluated based on our equity in the pretax earnings of our affiliate. Under this structure, we have the following primary operating segments: North America, South America, Africa, Europe, Asia, Dark Air-Cured, Special Services, and Oriental. North America, South America, Africa, Europe, and Asia are primarily involved in flue-cured and/or burley leaf tobacco operations for supply to cigarette manufacturers. Dark Air-Cured supplies dark air-cured tobacco to manufacturers of cigar, pipe tobacco, and smokeless tobacco products, and Oriental supplies oriental tobacco to cigarette manufacturers. From time to time, the segments may trade in tobaccos that differ from their main varieties, but those activities are not significant to their overall results. Special Services provides just-in-time inventory services for certain customers and laboratory services including physical and chemical product testing for customers.

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The five regional operating segments serving our cigarette manufacturer customer base share similar characteristics in the nature of their products and services, production processes, class of customer, product distribution methods, and regulatory environment. Based on the applicable accounting guidance, four of the regions South America, Africa, Europe, and Asia are aggregated into a single reporting segment, Other Regions, because they also have similar economic characteristics. North America is reported as an individual operating segment because its economic characteristics are dissimilar from the other regions, as its operations do not require significant working capital investments for crop financing and inventory, and toll processing is an important source of its operating income. The Dark Air-Cured, Special Services, and Oriental segments, which have dissimilar characteristics in some of the categories mentioned above, are reported as Other Tobacco Operations because each is below the measurement threshold for separate reporting.

Financial Information about Segments

Our North America and Other Regions segments, which are part of our flue-cured and burley tobacco operations, accounted for 17% and 68% of our revenues and 19% and 63% of our segment operating income, respectively, in fiscal year 2007. Our Other Tobacco Operations segment accounted for 14% of our revenues and 18% of our segment operating income in fiscal year 2007. Sales and other operating revenues and operating income attributable to our reportable segments for each of the last three fiscal years along with segment assets for each reportable segment at March 31, 2007, 2006, and 2005, are set forth in Note 14 to our consolidated financial statements, which are included in this Annual Report. Information with respect to the geographic distribution of our revenues and long-lived assets is also set forth in Note 14 to our consolidated financial statements.

C. Employees

We employed over 25,000 employees throughout the world during the fiscal year ended March 31, 2007. This figure is estimated because the majority of our personnel are seasonal employees.

D. Research and Development

No material amounts were expended for research and development during the fiscal years ended March 31, 2007, 2006, or 2005.

E. Patents, etc.

We hold no material patents, licenses, franchises, or concessions.

F. Government Regulation, Environmental Matters and Other Matters

Our business is subject to general governmental regulation in the United States and in foreign jurisdictions where we conduct business. Such regulation includes, but is not limited to, matters relating to environmental protection. To date, governmental provisions regulating the discharge of material into the environment have not had a material effect upon our capital expenditures, earnings, or competitive position. See Risk Factors for a discussion of government regulations and other factors that may affect our business.

Item 1A. Risk Factors

Operating Factors

The leaf tobacco industry is highly competitive, and we are heavily reliant on a few large customers.

We are one of two major independent global competitors in the highly competitive leaf tobacco industry, both of whom are reliant upon a few large customers. The loss of one of those large customers or a significant decrease in their respective demand for our products or services could significantly decrease our sales of products or services, which would have a material adverse effect on our results of operations. The competition among leaf tobacco merchants is based on the ability to meet customer specifications in the buying, processing, and financing of tobacco, as well as the price charged for products and services. However, because we, like our competitors, rely upon a few significant customers, the consolidation or failure of any of these large or significant customers could contribute to a significant decrease in our sales of products and services.

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We are seeing an increase in competition from small competitors in some of the markets where we conduct business. These small competitors typically have lower overhead requirements. They provide little or no support to farmers. Due to their lower cost structures, they often can offer a price on products that is lower than our price. If our customers shift significant purchases to these smaller competitors, our financial results could be negatively impacted.

Our financial results can be significantly affected by changes in the balance of supply and demand for leaf tobacco.

Because we are a leaf tobacco merchant, our financial results can be significantly affected by changes in the overall balance of worldwide supply and demand for leaf tobacco. The demand for tobacco, which is based upon customers expectations of their future requirements, can change from time to time depending upon internal and external factors affecting the demand for their products. Our customers expectations, and thus their demand for leaf tobacco, are influenced by a number of factors, including:

- trends in the global consumption of cigarettes,
- trends in sales of cigars and other tobacco products, and
- levels of competition among our customers.

The total supply of tobacco at any given time is a function of current tobacco production, inventories held by manufacturers, and the volumes of uncommitted stocks of processed tobacco from prior years production. Production of tobacco in a given year may be significantly affected by such factors as:

- the amount of tobacco planted by farmers throughout the world,
- weather and natural disasters, and
- crop disease.

Any significant change in these factors could cause a material imbalance in the supply and demand for tobacco, which would affect our results of operations.

Our financial results will vary according to growing conditions, customer requirements, and other factors. These factors also reduce the ability to gauge our performance and increase the risk of an investment in Universal.

Our financial results, particularly the quarterly financial results, may be significantly affected by fluctuations in tobacco growing seasons and crop sizes. The cultivation of tobacco is dependent upon a number of factors, including weather and other natural events, and our processing schedule and results of operations can be significantly altered by these factors.

Further, the timing and unpredictability of customer orders and shipments may require us to keep tobacco in inventory, increase our risk, and result in variations in quarterly and annual financial results. We base sales recognition on the passage of ownership, usually with shipment of product. Since individual shipments may represent significant amounts of revenue, our quarterly and annual financial results may vary significantly depending on the needs and shipping instructions of our customers. These fluctuations result in varying volumes and sales in given periods, which also reduce the comparability of financial results for different periods or for the same periods in different years.

Major shifts in customer requirements for tobacco supply may significantly affect our operating results.

If our customers significantly alter their requirements for tobacco volumes from certain regions, we may have to change our production facilities and alter our fixed asset base in certain origins. Permanent or long-term reduction in demand for tobacco from origins where we have operations may trigger restructuring and impairment charges. We may also need to make significant capital investments in other regions to develop the needed infrastructure to meet customer supply requirements.

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In areas where we purchase leaf tobacco directly from farmers, we bear the risk that the tobacco we receive will not meet quality and quantity requirements.

When we contract directly with tobacco farmers or tobacco farmer cooperatives, which is the method we use to purchase tobacco in most countries, we bear the risk that the tobacco delivered may not meet customer quality and quantity requirements. If the tobacco does not meet such market requirements, we may not be able to meet all of our customers orders, which would have an adverse effect on profitability and results of operations. Because in a contract market we buy all of the farmers production which encompasses many styles and customer orders, we also have a risk that not all of that production will be readily marketable. In addition, in many foreign countries, when we purchase tobacco directly from farmers, we provide them with financing. Unless we receive marketable tobacco that meets the quality and quantity specifications of our customers, we bear the risk that we will not be able to fully recover our crop advances or recover them in a reasonable period of time. Although we purchase a portion of our leaf tobacco through public auction, as well as privately-negotiated contract purchases, several countries where auction markets are used today may be moving toward direct purchasing, thus increasing the areas subject to this risk.

Weather and other conditions can affect the marketability of our products.

Tobacco is subject to vagaries of the weather and the environment that can, in some cases, change the quality or size of the crops. If a weather event is particularly severe, such as a major drought or hurricane, the affected crop could be destroyed or damaged to an extent that it would be less desirable to manufacturers, which would result in a reduction in revenues. If such an event is also widespread, it could affect our ability to acquire the quantity of products required by our customers. In addition, other items can affect the marketability of tobacco, including, among other things, the presence of:

- foreign matter,
- genetically modified organisms, and
- excess residues of pesticides, fungicides, and herbicides.

A significant event impacting the condition or quality of a large amount of any of the crops that we buy could make it difficult for us to sell these products or to fill customers orders.

Regulatory and Governmental Factors

Government efforts to reduce tobacco consumption could have a significant impact on the businesses of our customers, which would, in turn, affect our results of operations.

The U.S. federal government and certain state and local governments have taken or proposed actions that may have the effect of reducing U.S. consumption of tobacco products and indirectly reducing demand for our products and services. These activities have included:

- the U.S. Environmental Protection Agency s decision to classify environmental tobacco smoke as a Group A (known human) carcinogen,
- restrictions on the use of tobacco products in public places and places of employment,
- proposals to have the U.S. Food and Drug Administration regulate nicotine as a drug and sharply restrict tobacco product advertising and promotion,

proposals to increase the federal, state, and local excise taxes on cigarettes and other tobacco products,

federal and state government litigation and other actions, including the creation of the Master Settlement Agreement (MSA) in the late 1990s, to recoup monies from tobacco product manufacturers to pay for the health care costs associated with tobacco product usage and environmental tobacco smoke exposure,

efforts by states attorneys general to enforce and/or amend certain sections of the MSA, and

the policy of the U.S. government to link certain federal grants to the enforcement of state laws restricting the sale of tobacco products.

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Numerous other legislative and regulatory anti-smoking measures have been proposed at the federal, state, and local levels. Excluding the effect of tobacco contained in cigarettes imported into the United States, we estimate that historically between 12% and 15% of the flue-cured and burley tobaccos that we handle worldwide are ultimately consumed in the United States. Flue-cured and burley tobacco operations provide 86% of our revenues.

A number of foreign governments and global non-government organizations also have taken or proposed steps to restrict or prohibit tobacco product advertising and promotion, to increase taxes on tobacco products, and to discourage tobacco product consumption. A number of such measures are included in the Framework Convention on Tobacco Control (FCTC), which was negotiated and promoted globally under the auspices of the World Health Organization (WHO). We cannot predict the extent to which the efforts of governments or non-governmental agencies to reduce tobacco consumption might affect the business of our primary customers. However, a significant decrease in worldwide tobacco consumption brought about by existing or future governmental laws and regulations would reduce demand for our products and services and could have a material adverse effect on our results of operations.

Government actions can have a significant effect on the sourcing of tobacco. If some of the current efforts are successful, we could have difficulty obtaining sufficient tobacco to provide for our customers requirements, which could have an adverse effect on our performance and results of operations.

Various proposals to reform U.S. immigration laws could impact the number of legal temporary agricultural workers entering the United States to work on tobacco producing farms. In addition, the WHO, through the FCTC, has created a formal study group to identify and assess crop diversification initiatives and alternatives to leaf tobacco growing in countries whose economies depend upon tobacco production. The study group began its work in February 2007. If the amount of legal temporary agricultural workers allowed into the United States were further restricted or if certain countries were to partner with the FCTC study group and seek to eliminate or significantly reduce leaf tobacco production, we could encounter difficulty in sourcing leaf tobacco to fill customer requirements, which could have an adverse effect on our results of operations.

Because we conduct a significant portion of our operations internationally, political uncertainties in certain countries could have an adverse effect on our performance and results of operations.

Our international operations are subject to uncertainties and risks relating to the political stability of certain foreign governments, principally in developing countries and emerging markets, and to the effects of changes in the trade policies and economic regulations of foreign governments. These uncertainties and risks, which include, among other factors, undeveloped or antiquated commercial law and the expropriation or nationalization of assets, may adversely impact our ability to effectively manage our operations in those countries. For example, in the past, we have experienced significant year-to-year fluctuations in earnings due to changes in the Brazilian government s economic policies, and government actions in Zimbabwe have reduced the tobacco crop there, causing us to shift sourcing of tobacco to other countries. Over the last two years, market disruptions in Malawi have made operations there less certain. We have substantial capital investments in South America and Africa, and the performance of our operations in those regions can materially affect our earnings from tobacco operations. If the political situation in any of the countries where we conduct business were to deteriorate significantly, our ability to recover assets located there could be impaired. To the extent that we do not replace any lost volumes of tobacco with tobacco from other sources, or we incur increased costs related to such replacement, our results of operations would suffer.

Changes in tax laws in the countries where we do business may adversely affect our results of operations.

Through our subsidiaries, we are subject to the tax laws of many jurisdictions. Changes in tax laws or the interpretation of tax laws can affect our earnings, as can the resolution of various pending and contested tax issues. For example, changes in tax law in the state of Rio Grande do Sul in Brazil, which limit the amount of tax credits generated on interstate sales of tobacco in Brazil increased our cost of doing business in that country in fiscal years 2005 and 2006. See Note 13 of Notes to Consolidated Financial Statements for additional information on this tax.

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Financial Factors

Failure of our customers or farmers to repay extensions of credit could materially impact our results of operations.

We extend credit to both farmers and customers. A significant delay in payment or a significant bad debt provision related to amounts due could adversely affect our results of operations. In addition, crop advances to farmers are generally secured by the farmers agreement to deliver green tobacco. In the event of crop failure or permanent reductions in crop sizes, full recovery of advances may never be realized, or otherwise could be delayed until future crops are delivered.

Fluctuations in foreign currency exchange rates may affect our results of operations.

We account for most of our tobacco operations using the U.S. dollar as the functional currency. The international tobacco trade generally is conducted in U.S. dollars. This limits foreign exchange risk to that which is related to production costs, overhead, and income taxes in the source country. In certain tobacco markets that are primarily domestic, we use the local currency as the functional currency. Examples of these domestic markets are Hungary and Poland. In these domestic markets, reported earnings are affected by the translation of the local currency into the U.S. dollar. See also Qualitative and Quantitative Disclosure About Market Risk.

Our purchases of tobacco are often made in local currency, and we also provide farmer advances that are denominated in the local currency. Currency gains or losses on those advances, which are period costs, are usually offset by decreases or increases in the cost of tobacco, which is priced in the local currency. However, the effects of differences in the cost of tobacco are generally not realized until the tobacco is sold, which often occurs in a subsequent quarter or fiscal year. The difference in timing could affect our profitability in a given quarter or fiscal year.

Changes in exchange rates can also make a particular crop more or less expensive in U.S. dollar terms. If a particular crop is viewed as expensive in U.S. dollar terms, it may be less attractive in the world market. This could negatively affect the profitability of such crop and our results of operations.

Because there is no forward foreign exchange market in many of the major countries where we source tobacco, we often manage our foreign exchange risk by matching funding for inventory purchases with the currency of sale and by minimizing our net investment in these countries. To the extent that we have net monetary assets or liabilities in local currency, we may have currency remeasurement gains or losses that will affect our results of operations.

Changes in interest rates may affect our results of operations.

In our business, customers usually pre-finance purchases or pay market rates of interest for inventory purchased on order. We borrow long-term debt to reduce liquidity issues. Through hedging agreements, we swap the interest rates on our existing fixed-rate debt to floating market interest rates to better match the interest rates that we charge our customers. To the extent we are unable to match these interest rates, a decrease in short-term interest rates could increase our net financing costs.

Item 1B. Unresolved Staff Comments

None

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Item 2. Properties

Except as noted, we own the following significant properties (greater than 500,000 square feet):

Location	Principal Use	Area (Square Feet)
Flue-Cured and Burley Leaf Tobacco Operations:		
North America:		
United States		
Nash County, North Carolina	Factory and storages	1,244,000
Canada		
Simcoe	Factory and storages	569,000
Other Regions:		
Brazil		
Santa Cruz	Factory and storages	2,770,000
Joinville(1)	Factory and storages	1,075,000
Venancio Aires	Storages	860,000
Malawi		
Lilongwe	Factory and storages	673,000
Mozambique		
Tete	Factory and storages	762,000
Tanzania		
Morogoro	Factory and storages	779,000
Zimbabwe		
Harare(2)	Factory and storages	1,065,000
Other Tobacco Operations:		
United States		
Lancaster, Pennsylvania	Factory and storages	636,000

(1) Leased from a third party

(2) Owned by an unconsolidated subsidiary.

We own the land and building located at 1501 North Hamilton Street in Richmond, Virginia, where we are headquartered. The building contains approximately 83,000 square feet of floor space, which is adequate for our needs.

Our business involves, among other things, storing and processing green tobacco and storing processed tobacco. We operate processing facilities in major tobacco growing areas. In addition, we require tobacco storage facilities that are in close proximity to the processing facilities. We own most of the tobacco storage facilities, but we lease additional space, as the need arises, and expenses related to such leases are not material. We believe that the properties currently utilized in our tobacco operations are maintained in good operating condition and are suitable and adequate for our purposes at our current volumes.

In addition to our significant properties listed above, we own other processing facilities in the following countries: Germany, Hungary, Italy, the Netherlands, the Philippines, Poland, and the United States. In addition, we have ownership interests in processing plants in Guatemala and Mexico and have access to processing facilities in other areas, such as Argentina, India, the People s Republic of China, Spain, and Zambia. Socotab L.L.C., a joint venture in which we own a minority interest, owns two oriental tobacco-processing plants in both Turkey and Macedonia and one each in Greece and Bulgaria.

Except for the Lancaster, Pennsylvania facility, the facilities described above are engaged primarily in processing tobacco used by manufacturers in the production of cigarettes. The Lancaster facility and another facility in Virginia, as well as facilities in Brazil, the Dominican Republic, Indonesia, Nicaragua, Paraguay, and the Philippines, process tobacco used in making cigar, pipe, and smokeless products, as well as components of certain roll-your-own products.

Item 3. 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 (approximately $27 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 approximately $14.9 million 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 main ground of appeal is that the Commission erred in imposing liability on Deltafina as a cartel participant, particularly as the cartel leader, when Deltafina was not an actual party to the agreement and was incapable of acting in the relevant market. In addition, Deltafina argues that (i) the Commission failed to allege that Deltafina was a member of the cartel and cartel leader prior to issuing its decision, thereby impairing Deltafina s right to defend itself, and (ii) that the Commission failed to try to prove that the practices affected trade between Member States of the European Community. The appeal also argues that the Commission incorrectly calculated the amount of the Deltafina fine. The appeal process is likely to take several years to complete, and the ultimate outcome is uncertain. 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.

European Commission Fines in Italy

In 2002, we reported that we were aware that the Commission was investigating certain aspects of the tobacco leaf 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 the disclosure would affect Deltafina s immunity. On November 15, 2005, we received notification that the Commission had imposed fines totaling 30 million (about $41 million) 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 with the Commission s Statement of Objections and 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 in order to stay execution during the appeals process. A cash deposit of 8 million (about $11 million) secures a portion of the bank guarantee.

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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. At this time, the payments involved appear to have approximated $1 million over a five-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 has 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 whether the authorities will determine that violations have occurred, and if they do, what sanctions they might 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 our results of operations in any quarter. We will continue to cooperate with the authorities in these matters.

Employment Litigation Verdict

In September 2006, a California jury decided a case involving an employment matter at one of our agri-products subsidiaries in favor of the plaintiffs and awarded them compensatory damages of approximately $0.2 million and punitive damages of $25 million. In December 2006, the trial court granted our motion to substantially reduce the punitive damages to approximately $1.25 million, bringing the total amount of the award to approximately $1.45 million. Universal Corporation and the other defendants also filed a notice of appeal, as we believed there were errors in the decision of the court despite the significant reduction in punitive damages. On May 16, 2007, the plaintiffs agreed with us and the other defendants to a final settlement on all the issues. As part of the settlement, the parties agreed that the terms of the settlement would be confidential.

Other Legal Matters

In addition to the above-mentioned matters, some of our subsidiaries are involved in other litigation incidental to their business activities. While the outcome of these matters cannot be predicted with certainty, we are vigorously defending the claims and do 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 the our results of operations for a particular fiscal reporting period could be material.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the quarter ended March 31, 2007.

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PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Common Equity

Our common stock is traded on the New York Stock Exchange (NYSE) under the symbol UVV. The following table sets forth the high and low sales prices per share of the common stock on the NYSE Composite Tape, based upon published financial sources, and the dividends declared on each share of common stock for the quarter indicated.

		First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2007					
Cash dividends declared		$ 0.43	$ 0.43	$ 0.44	$ 0.44
Market price range	High	38.41	38.63	50.05	61.35
	Low	36.02	35.02	36.14	46.70
2006					
Cash dividends declared		$ 0.42	$ 0.42	$ 0.43	$ 0.43
Market price range	High	48.03	47.70	43.99	48.21
	Low	43.08	38.83	36.31	36.17
2005					
Cash dividends declared		$ 0.39	$ 0.39	$ 0.42	$ 0.42
Market price range	High	53.01	50.14	49.80	50.57
	Low	46.20	42.25	43.31	45.77

Our current dividend policy anticipates the payment of quarterly dividends in the future. However, the declaration and payment of dividends to holders of common stock is at the discretion of the Board of Directors and will be dependent upon our future earnings, financial condition, and capital requirements. Under the terms of the Series B 6.75% Convertible Perpetual Preferred Stock (the Preferred Stock), we may not declare or pay dividends on our common stock unless dividends on the Preferred Stock for the four most recent consecutive dividend periods have been declared and paid. The Preferred Stock contains provisions that prohibit the payment of cash dividends if certain income and shareholders equity levels are not met. Under certain of our credit facilities, we must meet financial covenants relating to minimum tangible net worth and maximum levels of long-term debt. If we were not in compliance with them, these financial covenants could restrict our ability to pay dividends. We were in compliance with all such covenants at March 31, 2007. At May 25, 2007, there were 1,781 holders of record of our common stock. See Notes 7 and 11 of Notes to Consolidated Financial Statements for more information on debt covenants and equity securities.

Purchases of Equity Securities

Neither we nor any affiliated purchasers made any purchases of our equity during the three months ended March 31, 2007.

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Item 6. Selected Financial Data

	Fiscal Years Ended March 31, 2007	2006	2005	Nine-Month Transition Year Ended March 31, 2004	Fiscal Year Ended June 30, 2003
	(in thousands, except per share data, ratios and number of shareholders)				
Summary of Operations					
Sales and other operating revenues	$ 2,007,272	$ 1,781,312	$ 1,667,193	$ 1,272,387	$ 1,590,621
Income (loss) from continuing operations	$ 80,411	$ (2,973)	$ 68,556	$ 84,937	$ 88,545
Income (loss) from discontinued operations	$ (36,059)	$ 10,913	$ 27,457	$ 14,699	$ 22,049
Net income	$ 44,352	$ 7,940	$ 96,013	$ 99,636	$ 110,594
Return on beginning common shareholders equity	3.1%	1.0%	12.6%	16.1% *	18.8%
Earnings (loss) per common share:					
Basic:					
From continuing operations	$ 2.53	$ (0.12)	$ 2.68	$ 3.39	$ 3.48
From discontinued operations	$ (1.39)	$ 0.43	$ 1.08	$ 0.58	$ 0.87
Net income	$ 1.14	$ 0.31	$ 3.76	$ 3.97	$ 4.35
Diluted:					
From continuing operations	$ 2.52	$ (0.12)	$ 2.66	$ 3.36	$ 3.47
From discontinued operations	$ (1.39)	$ 0.43	$ 1.07	$ 0.58	$ 0.87
Net income	$ 1.13	$ 0.31	$ 3.73	$ 3.94	$ 4.34
Financial Position at Year End					
Current ratio	2.23	1.94	1.84	2.05	1.67
Total assets	$ 2,328,822	$ 2,892,664	$ 2,885,324	$ 2,498,408	$ 2,243,074
Long-term obligations	$ 398,952	$ 762,201	$ 838,687	$ 770,296	$ 614,994
Working capital	$ 852,391	$ 877,051	$ 819,047	$ 789,530	$ 550,716
Shareholders equity	$ 1,030,733	$ 964,871	$ 822,388	$ 759,833	$ 620,278
General					
Ratio of earnings to fixed charges	3.32	1.34	3.59	6.14	4.54
Ratio of earnings to combined fixed charges and preference dividends	2.36	1.34	3.59	6.14	4.54
Number of common shareholders	1,807	1,951	2,042	2,126	2,267
Weighted average common shares outstanding:					
Basic	25,935	25,707	25,553	25,072	25,420
Diluted	26,051	25,707	25,717	25,277	25,499
Dividends per share of convertible perpetual preferred stock, annual rate	$ 67.50	$	$	$	$
Dividends per common share	$ 1.74	$ 1.70	$ 1.62	$ 1.14	$ 1.42
Book value per common share	$ 30.34	$ 29.96	$ 32.04	$ 29.86	$ 24.89

* Based on nine-month net income.

The calculations of the ratio of earnings to fixed charges and the ratio of earnings to combined fixed charges and preference dividends are shown in Exhibit 12. Fixed charges primarily represent interest expense we incurred during the designated reporting period, and preference dividends represent the pre-tax equivalent of dividends on preferred stock.

We changed our fiscal year end from June 30 to March 31, effective for fiscal year 2004. Selected financial data for fiscal year 2004 is presented for the nine-month transition year ended March 31, 2004.

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Significant items included in the operating results in the above table are as follows:

Fiscal Year 2007 $30.9 million in impairment charges, primarily related to our review of flue-cured growing projects in Africa and our decision to exit those projects at the end of the 2006-07 crop year. After minority interest and income tax effects, the charges reduced income from continuing operations and net income by $24.2 million, or $0.93 per diluted share. In addition, we recorded provisions for uncollectible farmer advances in Brazil and in several African countries totaling $31.9 million. Over half of those provisions related to the growing projects that we are exiting. The results also included lower of cost or market inventory provisions of $12.8 million related to tobacco produced in those African growing projects. After minority interest and income tax effects, the provisions reduced income from continuing operations and net income by $27.5 million, or $1.06 per diluted share. We also recorded a net loss on the sale of a significant portion of our non-tobacco operations and an impairment charge on the remaining non-tobacco operations held for sale. On a combined basis, those items created a loss from discontinued operations and reduced net income by $44.5 million before income taxes, $45.0 million after tax, or $1.74 per diluted share.

Fiscal Year 2006 $57.5 million in restructuring and impairment charges related to our investment in our Zimbabwe operations, the closure or our Danville, Virginia processing facility, and other cost reduction initiatives, which reduced income from continuing operations and net income by $46.3 million, or $1.80 per diluted share. Results also included significantly higher provisions for losses on uncollectible farmer advances in several African countries, Brazil, and the Philippines that reduced pretax earnings by $26.2 million and lower of cost or market inventory charges of $10.2 million related to African leaf growing projects that we decided to exit in fiscal year 2007. The total of these charges and provisions reduced income from continuing operations and net income by $19.2 million, or $0.75 per diluted share. In addition, significant market price declines in two commodities handled by our agri-products operations (almonds and sunflower seeds) resulted in $17.2 million in inventory valuation and purchase commitment losses that reduced income from discontinued operations and net income by $10.9 million, or $0.42 per diluted share.

Fiscal Year 2005 a $14.9 million charge to recognize fines assessed by the European Commission against two of the Company s subsidiaries related to tobacco buying practices in Spain. The charge reduced income from continuing operations and net income by $14.9 million, or $0.58 per diluted share.

Fiscal Year 2004 a $7.6 million charge related to a customer s rejection of certain shipments of tobacco by a foreign subsidiary. This charge reduced income from continuing operations and net income by $4.9 million, or $0.19 per diluted share. An additional $3.2 million charge was recorded for the rejection of additional shipments that occurred in the following quarter. Results for that quarter were reported as a direct addition to retained earnings due to the year-end change and elimination of the foreign reporting lag. The total charge related to the customer s rejection of these shipments was $10.8 million before taxes, or $7.0 million after taxes.

Fiscal Year 2003 restructuring charges of $33.0 million, a charge of $12.0 million related to the settlement of a lawsuit, a currency remeasurement gain of $20.2 million, and asset sale gains of $6.3 million. These items reduced income from continuing operations and net income by $12.1 million, or $0.48 per diluted share.

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Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of financial condition and results of operations is provided to enhance the understanding of, and should be read in conjunction with, Part I, Item 1, Business and Consolidated Financial Statements and the related Notes. For information on risks and uncertainties related to our business that may make past performance not indicative of future results, or cause actual results to differ materially from any forward-looking statements, see General, and Part I, Item 1A, Risk Factors.

OVERVIEW

We are one of the world s leading independent leaf tobacco merchants and processors. Although we also have agri-products operations, we are holding those operations for sale and consider them to be discontinued operations. We derive most of our revenues from sales of processed tobacco to manufacturers of tobacco products throughout the world and from fees and commissions for specific services.

During the last three fiscal years, we have been operating in an oversupply environment. Fiscal year 2005 marked the beginning of the oversupply in flue-cured tobacco as worldwide production, excluding China, increased by 18%, or about 275 million kgs. The excess tobacco was primarily grown in Brazil where below normal tobacco quality combined with a stronger currency to make that growth less attractive to manufacturers. During the same time, a 16% increase in burley crops, primarily in Malawi and Brazil, resulted in an oversupply of that type of tobacco as well. By the end of fiscal year 2007, markets are in better balance, and burley may be in short supply. Since 2005, we have been working to reduce our crop sizes as the market recovers from the oversupply. In addition, we have reduced U.S. capacity by closing a factory, completed the construction of a factory in Mozambique, reduced overhead, and are ending our direct involvement in the production of flue-cured tobacco in Africa.

Our performance suffered in fiscal year 2006 as a result of weather problems in several countries, which either reduced crop quality or yield; the weakness of the U.S. dollar against several foreign currencies in which we purchase tobacco, which increased costs; unusually high provisions for losses on farmer advances that arose in part because of crop quality; start-up costs related to the new Mozambique factory; and a decline in sales volumes for blended strips, which were no longer required by our customers. In addition, we recorded restructuring and impairment charges related to the closure of our Danville, Virginia, tobacco processing facility and an impairment charge to reduce our investment in our tobacco operations in Zimbabwe to estimated fair value following the deconsolidation of that investment for accounting purposes.

In fiscal year 2007, we continued to work on oversupply issues and significantly reduced our growing projects in Africa. We took several charges related to reducing our crop sizes and our growing projects. We also concentrated on selling uncommitted inventory and improving operating margins. With the sale of most of the non-tobacco operations and the completion of tobacco capital projects, heavy demands for capital have diminished. We have reduced our debt levels and improved our cash flow significantly.

We will continue our efforts to improve operating results in fiscal year 2008. We have made the decision to end our direct involvement in various flue-cured growing projects in Africa and are taking the necessary steps to right-size the operations. Looking ahead, we expect new challenges. We have reduced our Brazilian flue-cured production and the quality of the crop is better, but smaller burley crops in Africa along with higher costs in most of the major producing areas of the world will present challenges for next year. The U.S. dollar continues to be weak against many currencies and although we work with our customers to mitigate the effect of that where we can, it remains a source of higher costs in many areas. In addition, in the current year, our North American operations benefited from the higher sales volume associated with the sale of old-crop burley tobacco, but fiscal year 2008 will not have the same benefit. Tobacco production in Canada has fallen severely over the last few years and is forecast to decline by about one-third for fiscal year 2008. We are continuing to work to reduce our cost structure there. Fiscal year 2008 should not see the same level of impairment and restructuring costs that we have recognized over the last two years. We believe that we have been taking the necessary actions to improve our performance for the long term.

DISCONTINUED OPERATIONS

We previously had operations in lumber and building products and in agri-products. We sold the lumber and building products businesses, along with a portion of the agri-products operations, on September 1, 2006. In December 2006, we adopted a plan to sell the remaining agri-product operations. The lumber and building products operations and agri-products operations are reported as discontinued operations for all periods in the accompanying financial statements, and Management s Discussion and Analysis of Financial Condition and Results of Operations has been revised to reflect the discontinued operations.

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RESULTS OF OPERATIONS

Fiscal Year Ended March 31, 2007, Compared to the Fiscal Year Ended March 31, 2006

For the fiscal year ended March 31, 2007, income from continuing operations was $80.4 million, or $2.52 per diluted share, including the effect of the restructuring and impairment charges recognized throughout the fiscal year. Those charges, which totaled about $31 million, were primarily composed of impairment charges on long-lived assets and Company-managed farming operations in Africa and, combined with related tax effects, reduced net income by $24.2 million, or $0.93 per diluted share. For last year, we reported a loss from continuing operations of $3.0 million, or $0.12 per share, including the effect of restructuring and impairment charges of $57.5 million, or $1.80 per diluted share. Income from continuing operations showed a marked improvement over last year, reflecting better results in all segments. Revenues for fiscal year 2007 increased by about 13%, to $2 billion. Net income for the fiscal year, which includes results from discontinued operations, was $44.4 million, or $1.13 per diluted share, compared to $7.9 million, or $0.31 per diluted share, last year.

Flue-cured and burley operations earned $172 million, up $73 million from last year. Results of the North America segment improved by $15.2 million, and the primary factors causing that improvement were increased export and processing volumes, cost savings related to last year s closure of the Danville, Virginia, facility, one-time sales of tobacco purchased from the stabilization cooperatives, and better pricing. The North America segment also benefited from carryover sales of prior year tobacco. North America revenues increased by $92 million, or 36%, principally due to sales of old crop tobacco. The results of the Other Regions segment increased by $57.7 million, primarily due to better pricing and sales mix. Operating improvements were evident in African operations, in Europe, and in South America. In addition, comparisons benefited from the absence of losses incurred in our Zimbabwe operations prior to their deconsolidation last year and lower remeasurement losses of approximately $11 million. The reduction in remeasurement losses is partly responsible for the reduction in selling, general, and administrative expenses as a percentage of revenues. Finally, results of the Other Regions segment also reflected the favorable resolution of a tax case in South America that resulted in the recovery of $8.5 million in revenue taxes and interest. The recovery was recorded as part of sales and other operating revenues. Provisions for farmer receivables totaled $32 million for Africa and South America, compared to $28.5 million in fiscal year 2006. Of these provisions, over half related to African leaf growing projects that we are exiting. Results also included inventory valuation charges related to African flue-cured tobacco of approximately $13 million in fiscal year 2007 and $10 million in fiscal year 2006. Revenues of the Other Regions segment for the year increased by 9% primarily due to higher sales prices in South America, where we experienced increased farmer prices and a strong local currency.

The Other Tobacco Operations segment also showed substantial improvement for the fiscal year. The dark air-cured operations benefited from higher sales volumes for wrapper and increased leaf sales. The operations also benefited from our decisions to reduce overhead and to close our Colombia dark tobacco operation. Volume attributed to our 49%-owned Oriental tobacco joint venture was lower for the year primarily due to shipment timing. Revenues for this segment increased by $17.7 million in the fiscal year.

Interest income increased to $10.8 million from $2.1 million last year, as we invested excess cash from operations and from the proceeds of the Deli sale pending its use to retire debt and fund seasonal operating requirements.

The consolidated effective income tax rate for continuing operations for the twelve months ended March 31, 2007, was approximately 45%. The rate is higher than the 35% U.S. marginal corporate tax rate due primarily to excess foreign taxes in countries where the tax rate exceeds the U.S. tax rate, low tax benefits provided on a foreign subsidiary with an operating loss, high state income taxes due to improved earnings in the United States, and a limited income tax benefit provided on current year losses in Zambia.

For the fiscal year ended March 31, 2007, the loss from discontinued operations was $36 million, or $1.39 per diluted share. Results from discontinued operations for the fiscal year reflected the operating results and the actual and estimated effects of selling or adopting a plan to sell our non-tobacco businesses, the largest part of which was completed in the second fiscal quarter.

Fiscal Year Ended March 31, 2006, Compared to the Fiscal Year Ended March 31, 2005

Net income for the fiscal year ended March 31, 2006, was $7.9 million, or $0.31 per diluted share, compared to $96 million, or $3.73 per diluted share for the fiscal year ended March 31, 2005. Continuing operations produced a loss after taxes of $3 million or $0.12 per share in fiscal year 2006 compared to income of $68.6 million or $2.66 per share in fiscal year 2005. Restructuring and impairment charges and lower operating income in our Other Regions and Other Tobacco Operations business segments negatively

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impacted results for fiscal year 2006. We recorded $57.5 million ($46.3 million after taxes or $1.80 per diluted share) in restructuring and impairment charges related to the closure of our tobacco processing plant in Danville, Virginia, our overhead reduction program, and our investment in Zimbabwe.

We deconsolidated our operations in Zimbabwe as of January 1, 2006, under U.S. accounting requirements that apply under certain conditions to foreign subsidiaries that are subject to foreign exchange controls and other government restrictions. After deconsolidation, we recorded a non-cash charge of $29.2 million to adjust the investment in those operations to estimated fair value. There was no tax benefit associated with this charge. The investment is now accounted for using the cost method and is reported on the balance sheet in investments in unconsolidated affiliates. Business operations in Zimbabwe were not impacted by the financial reporting change or the non-cash charge, and we intend to continue our operations there. In fiscal year 2006, we closed our Danville, Virginia, processing plant and incurred a restructuring charge of $26.0 million. Additional charges of $2.3 million were related to other cost reduction initiatives. Revenues were $1.8 billion for fiscal year 2006, compared to $1.7 billion in fiscal year 2005.

Other Regions segment results for fiscal year 2006 were down by $61.4 million, or about 45%, compared to fiscal year 2005 due primarily to poor results in South America and Africa. Higher costs due to the relative strength of the Brazilian currency and the poor quality of the crop, caused by adverse weather conditions, combined to reduce operating margins in South America. In Africa, results were impacted by incremental currency remeasurement and exchange losses totaling about $17 million, expenses associated with the factory start-up in Mozambique of approximately $4.2 million, higher overhead costs, and lower margins on burley tobacco sales due to pricing pressures associated with the overhang from the large Malawi burley crop in 2004. In addition, our flue-cured growing projects in Malawi and Zambia were negatively impacted by low crop yields caused by inadequate rainfall. The Zambian projects also suffered higher labor and operating costs generated by the substantial appreciation of the Zambian currency. However, African results were also impacted by increased volume from Tanzania and from carryover shipments of the Malawi crop from fiscal year 2005. Other Regions segment results for fiscal year 2006 also included incremental provisions of about $26.2 million for uncollectible farmer advances, in several African countries, Brazil, and the Philippines. Fiscal year 2005 results reflected a charge of $14.9 million for European Commission fines on certain of our subsidiaries related to tobacco buying practices in Spain, which reduced results for that period by $0.58 per diluted share. In addition, in our Other Tobacco Operations segment, sales volumes of blended strips were lower for the year due to a sharp decline in demand for that product.

Although overall segment operating income was down, results for the North America segment were improved. U.S. operations benefited from operating efficiencies, higher sales volumes, and savings from the closing of the Danville plant. Tobacco revenues increased for the year by about 7% primarily because of carryover shipments of the Malawi crop from fiscal year 2005 and an increase in prices for Brazilian tobacco related to the stronger Brazilian currency.

We did not record a charge for the European Commission fine of 30 million related to green tobacco buying practices in Italy, which was announced in October 2005. Universal Corporation and its Italian subsidiary, Deltafina, were jointly assessed the fine after the European Commission revoked Deltafina s conditional immunity, which had been granted in 2002. Based on consultation with outside counsel, we believe that the terms of the immunity agreement were not breached and that immunity will be restored through the appeal of the decision in the courts. Universal Corporation and Deltafina each have appealed the decision to the Court of First Instance of the European Communities.

Selling, general, and administrative expenses increased at a faster rate than revenues because currency losses and charges for uncollectible supplier advances are included in that line item. Lower incentive compensation accruals, lower executive benefit costs, and a currency gain on a foreign withholding tax refund generated a reduction in costs of $6.2 million. Interest expense was substantially higher for fiscal year 2006 due to higher average borrowing levels and higher short-term interest rates.

The consolidated effective income tax rate for fiscal year 2006 was about 150% compared to 43% for fiscal year 2005. There was no tax benefit associated with the impairment charge to reduce the Company s investment in Zimbabwe, which significantly increased the effective income tax rate for the year. In addition, our effective tax rate remained above the statutory U.S. rate due to excess foreign taxes recorded in countries where the tax rate exceeds the U.S. rate, and local tax expense recorded by a foreign subsidiary with a U.S. dollar loss for fiscal year 2006.

Results for discontinued operations declined by $16.5 million due to the ongoing pricing pressure in DIY markets for lumber and building products in the Netherlands as well as inventory writedowns in sunflower seeds and almonds. Market conditions were favorable in the Dutch construction supply market and in rubber, cashews, and seeds.

Accounting Pronouncements

We adopted the following accounting pronouncements during the fiscal year ended March 31, 2007:

FASB Statement of Financial Accounting Standards No. 123R, Share-Based Payment (SFAS 123R), adopted at the beginning of the fiscal year. SFAS 123R requires that share-based payments, such as grants of stock options, stock appreciation rights, restricted shares, and restricted share units, be measured at fair value and reported as expense in the financial statements over the requisite service period. Previously, we accounted for stock-based compensation awards in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) and did not recognize significant amounts of compensation expense for share-based awards since fixed stock options with an exercise price equal to the market price at date of grant were the primary type of awards granted. We recorded approximately $4.2 million of stock-based compensation expense under SFAS 123R in fiscal year 2007. Additional disclosures are provided in Notes 1 and 12 to the consolidated financial statements.

FASB Statement of Financial Accounting Standards No. 151, Inventory Costs, and amendment of ARB No. 43, Chapter 4 (SFAS 151), also adopted at the beginning of the fiscal year. SFAS 151 amended Accounting Research Bulletin No. 43 (ARB 43) to clarify that abnormal amounts of production-related costs, such as idle facility expense, freight, handling costs, and wasted materials, should be recognized as current-period charges rather than being recorded as inventory cost. SFAS 151 also requires that allocation of fixed production overhead to inventory cost be based on the normal capacity of a company s production facilities. The impact of adopting SFAS 151 was not material to our financial statements.

The recognition and disclosure 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), adopted effective March 31, 2007. The recognition provisions of SFAS 158 require employers who sponsor defined benefit pension or postretirement plans to recognize the overfunded or underfunded status of each plan as an asset or liability in the balance sheet and to recognize actuarial gains and losses and prior service costs and credits that are not included in pension or postretirement benefit expense as a component of comprehensive income. SFAS 158 also has measurement timing provisions that require that the funded status of plans be measured as of the balance sheet date, thereby eliminating the option allowed under the prior guidance to measure the funded status at a date up to 90 days before the balance sheet date. The measurement timing provisions of SFAS 158 are not effective until fiscal years ending after December 15, 2008, and we have not yet adopted them. As a result of adopting the recognition provisions of SFAS 158, our liability for pensions and other postretirement benefits at March 31, 2007, was increased by approximately $44 million, and our balance for accumulated other comprehensive loss was increased by approximately $29 million. Additional disclosures related to the adoption of SFAS 158 are provided in Note 10.

In addition to the accounting pronouncements adopted in fiscal year 2007, the following pronouncements have been issued and will become effective in future periods:

FASB Interpretation 48, Accounting for Uncertainty in Income Taxes (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 requires that positions taken or expected to be taken in tax returns meet a more-likely-than-not threshold 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. FIN 48 is effective for fiscal years beginning after December 15, 2006, and we will adopt it in the first quarter of the fiscal year ending March 31, 2008. We are still in the process of reviewing tax positions throughout our worldwide organization and have not yet quantified the effect of adopting FIN 48 on our financial statements.

FASB Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS 157), which establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 is applicable for fiscal years beginning after November 15, 2007. We are reviewing the guidance in SFAS 157, but currently do not expect that it will have a material effect on our financial statements.

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LIQUIDITY AND CAPITAL RESOURCES

Overview

During fiscal year 2007, we took significant steps to improve operating cash flow and reduce debt. We have begun to see the results of those actions. On September 1, 2006, we completed the sale (the Deli Sale) of the non-tobacco businesses managed by our wholly owned subsidiary Deli Universal Inc. (the Deli Operations). Those businesses were our entire lumber and building products distribution segment and a portion of our agri-products segment. The total value of the transaction was $565 million. After selling and other expenses, we realized a net value of approximately $551 million, consisting of net proceeds of $397 million and the buyer s assumption of $154 million in debt of the acquired businesses. In December 2006, we approved a plan to sell the remaining non-tobacco businesses that were not part of the sale of the Deli Operations. Two of these businesses have been sold, and we expect to sell the remainder within the next nine months. Our financial statements now report the operating results and the assets and liabilities of the non-tobacco businesses as discontinued operations for all periods in the accompanying consolidated financial statements.

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. 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.

Cash Flow

During fiscal year 2007, we generated a significant amount of cash, including $393 million from the sale of non-tobacco businesses and other assets, $246 million from our operations, $70 million from the issuance of equity, primarily pursuant to employee option exercises, and $18 million from discontinued operations, net of debt retired. After using $349 million to reduce debt, spending $25 million on capital projects, and returning $60 million to shareholders in the form of dividends, we invested the remaining cash, pending its use to retire maturing debt and fund seasonal crop needs. At March 31, 2007, we had $313 million in short-term cash investments.

Working Capital

Working capital at March 31, 2007, was $852 million, nearly the same as last year s working capital of $877 million. Accounts receivable increased by about $48 million. Much of the increase was due to late shipments of African tobaccos, which had been delayed by heavy traffic at the port of Beira in Mozambique. Due to changes in the means of funding African operations, accounts receivable unconsolidated affiliates increased by about $20 million year over year. These increases in accounts receivable were offset by reductions in tobacco inventories as we focused on selling old crop leaf. Our uncommitted tobacco inventories increased to approximately $120 million, or about 20% of tobacco inventory due to the weaker U.S. dollar and earlier purchases in one region, compared to $112 million at March 31, 2006, which represented 17% of tobacco inventory. We do not consider these levels excessive. Increases in customer advances and deposits reduced working capital by $35 million. The level of customer advances can vary from year to year as customers review their circumstances. Accordingly, we consider such advances as borrowings when we review our balance sheet structure. Notes payable and overdrafts decreased by $188 million as we used a portion of the proceeds from the Deli sale to repay short-term debt and fund seasonal crop needs. That decrease was largely offset by the change in our current portion of long-term debt, which increased because a $150 million medium-term note will mature in fiscal year 2008.

Capital Spending

Our capital expenditures are generally limited to those that add value for the customer, replace or maintain equipment, increase efficiency, or position us for future growth. Our capital expenditures for continuing operations were approximately $25.2 million in fiscal year 2007, $55.7 million in fiscal year 2006, and $78.9 million in fiscal year 2005. In fiscal years 2006 and 2005, a significant portion of the capital spending was related to the construction of a new factory in Mozambique, which cost over $50 million. That factory was completed and started operations in late summer 2005. We have reduced capital spending to a level below depreciation. We do not foresee that major investments in tobacco processing facilities will be necessary in the near term.

Outstanding Debt and Other Financing Arrangements

Total debt and customer advances decreased by about $360 million during fiscal year 2007, and total debt and customer advances as a percentage of total capitalization (including total debt, customer advances, minority interests, and shareholders equity) decreased to approximately 44% from 55% at March 31, 2006. Net of cash, total debt as a percentage of total capitalization decreased to approximately 31% at March 31, 2007. Total long-term obligations, including current maturities, decreased by $208 million to $563 million, while notes payable decreased by $188 million to $131 million. The reduction in debt, excluding customer advances, is greater than the amounts shown for continuing operations on the statement of cash flows because of the effect of discontinued operations.

Bank Facilities

As of March 31, 2007, we had approximately $621 million in uncommitted lines of credit, of which approximately $490 million were unused and available to support seasonal working capital needs. We also have a five-year committed revolving credit facility totaling $500 million. The facility will mature on January 7, 2010. As of March 31, 2007, we had nothing outstanding under the revolving credit facility. We provide for short-term needs through bilateral bank lines and our revolving credit facility, and we plan to use cash balances to provide for seasonal needs. Under the terms of our bank agreements, we must maintain certain levels of tangible net worth and observe restrictions on debt levels. We were in compliance with all such covenants at March 31, 2007. Our long-term credit ratings are Ba1 with Moody s Investors Service and BBB- with Standard & Poor s.

Derivatives

From time to time, we use interest rate swap agreements to manage our exposure to changes in interest rates. These agreements typically adjust interest rates on designated long-term obligations from fixed to variable. The swaps are accounted for as fair value hedges. At March 31, 2007, our outstanding interest rate swap agreements were not material.

Near the end of fiscal year 2004, we entered a foreign currency swap with a third party to mitigate our exposure to changes in exchange rates related to a foreign currency-denominated receivable from our Dutch non-tobacco subsidiary. The swap converted a fixed-rate, foreign currency-denominated receivable to a fixed rate receivable denominated in U.S. dollars. It was accounted for as a cash flow hedge, and its notional amount was approximately 97.5 million euros ($118 million) at March 31, 2006. The swap was terminated in the summer of 2006 in connection with the sale of the Dutch non-tobacco businesses.

We also enter forward contracts from time to time to hedge certain foreign currency exposures. These contracts are marked to current market values each quarter and were not material at March 31, 2007.

Pension Funding

Funds supporting our ERISA-regulated U.S. defined benefit pension plans increased by $11 million to $149 million because of positive performance of the investment portfolio during the year ended December 31, 2006, the measurement date for the plans. As of April 30, 2007, the market value of the fund was about $169 million, compared to the accumulated benefit obligation (ABO) of $160 million and the projected benefit obligation (PBO) of $182 million. The ABO and PBO are calculated on the basis of certain assumptions that are outlined in Note 10 of Notes to Consolidated Financial Statements. We contributed $15 million to the fund in February 2007, which is more than the contribution required by ERISA, and we expect to make a contribution during the next year. It is our policy to monitor the performance of the funds and to review the adequacy of our funding and contributions to those funds. As of March 31, 2007, the target fund allocation was as follows: 55% to domestic equity securities, 15% to international equity securities, and 30% to fixed income securities.

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Contractual Obligations

Our contractual obligations as of March 31, 2007, were as follows:

(in millions of dollars)	Total	2008	2009-2010	2011-2012	Thereafter
Notes payable and long-term debt[1]	$ 823.5	$ 335.8	$ 120.6	$ 140.3	$ 226.8
Operating lease obligations	38.2	11.9	16.0	9.7	0.6
Inventory purchase obligations:					
Tobacco	565.1	460.8	63.7	26.4	14.2
Agricultural materials	20.0	20.0			
Capital expenditure obligations	5.6	5.6			
Other purchase obligations	5.2	4.4	0.3	0.3	0.2
Total	$ 1,457.6	$ 838.5	$ 200.6	$ 176.7	$ 241.8

1 Includes interest payments. Interest payments on $131 million of variable rate debt were estimated on the basis of March 31, 2007 rates.

In addition to principal and interest payments on notes payable and long-term debt, our contractual obligations include operating lease payments, inventory purchase commitments, and capital expenditure commitments. Operating lease obligations represent minimum payments due under leases for various production, storage, distribution, and other facilities, as well as vehicles and equipment. Tobacco inventory purchase obligations primarily represent contracts to purchase tobacco from farmers. The amounts shown above are estimates since actual quantities purchased will depend on crop yield and prices will depend on the quality of the tobacco delivered. More than half of our crop year contracts to purchase tobacco are with farmers in Brazil. Tobacco purchase obligations have been partially funded by advances to farmers, which totaled approximately $113 million as of March 31, 2007.

We believe that our financial resources are adequate to support our capital needs. Those resources include cash from operations, cash balances, the ability to issue debt to the public under our shelf registration statement, and committed and uncommitted bank lines. Any excess cash flow from operations after dividends, capital expenditures, and any necessary debt reduction will be available to fund expansion, purchase our stock, or otherwise enhance shareholder value.

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CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS

In preparing the financial statements in accordance with generally accepted accounting principles in the United States (GAAP), we are required to make estimates and assumptions that have an impact on the assets, liabilities, revenue, and expense amounts reported. These estimates can also affect our supplemental information disclosures, including information about contingencies, risk, and financial condition. We believe, given current facts and circumstances, our estimates and assumptions are reasonable, adhere to GAAP, and are consistently applied. However, changes in the assumptions used could result in a material adjustment to the financial statements. Our critical accounting estimates and assumptions are in the following areas:

Inventories

Inventories of tobacco are valued at the lower of cost or market with cost determined under the specific cost method. Raw materials are clearly identified at the time of purchase. We track the costs associated with raw materials in the final product lots, and maintain this identification through the time of sale. We also capitalize direct and indirect costs related to processing raw materials. This method of cost accounting is referred to as the specific cost or specific identification method. We write down inventory for changes in market value based upon assumptions related to future demand and market conditions if the indicated market value is below cost. Future demand assumptions can be impacted by changes in customer sales, changes in customers inventory positions and policies, competitors pricing policies and inventory positions, changing customer needs, and varying crop sizes and qualities. Market conditions that differ significantly from those assumed by management could result in additional write downs. We experience inventory write downs routinely. Inventory write downs in fiscal years 2007, 2006, and 2005 were $17.6 million, $11.8 million, and $4.3 million, respectively.

Advances to Suppliers and Guarantees of Bank Loans to Suppliers

We provide agronomy services and seasonal crop advances of, or for, seed, fertilizer, and other supplies. These advances are short term in nature and are customarily repaid upon delivery of tobacco to us. Primarily in Brazil and certain African countries, we have also made long-term advances to tobacco farmers to finance curing barns and other farm infrastructure. In Brazil, we also guarantee both short-term and long-term loans made to farmers for the same purposes. In some years, due to low crop yields and other factors, individual farmers may not deliver sufficient volumes of tobacco to repay maturing advances. In that case, we may extend repayment of the advances into the following crop year or satisfy the guarantee by acquiring the loan from the bank. In either situation, we will incur losses whenever we are unable to recover the full amount of the loans and advances. At each reporting period, we must make estimates and assumptions in determining the valuation allowance for advances to farmers and the liability to accrue for our obligations under bank loan guarantees.

Goodwill

We review the carrying value of goodwill as necessary, and at least annually, utilizing a discounted cash flow model. The preparation of discounted future operating cash flow analyses requires significant management judgment with respect to operating earnings growth rates and the selection of an appropriate discount rate. Neither a one-percentage-point increase in the discount rate assumption nor a one-percentage-point decline in the cash flow growth rate assumption would result in an impairment charge. However, significant changes in estimates of future cash flows, such as those caused by unforeseen events or changes in market conditions, could result in an impairment charge.

Income Taxes

Our effective tax rate is based on our expected income, statutory tax rates, and tax planning opportunities in the various jurisdictions in which we operate. Significant judgment is required in determining the effective tax rate and evaluating our tax position. The effective tax rate is applied to quarterly operating results. We are subject to the tax laws of many jurisdictions, and could be subject to a tax audit in each of these jurisdictions, which could result in adjustments to tax expense in future periods. In the event that there is a significant, unusual, or one-time item recognized in our results, the tax attributed to that item would be recorded at the same time as the item. For example, in fiscal year 2005, we recorded a charge for certain fines imposed by the European Commission that will not be deductible for income tax purposes in the related countries where assessed. No tax benefit was recognized on this charge, which increased the consolidated tax rate. In fiscal year 2006, a similar situation arose when we recognized an impairment charge on our investment in Zimbabwe, which did not provide a deduction for income tax purposes.

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Tax regulations require items to be included in the tax return at different times than the items are reflected in the financial statements. As a result, our effective tax rate reflected in the financial statements is different than that reported in our tax returns. Some of these differences are permanent, such as expenses that are not tax deductible, while others are related to timing issues, such as differences in depreciation methods. Timing differences create deferred tax assets and liabilities. Deferred tax assets generally represent items that can be used as a tax deduction or credit in future tax returns for which we have already recorded the tax benefit in our financial statements. We record valuation allowances for deferred tax assets when the amount of estimated future taxable income is not likely to support the use of the deduction or credit. We had approximately $24 million in foreign tax credit carryforwards at March 31, 2007, that are available to reduce our obligations to pay U.S. federal income taxes on our earnings in future years. Those foreign tax credit carryforwards will expire at dates ranging from seven to ten years in the future if our earnings and current obligations to pay U.S. federal income taxes are not sufficient to allow their utilization before they expire. Any significant reduction in future taxable income, changes in our sources of taxable income, or changes in U.S. or foreign tax laws could result in the expiration of foreign tax credit carryforwards. Deferred tax liabilities generally represent tax expense recognized in our f