Universal Corporation (UVV)

Updated July 3rd, 2018 by Nick McCullum

Key Metrics

Current Price:	$67	**5 Year CAGR Estimate:**	4.5%	**Quality Percentile:**	N/A
Fair Value Price:	$54	**5 Year Growth Estimate:**	4.0%	**Momentum Percentile:**	N/A
% Fair Value:	124%	**5 Year Valuation Multiple Estimate:**	-4.0%	**Total Return Percentile:**	N/A
Dividend Yield:	4.5%	**5 Year Price Target**	$72	**Valuation Percentile:**	N/A

Overview & Current Events

Universal Corporation is the world's largest leaf tobacco exporter and importer. The company is the wholesale purchaser and processor of tobacco that operates between farms and the companies that manufacture cigarettes, pipe tobacco, and cigars. Universal Corporation was founded in 1886, is headquartered in Richmond, Virginia, and trades with a market capitalization of $1.2 billion. With 46 years of dividend increases, Universal Corporation is a Dividend Champion.

In late May, Universal Corporation reported (5/23/18) financial results for the fourth quarter and full year of fiscal 2018. Earnings-per-share of $4.14 soared over the $0.88 reported in the prior year's period, but most ($2.99, to be precise) of this growth came from a one-time benefit related to federal tax reform. Excluding this charge, Universal generated earnings-per-share of $1.15, which still represented robust growth of 30.7% over the prior year's period. For the full-year period, Universal's adjusted earnings-per-share of $3.96 declined very slightly from the $3.97 reported last year.

In a separate but concurrent press release, the company also announced a new capital allocation strategy, which has resulted from a detailed review of its business that began in November of 2016. Universal's capital allocation will now focus on four priorities: strengthening the core tobacco business; increasing its dividend; exploring growth opportunities in adjacent industries; and returning excess capital to shareholders through share repurchases. Universal kicked off this new capital allocation plan by announcing a *36% dividend increases*. All said, the company's two press releases were well-received by the markets and shares soared by more than 30% following the announcement.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$4.32	$5.68	$5.30	$3.25	$4.66	$5.25	$4.06	$3.92	$3.97	$3.96	***$4.53***	***$5.50***
DPS	$1.82	$1.86	$1.90	$1.94	$1.98	$2.02	$2.06	$2.10	$2.12	$2.16	***$3.00***	***$3.65***

Universal Corporation's earnings-per-share are essentially unchanged from a decade ago. As the leader in a declining industry, we do not expect the company to deliver strong growth on a *business-wide basis* for the foreseeable future.

Per-share value is a different story, however. In our last quarterly update, we explained that Universal's chronically undervalued stock meant that it could generate per-share value by implementing aggressive share repurchases. The combination of weaker-than-expected 2017 earnings as well as a soaring stock price has meant that the company's valuation is no longer as attractive at the time of that writing. Still, we believe that 4% growth in earnings-per-share is feasible for this tobacco corporation.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	10.2	7.4	7.9	13.0	10.6	10.5	12.5	14.3	16.3	16.0	***14.7***	***13.0***
Avg. Yld.	4.1%	4.4%	4.5%	4.6%	4.0%	3.7%	4.2%	4.0%	3.5%	3.4%	***4.5%***	***4.0%***

We are maintaining our 2018 earnings-per-share estimate of $4.53. Using this estimate, the company is trading at a price-to-earnings ratio of 14.7. The company's average price-to-earnings ratio over the last 5 years has been about 14. However, given poor prospects for Universal's core business, we believe a 12x earnings multiple is a reasonable estimate of the company's fair value. If Universal Corporation's valuation contracts to 12 times earnings over the next 5 years, this will reduce the company's annualized returns by 4.0%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	19.7%	24.3%	22.9%	22.8%	20.8%	20.1%	19.1%	18.7%	18.3%	18.6%	***19.0%***	***19.0%***
Debt/A	49.0%	51.9%	52.7%	46.8%	47.8%	45.4%	39.3%	37.7%	36.6%	39.4%	***40.0%***	***40.0%***
Int. Cov.	9.0	7.0	12.2	13.1	8.6	10.7	13.0	10.6	13.0	12.5	***13.0***	***15.0***
Payout	42.1%	32.7%	35.8%	59.7%	42.5%	38.5%	50.7%	53.6%	54.8%	49.7%	***50.0%***	***55.0%***
Std. Dev.	44.2%	39.2%	35.3%	29.0%	18.6%	22.3%	24.0%	25.6%	20.8%	30.0%	***25.0%***	***20.0%***

Universal Corporation's competitive advantage comes from having a leadership position in a slow-changing and unattractive industry. Simply put, people aren't looking to start new tobacco companies these days. This gives the company staying power in a world where many other more glamorous companies have futures that are far less certain.

Although Universal Corporation's gross profits to total assets ratio has declined over time, the company has made meaningful progress on a number of other important quality metrics. Debt to total assets and interest coverage have materially improved, and the company's payout ratio of about 50% leaves a large margin of error in case operational results deteriorate temporarily. For these reasons, Universal Corporation will appeal to the conservative, income-oriented investor.

Final Thoughts & Recommendation

The most noticeable component of Universal Corporation's expected total return profile is the company's dividend yield. However, the company's price jump after its fourth-quarter earnings release had left it statistically overvalued at current prices. Accordingly, we are recommending that dividend investors avoid this security for now in favor of other, more attractively-priced opportunities within the consumer staples sector.

Total Return Breakdown by Year