



Universal Corporation (UUV)

Updated August 8th, 2018 by Nick McCullum

Key Metrics

Current Price: \$60	5 Year CAGR Estimate: 7.1%	Volatility Percentile: 82.8%
Fair Value Price: \$59	5 Year Growth Estimate: 4.0%	Momentum Percentile: 69.3%
% Fair Value: 102%	5 Year Valuation Multiple Estimate: -1.9%	Valuation Percentile: 37.3%
Dividend Yield: 5.0%	5 Year Price Target \$72	Total Return Percentile: 35.1%

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 \$1.5 billion. With 46 years of dividend increases, Universal Corporation is a Dividend Champion.

In early August, Universal Corporation reported (8/7/18) financial results for the first quarter of fiscal 2019. Recall that the company operates under an unusual financial calendar that ends on March 31st. In the quarter, Revenue increased by 33.4% while operating income expanded by 31.2%. On the bottom line, Universal Corporation generated \$13.2 million in net income, which compares very favorably to the \$3.6 million in net income reported in the same period a year ago. Per-share results were similarly strong. Universal Corporation reported diluted earnings-per-share of \$0.52, up from \$0.14 last year. Importantly, the company's press release included this material disclosure: *"The first quarter of fiscal year 2019 included a non-recurring tax benefit from the reversal of a previously recorded foreign dividend withholding tax liability that reduced income taxes and increased net income by \$6.9 million, or \$0.27 per diluted share"*. Excluding this \$0.27 per share non-recurring tailwind, the company's bottom line was still \$0.25, a 79% increase over last year's first quarter. Universal Corporation's strong performance was driven by higher total volumes, improved processing revenues, and a more profitable product mix. Despite the company's strong financial performance, Universal Corporation's stock fell by more than 12% following the earnings release.

Previously, Universal Corporation announced (5/23/18) 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 increase*. This press release, which was published in conjunction with the company's fourth quarter earnings release, was well-received by the markets and shares soared by more than 30% following the announcement.

Growth on a Per-Share Basis

Year ¹	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
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 cheap stock meant that it could generate meaningful per-share value by implementing aggressive share repurchases. We believe that 4% growth in earnings-per-share is feasible for this tobacco corporation, largely due to the opportunity available to the company's capital allocators in the form of stock buybacks.

¹ Note: Universal Corporation's fiscal year ends on March 31 of the calendar year. Example: fiscal 2018 ended on March 31, 2018. Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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	13.2	12.0
Avg. Yld.	4.1%	4.4%	4.5%	4.6%	4.0%	3.7%	4.2%	4.0%	3.5%	3.4%	5.0%	4.0%

We are maintaining our 2019 earnings-per-share estimate of \$4.53. Using this estimate, the company is trading at a price-to-earnings ratio of 13.2. 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 1.9%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

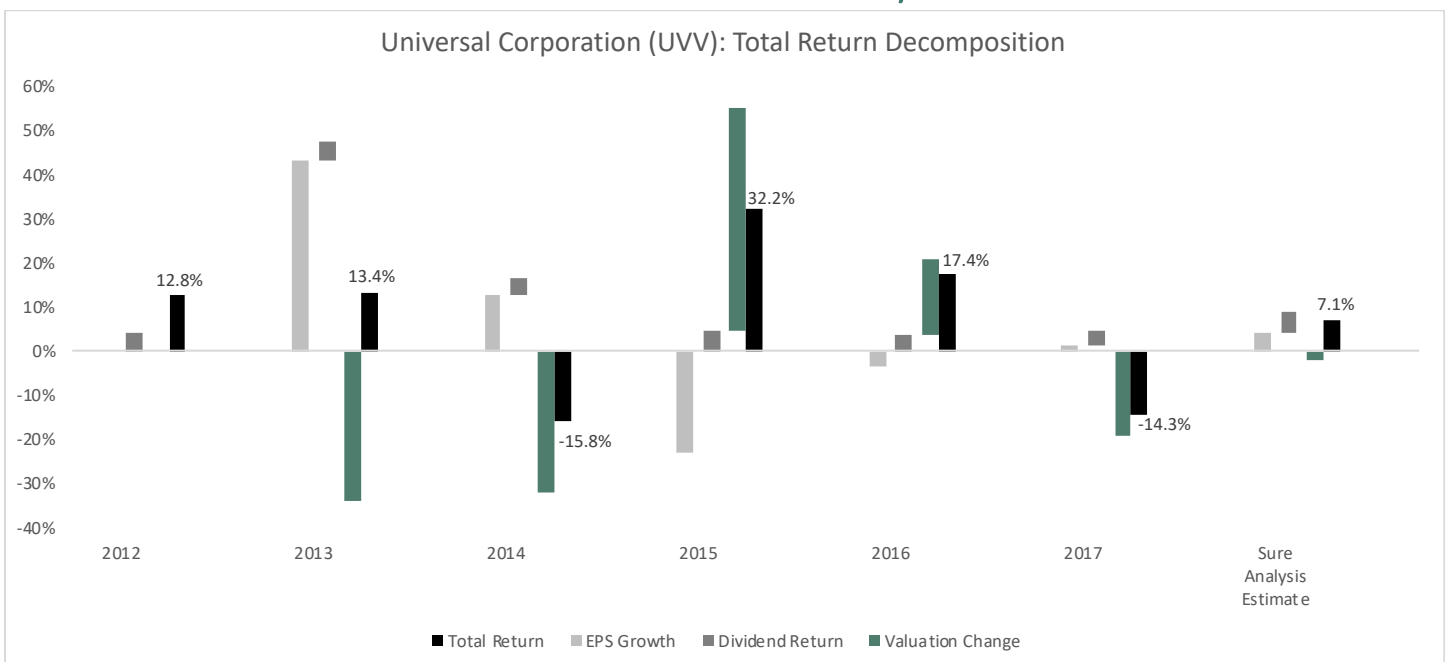
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	19.7%	24.3%	22.9%	22.8%	20.8%	20.1%	19.1%	18.7%	18.3%	18.6%	19.0%	19.0%
Debt/A	49.0%	51.9%	52.7%	46.8%	47.8%	45.4%	39.3%	37.7%	36.6%	39.4%	40.0%	40.0%
Int. Cov.	9.0	7.0	12.2	13.1	8.6	10.7	13.0	10.6	13.0	12.5	13.0	15.0
Payout	42.1%	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%

Although Universal Corporation's gross profits to assets ratio has declined over time, it 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, which has become even more compelling after the company's post-earnings price decline and its 30% dividend increase. For yield-hungry investors that are attracted to recession-resistant business models, Universal Corporation is a potential buy at current prices. For investors concerned more with total returns (and not necessarily dividend payments), Universal Corporation earns a hold recommendation at current prices.

Total Return Breakdown by Year



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