

ALLIANCE ONE INTERNATIONAL, INC.  
Form 10-Q  
February 04, 2011

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED December 31, 2010**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_.**

**Alliance One International, Inc.**  
(Exact name of registrant as specified in its charter)

**Virginia**

\_\_\_\_\_  
(State or other jurisdiction of incorporation)

**001-13684**

\_\_\_\_\_  
(Commission File Number)

**54-1746567**

\_\_\_\_\_  
(I.R.S. Employer Identification No.)

8001 Aerial Center Parkway  
Morrisville, NC 27560-8417  
(Address of principal executive offices)

(919) 379-4300  
(Registrant's telephone number, including area code)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [ ] No [ ]

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

Large accelerated filer [ ] Accelerated  
filer [X]

Non-accelerated filer [ ] Smaller reporting company [ ]  
(Do not check if a smaller reporting company)

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

As of January 31, 2011, the registrant had 87,084,833 shares outstanding of Common Stock (no par value) excluding 7,853,121 shares owned by a wholly owned subsidiary.

## Alliance One International, Inc. and Subsidiaries

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## Part I. Financial Information

### Item 1. Financial Statements

Alliance One International, Inc. and Subsidiaries  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
 Three and Nine Months Ended December 31, 2010 and 2009  
*(Unaudited)*

| <i>(in thousands, except per share data)</i>   | Three Months Ended |            | Nine Months Ended |              |
|--|--------------------|------------|-------------------|--------------|
|  | December 31,       |            | December 31,      |              |
|  | 2010               | 2009       | 2010              | 2009         |
| Sales and other operating revenues   | \$ 522,144         | \$ 658,353 | \$ 1,572,349      | \$ 1,743,991 |
| Cost of goods and services sold  | 461,507            | 560,252    | 1,362,227         | 1,451,102    |
| Gross profit   | 60,637             | 98,101     | 210,122           | 292,889      |
| Selling, administrative and general expenses   | 37,415             | 38,070     | 116,207           | 116,461      |
| Other income   | 20,318             | 112        | 39,960            | 2,817        |
| Restructuring charges  | 13,385             | -          | 13,385            | -            |
| Operating income   | 30,155             | 60,143     | 120,490           | 179,245      |
| Debt retirement expense  | 1,141              | 62         | 4,584             | 40,351       |
| Interest expense (includes debt amortization of \$2,680 and \$2,518 for the three months and \$7,327 and \$6,803 for the nine months in 2010 and 2009, respectively) | 25,277             | 29,479     | 79,102            | 87,224       |
| Interest income  | 1,660              | 957        | 5,579             | 3,062        |
| Income before income taxes and other items   | 5,397              | 31,559     | 42,383            | 54,732       |
| Income tax expense (benefit)   | 8,470              | (14,891)   | 12,756            | (5,219)      |
|  | 1,072              | 1,338      | 2,266             | 1,338        |

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Equity in net income of investee  
companies

|  |            |           |           |           |
|--|------------|-----------|-----------|-----------|
| Net income (loss)  | (2,001)    | 47,788    | 31,893    | 61,289    |
| Less: Net income (loss) attributable to noncontrolling interests   | (12)       | 530       | (219)     | 1,011     |
| Net income (loss) attributable to Alliance One International, Inc. | \$ (1,989) | \$ 47,258 | \$ 32,112 | \$ 60,278 |

Earnings (loss) per share:

|         |          |        |        |        |
|---------|----------|--------|--------|--------|
| Basic   | \$ (.02) | \$ .53 | \$ .36 | \$ .68 |
| Diluted | \$ (.02) | \$ .43 | \$ .32 | \$ .60 |

Weighted average number of shares  
outstanding:

|         |        |         |         |         |
|---------|--------|---------|---------|---------|
| Basic   | 86,803 | 88,689  | 88,125  | 88,589  |
| Diluted | 86,803 | 111,937 | 111,337 | 104,058 |

*See notes to condensed consolidated financial statements*

Alliance One International, Inc. and Subsidiaries  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
*(Unaudited)*

| <i>(in thousands)</i>                                   | December<br>31,<br>2010 | December<br>31,<br>2009 | March 31,<br>2010 |
|---|-------------------------|-------------------------|-------------------|
| <b>ASSETS</b>   |                         |                         |                   |
| Current assets  |                         |                         |                   |
| Cash and cash equivalents                               | \$ 41,401               | \$ 109,518              | \$ 129,738        |
| Trade and other receivables, net                        | 185,042                 | 256,310                 | 207,387           |
| Accounts receivable, related parties                    | 71,167                  | 33,116                  | 30,061            |
| Inventories   | 819,983                 | 736,220                 | 824,147           |
| Advances to tobacco suppliers                           | 103,715                 | 105,592                 | 70,749            |
| Recoverable income taxes                                | 2,843                   | 14,002                  | 11,447            |
| Current deferred taxes                                  | 34,493                  | 30,391                  | 37,209            |
| Prepaid expenses  | 52,301                  | 57,953                  | 67,288            |
| Assets held for sale                                    | 439                     | 836                     | 819               |
| Current derivative asset                                | 218                     | 1,075                   | 2,528             |
| Other current assets                                    | 516                     | 5,704                   | 1,579             |
| Total current assets                                    | 1,312,118               | 1,350,717               | 1,382,952         |
| Other assets  |                         |                         |                   |
| Investments in unconsolidated affiliates                | 25,468                  | 22,619                  | 23,202            |
| Goodwill and other intangible assets                    | 41,510                  | 46,437                  | 44,991            |
| Deferred income taxes                                   | 151,033                 | 145,941                 | 148,971           |
| Other deferred charges                                  | 22,979                  | 29,527                  | 27,789            |
| Other noncurrent assets                                 | 77,531                  | 97,350                  | 90,070            |
|   | 318,521                 | 341,874                 | 335,023           |
| Property, plant and equipment, net                      | 225,711                 | 192,852                 | 193,224           |
|   | \$ 1,856,350            | \$ 1,885,443            | \$ 1,911,199      |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>              |                         |                         |                   |
| Current liabilities                                     |                         |                         |                   |
| Notes payable to banks                                  | \$ 239,786              | \$ 286,406              | \$ 188,981        |
| Accounts payable  | 69,969                  | 50,799                  | 146,395           |
| Due to related parties                                  | 13,581                  | 11,546                  | 20,275            |
| Advances from customers                                 | 92,477                  | 61,846                  | 102,286           |
| Accrued expenses and other current liabilities          | 102,112                 | 114,132                 | 113,048           |
| Current derivative liability                            | -                       | 2,716                   | -                 |
| Income taxes  | 11,349                  | 12,797                  | 16,281            |
| Long-term debt current                                  | 435                     | 19,335                  | 457               |
| Total current liabilities                               | 529,709                 | 559,577                 | 587,723           |
| Long-term debt  | 762,617                 | 806,238                 | 788,880           |
| Deferred income taxes                                   | 3,730                   | 7,750                   | 4,399             |
| Liability for unrecognized tax benefits                 | 26,741                  | 23,289                  | 20,168            |
| Pension, postretirement and other long-term liabilities | 114,470                 | 98,885                  | 115,107           |

|  |             |             |             |              |              |              |
|--|-------------|-------------|-------------|--------------|--------------|--------------|
|  |             |             |             | 907,558      | 936,162      | 928,554      |
|  |             |             | March       |              |              |              |
|  | Dec. 31,    | Dec. 31,    | 31,         |              |              |              |
| Stockholders equity                                      | <u>2010</u> | <u>2009</u> | <u>2010</u> |              |              |              |
| Common Stock no  |             |             |             |              |              |              |
| par value:   |             |             |             |              |              |              |
| Authorized shares  | 250,000     | 250,000     | 250,000     |              |              |              |
| Issued shares  | 94,939      | 96,942      | 96,966      | 452,980      | 464,387      | 460,971      |
| Retained deficit   |             |             |             | (17,130)     | (68,131)     | (49,242)     |
| Accumulated other comprehensive loss                     |             |             |             | (20,534)     | (11,340)     | (21,329)     |
| Total stockholders equity of Alliance One International, |             |             |             |              |              |              |
| Inc.   |             |             |             | 415,316      | 384,916      | 390,400      |
| Noncontrolling interests                                 |             |             |             | 3,767        | 4,788        | 4,522        |
| Total equity   |             |             |             | 419,083      | 389,704      | 394,922      |
|  |             |             |             | \$ 1,856,350 | \$ 1,885,443 | \$ 1,911,199 |

See notes to condensed consolidated financial statements

Alliance One International, Inc. and Subsidiaries  
**CONDENSED STATEMENTS OF CONSOLIDATED STOCKHOLDERS EQUITY**  
*(Unaudited)*

|   |  |              |             |             |                |              |
|---|--|--------------|-------------|-------------|----------------|--------------|
|   | Attributable to Alliance One International, Inc. |              |             |             |                |              |
|   | Accumulated                                      |              |             |             |                |              |
|   | Other Comprehensive Loss                         |              |             |             |                |              |
|   | Currency   |              |             |             |                |              |
|   | Common   | Retained     | Translation | Pensions,   | Noncontrolling | Total        |
| <i>(in thousands)</i>   | Stock  | Deficit      | Adjustment  | Net of Tax  | Interests      | Stockholders |
|   |  |              |             |             |                | Equity       |
| Balance, March 31, 2009   | \$ 468,195                                       | \$ (128,409) | \$ (1,870)  | \$ (11,255) | \$ 4,119       | \$ 330,780   |
| Net income  | -  | 60,278       | -           | -           | 1,011          | 61,289       |
| Stock warrants issued   | 16,821   | -            | -           | -           | -              | 16,821       |
| Call option related to convertible debentures, net of tax of \$13,796 | (25,622)   | -            | -           | -           | -              | (25,622)     |
| Restricted stock surrendered  | (249)  | -            | -           | -           | -              | (249)        |
| Stock-based compensation  | 5,242  | -            | -           | -           | -              | 5,242        |
| Adjustment in pensions  | -  | -            | -           | (359)       | -              | (359)        |
| Noncontrolling interest dividend paid                                 | -  | -            | -           | -           | (360)          | (360)        |
| Conversion of foreign currency financial statements                   | -  | -            | 2,144       | -           | 18             | 2,162        |
|   | \$ 464,387                                       | \$ (68,131)  | \$ 274      | \$ (11,614) | \$ 4,788       | \$ 389,704   |

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Balance, December 31,  
2009

|   |            |             |            |             |          |            |
|---|------------|-------------|------------|-------------|----------|------------|
| Balance, March 31, 2010                                   | \$ 460,971 | \$ (49,242) | \$ (3,691) | \$ (17,638) | \$ 4,522 | \$ 394,922 |
| Net income (loss)   | -          | 32,112      | -          | -           | (219)    | 31,893     |
| Restricted stock<br>surrendered                           | (585)      | -           | -          | -           | -        | (585)      |
| Exercise of employee<br>stock options                     | 106        | -           | -          | -           | -        | 106        |
| Stock-based<br>compensation                               | 1,509      | -           | -          | -           | -        | 1,509      |
| Shares purchased  | (9,042)    | -           | -          | -           | -        | (9,042)    |
| Purchase of additional<br>investment<br>in subsidiary     | 21         | -           | -          | -           | (234)    | (213)      |
| Noncontrolling interest<br>dividend paid                  | -          | -           | -          | -           | (284)    | (284)      |
| Conversion of foreign<br>currency<br>financial statements | -          | -           | 795        | -           | (18)     | 777        |
| Balance, December 31,<br>2010                             | \$ 452,980 | \$ (17,130) | \$ (2,896) | \$ (17,638) | \$ 3,767 | \$ 419,083 |

*See notes to condensed consolidated financial statements*



Alliance One International, Inc. and Subsidiaries  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
 Nine Months Ended December 31, 2010 and 2009  
*(Unaudited)*

| <i>(in thousands)</i>   | December<br>31,<br>2010 | December<br>31,<br>2009 |
|---|-------------------------|-------------------------|
| <b>Operating activities</b>   |                         |                         |
| Net income  | \$ 31,893               | \$ 61,289               |
| Adjustments to reconcile net income to net cash used by operating activities: |                         |                         |
| Depreciation and amortization   | 20,872                  | 21,904                  |
| Debt amortization/interest  | 10,076                  | 8,604                   |
| Debt retirement cost  | 4,584                   | 40,351                  |
| Restructuring charges   | 11,547                  | -                       |
| Gain on foreign currency transactions   | (10,116)                | (3,782)                 |
| Gain on other sales of assets   | (37,525)                | -                       |
| Changes in operating assets and liabilities, net                              | (131,824)               | (160,634)               |
| Other, net  | 4,543                   | 48                      |
| Net cash used by operating activities   | (95,950)                | (32,220)                |
| <b>Investing activities</b>   |                         |                         |
| Purchases of property, plant and equipment                                    | (52,480)                | (9,299)                 |
| Proceeds from sale of property, plant and equipment                           | 2,882                   | 7,673                   |
| Proceeds on other sales of assets   | 45,834                  | -                       |
| Foreign currency derivatives  | -                       | (5,026)                 |
| Proceeds from notes receivable  | 1,270                   | 6,558                   |
| Additional investment in notes receivable                                     | (159)                   | (11,731)                |
| Other, net  | 24                      | (1,093)                 |
| Net cash used by investing activities   | (2,629)                 | (12,918)                |
| <b>Financing activities</b>   |                         |                         |
| Net proceeds from short-term borrowings                                       | 55,023                  | 17,415                  |
| Proceeds from long-term borrowings  | 121,000                 | 1,040,509               |
| Repayment of long-term borrowings   | (151,076)               | (908,654)               |
| Debt issuance cost  | (3,717)                 | (36,095)                |
| Debt retirement cost  | (2,262)                 | (23,456)                |
| Proceeds from issuance of warrants  | -                       | 16,821                  |
| Purchase of call options  | -                       | (39,418)                |
| Repurchase of common stock  | (9,042)                 | -                       |
| Other, net  | 219                     | (360)                   |
| Net cash provided by financing activities                                     | 10,145                  | 66,762                  |
| Effect of exchange rate changes on cash                                       | 97                      | 229                     |
| Increase (decrease) in cash and cash equivalents                              | (88,337)                | 21,853                  |
| Cash and cash equivalents at beginning of period                              | 129,738                 | 87,665                  |

|  |           |            |
|--|-----------|------------|
| Cash and cash equivalents at end of period | \$ 41,401 | \$ 109,518 |
|--|-----------|------------|

*See notes to condensed consolidated financial statements*

Alliance One International, Inc. and Subsidiaries  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
*(in thousands)*

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation**

Because of the seasonal nature of the Company's business, the results of operations for any fiscal quarter will not necessarily be indicative of results to be expected for other quarters or a full fiscal year. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair statement of financial position, results of operation and cash flows at the dates and for the periods presented have been included. The unaudited information included in this Form 10-Q should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2010.

The Company historically presented the current and noncurrent advances on purchases of tobacco (prepaid inventory) at contractually stated amounts on the face of its balance sheet. The Company changed its presentation of advances on purchases of tobacco as of March 31, 2010 to present the advances at the lower of its cost basis or estimated recoverable amounts instead of its contractually stated or notional amount. The Company believes this change in presentation provides a more transparent view of its application of an inventory model in accounting for its advances on purchases of tobacco. Historically, the Company reported deferred amounts including the mark-up, interest and unrecoverable provisions in inventories. The Company has reclassified these amounts from inventories to current and long term advances to tobacco suppliers. The amount reclassified from inventories to current advances to tobacco suppliers was a reduction of \$33,857 and a reduction of \$3,908 to long term advances to tobacco suppliers included in other noncurrent assets at December 31, 2009.

**Taxes Collected from Customers**

Certain subsidiaries are subject to value added taxes on local sales. These amounts have been included in sales and were \$6,868 and \$6,833 for the three months ended December 31, 2010 and 2009, respectively and \$25,538 and \$25,124 for the nine months ended December 31, 2010 and 2009, respectively.

**Other Deferred Charges**

Other deferred charges are primarily deferred financing costs that are amortized over the life of the debt.

**Sale of Brazilian Assets**

On June 21, 2010, the Company's subsidiary in Brazil announced it had entered into an agreement with Philip Morris Brasil Industria e Comercio Ltda (PMB), an affiliate of Philip Morris International, Inc. (PMI). In connection with the transaction, the Company assigned contracts with approximately 9,000 tobacco suppliers in Southern Brazil representing approximately 20% of current Brazilian volume and sold some of its related assets to PMB at September 30, 2010. The Company recorded a gain of \$18,101 on the sale of these assets in Other Income in the condensed consolidated statements of operations at September 30, 2010. The Company sold the remaining related assets to PMB during the quarter ended December 31, 2010 and recorded a gain of \$19,424 in Other Income in the condensed consolidated statements of operations at December 31, 2010. The Company expects to continue to supply processed tobacco to PMI and to process tobacco for PMB grown by PMB's contracted suppliers under a long-term processing agreement.

## **New Accounting Standards**

### ***Recently Adopted Accounting Pronouncements***

On April 1, 2010, the Company adopted new accounting guidance on accounting for transfers of financial assets. The objective of this accounting guidance is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement in transferred financial assets. The Company adopted this new accounting guidance with no material impact to its financial condition and results of operations. See Note 16 Sale of Receivables for further details.

On April 1, 2010, the Company adopted new accounting guidance on accounting for variable interest entities. The objective of this accounting guidance is to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. The Company adopted this new accounting guidance with no material impact to its financial condition and results of operations. See Note 6 Variable Interest Entities for further details.

### ***Recent Accounting Pronouncements Not Yet Adopted***

In October 2009, the FASB issued new accounting guidance on accounting for multiple-deliverable revenue arrangements. The objective of this accounting guidance is to address the accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit. This accounting guidance will be effective for the Company on April 1, 2011. The Company is evaluating the impact of this new accounting guidance on its financial condition and results of operations.



Alliance One International, Inc. and Subsidiaries

## 1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### **New Accounting Standards** *(Continued)*

#### ***Recent Accounting Pronouncements Not Yet Adopted*** *(Continued)*

In January 2010, the FASB issued new accounting guidance on fair value measurements and disclosures. This guidance requires reporting entities to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. It will also require reporting entities to present separately information about purchases, sales, issuances, and settlements in their Level 3 fair value reconciliations. The new disclosures and clarifications of existing disclosures (the Level 1 and Level 2 changes) were effective for the Company on January 1, 2010 with no material impact to the Company. The disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements will be effective for the Company on April 1, 2011. The Company does not expect these new disclosure requirements to have a material impact on its financial condition or results of operations.

## 2. INCOME TAXES

### **Accounting for Uncertainty in Income Taxes**

As of December 31, 2010, the Company's unrecognized tax benefits totaled \$20,469, all of which would impact the Company's effective tax rate if recognized.

The Company recognizes interest and penalties related to unrecognized tax benefits in income tax expense. As of December 31, 2010, accrued interest and penalties totaled \$9,676 and \$3,596, respectively.

The Company expects to continue accruing interest expenses related to the unrecognized tax benefits described above. Additionally, the Company may be subject to fluctuations in the unrecognized tax liability due to currency exchange rate movements.

Other than the expiration of an applicable statute of limitations pertaining to international unrecognized tax benefits of \$3,778, interest of \$7,878, and penalties of \$2,157, the Company does not foresee any reasonably possible changes in the unrecognized tax benefits in the next twelve months but must acknowledge circumstances can change due to unexpected developments in the law. In certain jurisdictions, tax authorities have challenged positions that the Company has taken that resulted in recognizing benefits that are material to its financial statements. The Company believes it is more likely than not that it will prevail in these situations and accordingly have not recorded liabilities for these positions. The Company expects the challenged positions to be settled at a time greater than twelve months

from its balance sheet date.

The Company and its subsidiaries file a U.S. federal consolidated income tax return as well as returns in several U.S. states and a number of foreign jurisdictions. As of December 31, 2010, the Company's earliest open tax year for U.S. federal income tax purposes was its fiscal year ended March 31, 2007. Open tax years in state and foreign jurisdictions generally range from three to six years.

During the three months ended December 31, 2010, certain events led to a change in management's judgment related to the recognition of tax benefits for certain U.S. foreign tax credit carryovers. As a result, during the three months ended December 31, 2010, the Company recorded a \$7,000 income tax expense for unrecognized tax benefits and the corresponding reduction of deferred tax asset for foreign tax credit carryovers. During January 2011, the Company and U.S. Internal Revenue Service agreed to a resolution of the examination of its U.S. federal income tax returns for fiscal years March 31, 2007 and March 31, 2008, resulting in an adjustment to foreign tax credit carryovers.

### **Provision for the Nine Months Ended December 31, 2010**

The effective tax rate used for the nine months ended December 31, 2010 was an expense of 30.1% compared to a benefit of 9.5% for the nine months ended December 31, 2009. The effective tax rates for these periods are based on the current estimate of full year results including the effect of taxes related to specific events which are recorded in the interim period in which they occur. The Company expects the tax rate for the year ended March 31, 2011 to be 25.6% after absorption of discrete items.

For the nine months ended December 31, 2010, the Company recorded a specific event adjustment expense of \$4,324, bringing the effective tax rate estimated for the nine months of 19.9% to 30.1%. This specific event adjustment expense relates primarily to additional income tax, interest, and exchange losses related to liabilities for unrecognized tax benefits, reductions in foreign tax credit carryforwards and net exchange gains on income tax accounts. For the nine months ended December 31, 2009, the Company recorded a specific event adjustment benefit of \$22,089 bringing the effective tax rate estimated for the nine months of 30.8% to 9.5%. This specific event adjustment benefit relates primarily to a reversal of income tax, interest, penalties, and exchange losses related to liabilities for unrecognized tax benefits, and to net exchange gains on income tax accounts. The difference in the estimated effective tax rate for the nine months ended December 31, 2010 from the statutory rate is primarily due to foreign income tax rates lower than the U.S. rate, currency exchange and amortization of goodwill partially offset by increases in unrecognized tax benefits.

## Alliance One International, Inc. and Subsidiaries

## 3. GUARANTEES

The Company and certain of its foreign subsidiaries guarantee bank loans to suppliers to finance their crops. Under longer-term arrangements, the Company may also guarantee financing on suppliers' construction of curing barns or other tobacco production assets. The Company also guarantees bank loans to certain tobacco cooperatives to assist with the financing of their suppliers' crops. Guaranteed loans are generally repaid concurrent with the delivery of tobacco to the Company. The Company is obligated to repay any guaranteed loan should the supplier or tobacco cooperative default. If default occurs, the Company has recourse against the supplier or cooperative. The following table summarizes amounts guaranteed and the fair value of those guarantees:

|                                     | December 31, 2010 | December 31, 2009 | March 31, 2010 |
|-------------------------------------|-------------------|-------------------|----------------|
| Amounts guaranteed (not to exceed)  | \$ 102,324        | \$ 188,701        | \$ 184,575     |
| Amounts outstanding under guarantee | 100,040           | 173,555           | 184,382        |
| Fair value of guarantees            | 4,866             | 11,984            | 13,478         |

Of the guarantees outstanding at December 31, 2010 approximately 82% expire within one year and the remainder within five years. The fair value of guarantees is recorded in Accrued Expenses and Other Current Liabilities in the condensed consolidated balance sheets and included in crop costs.

In Brazil, some suppliers obtain government subsidized rural credit financing from local banks that is guaranteed by the Company. The Company withholds amounts owed to suppliers related to the rural credit financing of the supplier upon delivery of tobacco to the Company. The Company remits payments to the local banks on behalf of the guaranteed suppliers. Terms of rural credit financing are such that repayment is due to local banks based on contractual due dates. As of December 31, 2010 and 2009 and March 31, 2010, respectively, the Company had balances of \$301, \$1,420 and \$55,926 that were due to local banks on behalf of suppliers. These amounts are included in Accounts Payable in the condensed consolidated balance sheets.

## 4. RESTRUCTURING CHARGES

In response to shifting supply and demand balances and the changing business models of the Company's customers, the Company began implementing several strategic initiatives. The first was to begin realigning the Company's organization by transitioning the United Kingdom finance and logistics functions to the United States in October 2010 and closing the Netherlands office in November 2010. In December 2010, new leadership was appointed to better position the Company for the future. At December 31, 2010, other global initiatives were underway to increase operational efficiency and effectiveness. The initiatives will continue over the coming quarters as the Company continues to define and execute the necessary changes to support core business functions.



At December 31, 2010, the company has incurred \$13,385 in employee separation and other charges, all related to the Other Regions segment, of which \$1,838 has been paid. The remaining balance will be paid primarily in the next twelve months and is recorded in Accrued Expenses and Other Current Liabilities on the condensed consolidated balance sheet.

## 5. GOODWILL AND INTANGIBLES

Goodwill represents costs in excess of fair values assigned to the underlying net assets of acquired businesses. Goodwill is not subject to systematic amortization, but rather is tested for impairment annually or whenever events and circumstances indicate that an impairment may have occurred. The Company has chosen the first day of the last quarter of its fiscal year as the date to perform its annual goodwill impairment test.

## Alliance One International, Inc. and Subsidiaries

5. GOODWILL AND INTANGIBLES *(Continued)*

The Company has no intangible assets with indefinite useful lives. It does have other intangible assets which are being amortized. The following table summarizes the changes in the Company's goodwill and other intangibles for the three months and nine months ended December 31, 2010 and 2009:

|  | Goodwill              |                                  | Amortizable Intangibles                    |  |           |
|--|-----------------------|----------------------------------|--|--|-----------|
|  | Other Regions Segment | Customer Relationship Intangible | Production and Supply Contract Intangibles | Internally Developed Software Intangible | Total     |
| Weighted average remaining useful life in years as of March 31, 2010 | -                     | 15                               | 6  | 4  |           |
| March 31, 2009 balance:  |                       |                                  |  |  |           |
| Gross carrying amount  | \$ 2,794              | \$ 33,700                        | \$ 7,844                                   | \$ 13,776                                | \$ 58,114 |
| Accumulated amortization   | -                     | (6,529)                          | (270)                                      | (1,438)                                  | (8,237)   |
| Net March 31, 2009   | 2,794                 | 27,171                           | 7,574                                      | 12,338                                   | 49,877    |
| Additions  | -                     | -                                | -  | 329                                      | 329       |
| Amortization expense   | -                     | (422)                            | (54)                                       | (664)                                    | (1,140)   |
| Net June 30, 2009  | 2,794                 | 26,749                           | 7,520                                      | 12,003                                   | 49,066    |
| Amortization expense   | -                     | (421)                            | (371)                                      | (696)                                    | (1,488)   |
| Net September 30, 2009   | 2,794                 | 26,328                           | 7,149                                      | 11,307                                   | 47,578    |
| Additions  | -                     | -                                | 49   | 203                                      | 252       |
| Amortization expense   | -                     | (421)                            | (276)                                      | (696)                                    | (1,393)   |
| Net December 31, 2009  | 2,794                 | 25,907                           | 6,922                                      | 10,814                                   | 46,437    |
| Additions  | -                     | -                                | -  | 151                                      | 151       |
| Amortization expense   | -                     | (421)                            | (481)                                      | (695)                                    | (1,597)   |
| Net March 31, 2010   | 2,794                 | 25,486                           | 6,441                                      | 10,270                                   | 44,991    |
| Amortization expense   | -                     | (421)                            | (47)                                       | (696)                                    | (1,164)   |
| Net June 30, 2010  | 2,794                 | 25,065                           | 6,394                                      | 9,574                                    | 43,827    |
| Additions  | -                     | -                                | -  | 251                                      | 251       |
| Amortization expense   | -                     | (422)                            | (22)                                       | (740)                                    | (1,184)   |
| Net September 30, 2010   | 2,794                 | 24,643                           | 6,372                                      | 9,085                                    | 42,894    |
| Amortization expense   | -                     | (421)                            | (233)                                      | (730)                                    | (1,384)   |
| Net December 31, 2010  | \$ 2,794              | \$ 24,222                        | \$ 6,139                                   | \$ 8,355                                 | \$ 41,510 |

The following table summarizes the estimated intangible asset amortization expense for the next five years and beyond:

| For Fiscal<br>Years Ended | Customer<br>Relationship<br>Intangible | Production<br>and Supply<br>Contract<br>Intangible | Internally<br>Developed<br>Software<br>Intangible | Total     |
|---------------------------|--|--|---|-----------|
| 2011                      | \$ 1,685                               | \$ 1,095   | \$ 2,904  | \$ 5,684  |
| 2012                      | 1,685                                  | 1,173  | 2,942   | 5,800     |
| 2013                      | 1,685                                  | 1,251  | 2,942   | 5,878     |
| 2014                      | 1,685                                  | 1,251  | 1,504   | 4,440     |
| 2015                      | 1,685                                  | 1,173  | 191   | 3,049     |
| Later                     | 17,061                                 | 498  | 38  | 17,597    |
|                           | \$ 25,486                              | \$ 6,441   | \$ 10,521   | \$ 42,448 |

\* Estimated amortization expense for the internally developed software is based on costs accumulated as of December 31, 2010. These estimates will change as new costs are incurred and until the software is placed into service in all locations.

Alliance One International, Inc. and Subsidiaries

**6. VARIABLE INTEREST ENTITIES**

On April 1, 2010, the Company adopted new accounting guidance on accounting for variable interest entities ( VIEs ). This accounting guidance amended the consolidation guidance applicable to VIEs and required additional disclosures concerning an enterprise's continuing involvement with VIEs.

**Consolidated Variable Interest Entities**

The Company holds a variable interest in one joint venture in which the Company is the primary beneficiary because of its power to direct activities that most significantly impact the economic performance of the entity. The joint venture is an enterprise that serves as a dedicated inventory supply source in Asia and the Company's variable interest in this joint venture relate to working capital advances and guarantees of the joint venture's borrowings.

As the primary beneficiary of this VIE, the entity's material assets, liabilities and results of operations are included in the Company's consolidated financial statements. The following table summarizes the material carrying amounts of the entity's assets, all of which are restricted, and liabilities included in the Company's consolidated balance sheets at March 31, 2010 and December 31, 2010.

| <b>Assets of Consolidated VIE</b>      | March 31, 2010 | December 31, 2010 |
|--|----------------|-------------------|
| Inventory                              | \$ 12,069      | \$ 14,269         |
| Advances to suppliers                  | 3,746          | 3,694             |
| <b>Liabilities of Consolidated VIE</b> |                |                   |
| Notes payable to banks                 | -              | 4,764             |

Amounts presented in the table above as restricted assets relating to the consolidated VIE are adjusted for intercompany eliminations.

**Nonconsolidated Variable Interest Entities**

The Company holds variable interests in four joint ventures that are accounted for under the equity method of accounting. These joint ventures procure inventory on behalf of the Company and the other joint venture partners. The variable interests relate to equity investments and advances made by the Company to the joint ventures. In addition, the Company also guarantees one of its joint venture's borrowings which also represent a variable interest in that joint venture. The Company is not the primary beneficiary, as it does not have the power to direct the activities that most significantly impact the economic performance of the entities as a result of the entities' management and board of

directors structure. Therefore, these entities are not consolidated. At March 31, 2010 and December 31, 2010, the Company's investment in these joint ventures was \$22,878 and \$25,144, respectively and is classified as Investments in Unconsolidated Affiliates in the condensed consolidated balance sheets. The Company's advances to these joint ventures were \$8,936 at March, 31, 2010 and December 31, 2010, and are classified as Accounts Receivable, Related Parties in the condensed consolidated balance sheets. The Company's guarantee to a joint venture was \$17,121 and \$16,921 at March 31, 2010 and December 31, 2010, respectively. The investments, advances and guarantee in these joint ventures represent the Company's maximum exposure to loss.

## 7. SEGMENT INFORMATION

The Company purchases, processes, sells and stores leaf tobacco. Tobacco is purchased in more than 45 countries and shipped to more than 90 countries. The sales, logistics and billing functions of the Company are primarily concentrated in service centers outside of the producing areas to facilitate access to its major customers. Within certain quality and grade constraints, tobacco is fungible and, subject to these constraints, customers may choose to fulfill their needs from any of the areas where the Company purchases tobacco.

Selling, logistics, billing, and administrative overhead, including depreciation, which originates primarily from the Company's corporate and sales offices are allocated to the segments based upon segment operating income. The Company reviews performance data from purchase through sale based on the source of the product and all intercompany transactions are allocated to the region that either purchases or processes the tobacco.

## Alliance One International, Inc. and Subsidiaries

7. SEGMENT INFORMATION *(Continued)*

The following table presents the summary segment information for the three months and nine months ended December 31, 2010 and 2009:

|  | Three Months Ended<br>December 31, |            | Nine Months Ended<br>December 31, |              |
|--|------------------------------------|------------|-----------------------------------|--------------|
|  | 2010                               | 2009       | 2010                              | 2009         |
| Sales and other operating revenues:        |                                    |            |                                   |              |
| South America                              | \$ 140,491                         | \$ 176,766 | \$ 634,645                        | \$ 743,374   |
| Other regions                              | 381,653                            | 481,587    | 937,704                           | 1,000,617    |
| Total revenue                              | \$ 522,144                         | \$ 658,353 | \$ 1,572,349                      | \$ 1,743,991 |
| Operating income:                          |                                    |            |                                   |              |
| South America                              | \$ 21,640                          | \$ 6,930   | \$ 71,557                         | \$ 78,736    |
| Other regions                              | 8,515                              | 53,213     | 48,933                            | 100,509      |
| Total operating income                     | 30,155                             | 60,143     | 120,490                           | 179,245      |
| Debt retirement expense                    | 1,141                              | 62         | 4,584                             | 40,351       |
| Interest expense                           | 25,277                             | 29,479     | 79,102                            | 87,224       |
| Interest income                            | 1,660                              | 957        | 5,579                             | 3,062        |
| Income before income taxes and other items | \$ 5,397                           | \$ 31,559  | \$ 42,383                         | \$ 54,732    |

**Analysis of Segment Assets**

|                 | December 31, 2010 | December 31, 2009 | March 31, 2010 |
|-----------------|-------------------|-------------------|----------------|
| Segment assets: |                   |                   |                |
| South America   | \$ 639,111        | \$ 651,252        | \$ 806,088     |
| Other regions   | 1,217,239         | 1,234,191         | 1,105,111      |
| Total assets    | \$ 1,856,350      | \$ 1,885,443      | \$ 1,911,199   |

## 8. EARNINGS PER SHARE

The weighted average number of common shares outstanding is reported as the weighted average of the total shares of common stock outstanding net of shares of common stock held by a wholly owned subsidiary. Shares of common stock owned by the subsidiary were 7,853 at December 31, 2010 and 2009. This subsidiary waives its right to receive dividends and it does not have the right to vote.

Certain potentially dilutive options were not included in the computation of earnings per diluted share because their exercise prices were greater than the average market price of the shares of common stock during the period and their effect would be antidilutive. These shares totaled 1,222 at a weighted average exercise price of \$7.02 per share at December 31, 2010 and 1,626 at a weighted average exercise price of \$7.02 per share at December 31, 2009.

In connection with the offering of the Company's 5 ½% Convertible Senior Subordinated Notes due 2014, issued on July 2, 2009 (the Convertible Notes), the Company entered into privately negotiated convertible note hedge transactions (the convertible note hedge transactions) equal to the number of shares that underlie the Company's Convertible Notes. These convertible note hedge transactions are expected to reduce the potential dilution of the Company's common stock upon conversion of the Convertible Notes in the event that the value per share of common stock exceeds the initial conversion price of \$5.0280 per share. These shares were not included in the computation of earnings per diluted share because their inclusion would be antidilutive.

On July 28, 2010, the Company's board of directors authorized the purchase up to \$40,000 of its common stock through June 30, 2012. As of December 31, 2010, the Company has purchased 2,380 shares of its common stock at a weighted average price paid per share of \$3.78.

## Alliance One International, Inc. and Subsidiaries

## 8. EARNINGS PER SHARE (Continued)

The following table summarizes the computation of earnings per share for the three months and nine months ended December 31, 2010 and 2009, respectively.

| <i>(in thousands, except per share data)</i>  | Three Months Ended<br>December 31, |           | Nine Months Ended<br>December 31, |           |
|---|------------------------------------|-----------|-----------------------------------|-----------|
|   | 2010                               | 2009      | 2010                              | 2009      |
| <b>BASIC EARNINGS</b>   |                                    |           |                                   |           |
| Net income (loss) attributable to Alliance One International, Inc.  | \$ (1,989)                         | \$ 47,258 | \$ 32,112                         | \$ 60,278 |
| <b>SHARES</b>   |                                    |           |                                   |           |
| Weighted average number of shares outstanding   | 86,803                             | 88,689    | 88,125                            | 88,589    |
| <b>BASIC EARNINGS (LOSS) PER SHARE</b>  | \$ (.02)                           | \$ .53    | \$ .36                            | \$ .68    |
| <b>DILUTED EARNINGS</b>   |                                    |           |                                   |           |
| Net income (loss) attributable to Alliance One International, Inc.  | \$ (1,989)                         | \$ 47,258 | \$ 32,112                         | \$ 60,278 |
| Plus interest expense on 5 1/2% convertible notes, net of tax   | -*                                 | 1,047     | 3,083                             | 2,044     |
| Net income (loss) attributable to Alliance One International, Inc. as adjusted  | \$ (1,989)                         | \$ 48,305 | \$ 35,195                         | \$ 62,322 |
| <b>SHARES</b>   |                                    |           |                                   |           |
| Weighted average number of common shares outstanding  | 86,803                             | 88,689    | 88,125                            | 88,589    |
| Plus: Restricted shares issued and shares applicable to stock options and restricted stock units, net of shares assumed to be purchased from proceeds at average market price | -*                                 | 376       | 340                               | 390       |
| Assuming conversion of 5 1/2% convertible notes at the time of issuance   | -*                                 | 22,872    | 22,872                            | 15,079    |
| Shares applicable to stock warrants   | -**                                | -**       | -**                               | -**       |
|   | 86,803                             | 111,937   | 111,337                           | 104,058   |



Adjusted weighted average number of  
common shares outstanding

|                                      |          |        |        |        |
|--------------------------------------|----------|--------|--------|--------|
| DILUTED EARNINGS (LOSS) PER<br>SHARE | \$ (.02) | \$ .43 | \$ .32 | \$ .60 |
|--------------------------------------|----------|--------|--------|--------|

\* Assumed conversion of convertible notes at the beginning of the period has an antidilutive effect on earnings (loss) per share.

For the three months ended December 31, 2010, all outstanding restricted shares and shares applicable to stock options and

restricted stock unit are excluded because their inclusion would have an anti dilutive effect on the loss per share.

\*\* For the three months and nine months ended December 31, 2010 and 2009, the warrants were not assumed exercised because the exercise price was more than the average price for the periods presented.

## 9. COMPREHENSIVE INCOME

The components of comprehensive income were as follows:

|   | Three Months Ended |           | Nine Months Ended |           |
|---|--------------------|-----------|-------------------|-----------|
|   | December 31,       |           | December 31,      |           |
|   | 2010               | 2009      | 2010              | 2009      |
| Net income (loss)   | \$ (2,001)         | \$ 47,788 | \$ 31,893         | \$ 61,289 |
| Equity currency conversion adjustment                               | (45)               | (1,264)   | 777               | 2,162     |
| Pension adjustment, net of tax                                      | -                  | (359)     | -                 | (359)     |
| Total comprehensive income (loss)                                   | (2,046)            | 46,165    | 32,670            | 63,092    |
| Comprehensive income (loss) attributable to noncontrolling interest | (15)               | 521       | (237)             | 1,029     |
| Total comprehensive income (loss) attributable to the Company       | \$ (2,031)         | \$ 45,644 | \$ 32,907         | \$ 62,063 |

## Alliance One International, Inc. and Subsidiaries

## 10. STOCK-BASED COMPENSATION

The Company recorded stock-based compensation expense related to stock-based awards granted under its various employee and non-employee stock incentive plans of \$644 and \$1,823 for the three months ended December 31, 2010 and 2009, respectively, and \$1,509 and \$5,233 for the nine months ended December 31, 2010 and 2009, respectively.

The Company's shareholders amended the 2007 Incentive Plan (the 2007 Plan) at its Annual Meeting of Shareholders on August 6, 2009. The 2007 Plan is an omnibus plan that provides the flexibility to grant a variety of equity awards including stock options, stock appreciation rights, stock awards, stock units, performance awards and incentive awards to officers, directors and employees of the Company.

During the three months and nine months ended December 31, 2010 and 2009, respectively, the Company made the following stock-based compensation awards:

| <i>(in thousands, except grant date fair value)</i> | Three Months Ended |      | Nine Months Ended |         |
|---|--------------------|------|-------------------|---------|
|   | December 31,       |      | December 31,      |         |
|   | 2010               | 2009 | 2010              | 2009    |
| <b>Restricted Stock</b>                             |                    |      |                   |         |
| Number Granted                                      | -                  | -    | 143               | 192     |
| Grant Date Fair Value                               | \$ -               | \$ - | \$ 3.34           | \$ 4.25 |
| <b>Restricted Stock Units</b>                       |                    |      |                   |         |
| Number Granted                                      | 947                | -    | 947               | 106     |
| Grant Date Fair Value                               | \$ 4.59            | \$ - | \$ 4.59           | \$ 4.26 |
| <b>Performance Shares</b>                           |                    |      |                   |         |
| Number Granted                                      | -                  | -    | -                 | 1,758   |
| Grant Date Fair Value                               | \$ -               | \$ - | \$ -              | \$ 4.19 |
| <b>Performance Based Restricted Stock Units</b>     |                    |      |                   |         |
| Number Granted                                      | 2,048              | -    | 2,048             | -       |
| Grant Date Fair Value                               | \$ 4.59            | \$ - | \$ 4.59           | \$ -    |

Under the terms of both the Performance Shares and Performance Based Restricted Stock Units, shares ultimately issued will be contingent upon specified business performance goals. If minimum standards are not attained, compensation paid under these awards will be zero. Alternatively, if the maximum performance levels described by the plan are attained, the awards may be 150% of the stated award.

## 11. CONTINGENCIES AND OTHER INFORMATION

## Non-Income Tax

The government in the Brazilian State of Parana ( Parana ) issued a tax assessment on October 26, 2007 with respect to local intrastate trade tax credits that result primarily from tobacco transferred between states within Brazil. The assessment for intrastate trade tax credits taken is \$7,908 and the total assessment including penalties and interest through December 31, 2010 is \$17,275. The Company believes it has properly complied with Brazilian law and will contest any assessment through the judicial process. Should the Company lose in the judicial process, the loss of the intrastate trade tax credits would have a material impact on the financial statements of the Company.

The assessment of \$7,908 represents intrastate trade tax credit amounts which were offset against intrastate trade tax payables as allowed under Brazilian law. At December 31, 2010, the Company also has intrastate trade tax credits from Parana of \$14,113. During fiscal 2008, the Company recorded an impairment charge of \$7,143. After the assessment, the Company has treated new expenditures for intrastate trade taxes on tobacco acquisition as a cost of inventory procurement.

The Company also has local intrastate trade tax credits in the Brazil State of Rio Grande do Sul ( Rio Grande ) of \$68,952 and \$59,077 at December 31, 2010 and 2009, respectively. Based on management's expectations about future realization, the Company has recorded a valuation allowance on the Rio Grande intrastate trade tax credits of \$36,110 and \$7,419 at December 31, 2010 and 2009, respectively. The allowance on the Rio Grande intrastate trade tax credits may be adjusted in future periods based on market conditions and the Company's ability to use the tax credits.

The Company's subsidiary in Brazil has constructed a new tobacco processing facility in the State of Santa Catarina with the annual production capacity of 70 million kilos. The Company will process the 2011 crop in the new facility. As a result of moving production to Santa Catarina, the Company has excess intrastate tax credits. Therefore, the Company reached an agreement with the government of Santa Catarina to allow the Company to sell its excess credits (receivables) to third parties and recorded a valuation allowance of \$3,500 in fiscal 2010. The Company has Santa Catarina intrastate tax credits of \$27,987 at December 31, 2010. Based on management's expectations about future realization, the Company has recorded a total valuation allowance on the Santa Catarina intrastate trade tax credits of \$12,076 at December 31, 2010.

Alliance One International, Inc. and Subsidiaries

## 11. CONTINGENCIES AND OTHER INFORMATION (*Continued*)

### **Non-Income Tax** (*Continued*)

As of January 1, 2011, a new government was elected in the State of Santa Catarina and they temporarily suspended the sale of excess intrastate tax credits. The allowance on the Santa Catarina intrastate tax credits may be adjusted in future periods based on market conditions and the Company's ability to use the tax credits.

In 2001, the Company's subsidiary in Brazil won a claim related to certain excise taxes ( IPI credit bonus ) for the years 1983 through 1990. The Company used this IPI credit bonus to offset federal income and other taxes until January 2005 when it received a Judicial Order to suspend the IPI compensation. In addition, the Company received an assessment in 2006 for federal income taxes that were offset by the IPI credit bonus. The assessment is valued at \$29,184 at December 31, 2010. The Company appealed the assessment and believes it has properly utilized the IPI credit bonus. No benefit for the utilization of the IPI credit bonus has been recognized as it has been recorded in Pension, Postretirement and Other Long-Term Liabilities. As a result of various legislative and judicial actions, the Company does not expect a ruling in the near future, which would directly impact the outcome of the Company's appeal of the tax assessment as well as its utilization of its remaining IPI credit bonus. No benefit for any potential future utilization of IPI credit bonus has been recognized.

### **Other**

In October 2001, the Directorate General for Competition ( DGCOMP ) of the European Commission ( EC ) began an administrative investigation into certain tobacco buying and selling practices alleged to have occurred within the leaf tobacco industry in some countries within the European Union, including Spain, Italy, Greece and potentially other countries. The Company and its subsidiaries in Spain, Italy and Greece have been subject to these investigations. In respect of the investigation into practices in Spain, in 2004, the EC fined the Company and its Spanish subsidiaries €4,415 (US\$5,641). In respect of the investigation into practices in Italy, in October 2005, the EC announced that the Company and its Italian subsidiaries have been assessed a fine in the aggregate amount of €24,000 (US\$28,800). With respect to both the Spanish and Italian investigations, the fines imposed on the Company and its predecessors and subsidiaries were part of fines assessed on several participants in the applicable industry. With respect to the investigation relating to Greece, the EC informed the Company in March 2005 it had closed its investigation in relation to the Greek leaf tobacco industry buying and selling practices. The Company, along with its applicable subsidiaries, has appealed the decisions of the EC with respect to Spain and Italy to the Court of First Instance of the European Commission for the annulment or modification of the decision, but the outcome of the appeals process as to both timing and results is uncertain. The Company has fully recognized the impact of each of the fines set forth above and has paid all of such fines as part of the appeal process.

The Company had previously disclosed that it had received notice from Mindo, S.r.l., the purchaser in June 2004 of the Company's Italian subsidiary Dimon Italia, S.r.l., of its intent to assert against the Company, or its subsidiaries, a claim arising out of that sale transaction. That claim, which may be followed by additional claims, was filed before the Court of Rome on April 12, 2007. The claim, allegedly arising from a guaranty letter issued by a

consolidated subsidiary of the Company in connection with the sale transaction, seeks the recovery of €7,377 (US\$9,776) plus interest and costs. The Company believes the claim to be without merit and is vigorously defending it. No amounts have been reserved with respect to such claim.

On August 6, 2010, the Company entered into settlement agreements with the Department of Justice ( DOJ ) and the Securities and Exchange Commission ( SEC ) to resolve those agencies' investigations of the Company relating to alleged violations under the Foreign Corrupt Practices Act ( FCPA ) which occurred prior to the merger that formed the Company in May, 2005. Pursuant to the settlement negotiated with DOJ, two of the Company's foreign subsidiaries, Alliance One Tobacco Osh, LLC and Alliance One International AG (successors to DIMON International (Kyrgyzstan) and DIMON International AG, respectively), agreed to plead guilty to FCPA violations committed by DIMON International (Kyrgyzstan) and DIMON International AG prior to the merger creating the Company, and to pay fines totaling \$9,450. Additionally, the Company entered into a non-prosecution agreement by the terms of which the DOJ will not prosecute the Company if, for a period of three years, the Company meets its obligations as set out in the agreement. On October 21, 2010, the U.S. District Court for the Western District of Virginia in Danville, Virginia accepted these guilty pleas and entered a judgment consistent with the terms of the settlement agreement. The settlement negotiated with the SEC includes the Company's agreement to disgorge profits in the amount of \$10,000 and to abide by an injunction against further FCPA violations. On August 26, 2010, the U.S. District Court for the District of Columbia approved the terms of the settlement with the SEC and entered the injunction contemplated by the settlement agreement. Both settlements require the Company to retain an independent compliance monitor for a term of three years. The Company provided for these losses at March 31, 2010 and \$10,000 was paid to the SEC on August 30, 2010 and \$9,452 was paid to the U.S. District Court on October 28, 2010.

Alliance One International, Inc. and Subsidiaries

## 11. CONTINGENCIES AND OTHER INFORMATION (*Continued*)

### **Other** (*Continued*)

On December 13, 2007, the Public Prosecutors' offices in the States of Santa Catarina and Parana filed claims against the Company's Brazilian subsidiary, Alliance One Brazil Exportadora de Tabacos Ltda. (AOB) and a number of other tobacco processors on behalf of all tobacco suppliers in those states. The lawsuits primarily assert that there exists an employment relationship between tobacco processors and tobacco suppliers. The Company believes these claims to be without merit and intends to vigorously defend them. Ultimate exposure if an unfavorable outcome is received is not determinable.

At the initial hearing in Santa Catarina, on January 29, 2008, the Court granted the Company's motion to have that case removed to the Labor Court in Brasilia. No hearing date has yet been set.

In the state of Parana, the relief sought by the Public Prosecutor was granted by the local Labor Court. The Company appealed that initial ruling and it was overturned in part and affirmed in part. The Company has appealed from that part of the initial ruling which was affirmed and no ruling has yet been rendered on the appeal. The Company has separately asserted, on April 11, 2008, a lack of jurisdiction motion similar to that which it asserted in the case in Santa Catarina which resulted in the transfer of that case to the Labor Court in Brasilia. No hearing date for that motion has been set.

On June 6, 2008, AOB and a number of other tobacco processors were notified of a class action initiated by the ALPAG - Associação Lourenciana de Pequenos Agricultores ("Association of Small Farmers of São Lourenço"). The class action's focus is a review of tobacco supplier contracts and business practices, specifically aiming to prohibit processors from notifying the national credit agency of producers in debt, prohibiting processors from deducting tobacco suppliers' debt from payments for tobacco, and seeking the modification of other contractual terms historically used in the purchase of tobacco. The Company presented its defense locally and the case has been transferred to the Federal Court in Brasilia. No hearing date

has been set. The Company believes this claim to be without merit and intends to vigorously defend it. Ultimate exposure if an unfavorable outcome is received is not determinable.

In accordance with generally accepted accounting principles, the Company records all known asset retirement obligations (ARO) for which the liability can be reasonably estimated. Currently, it has identified an ARO associated with one of its facilities that requires it to restore the land to its initial condition upon vacating the facility. The Company has not recognized a liability under generally accepted accounting principles for this ARO because the fair value of restoring the land at this site cannot be reasonably estimated since the settlement date is unknown at this time. The settlement date is unknown because the land restoration is not required until title is returned to the government, and the Company has no current or future plans to return the title. The Company will recognize a liability in the period in which sufficient information is available to reasonably estimate its fair value. The Company has no additional material AROs.

On December 24, 2010, a third-party warehouse in South Africa was destroyed by fire. This warehouse contained approximately \$6,072 of the Company's inventory. The Company believes that its loss is fully insured and has recorded a receivable of the amount of loss for the probable recovery.

## 12. DEBT ARRANGEMENTS

### Senior Notes

On March 7, 2007, the Company issued \$150,000 of 8 ½% Senior Notes due 2012 at a 0.5% original issue discount to reflect an 8.6% yield to maturity. On July 2, 2009, the Company completed a number of refinancing transactions in which it purchased \$120,365 aggregate principal amount of the existing notes pursuant to a cash tender offer. During the three months ended June 30, 2010, the Company purchased \$23,635 of the remaining notes on the open market. All purchased securities were canceled leaving \$6,000 of the 8 ½% senior notes outstanding at June 30, 2010. Associated cash premiums and other costs paid were \$650. Deferred financing costs and amortization of original issue discount of \$282 were accelerated.

On July 2, 2009, the Company issued \$570,000 of 10% Senior Notes due 2016 at a 4.823% original issue discount to reflect an 11.0% yield to maturity. On August 26, 2009, the Company issued an additional \$100,000 tranche of 10% Senior Notes due 2016 at a 2.5% original issue discount to reflect a 10.512% yield to maturity. These additional notes form part of the same series as the Senior Notes issued on July 2, 2009. The aggregate principal amount of the outstanding Senior Notes was \$670,000. During the three months ended September 30, 2010, the Company purchased \$25,000 of these notes on the open market. All purchased securities were canceled leaving \$645,000 of the 10% senior notes outstanding at September 30, 2010. Associated cash premiums and other costs paid were \$1,038. Deferred financing costs and amortization of original issue discount of \$1,474 were accelerated. During the three months ended December 31, 2010, the Company purchased \$10,000 of these notes on the open market. All purchased securities were canceled leaving \$635,000 of the 10% senior notes outstanding at December 31, 2010. Associated cash premiums and other costs paid were \$575. Deferred financing costs and amortization of original issue discount of \$566 were accelerated.

At December 31, 2010, the Company did not satisfy the fixed charge coverage ratio required under the Senior Notes indenture to permit the Company to access the restricted payments basket for the purchase of common stock and other actions under that basket. The Company from time to time may not satisfy the required ratio.

## Alliance One International, Inc. and Subsidiaries

## 13. DERIVATIVE FINANCIAL INSTRUMENTS

**Fair Value of Derivative Financial Instruments**

The Company recognizes all derivative financial instruments, such as interest rate swap contracts and foreign exchange contracts at fair value. Changes in the fair value of derivative financial instruments are either recognized periodically in income or in shareholders' equity as a component of other comprehensive income depending on whether the derivative financial instrument qualifies for hedge accounting, and if so, whether it qualifies as a fair value hedge or a cash flow hedge. Changes in fair values of derivatives accounted for as fair value hedges are recorded in income along with the portions of the changes in the fair values of the hedged items that relate to the hedged risk(s). Changes in fair values of derivatives accounted for as cash flow hedges, to the extent they are effective as hedges, are recorded in other comprehensive income net of deferred taxes. Changes in fair values of derivatives not qualifying as hedges are reported in income. During the three months and nine months ended December 31, 2010 and 2009, there were no qualified cash flow or fair value hedges. Estimates of fair value were determined in accordance with generally accepted accounting principles. The following table summarizes the fair value of the Company's derivatives by type at December 31, 2010 and 2009 and March 31, 2010.

|  | Fair Values of Derivative Instruments |            |                              |            |
|--|---------------------------------------|------------|------------------------------|------------|
|  | Assets                                |            | Liabilities                  |            |
| Derivatives Not Designated as Hedging Instruments: | Balance Sheet Account                 | Fair Value | Balance Sheet Account        | Fair Value |
| Foreign currency contracts                         |                                       |            |                              |            |
| at December 31, 2010 (a)                           | Current derivative asset              | \$ 218     | Current derivative liability | \$ -       |
| Foreign currency contracts                         |                                       |            |                              |            |
| at December 31, 2009 (a)                           | Current derivative asset              | \$ 1,075   | Current derivative liability | \$ 2,716   |
| Foreign currency contracts                         |                                       |            |                              |            |
| at March 31, 2010 (a)                              | Current derivative asset              | \$ 2,528   | Current derivative liability | \$ -       |

(a) The cumulative adjustment for non-performance risk was a loss of \$0, \$7 and \$4 at December 31, 2010 and 2009 and March 31, 2010, respectively.

**Earnings Effects of Derivatives**



**Foreign Currency Contracts**

The Company periodically enters into forward or option currency contracts to protect against volatility associated with certain non-U.S. dollar denominated forecasted transactions. When these derivatives qualify for hedge accounting treatment, they are accounted for as cash flow hedges and are recorded in other comprehensive income, net of deferred taxes.

The Company has entered into forward currency contracts to hedge cash outflows in foreign currencies around the world for green tobacco purchases and processing costs as well as selling, administrative and general costs as the Company deems necessary. These contracts do not meet the requirements for hedge accounting treatment under generally accepted accounting principles, and as such, all changes in fair value are reported in income.

The following table summarizes the earnings effects of derivatives in the condensed consolidated statements of operations for the three months and nine months ended December 31, 2010 and 2009.

| Derivatives Not Designated as Hedging Instruments | Location of Gain (Loss) Recognized in Income | Gain (Loss) Recognized in Income |            |                   |           |
|---|--|----------------------------------|------------|-------------------|-----------|
|   |  | Three Months Ended               |            | Nine Months Ended |           |
|   |  | December 31,                     |            | December 31,      |           |
|   |  | 2010                             | 2009       | 2010              | 2009      |
| Foreign currency contracts                        | Cost of goods and services sold              | \$ 15                            | \$ (2,980) | \$ 3,771          | \$ 12,889 |
| Foreign currency contracts                        | Selling, administrative and general expenses | 10                               | 200        | 100               | 3,599     |
| Total   |  | \$ 25                            | \$ (2,780) | \$ 3,871          | \$ 16,488 |

**Credit Risk**

Financial instruments, including derivatives, expose the Company to credit loss in the event of non-performance by counterparties. The Company manages its exposure to counterparty credit risk through specific minimum credit standards, diversification of counterparties, and procedures to monitor concentrations of credit risk. If a counterparty fails to meet the terms of an arrangement, the Company's exposure is limited to the net amount that would have been received, if any, over the

arrangement's remaining life. The Company does not anticipate non-performance by the counterparties and no material loss would be expected from non-performance by any one of such counterparties.

## Alliance One International, Inc. and Subsidiaries

## 14. PENSION AND POSTRETIREMENT BENEFITS

The Company has a defined benefit plan that provides retirement benefits for substantially all U.S. salaried personnel based on years of service rendered, age and compensation. The Company also maintains various other Excess Benefit and Supplemental Plans that provide additional benefits to (1) certain individuals whose compensation and the resulting benefits that would have actually been paid are limited by regulations imposed by the Internal Revenue Code and (2) certain individuals in key positions. The Company funds these plans in amounts consistent with the funding requirements of federal law and regulations.

Additional non-U.S. defined benefit plans sponsored by certain subsidiaries cover certain full-time employees located in Germany, Turkey, Malawi and the United Kingdom.

Components of Net Periodic Benefit Cost

Net periodic pension cost for continuing operations consisted of the following:

|                                    | Three Months Ended |          | Nine Months Ended |          |
|------------------------------------|--------------------|----------|-------------------|----------|
|                                    | December 31,       |          | December 31,      |          |
|                                    | 2010               | 2009     | 2010              | 2009     |
| Service cost                       | \$ 805             | \$ 895   | \$ 2,417          | \$ 2,685 |
| Interest expense                   | 2,192              | 2,236    | 6,577             | 6,707    |
| Expected return on plan assets     | (1,428)            | (1,114)  | (4,284)           | (3,340)  |
| Amortization of prior service cost | 6                  | (44)     | 17                | (133)    |
| Actuarial (gain) loss              | 335                | (2)      | 1,004             | (6)      |
| Special termination benefits       | 204                | -        | 204               | -        |
| Net periodic pension cost          | \$ 2,114           | \$ 1,971 | \$ 5,935          | \$ 5,913 |

Employer Contributions

The Company's investment objectives are to generate consistent total investment return to pay anticipated plan benefits, while minimizing long-term costs. Financial objectives underlying this policy include maintaining plan contributions at a reasonable level relative to benefits provided and assuring that unfunded obligations do not grow to a level to adversely affect the Company's financial health. As of December 31, 2010, contributions of \$8,190 were made to pension plans for fiscal 2011. Additional contributions to pension plans of approximately \$2,580 are expected during the remainder of fiscal 2011. However, this amount is subject to change, due primarily to potential plan combinations, asset performance significantly above or below the assumed long-term rate of return on pension assets and significant changes in interest rates.

**Postretirement Health and Life Insurance Benefits**

The Company also provides certain health and life insurance benefits to retired employees, and their eligible dependents, who meet specified age and service requirements. As of December 31, 2010, contributions of \$530 were made to the plans for fiscal 2011. Additional contributions of \$386 to the plans are expected during the rest of fiscal 2011. The Company retains the right, subject to existing agreements, to modify or eliminate the postretirement medical benefits.

Components of Net Periodic Benefit Cost

Net periodic benefit cost for postretirement health and life insurance benefit plans consisted of the following:

|                                     | Three Months Ended<br>December 31, |            | Nine Months Ended<br>December 31, |            |
|-------------------------------------|------------------------------------|------------|-----------------------------------|------------|
|                                     | 2010                               | 2009       | 2010                              | 2009       |
| Service cost                        | \$ 20                              | \$ 16      | \$ 60                             | \$ 48      |
| Interest expense                    | 166                                | 189        | 499                               | 564        |
| Amortization of prior service cost  | (410)                              | (415)      | (1,232)                           | (1,245)    |
| Actuarial loss                      | 108                                | 76         | 325                               | 229        |
| Curtailement gain recognized        | -                                  | (777)      | -                                 | (777)      |
| Settlement gain recognized          | -                                  | (290)      | -                                 | (290)      |
| Net periodic pension cost (benefit) | \$ (116)                           | \$ (1,201) | \$ (348)                          | \$ (1,471) |

## Alliance One International, Inc. and Subsidiaries

## 15. INVENTORIES

The following table summarizes the Company's costs in inventory:

|                     | December 31, 2010 | December 31, 2009 | March 31, 2010 |
|---------------------|-------------------|-------------------|----------------|
| Processed tobacco   | \$ 700,144        | \$ 549,926        | \$ 417,996     |
| Unprocessed tobacco | 79,765            | 140,198           | 354,155        |
| Other               | 40,074            | 46,096            | 51,996         |
|                     | \$ 819,983        | \$ 736,220        | \$ 824,147     |

## 16. SALE OF RECEIVABLES

On April 1, 2010, the Company adopted new accounting guidance on accounting for the transfers of financial assets. This new accounting guidance is intended to improve the information provided in financial statements concerning transfers of financial assets, including the effects of transfers on financial position, financial performance and cash flows, and any continuing involvement of the transferor with the transferred financial assets.

The Company has entered into an accounts receivable securitization program whereby it sells certain of its trade accounts receivable to a third-party bankruptcy-remote special purpose entity ( SPE ) which, in turn, sells the receivables to a third-party commercial paper conduit. The SPE was formed for the sole purpose of buying and selling receivables generated by the Company.

The sales price consists of 90% of the face value of the receivable, less contractual dilutions which limit the amount that may be outstanding from any one particular customer and insurance reserves that also have the effect of limiting the risk attributable to any one customer. Upon sale, the Company removes the carrying value of the receivable sold and records the fair value of its beneficial interest in the receivable in accounts receivable. The fair value of the beneficial interest is calculated by applying the commercial paper rate and the servicing rate to the balance of the outstanding receivables in the facility. The Company receives a 0.5% per annum servicing fee on receivables sold and outstanding which is recorded as a reduction of selling, administrative and general expenses. This fee is compensatory and no servicing asset or liability has resulted from the sale. The receivables sold are non-interest bearing. This in conjunction with the short life of the receivables sold and outstanding causes the effects of any prepayments on the value of assets recorded to be inconsequential.

Losses on sale of receivables are recorded as a component of Other Income in the condensed consolidated statements of operations.

The following table summarizes the Company's accounts receivable securitization information as of December 31:

|  | 2010       | 2009       |
|--|------------|------------|
| Receivables outstanding in facility:                                     |            |            |
| As of April 1  | \$ 105,579 | \$ 100,611 |
| Sold   | 486,847    | 623,550    |
| Collected  | (519,784)  | (638,221)  |
| As of December 31  | \$ 72,642  | \$ 85,940  |
| Beneficial interest as of December 31 (a)                                | \$ 23,350  | \$ 8,084   |
| Impact on beneficial interest resulting from increases in discount rate: |            |            |
| 10%  | \$ 33      | \$ 50      |
| 20%  | \$ 65      | \$ 100     |
| Criteria to determine beneficial interest as of December 31:             |            |            |
| Weighted average life in days  | 71         | 70         |
| Discount rate (inclusive of 0.5% servicing fee)                          | 2.48%      | 3.1%       |
| Unused balance fee   | 0.40%      | 0.25%      |
| Cash proceeds for the nine months ended December 31:                     |            |            |
| Current purchase price   | \$ 335,065 | \$ 455,011 |
| Deferred purchase price  | 163,097    | 158,197    |
| Service fees   | 399        | 376        |
| Total  | \$ 498,561 | \$ 613,584 |
| Loss on sale of receivables  |            |            |
| Three months ended December 31   | \$ 715     | \$ 791     |
| Nine months ended December 31  | \$ 1,662   | \$ 1,957   |

(a) Beneficial interest as of March 31, 2010 was \$25,125 and was determined using a weighted average life in days of 95,

a discount rate of 3.0% and an unused balance fee of 0.25%.

Alliance One International, Inc. and Subsidiaries

## 16. SALE OF RECEIVABLES (Continued)

It is the Company's intention to maximize the receivables sold under the revolving agreement meaning that amounts collected by the pool would be reinvested in the purchase of additional eligible receivables. The table below indicates the utilization of the revolving agreement:

| Nine Months Ended<br>December 31, | Twelve Months<br>Ended |
|-----------------------------------|------------------------|
|-----------------------------------|------------------------|

|                             | 2010      | 2009      | March 31, 2010 |
|-----------------------------|-----------|-----------|----------------|
| Average outstanding balance | \$ 63,553 | \$ 74,835 | \$ 76,711      |
| Maximum outstanding balance | 99,113    | 96,365    | 99,712         |
| Minimum outstanding balance | 16,738    | 47,174    | 47,174         |

## 17. FAIR VALUE MEASUREMENTS

The Company follows the current accounting guidance for fair value measurements for financial and non-financial assets and liabilities. The financial assets and liabilities measured at fair value include derivative instruments, securitized beneficial interests and guarantees. The non-financial assets and liabilities measured at fair value primarily include assessments of investments in subsidiaries, goodwill and other intangible assets and long-lived assets for potential impairment. The carrying value and estimated fair value of the Company's long term debt are shown in the table below.

|                       | December 31, 2010 | December 31, 2009 | March 31, 2010 |
|-----------------------|-------------------|-------------------|----------------|
| <b>Long term debt</b> |                   |                   |                |
| Carrying value        | \$ 763,052        | \$ 825,573        | \$ 789,337     |
| Estimated fair value  | 796,213           | 912,291           | 845,642        |

A three-level valuation hierarchy is used to determine fair value as follows:

Level 1 Quoted prices for identical assets or liabilities in active markets.

Level 2 Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3 Significant inputs to the valuation model are unobservable.

The following tables present the Company's assets and liabilities measured at fair value on a recurring basis:

| Derivative<br>financial | Securitized<br>beneficial | <b>Total<br/>Assets</b> | Derivative<br>financial | Guarantees | <b>Total<br/>Liabilities</b> |
|-------------------------|---------------------------|-------------------------|-------------------------|------------|------------------------------|
|-------------------------|---------------------------|-------------------------|-------------------------|------------|------------------------------|

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|                                     | instruments     | interests        |                  | instruments     |                  |                  |
|-------------------------------------|-----------------|------------------|------------------|-----------------|------------------|------------------|
| Level 1                             | \$ -            | \$ -             | \$ -             | \$ -            | \$ -             | \$ -             |
| Level 2                             | 218             | -                | 218              | -               | -                | -                |
| Level 3                             | -               | 23,350           | 23,350           | -               | 4,866            | 4,866            |
| <b>Totals for December 31, 2010</b> | <b>\$ 218</b>   | <b>\$ 23,350</b> | <b>\$ 23,568</b> | <b>\$ -</b>     | <b>\$ 4,866</b>  | <b>\$ 4,866</b>  |
| Level 1                             | \$ -            | \$ -             | \$ -             | \$ -            | \$ -             | \$ -             |
| Level 2                             | 1,075           | -                | 1,075            | 2,716           | -                | 2,716            |
| Level 3                             | -               | 8,084            | 8,084            | -               | 11,984           | 11,984           |
| <b>Totals for December 31, 2009</b> | <b>\$ 1,075</b> | <b>\$ 8,084</b>  | <b>\$ 9,159</b>  | <b>\$ 2,716</b> | <b>\$ 11,984</b> | <b>\$ 14,700</b> |
| Level 1                             | \$ -            | \$ -             | \$ -             | \$ -            | \$ -             | \$ -             |
| Level 2                             | 2,528           | -                | 2,528            | -               | -                | -                |
| Level 3                             | -               | 25,125           | 25,125           | -               | 13,478           | 13,478           |
| <b>Totals for March 31, 2010</b>    | <b>\$ 2,528</b> | <b>\$ 25,125</b> | <b>\$ 27,653</b> | <b>\$ -</b>     | <b>\$ 13,478</b> | <b>\$ 13,478</b> |

## Alliance One International, Inc. and Subsidiaries

## 17. FAIR VALUE MEASUREMENTS (Continued)

The following tables present the changes in Level 3 instruments measured on a recurring basis:

|  | Three Months Ended<br>December 31, 2010                 |            | Nine Months Ended<br>December 31, 2010                  |            |
|--|---|------------|---|------------|
|  | Beneficial<br>Interest<br>in Securitized<br>Receivables | Guarantees | Beneficial<br>Interest<br>in Securitized<br>Receivables | Guarantees |
| Beginning Balance  | \$ 25,528   | \$ 4,830   | \$ 25,125   | \$ 13,478  |
| Total losses (realized / unrealized<br>included in earnings) | (715)   | -          | (1,662)   | -          |
| Purchases, issuances, and settlements,<br>net                | (1,463)   | 36         | (113)   | (8,612)    |
| Ending Balance   | \$ 23,350   | \$ 4,866   | \$ 23,350   | \$ 4,866   |

|  | Three Months Ended<br>December 31, 2009                 |            | Nine Months Ended<br>December 31, 2009                  |            |
|--|---|------------|---|------------|
|  | Beneficial<br>Interest<br>in Securitized<br>Receivables | Guarantees | Beneficial<br>Interest<br>in Securitized<br>Receivables | Guarantees |
| Beginning Balance  | \$ 11,893   | \$ 7,019   | \$ 26,833   | \$ 14,584  |
| Total losses (realized / unrealized<br>included in earnings) | 791   | -          | 1,957   | -          |
| Purchases, issuances, and settlements,<br>net                | (4,600)   | 4,965      | (20,706)  | (2,600)    |
| Ending Balance   | \$ 8,084  | \$ 11,984  | \$ 8,084  | \$ 11,984  |

The amount of unrealized losses relating to assets still held December 31, 2010 and 2009 and March 31, 2010 was \$366, \$524 and \$826, respectively, all relating to securitized beneficial interests. Gains and losses included in earnings are reported in Other Income in the condensed consolidated statements of operations. The Company did not have any non-recurring fair value adjustments during the nine months ended December 31, 2010 or December 31, 2009.

**Valuation methodologies**





Alliance One International, Inc. and Subsidiaries

18. RELATED PARTY TRANSACTIONS *(Continued)*

The Company's operating subsidiaries have entered into transactions with affiliates of the Company for the purpose of procuring inventory.

The Company's balances due to and from related parties are primarily with its deconsolidated Zimbabwe subsidiary. The remaining related party balances and transactions relate to the Company's equity basis investments in companies located in Asia which purchase and process tobacco.

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Alliance One International, Inc. and Subsidiaries

Item 2. Management's Discussion and Analysis of  
Financial Condition and Results of Operations

**EXECUTIVE OVERVIEW**

The following executive overview is intended to provide significant highlights of the discussion and analysis that follows.

**Financial Results**

Revenues and gross profits continue to be impacted by Japan Tobacco Inc.'s vertical integration initiative. In addition, increasing oversupply in certain markets and changes in customer buying patterns have reduced sales and margins. As a result, lower processing volumes as well as higher local costs negatively impacted our gross profit percentage. In response to the changes in the industry, we began several strategic initiatives this quarter to increase operational efficiency and effectiveness. These initiatives will continue over future quarters as we define and execute necessary changes to support our core business functions. Operating income did benefit this quarter due to the completion of the sale of assets in Brazil to Philip Morris International, Inc. Our effective tax rate for the quarter increased from a benefit of 47.2% to an expense of 156.9% primarily due to the reversal of unrecognized tax benefit liabilities in the prior year compared to a reduction in foreign tax credit carryforwards and the related deferred tax asset this year. The result of all these factors was a decrease in net income for the three months ending December 31, 2010 of \$49.2 million compared to the three months ending December 31, 2009.

**Liquidity**

Liquidity requirements for our business are impacted by crop seasonality, foreign currency and interest rates, green tobacco prices, crop quality and other factors. We continuously monitor and adjust funding sources as required based on business dynamics, utilizing cash from operations, our revolving credit facility, short term credit lines throughout the world, sales of accounts receivable, active working capital management and advances from customers. As of December 31, 2010, we had \$789.5 million of cash and available credit comprised of \$41.4 million of cash and \$748.1 million in available credit inclusive of \$262.0 million undrawn on our revolver, \$475.8 million of notes payable to banks, and \$10.3 million exclusively for letters of credit. We continually modify the makeup of our available liquidity

to enhance business flexibility and reduce costs.

## **Outlook**

Oversupply will likely continue to increase this coming crop year. Looking to the crop after that, we believe that lower prices paid for the coming crop, combined with the profitability of competing crops, may cause many suppliers to produce less tobacco and begin reversing the oversupply trend. We are committed to the successful implementation of the required changes to our business model to reposition our business and we will continue to improve our capital structure while monitoring the market for both our debt and equity securities.

## Alliance One International, Inc. and Subsidiaries

**RESULTS OF OPERATIONS:****Condensed Consolidated Statements of Operations**

|  | Three Months Ended<br>December 31,<br>Change |           |        |         | Nine Months Ended<br>December 31,<br>Change |            |        |            |
|--|--|-----------|--------|---------|---|------------|--------|------------|
|  | 2010   | \$        | %      | 2009    | 2010  | \$         | %      | 2009       |
| <i>(in million, except percentages)</i>                |  |           |        |         |   |            |        |            |
| Sales and other operating revenues                     | \$ 522.1                                     | \$(136.3) | (20.7) | \$658.4 | \$ 1,572.3                                  | \$(171.7)  | (9.8)  | \$ 1,744.0 |
| Gross profit   | 60.6   | (37.5)    | (38.2) | 98.1    | 210.1                                       | (82.8)     | (28.3) | 292.9      |
| Selling, administrative and general expenses           | 37.4   | (0.7)     | (1.8)  | 38.1    | 116.2                                       | (0.3)      | (0.3)  | 116.5      |
| Other income   | 20.3   | 20.2      |        | 0.1     | 40.0  | 37.2       |        | 2.8        |
| Restructuring charges                                  | 13.4   | 13.4      |        | -       | 13.4  | 13.4       |        | -          |
| Debt retirement expense                                | 1.1  | 1.1       |        | -       | 4.6   | (35.8)     |        | 40.4       |
| Interest expense                                       | 25.3   | (4.2)     |        | 29.5    | 79.1  | (8.1)      |        | 87.2       |
| Interest income  | 1.7  | 0.7       |        | 1.0     | 5.6   | 2.5        |        | 3.1        |
| Income tax expense (benefit)                           | 8.5  | 23.4      |        | (14.9)  | 12.8  | 18.0       |        | (5.2)      |
| Equity in net income of investee companies             | 1.1  | (0.2)     |        | 1.3     | 2.3   | 1.0        |        | 1.3        |
| Income (loss) attributable to noncontrolling interests | -  | (0.5)     |        | 0.5     | (0.2)                                       | (1.2)      |        | 1.0        |
| Net income (loss) attributable to the Company          | \$ (2.0)                                     | \$ (49.3) |        | \$ 47.3 | \$ 32.1                                     | \$ (28.2)* |        | \$ 60.3*   |

\* Amounts do not equal column totals due to rounding.

**Sales and Other Operating Revenue Supplemental Information**

|   | Three Months Ended<br>December 31,<br>Change |           |        |          | Nine Months Ended<br>December 31,<br>Change |           |        |            |
|---|--|-----------|--------|----------|---|-----------|--------|------------|
|   | 2010   | \$        | %      | 2009     | 2010  | \$        | %      | 2009       |
| <i>(in millions, except percentages and per kilo amounts)</i> |  |           |        |          |   |           |        |            |
| Tobacco sales and other operating revenues:                   |  |           |        |          |   |           |        |            |
| Sales and other operating revenues                            | \$ 491.0                                     | \$(128.8) | (20.8) | \$ 619.8 | \$ 1,532.4                                  | \$(159.9) | (9.4)  | \$ 1,692.3 |
| Kilos   | 107.9  | (17.2)    | (13.7) | 125.1    | 340.6                                       | (38.5)    | (10.2) | 379.1      |
| Average price per kilo  | \$ 4.55                                      | \$ (.40)  | (8.1)  | \$ 4.95  | \$ 4.50                                     | \$ .04    | 0.9    | \$ 4.46    |

|  |          |            |        |          |            |            |        |            |
|--|----------|------------|--------|----------|------------|------------|--------|------------|
| Processing and other revenues            | \$ 31.1  | \$ (7.5)   | (19.4) | \$ 38.6  | \$ 39.9    | \$ (11.8)  | (22.8) | \$ 51.7    |
| Total sales and other operating revenues | \$ 522.1 | \$ (136.3) | (20.7) | \$ 658.4 | \$ 1,572.3 | \$ (171.7) | (9.8)  | \$ 1,744.0 |

### Three Months Ended December 31, 2010 Compared to Three Months Ended December 31, 2009

*Summary.* Sales and other operating revenues decreased 20.7% from \$658.4 million in 2009 to \$522.1 million in 2010 and gross profit decreased 38.2% from \$98.1 million in 2009 to \$60.6 million in 2010. Sales decreases are the result of a 13.7% or 17.2 million kilo decrease in quantities sold, an 8.1% or \$0.40 per kilo decrease in average sales prices and a 19.4% decrease in processing and other revenues. Gross profit as a percentage of sales decreased from 14.9% in 2009 to 11.6% in 2010 primarily due to less processing volumes resulting from reduced customer requirements and the impact of JTI's vertical integration, higher local costs and product mix. This is the primary reason for our operating income decreasing \$30.0 million compared to the prior year. Partially offsetting the impact of decreased gross profits on our operating income are increased gains on the sale of assets of \$20.2 million primarily related to the sale of the remaining assets per our agreement with Philip Morris International, Inc. in Brazil and a slight decrease in selling, administrative and general expenses. Another factor contributing to the decrease in our operating income compared to the prior year is \$13.4 million in restructuring charges incurred this quarter.

In response to shifting supply and demand balances and the changing business models of our customers, we began implementing several strategic initiatives this quarter including the transition of our United Kingdom finance and logistics functions to the United States and the closing of our Netherlands office. New leadership was also appointed to better position us for the future. Other global initiatives are underway to increase operational efficiency and effectiveness. These initiatives will continue over the coming quarters as we continue to define and execute the necessary changes to support core business functions. There will likely be additional charges related to further restructuring activities in subsequent periods.

Alliance One International, Inc. and Subsidiaries

**RESULTS OF OPERATIONS** *(Continued)*

**Three Months Ended December 31, 2010 Compared to Three Months Ended December 31, 2009** *(Continued)*

*Summary (Continued)*

This quarter, we purchased \$10.0 million of our 10% senior notes as we continue to focus on reducing leverage. Our interest costs decreased \$4.2 million primarily as a result of lower interest rates on our seasonal financing compared to the prior year. While decreased interest costs and increased gains on sale of assets were positive impacts on pretax income compared to the prior year, the decreases in revenues and gross margins resulted in our pretax income decreasing from \$31.6 million in 2009 to \$5.4 million in 2010. Our effective tax rate increased from a benefit of 47.2% in 2009 to an expense of 156.9% in 2010. The significant variance in the effective tax rate between 2010 and 2009 is primarily related to reductions in foreign tax credit carryforwards, foreign currency translation adjustments related to income taxes and the reversal of unrecognized tax benefit liabilities in 2009.

South America Region. Tobacco revenues decreased \$36.4 million or 20.6% primarily due to a decrease of 11.3 million kilos in quantities sold partially offset by an increase of \$0.70 per kilo in average sales prices. The decrease in volume is mainly attributable to the timing of shipments that were delayed until the third quarter in the prior year and the delay of shipments to future quarters in the current year. The increase in average sales price is primarily due to improved customer pricing to offset higher costs in local currency and exchange rate appreciation.

Gross profit decreased \$2.2 million compared to the prior year. The increased average sales prices were not sufficient to offset the impact of decreased volumes due to the timing of shipments.

Other Regions. Tobacco revenues decreased \$92.4 million or 20.9% primarily as a result of a decrease of \$0.76 per kilo in average sales prices and a decrease of 5.9 million kilos in quantities sold. Processing and other revenues decreased 19.4% or \$7.5 million primarily due to reduced customer requirements in North America. Gross profits decreased \$35.3 million in 2010 compared to 2009.

Revenues and gross profits were negatively impacted by the impact of JTI's vertical integration initiative. The timing of shipments between quarters this year compared to the prior year, less opportunistic sales in the current year

and product mix negatively impacted revenues and margins as well.

### **Nine Months Ended December 31, 2010 Compared to Nine Months Ended December 31, 2009**

*Summary.* Sales and other operating revenues decreased 9.8% from \$1,744.0 million in 2009 to \$1,572.3 million in 2010 and gross profit decreased 28.3% from \$292.9 million in 2009 to \$210.1 million in 2010. Sales decreases are the result of a 10.2% or 38.5 million kilo decrease in quantities sold and an \$11.8 million decrease in processing and other revenues partially offset by a slight increase of \$0.04 per kilo in average sales prices. Gross profit as a percentage of sales decreased from 16.8% in 2009 to 13.4% in 2010 primarily due to less processing volumes from the impact of JTI's vertical integration and opportunistic sales in the prior year, higher local costs and product mix. This is the primary reason for our operating income decreasing \$58.8 million compared to the prior year. Partially offsetting the impact of decreased gross profits on our operating income are increased gains on the sale of assets of \$37.2 million primarily related to our sale of contracts with tobacco suppliers and other assets in Brazil to Philip Morris International, Inc. and a slight decrease in selling, administrative and general expenses. Another factor contributing to the decrease in our operating income compared to the prior year is \$13.4 million in restructuring charges incurred this year.

We began implementing several strategic initiatives this year including the transition of overseas finance and logistics functions to the United States, the closing of our Netherlands office and changes in leadership. Other global initiatives are underway in response to shifting supply and demand balances and the changing business models of our customers. These initiatives will continue over the coming quarters as we continue to define and execute the necessary changes to support core business functions.

This year, we purchased \$23.6 million of our 8.5% senior notes and \$35.0 million of our 10% senior notes as we focus on reducing leverage. Associated cash premiums and other costs, and the related accelerated amortization of deferred financing costs and original issue discount, resulted in our recording \$4.6 million of debt retirement expense this year. In the prior year, we completed a number of refinancing transactions which resulted in recognition of \$40.4 million in significant one-time costs to retire our existing debt and accelerated recognition of the related deferred financing costs and original issue discounts. Our interest costs decreased \$8.1 million primarily as a result of lower interest rates on our seasonal financing compared to the prior year. While the increased gain on sale of assets this year and the non-recurrence of the significant debt retirement costs in the prior year positively impacted our pretax income, the decreases in revenues and gross margins resulted in our pretax income decreasing from \$54.7 million in 2009 to \$42.4 million in 2010. Our effective tax rate increased from a benefit of 9.5% in 2009 to an expense of 30.1% in 2010. The significant variance in the effective tax rate between 2010 and 2009 is primarily related to reductions in foreign tax credit carryforwards, foreign currency translation adjustments related to income taxes and the reversal of unrecognized tax benefit liabilities in 2009.



Alliance One International, Inc. and Subsidiaries

## **RESULTS OF OPERATIONS** *(Continued)*

### **Nine Months Ended December 31, 2010 Compared to Nine Months Ended December 31, 2009** *(Continued)*

South America Region. Tobacco revenues decreased \$108.8 million or 14.7% primarily due to a decrease of 44.4 million kilos in quantities sold partially offset by an increase of \$0.82 per kilo in average sales prices. The decrease in volume is mainly attributable to the impact of JTI's vertical integration initiative in Brazil in the prior fiscal year. The increase in average sales price is primarily due to product mix and improved customer pricing to offset higher costs in local currency and exchange rate appreciation.

Gross profit decreased \$50.9 million due to the impact of JTI's initiative, increased prices of tobacco paid to suppliers and the exchange rate impact on purchase and processing costs which are denominated in local currency.

Other Regions. Tobacco revenues decreased \$51.1 million or 5.4% primarily as a result of a \$0.34 per kilo decrease in average sales prices partially offset by an increase of 6.0 million kilos in quantities sold. Processing and other revenues decreased 22.8% or \$11.8 million primarily as a result of decreased processing volumes in Asia and North America. Gross profits decreased \$31.9 million in 2010 compared to 2009.

Volume increases were primarily in Asia partially offset by the negative impact of JTI's vertical integration initiative and shipping delays, including congestion at the port of Beira arising from inadequate dredging. Decreased average sales prices were primarily due to product mix and the increased sales of lower priced byproducts. Gross margin decreases were primarily the result of JTI's vertical integration initiative, product mix and shipping delays.

## **LIQUIDITY AND CAPITAL RESOURCES:**

### *Overview*

Our business is seasonal, and purchasing, processing and selling activities have several associated peaks where cash on hand and outstanding indebtedness may be significantly greater or less than at fiscal year-end. We utilize capital in excess of cash flow from operations to finance accounts receivable, inventory and advances to tobacco suppliers in foreign countries, including Argentina, Brazil, Guatemala, Malawi, Tanzania, Turkey and Zambia. In addition, from time to time, we may elect to purchase, redeem, repay, retire or cancel indebtedness prior to stated maturity under our various foreign credit lines, senior secured credit agreement or indentures, as permitted therein. On July 28, 2010, our board of directors authorized the purchase up to \$40.0 million of our common stock over the next two years and we purchased 2.4 million shares of our common stock at a weighted average price paid per share of \$3.78 through

December 31, 2010. Effective December 31, 2010, we did not satisfy the fixed charge coverage ratio required under the Senior Notes indenture to permit us to access the restricted payments basket for the purchase of common stock and other actions under that basket. From time to time we may not satisfy the required ratio.

As of December 31, 2010, we are in the process of repaying our South American related crop lines as we continue to ship inventory and collect receivables. In Africa, we continue to ship product which should continue into the first quarter of fiscal year 2012 as well as the purchase of the new crop which should begin mid-March. In Asia, the Indian Mysore and Indonesian crops are approaching the end of the processing and shipping is in full force. Europe continues shipping of the current crop and is preparing to purchase the new crop during the fourth fiscal quarter. North America has completed flue cured processing with shipping winding down and has commenced the purchasing, processing and shipping of the burley crop which should continue into the fourth fiscal quarter, seasonally elevating its working capital requirements. Depreciation of the U.S. dollar versus many of the currencies in which we have costs may continue to have an impact on our working capital requirements, as such, we will monitor and hedge foreign currency costs prudently, and as needed on a currency by currency basis. Looking forward, we may purchase, redeem, repay, retire or cancel indebtedness prior to stated maturity under our various foreign credit lines, senior secured credit agreement or indentures as permitted.

### **Working Capital**

Our working capital decreased from \$795.2 million at March 31, 2010 to \$782.4 million at December 31, 2010. Our current ratio was 2.5 to 1 at December 31, 2010 compared to 2.4 to 1 at March 31, 2010. The decrease in working capital is primarily related to increased notes payable to banks partially offset by increased inventories and advances to tobacco suppliers. These changes are attributable to the impact of a global oversupply of tobacco and the related financing, the purchasing and processing of tobacco in the United States and Malawi as well as the financing of crops in South America and in Europe.

The following table is a summary of items from the Condensed Consolidated Balance Sheet and Condensed Consolidated Statements of Cash Flows.

Alliance One International, Inc. and Subsidiaries

**LIQUIDITY AND CAPITAL RESOURCES** (Continued)**Working Capital** (Continued)

| <i>(in millions, except for current ratio)</i>                        | December 31, | As of<br>2009 | March 31,<br>2010 |
|---|--------------|---------------|-------------------|
|   | 2010         |               |                   |
| Cash and cash equivalents   | \$ 41.4      | \$ 109.5      | \$ 129.7          |
| Net trade receivables   | 185.0        | 256.3         | 207.4             |
| Inventories and advances to tobacco suppliers                         | 923.7        | 841.8         | 894.9             |
| Total current assets  | 1,312.1      | 1,350.7       | 1,382.9           |
| Notes payable to banks  | 239.8        | 286.4         | 189.0             |
| Accounts payable  | 70.0         | 50.8          | 146.4             |
| Advances from customers   | 92.5         | 61.8          | 102.3             |
| Total current liabilities   | 529.7        | 559.6         | 587.7             |
| Current ratio   | 2.5 to 1     | 2.4 to 1      | 2.4 to 1          |
| Working capital   | 782.4        | 791.1         | 795.2             |
| Total long term debt  | 762.6        | 806.2         | 788.9             |
| Stockholders' equity attributable to Alliance One International, Inc. | 415.3        | 384.9         | 390.4             |
| Net cash provided (used) by:  |              |               |                   |
| Operating activities  | (96.0)       | (32.2)        |                   |
| Investing activities  | (2.6)        | (12.9)        |                   |
| Financing activities  | 10.1         | 66.8          |                   |

**Operating Cash Flows**

Net cash used by operating activities increased \$63.8 million in 2010 compared to 2009. The increase in cash used was primarily due to a \$94.6 million decrease in operating cash flows from net income partially offset by a \$30.8 million positive change in income taxes. The decrease in cash used for receivables was offset by the increase in cash used for payables. In addition, the increase in cash provided by inventories and advances to suppliers was offset by the decrease in cash provided by customer advances.

**Investing Cash Flows**

Net cash used by investing activities decreased \$10.3 million in 2010 compared to 2009. The decrease in cash used is primarily attributable to the non-recurrence of investments in notes receivables in the prior year. Proceeds from the sale of assets to PMI in Brazil are offset by increased purchases of property, plant and equipment due to the

construction of our new facility in Brazil.

### **Financing Cash Flows**

Net cash provided by financing activities decreased \$56.7 million in 2010 compared to 2009. This decrease is primarily due to a decrease of \$103.8 million in net long-term debt proceeds primarily from our debt refinancing in the prior year, \$58.1 million primarily related to purchase of our 8.5% senior notes and 10% senior notes in the current year as well as \$9.0 million expended to purchase 2.4 million shares of our common stock this year. Partially offsetting this decrease is a \$37.6 million increase in the net change in short-term borrowings and a \$76.2 million decrease in debt issuance, debt retirement and other debt related costs primarily associated with our refinancing transactions in the prior year. We continuously monitor and adjust our funding sources based on business dynamics in order to enhance business flexibility and reduce costs.

### **Debt Financing**

We continue to finance our business with a combination of short-term seasonal credit lines, our revolving credit facility, long-term debt securities, customer advances and cash from operations. At December 31, 2010 we had cash of \$41.4 million and total debt outstanding of \$1,002.8 million comprised of \$239.8 million of notes payable to banks, \$28.0 million of revolver borrowings, \$3.1 million of other long-term debt, \$610.9 million of 10% senior notes, \$6.0 million of 8.5% senior notes and \$115.0 million of 5 ½% convertible senior subordinated notes. The \$50.8 million seasonal increase in notes payable to banks from March 31, 2010 to December 31, 2010 results from anticipated seasonal fluctuation to account for the current purchase and processing of African and Brazilian tobaccos. Available credit as of December 31, 2010 was \$748.1 million comprised of \$262.0 million under our revolver, \$475.8 million of notes payable to banks and \$10.3 million of availability exclusively for letters of credit. We expect to incur \$75.0 million of capital expenditures during fiscal year 2011 including our continuing SAP software implementation and new Brazilian factory. Maintenance expenditures are anticipated to be between \$20.0 million and \$25.0 million. We may also decide to deploy additional discretionary amounts to enhance future business prospects, but only if stringent management return thresholds are likely to be achieved. No cash dividends were paid to stockholders during the quarter ended December 31, 2010. We believe that these sources of liquidity versus our requirements will be sufficient to fund our anticipated needs for the remainder of fiscal year 2011.

## Alliance One International, Inc. and Subsidiaries

**LIQUIDITY AND CAPITAL RESOURCES** (Continued)**Debt Financing** (Continued)

The following table summarizes our debt financing as of December 31, 2010:

|   | Outstanding    |                   | Lines and         | December 31, 2010 |               |
|---|----------------|-------------------|-------------------|-------------------|---------------|
|   | March 31, 2010 | December 31, 2010 | Letters Available |                   | Interest Rate |
| Senior secured credit facility:                     |                |                   |                   |                   |               |
| Revolver  | \$ -           | \$ 28.0           | \$ 262.0          | (1)               | 4.75%         |
| Senior notes:                                       |                |                   |                   |                   |               |
| 10% senior notes due 2016                           | 642.2          | 610.9             | -                 |                   | 10.0%         |
| 8 ½% senior notes due 2012                          | 29.6           | 6.0               | -                 |                   | 8.5%          |
|   | 671.8          | 616.9             | -                 |                   |               |
| 5 ½% convertible senior subordinated notes due 2014 | 115.0          | 115.0             | -                 |                   | 5.5%          |
| Other long-term debt                                | 2.5            | 3.1               | 1.5               |                   | 7.8% (2)      |
| Notes payable to banks (3)                          | 189.0          | 239.8             | 474.3             |                   | 3.5% (2)      |
| Total debt  | \$ 978.3       | \$ 1,002.8        | 737.8             |                   |               |
| Short term  | \$ 189.0       | \$ 239.8          |                   |                   |               |
| Long term:  |                |                   |                   |                   |               |
| Long term debt current                              | \$ 0.4         | \$ 0.4            |                   |                   |               |
| Long term debt                                      | 788.9          | 762.6             |                   |                   |               |
|   | \$ 789.3       | \$ 763.0          |                   |                   |               |
| Letters of credit                                   | \$ 5.3         | \$ 3.7            | 10.3              |                   |               |
| Total credit available                              |                |                   | \$ 748.1          |                   |               |

(1) As of December 31, 2010, pursuant to Section 2.1 (A) (iv) of the Credit Agreement, the full Revolving Committed Amount was available based on the calculation of the lesser of the Revolving Committed Amount and the Working Capital Amount.

(2) Weighted average rate for the nine months ended December 31, 2010

(3) Primarily foreign seasonal lines of credit

### **Foreign Seasonal Lines of Credit**

We have typically financed our non-U.S. operations with uncommitted unsecured short-term seasonal lines of credit at the local level. These operating lines are seasonal in nature, normally extending for a term of 180 to 270 days corresponding to the tobacco crop cycle in that location. These facilities are typically uncommitted in that the lenders have the right to cease making loans and demand repayment of loans at any time. These loans are typically renewed at the outset of each tobacco season. As of December 31, 2010, we had approximately \$239.8 million drawn and outstanding on foreign seasonal lines with maximum capacity totaling \$728.1 million subject to limitations as provided for in the Credit Agreement. Additionally against these lines there was \$10.3 million available in unused letter of credit capacity with \$3.7 million issued but unfunded.

Alliance One International, Inc. and Subsidiaries

**RECENT ACCOUNTING PRONOUNCEMENTS NOT YET ADOPTED:**

In October 2009, the FASB issued new accounting guidance on accounting for multiple-deliverable revenue arrangements. The objective of this accounting guidance is to address the accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit. This accounting guidance will be effective for us on April 1, 2011. We are evaluating the impact of this new accounting guidance on our financial condition and results of operations.

In January 2010, the FASB issued new accounting guidance on fair value measurements and disclosures. This guidance requires reporting entities to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. It will also require reporting entities to present separately information about purchases, sales, issuances, and settlements in their Level 3 fair value reconciliations. The new disclosures and clarifications of existing disclosures (the Level 1 and Level 2 changes) were effective for us on January 1, 2010. The disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements will be effective for us on April 1, 2011. We do not expect these new disclosure requirements to have a material impact on our financial condition or results of operations.

**FACTORS THAT MAY AFFECT FUTURE RESULTS:**

Readers are cautioned that the statements contained herein regarding expectations for our performance are forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These statements are based on current expectations of future events. If underlying assumptions prove inaccurate or unknown risks or uncertainties materialize, actual results could vary materially from our expectations and projections. Risks and uncertainties include changes in the timing of anticipated shipments, changes in anticipated geographic product sourcing, political instability in sourcing locations, currency and interest rate fluctuations, shifts in the global supply and demand position for our tobacco products, and the impact of regulation and litigation on our customers. A further list and description of these risks, uncertainties and other factors can be found in our Annual Report on Form 10-K for the fiscal year ended March 31, 2010 and other filings with the Securities and Exchange Commission. At December 31, 2010, we have \$22.5 million of Egyptian-based receivables. The current turmoil has not impacted our consolidated financial position, results of operations or cash flows, but we continue to assess the potential impact of the current crisis. We assume no obligation to update any forward-looking statements as a result of new information or future events or developments, except as required by law.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

There have been no significant changes to our market risk since March 31, 2010. For a discussion on our exposure to market risk, refer to Part II, Item 7A Quantitative and Qualitative Disclosures About Market Risk contained in our Annual Report on Form 10-K for the year ended March 31, 2010.

#### **Item 4. Controls and Procedures**

##### **Evaluation of Disclosure Controls and Procedures**

We maintain disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act)) designed to provide reasonable assurance that the information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that this information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. It should be noted that, because of inherent limitations, our disclosure controls and procedures, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the disclosure controls and procedures are met.

In connection with the preparation of this Quarterly Report on Form 10-Q, our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as required by Rule 13a-15(b) of the Exchange Act), as of December 31, 2010. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act) were effective to provide reasonable assurance as of December 31, 2010.

##### **Changes in Internal Control Over Financial Reporting**

As required by Rule 13a-15(d) under the Exchange Act, the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, have evaluated the Company's internal control over financial reporting to determine whether any changes occurred during the quarter covered by this quarterly report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.



Alliance One International, Inc. and Subsidiaries

**Item 4. Controls and Procedures** *(Continued)*

**Changes in Internal Control Over Financial Reporting** *(Continued)*

The Company is currently implementing an ERP system using SAP applications. The implementation is part of a multi-year plan to install SAP at certain operations throughout the world to improve the Company's business processes and deliver enhanced operational and financial performance. During the three months ended December 31, 2010, further developments to the financial reporting process were implemented for operations that have previously implemented SAP and the Company substantially completed the process of implementing SAP in its Argentina and Netherlands operations. This phase of the project has involved changes to certain internal controls over financial reporting, which the Company believes were material.

Other than the financial reporting developments for the Company's operations that have previously implemented SAP and implementation of SAP in its Argentina and Netherlands operations discussed above there were no changes that occurred during the three months ended December 31, 2010 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Part II. Other Information**

**Item 1. Legal Proceedings**

In October 2001, the Directorate General for Competition ( DGCOMP ) of the European Commission ( EC ) began an administrative investigation into certain tobacco buying and selling practices alleged to have occurred within the leaf tobacco industry in some countries within the European Union, including Spain, Italy, Greece and potentially other countries. The Company and its subsidiaries in Spain, Italy and Greece have been subject to these investigations. In respect of the investigation into practices in Spain, in 2004, the EC fined the Company and its Spanish subsidiaries €4.4 million (US\$5.6 million). In respect of the investigation into practices in Italy, in October 2005, the EC announced that the Company and its Italian subsidiaries have been assessed a fine in the aggregate amount of €24.0 million (US\$28.8 million). With respect to both the Spanish and Italian investigations, the fines imposed on the Company and its predecessors and subsidiaries were part of fines assessed on several participants in the applicable industry. With respect to the investigation relating to Greece, the EC informed the Company in March 2005 it had closed its investigation in relation to the Greek leaf tobacco industry buying and selling practices. The Company, along with its applicable subsidiaries, has appealed the decisions of the EC with respect to Spain and Italy to the Court of First Instance of the European Commission for the annulment or modification of the decision, but the outcome of the

appeals process as to both timing and results is uncertain. The Company has fully recognized the impact of each of the fines set forth above and has paid all of such fines as part of the appeal process.

On August 6, 2010, the Company entered into settlement agreements with the Department of Justice ( DOJ ) and the Securities and Exchange Commission ( SEC ) to resolve those agencies' investigations of the Company relating to alleged violations under the Foreign Corrupt Practices Act ( FCPA ) which occurred prior to the merger that formed the Company in May, 2005. Pursuant to the settlement negotiated with DOJ, two of the Company's foreign subsidiaries, Alliance One Tobacco Osh, LLC and Alliance One International AG (successors to DIMON International (Kyrgyzstan) and DIMON International AG, respectively), agreed to plead guilty to FCPA violations committed by DIMON International (Kyrgyzstan) and DIMON International AG prior to the merger creating the Company, and to pay fines totaling \$9.45 million. Additionally, the Company entered into a non-prosecution agreement by the terms of which the DOJ will not prosecute the Company if, for a period of three years, the Company meets its obligations as set out in the agreement. On October 21, 2010, the U.S. District Court for the Western District of Virginia in Danville, Virginia accepted these guilty pleas and entered a judgment consistent with the terms of the settlement agreement. The settlement negotiated with the SEC includes the Company's agreement to disgorge profits in the amount of \$10.0 million and to abide by an injunction against further FCPA violations. On August 26, 2010, the U.S. District Court for the District of Columbia approved the terms of the settlement with the SEC and entered the injunction contemplated by the settlement agreement. Both settlements require the Company to retain an independent compliance monitor for a term of three years. The Company provided for these losses at March 31, 2010 and \$10.0 million was paid to the SEC on August 30, 2010 and \$9.452 million was paid to the U.S. District Court on October 28, 2010.

The Company had previously disclosed that it had received notice from Mindo, S.r.l., the purchaser in June 2004 of the Company's Italian subsidiary Dimon Italia, S.r.l., of its intent to assert against the Company, or its subsidiaries, a claim arising out of that sale transaction. That claim, which may be followed by additional claims, was filed before the Court of Rome on April 12, 2007. The claim, allegedly arising from a guaranty letter issued by a consolidated subsidiary of the Company in connection with the sale transaction, seeks the recovery of €7.4 million (US\$9.8 million) plus interest and costs.

On December 13, 2007, the Public Prosecutors' offices in the States of Santa Catarina and Parana filed claims against the Company's Brazilian subsidiary, Alliance One Brazil Exportadora de Tabacos Ltda. ( AOB ) and a number of other tobacco processors, on behalf of all tobacco suppliers in those states. The lawsuits primarily assert that there exists an employment relationship between tobacco processors and tobacco suppliers.

Alliance One International, Inc. and Subsidiaries

Item 1. Legal Proceedings (*Continued*)

At the initial hearing in Santa Catarina, on January 29, 2008, the Court granted the Company's motion to have that case moved to the Labor Court in Brasilia. No hearing date has yet been set.

In the state of Parana, the relief sought by the Public Prosecutor was granted by the local Labor Court. The Company appealed that initial ruling and it was overturned in part and affirmed in part. The Company has appealed from that part of the initial ruling which was affirmed and no ruling has yet been rendered on the appeal. The Company has separately asserted, on April 11, 2008, a lack of jurisdiction motion similar to that which it asserted in the case in Santa Catarina which resulted in the transfer of that case to the Labor Court in Brasilia. No hearing date for that motion has been set.

On June 6, 2008, AOB and a number of other tobacco processors were notified of a class action initiated by the ALPAG - Associação Lourenciana de Pequenos Agricultores ("Association of Small Farmers of São Lourenço"). The class

action's focus is a review of tobacco supplier contracts and business practices, specifically aiming to prohibit processors from notifying the national credit agency of producers in debt, prohibiting processors from deducting tobacco suppliers' debt from payments for tobacco, and seeking the modification of other contractual terms historically used in the purchase of tobacco. The Company presented its defense locally and the case has been transferred to the Federal Court in Brasilia. No hearing date has been set. The Company believes this claim to be without merit and intends to vigorously defend it. Ultimate exposure if an unfavorable outcome is received is not determinable.

Item 1A. Risk Factors

None.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Reserved

Item 5. Other Information

None.

Item 6. Exhibits.

|              |   |
|--------------|---|
| <u>10.1</u>  | Form of Performance-based Stock Unit Award Agreement (filed herewith)   |
| <u>10.2</u>  | Form of Restricted Stock Unit Agreement (filed herewith)  |
| <u>10.3</u>  | Form of Restricted Stock Unit Agreement (Supplemental Award) (filed herewith)   |
| 10.4         | Separation Agreement dated as of December 14, 2010 between Alliance One International, Inc. and Robert E. Harrison, incorporated by reference to Exhibit 10.1 of the Current Report on Form 10-K, filed on December 15, 2010 (SEC File No 1-3684) |
| <u>31.01</u> | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)   |
| <u>31.02</u> | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)   |
| <u>32</u>    | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith)   |



Alliance One International, Inc. and Subsidiaries

SIGNATURE

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

Alliance One International, Inc.

/s/ Hampton R. Poole,  
Jr.  
Hampton R. Poole, Jr.  
Vice President - Controller  
(Chief Accounting Officer)

Date: February 4, 2011

Alliance One International, Inc. and Subsidiaries

Index of Exhibits

Exhibits

|              |   |
|--------------|---|
| <u>10.1</u>  | Form of Performance-based Stock Unit Award Agreement (filed herewith)   |
| <u>10.2</u>  | Form of Restricted Stock Unit Agreement (filed herewith)  |
| <u>10.3</u>  | Form of Restricted Stock Unit Agreement (Supplemental Award) (filed herewith)   |
| 10.4         | Separation Agreement dated as of December 14, 2010 between Alliance One International, Inc. and Robert E. Harrison, incorporated by reference to Exhibit 10.1 of the Current Report on Form 10-K, filed on December 15, 2010 (SEC File No 1-3684) |
| <u>31.01</u> | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)   |
| <u>31.02</u> | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)   |
| <u>32</u>    | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith)   |

