

Hershey Company — 2009

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HSY

www.hersheys.com

The largest producer of chocolate in North America, Hershey Company reported second quarter 2009 sales up 5.9 percent to \$1.17 billion and profit of \$71.3 million on July 23, the fourth strong quarter in a row for the company. Advertising expenses for the quarter increased by 46 percent as the company continued to promote iconic brands such as the Hershey Kiss and Reese's products.

Some of Hershey's premium products of have faltered lately as customers switched to lower price products. So, the company plans to discontinue their Cacao Reserve brand as well as their Starbucks chocolate partnership. The company also plans to close their online gift business, which featured seasonal products and gifts that could be personalized by the consumer.

Due to lower commodity prices, total charges to Hershey's Global Supply Transformation Program have been forecasted downward from \$665 million to \$640 million. Hershey now expects year-end 2009 profits of 6 to 8 percent. Thus, the company overall has weathered the economic recession quite well as their recent news releases have been pretty sweet.

History

Although most visitors think of "Chocolate World" in Hershey, Pennsylvania, as a theme park designed for the true chocolate lover, the facility was designed to include housing, parks, and schools for employees of Hershey Foods. On August 31, 2009, the theme park eclipsed having its 75th million visitor. By 1909, Milton Hershey and his wife had established the Milton Hershey School for orphan boys and subsequently donated their entire personal fortune to the Hershey Trust Company to administer the school. The school continues to operate in Hershey, and provides free education and residential services including meals and health care to almost 17,000 children in need, and still is be administered via The Hershey Trust Company. More than 77 percent of the students who attend the school are from Pennsylvania, and the enrollment is ethnically diverse with both boys and girls attending the school.

Ethics/Sustainability

Hershey's commitment to social responsibility extends beyond their school to both their products and supplier relationships. The company is actively involved in the International Cocoa Initiative Foundation, designed to eliminate child labor or forced labor in cocoa-producing regions. Hershey is also actively involved in organizations such as the World Cocoa Foundation, which supports environmental projects that include nonchemical pest management practices, and which encourage sustainable farming practices to support ecosystems in the region. Hershey also closely monitors its supply relationships and purchases palm oil from suppliers with membership in the Roundtable on Sustainable Oil.

Hershey's role as an environmental steward is also evident that its plants use recycled water that is later purified for various landscaping projects. Changes in product packaging have resulted in lighter materials and less waste during the manufacturing

process, and Hershey extensively recycles materials from their East Coast factories. Hershey monitors greenhouse gas emissions from operations and has installed energy-efficient lighting in all of their plants.

With revenues in excess of \$5 billion, Hershey continues to produce chocolate and confectionery products in Hershey, Pennsylvania, and has recently expanded its global presence via joint ventures in China and India.

Internal Issues

Mission Statement

The mission of the Hershey Company is **“Bringing sweet moments of Hershey happiness to the world every day.”**

To our stakeholders, this means:

Consumers: Delivering quality consumer driven confectionery experiences for all occasions.

Employees: Winning with an aligned and empowered organization while having fun.

Business Partners: Building collaborative relationships for profitable growth with our customers, suppliers, and partners.

Shareholders: Creating sustainable value.

Communities: Honoring our heritage through continued commitment to making a positive difference.

Marketing and Sales

Hershey’s iconic brands such as Hershey Bar, Hershey Kisses, and Reese’s are instantly recognized within the domestic market. Hershey concentrates advertising revenues on these brands while also promotes the health benefits of flavonols in its dark chocolate products. The company offers a line of natural and organic chocolates under the Dagoba brand that are sold in natural food and gourmet stores. Other snack products of the company include Hershey Snacksters, Hershey and Reese’s granola bars, and Mauna Loa macadamia nuts. Hershey plans to increase its advertising from \$30 million to \$35 million in 2009 in order to promote its iconic brands.

Seasonal sales such as Halloween and Valentine’s Day account for 10 percent of the annual sales in the industry. Hershey sales are higher during the third and fourth quarter of the year, reflecting these industry trends. The company relies on special promotions to increase holiday sales, and it also uses advertising programs to supplement seasonal sales. Hershey also has special editions products that are themed with events, such as their Dark Knight Collection (milk chocolate peanut butter bars) created for the release of the movie *Dark Knight*. The company also encourages customers to personalize messages and gifts via its interactive home page (www.hersheygifts.com).

Hershey was one of the first companies to engage in experiential marketing with the launch of the Hershey Chocolate World in 1973 in Hershey, Pennsylvania, which encouraged consumers to visit the theme park replete with Hershey products. Hershey opened their first flagship store at New York City’s Time Square and recently opened Hershey Chocolate World in Shanghai prior to the 2008 Olympics.

Hershey products are sold to more than 2 million retail outlets, including wholesale distributors, chain grocery stores, convenience stores, and wholesale clubs as well as natural food stores. The McLean Company is the largest wholesale distributor of Hershey products and accounts for 26 percent of the total net sales for the company.

Research and Development

Hershey uses cross-functional product development to produce new products and expand product lines for their iconic brands such as Hershey’s and Reese’s products. Direct research on consumer preferences as well as process innovations are supported via the Hershey Center of Health and Nutrition developed in 2007. This center is involved in scientific research and also collaborates with external organizations to develop products to

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For the years ended December 31	2008	2007	2006
In thousands of dollars except per share amounts			
Net Sales	\$ 5,132,768	\$ 4,946,716	\$ 4,944,230
Costs and Expenses:			
Cost of sales	3,375,050	3,315,147	3,076,718
Selling, marketing and administrative	1,073,019	895,874	860,378
Business realignment and impairment charges, net	94,801	276,868	14,576
Total costs and expenses	4,542,870	4,487,889	3,951,672
Income before Interest and Income Taxes	589,898	458,827	992,558
Interest expense, net	97,876	118,585	116,056
Income before Income Taxes	492,022	340,242	876,502
Provision for income taxes	180,617	126,088	317,441
Net Income	\$ 311,405	\$ 214,154	\$ 559,061
Net Income Per Share—Basic—Class B Common Stock	\$ 1.27	\$.87	\$ 2.19
Net Income Per Share—Diluted—Class B Common Stock	\$ 1.27	\$.87	\$ 2.17
Net Income Per Share—Basic—Common Stock	\$ 1.41	\$.96	\$ 2.44
Net Income Per Share—Diluted—Common Stock	\$ 1.36	\$.93	\$ 2.34

Source: Hershey Company's 2008 Form 10K.

EXHIBIT 3 Hershey Company's Balance Sheets

PERIOD ENDING	(all numbers in thousands)		
	31-Dec-08	31-Dec-07	31-Dec-06
Assets			
Current Assets			
Cash and Cash Equivalents	37,103	129,198	97,141
Short Term Investments	—	—	—
Net Receivables	526,056	570,953	584,033
Inventory	592,530	600,185	648,820
Other Current Assets	189,256	126,238	87,818
Total Current Assets	1,344,945	1,426,574	1,417,812
Long Term Investments	—	—	—
Property Plant and Equipment	1,458,949	1,539,715	1,651,300
Goodwill	554,677	584,713	501,955
Intangible Assets	110,772	155,862	140,314
Accumulated Amortization	—	—	—
Other Assets	151,561	540,249	446,184
Deferred Long Term Asset Charges	13,815	—	—
Total Assets	3,634,719	4,247,113	4,157,565
Liabilities			
Current Liabilities			
Accounts Payable	768,708	574,773	609,540
Short/Current Long Term Debt	501,504	856,392	843,998
Other Current Liabilities	—	187,605	—
Total Current Liabilities	1,270,212	1,618,770	1,453,538

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acquisitions and joint ventures with established firms in the international market (www.marketline.com).

In 2007, Hershey announced a joint venture with Lotte Confectionery Company, a leading confectionery company in Korea, to produce products for China. The manufacturing facility, that is located in Jinshan, China, is designed to produce Hershey and Lotte products that are tailored to the needs of the Chinese market. The joint venture is also designed to expand Hershey's presence in other Asian markets such as Korea and Japan. Hershey will also distribute and promote Lotte's refreshment products in the United States.

Hershey also announced a joint venture with Godrej Beverages, a leading consumer goods, confectionery, and food company in India in 2007. The Hershey and Godrej venture will distribute Hershey products via Godrej's distribution network to over 1.6 million outlets in India. Hershey will have a 51 percent ownership stake in the joint venture, which is designed to capitalize on Hershey's strong brands in the confectionery industry with projected annual sales of \$70 million for the company.

Hershey acquired Grupo Lorena, a leading confectionary company in Mexico, with sales in excess of \$30 million. This acquisition allowed Hershey to leverage these acquired brands both within Mexico and within the emerging Hispanic markets in the United States (www.lexis-nexis.com).

Governance

All of the outstanding shares of the Hershey Trust Company are owned by the Milton Hershey School Trust, which is the controlling stockholder for The Hershey Company. As the controlling stockholder, the "trust has the right to cast 79.9% of all the votes entitled to be cast on matters requiring the vote of the Common Stock and Class B Common Stock voting together." (Hershey, *10K*, 2008). There are 10 directors on the Milton Hershey Trust Company, and three members—James Nevels, LeRoy Zimmerman, and Robert Cavanaugh—are members of the board of directors of the Hershey Trust Company, members of the board of managers of the Milton Hershey School, and board directors of The Hershey Company.

According to the 2008 *Annual Report*, there are nine directors on the board of The Hershey Company, and the board meets six times per year in addition to meetings scheduled by various committees of the board. Board members are required to own at least 200 shares of common stock, and they are compensated annually. The Hershey board has several standing committees, including an Audit, Governance, Compensation, and Executive Organization, and an Executive committee that meet periodically in accordance with governance guidelines. A complete list of committee charters is available at www.thehersheycompany.com/about/committees.

In February of 2008, the company announced that James E. Nevels, a board member of the Hershey Trust Company, would replace Kenneth Wolf as chairman of the board of directors of The Hershey Company. This resignation was requested by the Hershey Trust Company, trustee of the Milton Hershey School, and The Hershey Company's controlling stockholders. The trust did consider a sale of The Hershey Company in 2002, but the sale was appealed by the attorney general of Pennsylvania due to public opposition from various stakeholders in the community. Existing legislation requires that the Milton Hershey Trust give notice to the attorney general of Pennsylvania prior to a sale of the company.

Industry Analysis

Confectionery products include chocolate, gum, cereal bars, and sugar confectionery products with a projected global market value of \$107.4 billion by 2010. Chocolate currently accounts for 55.8 percent of the market's overall global value. Mergers and acquisitions in the past few years have influenced both the market share and product portfolio of global firms in the confectionery industry. Mars, a privately owned company, acquired William Wrigley, one of the largest chewing gum firms in America, for \$23 billion in May 2008. Nestle, one of the global leaders in the industry, expanded its nutritional product with the acquisition of Jenny Craig, a company with an established brand of nutritional weight-management products.

Cadbury

Cadbury, formerly known as Cadbury Schweppes, is a confectionery and nonalcoholic beverage company headquartered in London. In May 2008, the board of Cadbury Schweppes made the decision to split the company into two separately listed companies. The company was split into Cadbury plc (currently the worldwide confectionery operations listed on the London Stock Exchange) and The DPS (Dr Pepper Snapple) Group, formerly Cadbury Schweppes American Beverages (CSAB) now listed as DPS in on the New York Stock Exchange. Key brands include Dr Pepper, Canada Dry, Snapple, and Sunkist products with DPS brands ranked as the third largest refreshment beverage business in North America.

Some of the leading chocolate brands of the company include the Cadbury Chocolate Cream Egg and Mr. Big Bar, as well as confectionery brands such as Trident gum and Dentyne Ice, which complement the gum brands of the company. The company also makes Hall's cough drops, and controls over 22 percent of the medicated confectionery market. Due to increased consumer concerns about artificial ingredients, the company also manufactures a line of products with no artificial colors or artificial flavorings under the Natural Confectionery Company. The company is a market leader in the global confectionery industry with a market share of 10.1 percent. Within the chocolate category, Cadbury has a 71 percent market share in India, and enjoys a 53 percent market share in the chocolate category in Australia. Cadbury reported revenues of \$5,384 million and operating profit of \$388 million in 2008. Revenue growth was particularly strong in emerging markets such as India, South Africa, and South America (www.marketline.com).

Mars

Mars is a privately held company headquartered in McLean, Virginia. The company was formed by Frank Mars in 1922 and currently operates in over 66 countries. Mars has several business units, including snack food (42 percent), pet care (49.5 percent), food (6.5 percent), and drinks (1.8 percent), which contribute to their diverse product portfolio. Some of the leading brands of the company include M & M's and Snickers, Pedigree and Whiskas pet food, as well as Flavia drinks, and Uncle Ben's rice. Due to increased consumer preference for low-fat and organic products, Mars Nutrition and Health Well Being has also developed a line of low-fat products and healthy snacks.

In 2008, Mars purchased the William Wrigley Company, which includes such brands as Orbit and Doublemint gum. Under the terms of the \$23 billion acquisition, the Wrigley Company will become a subsidiary of Mars and will operate along with Mars's other business units of Chocolate, Pet Care, Food, Drinks, and Symbioscience. Mars nonchocolate confectionery brands such as Skittles and Starburst will also be transferred to the Wrigley unit. Wrigley sells products in over 180 countries, and the acquisition extends the brand portfolio of the company and increased worldwide distribution channels for Mars. Mars products are sold worldwide, and the company has locations in North America, Latin America, Europe, and the Middle East (www.marketline.com).

Future Direction

Hershey, as well as other competitors in the industry, is acquiring nonchocolate products as well as nutritional products to complement its existing products.

Hershey uses tons of sugar. However, poor harvests in two of the world's largest producers of sugar, Brazil and India, sent sugar prices soaring in the second half of 2009. Wholesale sugar prices in the U.S. were up more than 70 percent in the first eight months of 2009, reaching a near 30-year high of 22.21 cents a pound. Some research analysts expect that international wholesale sugar prices may reach 40 cents a pound. "I think U.S. consumers should expect elevated prices for a while," said Jack Roney, an economist with the American Sugar Alliance, an organization that represents U.S. sugar growers and their interests. India, which up until two years ago was a net exporter of sugar, has become a net importer of sugar after two straight poor harvests and resilient demand. Brazil's

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