

HERSHEY CO  
Form 10-Q  
November 07, 2007

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

**FORM 10-Q**

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended **September 30, 2007**

OR

- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the transition period  
from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-183

**THE HERSHEY COMPANY**

100 Crystal A Drive  
Hershey, PA 17033

Registrant's telephone number: **717-534-4200**

State of Incorporation  
**Delaware**

IRS Employer Identification No.  
**23-0691590**

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  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, \$1 par value – 166,238,647 shares, as of October 19, 2007. Class B Common Stock, \$1 par value – 60,811,010 shares, as of October 19, 2007.

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**THE HERSHEY COMPANY****INDEX**

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**PART I - FINANCIAL INFORMATION****Item 1. Consolidated Financial Statements (Unaudited)**

**THE HERSHEY COMPANY**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(in thousands except per share amounts)

	<b>For the Three Months Ended</b>	
	<b>September 30,</b>	<b>October 1,</b>
	<b>2007</b>	<b>2006</b>
<b>Net Sales</b>	\$ 1,399,469	\$ 1,416,202
<b>Costs and Expenses:</b>		
Cost of sales	928,846	870,733
Selling, marketing and administrative	229,809	221,842
Business realignment charge, net	112,043	1,568
<b>Total costs and expenses</b>	<b>1,270,698</b>	<b>1,094,143</b>
<b>Income before Interest and Income Taxes</b>	<b>128,771</b>	<b>322,059</b>
Interest expense, net	33,055	31,835
<b>Income before Income Taxes</b>	<b>95,716</b>	<b>290,224</b>
Provision for income taxes	32,932	105,103
<b>Net Income</b>	<b>\$ 62,784</b>	<b>\$ 185,121</b>
<b>Earnings Per Share - Basic - Class B Common Stock</b>	<b>\$ .26</b>	<b>\$ .73</b>
<b>Earnings Per Share - Diluted - Class B Common Stock</b>	<b>\$ .26</b>	<b>\$ .72</b>
<b>Earnings Per Share - Basic - Common Stock</b>	<b>\$ .28</b>	<b>\$ .81</b>
<b>Earnings Per Share - Diluted - Common Stock</b>	<b>\$ .27</b>	<b>\$ .78</b>
<b>Average Shares Outstanding - Basic - Common Stock</b>	<b>167,165</b>	<b>173,232</b>
<b>Average Shares Outstanding - Basic - Class B Common Stock</b>	<b>60,812</b>	<b>60,816</b>
<b>Average Shares Outstanding - Diluted</b>	<b>230,388</b>	<b>237,681</b>
<b>Cash Dividends Paid per Share:</b>		
Common Stock	\$ .2975	\$ .2700
Class B Common Stock	\$ .2678	\$ .2425

The accompanying notes are an integral part of these consolidated financial statements.  
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**THE HERSHEY COMPANY**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(in thousands except per share amounts)

	<b>For the Nine Months Ended</b>	
	<b>September 30, 2007</b>	<b>October 1, 2006</b>
<b>Net Sales</b>	\$ 3,604,494	\$ 3,607,621
<b>Costs and Expenses:</b>		
Cost of sales	2,390,402	2,222,175
Selling, marketing and administrative	663,112	660,114
Business realignment charge, net	219,316	9,139
Total costs and expenses	3,272,830	2,891,428
<b>Income before Interest and Income Taxes</b>	331,664	716,193
Interest expense, net	90,523	84,528
<b>Income before Income Taxes</b>	241,141	631,665
Provision for income taxes	81,330	226,176
<b>Net Income</b>	\$ 159,811	\$ 405,489
<b>Earnings Per Share - Basic - Class B Common Stock</b>	\$ .65	\$ 1.58
<b>Earnings Per Share - Diluted - Class B Common Stock</b>	\$ .65	\$ 1.57
<b>Earnings Per Share - Basic - Common Stock</b>	\$ .72	\$ 1.76
<b>Earnings Per Share - Diluted - Common Stock</b>	\$ .69	\$ 1.69
<b>Average Shares Outstanding - Basic - Common Stock</b>	168,444	175,977
<b>Average Shares Outstanding - Basic - Class B Common Stock</b>	60,814	60,817
<b>Average Shares Outstanding - Diluted</b>	232,026	240,326
<b>Cash Dividends Paid per Share:</b>		
Common Stock	\$ .8375	\$ .7600
Class B Common Stock	\$ .7528	\$ .6825

The accompanying notes are an integral part of these consolidated financial statements.





**THE HERSHEY COMPANY**  
**CONSOLIDATED BALANCE SHEETS**  
(in thousands of dollars)

ASSETS	September 30, 2007	December 31, 2006
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 41,573	\$ 97,141
Accounts receivable - trade	638,312	522,673
Inventories	775,380	648,820
Deferred income taxes	58,067	61,360
Prepaid expenses and other	145,433	87,818
Total current assets	1,658,765	1,417,812
<b>Property, Plant and Equipment, at cost</b>	<b>3,698,313</b>	<b>3,597,756</b>
Less-accumulated depreciation and amortization	(2,147,961)	(1,946,456)
Net property, plant and equipment	1,550,352	1,651,300
<b>Goodwill</b>	<b>601,017</b>	<b>501,955</b>
<b>Other Intangibles</b>	<b>150,136</b>	<b>140,314</b>
<b>Other Assets</b>	<b>495,307</b>	<b>446,184</b>
Total assets	\$ 4,455,577	\$ 4,157,565
<b>LIABILITIES, MINORITY INTEREST AND STOCKHOLDERS' EQUITY</b>		
<b>Current Liabilities:</b>		
Accounts payable	\$ 252,276	\$ 155,517
Accrued liabilities	482,215	454,023
Accrued income taxes	5,041	—
Short-term debt	1,086,098	655,233
Current portion of long-term debt	15,008	188,765
Total current liabilities	1,840,638	1,453,538
<b>Long-term Debt</b>	<b>1,271,658</b>	<b>1,248,128</b>
<b>Other Long-term Liabilities</b>	<b>616,103</b>	<b>486,473</b>
<b>Deferred Income Taxes</b>	<b>171,545</b>	<b>286,003</b>
Total liabilities	3,899,944	3,474,142
<b>Minority Interest</b>	<b>16,284</b>	<b>—</b>
<b>Stockholders' Equity:</b>		
Preferred Stock, shares issued: none in 2007 and 2006	—	—
Common Stock, shares issued: 299,090,734 in 2007 and 299,085,666 in 2006	299,090	299,085
Class B Common Stock, shares issued: 60,811,010 in 2007 and 60,816,078 in 2006	60,811	60,816
Additional paid-in capital	330,887	298,243
Retained earnings	3,938,695	3,965,415
Treasury-Common Stock shares at cost: 132,875,127 in 2007 and 129,638,183 in 2006	(4,000,719)	(3,801,947)
Accumulated other comprehensive loss	(89,415)	(138,189)

Total stockholders' equity		539,349		683,423
Total liabilities, minority interest, and stockholders' equity	\$	4,455,577	\$	4,157,565

The accompanying notes are an integral part of these consolidated balance sheets.

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**THE HERSHEY COMPANY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands of dollars)

	For the Nine Months Ended	
	September 30, 2007	October 1, 2006
<b>Cash Flows Provided from (Used by) Operating Activities</b>		
Net Income	\$ 159,811	\$ 405,489
Adjustments to Reconcile Net Income to Net Cash		
Provided from Operations:		
Depreciation and amortization	227,776	148,726
Stock-based compensation expense, net of tax of \$7,181 and \$14,596, respectively	12,822	26,174
Excess tax benefits from exercise of stock options	(9,804)	(5,315)
Deferred income taxes	65,234	19,765
Business realignment initiatives, net of tax of \$118,786 and \$1,910, respectively	197,876	4,137
Contributions to pension plans	(9,285)	(18,217)
Changes in assets and liabilities, net of effects from business acquisitions:		
Accounts receivable - trade	(110,415)	(173,436)
Inventories	(128,561)	(154,013)
Accounts payable	91,221	(3,853)
Other assets and liabilities	(181,391)	(23,104)
Net Cash Flows Provided from Operating Activities	315,284	226,353
<b>Cash Flows Provided from (Used by) Investing Activities</b>		
Capital additions	(118,204)	(119,357)
Capitalized software additions	(9,526)	(10,580)
Business acquisitions	(97,030)	—
Net Cash Flows (Used by) Investing Activities	(224,760)	(129,937)
<b>Cash Flows Provided from (Used by) Financing Activities</b>		
Net increase in short-term debt	424,067	20,970
Long-term borrowings	—	496,728
Repayment of long-term debt	(188,852)	(176)
Cash dividends paid	(186,531)	(174,446)
Exercise of stock options	43,878	26,123
Excess tax benefits from exercise of stock options	9,804	5,315
Repurchase of Common Stock	(248,458)	(490,478)
Net Cash Flows (Used by) Financing Activities	(146,092)	(115,964)
Decrease in Cash and Cash Equivalents	(55,568)	(19,548)
Cash and Cash Equivalents, beginning of period	97,141	67,183
Cash and Cash Equivalents, end of period	\$ 41,573	\$ 47,635
Interest Paid	\$ 115,974	\$ 96,676

Income Taxes Paid	\$	145,230	\$	211,997
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The accompanying notes are an integral part of these consolidated financial statements.

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**THE HERSHEY COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. BASIS OF PRESENTATION**

Our unaudited consolidated financial statements provided in this report include the accounts of the Company and our majority-owned subsidiaries and entities in which we have a controlling financial interest after the elimination of intercompany accounts and transactions. We prepared these statements in accordance with the instructions to Form 10-Q. These statements do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements.

We included all adjustments (consisting only of normal recurring accruals) which we believe were considered necessary for a fair presentation. We reclassified certain prior year amounts to conform to the 2007 presentation. Operating results for the nine months ended September 30, 2007 may not be indicative of the results that may be expected for the year ending December 31, 2007, because of the seasonal effects of our business.

**Items Affecting Comparability**

Securities and Exchange Commission Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Misstatements When Quantifying Misstatements in Current Year Financial Statements* (“SAB No. 108”), required companies to change the accounting principle used for evaluating the effect of possible prior year misstatements when quantifying misstatements in current year financial statements. As a result, at December 31, 2006, we changed one of the five criteria of our revenue recognition policy, resulting in a delay in the recognition of revenue on goods in-transit until they are received by our customers. As permitted by SAB No. 108, we adjusted our financial statements for the three-month and nine-month periods ended October 1, 2006 to provide comparability. These adjustments were not material to our results of operations for those periods. For more information, refer to the consolidated financial statements and notes included in our 2006 Annual Report on Form 10-K.

**2. BUSINESS ACQUISITIONS**

In May 2007, we entered into an agreement with Godrej Beverages and Foods, Ltd., one of India’s largest consumer goods, confectionery and food companies, to manufacture and distribute confectionery products, snacks and beverages across India. Under the agreement, we invested \$58.7 million during the second quarter and own a 51% controlling interest. Total liabilities assumed were \$60.7 million. Effective in May 2007, this business acquisition was included in our consolidated results, including the related minority interest.

Also in May 2007, our Company and Lotte Confectionery Co., LTD., entered into a manufacturing agreement in China that will produce Hershey products and certain Lotte products for the market in China. We invested \$18.3 million in the second quarter and \$20.0 million in the third quarter of 2007 and own a 44% interest. We are accounting for this investment using the equity method.

### 3. STOCK COMPENSATION PLANS

At our annual meeting of stockholders, held April 17, 2007, stockholders approved The Hershey Company Equity and Incentive Compensation Plan (“EICP”). The EICP is an amendment and restatement of our former Key Employee Incentive Plan, a share-based employee incentive compensation plan, and is also a continuation of our Broad Based Stock Option Plan, Broad Based Annual Incentive Plan and Directors’ Compensation Plan. Following its adoption on April 17, 2007, the EICP became the single plan under which grants using shares for compensation and incentive purposes will be made. The following table summarizes our stock compensation costs:

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2007	October 1, 2006	September 30, 2007	October 1, 2006
	(in millions of dollars)			
Total compensation amount charged against income for stock compensation plans, including stock options, performance stock units (“PSUs”) and restricted stock units	\$ 7.6	\$12.3	\$ 20.0	\$ 41.8
Total income tax benefit recognized in Consolidated Statements of Income for share-based compensation	\$ 2.8	\$ 4.5	\$ 7.2	\$ 15.0

The decrease in share-based compensation expense from 2006 to 2007 was primarily associated with lower performance expectations for PSUs and the timing of stock option grants in 2007. Our annual grant of stock options to management level employees, which customarily has occurred in February of each year, was delayed in 2007 pending approval by our stockholders of the EICP at the annual meeting in April 2007. In 2008, we intend to resume our customary February grant schedule.

We estimated the fair value of each stock option grant on the date of the grant using a Black-Scholes option-pricing model and the weighted-average assumptions set forth in the following table:

	For the Nine Months Ended	
	September 30, 2007	October 1, 2006
Dividend yields	2.0%	1.6%
Expected volatility	19.5%	23.7%
Risk-free interest rates	4.6%	4.6%
Expected lives in years	6.6	6.6

#### Stock Options

A summary of the status of our stock options as of September 30, 2007, and the change during 2007 is presented below:

Stock Options	For the Nine Months Ended September 30, 2007		
	Shares	Weighted-	Weighted-Average

		<b>Average Exercise Price</b>	<b>Remaining Contractual Term</b>
Outstanding at beginning of the period	13,855,113	\$40.29	6.3 years
Granted	2,115,225	\$54.27	
Exercised	(1,473,627)	\$29.81	
Forfeited	(288,902)	\$54.52	
Outstanding as of September 30, 2007	14,207,809	\$43.17	6.4 years
Options exercisable as of September 30, 2007	8,487,112	\$37.24	5.1 years

	<b>For the Nine Months Ended</b>	
	<b>September 30,</b>	<b>October 1,</b>
	<b>2007</b>	<b>2006</b>
Weighted-average fair value of options granted (per share)	\$ 12.94	\$ 15.07
Intrinsic value of options exercised (in millions of dollars)	\$ 32.2	\$