

HERSHEY CO  
Form 10-Q  
August 13, 2009

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 July 5, 2009

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 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.

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

Smaller reporting company ☐

Edgar Filing: HERSHEY CO - Form 10-Q

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange 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 – 166,457,522 shares, as of July 24, 2009.

Class B Common Stock, \$1 par value – 60,709,308 shares, as of July 24, 2009.

---

THE HERSHEY COMPANY  
INDEX

| Part I. Financial Information                                                                    | Page Number |
|--------------------------------------------------------------------------------------------------|-------------|
| Item 1. Consolidated Financial Statements (Unaudited)                                            |             |
| Consolidated Statements of Income                                                                |             |
| Three months ended July 5, 2009 and June 29, 2008                                                | 3           |
| Consolidated Statements of Income                                                                |             |
| Six months ended July 5, 2009 and June 29, 2008                                                  | 4           |
| Consolidated Balance Sheets                                                                      |             |
| July 5, 2009 and December 31, 2008                                                               | 5           |
| Consolidated Statements of Cash Flows                                                            |             |
| Six months ended July 5, 2009 and June 29, 2008                                                  | 6           |
| Notes to Consolidated Financial Statements                                                       | 7           |
| Item 2. Management's Discussion and Analysis of<br>Results of Operations and Financial Condition | 23          |
| Item 3. Quantitative and Qualitative Disclosures<br>About Market Risk                            | 29          |
| Item 4. Controls and Procedures                                                                  | 29          |
| Part II. Other Information                                                                       |             |
| Item 2. Unregistered Sales of Equity Securities and Use<br>of Proceeds                           | 31          |
| Item 4. Submission of Matters to a Vote of Security Holders                                      | 31          |
| Item 6. Exhibits                                                                                 | 32          |



## PART I - FINANCIAL INFORMATION

## Item 1. Consolidated Financial Statements (Unaudited)

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

|                                                           | For the Three Months Ended |                  |
|-----------------------------------------------------------|----------------------------|------------------|
|                                                           | July 5,<br>2009            | June 29,<br>2008 |
| Net Sales                                                 | \$1,171,183                | \$1,105,437      |
| Costs and Expenses:                                       |                            |                  |
| Cost of sales                                             | 717,893                    | 722,926          |
| Selling, marketing and administrative                     | 298,710                    | 266,612          |
| Business realignment and impairment charges, net          | 37,904                     | 21,786           |
| Total costs and expenses                                  | 1,054,507                  | 1,011,324        |
| Income before Interest and Income Taxes                   | 116,676                    | 94,113           |
| Interest expense, net                                     | 22,734                     | 23,610           |
| Income before Income Taxes                                | 93,942                     | 70,503           |
| Provision for income taxes                                | 22,644                     | 29,036           |
| Net Income                                                | \$71,298                   | \$41,467         |
| Earnings Per Share - Basic - Class B Common Stock         | \$.29                      | \$.17            |
| Earnings Per Share - Diluted - Class B Common Stock       | \$.29                      | \$.17            |
| Earnings Per Share - Basic - Common Stock                 | \$.32                      | \$.19            |
| Earnings Per Share - Diluted - Common Stock               | \$.31                      | \$.18            |
| Average Shares Outstanding - Basic - Common Stock         | 166,846                    | 166,624          |
| Average Shares Outstanding - Basic - Class B Common Stock | 60,710                     | 60,806           |
| Average Shares Outstanding - Diluted                      | 228,489                    | 228,664          |

|                                |         |         |
|--------------------------------|---------|---------|
| Cash Dividends Paid Per Share: |         |         |
| Common Stock                   | \$.2975 | \$.2975 |
| Class B Common Stock           | \$.2678 | \$.2678 |

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

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

|                                                           | For the Six Months Ended |                  |
|-----------------------------------------------------------|--------------------------|------------------|
|                                                           | July 5,<br>2009          | June 29,<br>2008 |
| Net Sales                                                 | \$2,407,214              | \$2,265,779      |
| Costs and Expenses:                                       |                          |                  |
| Cost of sales                                             | 1,513,696                | 1,506,816        |
| Selling, marketing and administrative                     | 573,166                  | 516,561          |
| Business realignment and impairment charges, net          | 50,742                   | 25,871           |
| Total costs and expenses                                  | 2,137,604                | 2,049,248        |
| Income before Interest and Income Taxes                   | 269,610                  | 216,531          |
| Interest expense, net                                     | 46,630                   | 47,996           |
| Income before Income Taxes                                | 222,980                  | 168,535          |
| Provision for income taxes                                | 75,788                   | 63,823           |
| Net Income                                                | \$147,192                | \$104,712        |
| Earnings Per Share - Basic - Class B Common Stock         | \$.60                    | \$.43            |
| Earnings Per Share - Diluted - Class B Common Stock       | \$.60                    | \$.43            |
| Earnings Per Share - Basic - Common Stock                 | \$.66                    | \$.47            |
| Earnings Per Share - Diluted - Common Stock               | \$.64                    | \$.46            |
| Average Shares Outstanding - Basic - Common Stock         | 166,817                  | 166,701          |
| Average Shares Outstanding - Basic - Class B Common Stock | 60,710                   | 60,806           |
| Average Shares Outstanding - Diluted                      | 228,396                  | 228,798          |
| Cash Dividends Paid Per Share:                            |                          |                  |
| Common Stock                                              | \$.5950                  | \$.5950          |
| Class B Common Stock                                      | \$.5356                  | \$.5356          |

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

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

|                                                                                   | July 5,<br>2009 | December 31,<br>2008 |
|-----------------------------------------------------------------------------------|-----------------|----------------------|
| <b>ASSETS</b>                                                                     |                 |                      |
| Current Assets:                                                                   |                 |                      |
| Cash and cash equivalents                                                         | \$ 28,768       | \$ 37,103            |
| Accounts receivable - trade                                                       | 272,542         | 455,153              |
| Inventories                                                                       | 642,505         | 592,530              |
| Deferred income taxes                                                             | 65,854          | 70,903               |
| Prepaid expenses and other                                                        | 169,255         | 189,256              |
| Total current assets                                                              | 1,178,924       | 1,344,945            |
| Property, Plant and Equipment, at cost                                            | 3,400,412       | 3,437,420            |
| Less-accumulated depreciation and amortization                                    | (1,959,882)     | (1,978,471 )         |
| Net property, plant and equipment                                                 | 1,440,530       | 1,458,949            |
| Goodwill                                                                          | 563,622         | 554,677              |
| Other Intangibles                                                                 | 125,315         | 110,772              |
| Deferred Income Taxes                                                             | 21,182          | 13,815               |
| Other Assets                                                                      | 163,849         | 151,561              |
| Total assets                                                                      | \$ 3,493,422    | \$ 3,634,719         |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                       |                 |                      |
| Current Liabilities:                                                              |                 |                      |
| Accounts payable                                                                  | \$ 279,706      | \$ 249,454           |
| Accrued liabilities                                                               | 460,304         | 504,065              |
| Accrued income taxes                                                              | —               | 15,189               |
| Short-term debt                                                                   | 245,434         | 483,120              |
| Current portion of long-term debt                                                 | 16,495          | 18,384               |
| Total current liabilities                                                         | 1,001,939       | 1,270,212            |
| Long-term Debt                                                                    | 1,504,475       | 1,505,954            |
| Other Long-term Liabilities                                                       | 503,638         | 504,963              |
| Deferred Income Taxes                                                             | 26,190          | 3,646                |
| Total liabilities                                                                 | 3,036,242       | 3,284,775            |
| Stockholders' Equity:                                                             |                 |                      |
| The Hershey Company Stockholders' Equity                                          |                 |                      |
| Preferred Stock, shares issued:none in 2009 and 2008                              | —               | —                    |
| Common Stock, shares issued: 299,192,436 in 2009 and 299,190,836 in 2008          | 299,192         | 299,190              |
| Class B Common Stock, shares issued: 60,709,308 in 2009 and 60,710,908 in 2008    | 60,709          | 60,711               |
| Additional paid-in capital                                                        | 375,559         | 352,375              |
| Retained earnings                                                                 | 3,991,467       | 3,975,762            |
| Treasury-Common Stock shares at cost: 132,777,431 in 2009 and 132,866,673 in 2008 | (4,008,120)     | (4,009,931 )         |
| Accumulated other comprehensive loss                                              | (301,051 )      | (359,908 )           |
| The Hershey Company stockholders' equity                                          | 417,756         | 318,199              |

Edgar Filing: HERSHEY CO - Form 10-Q

|                                            |              |              |
|--------------------------------------------|--------------|--------------|
| Noncontrolling interests in subsidiaries   | 39,424       | 31,745       |
| Total stockholders' equity                 | 457,180      | 349,944      |
| Total liabilities and stockholders' equity | \$ 3,493,422 | \$ 3,634,719 |

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

-5-

---

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

|                                                                                                   | For the Six Months Ended |                  |
|---------------------------------------------------------------------------------------------------|--------------------------|------------------|
|                                                                                                   | July 5,<br>2009          | June 29,<br>2008 |
| Cash Flows Provided from (Used by) Operating Activities                                           |                          |                  |
| Net Income                                                                                        | \$ 147,192               | \$ 104,712       |
| Adjustments to Reconcile Net Income to Net Cash<br>Provided from Operations:                      |                          |                  |
| Depreciation and amortization                                                                     | 94,058                   | 125,088          |
| Stock-based compensation expense, net of tax of \$11,270 and \$6,546, respectively                | 20,567                   | 11,537           |
| Excess tax benefits from exercise of stock options                                                | (1,069 )                 | (559 )           |
| Deferred income taxes                                                                             | 38,495                   | 39,795           |
| Business realignment initiatives, net of tax of \$24,898 and \$23,774, respectively               | 36,765                   | 46,155           |
| Contributions to pension plans                                                                    | (2,026 )                 | (3,813 )         |
| Changes in assets and liabilities, net of effects from business acquisitions and<br>divestitures: |                          |                  |
| Accounts receivable - trade                                                                       | 184,336                  | 183,876          |
| Inventories                                                                                       | (66,893 )                | (95,618 )        |
| Accounts payable                                                                                  | 29,031                   | 58,133           |
| Other assets and liabilities                                                                      | (34,275 )                | (149,234 )       |
| Net Cash Flows Provided from Operating Activities                                                 | 446,181                  | 320,072          |
| Cash Flows Provided from (Used by) Investing Activities                                           |                          |                  |
| Capital additions                                                                                 | (66,273 )                | (138,374 )       |
| Capitalized software additions                                                                    | (7,543 )                 | (8,157 )         |
| Proceeds from sales of property, plant and equipment                                              | 3,061                    | 76,860           |
| Business acquisition                                                                              | (15,220 )                | —                |
| Proceeds from divestiture                                                                         | —                        | 1,960            |
| Net Cash Flows (Used by) Investing Activities                                                     | (85,975 )                | (67,711 )        |
| Cash Flows Provided from (Used by) Financing Activities                                           |                          |                  |
| Net decrease in short-term debt                                                                   | (237,409 )               | (430,916 )       |
| Long-term borrowings                                                                              | —                        | 247,845          |
| Repayment of long-term debt                                                                       | (4,763 )                 | (2,167 )         |
| Cash dividends paid                                                                               | (131,487 )               | (131,481 )       |
| Exercise of stock options                                                                         | 6,041                    | 21,114           |
| Excess tax benefits from exercise of stock options                                                | 1,069                    | 559              |
| Contributions from noncontrolling interests in subsidiaries                                       | 7,322                    | —                |
| Repurchase of Common Stock                                                                        | (9,314 )                 | (41,086 )        |
| Net Cash Flows (Used by) Financing Activities                                                     | (368,541 )               | (336,132 )       |
| Decrease in Cash and Cash Equivalents                                                             | (8,335 )                 | (83,771 )        |
| Cash and Cash Equivalents, beginning of period                                                    | 37,103                   | 129,198          |
| Cash and Cash Equivalents, end of period                                                          | \$28,768                 | \$45,427         |

Edgar Filing: HERSHEY CO - Form 10-Q

|                   |           |          |
|-------------------|-----------|----------|
| Interest Paid     | \$46,665  | \$47,259 |
| Income Taxes Paid | \$109,182 | \$94,988 |

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

-6-

---

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 have a controlling financial interest if we own a majority of the outstanding voting common stock and the noncontrolling stockholders do not have substantive participating rights, or we have significant control over an entity through contractual or economic interests in which we are the primary beneficiary. 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 ("GAAP") 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 2009 presentation. Operating results for the six months ended July 5, 2009 may not be indicative of the results that may be expected for the year ending December 31, 2009, because of the seasonal effects of our business. For more information, refer to the consolidated financial statements and notes included in our 2008 Annual Report on Form 10-K.

In May 2009, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 165, Subsequent Events ("SFAS No. 165"). This new standard is effective for both interim and annual financial statements ending after June 15, 2009. SFAS No. 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued.

We adopted SFAS No. 165 as of July 5, 2009 and have evaluated all subsequent events through the date and time our financial statements were issued on August 13, 2009. The adoption of this standard did not have a material impact on our financial accounting or reporting. See Note 19 for related subsequent event disclosures.

2. BUSINESS ACQUISITIONS AND DIVESTITURES

In January 2008 our Brazilian subsidiary, Hershey do Brasil, entered into a cooperative agreement with Pandurata Alimentos LTDA ("Bauducco"), a leading manufacturer of baked goods in Brazil whose primary brand is Bauducco. The arrangement with Bauducco leverages Bauducco's strong sales and distribution capabilities for our products throughout Brazil. Under this agreement we manufacture and market, and they sell and distribute our products. In the first quarter of 2008, we received approximately \$2.0 million in cash and recorded an other intangible asset of \$13.7 million associated with the cooperative agreement with Bauducco in exchange for our conveying to Bauducco a 49% interest in Hershey do Brasil. We maintain a 51% controlling interest in Hershey do Brasil.

In March 2009, the Company completed the acquisition of the Van Houten Singapore consumer business. The acquisition from Barry Callebaut, AG provides the Company with an exclusive license of the Van Houten brand name and related trademarks in Asia and the Middle East for the retail and duty free distribution channels. The purchase price for the acquisition of Van Houten Singapore and the licensing agreement was approximately \$15.2 million.

Results subsequent to the acquisition dates were included in the consolidated financial statements. Had the results of the acquisitions been included in the consolidated financial statements for each of the periods presented, the effect would not have been material.

3. NONCONTROLLING INTERESTS IN SUBSIDIARIES

As of January 1, 2009, the Company adopted FASB Statement of Financial Accounting Standards No. 160, Noncontrolling Interests in Consolidated Financial Statements — an amendment of ARB No. 51 (“SFAS No. 160”). SFAS No. 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary (formerly known as minority interest) and for the deconsolidation of a subsidiary and requires the noncontrolling interest to be reported as a component of equity. In addition, changes in a parent’s ownership interest while the parent retains its controlling interest will be accounted for as equity transactions, and any retained noncontrolling equity investment upon the deconsolidation of a subsidiary will be measured initially at fair value.

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

-7-

---

beverages across India. Under the agreement, we own a 51% controlling interest in Godrej Hershey Ltd. In January 2009, the Company contributed cash of approximately \$8.7 million to Godrej Hershey Ltd. and owners of the noncontrolling interests in Godrej Hershey Ltd. contributed approximately \$7.3 million. The ownership interest percentages in Godrej Hershey Ltd. did not change significantly as a result of these contributions. The noncontrolling interests in Godrej Hershey Ltd. are included in the equity section of the Consolidated Balance Sheets.

We also own a 51% controlling interest in Hershey do Brasil under the cooperative agreement with Bauducco. The noncontrolling interest in Hershey do Brasil is included in the equity section of the Consolidated Balance Sheets.

The increase in noncontrolling interests in subsidiaries from \$31.7 million as of December 31, 2008 to \$39.4 million as of July 5, 2009 reflected the \$7.3 million contribution from the noncontrolling interests in Godrej Hershey Ltd. and the impact of currency translation adjustments, partially offset by a reduction resulting from the recording of the share of losses pertaining to the noncontrolling interests. The recording of the share of losses pertaining to the noncontrolling interests in subsidiaries increased income by \$2.4 million for the six months ended July 5, 2009 and by \$3.2 million for the six months ended June 29, 2008 and was included in selling, marketing and administrative expenses.

#### 4. STOCK COMPENSATION PLANS

The Hershey Company Equity and Incentive Compensation Plan ("EICP") is the plan under which grants using shares for compensation and incentive purposes are made. The following table summarizes our stock compensation costs:

|                                                                                                                                 | For the Three Months Ended |                  | For the Six Months Ended |                  |
|---------------------------------------------------------------------------------------------------------------------------------|----------------------------|------------------|--------------------------|------------------|
|                                                                                                                                 | July 5,<br>2009            | June 29,<br>2008 | July 5,<br>2009          | June 29,<br>2008 |
|                                                                                                                                 | (in millions of dollars)   |                  |                          |                  |
| Total compensation amount charged against income for stock options, performance stock units ("PSUs") and restricted stock units | \$ 20.3                    | \$ 9.0           | \$ 31.5                  | \$ 17.8          |
| Total income tax benefit recognized in the Consolidated Statements of Income for share-based compensation                       | \$ 6.4                     | \$ 3.4           | \$ 11.1                  | \$ 6.4           |

The increase in share-based compensation expense for the second quarter and first six months of 2009 resulted from higher performance expectations for our PSU awards.

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 Six Months Ended |                  |
|--------------------------|--------------------------|------------------|
|                          | July 5,<br>2009          | June 29,<br>2008 |
| Dividend yields          | 3.3%                     | 2.4%             |
| Expected volatility      | 21.6%                    | 18.1%            |
| Risk-free interest rates | 2.1%                     | 3.1%             |
| Expected lives in years  | 6.6                      | 6.6              |



## Stock Options

A summary of the status of our stock options as of July 5, 2009, and the change during 2009 is presented below:

| Stock Options                          | For the Six Months Ended July 5, 2009 |                                 |                                             |
|----------------------------------------|---------------------------------------|---------------------------------|---------------------------------------------|
|                                        | Shares                                | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term |
| Outstanding at beginning of the period | 16,671,643                            | \$42.08                         | 6.6 years                                   |
| Granted                                | 3,145,970                             | \$34.90                         |                                             |
| Exercised                              | (227,972)                             | \$26.50                         |                                             |
| Forfeited                              | (353,653)                             | \$44.58                         |                                             |
| Outstanding as of July 5, 2009         | 19,235,988                            | \$41.04                         | 6.5 years                                   |
| Options exercisable as of July 5, 2009 | 10,599,968                            | \$42.27                         | 5.0 years                                   |

|                                                               | For the Six Months Ended |               |
|---------------------------------------------------------------|--------------------------|---------------|
|                                                               | July 5, 2009             | June 29, 2008 |
| Weighted-average fair value of options granted (per share)    | \$ 5.31                  | \$ 6.21       |
| Intrinsic value of options exercised (in millions of dollars) | \$ 2.1                   | \$ 4.9        |

—As of July 5, 2009, the aggregate intrinsic value of options outstanding was \$25.7 million and the aggregate intrinsic value of options exercisable was \$18.9 million.

—As of July 5, 2009, there was \$37.0 million of total unrecognized compensation cost related to non-vested stock option compensation arrangements granted under our stock option plans. That cost is expected to be recognized over a weighted-average period of 2.6 years.

## Performance Stock Units and Restricted Stock Units

A summary of the status of our performance stock units and restricted stock units as of July 5, 2009, and the change during 2009 is presented below:

| Performance Stock Units and Restricted Stock Units | For the Six Months Ended July 5, 2009 | Weighted-average grant date fair value for equity awards or market value for liability awards |
|----------------------------------------------------|---------------------------------------|-----------------------------------------------------------------------------------------------|
|                                                    |                                       |                                                                                               |
| Outstanding at beginning of year                   | 766,209                               | \$36.13                                                                                       |
| Granted                                            | 559,939                               | \$35.00                                                                                       |
| Performance assumption change                      | 561,420                               | \$37.76                                                                                       |
| Vested                                             | (243,027)                             | \$34.55                                                                                       |
| Forfeited                                          | (10,140)                              | \$36.21                                                                                       |
| Outstanding as of July 5, 2009                     | 1,634,401                             | \$37.21                                                                                       |

As of July 5, 2009, there was \$38.7 million of unrecognized compensation cost relating to non-vested performance stock units and restricted stock units. We expect to recognize that cost over a weighted-average period of 2.4 years.

For the Six Months Ended

Edgar Filing: HERSHEY CO - Form 10-Q

|                                                                                                                         | July 5,<br>2009 | June 29,<br>2008 |
|-------------------------------------------------------------------------------------------------------------------------|-----------------|------------------|
| Intrinsic value of share-based liabilities paid, combined with the fair value of shares vested (in millions of dollars) | \$ 8.1          | \$ 8.9           |

-9-

---

Deferred performance stock units, deferred restricted stock units, and directors' fees and accumulated dividend amounts representing deferred stock units totaled 509,615 units as of July 5, 2009. Each unit is equivalent to one share of the Company's Common Stock.

No stock appreciation rights were outstanding as of July 5, 2009.

For more information on our stock compensation plans, refer to the consolidated financial statements and notes included in our 2008 Annual Report on Form 10-K and our proxy statement for the 2009 annual meeting of stockholders.

## 5. INTEREST EXPENSE

Net interest expense consisted of the following:

|                       | For the Six Months Ended  |                  |
|-----------------------|---------------------------|------------------|
|                       | July 5,<br>2009           | June 29,<br>2008 |
|                       | (in thousands of dollars) |                  |
| Interest expense      | \$ 48,466                 | \$ 51,943        |
| Interest income       | (545 )                    | (1,047 )         |
| Capitalized interest  | (1,291 )                  | (2,900 )         |
| Interest expense, net | \$ 46,630                 | \$ 47,996        |

## 6. BUSINESS REALIGNMENT INITIATIVES

In February 2007, we announced a comprehensive, three-year supply chain transformation program (the "global supply chain transformation program or GSCT") and, in December 2007, we initiated a business realignment program associated with our business in Brazil (together, "the 2007 business realignment initiatives"). In December 2008, we approved a modest expansion in the scope of the global supply chain transformation program to include the closure of two subscale manufacturing facilities of Artisan Confections Company, a wholly-owned subsidiary, and consolidation of the associated production into existing U.S. facilities, along with rationalization of other select portfolio items. The affected facilities are located in Berkeley and San Francisco, California. The additional business realignment charges related to the expansion in scope will be recorded in 2009 and include severance for approximately 150 impacted employees.

The original estimated pre-tax cost of the program announced in February 2007 was from \$525 million to \$575 million over three years. The total included from \$475 million to \$525 million in business realignment costs and approximately \$50 million in project implementation costs. The increase in scope approved in December 2008 increased the total expected cost by about \$25 million. In addition, the current trends of employee lump sum withdrawals from the defined benefit pension plans are expected to result in non-cash pension settlement charges of up to \$65 million in 2009 and 2010. Therefore, we now expect total pre-tax charges and non-recurring project implementation costs of \$640 million to \$665 million for the GSCT. Total costs of \$61.7 million were recorded during the first six months of 2009, costs of \$130.0 million were recorded in 2008 and costs of \$400.0 million were recorded in 2007 for this program.

In an effort to improve the performance of our business in Brazil, in January 2008 Hershey do Brasil entered into a cooperative agreement with Bauducco. Business realignment and impairment charges of \$4.9 million were recorded in 2008 and charges of \$12.6 million were recorded in 2007.



Charges (credits) associated with business realignment initiatives recorded during the three-month and six-month periods ended July 5, 2009 and June 29, 2008 were as follows:

|                                                                               | For the Three<br>Months Ended |                  | For the Six<br>Months Ended |                  |
|-------------------------------------------------------------------------------|-------------------------------|------------------|-----------------------------|------------------|
|                                                                               | July 5,<br>2009               | June 29,<br>2008 | July 5,<br>2009             | June 29,<br>2008 |
| (in thousands of dollars)                                                     |                               |                  |                             |                  |
| Cost of sales – 2007 business realignment initiatives                         | \$3,116                       | \$15,027         | \$7,167                     | \$40,181         |
| Selling, marketing and administrative – 2007 business realignment initiatives | 1,671                         | 2,443            | 3,754                       | 3,877            |
| Business realignment and impairment charges, net:                             |                               |                  |                             |                  |
| Global supply chain transformation program                                    |                               |                  |                             |                  |
| Losses (gains) on sale of fixed assets                                        | —                             | 7,110            | —                           | (6,790 )         |
| Fixed asset impairments and plant closure expenses                            | 6,546                         | 5,488            | 16,889                      | 15,265           |
| Employee separation costs                                                     | 383                           | 3,242            | 2,878                       | 7,131            |
| Pension settlement loss                                                       | 30,555                        | 4,743            | 30,555                      | 4,743            |
| Contract termination costs                                                    | 420                           | 1,591            | 420                         | 1,591            |
| Brazilian business realignment                                                |                               |                  |                             |                  |
| Employee separation (credits) costs                                           | —                             | (334 )           | —                           | 1,526            |
| Fixed asset impairment (credits) charges                                      | —                             | (5 )             | —                           | 717              |
| Contract termination costs and other exit (credits) costs                     | —                             | (49 )            | —                           | 1,688            |
| Total business realignment and impairment charges, net                        | 37,904                        | 21,786           | 50,742                      | 25,871           |
| Total net charges associated with 2007 business realignment initiatives       | \$42,691                      | \$39,256         | \$61,663                    | \$69,929         |

The charge of \$3.1 million recorded in cost of sales during the second quarter of 2009 related primarily to the accelerated depreciation of fixed assets over a reduced estimated remaining useful life and start-up costs associated with the global supply chain transformation program. The \$1.7 million recorded in selling, marketing and administrative expenses related primarily to project administration for the global supply chain transformation program. The \$6.5 million of fixed asset impairments and plant closure expenses for 2009 related primarily to the preparation of plants for sale and line removal costs. In determining the costs related to fixed asset impairments, fair value was estimated based on the expected sales proceeds. Certain real estate with a carrying value of \$20.5 million was being held for sale as of July 5, 2009. The global supply chain transformation program employee separation costs were related to involuntary terminations at the manufacturing facilities of Artisan Confections Company which are being closed. As of July 5, 2009, manufacturing facilities located in Dartmouth, Nova Scotia; Oakdale, California; and Montreal, Quebec have been closed and sold. The facilities located in Naugatuck, Connecticut; Reading, Pennsylvania; and Smiths Falls, Ontario have been closed and are being held for sale. The higher pension settlement loss in the second quarter of 2009 compared to the second quarter of 2008 resulted from an increase in actuarial losses associated with the significant decline in the fair value of pension assets in 2008, along with the increased level of lump sum withdrawals from a defined benefit pension plan related to employee departures associated with the global supply chain transformation program.

The charge of \$7.2 million recorded in cost of sales during the first six months of 2009 for the global supply chain transformation program related to the accelerated depreciation of fixed assets over a reduced estimated remaining

useful life and start-up costs associated with the global supply chain transformation program. The \$3.8 million recorded in selling, marketing and administrative expenses related primarily to project administration for the global supply chain transformation program. The \$16.9 million of fixed asset impairments and plant closure expenses related primarily to the preparation of plants for sale and line removal costs. In determining the costs related to fixed asset impairments, fair value was estimated based on the expected sales proceeds. The global supply chain transformation program employee separation costs were related to involuntary terminations at the manufacturing facilities of Artisan Confections Company which are being closed.

-11-

---

The charge of \$15.0 million recorded in cost of sales during the second quarter of 2008 related primarily to the accelerated depreciation of fixed assets over a reduced estimated remaining useful life and start-up costs associated with the global supply chain transformation program. The \$2.4 million recorded in selling, marketing and administrative expenses related primarily to project administration for the global supply chain transformation program. In determining the costs related to fixed asset impairments, fair value was estimated based on the expected sales proceeds. The \$7.1 million of losses on sale of fixed assets resulted from the write-off of machinery and equipment at a plant which was sold during the quarter. The \$5.5 million of fixed asset impairments and plant closure expenses for 2008 related primarily to the preparation of plants for sale and line removal costs. The global supply chain transformation program employee separation costs related to involuntary terminations at the North American manufacturing facilities which were being closed.

The charge of \$40.2 million recorded in cost of sales during the first six months of 2008 related primarily to the accelerated depreciation of fixed assets over a reduced estimated remaining useful life and start-up costs associated with the global supply chain transformation program. The \$3.9 million recorded in selling, marketing and administrative expenses related primarily to project administration for the global supply chain transformation program. In determining the costs related to fixed asset impairments, fair value was estimated based on the expected sales proceeds. The \$6.8 million of gains on sale of fixed assets resulted from the receipt of proceeds in excess of the carrying value primarily from the sale of a warehousing and distribution facility. The \$15.3 million of fixed asset impairments and plant closure expenses for 2008 related primarily to the preparation of plants for sale and line removal costs. The global supply chain transformation program employee separation costs related to involuntary terminations at the North American manufacturing facilities which were being closed.

The 2008 (credits) charges for the Brazilian business realignment were related to costs for involuntary terminations and costs associated with office consolidation related to the cooperative agreement with Bauducco.

The July 5, 2009 liability balance relating to the 2007 business realignment initiatives was \$14.3 million for employee separation costs to be paid primarily in 2009. Charges for employee separation costs of \$3.1 million were recorded during the first six months of 2009. During the first six months of 2009, we made payments against the liabilities recorded for the 2007 business realignment initiatives of \$19.8 million principally related to employee separation costs.

## 7. EARNINGS PER SHARE

In accordance with Statement of Financial Accounting Standards No. 128, Earnings Per Share, we compute Basic and Diluted Earnings Per Share based on the weighted-average number of shares of the Common Stock and the Class B Common Stock outstanding as follows:

|                                       | For the Three<br>Months Ended           |                  | For the Six<br>Months Ended |                  |
|---------------------------------------|-----------------------------------------|------------------|-----------------------------|------------------|
|                                       | July 5,<br>2009                         | June 29,<br>2008 | July 5,<br>2009             | June 29,<br>2008 |
|                                       | (in thousands except per share amounts) |                  |                             |                  |
| Net income                            | \$ 71,298                               | \$ 41,467        | \$ 147,192                  | \$ 104,712       |
| Weighted-average shares - Basic       |                                         |                  |                             |                  |
| Common Stock                          | 166,846                                 | 166,624          | 166,817                     | 166,701          |
| Class B Common Stock                  | 60,710                                  | 60,806           | 60,710                      | 60,806           |
| Total weighted-average shares - Basic | 227,556                                 | 227,430          | 227,527                     | 227,507          |
| Effect of dilutive securities:        |                                         |                  |                             |                  |

Edgar Filing: HERSHEY CO - Form 10-Q

|                                        |         |         |         |         |
|----------------------------------------|---------|---------|---------|---------|
| Employee stock options                 | 648     | 937     | 620     | 956     |
| Performance and restricted stock units | 285     | 297     | 249     | 335     |
| Weighted-average shares - Diluted      | 228,489 | 228,664 | 228,396 | 228,798 |
| Earnings Per Share - Basic             |         |         |         |         |
| Class B Common Stock                   | \$ .29  | \$ .17  | \$ .60  | \$ .43  |
| Common Stock                           | \$ .32  | \$ .19  | \$ .66  | \$ .47  |
| Earnings Per Share - Diluted           |         |         |         |         |
| Class B Common Stock                   | \$ .29  | \$ .17  | \$ .60  | \$ .43  |
| Common Stock                           | \$ .31  | \$ .18  | \$ .64  | \$ .46  |

The Class B Common Stock is convertible into Common Stock on a share for share basis at any time. In accordance with proposed FASB Staff Position No. FAS 128-a, Computational Guidance for Computing Diluted EPS under the Two-Class Method, the calculation of earnings per share-diluted for the Class B Common Stock was performed using the two-class method and the calculation of earnings per share-diluted for the Common Stock was performed using the if-converted method.

|                                                                                                                    | For the Three<br>Months Ended |                  | For the Six<br>Months Ended |                  |
|--------------------------------------------------------------------------------------------------------------------|-------------------------------|------------------|-----------------------------|------------------|
|                                                                                                                    | July 5,<br>2009               | June 29,<br>2008 | July 5,<br>2009             | June 29,<br>2008 |
|                                                                                                                    | (in millions)                 |                  |                             |                  |
| Stock options excluded from diluted earnings per share calculation because the effect would have been antidilutive | 15.6                          | 12.8             | 17.1                        | 12.8             |

## 8. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

We account for derivative instruments in accordance with FASB Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended ("SFAS No. 133"). SFAS No. 133 requires us to recognize all derivative instruments at fair value. We classify derivatives as assets or liabilities on the balance sheet. Accounting for the change in fair value of the derivative depends on:

- whether the instrument qualifies for, and has been designated as, a hedging relationship; and
- the type of hedging relationship.

There are three types of hedging relationships:

- cash flow hedge;
- fair value hedge; and
- hedge of foreign currency exposure of a net investment in a foreign operation.

As of July 5, 2009 and December 31, 2008, we classified all of our derivative instruments as cash flow hedges.

The amount of net losses on cash flow hedging derivatives, including foreign exchange forward contracts, interest rate swap agreements and commodities futures contracts, expected to be reclassified into earnings in the next twelve months was approximately \$9.6 million after tax as of July 5, 2009. This amount was primarily associated with commodities futures contracts.

For more information, refer to the consolidated financial statements and notes included in our 2008 Annual Report on Form 10-K.

### Objectives, Strategies and Accounting Policies Associated with Derivative Instruments

We use certain derivative instruments, from time to time, to manage interest rate, foreign currency exchange rate and commodity market price risk exposures. We enter into interest rate swap agreements and foreign currency forward contracts and options for periods consistent with their related underlying exposures. We enter into commodities futures and options contracts for varying periods. Our commodities futures and options contracts are effective as

hedges of market price risks associated with anticipated raw material purchases, energy requirements and transportation costs.

We do not hold or issue derivative instruments for trading purposes and are not a party to any instruments with leverage or prepayment features. In entering into these contracts, we have assumed the risk that might arise from the possible inability of counterparties to meet the terms of their contracts. We mitigate this risk by performing financial assessments prior to contract execution, conducting periodic evaluations of counterparty performance and maintaining a diverse portfolio of qualified counterparties. We do not expect any significant losses from counterparty defaults.

#### Interest Rate Swaps

In order to minimize financing costs and to manage interest rate exposure, from time to time, we enter into interest rate swap agreements. We include gains and losses on interest rate swap agreements in other comprehensive income. We recognize gains and losses on interest rate swap agreements as an adjustment to interest expense in the same period as the hedged interest payments affect earnings. We classify cash flows from interest rate swap agreements as net cash

provided from operating activities on the Consolidated Statements of Cash Flows. Our risk related to interest rate swap agreements is limited to the cost of replacing the agreements at prevailing market rates.

#### Foreign Exchange Forward Contracts

We enter into foreign exchange forward contracts to hedge transactions primarily related to commitments and forecasted purchases of equipment, raw materials and finished goods denominated in foreign currencies. We may also hedge payment of forecasted intercompany transactions with our subsidiaries outside the United States. These contracts reduce currency risk from exchange rate movements. We generally hedge foreign currency price risks for periods from 3 to 24 months.

Foreign exchange forward contracts are effective as hedges of identifiable foreign currency commitments. Since there is a direct relationship between the foreign currency derivatives and the foreign currency denomination of the transactions, the derivatives are highly effective in hedging cash flows related to transactions denominated in the corresponding foreign currencies. We designate our foreign exchange forward contracts as cash flow hedging derivatives.

These contracts meet the criteria for cash flow hedge accounting treatment. Accordingly, we include related gains and losses in other comprehensive income. Subsequently, we recognize the gains and losses in cost of sales or selling, marketing and administrative expense in the same period that the hedged items affect earnings. In entering into these contracts, we have assumed the risk that might arise from the possible inability of counterparties to meet the terms of their contracts. We do not expect any significant losses from counterparty defaults.

We classify the fair value of foreign exchange forward contracts as prepaid expenses and other current assets, other non-current assets, accrued liabilities or other long-term liabilities on the Consolidated Balance Sheets. We report the offset to the contracts in accumulated other comprehensive loss, net of income taxes. We record gains and losses on these contracts as a component of other comprehensive income and reclassify them into earnings in the same period during which the hedged transaction affects earnings. For hedges associated with the purchase of equipment, we designate the related cash flows as net cash flows (used by) provided from investing activities on the Consolidated Statements of Cash Flows. We classify cash flows from other foreign exchange forward contracts as net cash provided from operating activities.

As of July 5, 2009, the fair value of foreign exchange forward contracts with gains totaled \$7.2 million and the fair value of foreign exchange forward contracts with losses totaled \$2.3 million. Over the last three years the volume of activity for foreign exchange forward contracts to purchase foreign currencies ranged from a contract amount of \$.8 million to \$35.6 million. Over the same period, the volume of activity for foreign exchange forward contracts to sell foreign currencies ranged from a contract amount of \$13.6 million to \$165.1 million.

#### Commodities Futures and Options Contracts

We enter into commodities futures and options contracts to reduce the effect of raw material price fluctuations and to hedge transportation costs. We generally hedge commodity price risks for 3 to 24 month periods. The commodities futures and options contracts are highly effective in hedging price risks for our raw material requirements and transportation costs. Because our commodities futures and options contracts meet hedge criteria, we account for them as cash flow hedges. Accordingly, we include gains and losses on hedging in other comprehensive income. We recognize gains and losses ratably in cost of sales in the same period that we record the hedged raw material requirements in cost of sales.

We use exchange traded futures contracts to fix the price of unpriced physical forward purchase contracts. Physical forward purchase contracts meet the SFAS No. 133 definition of “normal purchases and sales” and, therefore, are not accounted for as derivative instruments. On a daily basis, we receive or make cash transfers reflecting changes in the value of futures contracts (unrealized gains and losses). As mentioned above, such gains and losses are included as a component of other comprehensive income. The cash transfers offset higher or lower cash requirements for payment of future invoice prices for raw materials, energy requirements and transportation costs. Futures held in excess of the amount required to fix the price of unpriced physical forward contracts are effective as hedges of anticipated purchases.

Over the last three years our total annual volume of futures and options traded in conjunction with commodities hedging strategies ranged from 55,000 to 70,000 contracts. We use futures and options contracts in combination with forward purchasing of cocoa products, sugar, corn sweeteners, natural gas, fuel oil and certain dairy products primarily to provide favorable pricing opportunities and flexibility in sourcing our raw material and energy requirements. Our commodity procurement practices are intended to reduce the risk of future price increases and provide visibility to future costs, but also may potentially limit our ability to benefit from possible price decreases.

## Hedge Effectiveness—Commodities

We perform an assessment of hedge effectiveness for commodities futures and options contracts on a quarterly basis. Because of the rollover strategy used for commodities futures contracts, as required by futures market conditions, some ineffectiveness may result in hedging forecasted manufacturing requirements. This occurs as we switch futures contracts from nearby contract positions to contract positions that are required to fix the price of anticipated manufacturing requirements. Hedge ineffectiveness may also result from variability in basis differentials associated with the purchase of raw materials for manufacturing requirements. In accordance with SFAS No. 133, we record the ineffective portion of gains or losses on commodities futures and options contracts currently in cost of sales.

The prices of commodities futures contracts reflect delivery to the same locations where we take delivery of the physical commodities. Therefore, there is no ineffectiveness resulting from differences in location between the derivative and the hedged item.

## Financial Statement Location and Amounts Pertaining to Derivative Instruments

The fair value of derivative instruments in the Consolidated Balance Sheet as of July 5, 2009 was as follows:

| Balance Sheet Caption                    | Interest Rate Swap<br>Agreements | Foreign Exchange<br>Forward Contracts<br>and Options<br>(in thousands of dollars) | Commodities<br>Futures and<br>Options<br>Contracts |
|------------------------------------------|----------------------------------|-----------------------------------------------------------------------------------|----------------------------------------------------|
| Prepaid expense and other current assets | \$ —                             | \$ 7,161                                                                          | \$ 4,621                                           |
| Other assets                             | \$ 8,623                         | \$ —                                                                              | \$ —                                               |
| Accrued liabilities                      | \$ —                             | \$ 2,275                                                                          | \$ 8,851                                           |

The fair value of the interest rate swap agreements represents the difference in the present values of cash flows calculated at the contracted interest rates and at current market interest rates at the end of the period. We calculate the fair value of interest rate swap agreements quarterly based on the quoted market price for the same or similar financial instruments.

We define the fair value of foreign exchange forward contracts and options as the amount of the difference between the contracted and current market foreign currency exchange rates at the end of the period. We estimate the fair value of foreign exchange forward contracts and options on a quarterly basis by obtaining market quotes of spot and forward rates for contracts with similar terms, adjusted where necessary for maturity differences.

As of July 5, 2009, prepaid expense and other current assets were associated with the fair value of commodity options contracts. Accrued liabilities were related to cash transfers payable on commodities futures contracts reflecting the change in quoted market prices on the last trading day for the period. We make or receive cash transfers to or from commodity futures brokers on a daily basis reflecting changes in the value of futures contracts on the IntercontinentalExchange or various other exchanges. These changes in value represent unrealized gains and losses.

The effect of derivative instruments on the Consolidated Statements of Income for the six months ended July 5, 2009 was as follows:

| Cash Flow Hedging Derivatives                                                        | Interest Rate<br>Swap<br>Agreements | Foreign Exchange<br>Forward Contracts<br>and Options<br>(in thousands of dollars) | Commodities<br>Futures and<br>Options<br>Contracts |
|--------------------------------------------------------------------------------------|-------------------------------------|-----------------------------------------------------------------------------------|----------------------------------------------------|
| Gains (losses) recognized in other comprehensive income ("OCI") (effective portion)  | \$ 8,623                            | \$ 1,634                                                                          | \$ 2,615                                           |
| Gains (losses) reclassified from accumulated OCI into income (effective portion) (a) | \$ —                                | \$ 5,419                                                                          | \$ (11,400)                                        |
| Gains (losses) recognized in income (ineffective portion) (b)                        | \$ —                                | \$ —                                                                              | \$ (431)                                           |

(a) Gains (losses) reclassified from accumulated OCI into earnings were included in cost of sales for commodities futures and options contracts and in selling, marketing and administrative expenses for foreign exchange forward contracts and options.

(b) Gains (losses) recognized in earnings were included in cost of sales.

All gains (losses) recognized in earnings were related to the ineffective portion of the hedging relationship. We recognized no components of gains and losses on cash flow hedging derivatives in income due to excluding such components from the hedge effectiveness assessment.

## 9. COMPREHENSIVE INCOME

A summary of the components of comprehensive income (loss) is as follows:

| For the Three Months Ended July 5, 2009   |                   |                                                          |                     |
|-------------------------------------------|-------------------|----------------------------------------------------------|---------------------|
|                                           | Pre-Tax<br>Amount | Tax<br>(Expense)<br>Benefit<br>(in thousands of dollars) | After-Tax<br>Amount |
| Net income                                |                   |                                                          | \$ 71,298           |
| Other comprehensive income (loss):        |                   |                                                          |                     |
| Foreign currency translation adjustments  | \$ 18,371         | \$ —                                                     | 18,371              |
| Pension and post-retirement benefit plans | 39,953            | (15,571 )                                                | 24,382              |
| Cash flow hedges:                         |                   |                                                          |                     |
| Losses on cash flow hedging derivatives   | (8,172 )          | 3,320                                                    | (4,852 )            |
| Reclassification adjustments              | 5,755             | (2,253 )                                                 | 3,502               |
| Total other comprehensive income          | \$ 55,907         | \$ (14,504 )                                             | 41,403              |
| Comprehensive income                      |                   |                                                          | \$ 112,701          |

| For the Three Months Ended June 29, 2008  |                   |                                                          |                     |
|-------------------------------------------|-------------------|----------------------------------------------------------|---------------------|
|                                           | Pre-Tax<br>Amount | Tax<br>(Expense)<br>Benefit<br>(in thousands of dollars) | After-Tax<br>Amount |
| Net income                                |                   |                                                          | \$ 41,467           |
| Other comprehensive income (loss):        |                   |                                                          |                     |
| Foreign currency translation adjustments  | \$ 3,787          | \$ —                                                     | 3,787               |
| Pension and post-retirement benefit plans | 4,830             | (1,918 )                                                 | 2,912               |
| Cash flow hedges:                         |                   |                                                          |                     |
| Gains on cash flow hedging derivatives    | 63,561            | (22,877 )                                                | 40,684              |
| Reclassification adjustments              | (18,767 )         | 6,761                                                    | (12,006 )           |
| Total other comprehensive income          | \$ 53,411         | \$ (18,034 )                                             | 35,377              |
| Comprehensive income                      |                   |                                                          | \$ 76,844           |

| For the Six Months Ended July 5, 2009    |                   |                                                          |                     |
|------------------------------------------|-------------------|----------------------------------------------------------|---------------------|
|                                          | Pre-Tax<br>Amount | Tax<br>(Expense)<br>Benefit<br>(in thousands of dollars) | After-Tax<br>Amount |
| Net income                               |                   |                                                          | \$ 147,192          |
| Other comprehensive income (loss):       |                   |                                                          |                     |
| Foreign currency translation adjustments | \$ 16,604         | \$ —                                                     | 16,604              |

Edgar Filing: HERSHEY CO - Form 10-Q

|                                           |           |              |            |
|-------------------------------------------|-----------|--------------|------------|
| Pension and post-retirement benefit plans | 48,098    | (18,706 )    | 29,392     |
| Cash flow hedges:                         |           |              |            |
| Gains on cash flow hedging derivatives    | 12,872    | (3,651 )     | 9,221      |
| Reclassification adjustments              | 5,981     | (2,341 )     | 3,640      |
| Total other comprehensive income          | \$ 83,555 | \$ (24,698 ) | 58,857     |
| Comprehensive income                      |           |              | \$ 206,049 |

-16-

---

For the Six Months Ended June 29, 2008

|                                           | Pre-Tax<br>Amount | Tax<br>(Expense)<br>Benefit<br>(in thousands of dollars) | After-Tax<br>Amount |
|-------------------------------------------|-------------------|----------------------------------------------------------|---------------------|
| Net income                                |                   |                                                          | \$ 104,712          |
| Other comprehensive income (loss):        |                   |                                                          |                     |
| Foreign currency translation adjustments  | \$ (95 )          | \$ —                                                     | (95 )               |
| Pension and post-retirement benefit plans | 4,924             | (1,961 )                                                 | 2,963               |
| Cash flow hedges:                         |                   |                                                          |                     |
| Gains on cash flow hedging derivatives    | 97,300            | (35,020 )                                                | 62,280              |
| Reclassification adjustments              | (28,964 )         | 10,452                                                   | (18,512 )           |
| Total other comprehensive income          | \$ 73,165         | \$ (26,529 )                                             | 46,636              |
| Comprehensive income                      |                   |                                                          | \$ 151,348          |

The components of accumulated other comprehensive income (loss) as shown on the Consolidated Balance Sheets are as follows:

|                                                       | July 5,<br>2009           | December 31,<br>2008 |
|-------------------------------------------------------|---------------------------|----------------------|
|                                                       | (in thousands of dollars) |                      |
| Foreign currency translation adjustments              | \$ (13,149 )              | \$ (29,753 )         |
| Pension and post-retirement benefit plans, net of tax | (284,961 )                | (314,353 )           |
| Cash flow hedges, net of tax                          | (2,941 )                  | (15,802 )            |
| Total accumulated other comprehensive loss            | \$ (301,051 )             | \$ (359,908 )        |

#### 10. INVENTORIES

We value the majority of our inventories under the last-in, first-out (“LIFO”) method and the remaining inventories at the lower of first-in, first-out (“FIFO”) cost or market. Inventories were as follows:

|                     | July 5,<br>2009           | December 31,<br>2008 |
|---------------------|---------------------------|----------------------|
|                     | (in thousands of dollars) |                      |
| Raw materials       | \$ 281,960                | \$ 215,309           |
| Goods in process    | 102,025                   | 95,986               |
| Finished goods      | 454,431                   | 419,016              |
| Inventories at FIFO | 838,416                   | 730,311              |
| Adjustment to LIFO  | (195,911 )                | (137,781 )           |
| Total inventories   | \$ 642,505                | \$ 592,530           |

The increase in raw material inventories as of July 5, 2009 resulted from the timing of deliveries to support manufacturing requirements and higher prices in 2009. The increase in finished goods inventories was primarily associated with seasonal sales patterns.

#### 11. SHORT-TERM DEBT

As a source of short-term financing, we utilize commercial paper or bank loans with an original maturity of three months or less. Our five-year unsecured revolving credit agreement expires in December 2012. The credit limit is \$1.1 billion with an option to borrow an additional \$400 million with the concurrence of the lenders. The unsecured revolving credit agreement contains certain financial and other covenants, customary representations, warranties and events of default. As of July 5, 2009, we complied with all covenants pertaining to the credit agreement. There were no significant compensating balance agreements that legally restricted these funds. For more information, refer to the consolidated financial statements and notes included in our 2008 Annual Report on Form 10-K.

12. LONG-TERM DEBT

In May 2006, we filed a shelf registration statement on Form S-3 that registered an indeterminate amount of debt securities. This registration statement was effective immediately upon filing under Securities and Exchange Commission regulations governing “well-known seasoned issuers” (the “WKSI Registration Statement”). In March 2008, the Company issued \$250 million of 5.0% Notes due April 1, 2013 under the WKSI Registration Statement. The net

proceeds of this debt issuance were used to repay a portion of the Company's outstanding indebtedness under its short-term commercial paper program. The May 2006 WKS Registration Statement expired in May 2009. Accordingly, in May 2009, we filed a new registration statement on Form S-3 to replace the May 2006 WKS Registration Statement. The May 2009 WKS Registration Statement registered an indeterminate amount of debt securities and was effective immediately.

### 13. FINANCIAL INSTRUMENTS

The carrying amounts of financial instruments including cash and cash equivalents, accounts receivable, accounts payable and short-term debt approximated fair value as of July 5, 2009 and December 31, 2008, because of the relatively short maturity of these instruments.

The carrying value of long-term debt, including the current portion, was \$1,521.0 million as of July 5, 2009, compared with a fair value of \$1,634.8 million, an increase of \$113.8 million over the carrying value, based on quoted market prices for the same or similar debt issues.

#### Interest Rate Swaps

In order to minimize financing costs and to manage interest rate exposure, the Company, from time to time, enters into interest rate swap agreements. In March 2009, the Company entered into forward starting interest rate swap agreements to hedge interest rate exposure related to the anticipated \$250 million of term financing expected to be executed during 2011 to repay \$250 million of 5.3% Notes maturing in September 2011. The weighted-average fixed rate on the forward starting swap agreements was 3.5%. The fair value of interest rate swap agreements was a net asset of \$8.6 million as of July 5, 2009. The Company's risk related to interest rate swap agreements is limited to the cost of replacing such agreements at prevailing market rates. For more information see Note 8. Derivative Instruments and Hedging Activities.

#### Foreign Exchange Forward Contracts

The following table summarizes our foreign exchange activity:

|                                                                   | July 5, 2009             |                    |
|-------------------------------------------------------------------|--------------------------|--------------------|
|                                                                   | Contract Amount          | Primary Currencies |
|                                                                   | (in millions of dollars) |                    |
| Foreign exchange forward contracts to purchase foreign currencies | \$9.7                    | Euros              |
| Foreign exchange forward contracts to sell foreign currencies     | \$65.3                   | Canadian dollars   |

Our foreign exchange forward contracts mature in 2009 and 2010. For more information, see Note 8. Derivative Instruments and Hedging Activities.

### 14. FAIR VALUE ACCOUNTING

As of January 1, 2008, we adopted certain provisions of FASB Statement of Financial Accounting Standards No. 157, Fair Value Measurements ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS No. 157 applies when another standard required or permits assets or liabilities to be measured at fair value. Accordingly, SFAS No. 157 does not require any new fair value measurements. As of January 1, 2009, we adopted the remaining provisions of SFAS No. 157 relating to nonfinancial assets and liabilities that are not recognized or disclosed at fair value on a recurring basis. The adoption of SFAS No. 157 did not materially impact our consolidated financial statements.

We use certain derivative instruments, from time to time, to manage interest rate, foreign currency exchange rate and commodity market price risk exposures, all of which are recorded at fair value based on quoted market prices or rates.

A summary of our cash flow hedging derivative assets and liabilities measured at fair value on a recurring basis as of July 5, 2009, is as follows:

| Description                   | Fair Value as of July 5, 2009 | Quoted Prices in Active Markets of Identical Assets (Level 1)<br>(in thousands of dollars) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|-------------------------------|-------------------------------|--------------------------------------------------------------------------------------------|-----------------------------------------------|-------------------------------------------|
| <b>Assets</b>                 |                               |                                                                                            |                                               |                                           |
| Cash flow hedging derivatives | \$ 20,405                     | \$ 4,621                                                                                   | \$ 15,784                                     | \$ —                                      |
| <b>Liabilities</b>            |                               |                                                                                            |                                               |                                           |
| Cash flow hedging derivatives | \$ 11,126                     | \$ 8,851                                                                                   | \$ 2,275                                      | \$ —                                      |

As of July 5, 2009, cash flow hedging derivative Level 1 assets were associated with the fair value of commodity options contracts. As of July 5, 2009, cash flow hedging derivative Level 1 liabilities were related to cash transfers payable on commodities futures contracts reflecting the change in quoted market prices on the last trading day for the period. As of July 5, 2009, cash flow hedging derivative Level 2 assets were related to the fair value of interest rate swap agreements and foreign exchange forward contracts with gains. Cash flow hedging Level 2 liabilities were related to the fair value of foreign exchange forward contracts with losses. For more information, see Note 8. Derivative Instruments and Hedging Activities.

## 15. INCOME TAXES

The number of years with open tax audits varies depending on the tax jurisdiction. Our major taxing jurisdictions include the United States (federal and state) and Canada. During the second quarter of 2009, the U.S. Internal Revenue Service completed its audit of our U.S. income tax returns for 2005 and 2006, resulting in the resolution of tax contingencies associated with the 2004, 2005 and 2006 tax years.

## 16. PENSION AND OTHER POST-RETIREMENT BENEFIT PLANS

Components of net periodic benefits cost (income) consisted of the following:

|                                      | Pension Benefits           |                  | Other Benefits  |                  |
|--------------------------------------|----------------------------|------------------|-----------------|------------------|
|                                      | For the Three Months Ended |                  |                 |                  |
|                                      | July 5,<br>2009            | June 29,<br>2008 | July 5,<br>2009 | June 29,<br>2008 |
|                                      | (in thousands of dollars)  |                  |                 |                  |
| Service cost                         | \$ 6,421                   | \$ 6,739         | \$ 381          | \$ 390           |
| Interest cost                        | 14,699                     | 14,886           | 4,513           | 4,748            |
| Expected return on plan assets       | (17,852 )                  | (26,575 )        | —               | —                |
| Amortization of prior service cost   | 302                        | 324              | (118 )          | (114 )           |
| Recognized net actuarial loss (gain) | 8,246                      | (240 )           | (47 )           | (55 )            |
| Administrative expenses              | 93                         | 91               | —               | —                |
| Net periodic benefits cost (income)  | 11,909                     | (4,775 )         | 4,729           | 4,969            |
| Special termination benefits         | —                          | 147              | —               | —                |

Edgar Filing: HERSHEY CO - Form 10-Q

|                                    |           |        |          |          |
|------------------------------------|-----------|--------|----------|----------|
| Settlement losses                  | 30,555    | 4,843  | —        | —        |
| Total amount reflected in earnings | \$ 42,464 | \$ 215 | \$ 4,729 | \$ 4,969 |

We made contributions of \$.8 million and \$5.6 million to the pension plans and other benefits plans, respectively, during the second quarter of 2009. In the second quarter of 2008, we made contributions of \$.5 million and \$6.0 million to our pension and other benefits plans, respectively. The contributions in 2009 and 2008 primarily reflected benefit payments from our non-qualified pension plans and post-retirement benefit plans.

In the second quarter of 2009, there was net periodic pension benefits expense of \$11.9 million, compared with net periodic benefits income of \$4.8 million in the second quarter of 2008. The higher net periodic pension benefits expense primarily reflected the significant decline in the value of pension assets during 2008 reflecting the unprecedented

volatility and deterioration in financial market and economic conditions. The special termination benefits and settlement losses recorded in the second quarter of 2009 and 2008 related to the 2007 business realignment initiatives.

Components of net periodic benefits cost (income) consisted of the following:

|                                      | Pension Benefits |                                                                           | Other Benefits  |                  |
|--------------------------------------|------------------|---------------------------------------------------------------------------|-----------------|------------------|
|                                      | July 5,<br>2009  | For the Six Months Ended<br>June 29,<br>2008<br>(in thousands of dollars) | July 5,<br>2009 | June 29,<br>2008 |
| Service cost                         | \$ 12,889        | \$ 14,764                                                                 | \$ 764          | \$ 877           |
| Interest cost                        | 29,282           | 29,899                                                                    | 9,330           | 10,170           |
| Expected return on plan assets       | (35,382 )        | (53,908 )                                                                 | —               | —                |
| Amortization of prior service cost   | 601              | 643                                                                       | (238 )          | (228 )           |
| Recognized net actuarial loss (gain) | 16,691           | (287 )                                                                    | (73 )           | (2 )             |
| Administrative expenses              | 187              | 179                                                                       | —               | —                |
| Net periodic benefits cost (income)  | 24,268           | (8,710 )                                                                  | 9,783           | 10,817           |
| Special termination benefits         | —                | 147                                                                       | —               | —                |
| Settlement losses                    | 30,555           | 4,843                                                                     | —               | —                |
| Total amount reflected in earnings   | \$ 54,823        | \$ (3,720 )                                                               | \$ 9,783        | \$ 10,817        |

We made contributions of \$2.0 million and \$12.2 million to the pension plans and other benefits plans, respectively, during the first six months of 2009. In the first six months of 2008, we made contributions of \$3.8 million and \$11.9 million to our pension and other benefits plans, respectively. The contributions in 2009 and 2008 also included benefit payments from our non-qualified pension plans and post-retirement benefit plans.

In the first six months of 2009, there was net periodic pension benefits expense of \$24.3 million, compared with net periodic pension benefits income of \$8.7 million in the first six months of 2008. The net periodic pension benefits expense was primarily due to the significant decline in the value of pension assets during 2008 reflecting the unprecedented volatility and deterioration in financial market and economic conditions. The special termination benefits and settlement losses in the first six months of 2009 and 2008 related to the 2007 business realignment initiatives.

For 2009, there are no minimum funding requirements in excess of available credits for the domestic plans and minimum funding requirements for the non-domestic plans are not material. The Company may choose to make contributions to pension plans in excess of minimum funding requirements depending on pension asset performance during 2009. We currently expect such contributions to be between \$50 million and \$100 million, including benefit payments from our non-qualified plans.

For more information, refer to the consolidated financial statements and notes included in our 2008 Annual Report on Form 10-K.

## 17. SHARE REPURCHASES

## Repurchases and Issuances of Common Stock

A summary of cumulative share repurchases and issuances is as follows:

|                                                                                                  | For the Six Months Ended July 5,<br>2009 |             |
|--------------------------------------------------------------------------------------------------|------------------------------------------|-------------|
|                                                                                                  | Shares                                   | Dollars     |
|                                                                                                  | (in thousands)                           |             |
| Shares repurchased in the open market under pre-approved share repurchase programs               | —                                        | \$ —        |
| Shares repurchased to replace Treasury Stock issued for stock options and incentive compensation | 252                                      | 9,314       |
| Total share repurchases                                                                          | 252                                      | 9,314       |
| Shares issued for stock options and incentive compensation                                       | (341 )                                   | (11,125 )   |
| Net change                                                                                       | (89 )                                    | \$ (1,811 ) |

In December 2006, our Board of Directors approved a \$250 million share repurchase program. As of July 5, 2009, \$100.0 million remained available for repurchases of Common Stock under this program.

## 18. PENDING ACCOUNTING PRONOUNCEMENTS

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 166, Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140 (“SFAS No. 166”). SFAS No. 166 addresses how information should be provided about transfers of financial assets; the effects of a transfer on a company’s financial position, performance and cash flows; and a transferor’s continuing involvement in transferred financial assets. SFAS No. 166 removes the concept of a qualifying special-purpose entity and modifies or eliminates certain other provisions related to transfers of financial assets. It also establishes additional requirements, including a requirement for enhanced disclosures to provide financial statement users with greater transparency.

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 167, Amendments to FASB Interpretation No. 46(R) (“SFAS No. 167”). SFAS No. 167 amends certain requirements of FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities, to improve financial reporting by enterprises involved with variable interest entities, and to provide more relevant and reliable information to users of financial statements.

SFAS Nos. 166 and 167 are effective for us as of January 1, 2010 and we are currently evaluating the impact on our consolidated financial statements upon adoption.

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 168, The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162 (“SFAS No. 168”). SFAS No. 168 becomes the source of authoritative GAAP recognized by the FASB to be applied by nongovernmental entities. It identifies the sources of accounting principles and the framework

for selecting the principles used in the preparation of financial statements. SFAS No. 168 is effective for us in our third quarter of 2009. There will be no impact on our consolidated financial statements upon adoption; however, this standard will impact our financial reporting as we begin to use the new codification when referring to GAAP in our financial statements.

19. SUBSEQUENT EVENT

Arnold G. Langbo and Charles B. Strauss resigned from the Board of Directors of The Hershey Company effective August 10, 2009. Following a decision by the Board of Directors to establish a Finance and Risk Management Committee that also delegated to such Committee responsibilities with respect to reviewing and monitoring the Company's annual plan and certain strategic matters including but not limited to acquisitions and dispositions, Messrs. Langbo and Strauss decided to resign from the Board of Directors based on their views, expressed before the committee was established, that retaining responsibility for these matters with the Board of Directors as a whole was a better corporate governance structure for the Company.

-21-

---

Mr. Langbo served as chair of the Compensation and Executive Organization Committee of the Board of Directors and was a member of the Executive Committee of the Board at the time of his resignation. Mr. Strauss was chair of the Audit Committee of the Board of Directors and was a member of the Compensation and Executive Organization Committee and the Executive Committee of the Board at the time of his resignation. The Board of Directors has appointed Robert F. Cavanaugh, a current independent member of the Board, as chair of the Compensation and Executive Organization Committee and David L. Shedlarz, a current independent member of the Board, as chair of the Audit Committee. Pursuant to their appointments as chairs of Board committees, Messrs. Cavanaugh and Shedlarz will also become members of the Executive Committee.

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

## SUMMARY OF OPERATING RESULTS

## Analysis of Selected Items from Our Income Statement

|                                    | For the Three Months Ended              |                  |                                             | For the Six Months Ended |                  |                                             |
|------------------------------------|-----------------------------------------|------------------|---------------------------------------------|--------------------------|------------------|---------------------------------------------|
|                                    | July 5,<br>2009                         | June 29,<br>2008 | Percent<br>Change<br>Increase<br>(Decrease) | July 5,<br>2009          | June 29,<br>2008 | Percent<br>Change<br>Increase<br>(Decrease) |
|                                    | (in thousands except per share amounts) |                  |                                             |                          |                  |                                             |
| Net Sales                          | \$ 1,171.2                              | \$ 1,105.4       | 5.9%                                        | \$ 2,407.2               | \$ 2,265.8       | 6.2%                                        |
| Cost of Sales                      | 717.9                                   | 722.9            | (0.7)%                                      | 1,513.7                  | 1,506.8          | 0.5%                                        |
| Gross Profit                       | 453.3                                   | 382.5            | 18.5%                                       | 893.5                    | 759.0            | 17.7%                                       |
| Gross Margin                       | 38.7%                                   | 34.6%            |                                             | 37.1%                    | 33.5%            |                                             |
| SM&A Expense                       | 298.7                                   | 266.6            | 12.0%                                       | 573.2                    | 516.6            | 11.0%                                       |
| SM&A Expense as a percent of sales | 25.5%                                   | 24.1%            |                                             | 23.8%                    | 22.8%            |                                             |
| Business Realignment Charges, net  | 37.9                                    | 21.8             | 74.0%                                       | 50.7                     | 25.9             | 96.1%                                       |
| EBIT                               | 116.7                                   | 94.1             | 24.0%                                       | 269.6                    | 216.5            | 24.5%                                       |
| EBIT Margin                        | 10.0%                                   | 8.5%             |                                             | 11.2%                    | 9.6%             |                                             |
| Interest Expense, net              | 22.7                                    | 23.6             | (3.7)%                                      | 46.6                     | 48.0             | (2.8)%                                      |
| Provision for Income Taxes         | 22.7                                    | 29.0             | (22.0)%                                     | 75.8                     | 63.8             | 18.7%                                       |
| Effective Income Tax Rate          | 24.1%                                   | 41.2%            |                                             | 34.0%                    | 37.9%            |                                             |
| Net Income                         | \$ 71.3                                 | \$ 41.5          | 71.9%                                       | \$ 147.2                 | \$ 104.7         | 40.6%                                       |
| Net Income Per Share-Diluted       | \$ .31                                  | \$ .18           | 72.2%                                       | \$ .64                   | \$ .46           | 39.1%                                       |

## Results of Operations - Second Quarter 2009 vs. Second Quarter 2008

## Price Increases

In August 2008, we announced an increase in wholesale prices across the United States, Puerto Rico and export chocolate and sugar confectionery lines. This price increase was effective immediately, and represented a weighted average eleven percent increase on our instant consumable, multi-pack and packaged candy lines. These changes approximated a ten percent increase over the entire domestic product line.

In January 2008, we announced an increase in the wholesale prices of our domestic confectionery line, effective immediately. This price increase applied to our standard bar, king-size bar, 6-pack and vending lines and represented a weighted average increase of approximately thirteen percent on these items. These price changes approximated a three percent price increase over our entire domestic product line.

In April 2007, we announced an increase of approximately four percent to five percent in the wholesale prices of our domestic confectionery line, effective immediately. The price increase applied to our standard bar, king-size bar, 6-pack and vending lines. These products represent approximately one-third of our U.S. confectionery portfolio.

We implemented these pricing actions to help offset increases in input costs, including raw materials, fuel, utilities and transportation, and to support increased investments in advertising and consumer-focused marketing programs.

#### Net Sales

Net sales for the second quarter of 2009 were higher than the comparable period of 2008 due to favorable price realization, offset somewhat by sales volume decreases primarily in the United States, reflecting the impact of pricing elasticity. Increased sales for our international businesses were more than offset by the impact of foreign currency exchange rates which reduced net sales by approximately 2.1%. The acquisition of the Van Houten Singapore business increased net sales by \$2.9 million, or 0.3%.

-23-

---

### Key Marketplace Metrics

Consumer takeaway increased 28.8% during the second quarter of 2009 compared with the same period of 2008 due to the timing of the Easter season. Excluding seasonal sales, consumer takeaway increased 5.4%. Consumer takeaway is provided for channels of distribution accounting for approximately 80% of our U.S. confectionery retail business. These channels of distribution include food, drug, mass merchandisers, including Wal-Mart Stores, Inc., and convenience stores.

Market share in measured channels increased by 0.5 share points during the second quarter of 2009. The change in market share is provided for measured channels which include sales in the food, drug, convenience store and mass merchandiser classes of trade, excluding sales of Wal-Mart Stores, Inc.

### Cost of Sales and Gross Margin

Cost of sales decreased slightly in the second quarter of 2009 compared with the same period of 2008. The decrease was primarily due to lower sales volume, offset substantially by increased input and supply chain costs, principally reflecting higher pension expense and other overhead costs. Input costs were higher in the second quarter of 2009 versus 2008, primarily reflecting higher raw material and energy costs. Higher supply chain costs were offset somewhat by the impact of supply chain efficiencies and productivity, along with reduced costs for product obsolescence. Business realignment charges of \$3.1 million were included in cost of sales in the second quarter of 2009 compared with \$15.0 million in the second quarter of 2008.

The increase in gross margin in the second quarter of 2009 compared with the second quarter of 2008 was primarily due to favorable price realization, offset partially by increased supply chain costs and higher input costs. Approximately one-fourth of the gross margin increase was attributable to the impact of reduced costs for business realignment initiatives recorded in 2009 compared with 2008.

### Selling, Marketing and Administrative

Higher selling, marketing and administrative costs were principally associated with higher incentive compensation, pension and other employee-related expenses. Increased advertising expense, offset somewhat by a reduction in consumer promotions, also contributed to the increase. Expenses of \$1.7 million related to our business realignment initiatives were included in selling, marketing and administrative expenses in the second quarter of 2009 compared with \$2.4 million in the second quarter of 2008.

### Business Realignment Initiatives

Business realignment charges of \$37.9 million were recorded in the second quarter of 2009 associated with the 2007 business realignment initiatives. The charges were primarily related to pension settlement losses, plant closure expenses and fixed asset disposals. Business realignment charges of \$21.8 million were recorded in the second quarter of 2008 primarily associated with employee separation costs, pension settlement losses, contract termination costs, fixed asset disposals and plant closure expenses.

### Income Before Interest and Income Taxes and EBIT Margin

EBIT increased in the second quarter of 2009 compared with the second quarter of 2008 as a result of higher gross profit, partially offset by increased selling, marketing and administrative expenses and higher business realignment charges. Net pre-tax business realignment charges of \$42.7 million were recorded in the second quarter of 2009 compared with \$39.3 million recorded in the second quarter of 2008.

EBIT margin increased from 8.5% for the second quarter of 2008 to 10.0% for the second quarter of 2009. The increase was attributable to the higher gross margin, partially offset by higher selling, marketing and administrative expense as a percentage of sales. The impact of net business realignment charges reduced EBIT margin by 3.6 percentage points in both 2009 and 2008.

#### Interest Expense, Net

Net interest expense was lower in the second quarter of 2009 than the comparable period of 2008 primarily reflecting lower interest rates and lower average debt balances, offset partially by a decrease in capitalized interest.

-24-

---

## Income Taxes and Effective Tax Rate

Our effective income tax rate was 24.1% for the second quarter of 2009 compared with 41.2% for the same period of 2008. This decrease reflects the resolution of tax contingencies associated with the 2004, 2005 and 2006 tax years in the second quarter. The impact of tax rates associated with business realignment and impairment charges decreased the effective income tax rate by 4.2 percentage points in 2009 and increased the effective income tax rate by 2.2 percentage points in 2008.

## Net Income and Net Income Per Share

Net income in the second quarter of 2009 was reduced by \$26.7 million, or \$0.12 per share-diluted, and was reduced by \$25.5 million, or \$0.11 per share-diluted, in the second quarter of 2008 as a result of net charges associated with our business realignment initiatives. After considering the impact of business realignment charges in each period, earnings per share-diluted in the second quarter of 2009 increased \$0.14, or 48.3% as compared with the second quarter of 2008.

## Results of Operations – First Six Months 2009 vs. First Six Months 2008

### Net Sales

The increase in net sales was attributable to favorable price realization from list price increases, offset somewhat by sales volume decreases, primarily in the United States. Sales volume increases for our international businesses were more than offset by the unfavorable impact of foreign currency exchange rates which reduced net sales by approximately 2.3%. The acquisition of Van Houten Singapore increased net sales by \$4.0 million, or 0.2%, in the first six months of 2009.

### Key Marketplace Metrics

Consumer takeaway increased 8.9% during the first six months of 2009 compared with the same period of 2008. Consumer takeaway is provided for channels of distribution accounting for approximately 80% of our U.S. confectionery retail business. These channels of distribution include food, drug, mass merchandisers, including Wal-Mart Stores, Inc., and convenience stores.

Market share in measured channels improved by 0.5 share points during the first six months of 2009. The change in market share is provided for measured channels which include sales in the food, drug, convenience store and mass merchandiser classes of trade, excluding sales of Wal-Mart Stores, Inc.

### Cost of Sales and Gross Margin

The cost of sales increase in the first six months of 2009 compared with 2008 was primarily associated with higher input costs, particularly raw materials and energy, and increased supply chain costs. These increases were substantially offset by the impact of sales volume decreases, improved supply chain efficiencies and productivity, and lower product obsolescence costs. Lower business realignment charges included in cost of sales in 2009 compared with 2008 also substantially offset the cost of sales increases. Business realignment charges of \$7.2 million were included in cost of sales in the first six months of 2009, compared with \$40.2 million in the prior year.

The gross margin improvement resulted primarily from favorable price realization, offset partially by increased input and supply chain costs. Approximately one-third of the gross margin increase was attributable to the impact of

business realignment initiatives recorded in 2009 compared with 2008.

#### Selling, Marketing and Administrative

Selling, marketing and administrative expenses increased primarily as a result of higher administrative and selling costs, principally associated with higher pension, incentive compensation and other employee-related expenses. An increase in advertising expense was partly offset by lower consumer promotions. Expenses of \$3.8 million related to our 2007 business realignment initiatives were included in selling, marketing and administrative expenses in 2009 compared with \$3.9 million in 2008.

#### Business Realignment Initiatives

Business realignment charges of \$50.7 million were recorded in the first six months of 2009 compared with \$25.9 million in the same period of 2008. The charges in 2009 were primarily related to pension settlement losses, plant

-25-

---

closure expenses, fixed asset impairments and employee separation costs. Business realignment charges recorded in 2008 primarily related to fixed asset impairments and plant closure expenses, in addition to employee separation costs, offset partially by gains on sales of fixed assets.

#### Income Before Interest and Income Taxes and EBIT Margin

EBIT increased in the first six months of 2009 compared with the first six months of 2008 principally as a result of higher gross profit, offset by increased selling, marketing and administrative expenses and increased business realignment charges. Net pre-tax business realignment charges of \$61.7 million were recorded in the first six months of 2009 compared with \$69.9 million recorded in the first six months of 2008, a decrease of \$8.2 million.

EBIT margin increased from 9.6% for the first six months of 2008 to 11.2% for the first six months of 2009. The increase in EBIT margin was the result of the higher gross margin, partially offset by higher selling, marketing and administrative expense as a percentage of sales. The impact of net business realignment charges in the first six months of 2009 reduced EBIT margin by 2.6 percentage points and in the first six months of 2008 reduced EBIT margin by 3.0 percentage points.

#### Interest Expense, Net

Net interest expense was lower in the first six months of 2009 than the comparable period of 2008 primarily due to lower interest rates and lower average debt balances, partially offset by a decrease in capitalized interest.

#### Income Taxes and Effective Tax Rate

Our effective income tax rate was 34.0% for the first six months of 2009 and was decreased by 1.4 percentage points as a result of the effective tax rate associated with business realignment charges recorded during the first six months. We expect our effective income tax rate for the full year 2009 to be approximately 36.0%, excluding the impact of tax rates associated with business realignment charges during the year.

#### Net Income and Net Income Per Share

Net income in the first six months of 2009 was reduced by \$36.8 million, or \$0.17 per share-diluted, and was reduced by \$46.2 million, or \$0.20 per share-diluted, in the first six months of 2008 as a result of net charges associated with our business realignment initiatives. After considering the impact of business realignment charges in each period, earnings per share-diluted in the first six months of 2009 increased \$0.15 as compared with the first six months of 2008.

#### Liquidity and Capital Resources

Historically, our major source of financing has been cash generated from operations. Domestic seasonal working capital needs, which typically peak during the summer months, generally have been met by issuing commercial paper. Commercial paper may also be issued from time to time to finance ongoing business transactions such as the repayment of long-term debt, business acquisitions and for other general corporate purposes. During the first six months of 2009, cash and cash equivalents decreased by \$8.3 million.

Cash provided from operations was sufficient to fund the repayment of short-term debt of \$237.4 million, dividend payments of \$131.5 million, and capital additions and capitalized software expenditures of \$73.8 million.

Net cash provided from operating activities was \$446.2 million in 2009 and \$320.1 million in 2008. The increase was primarily the result of higher net income and the change in cash used by other assets and liabilities which decreased to

\$34.3 million for the first six months of 2009 from \$149.2 million for the same period of 2008. The decrease in the amount of cash used by other assets and liabilities from 2008 to 2009 primarily reflected the impact of business realignment initiatives, employee benefits and payroll, as well as the timing of payments associated with selling and marketing programs. Cash provided from working capital was \$146.5 million in 2009 and \$146.4 million in 2008.

In March 2009, the Company completed the acquisition of the Van Houten Singapore consumer business. The acquisition from Barry Callebaut, AG provides the Company with an exclusive license of the Van Houten brand name and related trademarks in Asia and the Middle East for the retail and duty free distribution channels. The purchase price for the acquisition of Van Houten Singapore and the licensing agreement was approximately \$15.2 million.

During the first quarter of 2008, Hershey do Brasil entered into a cooperative agreement with Bauducco. We received cash of \$2.0 million from Bauducco and recorded an intangible asset of \$13.7 million related to the agreement. We will maintain a 51% controlling interest in Hershey do Brasil.

Proceeds from the sale of manufacturing and distribution facilities and related equipment under the global supply chain transformation program were \$3.1 million in the first six months of 2009 and \$76.9 million in the first six months of 2008.

A receivable of approximately \$15.1 million was included in prepaid expenses and other current assets as of July 5, 2009 and \$14.5 million as of December 31, 2008 related to the recovery of damages from a product recall and temporary plant closure in Canada. The increase primarily resulted from currency exchange rate fluctuations. The product recall during the fourth quarter of 2006 was caused by a contaminated ingredient purchased from an outside supplier with whom we have filed a claim for damages and are currently in litigation.

Interest paid was \$46.7 million during the first six months of 2009 versus \$47.3 million for the comparable period of 2008. Income taxes paid were \$109.2 million during the first six months of 2009 versus \$95.0 million for the comparable period of 2008. The increase in taxes paid in 2009 was primarily related to the impact of higher annualized taxable income in 2009.

The ratio of current assets to current liabilities increased to 1.2:1.0 as of July 5, 2009 from 1.1:1.0 as of December 31, 2008. The capitalization ratio (total short-term and long-term debt as a percent of stockholders' equity, short-term and long-term debt) decreased to 79% as of July 5, 2009 from 85% as of December 31, 2008.

Generally, our short-term borrowings are in the form of commercial paper or bank loans with an original maturity of three months or less. Our five-year unsecured revolving credit agreement expires in December 2012. The credit limit is \$1.1 billion with an option to borrow an additional \$400 million with the concurrence of the lenders.

In March 2008, the Company issued \$250 million of 5.0% Notes due April 1, 2013 under the WKSJ Registration Statement. The net proceeds of this debt issuance were used to repay a portion of the Company's outstanding indebtedness under its short-term commercial paper program.

## Outlook

The outlook section contains a number of forward-looking statements, all of which are based on current expectations. Actual results may differ materially. Refer to the Safe Harbor Statement below as well as Risk Factors and other information contained in our 2008 Annual Report on Form 10-K for information concerning the key risks to achieving future performance goals.

For 2009, we now expect full year net sales growth to be within our three to five percent long-term objective from our pricing actions and core brand sales growth. We expect growth in net sales substantially driven by net price realization and our brand-building initiatives, offset somewhat by the impact of unfavorable foreign currency exchange rates. We expect unit sales volume to decline due to the elasticity effects of price increases implemented during 2008 which will result in higher everyday and promoted prices for consumers. The decline in sales volume will be mitigated somewhat by our brand-building initiatives, as the impact of the declines in unit sales volume is expected to be more than offset by price realization.

We continue to expect our commodity cost basket to increase significantly in 2009 compared with 2008, although the total increase is expected to be less than our initial estimate of \$175 million. We currently do not expect material price inflation for dairy products during the remainder of the year. The decline in the financial markets in 2008 significantly reduced the fair value of our pension plan assets which is expected to result in an increase in 2009 pension expense of approximately \$70 million. Despite these increases we plan to continue to invest in our core brands in the U.S. and key international markets to build on our momentum. Specifically, advertising expense is now expected to increase by 40 to 45 percent in 2009 and we expect to make further investments in category management

and global go-to-market capabilities. These cost increases will be more than offset by higher net pricing, savings from the global supply chain transformation program and on-going operating productivity improvement. We continue to expect an increase in earnings per share-diluted in 2009, excluding business realignment charges; with growth in adjusted earnings per share-diluted to be slightly above our long-term objective of six to eight percent.

For 2009, we expect total pre-tax business realignment and impairment charges for our global supply chain transformation program, including the increase in the scope of the program and non-cash pension settlement losses, to be in the range of \$85 million to \$120 million, or \$0.24 to \$0.33 per share-diluted.

#### Outlook for Global Supply Chain Transformation Program

We now expect total pre-tax charges and non-recurring project implementation costs for the global supply chain transformation program of \$640 million to \$665 million, including estimated pension settlement losses in 2009 and

-27-

---

2010. This includes pension settlement losses recorded in 2007 and 2008 as required in accordance with FASB Statement of Financial Accounting Standards No. 88, Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits (as amended) ("SFAS No. 88"). Pension settlement losses are non-cash charges for the Company. Such charges accelerate the recognition of pension expense related to actuarial gains and losses resulting from interest rate changes and differences in actual versus assumed returns on pension assets. The Company normally amortizes actuarial gains and losses over a period of about 13 years.

The global supply chain transformation program charges recorded in 2007 and 2008 included pension settlement losses of approximately \$24.6 million as employees leaving the Company under the program have been withdrawing lump sums from the defined benefit pension plans. An additional \$30.6 million in pension settlement losses were recorded in the first six months of 2009. In addition to these charges, incremental SFAS No. 88 pension settlement losses of \$15 million to \$34 million were added to the GSCT program estimates based upon the current trends of employee withdrawals, with \$15 million to \$20 million projected for 2009.

#### Subsequent Event

Arnold G. Langbo and Charles B. Strauss resigned from the Board of Directors of The Hershey Company effective August 10, 2009. Following a decision by the Board of Directors to establish a Finance and Risk Management Committee that also delegated to such Committee responsibilities with respect to reviewing and monitoring the Company's annual plan and certain strategic matters including but not limited to acquisitions and dispositions, Messrs. Langbo and Strauss decided to resign from the Board of Directors based on their views, expressed before the committee was established, that retaining responsibility for these matters with the Board of Directors as a whole was a better corporate governance structure for the Company.

Mr. Langbo served as chair of the Compensation and Executive Organization Committee of the Board of Directors and was a member of the Executive Committee of the Board at the time of his resignation. Mr. Strauss was chair of the Audit Committee of the Board of Directors and was a member of the Compensation and Executive Organization Committee and the Executive Committee of the Board at the time of his resignation. The Board of Directors has appointed Robert F. Cavanaugh, a current independent member of the Board, as chair of the Compensation and Executive Organization Committee and David L. Shedlarz, a current independent member of the Board, as chair of the Audit Committee. Pursuant to their appointments as chairs of Board committees, Messrs. Cavanaugh and Shedlarz will also become members of the Executive Committee.

### Safe Harbor Statement

We are subject to changing economic, competitive, regulatory and technological conditions, risks and uncertainties because of the nature of our operations. In connection with the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995, we note the following factors that, among others, could cause future results to differ materially from the forward-looking statements, expectations and assumptions that we have discussed directly or implied in this report. Many of the forward-looking statements contained in this report may be identified by the use of words such as “intend,” “believe,” “expect,” “anticipate,” “should,” “planned,” “projected,” “estimated,” and “potential,” among others.

The factors that could cause our actual results to differ materially from the results projected in our forward-looking statements include, but are not limited to the following:

- Issues or concerns related to the quality and safety of our products, ingredients or packaging could cause a product recall and/or result in harm to the Company’s reputation, negatively impacting our operating results;
  - Increases in raw material and energy costs could affect future financial results;
- Price increases may not be sufficient to offset cost increases and maintain profitability or may result in sales volume declines associated with pricing elasticity;
  - Market demand for new and existing products could decline;
  - Increased marketplace competition could hurt our business;
- Changes in governmental laws and regulations could increase our costs and liabilities or impact demand for our products;
- Political, economic, and/or financial market conditions in the United States and abroad could negatively impact our financial results;
  - International operations could fluctuate unexpectedly and adversely impact our business;
- Future developments related to the investigation by government regulators of alleged pricing practices by members of the confectionery industry could impact our reputation, the regulatory environment under which we operate, and our operating results;
  - Pension costs or funding requirements could increase at a higher than anticipated rate;
- Annual savings from initiatives to transform our supply chain and advance our value-enhancing strategy may be less than we expect;
- Implementation of our global supply chain transformation program may not occur within the anticipated timeframe and/or may exceed our cost estimates; and
  - Such other matters as discussed in our Annual Report on Form 10-K for 2008.

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

The potential net loss in fair value of foreign exchange forward contracts and interest rate swap agreements of ten percent resulting from a hypothetical near-term adverse change in market rates was \$1.4 million as of July 5, 2009 and was \$1.0 million as of December 31, 2008. The market risk resulting from a hypothetical adverse market price movement of ten percent associated with the estimated average fair value of net commodity positions decreased from \$44.1 million as of December 31, 2008, to \$36.3 million as of July 5, 2009. Market risk represents ten percent of the estimated average fair value of net commodity positions at four dates prior to the end of each period.

#### Item 4. Controls and Procedures

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934 (the "Exchange Act") is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is accumulated

-29-

---

and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

As of the end of the period covered by this quarterly report, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as required by Rule 13a-15 under the Exchange Act. This evaluation was carried out under the supervision and with the participation of the Company's management, including our Chief Executive Officer and Chief Financial Officer. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective. There has been no change during the most recent fiscal quarter in our internal control over financial reporting identified in connection with the evaluation that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II - OTHER INFORMATION

Items 1, 1A, 3 and 5 have been omitted as not applicable.

## Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds

## Issuer Purchases of Equity Securities

| Period                      | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | (d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (in thousands of dollars) |
|-----------------------------|--------------------------------------|----------------------------------|--------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------|
| April 6 through May 3, 2009 | —                                    | \$ —                             | —                                                                                    | \$ 100,017                                                                                                             |
| May 4 through May 31, 2009  | —                                    | \$ —                             | —                                                                                    | \$ 100,017                                                                                                             |
| June 1 through July 5, 2009 | —                                    | \$ —                             | —                                                                                    | \$ 100,017                                                                                                             |
| Total                       | —                                    |                                  | —                                                                                    |                                                                                                                        |

## Item 4 – Submission of Matters to a Vote of Security Holders

The Hershey Company's Annual Meeting of Stockholders was held on April 30, 2009. The following directors were elected by the holders of Common Stock and Class B Common Stock, voting together without regard to class:

| Name                | Votes For   | Votes Withheld |
|---------------------|-------------|----------------|
| Robert F. Cavanaugh | 711,894,443 | 38,873,176     |
| Charles A. Davis    | 746,751,340 | 4,016,279      |
| James E. Nevels     | 712,132,109 | 38,635,510     |
| Thomas J. Ridge     | 746,028,492 | 4,739,127      |
| David L. Shedlarz   | 748,657,312 | 2,110,307      |
| David J. West       | 746,832,723 | 3,934,896      |
| LeRoy S. Zimmerman  | 743,993,559 | 6,774,060      |

The following directors were elected by the holders of the Common Stock voting as a class:

| Name               | Votes For   | Votes Withheld |
|--------------------|-------------|----------------|
| Arnold G. Langbo   | 109,733,596 | 34,741,153     |
| Charles B. Strauss | 110,264,653 | 34,210,096     |

Holders of the Common Stock and the Class B Common Stock, voting together, ratified the appointment of KPMG LLP as the Company's independent auditors for 2009. Stockholders cast 749,355,446 votes for the appointment, 1,121,605 votes against the appointment and abstained from casting 290,568 votes on the appointment of independent auditors.

No other matters were submitted for stockholder action.

-31-

---

Item 6 - Exhibits

The following items are attached or incorporated herein by reference:

| Exhibit<br>Number | Description                                                                                                                                                           |
|-------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.1              | Terms and Conditions of Nonqualified Stock Option Awards under the Equity and Incentive Compensation Plan.                                                            |
| 10.2              | The Company's Executive Benefits Protection Plan (Group 3A), Amended and Restated as of July 1, 2009.                                                                 |
| 12.1              | Statement showing computation of ratio of earnings to fixed charges for the six months ended July 5, 2009 and June 29, 2008.                                          |
| 31.1              | Certification of David J. West, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                   |
| 31.2              | Certification of Humberto P. Alfonso, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                             |
| 32.1              | Certification of David J. West, Chief Executive Officer, and Humberto P. Alfonso, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS           | XBRL Instance Document                                                                                                                                                |
| 101.SCH           | XBRL Taxonomy Extension Schema                                                                                                                                        |
| 101.CAL           | XBRL Taxonomy Extension Calculation Linkbase                                                                                                                          |
| 101.LAB           | XBRL Taxonomy Extension Label Linkbase                                                                                                                                |
| 101.PRE           | XBRL Taxonomy Extension Presentation Linkbase                                                                                                                         |
| 101.REF           | XBRL Taxonomy Extension Reference Linkbase                                                                                                                            |

SIGNATURES

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

THE HERSHEY COMPANY  
(Registrant)

Date: August 13, 2009

/s/Humberto P. Alfonso  
Humberto P. Alfonso  
Chief Financial Officer

Date: August 13, 2009

/s/David W. Tacka  
David W. Tacka  
Chief Accounting Officer

EXHIBIT INDEX

|                 |                                                                                                                                                                      |
|-----------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Exhibit 10.1    | Terms and Conditions of Nonqualified Stock Option Awards under the Equity and Incentive Compensation Plan                                                            |
| Exhibit 10.2    | The Company's Executive Benefits Protection Plan (Group 3A), Amended and Restated as of July 1, 2009                                                                 |
| Exhibit 12.1    | Computation of Ratio of Earnings to Fixed Charges                                                                                                                    |
| Exhibit 31.1    | Certification of David J. West, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                                   |
| Exhibit 31.2    | Certification of Humberto P. Alfonso, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                             |
| Exhibit 32.1    | Certification of David J. West, Chief Executive Officer, and Humberto P. Alfonso, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 101.INS | XBRL Instance Document                                                                                                                                               |
| Exhibit 101.SCH | XBRL Taxonomy Extension Schema                                                                                                                                       |
| Exhibit 101.CAL | XBRL Taxonomy Extension Calculation Linkbase                                                                                                                         |
| Exhibit 101.LAB | XBRL Taxonomy Extension Label Linkbase                                                                                                                               |
| Exhibit 101.PRE | XBRL Taxonomy Extension Presentation Linkbase                                                                                                                        |
| Exhibit 101.REF | XBRL Taxonomy Extension Reference Linkbase                                                                                                                           |

