

HERSHEY CO  
Form 10-Q  
November 04, 2011

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

FORM 10-Q

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

For the quarterly period ended October 2, 2011

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

(Exact name of registrant as specified in its charter)

|                  |                     |
|------------------|---------------------|
| Delaware         | 23-0691590          |
| (State or other  | (I.R.S. Employer    |
| jurisdiction of  | Identification No.) |
| incorporation    |                     |
| or organization) |                     |

100 Crystal A Drive, Hershey, PA  
17033

(Address of principal executive offices)  
(Zip Code)

717-534-4200

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if  
changed since last report)

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

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

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

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 – 164,487,747 shares, as of October 21, 2011. Class B Common Stock, \$1 par value – 60,632,042 shares, as of October 21, 2011.

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## THE HERSHEY COMPANY

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## PART I - FINANCIAL INFORMATION

## Item 1. Consolidated Financial Statements (Unaudited)

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

|  | For the Three Months<br>Ended |                    |
|--|-------------------------------|--------------------|
|  | October 2,<br>2011            | October 3,<br>2010 |
| Net Sales  | \$1,624,249                   | \$1,547,115        |
| Costs and Expenses:  |                               |                    |
| Cost of sales  | 944,068                       | 891,895            |
| Selling, marketing and administrative                      | 356,878                       | 357,624            |
| Business realignment and impairment charges (credits), net | 2,187                         | (2,052 )           |
| Total costs and expenses                                   | 1,303,133                     | 1,247,467          |
| Income before Interest and Income Taxes                    | 321,116                       | 299,648            |
| Interest expense, net                                      | 23,041                        | 22,259             |
| Income before Income Taxes                                 | 298,075                       | 277,389            |
| Provision for income taxes                                 | 101,380                       | 97,220             |
| Net Income   | \$196,695                     | \$180,169          |
| Earnings Per Share - Basic - Class B Common Stock          | \$.81                         | \$.74              |
| Earnings Per Share - Diluted - Class B Common Stock        | \$.80                         | \$.73              |
| Earnings Per Share - Basic - Common Stock                  | \$.89                         | \$.81              |
| Earnings Per Share - Diluted - Common Stock                | \$.86                         | \$.78              |
| Average Shares Outstanding - Basic - Common Stock          | 165,917                       | 166,900            |
| Average Shares Outstanding - Basic - Class B Common Stock  | 60,632                        | 60,708             |
| Average Shares Outstanding - Diluted                       | 229,849                       | 230,491            |

| Cash Dividends Paid Per Share: |          |          |
|--------------------------------|----------|----------|
| Common Stock                   | \$ .3450 | \$ .3200 |
| Class B Common Stock           | \$ .3125 | \$ .2900 |

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

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

|  | For the Nine Months<br>Ended |                    |
|--|------------------------------|--------------------|
|  | October 2,<br>2011           | October 3,<br>2010 |
| Net Sales  | \$4,513,643                  | \$4,188,200        |
| Costs and Expenses:  |                              |                    |
| Cost of sales  | 2,612,957                    | 2,392,462          |
| Selling, marketing and administrative                      | 1,080,594                    | 1,035,250          |
| Business realignment and impairment (credits) charges, net | (5,927 )                     | 83,082             |
| Total costs and expenses                                   | 3,687,624                    | 3,510,794          |
| Income before Interest and Income Taxes                    | 826,019                      | 677,406            |
| Interest expense, net                                      | 70,869                       | 68,788             |
| Income before Income Taxes                                 | 755,150                      | 608,618            |
| Provision for income taxes                                 | 268,321                      | 234,332            |
| Net Income   | \$486,829                    | \$374,286          |
| Earnings Per Share - Basic - Class B Common Stock          | \$2.00                       | \$1.53             |
| Earnings Per Share - Diluted - Class B Common Stock        | \$1.98                       | \$1.52             |
| Earnings Per Share - Basic - Common Stock                  | \$2.20                       | \$1.68             |
| Earnings Per Share - Diluted - Common Stock                | \$2.12                       | \$1.63             |
| Average Shares Outstanding - Basic - Common Stock          | 166,223                      | 167,030            |
| Average Shares Outstanding - Basic - Class B Common Stock  | 60,649                       | 60,708             |
| Average Shares Outstanding - Diluted                       | 230,114                      | 230,138            |
| Cash Dividends Paid Per Share:                             |                              |                    |
| Common Stock   | \$1.0350                     | \$.9600            |

|                      |          |          |
|----------------------|----------|----------|
| Class B Common Stock | \$ .9375 | \$ .8700 |
|----------------------|----------|----------|

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



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

| ASSETS  | October 2,<br>2011 | December 31,<br>2010 |
|---|--------------------|----------------------|
| <b>Current Assets:</b>  |                    |                      |
| Cash and cash equivalents   | \$292,339          | \$ 884,642           |
| Accounts receivable - trade   | 620,745            | 390,061              |
| Inventories   | 654,455            | 533,622              |
| Deferred income taxes   | 106,694            | 55,760               |
| Prepaid expenses and other  | 139,782            | 141,132              |
| Total current assets  | 1,814,015          | 2,005,217            |
| Property, Plant and Equipment, at cost  | 3,507,324          | 3,324,763            |
| Less-accumulated depreciation and amortization                                    | (1,994,544)        | (1,887,061 )         |
| Net property, plant and equipment   | 1,512,780          | 1,437,702            |
| Goodwill  | 517,157            | 524,134              |
| Other Intangibles   | 113,803            | 123,080              |
| Deferred Income Taxes   | 11,313             | 21,387               |
| Other Assets  | 161,438            | 161,212              |
| Total assets  | \$4,130,506        | \$ 4,272,732         |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                       |                    |                      |
| <b>Current Liabilities:</b>   |                    |                      |
| Accounts payable  | \$430,251          | \$ 410,655           |
| Accrued liabilities   | 596,680            | 593,308              |
| Accrued income taxes  | 15,083             | 9,402                |
| Short-term debt   | 39,861             | 24,088               |
| Current portion of long-term debt   | 99,552             | 261,392              |
| Total current liabilities   | 1,181,427          | 1,298,845            |
| Long-term Debt  | 1,498,862          | 1,541,825            |
| Other Long-term Liabilities   | 495,540            | 494,461              |
| Total liabilities   | 3,175,829          | 3,335,131            |
| <b>Stockholders' Equity:</b>  |                    |                      |
| The Hershey Company Stockholders' Equity  |                    |                      |
| Preferred Stock, shares issued: none in 2011 and 2010                             | \$—                | \$ —                 |
| Common Stock, shares issued: 299,269,702 in 2011 and 299,195,325 in 2010          | 299,269            | 299,195              |
| Class B Common Stock, shares issued: 60,632,042 in 2011 and 60,706,419 in 2010    | 60,632             | 60,706               |
| Additional paid-in capital  | 470,491            | 434,865              |
| Retained earnings   | 4,633,156          | 4,374,718            |
| Treasury-Common Stock shares at cost: 134,572,801 in 2011 and 132,871,512 in 2010 | (4,243,616)        | (4,052,101 )         |
| Accumulated other comprehensive loss  | (292,260 )         | (215,067 )           |
| The Hershey Company stockholders' equity  | 927,672            | 902,316              |
| Noncontrolling interests in subsidiaries  | 27,005             | 35,285               |
| Total stockholders' equity  | 954,677            | 937,601              |

|  |             |              |
|--|-------------|--------------|
| Total liabilities and stockholders' equity | \$4,130,506 | \$ 4,272,732 |
|--|-------------|--------------|

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

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

|   | For the Nine Months Ended |                    |
|---|---------------------------|--------------------|
|   | October 2,<br>2011        | October 3,<br>2010 |
| <b>Cash Flows Provided from (Used by) Operating Activities</b>                                |                           |                    |
| Net Income  | \$ 486,829                | \$ 374,286         |
| Adjustments to Reconcile Net Income to Net Cash   |                           |                    |
| Provided from Operations:   |                           |                    |
| Depreciation and amortization   | 157,561                   | 145,736            |
| Stock-based compensation expense, net of tax of \$10,963 and \$13,850, respectively           | 19,831                    | 24,623             |
| Excess tax benefits from exercise of stock options  | (9,561 )                  | (690 )             |
| Deferred income taxes   | 4,157                     | 1,900              |
| Gain on sale of trademark licensing rights, net of tax of \$5,962                             | (11,072 )                 | —                  |
| Business realignment and impairment charges, net of tax of \$8,104 and \$17,618, respectively | 13,335                    | 73,073             |
| Contributions to pension plans  | (3,871 )                  | (4,053 )           |
| Changes in assets and liabilities, net of effects from business acquisitions:                 |                           |                    |
| Accounts receivable - trade   | (230,684 )                | (195,351 )         |
| Inventories   | (125,533 )                | (60,262 )          |
| Accounts payable  | 51,882                    | 62,318             |
| Other assets and liabilities  | (95,645 )                 | (33,381 )          |
| <b>Net Cash Flows Provided from Operating Activities</b>                                      | <b>257,229</b>            | <b>388,199</b>     |
| <b>Cash Flows Provided from (Used by) Investing Activities</b>                                |                           |                    |
| Capital additions   | (251,206 )                | (108,569 )         |
| Capitalized software additions  | (14,390 )                 | (15,131 )          |
| Proceeds from sales of property, plant and equipment  | 260                       | 2,090              |
| Proceeds from sale of trademark licensing rights  | 20,000                    | —                  |
| Business acquisition  | (5,750 )                  | —                  |
| <b>Net Cash Flows (Used by) Investing Activities</b>  | <b>(251,086 )</b>         | <b>(121,610 )</b>  |
| <b>Cash Flows Provided from (Used by) Financing Activities</b>                                |                           |                    |
| Net increase (decrease) in short-term debt  | 13,082                    | (8,480 )           |
| Long-term borrowings  | 478                       | 127                |
| Repayment of long-term debt   | (254,756 )                | (5,746 )           |
| Proceeds from lease financing agreement   | 47,601                    | —                  |
| Cash dividends paid   | (228,391 )                | (212,602 )         |
| Exercise of stock options   | 171,629                   | 74,004             |
| Excess tax benefits from exercise of stock options  | 9,561                     | 690                |
| Contributions from noncontrolling interests in subsidiaries                                   | —                         | 10,199             |
| Repurchase of Common Stock  | (357,650 )                | (133,439 )         |
| <b>Net Cash Flows (Used by) Financing Activities</b>  | <b>(598,446 )</b>         | <b>(275,247 )</b>  |

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|  |            |            |
|--|------------|------------|
| Decrease in Cash and Cash Equivalents          | (592,303 ) | (8,658 )   |
| Cash and Cash Equivalents, beginning of period | 884,642    | 253,605    |
| Cash and Cash Equivalents, end of period       | \$ 292,339 | \$ 244,947 |
| Interest Paid                                  | \$ 84,050  | \$ 90,654  |
| Income Taxes Paid                              | \$ 223,991 | \$ 236,632 |

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

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 shareholders 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. The financial statements were prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim reporting. These statements do not include all of the information and footnotes required by GAAP for complete financial statements.

Our significant interim accounting policies include the recognition of a pro-rata share of certain estimated annual amounts primarily for raw material purchase price variances, advertising expense, incentive compensation expenses and the effective income tax rate.

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 2011 presentation. Operating results for the nine months ended October 2, 2011 may not be indicative of the results that may be expected for the year ending December 31, 2011, because of the seasonal effects of our business. For more information, refer to the consolidated financial statements and notes included in our 2010 Annual Report on Form 10-K.

2. BUSINESS ACQUISITION

In February 2011, we acquired a 49% interest in Tri-Us, Inc. of Boulder, Colorado, a company that manufactures, markets and sells nutritional beverages under the “mix1” brand name. We invested \$5.8 million and are accounting for this investment using the equity method.

We included results subsequent to the acquisition date in the consolidated financial statements. If we had included the results of the acquisition in the consolidated financial statements for each of the periods presented, the effect would not have been material.

3. NONCONTROLLING INTERESTS IN SUBSIDIARIES

In May 2007, we entered into an agreement with Godrej Beverages and Foods, Ltd., one of India’s largest consumer goods, confectionery and food companies, to manufacture and distribute confectionery products, snacks and beverages across India. Under the agreement, we 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. In June 2010, the Company and the noncontrolling interests executed a rights agreement with Godrej Hershey Ltd. in the form of unsecured compulsorily and fully convertible debentures. The Company contributed cash of approximately \$11.1 million and the noncontrolling interests contributed \$9.3 million associated with the rights agreement. 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 a cooperative agreement with Pandurata Netherlands B.V. (“Bauducco”), a leading manufacturer of baked goods in Brazil whose primary brand is Bauducco. In September 2010, the Company contributed cash of approximately \$1.0 million to Hershey do Brasil and Bauducco contributed approximately \$0.9 million. The noncontrolling interest in Hershey do Brasil is included in the equity section of the Consolidated Balance Sheets.

The decrease in noncontrolling interests in subsidiaries from \$35.3 million as of December 31, 2010 to \$27.0 million as of October 2, 2011 reflected the noncontrolling interests’ share of losses of these entities as well as the impact of currency translation adjustments. The noncontrolling interests’ share of losses in subsidiaries increased income by \$5.0 million for the nine months ended October 2, 2011 and by \$7.3 million for the nine months ended October 3, 2010 and was included in selling, marketing and administrative expenses.

## 4. STOCK COMPENSATION PLANS

On February 22, 2011, our Board of Directors adopted The Hershey Company Equity and Incentive Compensation Plan, Amended and Restated as of February 22, 2011 (“EICP”), subject to approval by our stockholders at the 2011 annual meeting of stockholders. On April 28, 2011, our stockholders approved the amended and restated EICP. The EICP is the plan under which grants using shares for compensation and incentive purposes are made. The EICP was amended and restated to continue to provide annual and long-term compensation and incentives, and to reflect updates in corporate governance practices since it was last approved in April 2007. The following table summarizes our stock compensation costs:

|   | For the Three Months Ended |                    | For the Nine Months Ended |                    |
|---|----------------------------|--------------------|---------------------------|--------------------|
|   | October 2,<br>2011         | October 3,<br>2010 | October 2,<br>2011        | October 3,<br>2010 |
| In millions of dollars  |                            |                    |                           |                    |
| Total compensation amount charged against income for stock options, performance stock units (“PSUs”) and restricted stock units | \$ 6.8                     | \$ 11.3            | \$ 30.8                   | \$ 38.5            |
| Total income tax benefit recognized in the Consolidated Statements of Income for share-based compensation                       | \$ 2.3                     | \$ 3.7             | \$ 11.0                   | \$ 13.9            |

The decrease in share-based compensation expense for the third quarter and first nine months of 2011 resulted primarily from certain adjustments associated with accounting for performance stock units. In addition, the decrease in share-based compensation expense for the first nine months of 2011 was impacted by the forfeiture of unvested awards due to participant changes during the second quarter of 2011.

We estimated the fair value of the market-based total shareholder return component of the performance stock units using a Monte Carlo simulation model on the date of grant. We based the weighted-average estimated values of PSUs, as well as the weighted-average assumptions that we used in calculating the fair value, on estimates at the date of grant, as follows:

|                     | For the Nine Months Ended |                    |
|---------------------|---------------------------|--------------------|
|                     | October 2,<br>2011        | October 3,<br>2010 |
| Estimated values    | \$ 37.79                  | \$ 28.62           |
| Dividend yields     | 2.7%                      | 3.2%               |
| Expected volatility | 28.8%                     | 29.5%              |

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

|                          | For the Nine Months Ended |                    |
|--------------------------|---------------------------|--------------------|
|                          | October 2,<br>2011        | October 3,<br>2010 |
| Dividend yields          | 2.7%                      | 3.2%               |
| Expected volatility      | 22.6%                     | 21.7%              |
| Risk-free interest rates | 2.8%                      | 3.1%               |

Expected lives in years

6.6

6.5

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## Stock Options

A summary of the status of our stock options as of October 2, 2011, and the change during 2011 is presented below:

| Stock Options                             | Shares      | For the Nine Months Ended October 2, 2011 |   |
|---|-------------|---|---|
|   |             | Weighted-Average Exercise Price           | Weighted-Average Remaining Contractual Term |
| Outstanding at beginning of the period    | 17,997,082  | \$42.21                                   | 6.1 years                                   |
| Granted                                   | 2,184,035   | \$51.60                                   |   |
| Exercised                                 | (4,526,643) | \$37.99                                   |   |
| Forfeited                                 | (752,662)   | \$43.87                                   |   |
| Outstanding as of October 2, 2011         | 14,901,812  | \$44.79                                   | 6.0 years                                   |
| Options exercisable as of October 2, 2011 | 8,738,062   | \$46.79                                   | 4.5 years                                   |

  

|   | For the Nine Months Ended |                 |
|---|---------------------------|-----------------|
|   | October 2, 2011           | October 3, 2010 |
| Weighted-average fair value of options granted (per share)    | \$ 9.98                   | \$ 6.85         |
| Intrinsic value of options exercised (in millions of dollars) | \$ 75.3                   | \$ 23.5         |

As of October 2, 2011, the aggregate intrinsic value of options outstanding was \$218.9 million and the aggregate intrinsic value of options exercisable was \$112.3 million.

As of October 2, 2011, there was \$21.7 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 October 2, 2011, and the change during 2011 is presented below:

| Performance Stock Units and Restricted Stock Units | For the Nine Months Ended October 2, 2011 | Weighted-average grant date fair value for equity awards or market value for liability awards |
|--|---|---|
|  |   |   |
| Outstanding at beginning of year                   | 1,948,758                                 | \$38.00   |
| Granted  | 508,877                                   | \$52.23   |
| Performance assumption change                      | 143,876                                   | \$45.96   |
| Vested   | (661,676)                                 | \$37.28   |
| Forfeited  | (241,119)                                 | \$40.26   |
| Outstanding as of October 2, 2011                  | 1,698,716                                 | \$43.18   |

The table above excludes performance stock unit awards for 85,694 and 74,108 units as of December 31, 2010 and October 2, 2011, respectively, for which the measurement date had not yet occurred for accounting purposes.



As of October 2, 2011, there was \$39.0 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 2.1 years.

|   | For the Nine Months Ended |                    |
|---|---------------------------|--------------------|
|   | October 2,<br>2011        | October 3,<br>2010 |
| Intrinsic value of share-based liabilities paid, combined with the fair value of shares vested (in millions of dollars) | \$ 34.3                   | \$ 15.5            |

The higher amount in 2011 was primarily due to the higher performance attainment percentage associated with the performance stock unit awards vesting in 2011 compared with 2010.

Deferred performance stock units, deferred restricted stock units, and directors' fees and accumulated dividend amounts representing deferred stock units totaled 529,853 units as of October 2, 2011. Each unit is equivalent to one share of the Company's Common Stock.

No stock appreciation rights were outstanding as of October 2, 2011.

For more information on our stock compensation plans, refer to the consolidated financial statements and notes included in our 2010 Annual Report on Form 10-K and our proxy statement for the 2011 annual meeting of stockholders.

## 5. INTEREST EXPENSE

Net interest expense consisted of the following:

|                         | For the Nine Months Ended |                    |
|-------------------------|---------------------------|--------------------|
|                         | October 2,<br>2011        | October 3,<br>2010 |
| In thousands of dollars |                           |                    |
| Interest expense        | \$ 78,191                 | \$ 70,958          |
| Interest income         | (1,976)                   | (829)              |
| Capitalized interest    | (5,346)                   | (1,341)            |
| Interest expense, net   | \$ 70,869                 | \$ 68,788          |

## 6. BUSINESS REALIGNMENT AND IMPAIRMENT CHARGES

In June 2010, we announced Project Next Century (the "Next Century program") as part of our ongoing efforts to create an advantaged supply chain and competitive cost structure. As part of the program, production will transition from the Company's century-old facility at 19 East Chocolate Avenue in Hershey, Pennsylvania, to a planned expansion of the West Hershey facility, which was built in 1992. Production from the 19 East Chocolate Avenue plant, as well as a portion of the workforce, will be relocated to the West Hershey facility.

We estimate that the Next Century program will incur pre-tax charges and non-recurring project implementation costs of \$140 million to \$160 million over three years. This estimate includes \$120 million to \$140 million in pre-tax business realignment and impairment charges and approximately \$20 million in project implementation and start-up costs. Total costs of \$21.4 million were recorded during the first nine months of 2011 and total costs of \$53.9 million were recorded for the full year 2010.

In September 2011, we entered into a sale and leasing agreement for the 19 East Chocolate Avenue manufacturing facility with Chocolate Realty DST, a Delaware Statutory Trust. Chocolate Realty DST is not affiliated with the Milton Hershey School Trust. As a result of our continuing involvement and use of the property, we are deemed to be the “owner” of the property for accounting purposes. We received net proceeds of \$47.6 million and recorded a lease financing obligation of \$50.0 million under the leasing agreement. The initial term of the agreement expires in 2041.

Certain former manufacturing facilities with a carrying value of \$11.5 million were being held for sale as of October 2, 2011. The fair value of these facilities was estimated based on expected sales proceeds.

Business realignment and impairment charges and credits recorded during the three-month and nine-month periods ended October 2, 2011 and October 3, 2010 were as follows:

|   | For the Three<br>Months Ended |                    | For the Nine<br>Months Ended |                    |
|---|-------------------------------|--------------------|------------------------------|--------------------|
|   | October 2,<br>2011            | October 3,<br>2010 | October 2,<br>2011           | October 3,<br>2010 |
| In thousands of dollars   |                               |                    |                              |                    |
| Cost of sales – Next Century program                                | \$ 9,464                      | \$ 6,123           | \$ 23,346                    | \$ 7,099           |
| Selling, marketing and administrative<br>– Next Century program     | 1,868                         | 387                | 4,020                        | 510                |
| Business realignment and<br>impairment charges, net                 |                               |                    |                              |                    |
| Next Century program  |                               |                    |                              |                    |
| Plant closure expenses and fixed<br>asset impairment charges        | 1,600                         | 843                | 3,727                        | 5,147              |
| Employee separation costs (credits)                                 | 587                           | (2,895)            | (9,654)                      | 33,243             |
| Godrej Hershey Ltd. goodwill<br>impairment                          | —                             | —                  | —                            | 44,692             |
| Total business realignment and<br>impairment charges (credits), net | 2,187                         | (2,052)            | (5,927)                      | 83,082             |
| Total business realignment and<br>impairment charges                | \$ 13,519                     | \$ 4,458           | \$ 21,439                    | \$ 90,691          |

A charge of \$9.5 million was recorded in cost of sales during the third quarter of 2011 related primarily to the accelerated depreciation of fixed assets over a reduced remaining useful life and start-up costs associated with the Next Century program. A charge of \$1.9 million was recorded in selling, marketing and administrative expenses in the third quarter of 2011 related primarily to project administration for the Next Century program. Plant closure expenses of \$1.6 million were recorded in the third quarter of 2011 primarily related to costs associated with the relocation of production lines. Employee separation costs were \$0.6 million for the Next Century program in the third quarter of 2011, reflecting expected costs related to voluntary and involuntary terminations.

A charge of \$23.3 million was recorded in cost of sales during the first nine months of 2011 related to accelerated depreciation of fixed assets over a reduced remaining useful life associated with the Next Century program. A charge of \$4.0 million was recorded in selling, marketing and administrative expenses during the first nine months of 2011 for project administration. Plant closure expenses of \$3.7 million were recorded during the first nine months of 2011 primarily related to costs associated with the relocation of production lines. Employee separation costs were reduced by \$9.7 million during the first nine months of 2011 which consisted of an \$11.3 million credit reflecting lower expected costs related to voluntary and involuntary terminations at the two manufacturing facilities and a net benefits curtailment loss of \$1.6 million also related to the employee terminations. While the expected total number of jobs to be eliminated under the Next Century program has not changed, approximately 400 employees are expected to leave the Company under voluntary and involuntary severance benefit plans compared with the original estimate of 500 to 600 employees.

A charge of \$6.1 million was recorded in cost of sales during the third quarter of 2010 related to accelerated depreciation of fixed assets over a reduced remaining useful life associated with the Next Century program. A charge

of \$0.4 million was recorded in selling, marketing and administrative expenses in the third quarter of 2010 for project administration. In determining the costs related to fixed asset impairments, fair value was estimated based on the expected sales proceeds. Fixed asset impairments and plant closure expenses of \$0.8 million were recorded in the third quarter of 2010. The employee separation credit of \$2.9 million in the third quarter of 2010 was related to lower expected voluntary and involuntary terminations at the two manufacturing facilities based on severance elections received during the third quarter of 2010.

A charge of \$7.1 million was recorded in cost of sales during the first nine months of 2010 related primarily to accelerated depreciation of fixed assets over a reduced remaining useful life associated with the Next Century program. A charge of \$0.5 million was recorded in selling, marketing and administrative expenses during the first nine months of 2010 for project administration. Fixed asset impairments and plant closure expenses of \$5.1 million were recorded

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during the first nine months of 2010. Employee separation costs of \$33.2 million during the first nine months of 2010 were related to expected voluntary and involuntary terminations at the two manufacturing facilities.

As a result of operating performance that was below expectations, we completed an impairment evaluation of goodwill and other intangible assets of Godrej Hershey Ltd. during the second quarter of 2010. As a result of reduced expectations for future cash flows from lower than expected profitability, we determined that the carrying amount of Godrej Hershey Ltd. exceeded its fair value. We recorded a non-cash goodwill impairment charge of \$44.7 million in the second quarter of 2010 to reduce the carrying value of Godrej Hershey Ltd. to its fair value, including a reduction to reflect the share of the charge associated with the noncontrolling interests. There was no tax benefit associated with this charge.

The October 2, 2011 liability balance relating to the Next Century program was \$19.9 million for estimated employee separation costs which were recorded in 2010 and 2011 and will be paid in 2012 and 2013 as production transitions to the expanded West Hershey facility. During the first nine months of 2011, we made payments against the liabilities of \$1.7 million related to employee separation and project administration costs.

## 7. 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 Nine<br>Months Ended |                    |
|--|-------------------------------|--------------------|------------------------------|--------------------|
|  | October 2,<br>2011            | October 3,<br>2010 | October 2,<br>2011           | October 3,<br>2010 |
| In thousands except per share amounts  |                               |                    |                              |                    |
| Net income                             | \$ 196,695                    | \$ 180,169         | \$ 486,829                   | \$ 374,286         |
| Weighted-average shares - Basic        |                               |                    |                              |                    |
| Common Stock                           | 165,917                       | 166,900            | 166,223                      | 167,030            |
| Class B Common Stock                   | 60,632                        | 60,708             | 60,649                       | 60,708             |
| Total weighted-average shares - Basic  | 226,549                       | 227,608            | 226,872                      | 227,738            |
| Effect of dilutive securities:         |                               |                    |                              |                    |
| Employee stock options                 | 2,580                         | 2,126              | 2,564                        | 1,740              |
| Performance and restricted stock units | 720                           | 757                | 678                          | 660                |
| Weighted-average shares - Diluted      | 229,849                       | 230,491            | 230,114                      | 230,138            |
| Earnings Per Share - Basic             |                               |                    |                              |                    |
| Class B Common Stock                   | \$.81                         | \$.74              | \$2.00                       | \$1.53             |
| Common Stock                           | \$.89                         | \$.81              | \$2.20                       | \$1.68             |
| Earnings Per Share - Diluted           |                               |                    |                              |                    |
| Class B Common Stock                   | \$.80                         | \$.73              | \$1.98                       | \$1.52             |
| Common Stock                           | \$.86                         | \$.78              | \$2.12                       | \$1.63             |

The Class B Common Stock is convertible into Common Stock on a share-for-share basis at any time. 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 Nine<br>Months Ended |                    |
|--|-------------------------------|--------------------|------------------------------|--------------------|
|  | October 2,<br>2011            | October 3,<br>2010 | October 2,<br>2011           | October 3,<br>2010 |

2010

In millions

Stock options excluded from diluted  
earnings per share calculation  
because the effect would have been  
antidilutive

1.6

4.9

6.9

8.7

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## 8. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

We account for derivative instruments in accordance with Financial Accounting Standards Board accounting standards which require us to recognize all derivative instruments at fair value. We classify derivatives as assets or liabilities on the balance sheet. As of October 2, 2011 and December 31, 2010, all of our derivative instruments were classified as cash flow hedges.

The fair value of derivative instruments in the Consolidated Balance Sheet as of October 2, 2011 was as follows:

| Balance Sheet Caption<br>In thousands of dollars | Interest Rate<br>Swap<br>Agreements | Foreign<br>Exchange<br>Forward<br>Contracts<br>and Options | Commodities<br>Futures and<br>Options<br>Contracts |
|--|-------------------------------------|--|--|
| Prepaid expense and other current assets         | \$ —                                | \$ 8,596   | \$ 1,460   |
| Other assets                                     | \$ —                                | \$ 1,636   | \$ —   |
| Accrued liabilities                              | \$ 1,017                            | \$ 5,335   | \$ 29,559  |
| Other long-term liabilities                      | \$ —                                | \$ 818   | \$ —   |

The fair value of derivative instruments in the Consolidated Balance Sheet as of December 31, 2010 was as follows:

| Balance Sheet Caption<br>In thousands of dollars | Interest Rate<br>Swap<br>Agreements | Foreign Exchange<br>Forward<br>Contracts<br>and Options | Commodities<br>Futures and<br>Options<br>Contracts |
|--|-------------------------------------|---|--|
| Prepaid expense and other current assets         | \$ —                                | \$ 6,748  | \$ —   |
| Other assets                                     | \$ —                                | \$ 2,737  | \$ —   |
| Accrued liabilities                              | \$ 8,873                            | \$ 5,109  | \$ 3,233   |
| Other long-term liabilities                      | \$ —                                | \$ 2,348  | \$ —   |

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.

The fair value of foreign exchange forward contracts and options is 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 October 2, 2011, the fair value of foreign exchange forward contracts with gains totaled \$10.2 million and the fair value of foreign exchange forward contracts with losses totaled \$6.1 million.

As of October 2, 2011, prepaid expense and other current assets associated with commodities futures and options contracts were related to the fair value of commodity derivative instruments.

As of October 2, 2011, accrued liabilities associated with commodities futures and options contracts were related to the fair value of commodity derivative instruments as well as 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.

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The effect of derivative instruments on the Consolidated Statements of Income for the nine months ended October 2, 2011 was as follows:

| Cash Flow Hedging Derivatives<br>In thousands of dollars                             | Interest Rate<br>Swap<br>Agreements | Foreign Exchange<br>Forward Contracts<br>and Options | Commodities<br>Futures and<br>Options<br>Contracts |
|--|-------------------------------------|--|--|
| Gains (losses) recognized in other comprehensive income ("OCI") (effective portion)  | \$ 7,856                            | \$ (21,786)  | \$ (69,750)  |
| Gains (losses) reclassified from accumulated OCI into income (effective portion) (a) | \$ —                                | \$ 2,281   | \$ 22,400  |
| Gains (losses) recognized in income (ineffective portion) (b)                        | \$ —                                | \$ —   | \$ (691)   |

The effect of derivative instruments on the Consolidated Statements of Income for the nine months ended October 3, 2010 was as follows:

| Cash Flow Hedging Derivatives<br>In thousands of dollars                             | Interest Rate<br>Swap<br>Agreements | Foreign Exchange<br>Forward<br>Contracts<br>and Options | Commodities<br>Futures and<br>Options<br>Contracts |
|--|-------------------------------------|---|--|
| Gains (losses) recognized in other comprehensive income ("OCI") (effective portion)  | \$ (27,237)                         | \$ 6,477  | \$ (37,502)  |
| Gains (losses) reclassified from accumulated OCI into income (effective portion) (a) | \$ —                                | \$ (5,886)  | \$ 44,800  |
| Gains (losses) recognized in income (ineffective portion) (b)                        | \$ —                                | \$ —  | \$ 469   |

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

(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.

The amount of net losses on cash flow hedging derivatives, including foreign exchange forward contracts and options, interest rate swap agreements and commodities futures and options contracts, expected to be reclassified into earnings in the next twelve months was approximately \$22.1 million after tax as of October 2, 2011. This amount was primarily associated with commodities futures and options contracts.

For more information, refer to the consolidated financial statements and notes included in our 2010 Annual Report on Form 10-K.

## 9. COMPREHENSIVE INCOME

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

|   | For the Three Months Ended October 2,<br>2011 |                             |                     |
|---|---|-----------------------------|---------------------|
|   | Pre-Tax<br>Amount                             | Tax<br>(Expense)<br>Benefit | After-Tax<br>Amount |
| In thousands of dollars                   |   |                             |                     |
| Net income                                |   |                             | \$ 196,695          |
| Other comprehensive income (loss):        |   |                             |                     |
| Foreign currency translation adjustments  | \$(37,826 )                                   | \$—                         | (37,826 )           |
| Pension and post-retirement benefit plans | 8,178   | (2,993 )                    | 5,185               |
| Cash flow hedges:                         |   |                             |                     |
| Losses on cash flow hedging derivatives   | (78,216 )                                     | 31,444                      | (46,772 )           |
| Reclassification adjustments              | (11,504 )                                     | 4,479                       | (7,025 )            |
| Total other comprehensive loss            | \$(119,368 )                                  | \$32,930                    | (86,438 )           |
| Comprehensive income                      |   |                             | \$ 110,257          |

|   | For the Three Months Ended October 3,<br>2010 |                             |                     |
|---|---|-----------------------------|---------------------|
|   | Pre-Tax<br>Amount                             | Tax<br>(Expense)<br>Benefit | After-Tax<br>Amount |
| In thousands of dollars                   |   |                             |                     |
| Net income                                |   |                             | \$ 180,169          |
| Other comprehensive income (loss):        |   |                             |                     |
| Foreign currency translation adjustments  | \$ 12,243                                     | \$—                         | 12,243              |
| Pension and post-retirement benefit plans | 7,099   | (2,744 )                    | 4,355               |
| Cash flow hedges:                         |   |                             |                     |
| Losses on cash flow hedging derivatives   | (11,776 )                                     | 4,064                       | (7,712 )            |
| Reclassification adjustments              | (11,043 )                                     | 4,231                       | (6,812 )            |
| Total other comprehensive income          | \$(3,477 )                                    | \$5,551                     | 2,074               |
| Comprehensive income                      |   |                             | \$ 182,243          |

|   | For the Nine Months Ended October 2,<br>2011 |                             |                     |
|---|--|-----------------------------|---------------------|
|   | Pre-Tax<br>Amount                            | Tax<br>(Expense)<br>Benefit | After-Tax<br>Amount |
| In thousands of dollars                   |  |                             |                     |
| Net income                                |  |                             | \$ 486,829          |
| Other comprehensive income (loss):        |  |                             |                     |
| Foreign currency translation adjustments  | \$(24,219 )                                  | \$—                         | (24,219 )           |
| Pension and post-retirement benefit plans | 21,670                                       | (8,429 )                    | 13,241              |
| Cash flow hedges:                         |  |                             |                     |

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|   |              |          |           |
|---|--------------|----------|-----------|
| Losses on cash flow hedging derivatives | (83,680 )    | 32,622   | (51,058 ) |
| Reclassification adjustments            | (24,681 )    | 9,524    | (15,157 ) |
| Total other comprehensive loss          | \$(110,910 ) | \$33,717 | (77,193 ) |
| Comprehensive income                    |              |          | \$409,636 |

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|   | For the Nine Months Ended October 3, 2010 |                       |                  |
|---|---|-----------------------|------------------|
|   | Pre-Tax Amount                            | Tax (Expense) Benefit | After-Tax Amount |
| In thousands of dollars                   |   |                       |                  |
| Net income                                |   |                       | \$374,286        |
| Other comprehensive income (loss):        |   |                       |                  |
| Foreign currency translation adjustments  | \$9,370                                   | \$—                   | 9,370            |
| Pension and post-retirement benefit plans | 21,778                                    | (8,358 )              | 13,420           |
| Cash flow hedges:                         |   |                       |                  |
| Losses on cash flow hedging derivatives   | (58,264 )                                 | 21,958                | (36,306 )        |
| Reclassification adjustments              | (38,914 )                                 | 14,902                | (24,012 )        |
| Total other comprehensive loss            | \$(66,030 )                               | \$28,502              | (37,528 )        |
| Comprehensive income                      |   |                       | \$336,758        |

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

|   | October 2, 2011 | December 31, 2010 |
|---|-----------------|-------------------|
| In thousands of dollars                               |                 |                   |
| Foreign currency translation adjustments              | \$ (1,547 )     | \$ 22,672         |
| Pension and post-retirement benefit plans, net of tax | (257,339 )      | (270,580 )        |
| Cash flow hedges, net of tax                          | (33,374 )       | 32,841            |
| Total accumulated other comprehensive loss            | \$ (292,260 )   | \$ (215,067 )     |

## 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:

|                         | October 2, 2011 | December 31, 2010 |
|-------------------------|-----------------|-------------------|
| In thousands of dollars |                 |                   |
| Raw materials           | \$ 221,779      | \$ 209,058        |
| Goods in process        | 86,911          | 73,068            |
| Finished goods          | 502,907         | 404,666           |
| Inventories at FIFO     | 811,597         | 686,792           |
| Adjustment to LIFO      | (157,142 )      | (153,170 )        |
| Total inventories       | \$ 654,455      | \$ 533,622        |

The increase in finished goods inventories was primarily associated with seasonal sales patterns and increases in inventory levels in anticipation of the transition of production to our West Hershey manufacturing facility under the Next Century program.

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 October 2, 2011, 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 2010 Annual Report on Form 10-K.



## 12. LONG-TERM DEBT

In May 2009, 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 September 2011, we repaid \$250.0 million of 5.3% Notes due in 2011. In December 2010, we issued \$350 million of 4.125% Notes due in 2020. The Notes were issued under the WKSI Registration Statement. Also in December 2010, we paid \$63.4 million to repurchase \$57.5 million of our 6.95% Notes due in 2012 as part of a cash tender offer. We used a portion of the proceeds from the \$350 million of 4.125% Notes issued in December 2010 to fund the repurchase.

## 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 October 2, 2011 and December 31, 2010, because of the relatively short maturity of these instruments.

The carrying value of long-term debt, including the current portion, was \$1,598.4 million as of October 2, 2011, compared with a fair value of \$1,882.5 million, 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. The weighted-average fixed rate on the forward starting swap agreements was 3.5%. The forward starting swap agreements matured in September 2011, resulting in cash payments of approximately \$26 million. The loss on the swap agreements will be amortized as an increase to interest expense over the term of the anticipated \$250 million of term financing expected to be executed in 2011. Also in September 2011, we entered into forward starting swap agreements to continue to hedge interest rate exposure related to the term financing expected to be executed in 2011. The weighted-average fixed rate on the forward starting swap agreements is 1.4%. The fair value of interest rate swap agreements was a net liability of \$1.0 million as of October 2, 2011. 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:

| In millions of dollars  | October 2, 2011<br>Contract<br>Amount | Primary Currencies                                  |
|---|---------------------------------------|---|
| Foreign exchange forward contracts to purchase foreign currencies | \$ 79.4                               | Euros<br>British pound sterling<br>Canadian dollars |
|   | \$ 124.9                              |   |

Foreign exchange forward contracts  
to  
sell foreign currencies

Canadian dollars

Our foreign exchange forward contracts mature in 2011, 2012 and 2013. For more information, see Note 8. Derivative Instruments and Hedging Activities.

#### 14. FAIR VALUE ACCOUNTING

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.

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A summary of our cash flow hedging derivative assets and liabilities measured at fair value on a recurring basis as of October 2, 2011, is as follows:

| Description                   | Fair Value as of<br>October 2, 2011 | Quoted Prices<br>in Active<br>Markets of<br>Identical Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs (Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|-------------------------------|-------------------------------------|---|--|--|
| In thousands of dollars       |                                     |   |  |  |
| Assets                        |                                     |   |  |  |
| Cash flow hedging derivatives | \$ 11,692                           | \$ 1,460  | \$ 10,232  | \$ —   |
| Liabilities                   |                                     |   |  |  |
| Cash flow hedging derivatives | \$ 36,729                           | \$ 29,559   | \$ 7,170   | \$ —   |

As of October 2, 2011, cash flow hedging derivative Level 1 assets were related to the fair value of commodity derivative instruments. Cash flow hedging Level 1 liabilities were associated with the fair value of commodity derivative instruments and 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.

As of October 2, 2011, cash flow hedging derivative Level 2 assets were related to the fair value of foreign exchange forward contracts with gains. Cash flow hedging Level 2 liabilities were related to the fair value of interest rate swap agreements and foreign exchange forward contracts with losses. We define the fair value of foreign exchange forward contracts 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 on a quarterly basis by obtaining market quotes of spot and forward rates for contracts with similar terms, adjusted where necessary for maturity differences. For more information, see Note 8. Derivative Instruments and Hedging Activities and refer to the consolidated financial statements and notes included in our 2010 Annual Report on Form 10-K.

A summary of our cash flow hedging derivative assets and liabilities measured at fair value on a recurring basis as of December 31, 2010, is as follows:

| Description                   | Fair Value as of<br>December 31,<br>2010 | Quoted Prices<br>in Active<br>Markets of<br>Identical Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs (Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|-------------------------------|--|---|--|--|
| In thousands of dollars       |  |   |  |  |
| Assets                        |  |   |  |  |
| Cash flow hedging derivatives | \$ 9,485                                 | \$ —  | \$ 9,485   | \$ —   |
| Liabilities                   |  |   |  |  |
| Cash flow hedging derivatives | \$ 19,563                                | \$ 3,233  | \$ 16,330  | \$ —   |

As of December 31, 2010, 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 December 31, 2010, cash flow hedging derivative Level 2 assets were related to the fair value of foreign exchange forward contracts with gains. Cash flow hedging Level 2 liabilities were related to the fair value of interest rate swap agreements and foreign exchange forward contracts with losses.

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), Canada and Mexico. During the fourth quarter of 2009, the U.S. Internal Revenue Service (“IRS”) commenced its audit of our U.S. income tax returns for 2007 and 2008 and we expect the audit to conclude by the end of 2012. Tax examinations by various state taxing authorities could generally be conducted for years beginning in 2006. We are no longer subject to Canadian federal income tax examinations by the Canada Revenue Agency (“CRA”) for years before 2004, and we are no longer subject to Mexican federal income tax examinations by

Servicio de Administracion Tributaria (“SAT”) for years before 2004. During the third quarter of 2010, the CRA commenced its audit of our Canadian income tax returns for 2006 through 2009. U.S., Canadian and Mexican federal audit issues typically involve the timing of deductions and transfer pricing adjustments. We work with the IRS, the CRA and the SAT to resolve proposed audit adjustments and to minimize the amount of adjustments. We do not anticipate that any potential tax adjustments will have a significant impact on our financial position or results of operations.

We reasonably expect reductions in the liability for unrecognized tax benefits of approximately \$17.3 million within the next 12 months because of the expiration of statutes of limitations and settlements of tax audits.

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

Components of net periodic benefit cost for the periods indicated consisted of the following:

|   | Pension Benefits           |                    | Other Benefits     |                    |
|---|----------------------------|--------------------|--------------------|--------------------|
|   | For the Three Months Ended |                    |                    |                    |
|   | October 2,<br>2011         | October 3,<br>2010 | October 2,<br>2011 | October 3,<br>2010 |
| In thousands of dollars                     |                            |                    |                    |                    |
| Service cost                                | \$7,507                    | \$7,061            | \$333              | \$346              |
| Interest cost                               | 13,147                     | 13,367             | 3,744              | 4,061              |
| Expected return on plan assets              | (19,640 )                  | (19,022 )          | —                  | —                  |
| Amortization of prior service cost (credit) | 231                        | 287                | (63 )              | (69 )              |
| Recognized net actuarial loss (gain)        | 6,693                      | 7,129              | (18 )              | (33 )              |
| Administrative expenses                     | 134                        | 141                | 110                | 75                 |
| Net periodic benefit cost                   | 8,072                      | 8,963              | 4,106              | 4,380              |
| Curtailment credit                          | (7 )                       | —                  | —                  | —                  |
| Total amount reflected in earnings          | \$8,065                    | \$8,963            | \$4,106            | \$4,380            |

We made contributions of \$1.3 million and \$4.9 million to the pension plans and other benefits plans, respectively, during the third quarter of 2011. The \$4.9 million of contributions to other benefits plans included a reimbursement of \$0.7 million received during the third quarter of 2011 relating to the Early Retiree Reinsurance Program, a one-time government program providing reimbursement for a portion of pre-65 healthcare benefit costs. In the third quarter of 2010, we made contributions of \$1.4 million and \$3.6 million to our pension and other benefits plans, respectively. The contributions in 2011 and 2010 also included benefit payments from our non-qualified pension plans and post-retirement benefit plans.

The pension curtailment credit recorded in the third quarter of 2011 was related to Project Next Century.

Components of net periodic benefit cost for the periods indicated consisted of the following:

|   | Pension Benefits          |                    | Other Benefits     |                    |
|---|---------------------------|--------------------|--------------------|--------------------|
|   | For the Nine Months Ended |                    |                    |                    |
|   | October 2,<br>2011        | October 3,<br>2010 | October 2,<br>2011 | October 3,<br>2010 |
| In thousands of dollars                     |                           |                    |                    |                    |
| Service cost                                | \$22,544                  | \$21,198           | \$1,000            | \$1,038            |
| Interest cost                               | 39,752                    | 40,107             | 11,232             | 12,186             |
| Expected return on plan assets              | (58,675 )                 | (57,074 )          | —                  | —                  |
| Amortization of prior service cost (credit) | 692                       | 858                | (190 )             | (208 )             |

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|                                      |          |          |          |          |
|--------------------------------------|----------|----------|----------|----------|
| Recognized net actuarial loss (gain) | 20,779   | 21,391   | (54 )    | (100 )   |
| Administrative expenses              | 550      | 358      | 211      | 221      |
| Net periodic benefit cost            | 25,642   | 26,838   | 12,199   | 13,137   |
| Curtailment loss (credit)            | 1,826    | —        | (174 )   | —        |
| Total amount reflected in earnings   | \$27,468 | \$26,838 | \$12,025 | \$13,137 |

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We made contributions of \$3.9 million and \$13.6 million to the pension plans and other benefits plans, respectively, during the first nine months of 2011. The \$13.6 million of contributions to the other benefits plans included reimbursements of \$2.9 million received during 2011 relating to the Early Retiree Reinsurance Program. In the first nine months of 2010, we made contributions of \$4.1 million and \$16.1 million to our pension and other benefits plans, respectively. The contributions in 2011 and 2010 also included benefit payments from our non-qualified pension plans and post-retirement benefit plans.

The pension curtailment loss and other benefits curtailment credit recorded in the first nine months of 2011 related to Project Next Century which is described in more detail in Note 6. Business Realignment and Impairment Charges.

For 2011, there are no significant minimum funding requirements for our pension plans and planned voluntary funding of our pension plans in 2011 is not material.

For more information, refer to the consolidated financial statements and notes included in our 2010 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:

| In thousands   | For the Nine Months Ended<br>October 2, 2011 |            |
|--|--|------------|
|  | Shares                                       | Dollars    |
| Shares repurchased in the open market under pre-approved share repurchase programs               | 1,903  | \$ 100,015 |
| Shares repurchased to replace Treasury Stock issued for stock options and incentive compensation | 4,715  | 257,635    |
| Total share repurchases  | 6,618  | 357,650    |
| Shares issued for stock options and incentive compensation                                       | (4,917)                                      | (166,135)  |
| Net change   | 1,701  | \$ 191,515 |

In December 2006, our Board of Directors approved a \$250 million share repurchase program. As of April 3, 2011, we completed this share repurchase program. In April 2011, our Board of Directors approved a new \$250 million authorization to repurchase shares of our Common Stock. This authorization is in addition to the Company's policy of repurchasing shares in the open market to replace Treasury Stock shares issued in connection with stock option exercises or other equity-based compensation programs.

## 18. SUBSEQUENT EVENT

In October 2011, we entered into a new five-year agreement establishing an unsecured revolving credit facility to borrow up to \$1.1 billion, with an option to increase borrowings by an additional \$400 million with the consent of the lenders. We may use these funds for general corporate purposes, including commercial paper backstop and business acquisitions.

The unsecured committed revolving credit agreement contains a financial covenant whereby the ratio of (a) pre-tax income from operations from the most recent four fiscal quarters to (b) consolidated interest expense for the most recent four fiscal quarters may not be less than 2.0 to 1.0 at the end of each fiscal quarter. The credit agreement

contains customary representations and warranties and events of default. Payment of outstanding advances may be accelerated, at the option of the lenders, should we default in our obligation under the credit agreement.

Also in October 2011, we terminated the five-year credit agreement entered into in December 2006 which was scheduled to expire in December 2012.



## 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 Nine Months Ended |                    |   |
|--|----------------------------|--------------------|---|---------------------------|--------------------|---|
|  | October 2,<br>2011         | October 3,<br>2010 | Percent<br>Change<br>Increase<br>(Decrease) | October 2,<br>2011        | October 3,<br>2010 | Percent<br>Change<br>Increase<br>(Decrease) |
| In thousands except per share amounts                      |                            |                    |   |                           |                    |   |
| Net Sales  | \$1,624.3                  | \$1,547.1          | 5.0%  | \$4,513.6                 | \$4,188.2          | 7.8%  |
| Cost of Sales  | 944.1                      | 891.9              | 5.8   | 2,612.9                   | 2,392.5            | 9.2   |
| Gross Profit   | 680.2                      | 655.2              | 3.8   | 1,900.7                   | 1,795.7            | 5.8   |
| Gross Margin   | 41.9%                      | 42.4%              |   | 42.1%                     | 42.9%              |   |
| SM&A Expense   | 356.9                      | 357.6              | (0.2)                                       | 1,080.6                   | 1,035.2            | 4.4   |
| SM&A Expense as a percent of sales                         | 22.0%                      | 23.1%              |   | 23.9%                     | 24.7%              |   |
| Business Realignment and Impairment Charges (Credits), net | 2.2                        | (2.1)              | 206.6                                       | (5.9)                     | 83.1               | (107.1)                                     |
| EBIT   | 321.1                      | 299.7              | 7.2   | 826.0                     | 677.4              | 21.9  |
| EBIT Margin  | 19.8%                      | 19.4%              |   | 18.3%                     | 16.2%              |   |
| Interest Expense, net                                      | 23.0                       | 22.3               | 3.5   | 70.9                      | 68.8               | 3.0   |
| Provision for Income Taxes                                 | 101.4                      | 97.2               | 4.3   | 268.3                     | 234.3              | 14.5  |
| Effective Income Tax Rate                                  | 34.0%                      | 35.0%              |   | 35.5%                     | 38.5%              |   |
| Net Income   | \$196.7                    | \$180.2            | 9.2   | \$486.8                   | \$374.3            | 30.1  |
| Net Income Per Share-Diluted                               | \$0.86                     | \$0.78             | 10.3  | \$2.12                    | \$1.63             | 30.1  |

## Results of Operations – Third Quarter 2011 vs. Third Quarter 2010

## U.S. Price Increases

In March 2011, we announced a weighted-average increase in wholesale prices of approximately 9.7% across the majority of our U.S., Puerto Rico and export portfolio, effective immediately. The price increase applied to our instant consumable, multi-pack, packaged candy and grocery lines. Direct buying customers were able to purchase transitional amounts of product into May, and we do not expect seasonal net price realization until Easter 2012. Given this timing and some higher than anticipated costs, we do not expect this action to materially impact our financial results this year. We expect the majority of the financial benefit from this pricing action to impact our earnings in 2012.

Usually there is a time lag between the effective date of list price increases and the impact of the price increases on net sales. The impact of price increases is often delayed because we honor previous commitments to planned consumer and customer promotions and merchandising events that occur subsequent to the effective date of the price

increases. In addition, promotional allowances may be increased subsequent to the effective date, delaying or partially offsetting the impact of price increases on net sales.

#### Net Sales

Net sales increased 5.0% for the third quarter of 2011 over the comparable period of 2010 due primarily to net price realization, partially offset by sales volume decreases in the United States. Net price realization contributed about 5.4% to the net sales increase, primarily due to the impact of list price increases, offset somewhat by higher promotional rates. Sales volume declines of approximately 1% were primarily associated with lower core brand sales due to pricing elasticity. These core brand sales volume decreases were substantially offset by incremental sales of new products, primarily the introduction of Reese's Minis and Hershey's Drops in the United States. Favorable foreign currency exchange rates contributed approximately 0.6% to the sales increase.

### Key Marketplace Metrics

Consumer takeaway increased 8.7% during the third quarter of 2011 compared with the same period of 2010. 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 1.0 share point during the third quarter of 2011 compared with the same period of 2010. The change in market share is provided for measured channels by syndicated data which include sales in the U.S. food, drug, convenience store and mass merchandiser classes of trade, excluding Wal-Mart Stores, Inc.

### Cost of Sales and Gross Margin

Cost of sales increased by 5.8% in the third quarter of 2011 primarily due to higher input costs which increased cost of sales by about 4%. Higher supply chain costs were only partially offset by productivity improvements, resulting in a net increase to cost of sales of approximately 1%. Business realignment charges of \$9.5 million were included in cost of sales in the third quarter of 2011 compared with \$6.1 million recorded during the comparable period of 2010, contributing approximately 0.4% to the cost of sales increase.

Gross margin decreased by 0.5 percentage points for the third quarter of 2011 compared with the third quarter of 2010. Business realignment and impairment charges reduced gross margin by 0.3 percentage points as compared with 2010. Excluding the impact of business realignment and impairment charges, adjusted gross margin decreased by 0.2 percentage points in the third quarter of 2011 compared with the same period of 2010, reflecting higher input and supply chain costs. These cost increases were only partially offset by productivity improvements and favorable price realization.

### Selling, Marketing and Administrative

Selling, marketing and administrative expenses decreased primarily due to the \$17.0 million gain on the sale of certain non-core trademark licensing rights, substantially offset by increases in other selling, marketing and administrative costs primarily reflecting higher employee-related expenses. Advertising expense in the third quarter of 2011 increased approximately 7% from the same period in 2010.

Business realignment charges of \$1.9 million were included in selling, marketing and administrative expenses in the third quarter of 2011 compared with \$0.4 million in the third quarter of 2010.

### Business Realignment and Impairment Charges (Credits)

Pre-tax business realignment and impairment charges of \$2.2 million were recorded in the third quarter of 2011 associated with Project Next Century. The charges related primarily to costs associated with the relocation of production lines and employee separations.

In the third quarter of 2010, we recorded credits of \$2.1 million associated with Project Next Century which were related to previously recorded amounts for employee separation costs and reflected lower expected termination costs based on severance elections during the third quarter of 2010.

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

EBIT increased in the third quarter of 2011 compared with the third quarter of 2010 as a result of higher gross profit. The pre-tax gain of \$17.0 million on the sale of trademark licensing rights more than offset increases in selling, marketing and administrative expenses. Pre-tax business realignment and impairment charges of \$13.5 million were recorded in the third quarter of 2011 compared with \$4.5 million recorded in the third quarter of 2010.

EBIT margin increased from 19.4% for the third quarter of 2010 to 19.8% for the third quarter of 2011. The gain on the sale of trademark licensing rights recorded in the third quarter of 2011 increased EBIT margin by 1.1 percentage points and the impact of business realignment and impairment charges reduced EBIT margin by 0.8 percentage points. Net business realignment and impairment charges recorded in the third quarter of 2010 reduced EBIT margin by 0.3 percentage points. Excluding the impact of the gain on sale of trademark licensing rights and business realignment and impairment charges, adjusted EBIT margin was 19.6% in the third quarter of 2011 compared with 19.7% in the third quarter of 2010.

### Interest Expense, Net

Net interest expense was slightly higher in the third quarter of 2011 than the comparable period of 2010, primarily reflecting increased interest expense resulting from higher average debt outstanding, substantially offset by increased capitalized interest.

### Income Taxes and Effective Tax Rate

Our effective income tax rate was 34.0% for the third quarter of 2011 compared with 35.0% for the third quarter of 2010. The effective income tax rate was reduced by 0.2% in the third quarter of 2011 as a result of the net impact of tax rates associated with the gain on the sale of trademark licensing rights and business realignment and impairment charges. In the third quarter of 2010 the effective income tax rate was reduced by 0.1% as a result of the tax rates associated with business realignment charges recorded during the period. Excluding the impact of tax rates associated with the gain and business realignment and impairment charges, our effective tax rate decreased in 2011 as a result of the mix of income among various tax jurisdictions.

### Net Income and Net Income Per Share

Earnings per share-diluted for the third quarter of 2011 increased \$0.08 as compared with the third quarter of 2010. Net income in the third quarter of 2011 was increased by \$11.1 million, or \$0.05 per share-diluted, as a result of the gain on the sale of trademark licensing rights and was reduced by \$8.2 million, or \$0.03 per share-diluted, reflecting business realignment and impairment charges. In the third quarter of 2010, net income was reduced by \$2.7 million, or \$0.01 per share-diluted, as a result of net business realignment and impairment charges. Excluding the gain on the sale of trademark rights and the impact of business realignment and impairment charges, adjusted earnings per share-diluted increased \$0.05 per share, or 6.3%, in 2011 compared with 2010.

### Results of Operations – First Nine Months 2011 vs. First Nine Months 2010

#### Net Sales

An increase in net sales of 7.8% in the first nine months of 2011 compared with the same period in 2010 was attributable to sales volume increases of 4.5% primarily related to sales of new products, particularly in the U.S. Price realization in the U.S. and for our international businesses contributed approximately 3% to the net sales increase. The favorable impact of foreign currency exchange rates increased net sales by approximately 0.6%.

#### Key Marketplace Metrics

Consumer takeaway increased 8.3% during the first nine months of 2011 compared with the same period of 2010. 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 1.0 share point during the first nine months of 2011 compared with the same period of 2010. The change in market share is provided for measured channels by syndicated data which include sales in the U.S. food, drug, convenience store and mass merchandiser classes of trade, excluding Wal-Mart Stores, Inc.

#### Cost of Sales and Gross Margin

The cost of sales increase of 9.2% in the first nine months of 2011 compared with 2010 was primarily associated with higher sales volume which increased cost of sales by about 5%. Higher input and supply chain costs increased cost of sales by a total of approximately 5%. These cost increases were offset somewhat by supply chain productivity improvements which reduced cost of sales by approximately 2%. Business realignment and impairment charges of \$23.3 million were included in cost of sales in the first nine months of 2011, compared with \$7.1 million in the prior year, contributing approximately 1% of the cost of sales increase.

Gross margin decreased by 0.8 percentage point in the first nine months of 2011 compared with the same period of 2010. Higher input and supply chain costs reduced gross margin by about 2.6 percentage points, substantially offset by productivity improvements and price realization of approximately 2.3 percentage points. The impact of higher business realignment and impairment charges recorded in 2011 compared with 2010 reduced gross margin by 0.4 percentage points.

### Selling, Marketing and Administrative

Selling, marketing and administrative expenses increased in the first nine months of 2011 as a result of higher marketing and employee-related expenses, offset somewhat by the \$17.0 million gain on the sale of non-core trademark licensing rights. Advertising expense in the first nine months of 2011 increased approximately 14.5% from the same period in 2010.

Business realignment charges of \$4.0 million were included in selling, marketing and administrative expenses in the first nine months of 2011 compared with \$0.5 million in 2010.

### Business Realignment and Impairment (Credits) Charges

Total net pre-tax business realignment and impairment credits of \$5.9 million were recorded in the first nine months of 2011 compared with charges of \$83.1 million recorded in the comparable period of 2010. The net credits recorded in the first nine months of 2011 were associated with a reduction of employee separation expense of \$9.7 million, partially offset by asset retirement costs related to Project Next Century.

Total pre-tax business realignment and impairment charges of \$83.1 million were recorded in the first nine months of 2010, including a non-cash goodwill impairment charge of \$44.7 million related to our Godrej Hershey Ltd. joint venture and \$38.4 million associated with Project Next Century related to estimated employee severance and asset retirement costs.

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

EBIT increased in the first nine months of 2011 compared with the first nine months of 2010 as a result of higher gross profit and lower business realignment and impairment charges. Higher selling, marketing and administrative expenses were offset somewhat by the pre-tax gain of \$17.0 million on the sale of trademark licensing rights. Pre-tax net business realignment and impairment charges of \$21.4 million were recorded in the first nine months of 2011 compared with \$90.7 million recorded in the first nine months of 2010.

EBIT margin increased from 16.2% for the first nine months of 2010 to 18.3% for the first nine months of 2011 as the gain on the sale of trademark licensing rights increased EBIT margin by 0.4 percentage points and the net impact of business realignment and impairment charges reduced EBIT margin by 0.5 percentage points. Net business realignment and impairment charges recorded in the first nine months of 2010 reduced EBIT margin by 2.1 percentage points. Excluding the impact of the gain on sale of trademark licensing rights and business realignment and impairment charges, adjusted EBIT margin was 18.4% in the first nine months of 2011 compared with 18.3% for the comparable period of 2010.

### Interest Expense, Net

Net interest expense in the first nine months of 2011 was higher than the comparable period of 2010 due to higher average debt outstanding, partially offset by an increase in capitalized interest.

### Income Taxes and Effective Tax Rate

Our effective income tax rate was 35.5% for the first nine months of 2011 compared with 38.5% for the first nine months of 2010. The effective income tax rate was reduced by 0.1% in the first nine months of 2011 as a result of the effective tax rates associated with the gain on the sale of trademark licensing rights and business realignment and impairment charges. In the first nine months of 2010 the effective income tax rate was increased by 2.5% as a result

of the tax rates associated with business realignment charges recorded during the period. Excluding the impact of tax rates associated with the gain on sale of the trademark rights and business realignment and impairment charges, our effective tax rate decreased in 2011 as a result of the mix of income among various tax jurisdictions.

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## Net Income and Net Income Per Share

Earnings per share-diluted for the first nine months of 2011 increased \$0.49, or 30.1%, compared with the same period of the prior year. Net income in the first nine months of 2011 was increased by \$11.1 million, or \$0.05 per share-diluted, as a result of the gain on sale of trademark licensing rights and was reduced by \$13.3 million, or \$0.06 per share-diluted, as a result of net business realignment and impairment charges. In the first nine months of 2010, net income was reduced by \$73.1 million or \$0.31 per share-diluted as a result of business realignment and impairment charges. Excluding the gain on the sale of trademark rights and the impact of business realignment and impairment charges, adjusted earnings per share-diluted increased \$0.19 per share, or 9.8%, in 2011 compared with 2010.

## 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 utilizing cash on hand or 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 nine months of 2011, cash and cash equivalents decreased by \$592.3 million to \$292.3 million.

Cash on hand at the beginning of the period, cash provided from operations and other cash inflows, particularly from stock option exercises, during the first nine months of 2011 were sufficient to fund the repurchase of Common Stock of \$357.7 million, capital additions and capitalized software expenditures of \$265.6 million, repayment of long-term debt of \$254.8 million and dividend payments of \$228.4 million.

Net cash provided from operating activities was \$257.2 million for the first nine months of 2011 and \$388.2 million for the comparable period of 2010. The decrease was primarily attributable to the change in cash used by working capital as well as an increase in cash used by other assets and liabilities and the impact of business realignment and impairment charges, partially offset by higher net income in 2011. Cash used by working capital was \$304.3 million in 2011 and \$193.3 million in 2010. The increase was principally related to higher inventories resulting from seasonal sales patterns and increases in inventory levels in anticipation of the transition of production under the Next Century program, along with an increase in accounts receivable resulting from higher sales in 2011 compared with 2010. Cash used by changes in other assets and liabilities was \$95.6 million for the first nine months of 2011 compared with \$33.4 million for the same period of 2010. The increase in the amount of cash used by other assets and liabilities from 2010 to 2011 primarily reflected the timing of payments associated with selling and marketing programs and incentive compensation of \$32.1 million as well as the impact of business realignment and impairment charges of \$20.0 million.

During the third quarter 2011, the Company recorded an \$11.1 million gain, net of tax, on the sale of trademark licensing rights. We received net proceeds of \$20.0 million from this sale. Additionally, we entered into a sale and leasing agreement for the 19 East Chocolate Avenue manufacturing facility. Based on the leasing agreement, we are deemed to be the "owner" of the property for accounting purposes. We received net proceeds of \$47.6 million and recorded a lease financing obligation of \$50.0 million under the leasing agreement.

Interest paid was \$84.1 million during the first nine months of 2011 versus \$90.7 million for the comparable period of 2010. The decrease in interest paid in 2011 was due to timing of long-term interest payments. Income taxes paid were \$224.0 million during the first nine months of 2011 versus \$236.6 million for the comparable period of 2010. The decrease in taxes paid in 2011 was primarily related to reduced extension payments in the first nine months of 2011 compared with the first nine months of 2010, partially offset by the impact of higher annualized taxable income in 2011.

The ratio of current assets to current liabilities was 1.5:1.0 as of October 2, 2011 and December 31, 2010. The capitalization ratio (total short-term and long-term debt as a percent of stockholders' equity, short-term and long-term debt) decreased to 63% as of October 2, 2011 from 66% as of December 31, 2010.

Generally, our short-term borrowings are in the form of commercial paper or bank loans with an original maturity of three months or less. However, at the end of the third quarter of 2011, no commercial paper borrowings were outstanding. In October 2011, we entered into a new five-year unsecured revolving credit agreement and terminated our existing credit agreement entered into in December 2006. The credit limit of the new agreement is \$1.1 billion with an option to borrow an additional \$400 million with the concurrence of the lenders.

## 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 2010 Annual Report on Form 10-K for information concerning the key risks to achieving future performance goals.

We expect the economic environment to continue to be challenging during the remainder of 2011. In this environment, we will continue to build our business by focusing on a consumer-driven approach to core brand investment and new product innovation in the United States, along with investments in our strategic international businesses.

We will continue to focus on our core brands and leverage our scale at retail during 2011. Our third quarter results were strong and we expect to continue our marketplace momentum, including the roll-out and distribution of Hershey's Drops and Reese's Minis and the introduction of Hershey's Air Delight which began in June.

For the full year 2011, we now expect net sales growth, including the impact of foreign currency exchange rates, to be around 7%, greater than our long-term objective of 3% to 5%. Price increases effective in March 2011 are not expected to have a significant impact on financial results for the year. The impact of the price increase on our financial results for 2011 will be delayed because we will honor previous commitments to planned consumer and customer promotions and merchandising events subsequent to the effective date of the price increase. In addition, promotional allowances have increased subsequent to the effective date, partially offsetting the impact of price increases on net sales. We do not expect seasonal net price realization until Easter 2012.

Although the increase in advertising expense for the first nine months of 2011 was 14.5% compared with the same period of 2010, advertising expense is expected to decline in the fourth quarter versus 2010 considering the significant increase in our investment during the fourth quarter last year. For the full year, we now expect advertising to increase in the high-single digits on a percentage basis versus 2010. We will continue to invest in consumer insights, additional selling and go-to-market strategies in both the U.S. and international markets, new innovation on our Reese's and Hershey's franchises and quality merchandising and programming to drive profitable growth for both our Company and our customers. Excluding advertising expense, other selling, marketing and administrative expenses are expected to increase in the fourth quarter as we accelerate investments in go-to-market strategies and capabilities.

We expect our cost structure to remain at elevated levels during the remainder of 2011. Both primary and secondary commodity markets remain volatile and we expect that volatility to continue in the coming months. We have visibility into our cost structure for the remainder of the year and there is no change to our cost inflation outlook for the full year 2011. We also expect to continue to achieve productivity and efficiency improvements to help mitigate the impact of higher input costs. We expect growth in earnings per share-diluted to be around 25% on a GAAP basis in 2011. As indicated in the Note below, we continue to expect growth in adjusted earnings per share-diluted to be greater than our 6% to 8% long-term objective for the full year 2011 and increase around 10% for the full year.

During 2012 we expect the economic environment to remain challenging, however, we are well positioned to succeed in the marketplace. We will leverage our scale at retail in the U.S. and will work closely with our retail partners to enable achievement of our price elasticity model. We will also continue our disciplined investment in go-to-market capabilities within key international markets. While we anticipate significantly higher input costs in 2012, we will continue to focus on preserving our margin structure. Price increases implemented during 2011, along with productivity and cost savings initiatives will help mitigate the impact of increased commodity costs. Therefore, we expect 2012 net sales, including the impact of foreign currency exchange rates, and adjusted earnings per share-diluted growth to be within our long-term 3% to 5% and 6% to 8% objectives, respectively.

NOTE: In the Outlook above, the Company has provided income measures excluding certain items, in addition to net income determined in accordance with GAAP. These non-GAAP financial measures are used in evaluating results of operations for internal purposes. These non-GAAP measures are not intended to replace the presentation of financial results in accordance with GAAP. Rather, the Company believes exclusion of such items provides additional information to investors to facilitate the comparison of past and present operations.

In 2010, the Company recorded GAAP charges of \$53.9 million, or \$0.14 per share-diluted, attributable to Project Next Century. Additionally, in the second quarter of 2010, the Company recorded a non-cash goodwill impairment charge of \$44.7 million, or \$0.20 per share-diluted, related to the Godrej Hershey Ltd. joint venture. In the third quarter of 2011, the Company recorded a pre-tax gain of \$17.0 million, or \$0.05 per share-diluted, from the sale of trademark licensing rights. In 2011, the Company expects to record total GAAP charges of about \$38 million to \$43 million, or \$0.11 to \$0.12 per share-diluted, attributable to Project Next Century.

Below is a reconciliation of GAAP and non-GAAP items to the Company's 2010 adjusted earnings per share-diluted and projected adjusted earnings per share-diluted for 2011:

|  | 2010   | 2011<br>(Projected) |
|--|--------|---------------------|
| R e p o r t e d  |        | \$2.72 -            |
| EPS-Diluted  | \$2.21 | \$2.76              |
| Gain on sale of<br>trademark<br>licensing rights           | —      | \$(0.05)            |
| Total Business<br>Realignment<br>and Impairment<br>Charges | \$0.34 | \$0.11 -<br>\$0.12  |
| Adjusted<br>EPS-Diluted *                                  | \$2.55 | \$2.79 -<br>\$2.82  |

\*Excludes business realignment and impairment charges and the gain on sale of trademark licensing rights.

Possible adjustments to exclude business realignment and impairment charges for 2012 are not known at this time; therefore, the Company is unable to provide a reconciliation of projected adjusted earnings per share-diluted for 2012.

#### Outlook for Project Next Century

In June 2010, we announced Project Next Century as part of our ongoing efforts to create an advantaged supply chain and competitive cost structure. We expect total pre-tax charges and non-recurring project implementation costs for Project Next Century of \$140 million to \$160 million. During 2011, we expect to record \$38 million to \$43 million in program charges. During 2011, we expect capital expenditures for Project Next Century to be approximately \$190 million to \$200 million. Depreciation and amortization for 2011 is estimated to be approximately \$210 million, including accelerated depreciation of approximately \$25 million to \$30 million related to Project Next Century.

### 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

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, along with the availability of adequate supplies of raw materials 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;
- Disruption to our supply chain could impair our ability to produce or deliver our finished products, resulting in a negative impact on our operating results;
- Our financial results may be adversely impacted by the failure to successfully execute acquisitions, divestitures and joint ventures;
- 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 could negatively impact our financial results;
  - International operations could fluctuate unexpectedly and adversely impact our business;
- Disruptions, failures or security breaches of our information technology infrastructure could have a negative impact on our operations;
- 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;
- Implementation of our Project Next Century program may not occur within the anticipated timeframe and/or may exceed our cost estimates;

· Annual savings from initiatives to transform our supply chain and advance our value-enhancing strategy may be less than we expect; and

· Such other matters as discussed in our Annual Report on Form 10-K for 2010.

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

The potential net loss in fair value of interest rate swap agreements of ten percent resulting from a hypothetical near-term adverse change in market rates was \$1.7 million as of October 2, 2011 and was \$3.5 million as of December 31, 2010. The potential net loss in fair value of foreign exchange forward contracts and options resulting from a hypothetical near-term adverse change in market rates of ten percent was \$21.3 million as of October 2, 2011 and was \$24.7 million as of December 31, 2010. 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 increased from

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\$49.0 million as of December 31, 2010, to \$51.1 million as of October 2, 2011. 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 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<br>Number<br>of Shares<br>Purchased | (b) Average Price<br>Paid<br>per Share | (c) Total<br>Number<br>of Shares<br>Purchased as<br>Part<br>of Publicly<br>Announced<br>Plans<br>or Programs | (d) Approximate<br>Dollar Value of<br>Shares that May<br>Yet Be Purchased<br>Under the Plans<br>or Programs<br>In thousands of<br>dollars |
|--------------------------------------|---|--|--|---|
| July 4 through<br>July 31, 2011      | —   | \$ —                                   | —  | \$ 250,000  |
| August 1 through<br>August 28, 2011  | 2,502,388                                     | \$ 56.23                               | —  | \$ 250,000  |
| August 29 through<br>October 2, 2011 | 409,771                                       | \$ 58.57                               | —  | \$ 250,000  |
| Total                                | 2,912,159                                     | \$ 56.56                               | —  |   |

In April 2011, our Board of Directors approved a new \$250 million share repurchase program.

## Item 4 - Reserved

## Item 6 - Exhibits

The following items are attached or incorporated herein by reference:

| Exhibit<br>Number | Description  |
|-------------------|--|
| 12.1              | Statement showing computation of ratio of earnings to fixed charges for the nine months ended October 2, 2011 and October 3, 2010. |
| 31.1              | Certification of John P. Bilbrey, 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 John P. Bilbrey, 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.DEF XBRL Taxonomy Extension Definition 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: November 4, 2011 /s/Humberto P. Alfonso  
Humberto P. Alfonso  
Chief Financial Officer

Date: November 4, 2011 /s/David W. Tacka  
David W. Tacka  
Chief Accounting Officer

EXHIBIT INDEX

|                 |  |
|-----------------|--|
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| 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 John P. Bilbrey, Chief Executive Officer, and Humberto P. Alfonso, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
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