

HERSHEY CO  
Form 10-Q  
November 05, 2008

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

FORM 10-Q

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

For the quarterly period ended September 28, 2008

OR

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

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

Commission file number 1-183

THE HERSHEY COMPANY  
100 Crystal A Drive  
Hershey, PA 17033

Registrant's telephone number: 717-534-4200

State of Incorporation  
Delaware

IRS Employer Identification No.  
23-0691590

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

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

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

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 – 166,393,631 shares, as of October 17, 2008. Class B Common Stock, \$1 par value – 60,730,227 shares, as of October 17, 2008.

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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 Ended |                       |
|---|----------------------------|-----------------------|
|   | September 28,<br>2008      | September 30,<br>2007 |
| Net Sales   | \$ 1,489,609               | \$ 1,399,469          |
| Costs and Expenses:                                       |                            |                       |
| Cost of sales   | 988,380                    | 928,846               |
| Selling, marketing and administrative                     | 272,401                    | 229,809               |
| Business realignment and impairment charges, net          | 8,877                      | 112,043               |
| Total costs and expenses                                  | 1,269,658                  | 1,270,698             |
| Income before Interest and Income Taxes                   | 219,951                    | 128,771               |
| Interest expense, net                                     | 24,915                     | 33,055                |
| Income before Income Taxes                                | 195,036                    | 95,716                |
| Provision for income taxes                                | 70,498                     | 32,932                |
| Net Income  | \$ 124,538                 | \$ 62,784             |
| Earnings Per Share - Basic - Class B Common Stock         | \$ .51                     | \$ .26                |
| Earnings Per Share - Diluted - Class B Common Stock       | \$ .51                     | \$ .26                |
| Earnings Per Share - Basic - Common Stock                 | \$ .56                     | \$ .28                |
| Earnings Per Share - Diluted - Common Stock               | \$ .54                     | \$ .27                |
| Average Shares Outstanding - Basic - Common Stock         | 166,682                    | 167,165               |
| Average Shares Outstanding - Basic - Class B Common Stock | 60,784                     | 60,812                |
| Average Shares Outstanding - Diluted                      | 288,670                    | 230,388               |
| Cash Dividends Paid Per Share:                            |                            |                       |

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|                      |    |       |    |       |
|----------------------|----|-------|----|-------|
| Common Stock         | \$ | .2975 | \$ | .2975 |
| Class B Common Stock | \$ | .2678 | \$ | .2678 |

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 Ended |                       |
|---|---------------------------|-----------------------|
|   | September 28,<br>2008     | September 30,<br>2007 |
| Net Sales   | \$ 3,755,388              | \$ 3,604,494          |
| Costs and Expenses:                                       |                           |                       |
| Cost of sales   | 2,495,196                 | 2,390,402             |
| Selling, marketing and administrative                     | 788,962                   | 663,112               |
| Business realignment and impairment charges, net          | 34,748                    | 219,316               |
| Total costs and expenses                                  | 3,318,906                 | 3,272,830             |
| Income before Interest and Income Taxes                   | 436,482                   | 331,664               |
| Interest expense, net                                     | 72,911                    | 90,523                |
| Income before Income Taxes                                | 363,571                   | 241,141               |
| Provision for income taxes                                | 134,321                   | 81,330                |
| Net Income  | \$ 229,250                | \$ 159,811            |
| Earnings Per Share - Basic - Class B Common Stock         | \$ .93                    | \$ .65                |
| Earnings Per Share - Diluted - Class B Common Stock       | \$ .93                    | \$ .65                |
| Earnings Per Share - Basic - Common Stock                 | \$ 1.03                   | \$ .72                |
| Earnings Per Share - Diluted - Common Stock               | \$ 1.00                   | \$ .69                |
| Average Shares Outstanding - Basic - Common Stock         | 166,696                   | 168,444               |
| Average Shares Outstanding - Basic - Class B Common Stock | 60,798                    | 60,814                |
| Average Shares Outstanding - Diluted                      | 228,757                   | 232,026               |
| Cash Dividends Paid Per Share:                            |                           |                       |
| Common Stock  | \$ .8925                  | \$ .8375              |
| Class B Common Stock                                      | \$ .8034                  | \$ .7528              |

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

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

| ASSETS  | September 28,<br>2008 | December 31,<br>2007 |
|---|-----------------------|----------------------|
| Current Assets:   |                       |                      |
| Cash and cash equivalents   | \$ 135,632            | \$ 129,198           |
| Accounts receivable - trade   | 614,392               | 487,285              |
| Inventories   | 674,320               | 600,185              |
| Deferred income taxes   | 52,512                | 83,668               |
| Prepaid expenses and other  | 173,799               | 126,238              |
| Total current assets  | 1,650,655             | 1,426,574            |
| Property, Plant and Equipment, at cost  | 3,449,289             | 3,606,443            |
| Less-accumulated depreciation and amortization                                    | (1,969,722)           | (2,066,728)          |
| Net property, plant and equipment   | 1,479,567             | 1,539,715            |
| Goodwill  | 570,082               | 584,713              |
| Other Intangibles   | 163,738               | 155,862              |
| Other Assets  | 567,337               | 540,249              |
| Total assets  | \$ 4,431,379          | \$ 4,247,113         |
| <br>  |                       |                      |
| LIABILITIES, MINORITY INTEREST AND STOCKHOLDERS'<br>EQUITY                        |                       |                      |
| Current Liabilities:  |                       |                      |
| Accounts payable  | \$ 317,612            | \$ 223,019           |
| Accrued liabilities   | 505,950               | 538,986              |
| Accrued income taxes  | 10,633                | 373                  |
| Short-term debt   | 712,713               | 850,288              |
| Current portion of long-term debt   | 16,584                | 6,104                |
| Total current liabilities   | 1,563,492             | 1,618,770            |
| Long-term Debt  | 1,510,831             | 1,279,965            |
| Other Long-term Liabilities   | 532,441               | 544,016              |
| Deferred Income Taxes   | 172,486               | 180,842              |
| Total liabilities   | 3,779,250             | 3,623,593            |
| Minority Interest   | 38,245                | 30,598               |
| Stockholders' Equity:   |                       |                      |
| Preferred Stock, shares issued:<br>none in 2008 and 2007                          | —                     | —                    |
| Common Stock, shares issued: 299,162,017 in 2008 and<br>299,095,417 in 2007       | 299,161               | 299,095              |
| Class B Common Stock, shares issued: 60,739,727 in 2008 and<br>60,806,327 in 2007 | 60,740                | 60,806               |
| Additional paid-in capital  | 345,791               | 335,256              |
| Retained earnings   | 3,959,338             | 3,927,306            |
| Treasury-Common Stock shares at cost:   |                       |                      |

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|   |    |             |    |             |
|---|----|-------------|----|-------------|
| 132,823,723 in 2008 and 132,851,893 in 2007                   |    | (4,008,087) |    | (4,001,562) |
| Accumulated other comprehensive loss                          |    | (43,059)    |    | (27,979)    |
| Total stockholders' equity                                    |    | 613,884     |    | 592,922     |
| Total liabilities, minority interest and stockholders' equity | \$ | 4,431,379   | \$ | 4,247,113   |

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

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## THE HERSHEY COMPANY

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands of dollars)

|  | For the Nine Months Ended |                       |
|--|---------------------------|-----------------------|
|  | September 28,<br>2008     | September 30,<br>2007 |
| Cash Flows Provided from (Used by) Operating Activities  |                           |                       |
| Net Income   | \$ 229,250                | \$ 159,811            |
| Adjustments to Reconcile Net Income to Net Cash<br>Provided from Operations:                         |                           |                       |
| Depreciation and amortization  | 190,762                   | 227,776               |
| Stock-based compensation expense, net of tax of \$9,892 and<br>\$7,181, respectively                 | 17,283                    | 12,822                |
| Excess tax benefits from exercise of stock options   | (769)                     | (9,804)               |
| Deferred income taxes  | 58,367                    | 65,234                |
| Business realignment initiatives, net of tax of \$33,529 and<br>\$118,786, respectively              | 67,430                    | 197,876               |
| Contributions to pension plans   | (24,620)                  | (9,285)               |
| Changes in assets and liabilities, net of effects from business<br>acquisitions<br>and divestitures: |                           |                       |
| Accounts receivable - trade  | (127,564)                 | (110,415)             |
| Inventories  | (62,809)                  | (128,561)             |
| Accounts payable   | 94,593                    | 91,221                |
| Other assets and liabilities   | (193,332)                 | (181,391)             |
| Net Cash Flows Provided from Operating Activities  | 248,591                   | 315,284               |
| Cash Flows Provided from (Used by) Investing Activities  |                           |                       |
| Capital additions  | (198,446)                 | (118,204)             |
| Capitalized software additions   | (12,672)                  | (9,526)               |
| Proceeds from sales of property, plant and equipment   | 77,180                    | —                     |
| Business acquisitions  | —                         | (97,030)              |
| Proceeds from divestiture  | 1,960                     | —                     |
| Net Cash Flows (Used by) Investing Activities  | (131,978)                 | (224,760)             |
| Cash Flows Provided from (Used by) Financing Activities  |                           |                       |
| Net (decrease) increase in short-term debt   | (137,575)                 | 424,067               |
| Long-term borrowings   | 247,845                   | —                     |
| Repayment of long-term debt  | (3,281)                   | (188,852)             |
| Cash dividends paid  | (197,218)                 | (186,531)             |
| Exercise of stock options  | 34,635                    | 43,878                |
| Excess tax benefits from exercise of stock options   | 769                       | 9,804                 |
| Repurchase of Common Stock   | (55,354)                  | (248,458)             |
| Net Cash Flows (Used by) Financing Activities  | (110,179)                 | (146,092)             |
| Increase (Decrease) in Cash and Cash Equivalents   | 6,434                     | (55,568)              |
| Cash and Cash Equivalents, beginning of period   | 129,198                   | 97,141                |

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|  |    |         |    |         |
|--|----|---------|----|---------|
| Cash and Cash Equivalents, end of period | \$ | 135,632 | \$ | 41,573  |
| Interest Paid                            | \$ | 87,672  | \$ | 115,974 |
| Income Taxes Paid                        | \$ | 115,977 | \$ | 145,230 |

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

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THE HERSHEY COMPANY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

Our unaudited consolidated financial statements provided in this report include the accounts of the Company and our majority-owned subsidiaries and entities in which we have a controlling financial interest after the elimination of intercompany accounts and transactions. We have a controlling financial interest if we own a majority of the outstanding voting common stock and minority 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. These statements do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements.

We included all adjustments (consisting only of normal recurring accruals) which we believe were considered necessary for a fair presentation. Operating results for the nine months ended September 28, 2008 may not be indicative of the results that may be expected for the year ending December 31, 2008, because of the seasonal effects of our business. For more information, refer to the consolidated financial statements and notes included in our 2007 Annual Report on Form 10-K.

2. BUSINESS ACQUISITIONS AND DIVESTITURES

In May 2007, we entered into an agreement with Godrej Beverages and Foods, Ltd., one of India's largest consumer goods, confectionery and food companies, to manufacture and distribute confectionery products, snacks and beverages across India. Under the agreement, we invested \$61.5 million during 2007 and own a 51% controlling interest in Godrej Hershey Ltd. (formerly Godrej Hershey Foods and Beverages Company). Total liabilities assumed in 2007 were \$51.6 million. Effective in May 2007, this business acquisition was included in our consolidated results, including the related minority interest.

Also in May 2007, we entered into a manufacturing agreement in China with Lotte Confectionery Co., LTD., to produce Hershey products and certain Lotte products for the market in China. We invested \$39.0 million in 2007 and own a 44% interest. We are accounting for this investment using the equity method.

In January 2008, our Brazilian subsidiary, Hershey do Brasil, entered into a cooperative agreement with Pandurata Alimentos LTDA ("Bauducco"), a leading manufacturer of baked goods in Brazil whose primary brand is Bauducco. The arrangement with Bauducco will leverage Bauducco's strong sales and distribution capabilities for our products throughout Brazil. Under this agreement we will manufacture and market, and they will sell and distribute our products. In the fourth quarter of 2007, we recorded a goodwill impairment charge and approved a business realignment program associated with initiatives to improve distribution and enhance performance of our business in Brazil. In the first quarter of 2008, we received approximately \$2.0 million in cash and recorded an other intangible asset of \$13.7 million associated with the cooperative agreement with Bauducco in exchange for a 49% interest in Hershey do Brasil. We will maintain a 51% controlling interest in Hershey do Brasil.

3. STOCK COMPENSATION PLANS

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

|   | For the Three Months Ended |           | For the Nine Months Ended |           |
|---|----------------------------|-----------|---------------------------|-----------|
|   | September                  | September | September                 | September |
|   | 28,                        | 30,       | 28,                       | 30,       |
|   | 2008                       | 2007      | 2008                      | 2007      |
|   | (in millions of dollars)   |           |                           |           |
| Total compensation amount charged against income for stock options, performance stock units (“PSUs”) and restricted stock units | \$ 8.9                     | \$ 7.6    | \$ 26.7                   | \$20.0    |
| Total income tax benefit recognized in the Consolidated Statements of Income for share-based compensation                       | \$ 3.2                     | \$ 2.8    | \$ 9.6                    | \$ 7.2    |

The increase in share-based compensation expense for the third quarter of 2008 resulted from the impact of lowered performance expectations for the PSUs in 2007.

The increase in share-based compensation expense for the first nine months of 2008 resulted from the impact of lowered performance expectations for the PSUs in 2007 and the timing of the 2007 stock option grants. Our annual grant of stock options to management level employees, which customarily has occurred in February of each year, was delayed in 2007 pending approval by our stockholders of the EICP at the annual meeting in April 2007. In 2008, we resumed our customary February grant schedule.

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

|                          | For the Nine Months Ended |                          |
|--------------------------|---------------------------|--------------------------|
|                          | September 28,<br>2008     | September<br>30,<br>2007 |
| Dividend yield           | 2.4%                      | 2.0%                     |
| Expected volatility      | 18.1%                     | 19.5%                    |
| Risk-free interest rates | 3.1%                      | 4.6%                     |
| Expected lives in years  | 6.6                       | 6.6                      |

#### Stock Options

A summary of the status of our stock options as of September 28, 2008, and the change during 2008 is presented below:

|  | For the Nine Months Ended September 28, 2008 |                                    |   |
|--|--|------------------------------------|---|
|  | Shares                                       | Weighted-Average<br>Exercise Price | Weighted-Average<br>Remaining<br>Contractual Term |
| Stock Options                                |  |                                    |   |
| Outstanding at beginning of year             | 13,889,116                                   | \$43.26                            | 6.2 years   |
| Granted                                      | 4,417,229                                    | \$35.95                            |   |
| Exercised                                    | (1,109,550)                                  | \$31.22                            |   |
| Forfeited                                    | (402,192)                                    | \$46.53                            |   |
| Outstanding as of September 28, 2008         | 16,794,603                                   | \$42.05                            | 6.6 years   |
| Options exercisable as of September 28, 2008 | 8,804,772                                    | \$40.77                            | 5.0 years   |

|   | For the Nine Months Ended |                       |
|---|---------------------------|-----------------------|
|   | September 28,<br>2008     | September 30,<br>2007 |
| Weighted-average fair value of options granted (per share)    | \$ 6.20                   | \$ 12.94              |
| Intrinsic value of options exercised (in millions of dollars) | \$ 8.3                    | \$ 32.2               |

As of September 28, 2008, the aggregate intrinsic value of options outstanding was \$68.4 million and the aggregate intrinsic value of options exercisable was \$46.4 million.

As of September 28, 2008, there was \$42.6 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 2.5 years.





## Performance Stock Units and Restricted Stock Units

A summary of the status of our performance stock units and restricted stock units as of September 28, 2008, and the change during 2008 is presented below:

|  | For the Nine<br>Months Ended<br>September 28,<br>2008 | Weighted-average grant date<br>fair value for equity awards or<br>market value for liability awards |
|--|---|---|
| Performance Stock Units and Restricted Stock Units |   |   |
| Outstanding at beginning of year                   | 691,032   | \$ 38.14  |
| Granted  | 510,803   | \$ 37.80  |
| Performance assumption change                      | (58,875)  | \$ 50.37  |
| Vested   | (300,853)   | \$ 32.11  |
| Forfeited  | (33,111)  | \$ 40.45  |
| Outstanding as of September 28, 2008               | 808,996   | \$ 38.74  |

As of September 28, 2008, there was \$18.2 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 2.9 years.

|   | For the Nine Months Ended |                          |
|---|---------------------------|--------------------------|
|   | September<br>28,<br>2008  | September<br>30,<br>2007 |
| Intrinsic value of share-based liabilities paid,<br>combined with the fair value of<br>shares vested (in millions of dollars) | \$ 9.4                    | \$ 21.8                  |

The higher 2007 amount was due to the payment of awards earned for the 2004-2006 performance stock unit cycle. In 2008, no payment was made for the 2005-2007 performance stock unit cycle based on the Company's performance against the two financial objectives which fell below the threshold levels required to earn an award.

Deferred performance stock units, deferred restricted stock units, and directors' fees and accumulated dividend amounts representing deferred stock units totaled 434,148 units as of September 28, 2008. Each unit is equivalent to one share of the Company's Common Stock.

No stock appreciation rights were outstanding as of September 28, 2008.

For more information on our stock compensation plans, refer to the consolidated financial statements and notes included in our 2007 Annual Report on Form 10-K and our proxy statement for the 2008 annual meeting of stockholders.

## 4. INTEREST EXPENSE

Net interest expense consisted of the following:

|                  | For the Nine Months Ended |                       |
|------------------|---------------------------|-----------------------|
|                  | September 28,<br>2008     | September 30,<br>2007 |
|                  | (in thousands of dollars) |                       |
| Interest expense | \$ 78,775                 | \$ 92,690             |

|                       |           |           |
|-----------------------|-----------|-----------|
| Interest income       | (1,305)   | (1,919)   |
| Capitalized interest  | (4,559)   | (248)     |
| Interest expense, net | \$ 72,911 | \$ 90,523 |

#### 5. BUSINESS REALIGNMENT INITIATIVES

In February 2007, we announced a comprehensive, three-year supply chain transformation program (the “global supply chain transformation program”) and, in December 2007, we initiated a business realignment program associated with our business in Brazil (together, “the 2007 business realignment initiatives”).

When completed, the global supply chain transformation program will greatly enhance our manufacturing, sourcing and customer service capabilities, reduce inventories resulting in improvements in working capital and generate significant

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resources to invest in our growth initiatives. This program will provide for accelerated marketplace momentum within our core U.S. business, creation of innovative new product platforms to meet customer needs and disciplined global expansion. Under the program, which is being implemented in stages over three years, we will significantly increase manufacturing capacity utilization by reducing the number of production lines by more than one-third, outsource production of low value-added items and construct a flexible, cost-effective production facility in Monterrey, Mexico to meet current and emerging marketplace needs. The program will result in a total net reduction of 1,500 positions across our supply chain over the three-year implementation period.

The estimated pre-tax cost of the program announced in February 2007 was from \$525 million to \$575 million over three years. The total included from \$475 million to \$525 million in business realignment costs and approximately \$50 million in project implementation costs. The costs will be incurred primarily in 2007 and 2008. Total costs of \$400.0 million were recorded in 2007 and total costs of \$96.0 million were recorded during the first nine months of 2008 for this program.

In 2001, we acquired a small business in Brazil, Hershey do Brasil, that through 2007 had not gained profitable scale or adequate market distribution. In an effort to improve the performance of this business, in January 2008 Hershey do Brasil entered into a cooperative agreement with Bauducco. In the fourth quarter of 2007 we recorded a goodwill impairment charge of \$12.3 million associated with Hershey do Brasil, along with a business realignment charge of \$.3 million primarily related to employee separation costs. Business realignment charges of \$5.0 million were recorded in the first nine months of 2008.

Charges (credits) associated with business realignment initiatives recorded during the three-month and nine-month periods ended September 28, 2008 and September 30, 2007 were as follows:

|  | For the Three Months Ended |           | For the Nine Months Ended |           |
|--|----------------------------|-----------|---------------------------|-----------|
|  | September                  | September | September                 | September |
|  | 28,                        | 30,       | 28,                       | 30,       |
|  | 2008                       | 2007      | 2008                      | 2007      |
|  | (in thousands of dollars)  |           |                           |           |
| Cost of sales                                      |                            |           |                           |           |
| 2007 business realignment initiatives              | \$ 19,965                  | \$ 37,452 | \$ 60,146                 | \$ 88,618 |
| Selling, marketing and administrative              |                            |           |                           |           |
| 2007 business realignment initiatives              | 2,188                      | 2,395     | 6,065                     | 8,728     |
| Business realignment and impairment charges, net:  |                            |           |                           |           |
| Global supply chain transformation program:        |                            |           |                           |           |
| Losses (gains) on sale of fixed assets             | 233                        | —         | (6,557)                   | —         |
| Fixed asset impairments and plant closure expenses | 1,755                      | 8,284     | 17,020                    | 48,382    |
| Employee separation costs                          | 5,866                      | 103,759   | 17,740                    | 156,618   |
| Contract termination costs                         | 1                          | —         | 1,592                     | 14,316    |
| Brazilian business realignment:                    |                            |           |                           |           |
| Employee separation costs                          | 92                         | —         | 1,618                     | —         |

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|   |           |            |            |            |
|---|-----------|------------|------------|------------|
| Fixed asset impairment charges  | 35        | —          | 752        | —          |
| Contract termination and other exit costs                               | 895       | —          | 2,583      | —          |
| Total business realignment and impairment charges, net                  | 8,877     | 112,043    | 34,748     | 219,316    |
| Total net charges associated with 2007 business realignment initiatives | \$ 31,030 | \$ 151,890 | \$ 100,959 | \$ 316,662 |

The charge of \$20.0 million recorded in cost of sales during the third quarter of 2008 related primarily to the accelerated depreciation of fixed assets over a reduced estimated remaining useful life and start-up costs associated with the global supply chain transformation program. The \$2.2 million recorded in selling, marketing and administrative expenses

related primarily to project administration for the global supply chain transformation program. In determining the costs related to fixed asset impairments, fair value was estimated based on the expected sales proceeds. The \$.2 million of losses on sale of fixed assets resulted from reductions to the carrying value of assets being held for sale. The \$1.8 million of fixed asset impairments and plant closure expenses for 2008 related primarily to the preparation of plants for sale and production line removal costs. Certain real estate with a carrying value of \$10.5 million was being held for sale as of September 28, 2008. The global supply chain transformation program employee separation costs included \$4.0 million related to involuntary terminations at the North American manufacturing facilities which are being closed and \$1.9 million primarily related to pension settlements. The global supply chain transformation program had identified six manufacturing facilities which would be closed. As of September 28, 2008, the facilities located in Dartmouth, Nova Scotia; Montreal, Quebec and Oakdale, California have been closed and sold. The facility located in Naugatuck, Connecticut has been closed and is being held for sale. The facilities in Reading, Pennsylvania and Smiths Falls, Ontario are being held and used pending closure, following which they will be offered for sale.

The charge of \$60.1 million recorded in cost of sales during the first nine months of 2008 related primarily to the accelerated depreciation of fixed assets over a reduced estimated remaining useful life and start-up costs associated with the global supply chain transformation program. The \$6.1 million recorded in selling, marketing and administrative expenses related primarily to project administration for the global supply chain transformation program. In determining the costs related to fixed asset impairments, fair value was estimated based on the expected sales proceeds. The \$6.6 million of gains on sale of fixed assets resulted from the receipt of proceeds in excess of the carrying value primarily from the sale of a warehousing and distribution facility. The \$17.0 million of fixed asset impairments and plant closure expenses for 2008 related primarily to the preparation of plants for sale and production line removal costs. The global supply chain transformation program employee separation costs included \$10.9 million related to involuntary terminations at the North American manufacturing facilities which are being closed and \$6.8 million primarily related to pension settlements.

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

The charge of \$37.5 million recorded in cost of sales during the third quarter of 2007 for the 2007 business realignment initiatives related to the accelerated depreciation of fixed assets over a reduced estimated remaining useful life and costs related to inventory reductions. The \$2.4 million recorded in selling, marketing and administrative expenses related primarily to project administration. In determining the costs related to fixed asset impairments, fair value was estimated based on the expected sales proceeds. Certain real estate with a carrying value of \$5.1 million was being held for sale as of September 30, 2007. The employee separation costs included \$35.7 million for involuntary terminations at the six North American manufacturing facilities which are being closed. The employee separation costs also included \$68.1 million for charges relating to pension and other post-retirement benefits curtailments and special termination benefits.

The charge of \$88.6 million recorded in cost of sales during the first nine months of 2007 for the 2007 business realignment initiatives related to the accelerated depreciation of fixed assets over a reduced estimated remaining useful life and costs related to inventory reductions. The \$8.7 million recorded in selling, marketing and administrative expenses related primarily to project administration. In determining the costs related to fixed asset impairments, fair value was estimated based on the expected sales proceeds. The employee separation costs included \$59.3 million for involuntary terminations and \$97.3 million for charges relating to pension and other post-retirement benefits curtailments and special termination benefits.

The September 28, 2008 liability balance relating to the 2007 business realignment initiatives was \$40.2 million for employee separation costs. During the first nine months of 2008, we made payments against the liabilities recorded for the 2007 business realignment initiatives of \$40.4 million principally related to employee separation costs.



## 6. EARNINGS PER SHARE

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

|  | For the Three Months Ended              |                       | For the Nine Months Ended |                       |
|--|---|-----------------------|---------------------------|-----------------------|
|  | September 28,<br>2008                   | September 30,<br>2007 | September 28,<br>2008     | September 30,<br>2007 |
|  | (in thousands except per share amounts) |                       |                           |                       |
| Net income                             | \$ 124,538                              | \$ 62,784             | \$ 229,250                | \$ 159,811            |
| Weighted-average shares - Basic        |   |                       |                           |                       |
| Common Stock                           | 166,682                                 | 167,165               | 166,696                   | 168,444               |
| Class B Common Stock                   | 60,784                                  | 60,812                | 60,798                    | 60,814                |
| Total weighted-average shares - Basic  | 227,466                                 | 227,977               | 227,494                   | 229,258               |
| Effect of dilutive securities:         |   |                       |                           |                       |
| Employee stock options                 | 904                                     | 1,938                 | 939                       | 2,224                 |
| Performance and restricted stock units | 300                                     | 473                   | 324                       | 544                   |
| Weighted-average shares - Diluted      | 228,670                                 | 230,388               | 228,757                   | 232,026               |
| Earnings Per Share - Basic             |   |                       |                           |                       |
| Class B Common Stock                   | \$ .51                                  | \$ .26                | \$ .93                    | \$ .65                |
| Common Stock                           | \$ .56                                  | \$ .28                | \$ 1.03                   | \$ .72                |
| Earnings Per Share - Diluted           |   |                       |                           |                       |
| Class B Common Stock                   | \$ .51                                  | \$ .26                | \$ .93                    | \$ .65                |
| Common Stock                           | \$ .54                                  | \$ .27                | \$ 1.00                   | \$ .69                |

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

For the three-month and nine-month periods ended September 28, 2008, 14.3 million stock options were not included in the diluted earnings per share calculation because the effect would have been antidilutive. For the three-month and nine-month periods ended September 30, 2007, 6.8 million stock options were not included in the diluted earnings per share calculation because the effect would have been antidilutive.

## 7. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

We account for derivative instruments in accordance with Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended ("SFAS No. 133"). SFAS No. 133 requires us to recognize all derivative instruments at fair value. We classify the derivatives as assets or liabilities on the balance sheet. As of September 28, 2008 and September 30, 2007, all of our derivative instruments were designated as cash flow hedges.





## Summary of Activity

Our cash flow hedging derivative activity during the three months and nine months ended September 28, 2008 and September 30, 2007 was as follows:

|   | For the Three Months Ended |           | For the Nine Months Ended |           |
|---|----------------------------|-----------|---------------------------|-----------|
|   | September                  | September | September                 | September |
|   | 28,                        | 30,       | 28,                       | 30,       |
|   | 2008                       | 2007      | 2008                      | 2007      |
|   | (in millions of dollars)   |           |                           |           |
| Net after-tax (losses) gains on cash flow hedging derivatives   | \$(40.6)                   | \$(2.5)   | \$21.7                    | \$2.3     |
| Reclassification adjustment of gains (losses) from accumulated other comprehensive income to income, net of tax | 6.6                        | 0.6       | 25.1                      | (.4)      |
| Hedge ineffectiveness losses recognized in cost of sales, before tax  | (.7)                       | (.7)      | (.1)                      | (.7)      |

- Net gains and losses on cash flow hedging derivatives were primarily associated with commodities futures contracts.
- Reclassification adjustments from accumulated other comprehensive income (loss) to income related to gains or losses on commodities futures contracts were reflected in cost of sales. Reclassification adjustments for gains on interest rate swaps were reflected as an adjustment to interest expense.
- We recognized no components of gains or losses on cash flow hedging derivatives in income due to excluding such components from the hedge effectiveness assessment.

The amount of net gains on cash flow hedging derivatives, including foreign exchange forward contracts, interest rate swap agreements and commodities futures contracts, expected to be reclassified into earnings in the next twelve months was approximately \$4.1 million after tax as of September 28, 2008. This amount was primarily associated with commodities futures contracts.

For more information, refer to the consolidated financial statements and notes included in our 2007 Annual Report on Form 10-K.

## 8. COMPREHENSIVE INCOME

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

|                                    | For the Three Months Ended September 28, 2008 |                      |            |
|------------------------------------|---|----------------------|------------|
|                                    | Pre-Tax                                       | Tax                  | After-Tax  |
|                                    | Amount  | (Expense)<br>Benefit | Amount     |
|                                    | (in thousands of dollars)                     |                      |            |
| Net income                         |   |                      | \$ 124,538 |
| Other comprehensive income (loss): |   |                      |            |

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|   |    |          |    |         |          |
|---|----|----------|----|---------|----------|
| Foreign currency translation adjustments  | \$ | (17,153) | \$ | —       | (17,153) |
| Pension and post-retirement benefit plans |    | 4,438    |    | (1,817) | 2,621    |
| Cash flow hedges:                         |    |          |    |         |          |
| Losses on cash flow hedging derivatives   |    | (62,646) |    | 22,090  | (40,556) |
| Reclassification adjustments              |    | (10,365) |    | 3,737   | (6,628)  |
| Total other comprehensive loss            | \$ | (85,726) | \$ | 24,010  | (61,716) |
| Comprehensive income                      |    |          |    | \$      | 62,822   |

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|   | For the Three Months Ended September 30, 2007 |                      |           |
|---|---|----------------------|-----------|
|   | Pre-Tax                                       | Tax                  | After-Tax |
|   | Amount  | (Expense)<br>Benefit | Amount    |
|   | (in thousands of dollars)                     |                      |           |
| Net income                                |   |                      | \$ 62,784 |
| Other comprehensive income (loss):        |   |                      |           |
| Foreign currency translation adjustments  | \$ 16,738                                     | \$ —                 | 16,738    |
| Pension and post-retirement benefit plans | (282)   | 111                  | (171)     |
| Cash flow hedges:                         |   |                      |           |
| Losses on cash flow hedging derivatives   | (3,970)                                       | 1,430                | (2,540)   |
| Reclassification adjustments              | (987)   | 353                  | (634)     |
| Total other comprehensive income          | \$ 11,499                                     | \$ 1,894             | 13,393    |
| Comprehensive income                      |   |                      | \$ 76,177 |

|   | For the Nine Months Ended September 28, 2008 |                      |            |
|---|--|----------------------|------------|
|   | Pre-Tax                                      | Tax                  | After-Tax  |
|   | Amount                                       | (Expense)<br>Benefit | Amount     |
|   | (in thousands of dollars)                    |                      |            |
| Net income                                |  |                      | \$ 229,250 |
| Other comprehensive income (loss):        |  |                      |            |
| Foreign currency translation adjustments  | \$ (17,248)                                  | \$ —                 | (17,248)   |
| Pension and post-retirement benefit plans | 9,362  | (3,778)              | 5,584      |
| Cash flow hedges:                         |  |                      |            |
| Gains on cash flow hedging derivatives    | 34,654                                       | (12,930)             | 21,724     |
| Reclassification adjustments              | (39,329)                                     | 14,189               | (25,140)   |
| Total other comprehensive loss            | \$ (12,561)                                  | \$ (2,519)           | (15,080)   |
| Comprehensive income                      |  |                      | \$ 214,170 |

|   | For the Nine Months Ended September 30, 2007 |                      |            |
|---|--|----------------------|------------|
|   | Pre-Tax                                      | Tax                  | After-Tax  |
|   | Amount                                       | (Expense)<br>Benefit | Amount     |
|   | (in thousands of dollars)                    |                      |            |
| Net income                                |  |                      | \$ 159,811 |
| Other comprehensive income (loss):        |  |                      |            |
| Foreign currency translation adjustments  | \$ 44,056                                    | \$ —                 | 44,056     |
| Pension and post-retirement benefit plans | 3,438  | (1,481)              | 1,957      |
| Cash flow hedges:                         |  |                      |            |
| Gains on cash flow hedging derivatives    | 3,677  | (1,338)              | 2,339      |
| Reclassification adjustments              | 639  | (217)                | 422        |
| Total other comprehensive income          | \$ 51,810                                    | \$ (3,036)           | 48,774     |
| Comprehensive income                      |  |                      | \$ 208,585 |



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

|   | September 28,<br>2008     | December 31,<br>2007 |
|---|---------------------------|----------------------|
|   | (in thousands of dollars) |                      |
| Foreign currency translation adjustments              | \$ 27,562                 | \$ 44,810            |
| Pension and post-retirement benefit plans, net of tax | (73,981)                  | (79,565)             |
| Cash flow hedges, net of tax                          | 3,360                     | 6,776                |
| Total accumulated other comprehensive loss            | \$ (43,059)               | \$ (27,979)          |

## 9. 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:

|                     | September 28,<br>2008     | December 31,<br>2007 |
|---------------------|---------------------------|----------------------|
|                     | (in thousands of dollars) |                      |
| Raw materials       | \$ 249,266                | \$ 199,460           |
| Goods in process    | 111,739                   | 80,282               |
| Finished goods      | 444,215                   | 407,058              |
| Inventories at FIFO | 805,220                   | 686,800              |
| Adjustment to LIFO  | (130,900)                 | (86,615)             |
| Total inventories   | \$ 674,320                | \$ 600,185           |

The increase in raw material inventories as of September 28, 2008 resulted from the timing of deliveries to support manufacturing requirements and higher prices in 2008. The increase in finished goods inventories was primarily associated with seasonal sales patterns.

## 10. 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. In December 2006, we entered into a five-year unsecured revolving credit agreement. The credit limit is \$1.1 billion with an option to borrow an additional \$400 million with the concurrence of the lenders. During the fourth quarter of 2007, the lenders approved a one-year extension to the term of this agreement in accordance with our option under the agreement. These funds may be used for general corporate purposes. The unsecured revolving credit agreement contains certain financial and other covenants, customary representations, warranties, and events of default. As of September 28, 2008, 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 2007 Annual Report on Form 10-K.

In August 2007, we entered into an unsecured revolving short-term credit agreement to borrow up to an additional \$300 million because we believed at the time that seasonal working capital needs, share repurchases and other business activities would cause our borrowings to exceed the \$1.1 billion borrowing limit available under our five-year credit agreement. We used the funds borrowed under this new agreement for general corporate purposes, including commercial paper backstop. Although the new agreement was scheduled to expire in August 2008, we elected to terminate it in June 2008 because we determined that we no longer needed the additional borrowing capacity provided by the agreement.

11. LONG-TERM DEBT

In May 2006, we filed a shelf registration statement on Form S-3 that registered an indeterminate amount of debt securities. This registration statement was effective immediately upon filing under Securities and Exchange Commission regulations governing “well-known seasoned issuers” (the “WKSI Registration Statement”). In March 2008, the Company issued \$250 million of 5.0% Notes due April 1, 2013 under the WKSI Registration Statement. The net proceeds of this debt issuance were used to repay a portion of the Company’s outstanding indebtedness under its short-term commercial paper program.

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## 12. 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 September 28, 2008 and December 31, 2007, because of the relatively short maturity of these instruments.

The carrying value of long-term debt, including the current portion, was \$1,527.4 million as of September 28, 2008, compared with a fair value of \$1,481.6 million, a decrease of \$45.8 million from the carrying value, based on quoted market prices for the same or similar debt issues, reflecting tight credit market conditions.

## Foreign Exchange Forward Contracts

The following table summarizes our foreign exchange activity:

|   | September 28, 2008       |                                   |
|---|--------------------------|-----------------------------------|
|   | Contract<br>Amount       | Primary Currencies                |
|   | (in millions of dollars) |                                   |
| Foreign exchange forward contracts to purchase foreign currencies | \$ 21.5                  | British pounds<br>Mexican pesos   |
| Foreign exchange forward contracts to sell foreign currencies     | \$ 110.3                 | Canadian dollars<br>Mexican pesos |

Our foreign exchange forward contracts mature in 2008 and 2009.

We define the fair value of foreign exchange forward contracts as the amount of the difference between contracted and current market foreign currency exchange rates at the end of the period. On a quarterly basis, we estimate the fair value of foreign exchange forward contracts by obtaining market quotes of spot and forward rates for contracts with similar terms, adjusted where necessary for maturity differences. We do not hold or issue financial instruments for trading purposes.

The total fair value of our foreign exchange forward contracts included in prepaid expenses and other current assets, accrued liabilities and non-current assets (liabilities), as appropriate, on the Consolidated Balance Sheets were as follows:

|  | September<br>28,<br>2008 | December<br>31,<br>2007 |
|--|--------------------------|-------------------------|
|  | (in millions of dollars) |                         |
| Fair value of foreign exchange forward contracts – asset (liability) | \$ 2.3                   | \$ (2.1)                |

## 13. FAIR VALUE ACCOUNTING

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (“SFAS No. 157”). SFAS No. 157 applies a consistent definition to fair value, establishes a framework for measuring fair value in U.S. generally accepted accounting principles (“GAAP”), and expands disclosures about fair value measurements.

SFAS No. 157 establishes a fair value measurement hierarchy to price a particular asset or liability. The fair value of the asset or liability is determined based on inputs or assumptions that market participants would use in pricing the asset or liability. These assumptions consist of (1) observable inputs - market data obtained from independent sources, or (2) unobservable inputs - market data determined using the company's own assumptions about valuation.

SFAS No. 157 establishes a fair value hierarchy to prioritize the inputs to valuation techniques, with the highest priority being given to Level 1 inputs and the lowest priority to Level 3 inputs, as defined below:

- Level 1 Inputs – quoted prices in active markets for identical assets or liabilities;
- Level 2 Inputs – quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar instruments in markets that are not active; inputs other than quoted prices that are observable; and inputs that are derived from or corroborated by observable market data by correlation; and
- Level 3 Inputs – unobservable inputs used to the extent that observable inputs are not available. These reflect the entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability.



In addition, SFAS No. 157 requires disclosures about the use of fair value to measure assets and liabilities to enable the assessment of inputs used to develop fair value measures, and for unobservable inputs, to determine the effects of the measurements on earnings.

Effective January 1, 2008, we partially adopted SFAS No. 157 and have applied its provisions to financial assets and liabilities that are recognized or disclosed at fair value on a recurring basis (at least annually). We have not yet adopted SFAS No. 157 for nonfinancial assets and liabilities, in accordance with FASB Staff Position 157-2, Effective Date of FASB Statement No. 157 ("FSP 157-2"). FSP 157-2 defers the effective date of SFAS No. 157 to January 1, 2009, for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed on a recurring basis.

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

A summary of our cash flow hedging derivative assets and liabilities measured at fair value on a recurring basis as of September 28, 2008, is as follows:

| Description                   | Fair Value as of<br>September 28,<br>2008 | Quoted Prices<br>in Active<br>Markets of<br>Identical<br>Assets (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 | \$ 4,715                                  | \$ 2,375  | \$ 2,340 | \$ — |  |  |
| Liabilities                   |   |   |          |      |  |  |
| Cash flow hedging derivatives | \$ 3,274                                  | \$ 3,274  | \$ —     | \$ — |  |  |

As of September 28, 2008, cash flow hedging derivative Level 1 assets were related to commodity options contracts and Level 2 assets were principally related to the fair value of foreign exchange forward contracts. 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.

As of September 28, 2008, cash flow hedging derivative liabilities were related to cash transfers payable on commodities futures contracts reflecting the change in quoted market prices on the last trading day for the period. We account for commodities futures contracts in accordance with SFAS No. 133. 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.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115 ("SFAS No. 159"). SFAS No. 159 permits entities to choose to measure many financial instruments and other items at fair value. The objective of SFAS No. 159 is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions.

As of January 1, 2008, we elected not to adopt the fair value option under SFAS No. 159 for any financial instruments or other items.

14. INCOME TAXES

During the first quarter of 2008, the U.S. Internal Revenue Service commenced its audit of our U.S. income tax returns for 2005 and 2006. It is reasonably possible that this audit will be completed in 2009, but it is not possible at this time to estimate the resolution and any possible refunds or payments.

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

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

|                                      | Pension Benefits           |                       | Other Benefits           |                       |
|--------------------------------------|----------------------------|-----------------------|--------------------------|-----------------------|
|                                      | For the Three Months Ended |                       |                          |                       |
|                                      | September 28,<br>2008      | September 30,<br>2007 | September<br>28,<br>2008 | September 30,<br>2007 |
|                                      | (in thousands of dollars)  |                       |                          |                       |
| Service cost                         | \$ 7,364                   | \$ 10,384             | \$ 438                   | \$ 816                |
| Interest cost                        | 14,902                     | 15,618                | 5,078                    | 5,482                 |
| Expected return on plan assets       | (26,910)                   | (29,659)              | —                        | —                     |
| Amortization of prior service cost   | 322                        | 262                   | (115)                    | (42)                  |
| Recognized net actuarial (gain) loss | (134)                      | (104)                 | —                        | 33                    |
| Administrative expenses              | 107                        | 74                    | —                        | —                     |
| Net periodic benefits (income) cost  | (4,349)                    | (3,425)               | 5,401                    | 6,289                 |
| Special termination benefits         | (2)                        | 40,690                | —                        | 652                   |
| Settlement                           | 4,458                      | —                     | —                        | —                     |
| Curtailment                          | —                          | 4,106                 | —                        | 22,733                |
| Total amount reflected in earnings   | \$ 107                     | \$ 41,371             | \$ 5,401                 | \$ 29,674             |

We made contributions of \$20.8 million and \$6.0 million to the pension plans and other benefits plans, respectively, during the third quarter of 2008. In the third quarter of 2007, we made contributions of \$1.4 million and \$5.3 million to our pension and other benefits plans, respectively. The contributions in 2008 and 2007 primarily reflected benefit payments from our non-qualified pension plans and post-retirement benefit plans.

In the third quarter of 2008, there was net periodic pension benefits income of \$4.4 million, compared with net periodic pension benefits income of \$3.4 million in the third quarter of 2007. The special termination benefits, settlement and curtailment losses recorded in the third quarter of 2008 and 2007 primarily related to the 2007 business realignment initiatives.

|                                      | Pension Benefits          |                       | Other Benefits        |                       |
|--------------------------------------|---------------------------|-----------------------|-----------------------|-----------------------|
|                                      | For the Nine Months Ended |                       |                       |                       |
|                                      | September 28,<br>2008     | September 30,<br>2007 | September 28,<br>2008 | September 30,<br>2007 |
|                                      | (in thousands of dollars) |                       |                       |                       |
| Service cost                         | \$ 22,128                 | \$ 32,350             | \$ 1,315              | \$ 3,165              |
| Interest cost                        | 44,801                    | 44,837                | 15,248                | 14,943                |
| Expected return on plan assets       | (80,818)                  | (86,801)              | —                     | —                     |
| Amortization of prior service cost   | 965                       | 1,389                 | (343)                 | (116)                 |
| Recognized net actuarial (gain) loss | (421)                     | 806                   | (2)                   | 1,008                 |
| Administrative expenses              | 286                       | 375                   | —                     | —                     |
| Net periodic benefits (income) cost  | (13,059)                  | (7,044)               | 16,218                | 19,000                |
| Special termination benefits         | 145                       | 46,856                | —                     | 652                   |
| Settlement                           | 9,301                     | —                     | —                     | —                     |
| Curtailment                          | —                         | 8,321                 | —                     | 41,595                |
| Total amount reflected in earnings   | \$ (3,613)                | \$ 48,133             | \$ 16,218             | \$ 61,247             |

We made contributions of \$24.6 million and \$17.9 million to the pension plans and other benefits plans, respectively, during the first nine months of 2008. In the first nine months of 2007, we made contributions of \$9.3 million and \$15.7 million to our pension and other benefits plans, respectively.

In the first nine months of 2008, there was net periodic pension benefits income of \$13.1 million, compared with net periodic pension benefits income of \$7.0 million in the first nine months of 2007. The increased net periodic pension benefits income primarily reflected lower service cost resulting from a reduction in employment levels under the global supply chain transformation program, offset somewhat by a lower expected return on plan assets in 2008. The special

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termination benefits, settlement and curtailment losses recorded during the first nine months of 2008 and 2007 primarily related to the 2007 business realignment initiatives.

For 2008, there are no significant minimum funding requirements for our pension plans. During the remainder of 2008, we anticipate contributions to our pension plans of \$2.0 million to \$5.0 million which includes benefit payments from our non-qualified plans.

For more information, refer to the consolidated financial statements and notes included in our 2007 Annual Report on Form 10-K.

## 16. SHARE REPURCHASES

### Repurchases and Issuances of Common Stock

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

|  | For the Nine Months Ended<br>September 28, 2008 |          |
|--|---|----------|
|  | Shares  | Dollars  |
|  | (in thousands)                                  |          |
| Shares repurchased in the open market under pre-approved share repurchase programs               | —   | \$ —     |
| Shares repurchased to replace Treasury Stock issued for stock options and incentive compensation | 1,470   | 55,354   |
| Total share repurchases  | 1,470   | 55,354   |
| Shares issued for stock options and incentive compensation                                       | (1,498)   | (48,829) |
| Net change   | (28)  | \$ 6,525 |

- In December 2006, our Board of Directors approved a \$250 million share repurchase program. As of September 28, 2008, \$100.0 million remained available for repurchases of Common Stock under this program.

## 17. PENDING ACCOUNTING PRONOUNCEMENTS

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), Business Combinations (“SFAS No. 141R”), and Statement of Financial Accounting Standards No. 160, Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51 (“SFAS No. 160”). Both of these new standards are effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. These standards significantly change the accounting for and reporting of future business combinations and noncontrolling interests (minority interests) in consolidated financial statements. We are required to adopt these standards on January 1, 2009 and are currently evaluating their impact on our consolidated financial statements upon adoption.

SFAS No. 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquired business. SFAS No. 141R also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

SFAS No. 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary and requires the noncontrolling interest to be reported as a component of equity. In addition, changes in a parent's ownership interest while the parent retains its controlling interest will be accounted for as equity transactions, and any retained noncontrolling equity investment upon the deconsolidation of a subsidiary will be initially measured at fair value. Disclosures that clearly identify and distinguish between the interests of the parent and the interests of noncontrolling owners will be required.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133 (“SFAS No. 161”). SFAS No. 161 requires enhanced disclosures about an entity's derivative and hedging activities. Entities will be required to provide enhanced disclosures about how and why an entity uses derivative instruments, how these instruments are accounted for, and how they affect the entity's financial position, financial performance and cash flows. This new standard is effective for

our Company as of January 1, 2009 and we are currently evaluating the impact on disclosures associated with our derivative and hedging activities.

In May 2008, the FASB issued Statement of Financial Accounting Standards No. 162, The Hierarchy of Generally Accepted Accounting Principles (“SFAS No. 162”). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. We do not expect any significant changes to our financial accounting and reporting as a result of the issuance of SFAS No. 162.

## 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 |                          |   |
|--|---|--------------------------|---|---------------------------|--------------------------|---|
|  | September<br>28,<br>2008                | September<br>30,<br>2007 | Percent<br>Change<br>Increase<br>(Decrease) | September<br>28,<br>2008  | September<br>30,<br>2007 | Percent<br>Change<br>Increase<br>(Decrease) |
|  | (in thousands except per share amounts) |                          |   |                           |                          |   |
| Net Sales                              | \$ 1,489.6                              | \$ 1,399.5               | 6.4%  | \$ 3,755.4                | \$ 3,604.5               | 4.2%  |
| Cost of Sales                          | 988.4                                   | 928.9                    | 6.4%  | 2,495.2                   | 2,390.4                  | 4.4%  |
| Gross Profit                           | 501.2                                   | 470.6                    | 6.5%  | 1,260.2                   | 1,214.1                  | 3.8%  |
| Gross Margin                           | 33.6%                                   | 33.6%                    |   | 33.6%                     | 33.7%                    |   |
| SM&A Expense                           | 272.4                                   | 229.8                    | 18.5%                                       | 789.0                     | 663.1                    | 19.0%                                       |
| SM&A Expense as a<br>percent of sales  | 18.3%                                   | 16.4%                    |   | 21.0%                     | 18.4%                    |   |
| Business<br>Realignment<br>Charge, net | 8.9                                     | 112.0                    | (92.1)%                                     | 34.7                      | 219.3                    | (84.2)%                                     |
| EBIT                                   | 219.9                                   | 128.8                    | 70.8%                                       | 436.5                     | 331.7                    | 31.6%                                       |
| EBIT Margin                            | 14.8%                                   | 9.2%                     |   | 11.6%                     | 9.2%                     |   |
| Interest Expense, net                  | 24.9                                    | 33.1                     | (24.6)%                                     | 72.9                      | 90.5                     | (19.5)%                                     |
| Provision for Income<br>Taxes          | 70.5                                    | 32.9                     | 114.1%                                      | 134.3                     | 81.4                     | 65.2%                                       |
| Effective Income Tax<br>Rate           | 36.1%                                   | 34.4%                    |   | 36.9%                     | 33.7%                    |   |
| Net Income                             | \$ 124.5                                | \$ 62.8                  | 98.4%                                       | \$ 229.3                  | \$ 159.8                 | 43.5%                                       |
| Net Income Per<br>Share-Diluted        | \$ 0.54                                 | \$ 0.27                  | 100.0%                                      | \$ 1.00                   | \$ 0.69                  | 44.9%                                       |

## Results of Operations – Third Quarter 2008 vs. Third Quarter 2007

## U.S. Price Increases

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

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

In August 2008, we announced an increase in wholesale prices across the United States, Puerto Rico and export chocolate and sugar confectionery lines. This price increase was effective immediately, and represented a weighted average 11 percent increase on our instant consumable, multi-pack and packaged candy lines. These changes



approximated a 10 percent increase over the entire domestic product line. We implemented these pricing actions to help partially offset significant increases in input costs, including raw materials, packaging, fuel, utilities and transportation.

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 the Company honors previous commitments to planned consumer and customer promotions and merchandising events subsequent to the effective date of the price increases. In addition, promotional allowances may be increased for certain products subsequent to the effective date, delaying or partially offsetting the impact of price increases on net sales.

#### Net Sales

Net sales for the third quarter of 2008 were higher than the comparable period of 2007 primarily due to favorable price realization and sales volume increases. An increase of approximately 2% was attributable to sales volume increases associated with the timing of shipments for the buy-in related to price increases announced in August 2008. Increases in core brand sales volume in the United States were substantially offset by volume decreases for snack and refreshment

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products. Sales volume increases for our international businesses, particularly in India, Brazil and the Philippines, also contributed to the sales increase in the quarter.

#### Key Marketplace Metrics

Consumer takeaway increased 4.0% during the third quarter of 2008 compared with the same period of 2007. 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 declined by 0.1 share points during the third quarter of 2008. The change in market share is provided for measured channels which include sales in the food, drug, convenience store and mass merchandiser classes of trade, excluding sales of Wal-Mart Stores, Inc.

#### Cost of Sales and Gross Margin

Cost of sales in the third quarter of 2008 was higher than 2007 primarily due to increased input and energy costs. Higher costs associated with sales volume increases also contributed to the cost of sales increase, partially offset by supply chain productivity. Business realignment charges of \$20.0 million were included in cost of sales in the third quarter of 2008 compared with \$37.5 million in the third quarter of 2007.

Gross margin was flat compared with the same period of 2007. A gross margin decline resulting from higher input and energy costs was only partially offset by favorable price realization and supply chain productivity. This decline in gross margin was offset by the impact of lower costs associated with business realignment initiatives in 2008 compared with 2007.

#### Selling, Marketing and Administrative

Selling, marketing and administrative expenses increased primarily as a result of administrative and selling expenses and higher advertising and consumer promotion expenses. Higher administrative and selling costs were principally associated with employee-related expenses reflecting increased levels of retail coverage in the United States, the expansion of our international businesses and incentive compensation. Incentive compensation costs increased in 2008 as compared to 2007 because of the impact of reduced performance expectations in the third quarter of 2007. Higher advertising and consumer promotion expenses related to increased core brand support also contributed to the increase. Expenses of \$2.2 million related to our 2007 business realignment initiatives were included in selling, marketing and administrative expense for the third quarter of 2008 compared with \$2.4 million recorded in the third quarter of 2007.

#### Business Realignment Initiatives

Business realignment charges of \$8.9 million were recorded in the third quarter of 2008 associated with the 2007 business realignment initiatives. The charges were primarily associated with employee separation, fixed asset impairment and plant closure expenses. Business realignment charges of \$112.0 million were recorded in the third quarter of 2007 primarily associated with employee separation costs.

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

EBIT increased substantially in the third quarter of 2008 compared with the third quarter of 2007 as a result of lower net business realignment charges. Excluding the impact of business realignment charges, the increase in gross profit was more than offset by higher selling, marketing and administrative expenses. Net pre-tax business realignment charges of \$31.0 million were recorded in the third quarter of 2008 compared with \$151.9 million recorded in the third

quarter of 2007, a decrease of \$120.9 million.

EBIT margin increased from 9.2% for the third quarter of 2007 to 14.8% for the third quarter of 2008. The impact of net business realignment charges in 2008 compared with the third quarter of 2007, increased EBIT margin by 8.9%. A decrease of 3.3% resulted from the lower gross margin and higher selling, marketing and administrative expense as a percentage of sales.

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### Interest Expense, Net

Net interest expense was lower in the third quarter of 2008 than the comparable period of 2007 primarily reflecting lower interest rates and lower average debt balances in 2008 compared with 2007.

### Income Taxes and Effective Tax Rate

Our effective income tax rate was 36.1% for the third quarter of 2008. The impact of tax rates associated with business realignment and impairment charges recorded during the quarter increased the effective income tax rate by 0.6 percentage points.

### Net Income and Net Income Per Share

Net income in the third quarter of 2008 was reduced by \$21.3 million, or \$0.10 per share-diluted, and in the third quarter of 2007 was reduced by \$94.4 million, or \$0.41 per share-diluted, as a result of net charges associated with our business realignment initiatives. After considering the impact of business realignment charges in each period, earnings per share-diluted in the third quarter of 2008 decreased \$0.04 as compared with the third quarter of 2007.

### Results of Operations – First Nine Months 2008 vs. First Nine Months 2007

#### Net Sales

The increase in net sales was attributable to favorable price realization from list price increases, substantially offset by sales volume decreases primarily in the United States. Sales volume increases from Godrej Hershey Ltd. and our other international businesses, increased sales from new products, the impact of the buy-in related to price increases announced in August and a favorable foreign currency exchange rate also contributed to the sales increase. The acquisition of Godrej Hershey Ltd. incrementally increased net sales by \$37.2 million, or 1.0%.

#### Key Marketplace Metrics

Consumer takeaway increased 2.3% during the first nine months of 2008. Consumer takeaway is provided for channels of distribution accounting for approximately 80% of our U.S. confectionery retail business. These channels of distribution include food, drug, mass merchandisers, including Wal-Mart Stores, Inc., and convenience stores.

Market share in measured channels declined by 0.6 share points during the first nine months of 2008. The change in market share is provided for measured channels which include sales in the food, drug, convenience store and mass merchandiser classes of trade, excluding sales of Wal-Mart Stores, Inc.

#### Cost of Sales and Gross Margin

The cost of sales increase in the first nine months of 2008 compared with 2007 was primarily associated with higher input and energy costs. Contributing to the increase was the Godrej Hershey Ltd. acquisition, offset slightly by favorable supply chain productivity. Lower business realignment charges included in cost of sales in 2008 compared with 2007 also partially offset cost of sales increases. Business realignment charges of \$60.1 million were included in cost of sales in the first nine months of 2008, compared with \$88.6 million in the prior year.

The gross margin decline was related to higher input and energy costs, partially offset by favorable price realization, and improved supply chain productivity. The gross margin decline was substantially offset by lower business realignment charges recorded in 2008 compared with 2007.

Selling, Marketing and Administrative

Selling, marketing and administrative expenses increased primarily as a result of administrative and selling expenses and higher advertising and consumer promotion expenses. Higher administrative and selling costs were principally associated with employee-related expenses including higher incentive compensation expense, expansion of our international businesses, including Godrej Hershey Ltd., and increased levels of retail coverage primarily in the United States. Expenses of \$6.1 million related to our 2007 business realignment initiatives were included in selling, marketing and administrative expenses in 2008 compared with \$8.7 million in 2007.

### Business Realignment Initiatives

Business realignment charges of \$34.7 million were recorded in the first nine months of 2008 compared with \$219.3 million in the same period of 2007. The charges in 2008 were primarily related to fixed asset impairment and plant closure expenses, in addition to employee separation costs, offset partially by gains on sales of fixed assets. Business realignment charges recorded in 2007 primarily related to employee separation costs, fixed asset impairments and the closure of manufacturing facilities, along with the termination of certain contracts.

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

EBIT increased in the first nine months of 2008 compared with the first nine months of 2007 as a result of lower net business realignment charges associated with our business realignment initiatives. Net pre-tax business realignment charges of \$101.0 million were recorded in the first nine months of 2008 compared with \$316.7 million recorded in the first nine months of 2007, a decrease of \$215.7 million. The increase in EBIT resulting from lower business realignment charges was substantially offset by higher selling, marketing and administrative expenses.

EBIT margin increased from 9.2% for the first nine months of 2007 to 11.6% for the first nine months of 2008. Lower net business realignment charges in 2008 improved EBIT margin by 6.1 percentage points. This impact was substantially offset by higher selling, marketing and administrative expense as a percentage of sales, along with a lower gross margin.

### Interest Expense, Net

Net interest expense was lower in the first nine months of 2008 than the comparable period of 2007 primarily due to lower interest rates in the first nine months of 2008 as compared with the same period of 2007.

### Income Taxes and Effective Tax Rate

Our effective income tax rate was 36.9% for the first nine months of 2008 and was increased by 0.8 percentage points as a result of the effective tax rate associated with business realignment charges recorded during the first nine months. We expect our effective income tax rate for the full year 2008 to be 36.0%, excluding the impact of tax benefits associated with business realignment charges during the year.

### Net Income and Net Income Per Share

Net income in the first nine months of 2008 was reduced by \$67.4 million, or \$0.30 per share-diluted, and in the first nine months of 2007 was reduced by \$197.9 million, or \$0.85 per share-diluted, as a result of net charges associated with our business realignment initiatives. After considering the impact of business realignment charges in each period, earnings per share-diluted in the first nine months of 2008 decreased \$0.24 as compared with the first nine months of 2007.

### Liquidity and Capital Resources

Historically, our major source of financing has been cash generated from operations. Domestic seasonal working capital needs, which typically peak during the summer months, generally have been met by issuing commercial paper. Commercial paper may also be issued from time to time to finance ongoing business transactions such as the repayment of long-term debt, business acquisitions and for other general corporate purposes. During the first nine months of 2008, cash and cash equivalents increased by \$6.4 million.

Global capital and credit markets, including the commercial paper markets, have recently experienced increased volatility and disruption. Despite this volatility and disruption, we have continued to have full access to the commercial paper market and to generate operating cash flow sufficient to meet our financing needs. We believe that our operating cash flow, together with our unsecured revolving credit agreement, lines of credit and other available debt financing, will be adequate to meet our operating, investing and financing needs in the foreseeable future, although there can be no assurance that continued or increased volatility and disruption in the global capital and credit markets will not impair our ability to access these markets on commercially acceptable terms.

Cash provided from operations, long-term borrowings, and proceeds from the sale of property, plant and equipment were sufficient to fund the repayment of short-term debt of \$137.6 million, dividend payments of \$197.2 million, and capital additions and capitalized software expenditures of \$211.1 million.

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Cash used by inventories decreased from \$128.6 million in 2007 to \$62.8 million in 2008 primarily due to the impact of reductions in inventory levels resulting from the global supply chain transformation program and other initiatives to reduce inventories.

Cash used by other assets and liabilities was \$193.3 million for the first nine months of 2008 compared with cash used of \$181.4 million for the same period of 2007. The increase in the amount of cash used by other assets and liabilities from 2007 to 2008 primarily reflected the impact of business realignment initiatives and the timing of payments for employee benefits.

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

Proceeds from the sale of manufacturing and distribution facilities under the global supply chain transformation program were \$77.2 million in the first nine months of 2008.

A receivable of approximately \$17.0 million was included in prepaid expenses and other current assets as of September 28, 2008 and \$17.7 million as of December 31, 2007 related to the recovery of damages from a product recall and temporary plant closure in Canada. The decrease primarily resulted from foreign currency exchange rate fluctuations. The product recall during the fourth quarter of 2006 was caused by a contaminated ingredient purchased from an outside supplier with whom we have filed a claim for damages and are currently in litigation.

Interest paid was \$87.7 million during the first nine months of 2008 versus \$116.0 million for the comparable period of 2007. The decrease in interest paid resulted primarily from the lower interest rate environment. Income taxes paid were \$116.0 million during the first nine months of 2008 versus \$145.2 million for the comparable period of 2007. The decrease in taxes paid in 2008 was primarily related to the impact of lower annualized taxable income in 2008.

The ratio of current assets to current liabilities increased to 1.1:1.0 as of September 28, 2008 from 0.9:1.0 as of December 31, 2007. The capitalization ratio (total short-term and long-term debt as a percent of stockholders' equity, short-term and long-term debt) was 78% as of September 28, 2008 and December 31, 2007.

Generally, our short-term borrowings are in the form of commercial paper or bank loans with an original maturity of three months or less. In December 2006, we entered into a five-year credit agreement establishing an unsecured revolving credit facility to borrow up to \$1.1 billion with the option to increase borrowings by an additional \$400 million with the concurrence of the lenders. During the fourth quarter of 2007, the lenders approved a one-year extension to the term of this agreement in accordance with our option under the agreement. We may use these funds for general corporate purposes.

In August 2007, we entered into an unsecured revolving short-term credit agreement to borrow up to an additional \$300 million because we believed at the time that seasonal working capital needs, share repurchases and other business activities would cause our borrowings to exceed the \$1.1 billion borrowing limit available under our five-year credit agreement. We used the funds borrowed under this new agreement for general corporate purposes, including commercial paper backstop. Although the new agreement was scheduled to expire in August 2008, we elected to terminate it in June 2008 because we determined that we no longer needed the additional borrowing capacity provided by the agreement.

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



## 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 2007 Annual Report on Form 10-K for information concerning the key risks to achieving future performance goals.

During the second quarter of 2008, we announced a new consumer-driven business model with a comprehensive approach to deliver sustainable growth over the coming years. Our financial targets include long-term consolidated net sales growth targets in the three to five percent range and increases in earnings per share-diluted, excluding items affecting comparability, at an annual rate of six to eight percent. Items affecting comparability include business realignment and impairment charges and credits, gains or losses on the sale of certain businesses, and certain other items. For more information on items affecting comparability refer to Management's Discussion and Analysis of Financial Condition and Results of Operations included in our 2007 Annual Report on Form 10-K.

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Our net sales growth will primarily leverage our core portfolio of brands in the United States. We expect to deliver focused, disciplined innovation by improving our price-value equation through package and product upgrades and merchandising improvements resulting in increased price realization. We also expect growth from our international businesses primarily in faster-growing emerging markets.

Increases in earnings per share-diluted, excluding items affecting comparability, will be realized through aggressive productivity improvements and increased price realization, as we face continued commodity market volatility over the next several years. We expect to continue our strong investment both in brand building and in emerging markets.

Our current business environment is characterized by significantly higher commodity costs and increased competitive activity. For the full year 2008, we expect increases in input costs versus 2007 of approximately \$110 million, reducing gross margin by over 200 basis points, substantially offset by improved price realization. We will also incur higher costs for increased investment in brand support and selling capabilities in the United States, while we are taking steps to enhance product innovation across our portfolio. We will continue to invest in key international markets, particularly China and India.

To offset higher input costs, we have increased the wholesale prices of our domestic confectionery line and are implementing aggressive productivity and cost savings initiatives in addition to those already underway as part of our global supply chain transformation program. During 2008, we announced two increases in the wholesale prices of our products, however, the impact of these increases on net sales will not be fully realized until early 2009 because the Company has honored previous commitments to planned consumer and customer promotions and merchandising events subsequent to the effective date of the price increases. Price increases and productivity improvements will only partly offset input cost increases and expenses associated with investment spending plans, resulting in lower EBIT and EPS, excluding items affecting comparability.

We expect consolidated net sales to grow 3% to 4% in 2008. We have introduced Hershey's Bliss™ and Starbucks® branded chocolates and Reese's Clusters packaged candy this year to more fully participate in the premium and trade-up segments of the chocolate category in the United States. For the remainder of the Americas, we expect increases in net sales from our businesses in Canada, Mexico, and Brazil, along with incremental sales from the Godrej Hershey Ltd. acquisition.

For 2008, we expect total pre-tax business realignment and impairment charges for our global supply chain transformation program and restructuring our business in Brazil to be in the range of \$135 million to \$145 million, excluding possible increases in pension settlement charges discussed below. We expect costs of approximately \$80 million to be included in cost of sales, primarily for accelerated depreciation, and approximately \$10 million to be included in selling, marketing and administrative expenses for project management and start-up costs. The remainder of these costs will be included in business realignment and impairment charges. Total charges associated with our business realignment initiatives in 2008 are expected to reduce earnings per share-diluted by \$0.39 to \$0.42.

As a result of higher input costs and increased investment in trade and consumer promotional programs and advertising, along with investment in our international businesses, we expect EBIT to decrease in 2008, excluding the impact of business realignment and impairment charges. We expect EBIT margin to decline due to investments in advertising, selling capabilities and building infrastructure for our international businesses.

Business realignment and impairment charges associated with our global supply chain transformation program and the restructuring of our business in Brazil will reduce net income and earnings per share-diluted in 2008. Excluding the impact of these business realignment initiatives, net income is expected to decline reflecting the increased investments in our businesses. As a result, earnings per share-diluted, excluding items affecting comparability, is expected to be towards the lower end of the \$1.85 to \$1.90 range for 2008.

A reconciliation of GAAP and non-GAAP items to the Company's earnings per share-diluted outlook is as follows:

|   | 2008        |
|---|-------------|
| Expected EPS-diluted in accordance with GAAP                          | \$1.43-1.51 |
| Total business realignment and impairment charges                     | \$0.39-0.42 |
| Non-GAAP expected EPS-diluted excluding items affecting comparability | \$1.85-1.90 |

We believe that the disclosure of non-GAAP expected EPS-diluted excluding items affecting comparability provides investors with a better comparison of expected year-to-year operating results.

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For 2009, we expect net sales growth of two to three percent. We expect unit sales volume to decline in the United States due to the elasticity effects of price increases which will result in higher everyday and promoted prices for consumers. The impact of the declines in unit sales volume is expected to be more than offset by price realization. We expect growth in net sales for our international business at rates greater than in the United States.

Considering the unprecedented increases in raw material prices and other input costs and the extreme volatility in market prices, we expect significant cost increases in 2009. We expect increases in input and energy costs in 2009 of approximately \$200 million to \$225 million compared with 2008. We also expect increased costs resulting from foreign currency exchange rates in 2009 and significantly higher pension expense primarily reflecting the impact of the substantial decline in financial markets on pension assets. Additionally, we plan to continue investment in advertising and consumer support for our core brands in the United States and in the development of our international businesses. We expect these increases to be offset by savings from our global supply chain transformation program, other productivity initiatives and our previously announced price realization initiatives. As a result of this business environment, in 2009 we expect only a modest increase in earnings per share-diluted, excluding items affecting comparability.

#### Outlook for Global Supply Chain Transformation Program

We expect total pre-tax charges and non-recurring project implementation costs for the global supply chain transformation program of \$550 million - \$575 million. This includes a projection for pension settlement charges required in accordance with Financial Accounting Standards Board Statement of Financial Accounting Standards No. 88, Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits (as amended) ("SFAS No. 88"). Pension settlement charges are non-cash charges for the Company. Such charges accelerate the recognition of pension expenses related to actuarial gains and losses resulting from interest rate changes and differences in actual versus assumed returns on pension assets. The Company normally amortizes actuarial gains and losses over a period of about 14 years.

The global supply chain transformation program charges recorded in 2007 and year-to-date in 2008 have included pension settlement charges in the amount of approximately \$19 million as employees leaving the Company under the program have been withdrawing lump sums from the defined benefit pension plans. An additional charge will occur in the fourth quarter of 2008 related to Hershey's hourly pension plan. These charges are included in the current global supply chain transformation program estimates of \$550 million - \$575 million.

In addition to the settlement charges reflected above, additional SFAS No. 88 pension settlement charges of up to \$75 million may be incurred depending on decisions of impacted salaried employees to withdraw funds during the balance of 2008 and of impacted hourly employees to withdraw funds in 2009. The amount of the potential charges has increased significantly because of recent declines in financial markets.

The likely range of possible additional charges for the fourth quarter of 2008 is zero to \$27 million. There will be no charge if withdrawals by salaried employees are below the SFAS No. 88 settlement threshold level and will be approximately \$27 million, based on current market conditions, if they are above the threshold level.

The likely range of possible additional charges for 2009 is zero to \$50 million. There would be no charge if withdrawals by hourly employees are below the SFAS No. 88 settlement threshold level and \$25 million to \$50 million, based on current market conditions, if they are above the threshold level.

#### 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

Our results could differ materially because of the following factors, which include, but are not limited to:

- Our ability to implement and generate expected ongoing annual savings from the initiatives to transform our supply chain and advance our value-enhancing strategy;
- Changes in raw material and other costs and selling price increases;
- Our ability to execute our supply chain transformation within the anticipated timeframe in accordance with our

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cost estimates;

- The impact of future developments related to the product recall and temporary plant closure in Canada during the fourth quarter of 2006, including our ability to recover costs we incurred for the recall and plant closure from responsible third parties;
- The impact of future developments related to the investigation by government regulators of alleged pricing practices by members of the confectionery industry, including risks of subsequent litigation or further government action;
- Pension cost factors, such as actuarial assumptions, market performance and employee retirement decisions;
- Changes in our stock price, and resulting impacts on our expenses for incentive compensation, stock options and certain employee benefits;
- Market demand for our new and existing products;
- Changes in our business environment, including actions of competitors, changes in consumer preferences and behavior, and the impact of economic and financial market conditions on our customers, suppliers, consumers and lenders;
- Changes in governmental laws and regulations, including taxes;
- Risks and uncertainties related to our international operations; and
- Such other matters as discussed in our Annual Report on Form 10-K for 2007.

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

The potential net loss in fair value of foreign exchange forward contracts of ten percent resulting from a hypothetical near-term adverse change in market rates was \$.2 million as of September 28, 2008 and December 31, 2007. 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 \$31.7 million as of December 31, 2007, to \$41.9 million as of September 28, 2008. 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, 4 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<br>Price Paid<br>per Share | (c) Total Number<br>of Shares<br>Purchased as Part<br>of Publicly<br>Announced 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) |
|---|---|--|---|---|
| June 30 through<br>July 27, 2008        | —   | \$ —                                   | —   | \$100,017   |
| July 28 through<br>August 24, 2008      | 45,010  | \$ 36.18                               | —   | \$100,017   |
| August 25 through<br>September 28, 2008 | 335,000                                       | \$ 37.73                               | —   | \$100,017   |
| Total                                   | 380,010                                       |  | —   |   |

## 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 September 28, 2008 and September 30, 2007. |
| 31.1              | Certification of David J. West, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                      |
| 31.2              | Certification of Humberto P. Alfonso, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                |
| 32.1*             | Certification of David J. West, Chief Executive Officer, and Humberto P. Alfonso, Chief Financial Officer, pursuant to Section           |



\*Pursuant to Securities and Exchange Commission Release No. 33-8212, this certification will be treated as “accompanying” this Quarterly Report on Form 10-Q and not “filed” as part of such report for purposes of Section 18 of the Exchange Act or otherwise subject to the liability of Section 18 of the Exchange Act, and this certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that the Company specifically incorporates it by reference.

SIGNATURES

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

THE HERSHEY COMPANY  
(Registrant)

Date: November 5, 2008 /s/Humberto P. Alfonso  
Humberto P. Alfonso  
Chief Financial Officer

Date: November 5, 2008 /s/David W. Tacka  
David W. Tacka  
Chief Accounting Officer

EXHIBIT INDEX

|              |  |
|--------------|--|
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| Exhibit 32.1 | Certification of David J. West, Chief Executive Officer, and Humberto P. Alfonso, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

