

HERSHEY CO
Form 10-Q
October 30, 2015

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended October 4, 2015

OR

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

For the transition period

from _____ to _____

Commission file number 1-183

THE HERSHEY COMPANY

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation
or organization)

100 Crystal A Drive, Hershey, PA
17033

(Address of principal executive offices)

(Zip Code)

717-534-4200

(Registrant's telephone number, including area code)

Not Applicable

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

23-0691590

(I.R.S. Employer Identification No.)

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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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 – 156,173,507 shares, as of October 23, 2015.

Class B Common Stock, \$1 par value – 60,619,777 shares, as of October 23, 2015.

THE HERSHEY COMPANY
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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

THE HERSHEY COMPANY
CONSOLIDATED STATEMENTS OF INCOME

(in thousands except per share amounts)

(unaudited)

	Three Months Ended		Nine Months Ended	
	October 4, 2015	September 28, 2014	October 4, 2015	September 28, 2014
Net sales	\$1,960,779	\$1,961,578	\$5,477,404	\$5,411,741
Costs and expenses:				
Cost of sales	1,068,715	1,101,441	2,949,089	2,962,640
Selling, marketing and administrative	500,306	485,097	1,469,861	1,379,843
Goodwill impairment	30,991	—	280,802	—
Business realignment charges	57,753	16,372	82,972	20,544
Total costs and expenses	1,657,765	1,602,910	4,782,724	4,363,027
Operating profit	303,014	358,668	694,680	1,048,714
Interest expense, net	46,967	20,773	85,046	62,792
Other (income) expense, net	9,409	(7,528)	4,328	1,448
Income before income taxes	246,638	345,423	605,306	984,474
Provision for income taxes	91,867	121,682	305,739	340,070
Net income	\$154,771	\$223,741	\$299,567	\$644,404
Net income per share – basic:				
Common stock	\$0.73	\$1.03	\$1.40	\$2.97
Class B common stock	\$0.66	\$0.94	\$1.27	\$2.68
Net income per share – diluted:				
Common stock	\$0.70	\$1.00	\$1.35	\$2.86
Class B common stock	\$0.66	\$0.94	\$1.28	\$2.67
Dividends paid per share:				
Common stock	\$0.583	\$0.535	\$1.653	\$1.505
Class B common stock	\$0.530	\$0.486	\$1.502	\$1.356

See Notes to Unaudited Consolidated Financial Statements.

THE HERSHEY COMPANY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)
(unaudited)

	Three Months Ended		Nine Months Ended	
	October 4, 2015	September 28, 2014	October 4, 2015	September 28, 2014
Net income	\$154,771	\$223,741	\$299,567	\$644,404
Other comprehensive income, net of tax:				
Foreign currency translation adjustments	(26,631)	(17,321)	(51,681)	(12,016)
Pension and post-retirement benefit plans	9,969	3,624	20,896	10,784
Cash flow hedges:				
(Losses) gains on cash flow hedging derivatives	(43,914)	(932)	21,023	26,849
Reclassification adjustments	(6,214)	(15,544)	(17,711)	(35,566)
Total other comprehensive loss, net of tax	(66,790)	(30,173)	(27,473)	(9,949)
Total comprehensive income	\$87,981	\$193,568	272,094	634,455
Comprehensive (gain) loss attributable to noncontrolling interests	(820)	—	2,111	—
Comprehensive income attributable to The Hershey Company	\$87,161	\$193,568	\$274,205	\$634,455

See Notes to Unaudited Consolidated Financial Statements.

THE HERSHEY COMPANY
CONSOLIDATED BALANCE SHEETS

(in thousands except share data)

	October 4, 2015 (unaudited)	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	\$343,913	\$374,854
Short-term investments	—	97,131
Accounts receivable – trade, net	760,789	596,940
Inventories	813,583	801,036
Deferred income taxes	99,628	100,515
Prepaid expenses and other	191,417	276,571
Total current assets	2,209,330	2,247,047
Property, plant and equipment, net	2,187,736	2,151,901
Goodwill	689,684	792,955
Other intangible assets	388,747	294,841
Other assets	155,123	142,772
Total assets	\$5,630,620	\$5,629,516
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$448,599	\$482,017
Accrued liabilities	807,621	813,513
Accrued income taxes	40,619	4,616
Short-term debt	687,981	384,696
Current portion of long-term debt	250,421	250,805
Total current liabilities	2,235,241	1,935,647
Long-term debt	1,830,186	1,548,963
Other long-term liabilities	504,972	526,003
Deferred income taxes	123,095	99,373
Total liabilities	4,693,494	4,109,986
Stockholders' equity:		
The Hershey Company stockholders' equity		
Preferred stock, shares issued: none at October 4, 2015 and December 31, 2014, respectively	—	—
Common stock, shares issued: 299,281,967 and 299,281,967 at October 4, 2015 and December 31, 2014, respectively	299,281	299,281
Class B common stock, shares issued: 60,619,777 and 60,619,777 at October 4, 2015 and December 31, 2014, respectively	60,620	60,620
Additional paid-in capital	771,074	754,186
Retained earnings	5,807,281	5,860,784
Treasury – common stock shares, at cost: 143,155,476 and 138,856,786 at October 4, 2015 and December 31, 2014, respectively	(5,665,708) (5,161,236
Accumulated other comprehensive loss	(383,935) (358,573
The Hershey Company stockholders' equity	888,613	1,455,062
Noncontrolling interests in subsidiaries	48,513	64,468
Total stockholders' equity	937,126	1,519,530
Total liabilities and stockholders' equity	\$5,630,620	\$5,629,516
See Notes to Unaudited Consolidated Financial Statements.		

THE HERSHEY COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)
(unaudited)

	Nine Months Ended	
	October 4, 2015	September 28, 2014
Operating Activities		
Net income	\$299,567	\$644,404
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	182,855	153,006
Stock-based compensation expense	39,989	41,759
Excess tax benefits from stock-based compensation	(22,966)	(46,222)
Deferred income taxes	(10,385)	(10,031)
Non-cash business realignment and impairment charges	283,469	13,340
Contributions to pension and other benefit plans	(45,187)	(41,446)
Loss on early extinguishment of debt	28,326	—
Write-down of equity investments	13,895	—
Changes in assets and liabilities, net of effects from business acquisitions and divestitures:		
Accounts receivable - trade	(186,156)	(217,114)
Inventories	(2,064)	(165,205)
Accounts payable and accrued liabilities	(55,890)	(23,053)
Other assets and liabilities	62,411	37,995
Net cash provided by operating activities	587,864	387,433
Investing Activities		
Capital additions	(220,782)	(214,259)
Capitalized software additions	(17,111)	(18,007)
Proceeds from sales of property, plant and equipment	1,184	655
Proceeds from sale of business	32,408	—
Equity investments in tax credit qualifying partnerships	(3,775)	—
Business acquisitions, net of cash and cash equivalents acquired	(218,654)	(362,447)
Sale (purchase) of short-term investments	95,316	(98,309)
Net cash used in investing activities	(331,414)	(692,367)
Financing Activities		
Net increase in short-term debt	336,851	381,352
Long-term borrowings	599,031	1,348
Repayment of long-term debt	(351,042)	(1,075)
Cash dividends paid	(353,070)	(325,156)
Exercise of stock options	63,623	100,526
Excess tax benefits from stock-based compensation	22,966	46,222
Contributions from noncontrolling interest	—	2,940
Purchase of noncontrolling interest	(38,270)	—
Repurchase of common stock	(567,480)	(542,643)
Net cash used in financing activities	(287,391)	(336,486)
Decrease in cash and cash equivalents	(30,941)	(641,420)
Cash and cash equivalents, beginning of period	374,854	1,118,508
Cash and cash equivalents, end of period	\$343,913	\$477,088
Supplemental Disclosure		
Interest paid (excluding loss on early extinguishment of debt in 2015)	\$71,124	\$73,002

Income taxes paid	\$256,610	\$278,775
See Notes to Unaudited Consolidated Financial Statements.		

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THE HERSHEY COMPANY
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(in thousands)
(unaudited)

	Preferred Stock	Common Stock	Class B Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Common Stock	Accumulated Other Comprehensive Loss	Noncontrolling Interests Subsidiaries	Total Stockholders' Equity
Balance, December 31, 2014	\$—	\$299,281	\$60,620	\$754,186	\$5,860,784	\$(5,161,236)	\$(358,573)	\$64,468	\$1,519,530
Net income					299,567				299,567
Other comprehensive income (loss)							(25,362)	(2,111)	(27,473)
Dividends:									
Common stock, \$1.653 per share					(262,019)				(262,019)
Class B common stock, \$1.502 per share					(91,051)				(91,051)
Stock-based compensation				38,227					38,227
Exercise of stock options and incentive-based transactions				7,896		63,008			70,904
Repurchase of common stock						(567,480)			(567,480)
Impact of reclassification to and purchase of redeemable noncontrolling interest				(29,235)				(13,428)	(42,663)
Income attributed to noncontrolling interest								(416)	(416)
Balance, October 4, 2015	\$—	\$299,281	\$60,620	\$771,074	\$5,807,281	\$(5,665,708)	\$(383,935)	\$48,513	\$937,126

See Notes to Unaudited Consolidated Financial Statements.

THE HERSHEY COMPANY

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(amounts in thousands, except share data or if otherwise indicated)

1. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The unaudited consolidated financial statements provided in this report include the accounts of The Hershey Company (the “Company,” “Hershey,” “we” or “us”) and our majority-owned subsidiaries and entities in which we have a controlling financial interest after the elimination of intercompany accounts and transactions. We have a controlling financial interest if we own a majority of the outstanding voting common stock and the noncontrolling shareholders do not have substantive participating rights, or we have significant control over an entity through contractual or economic interests in which we are the primary beneficiary.

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial reporting and with the rules and regulations for reporting on Form 10-Q. Accordingly, they do not contain certain information and disclosures required by GAAP for comprehensive financial statements. Our significant interim accounting policies include the recognition of a pro-rata share of certain estimated annual amounts primarily for raw material purchase price variances, advertising expense, incentive compensation expenses and the effective income tax rate. We have included all adjustments (consisting only of normal recurring accruals) that we believe are considered necessary for a fair presentation.

Operating results for the quarter ended October 4, 2015 may not be indicative of the results that may be expected for the year ending December 31, 2015 because of seasonal effects on our business. These financial statements should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2014 (our “2014 Annual Report on Form 10-K”), which provides a more complete understanding of our accounting policies, financial position, operating results and other matters.

Other (Income) Expense, net

In the second quarter of 2015, we began presenting a new non-operating “other (income) expense, net” classification to report certain gains and losses associated with activities not directly related to our core operations. For the three and nine month periods ended September 28, 2014, we reclassified from selling, marketing and administrative expenses to other (income) expense, net total net gains of \$7,528 and net losses of \$1,448, respectively, to conform to the current year presentation. After considering these reclassifications, amounts reflected in other (income) expense, net include the following:

	Three Months Ended		Nine Months Ended	
	October 4, 2015	September 28, 2014	October 4, 2015	September 28, 2014
Gain on sale of non-core trademark	\$—	\$—	\$(9,950)	\$—
Write-down of equity investments in partnerships qualifying for tax credits (see Note 13)	9,249	—	13,893	—
Foreign currency exchange (gain) loss relating to strategy to cap Shanghai Golden Monkey acquisition price as denominated in U.S. dollars	—	(7,565)	—	5,544
Gain on acquisition of controlling interest in Lotte Shanghai Food Company	—	—	—	(4,628)
Other losses, net	160	37	385	532
Total	\$9,409	\$(7,528)	\$4,328	\$1,448

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU No. 2014-09 will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard was originally effective for us on January 1, 2017; however, in July 2015 the FASB decided to defer the effective date by

one year. Early application is not permitted, but reporting entities may choose to adopt the standard as of the original effective date. The standard permits the use of either the retrospective or cumulative effect transition method. We are currently evaluating the effect that ASU No. 2014-09 will have on our consolidated financial statements and related disclosures, our transition date and transition method.

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THE HERSHEY COMPANY

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(amounts in thousands, except share data or if otherwise indicated)

In April 2015, the FASB issued ASU No. 2015-03, Interest - Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs. ASU No. 2015-03 requires that debt issuance costs related to a recognized debt liability be presented in the

balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts.

This ASU is effective for fiscal years, and interim periods within those fiscal years beginning after December 15, 2015. Retrospective application is required and early adoption is permitted. The adoption of ASU No. 2015-03 is not expected to have a significant impact on our consolidated financial statements or related disclosures.

No other new accounting pronouncement issued or effective during the fiscal year had or is expected to have a material impact on our consolidated financial statements or related disclosures.