In Hershey's Possible Cadbury Bid, a School's Fate

By **SEAN SCULLY / PHILADELPHIA** Tuesday, Dec. 15, 2009

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Chocolate moves down the production line at the Cadbury factory in Birmingham, England

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As leaders of candymaker Hershey conduct their quiet deliberations as to whether to buy British company Cadbury, one thing is certain: their thoughts will be guided not so much by the financial interests of billionaire investors, hedge funds or even individual shareholders as they will by the fate of 1,800 poor children living on a former farm in rural Pennsylvania.

Unlike most companies, particularly foodmaker Kraft, which is also considering a bid for Cadbury, Hershey is controlled not by investors but by a charitable trust, established a century ago by company founder Milton Hershey to fund the education of orphans. The Hershey Trust, which holds 80% of the voting stock of the candy company, runs the Milton Hershey School not far from the corporate headquarters in central Pennsylvania, and it is required to maintain it in perpetuity.

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Neither the company nor the trust will talk specifically about the possibility of a bid for Cadbury, a decision that appears imminent, but they acknowledge that the needs of the school put the business decisions of the company in an unusual context. Dividends from the candy-company stock provide about 44% of the funding for the school.

"The trust is keenly interested in the performance of all its assets," trust spokesman Tim Reeves said, "but it's looking at that performance not just from the perspective of the next quarter but literally for the next quarter century and the next 100 years."

Milton Hershey and his wife Catherine, who never had any children of their own, founded the school in 1909, originally to serve orphaned boys. In 1918, after his wife's death, Hershey gave his entire personal fortune, about $60 million, to the school, then known as the Hershey Industrial School.

The school has evolved into a coeducational K-12 school, said to be the largest of its kind in the world, serving children from low-income families, particularly those in social need, which the school defines as coming from families afflicted with addiction, mental or physical illness, or incarceration. The majority of

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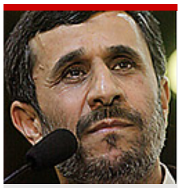

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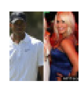

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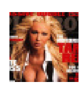

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students on the 2,600-acre (1,000 hectare) campus are from Pennsylvania, although it accepts students nationwide.

The school now has assets worth more than $6 billion, but the prize of its collection is the huge bloc of stock in the Hershey company.

Several of the historic food companies in the U.S., including Kellogg's and Campbell's Soup, have associated charitable trusts that own some stock, but none come close to rivaling Hershey in terms of the close financial entanglement of the company and the founder's philanthropic foundation.

After a series of bad years for Hershey, however, the trust board briefly toyed in 2007 with the idea of selling its stock to Wrigley, famous for its chewing-gum brand, but backed down within hours of closing the deal. State and federal authorities had tried to block the sale, in part because of concerns about the size of a combined Wrigley-Hershey company. Residents of the town of Hershey, meanwhile, expressed outrage and even convinced a local judge to delay the sale, saying it would cause "irreparable harm" to the community.

Board members had argued the sale was necessary to diversify the school's funding base, since slumping profits at the candy company could have far-reaching effects on the school's funding. The failure of that sale appears to have led the trust board to take a stronger role in the direction of the Hershey company, leading quickly to the resignation of CEO and Chairman Richard H. Lenny. Weeks later, the trust board forcibly replaced six of the 11 Hershey board members.

"They were realizing that consolidation was going to be playing out — was already playing out — in the global confectionary marketplace," research analyst Alexia Howard of Sanford Bernstein said. "The trust wanted to make certain that during that period, when the company was making big decisions about how this would play out, they wanted to be in more direct control of the company."

The possible purchase of Cadbury, a famous British candy brand, has been on the trust board's agenda ever since. The two companies already had a relationship, with Hershey acting as Cadbury's U.S. distributor. Cadbury had even considered buying Hershey when the trust first put it up for sale.

A merger now would give U.S.-focused Hershey an international presence to compete with powerhouse rivals such as Mars Inc., which recently merged with Hershey's would-be suitor Wrigley. It would also give Hershey a firmer foothold to compete in the chewing-gum market, since Cadbury owns a number of brands, including Trident, Dentyne and Chiclets.

But long-term consequences of such a merger will weigh heavily on the trust-board members since they must consider how it will affect their bottom line far into the future. Outbidding Kraft for Cadbury would force the company to take on a mountain of debt, analysts say, which could damage Hershey's strong credit rating. And raising that money could force the company to issue new stock, potentially diluting the control the trust enjoys.

That they are even considering such a deal shows that the trust-board members are looking past the immediate debt implications to the distant future of Hershey, Howard said.

"They're clearly thinking about the longer-term strategic landscape, where this is going to take the company," she said, "even if it ends up being a massive financial stretch in the near term."

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