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Corrections

In discussing The Hershey Co.'s possible acquisition of the larger British candy company Cadbury PLC, Robert J. **Chalfin**, a lecturer in management at the University of Pennsylvania's Wharton School, said he lacked sufficient data to comment on the success rate of a smaller company taking over a larger one. However, he said there is data supporting the success rate of "strategic" and "synergistic" mergers that could apply to the Hershey-Cadbury deal. A story on Page A1 of Sunday's editions was unclear.

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Hershey tries to keep trust of public

As The Hershey Co. considers a bid for Cadbury, the company and its controlling trust are working to avoid the mistakes of its aborted '02 sale.

Sunday, November 29, 2009

BY JOHN LUCIEW

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The Hershey Trust's pursuit of Cadbury is being guided by hard lessons from its embarrassing, aborted attempt to sell off The Hershey Co. in 2002.

Since the first rumor swirled of Hershey's possible interest in the British chocolate giant back in September, the trust's officials clearly signaled their intent to retain control of the candy company bequeathed to it by Milton Hershey to provide for disadvantaged children through the Milton Hershey School in Derry Twp.

Along with that local control, the trust wants to keep Hershey headquartered in Derry Twp. and preserve its employment and manufacturing footprint there, according to sources with knowledge of the trust.

And if the trust pushes The Hershey Co. to follow up its interest in Cadbury with a bid to rival Kraft Foods' \$16.4 billion formal offer, it would do so with the informed consent of state Attorney General Tom Corbett, whose office is charged with regulating charitable trusts.

In the wake of the trust's bungled attempt to sell its Hershey stake and the resulting resignations of trust board members in 2002, it was no coincidence that a former attorney general, LeRoy S. Zimmerman, was installed as the trust chairman. The miscommunications and changing political winds that put the trust at odds with then-Attorney General and GOP gubernatorial candidate Mike Fisher over the aborted 2002 sale were not to be repeated.

"There was a push from the AG's office to diversify. That was the push, and the board at the time thought that's what they had to do," David Black, the president and CEO of the Harrisburg Regional Chamber, said of Hershey's aborted sale.

"The sentiment of the community was greatly against this, and they learned lessons from that," Black said. "They learned there's a public trust with the Hershey entities. They are very much a part of central Pennsylvania. This time, it's The Hershey Co., and it will remain The Hershey Co."

Trust officials have refused to publicly discuss any aspect of The Hershey Co.'s possible play for Cadbury.

Trust spokesman Tim Reeves also would not comment. But Reeves has repeatedly pointed to Zimmerman's public pronouncements about the trust's desire to retain control of Hershey "in perpetuity" while prodding the domestically trapped candy company to grow internationally as the trust's guiding strategic principles.

While any bid for Cadbury would be made by The Hershey Co., not the trust, Kevin Harley, a spokesman for Corbett, said the attorney general's office would scrutinize the deal's impact on the trust's biggest asset -- its Hershey Co. holdings.

The trust, with roughly \$7 billion in assets, has about 30 percent of Hershey's outstanding shares and controls nearly 80 percent of the company's voting shares.

"It is a unique situation with the trust," Harley said. "Our role is in regard to the trust, not the business decisions of The Hershey Co. We would monitor any transaction to make sure the assets and the mission of the trust are protected."

On Tuesday, Harley said that no bid had been presented for review. But The Wall Street Journal, citing people familiar with the trust, reported that the trust has sought the attorney general's blessing for such a bid.

"They haven't given us anything to look at," Harley said of Hershey Trust officials. "If it comes to that point, we will review it."

By committing itself to controlling The Hershey Co. "in perpetuity," the trust is the ultimate long-term investor. As such, Zimmerman has enumerated the trust's vested interest in Hershey's shoring up a much bigger presence in rapidly expanding international markets.

Hershey derives more than 85 percent of its sales from the huge but slower-growing U.S. candy market.

Acquiring Cadbury, with its European sweep and its strong presence in India, would change Hershey's global footing.

'Sexier' combination

But can Hershey, the smallest player in what could shape up as a bidding war for Cadbury, outbid Kraft, the No. 2 global food company, for the iconic British chocolate maker, which itself is bigger than Hershey?

Moreover, does Hershey have the muscle to then dictate control of the merged entity?

The scenario is a reversal of the typical corporate takeover, in which the bigger fish swallows the smaller one. Yet some experts think it could work.

Hershey and Cadbury have a long relationship, with Hershey licensed to make and market the famous Cadbury eggs and other products in the U.S. And the two companies have entertained past overtures about a possible combination.

"They've been having these talks for years," said Robert J. Chalfin, a lecturer in management at the University of Pennsylvania's Wharton School and a principal in a New Jersey-based investment firm.

"It's not a relationship that was conceived in the past few weeks," he said.

In addition, a few Cadbury officials have been sending public signals that they view a pairing with another confectioner, such as Hershey, as much more palatable than a takeover by a Kraft conglomerate famous for its macaroni and cheese.

"With both of them being confectionery companies, that would be a sexier and faster-growing combination," said a New York investment banker who has been monitoring the Hershey-Cadbury courtship.

"Cheese and candy is a less appetizing combination," he added, noting Kraft's tighter margins and slower growth.

As for Hershey's size disadvantage, it might not be a prohibitive handicap when it comes to pursuing Cadbury.

Because there is so little overlap between the manufacturing and marketing footprints of the two companies, their pairing would be more complementary and less about compression and consolidation.

"Cadbury is a pretty good fit with Hershey," said Standard & Poor's equity analyst Tom Graves.

Constraints of debt

On the other hand, there could be far less cost savings to be squeezed out of a Hershey-Cadbury combination, perhaps making it harder for Hershey to justify a \$17 billion bid and the resulting heavy debt load.

"This would be more of a strategic or synergistic merger," Chalfin said. "Those deals can work. I don't know if I have enough data to say that they work just as well."

Debt from the deal could be Hershey's biggest obstacle -- both in terms of managing the merged entity and getting the proposal past Corbett, a Republican soon to be enmeshed in a governor's race of his own.

Financial analysts warned that Hershey would have trouble maintaining its credit rating if it took on more than \$4 billion in debt to swing a deal.

"They are not free to do whatever they want," Edward Jones analyst Jack Russo said of Hershey. "They have a fairly leveraged balance sheet, and they would be somewhat constrained by how much debt they can take on."

A former CEO of a Pennsylvania-based international company said affordability should be Hershey's first criterion in evaluating the prudence of any bid for Cadbury, given the challenges of managing a company that's "piled up with debt."

"They want to be the biggest [candy company] in the world," said the former CEO, who navigated numerous acquisitions but asked that his name not be used. "Well, you already are [among] the biggest in the U.S. What's wrong with that?"

For example, Hershey's stock, sure to drop in price the moment it announces a bid for Cadbury, could be stagnant for years if it can't successfully manage the resulting debt.

"They are taking on more risk," Chalfin said. "The decision is, is the risk worth the additional opportunities they are going to get?"

Several analysts speculated that iconic products such as Kit Kat and Rolo could be sold off to help Hershey finance a deal.

Jon Cox, an analyst at Kepler Capital Markets, said that the American licenses for Kit Kat and Rolo would raise less than \$1 billion, most likely from Swiss-held Nestle looking to regain global rights to Kit Kat. Others said that Nestle could also buy up Cadbury's Trident gum business in a Hershey breakup bid for Cadbury. Opportunity for diversity

With all the speculation focused on whether Hershey and Cadbury will make a deal, there's been scant attention to what the combination would look like and how it would operate, integrate and interact.

"The fundamental question is what does the beast look like when [the deal] is done," said the former Pennsylvania CEO. "It's either a camel with four humps or it isn't."

Experts said ego and emotion often trump pragmatics when once-competing corporate cultures collide.

"The downside is if the business mission is not clear to everyone, and there is a lot of internal acrimony as opposed to a focus on growing the business," Chalfin said.

But Black said both Hershey and central Pennsylvania would be richer if these two very different candy companies combine.

"We live in an international market, and that's not necessarily a bad thing," Black said.

"It brings diversity to our region, and it helps our companies compete in the global marketplace," he said. "You can't just sell candy bars in the U.S. when there is a huge international market out there. The days of burying our heads in the sand are over."

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