**THE HERSHEY COMPANY**

**ACCT 665**

**FINANCIAL STATEMENT ANALYSIS**

**SPRING 2023**

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# **PART 1: GENERAL INFORMATION**

## **SECTION 1: PROJECT QUESTIONS**

**1 | Who founded Hershey; and when, where, and what was the founders’ Philosophy?**

Hershey’s was established by Milton S. Hershey on February 9th, 1894, in Hershey, Pennsylvania. This business is governed by Delaware law.

Establishing parks, schools, churches, housing for laborers, and a school for orphaned boys was part of the founder's concept. His goal was to combine social responsibility with sound commercial practices to create a perfect American town. And he visioned to finance this goal by Hershey's success.

**2 | What does Hershey do?**

Hershey's is a confectionary and non-confectionary company primarily focused on chocolates and other products such as sweets, mints, and salty snacks.

Their strategy is to diversify product ranges by acquiring and merging with companies that offer salty snacks and healthy goods.

**3 | What is the average age of Hershey’s executive officers, including the gender ratio, and the average time employed by the company?**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Name** | **Gender** | **Time employed by the company** | **Title** | **Age** |
| Deepak Bhatia | Male | 1 | Senior Vice President, Chief Technology Officer | 50 |
| Michele G. Buck | Female | 19 | Chairman of the Board, President and Chief Executive Officer | 62 |
| Rohit Grover | Male | 25 | President, International | 51 |
| Jennifer L. McCalman | Female | 5 | Vice President, Chief Accounting Officer | 46 |
| Charles R. Raup | Male | 15 | President, U.S. Confection | 56 |
| Jason R. Reiman | Male | 28 | Senior Vice President, Chief Supply Chain Officer | 52 |
| Kristen J. Riggs | Female | 19 | President, Salty Snacks | 45 |
| Christopher M. Scalia | Male | 19 | Senior Vice President, Chief Human Resources Officer | 48 |
| James Turoff | Male | 10 | Senior Vice President, General Counsel and Secretary | 47 |
| Steven E. Voskuil | Male | 5 | Senior Vice President, Chief Financial Officer | 55 |

The average age of Hershey's executive officers is 51 years, reflecting their extensive experience, which can be beneficial to the company. Currently, 3 out of the 10 board members are women, making up approximately 30%, while 70% are men. The average tenure of the executive officers at the company is 15 years, indicating that they have been highly familiar with the company.

**4 | Why is Hershey located in Hershey, Pennsylvania?**

Pennsylvania is attractive because of its easy access to fresh milk supplied locally. The state has an extensive transportation network that dates back to the 20th century. Because of its proximity to important urban centers like New York City, Philadelphia, Baltimore, and Washington, D.C., the network is especially useful for distributing goods and facilitating distribution.

The region's appeal is further increased by the availability of a strong labor force. Another reason was the American-German population and there is a strong work ethic that would bring value to the company. Furthermore, Pennsylvania has historically had a regulatory environment that supports manufacturing, with laws that encourage investment and industrial growth.

**5 | How many reportable segments does Hershey have and what are they?**

There are three reportable segments in Hershey, which are North America Confectionary, North America Salty Snacks and International. Attached below are Net Sales and Income for each segment in 2023.

|  |  |  |
| --- | --- | --- |
| **Segment** | **Net Sales (million)** | **Income (million)** |
| North America Confectionary | $9,123.1 | $3,117.00 |
| North America Salty Snacks | $1,092.70 | $158.30 |
| International | $949.20 | $148.30 |

It is clear that Hershey's North America Confectionery led with 81.7% of sales and 91% of income in 2023. North America Salty Snacks had 9.8% of sales, 4.6% of income, and International had 8.5% of sales, 4.3% of income.

**6 | What acquisitions and divestitures have been made by Hershey in the last three years?**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Date** | **Company** | **Type** | **Goodwill & Intangible Assets** | **Purchase Consideration** |
| May 31,2023 | Weaver popcorn manufacturing,Inc. | Acquisition | $85,231,000 | $165,818,000 |
| December 14,2021 | Pretzels Inc. | Acquisition | $166,191,000 | $304,334,000 |
| December 13 , 2021 | Dot’s Pretzels,LLC | Acquisition | $284,427,000 | $891,169,000 |
| June 2025, 2021 | Lily’s Sweets,LLC | Acquisition | $175,826,000 | $427,210,000 |
| January 2021 | Lotte Shanghai Foods Co. | Divestiture |  |  |

**7 | What are Hershey’s principal products?**

Hershey’s principal product is chocolate, accounting for 80-90% of their offerings, including brands like Hershey's, Reese's, and Kisses. They also offer non-chocolate candies like Jolly Rancher, protein bars such as ONE, and snacks like Skinny Pop popcorn and Dot’s Homestyle Pretzels.

**8 | What are Hershey’s principal markets?**

Hershey's **principal markets** encompass a wide variety of **retail and wholesale outlets**, primarily within North America and across various international locations. The Company’s customers mainly are wholesale distributors, chain grocery stores, mass merchandisers, chain drug stores, vending companies, wholesale clubs, convenience stores, dollar stores, concessionaires, and department stores.

Key customer is **McLane Company, Inc.**, which alone accounts for about 28% of Hershey's net sales and serves as a primary distributor to Wal-Mart. This is a good approach as a significant partnership can maintain stable sales volumes. But it also involves some risks if this relationship is jeopardized, or market dynamics shift significantly towards online sales.

**9 | What is Hershey’s principal geographical area?**

Just focus on the principal geographical area which is US, and the number associated with US, instead of the international segment

Hershey’s **main operations and markets** are predominantly located in the United States. With its concentration on the US market, Hershey can benefit from deep market familiarity and operational efficiencies. To be more specific, The Company derived about 87.5% of its net sales from domestic customers in 2023. Additionally, approximately 82% of its long-lived assets were inside the United States as of December 31, 2023.

**10 | What is the status of Hershey’s ESG effort?**

Hershey is committed to environmental, social, and governance (ESG) initiatives through its Shared Goodness Promise. The company focuses on **sustainability efforts** such as reducing greenhouse gas emissions and making all plastic packaging recyclable, reusable, or compostable by 2030. Hershey also emphasizes **diversity and equitable pay**, maintaining 1:1 gender and racial pay equity for salaried employees in the U.S. The company actively participates in **community investment** and has established the Milton Hershey School for disadvantaged children.

**11 | What do you consider the five major risk factors for Hershey?**

1. Economic factors like inflation and supply chain disruptions can also impact costs and efficiency.
2. Maintaining a strong brand image is crucial, and labor issues within the supply chain can pose significant risks.
3. A shortage of cocoa, a key ingredient, could lead to main product shortages and affect production.
4. Regulatory changes across different regions could impose new costs and constraints on operations.
5. Environmental changes and sustainability pressures could influence regulatory requirements and corporate reputation.

**12 | How many manufacturing centers does Hershey use, and how many distribution centers do Hershey use?**

Hershey operates **13 manufacturing centers** with 10 of them in the US. Major manufacturing facilities are in states such as Pennsylvania and Virginia, as these states are well-known for their developed agriculture industry, and significant labor workforce. Hershey also uses **7 distribution centers** with 6 in the US, and 1 in Canada. Several are placed across the United States, including Pennsylvania, Illinois, and Utah. Both manufacturing and distribution facilities support Hershey’s extensive product portfolio and market reach.

|  |  |
| --- | --- |
| **Location** | **Type** |
| Hershey, Pennsylvania (2 principal plants) | Manufacturing—confectionery products and pantry items |
| Lancaster, Pennsylvania | Manufacturing—confectionery |
| Hazleton, Pennsylvania | Manufacturing—confectionery |
| Robinson, Illinois | Manufacturing—confectionery |
| Stuarts Draft, Virginia | Manufacturing—confectionery products and pantry items |
| Edgerton, Kansas | Manufacturing—salty snack products |
| Bluffton, Indiana | Manufacturing—salty snack products |
| Plymouth, Indiana | Manufacturing—salty snack products |
| Lawrence, Kansas | Manufacturing—salty snack products |
| Whitestown, Indiana | Manufacturing—salty snack products |
| Annville, Pennsylvania | Distribution |
| Palmyra, Pennsylvania | Distribution |
| Edwardsville, Illinois | Distribution |
| Ogden, Utah | Distribution |
| Kennesaw, Georgia | Distribution |
| Whitestown, Indiana | Distribution |
| Hershey, Pennsylvania | Corporate administrative |
| New York, New York | Retail |

**13 | Are there any major legal proceedings against the Hershey Company?**

Hershey does not have any major legal proceedings against The Company as of now. Hershey’s current legal problems are typically normal business issues that are not expected to have a material effect on Hershey’s financial health.

**14 | What were the significant audit issues in 2023 and were they resolved?**

The only critical audit issue in 2022 for Hershey was **valuation of accrued liabilities for trade promotions**. This involved estimating costs like discounts and rebates, which was unsettled and complicated due to the subjective judgments required. These judgements can be based on several factors such as customer engagement and historical sales trends.

The **audit resolved this issue** by testing the effectiveness of internal controls, reviewing the completeness and accuracy of promotional activities on the estimation process. These methodologies include sensitivity analyses of significant assumptions, historical trends, and third-party data comparisons.

**15 | How did Hershey perform in the first quarter of 2024?**

In the first quarter of 2024, The Hershey Company reported strong financial performance with the financial results summary as below:

* Consolidated net sales of $3,252.7 million, an increase of 8.9%.
* Organic, constant currency net sales increased 8.6%.
* Reported net income of $797.5 million, or $3.89 per share-diluted, an increase of 36.5%.
* Adjusted earnings per share-diluted of $3.07, an increase of 3.7%.

**16 | Who won The Hershey High School vs. The Hershey School football game in 1945?**

In accordance with the founder’s philosophy on community development, the Cocoa Bean Game began as a community service project of football games between The Hershey High School and The Hershey School.

This event was held every year from 1943 to 2019. In the football game in 1945, **Milton Hershey School won** with the score: Milton Hershey School **32** vs Hershey High School **12**.

## **SECTION 2: MD&A ANALYSIS**

**1 | Business Model and Growth Strategy**

Business Model: Hershey envisions becoming a leader in the snack industry. However, the chocolate market is highly saturated, and acquired protein bars and gums companies that they acquired have not been profitable. These factors prompted them to shift from their traditional product line to a diversification strategy.

Growth Plan: Their main growth plan is producing and distributing chocolates, their main product. Besides, they also plan to increase sales and growth by expanding into new market niches and diversifying their portfolio through acquisitions. This integrated strategy guarantees Hershey's competitiveness, flexibility in responding to market developments, and sustained leadership in the chocolate and snack sectors.

**2 | Overview**

Hershey’s principal product offerings include chocolate and non-chocolate confectionery products, along with gum, mints, snack items, and pantry items. Hershey’s strategic focus includes driving its core confection business, increasing sales by expanding into new markets and acquisitions. They have operational productivity as their sales have increased over the last three years. However, they are facing financial difficulties, because of their unprofitable acquisitions and high debt usage, which can put them in financial distress.

In May 2023, the company acquired manufacturing assets from Weaver Popcorn Manufacturing, Inc., enhancing its capacity for popcorn production, including the SkinnyPop brand. Throughout 2021, it expanded its snack and confectionery portfolio by acquiring Pretzels Inc., Dot’s Pretzels, LLC, and Lily’s Sweets, LLC, leaders in their respective categories. Additionally, in January 2021, it divested its stake in Lotte Shanghai Foods Co., Ltd., with minimal financial impact on its consolidated statements.

*A close-up of numbers

Description automatically generated*

**3 | Trends Affecting our Business**

Hershey's business is influenced by a mix of positive and negative trends. On the positive side, the demand for chocolate is steadily increasing, which helps boost sales volume and enhance the profitability of their chocolate products. This growing consumer interest allows Hershey to maintain or slightly increase prices while managing production costs effectively.

However, there are significant challenges as well. Frequent supply chain disruptions are causing delays in production and distribution. Additionally, the costs of raw materials, transportation, and labor are rising, with a notable 32% hike in cocoa costs. These increasing expenses are outpacing Hershey's ability to raise prices proportionately, as doing so too much could risk losing consumer demand. Consequently, while sales may continue to grow, profit margins are under pressure due to these escalating costs, making it a challenging environment for Hershey to navigate.

**4 | Segment Results**

The company showcased **robust financial growth across its three segments**. This growth is reflected by net sales, income and margin of each segment throughout the last three years.

A graph of orange and white bars

Description automatically generated**A graph of green bars

Description automatically generated**

**A graph of blue squares

Description automatically generated with medium confidence**

**North America Confectionery**: Over three last years, sales, income and margin in this segment increased steadily from 2021 to 2023. This trend has been driven largely by improved supply chain productivity and pricing strategies that offset a slight decline in volume due to reduced demand for core confection brands.

**North America Salty Snacks**: This segment saw significant growth, particularly from 2021 to 2022, with sales **nearly doubling** influenced by the acquisitions of Dot’s and Pretzels and strong sales from SkinnyPop. In 2023, sales continued to **grow to $1,092.7 million**, with income slightly decreasing due to increased marketing and promotional costs.

**International**: Same as North America Confectionary, all three indicators in the International segment grew strongly, with consistent year-over-year increases. Growth was fueled by effective price increases, favorable currency exchange impacts, and volume growth, particularly in Mexico, Brazil, and Latin America.

**5 | Liquidity and Capital Resources**

The Company’s **main cash requirement** comes from normal operation activities such as minimum rental commitments for offices, retail stores, warehouses, and distribution facilities, followed by the need for purchase of raw materials. Besides, Hershey’s cash demand is also to finance its acquisition and stock buyback activities.

Although Hershey's total debt remained steady at $4.8 billion through 2023, this number still reflects relatively high leverage. Additionally, the company’s net working capital has been negative for the past three years, indicating a significant reliance on debt financing and limited capacity to take on additional debt. Hershey has access to a $1.35 billion unsecured revolving credit facility, and $219 million under lines of credit. The company also mentioned a shelf registration statement filed with the SEC for potential future debt financing, because of this, they do not need to specify details of potential use of this debt. Overall, Hershey has **used debt to make acquisitions. But they have poor capital structure and have poor liquidity**, which could present the company’s financial challenges.

**6 | Critical Accounting Policies and Estimates**

Based on its nature and operations, here are Hershey’s most critical accounting policies and estimates:

*Accrued Liabilities for Trade Promotion Activities*

This was also the critical audit issue of Hershey in the financial year 2022. The estimated costs of promotion and incentives are based on and can be changed according to analysis of the programs offered, historical trends, and customer behaviors. However, **the difference** between actual annual promotional and the estimated amount usually is **immaterial**, about 3% for the last 3 years.

*Pension and Other Post-Retirement Benefits Plans*

To manage pension and other post-retirement benefits plans, The Company uses various financial assumptions, like expected returns on plan assets and discount rates. These assumptions are crucial as they **significantly influence the financial outcomes of these plans**. Specifically, a 1% change in the discount rate can increase/decrease pension liability by nearly 4 million on Dec 31, 2023.

*Business Acquisitions, Valuation and Impairment of Goodwill and Other Intangible Assets*

For an M&A strategic company like Hershey, accounting for business acquisitions is crucial. The Company recorded acquired assets and liabilities at fair values and noting any excess as goodwill. Goodwill and certain intangible assets need to be checked annually for value loss and not amortized. The evaluation involves estimating future cash flows, heavily influenced by market conditions and company projections.

*Income Taxes*

Like other companies, for Hershey, tax accounting is an important practice as it **could affect the company’s financial reporting**. The Company adjusts its income tax based on changes in judgments about uncertain tax positions. These adjustments include recognizing or revising unrecognized tax benefits and related penalties, driven by new audit findings or resolutions.

# **PART 2: FINANCIAL STATEMENT ANALYSIS**

## **SECTION 1: RATIO ANALYSIS**

1. **Productivity:** A/R Turnover, Inventory Turnover, Accounts Payable, Cash Conversion.

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2021** | **2022** | **2023** |
| **A/R Turnover** | 13.94 | 15.07 | 14.55 |
| **Inventory Turnover** | 5.04 | 5.48 | 4.91 |
| **A/P Turnover** | 7.74 | 7.12 | 6.00 |
| **Cash Conversion Cycle** | 51.40 | 39.59 | 38.62 |

The company's productivity has been robust over the past three years, as indicated by key financial metrics. Specifically, the Cash Conversion Cycle consistently declined from 51.40 days in 2021 to 38.62 days in 2023, demonstrating effective cash flow management. While A/R, Inventory, and A/P Turnover and Outstanding Days experienced minor fluctuations, they remained within a good range, reflecting Hershey’s efficient management of receivables, payables, and inventory.

1. **Debt**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2021** | **2022** | **2023** |
| **Times Interest Earned** | 18.51 | 19.19 | 19.64 |
| **Debt to Equity** | 1.82 | 1.45 | 1.17 |
| **Equity Multiplier** | 3.91 | 3.53 | 3.09 |

The rise in the Times Interest Earned ratio from 18.51 in 2021 to 19.64 in 2023 indicates a positive signal as it reflects growth in operating income, driven by acquisitions. Besides, Debt to Equity and the Equity Multiplier have also declined. However, analysis on those ratios reveals that debt still remains relatively high compared to equity, indicating Hershey’s heavy reliance on debt financing. That could pose some potential risks to the company.

1. **Profitability**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2021** | **2022** | **2023** |
| **Net Profit Margin (%)** | 16.47% | 15.79% | 16.68% |
| **Gross Profit Margin (%)** | 45.13% | 43.18% | 44.76% |
| **Operating Profit Margin (%)** | 22.78% | 21.70% | 22.94% |

The company has demonstrated good profitability with consistent profit margins over the past three years. The Gross Profit Margin remained stable and healthy at around 45%, even with material cost inflation, due to their pricing strategy that offset the inflation. Besides, despite acquisitions, they effectively managed operating expenses, resulting in a stable Operating Profit Margin. Specifically, the Operating Profit Margin remained steady and solid around 23% from 2021 to 2023.

1. **Return on Equity**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2021** | **2022** | **2023** |
| **ROE** | 59.16% | 54.31% | 50.33% |

Hershey's ROE decreased from 59.16% in 2021 to 50.31% in 2023 because dividend payout ratio did not increase proportionately to the increase in income. This led to increased equity and subsequently reduced the return on equity.

Despite the decrease in ROE, Hershey's profitability has improved, with ROA rising from 15.12% to 16.29%. Financial leverage has also decreased from 3.91 to 3.09, showing subtly reduced reliance on debt. The asset turnover improved slightly, and net profit margins remained stable, indicating efficient operations.

1. **Return on Net Operating Assets**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2021** | **2022** | **2023** |
| **RNOA** | 24.55% | 23.68% | 25.07% |

Hershey's RNOA decreased from 24.55% in 2021 to 23.68% in 2022 but improved to 25.07% in 2023. Overall, their changes are minor and just reflect the normal fluctuations of operations in the company. The drop in 2022 indicates a temporary decline in the efficiency of utilizing operating assets. The subsequent increase in 2023 shows a rebound in operational efficiency, suggesting the company has effectively optimized its use of net operating assets. This positive trend in 2023 is a good sign for Hershey's core business performance.

1. **Market Performance**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2021** | **2022** | **2023** |
| **EPS** | 7.34 | 8.22 | 9.31 |
| **P/E** | 28.27 | 25.25 | 22.29 |
| **Dividend Yield (%)** | 1.64% | 1.87% | 2.15% |
| **Book Value Per Share** | 13.38 | 16.10 | 20.05 |

Hershey's rising EPS was primarily due to their share’s buyback activities, and with profit increase. Book Value Per Share increased from 13.38 to 20.05 thanks to effective acquisitions, indicating the company’s growth. Additionally, the decrease in P/E ratio and marginal increase in dividend yield may attract investors, especially during the current downturn in the confectionery market.

## **SECTION 2: COMMON SIZE ANALYSIS**

**QUESTION:** Are there any major variations in the common size analysis for the Balance Sheet and Income Statements?

1. **Balance Sheet**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  |  |  | **Change compared to previous year** | |
| **Fiscal Year** | **2021** | **2022** | **2023** | **2022 vs 2021** | **2023 vs 2022** |
| **ASSETS** |  |  |  |  |  |
| Current assets: |  |  |  |  |  |
| Cash and cash equivalents | 3.16%  *329,266* | 4.24%  *463,889* | 3.38%  *401,902* | 1.07% | -0.86% |
| Accounts receivable—trade, net | 6.45%  *671,464* | 6.50%  *711,203* | 6.92%  *823,617* | 0.05% | 0.42% |
| Inventories | 9.49%  *988,511* | 10.71%  *1,173,119* | 11.27%  *1,340,996* | 1.22% | 0.55% |
| Prepaid expenses and other | 2.47%  *256,965* | 2.49%  *272,195* | 2.90%  *345,588* | 0.02% | 0.42% |
| Total current assets | 21.57%  *2,246,206* | 23.93%  *2,620,406* | 24.47%  *2,912,103* | 2.36% | 0.53% |
| **Property, plant and equipment, net** | 24.84%  *2,586,187* | 25.30%  ***2,769,702*** | 27.81%  ***3,309,678*** | 0.46% | **2.51%** |
| **Goodwill** | 25.29%  *2,633,174* | 23.81%  *2,606,956* | 22.65%  *2,696,050* | -1.48% | -1.16% |
| **Other intangibles** | 19.57%  *2,037,588* | 17.96%  *1,966,269* | 15.79%  *1,879,229* | -1.61% | -2.17% |
| **Other non-current assets** | 8.34%  *868,203* | 8.63%  *944,989* | 8.92%  *1,061,427* | 0.29% | 0.29% |
| **Deferred income taxes** | 0.39%  *40,873* | 0.37%  *40,498* | 0.37%  *44,454* | -0.02% | 0.00% |
| Total assets |  |  |  |  |  |
| **LIABILITIES AND STOCKHOLDERS’ EQUITY** | |  |  |  |  |
| Current liabilities: |  |  |  |  |  |
| Accounts payable | 6.65%  *692,338* | 8.86% *970,558* | 9.13% *1,086,183* | 2.22% | 0.26% |
| Accrued liabilities | 8.22%  *855,638* | 7.60%  *832,518* | 7.29%  *867,815* | -0.61% | -0.31% |
| Accrued income taxes | 0.03%  *3,070* | 0.06%  *6,710* | 0.25%  *29,457* | 0.03% | 0.19% |
| Short-term debt | 9.02%  *939,423* | 6.34%  *693,790* | 6.05%  *719,839* | -2.69% | -0.29% |
| Current portion of long-term debt | 0.03%  *2,844* | 6.88%  *753,578* | 2.56%  *305,058* | **6.86%** | -4.32% |
| Total current liabilities | 23.95%  *2,493,313* | 29.75%  *3,257,154* | 25.27%  *3,008,352* | 5.80% | -4.47% |
| **Long-term debt** | 39.25%  *4,086,627* | 30.54%  *3,343,977* | 31.83%  *3,789,132* | **-8.71%** | 1.29% |
| **Other long-term liabilities** | 7.56%  *787,058* | 6.57%  *719,742* | 5.55%  *660,673* | -0.99% | -1.02% |
| **Deferred income taxes** | 2.77%  *288,004* | 3.00%  *328,403* | 2.90%  *345,698* | 0.23% | -0.10% |
| Total liabilities | 73.52%  *7,655,002* | 69.86%  *7,649,276* | 65.56%  *7,803,855* | -3.66% | -4.30% |
| Stockholders’ equity: |  |  |  |  |  |
| The Hershey Company stockholders’ equity |  |  |  |  |  |
| Preferred stock, shares issued: |  |  |  |  |  |
| Common stock, shares issued: | 1.55%  *160,939* | 1.49%  *163,439* | 1.40%  *166,939* | -0.05% | -0.09% |
| Class B common stock, shares issued: | 0.58%  *60,614* | 0.53%  *58,114* | 0.46%  *54,614* | -0.05% | -0.07% |
| Additional paid-in capital | 12.10%  *1,260,331* | 11.84%  *1,296,572* | 11.30%  *1,345,580* | -0.26% | -0.54% |
| Retained earnings | 26.12%  *2,719,936* | 32.79%  *3,589,781* | 38.33%  *4,562,263* | **6.66%** | **5.54%** |
| Treasury—common stock shares, at cost | -11.48%  *1,195,376* | -14.21%  *1,556,029* | -15.12%  *1,800,232* | -2.73% | -0.91% |
| Accumulated other comprehensive loss | -2.39%  *249,215* | -2.30%  *252,333* | -1.93%  *230,078* | 0.09% | 0.37% |
| Total stockholders’ equity | 26.48%  *2,757,229* | 30.14%  *3,299,544* | 34.44%  *4,099,086* | 3.66% | 4.30% |
| Total liabilities and stockholders’ equity |  |  |  |  |  |

Common size analysis in Hershey’s Balance Sheet revealed a major variation in the debt structure over the last three years. To be more specific, the shift was from long-term debt to more short-term debt due to a large amount of notes due in the next 12 months. This contrasts with the previous year's pattern, though liabilities remain comparably high, posing potential threats to the company. Additionally, PPE increased significantly from 2022 to 2023 due to the acquisition of Weaver Popcorn Manufacturing. Sales and income growth led to higher retained earnings, while dividend payout rates did not proportionately match the income increase, all resulting in a rise in total equity.

1. **Income Statement**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | Change compared to previous year | | |
| Fiscal Year | 2020 | 2021 | 2022 | 2023 | 2021 vs 2020 | 2022 vs 2021 | 2023 vs 2022 |
| Net Sales |  |  |  |  |  |  |  |
| Cost of Sales | 54.58% | 54.87% | 56.82% | 55.24% | 0.29% | 1.95% | -1.59% |
|  | *4,448,450* | *4,922,739* | *5,920,509* | *6,167,176* |  |  |  |
| Gross Profit | 45.42% | 45.13% | 43.18% | 44.76% | -0.29% | -1.95% | 1.59% |
|  | *3,701,269* | *4,048,598* | *4,498,785* | *4,997,816* |  |  |  |
| Selling, marketing and administrative expense | 23.20% | 22.31% | 21.46% | 21.82% | -0.89% | -0.85% | 0.36% |
|  | *1,890,925* | *2,001,351* | *2,236,009* | *2,436,508* |  |  |  |
| Long-lived asset impairment charges | 0.11% | 0.00% | 0.00% | 0.00% | -0.11% | 0.00% | 0.00% |
|  | *9,143* | *-* | *-* | *-* |  |  |  |
| Business realignment costs | 0.23% | 0.04% | 0.02% | 0.00% | -0.19% | -0.02% | -0.02% |
|  | *18,503* | *3,525* | *1,989* | *441* |  |  |  |
| Operating profit | 21.87% | 22.78% | 21.70% | 22.94% | 0.91% | -1.08% | 1.24% |
|  | *1,782,698* | *2,043,722* | *2,260,787* | *2,560,867* |  |  |  |
| Interest expense, net | 1.83% | 1.42% | 1.32% | 1.36% | -0.41% | -0.10% | 0.04% |
|  | *149,374* | *127,417* | *137,557* | *151,785* |  |  |  |
| Other (income) expense, net | 1.70% | 1.33% | 1.98% | 2.12% | -0.37% | 0.65% | 0.15% |
|  | *138,327* | *119,081* | *206,159* | *237,218* |  |  |  |
| Income before income taxes | 18.34% | 20.03% | 18.40% | 19.45% | 1.69% | -1.63% | 1.05% |
|  | *1,494,997* | *1,797,224* | *1,917,071* | *2,171,864* |  |  |  |
| Provision for income taxes | 2.69% | 3.50% | 2.61% | 2.78% | 0.81% | -0.89% | 0.16% |
|  | *219,584* | *314,405* | *272,254* | *310,077* |  |  |  |
| Net income including noncontrolling interest | 15.65% | 16.53% | 15.79% | 16.68% | 0.88% | -0.74% | 0.89% |
|  | *1,275,413* | *1,482,819* | *1,644,817* | *1,861,787* |  |  |  |
| Less: Net gain attributable to noncontrolling interest | -0.04% | 0.06% | 0.00% | 0.00% | 0.10% | -0.06% | 0.00% |
|  | *(3,295)* | *5,307* | *-* | *-* |  |  |  |
| Net income attributable to The Hershey Company | 15.69% | 16.47% | 15.79% | 16.68% | 0.78% | -0.68% | 0.89% |
|  | *1,278,708* | *1,477,512* | *1,644,817* | *1,861,787* |  |  |  |

Upon reviewing the common size Income Statements for the past four years, there are no significant variations observed. The changes across all accounts are minor, generally within a ±2% range, indicating stability in the company's operations. The most significant expense is the cost of sales, which mainly drives Hershey's net income variations. Overall, the fluctuations in the income statement components are typical of normal business activities and do not suggest any substantial deviations or irregularities in financial performance.

## **SECTION 3: EQUITY ANALYSIS**

1. **How do you read the debt-to-equity relationship?**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2021** | **2022** | **2023** |
| **Debt to Equity** | 1.82 | 1.45 | 1.17 |

Over the past five years, Hershey has consistently repurchased shares, reducing the total equity available to shareholders. Thus, the relevant equity for calculating the debt-to-equity ratio excludes these treasury shares. The marginal decrease in the debt-to-equity ratio over the last three years indicates reduced reliance on debt financing. Another good point is that Hershey has not taken on new debt, contributing to this decrease. However, debt usage remains high compared to equity. Reducing reliance on debt is crucial to Hershey given their already high debt levels.

1. **How much of the equity is based on tangible assets and what is your evaluation of this?**

Hershey's equity is heavily reliant on intangible assets, with around 88% of their assets being intangible. This happened as they paid majorly for Intangible Assets, particularly Goodwill in their acquisitions. This is not favorable because intangible assets can fluctuate significantly in worth and are harder to value accurately compared to tangible assets. Consequently, the company’s financial performance could suffer if market conditions worsen or its brand value declines. Specifically, Hershey might face challenges in securing loans or investments if these intangible assets lose value, thereby increasing the company’s financial instability.

## **SECTION 4: CASH FLOW ANALYSIS**

**QUESTION:** How has Hershey spent its cash flow over the last three years and what is your opinion on this?

**ANSWER:**

Over the last three years, Hershey has generated a strong cash flow, with totaling $6.73 billion for operating activities, $4.21 billion for investing activities and $3.25 billion for financing activities.

**Investing Activities:** Hershey used a total of $1.79 billion over the last three years for capital additions, primarily for implementing the ERP system. Although this is a substantial investment, we are not sure about its benefits to the company. In 2021, they spent a huge amount, $1.60 billion, on three acquisitions. There were no acquisitions in 2022, and in 2023, they made one acquisition, resulting in a cash outflow of $165.8 million for that year.

**Financing Activities:** With the continuous effort in stock buyback, they spent $1.11 billion on that activity. Along with a commitment to paying dividends, they paid a total of $2.35 billion over the past 3 years, with the amount increasing continuously each year. Meanwhile, the company also paid attention to restructuring their debt structure, shifting from long-term to more short-term debt. Specifically, they spent $1.20 billion on repayment of long-term debt and $649.47 million on short-term debt.

**Operating Activities:** The acquisition of Weaver increased Hershey’s cash flow for pension and benefit plans due to an increase in employees. Additionally, the increase in PPE resulted in a significant depreciation expense, totaling $1.11 billion over three years.

Overall, Hershey appears to be prudently deploying its cash flow to drive long-term growth and shareholder value creation through a balanced approach of investing in its existing business, pursuing strategic acquisitions, restructuring their debt, and returning excess cash to shareholders. This capital allocation strategy seems reasonable given Hershey's strong market position and cash generation capabilities.

## **SECTION 5: SEGMENT ANALYSIS**

1. **What is your opinion of Hershey using acquisitions to achieve its sales growth?**

We believe that Hershey should focus on continuing to grow their strongest attribute, which is the confectionery line. Acquisitions could be a great plan if they need to diversify their portfolio, but it should not be their main focus for sales growth. Their strategy is not correct as of now because they are using a lot of money on the wrong acquisitions. If they wanted to make acquisitions, it might be easier to stay in the low-calorie confectionery market.

One of the most important factors about these acquisitions is that they have been bought by debt and cash flow operations. This factor makes the acquisitions more risky than beneficial.

1. **Do you feel these are strong acquisitions for their strategic plan?**

In our opinion, these acquisitions were not strong additions to their developmental plan. We know that Hershey is trying to enter the salty snack market but choosing two pretzel companies and one lower-calorie sweet snack, which fits better into their portfolio than the pretzel companies, does not seem wise. The acquisitions over the past years have proven to be unprofitable and therefore not the correct ones; people are not buying pretzels, and having two companies that produce them is a bad tactic.

If their strategic plan is to expand towards the salty market, they should have picked better acquisitions that represent the current market trends. Another mistake they made is that they acquired the companies but not the brands, making it very hard to get ahead of the market to begin with.

Expanding into new segments and new markets was the right choice, but the choice of their acquisitions was completely wrong.

## **SECTION 6: CONTROL ANALYSIS**

**QUESTION:** What is the significance and ramifications to Hershey on the Orphanage controlling the company in expansion, the sale of the company, etc.?

**ANSWER:**

The Hershey Trust Company, which holds around 80% voting control over The Hershey Company, significantly influences the company’s sales and acquisition strategies. The Trust’s primary mandate is to support the Milton Hershey School, prioritizing long-term stability and community benefits over short-term financial gains. As a result, Hershey’s expansion strategies are often conservative, focusing on sustainable growth rather than aggressive market moves.

As the confectionary market is currently saturated, their way to increase sales sustainably is through acquisition. For acquisition strategy, the company could more likely enter new markets and products to pursue long-term growth. While this conservative approach supports stability and continuity, it may also limit Hershey’s potential for aggressive growth and high-risk. This could also lead to potential conflicts between the Trust and other shareholders as other shareholders might prefer strategies that boost short-term stock prices.

## **SECTION 7: OVERVIEW**

**QUESTION:** What is your general overview of the financial condition of Hershey, both today (12/31/23) and going forward.

**ANSWER:**

Hershey’s productivity and profitability have been good for the past three years. Specifically, the company has maintained stable profit margins over the years despite inflation in material costs. However, their strategy of increasing prices to match inflation may only be effective in the short term. As costs continue to rise and existing sales contracts limit price adjustments, sales and income could stagnate or decline.

Their high debt relative to equity is also concerning, although they did not have new debt last year. In addition, negative working capital for the past three years indicates their poor liquidity. This limits their ability to take on more debt. Addressing this issue by reducing reliance on debt is important to avoid financing difficulties.

For their long-term and sustainable growth goal, acquisitions and market expansion are appropriate strategies. However, not all acquisitions have been profitable or aligned with market trends. They should focus on more strategic acquisitions that reflect current market favors.

Overall, given their debt issues and current market conditions, we suggest that Hershey should develop backup plans for financial distress to ensure stability.

# **PART 3: THREE YEAR FORECAST**