

Analysts: Kraft bid puts Cadbury out of Hershey's league

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By Bob Fernandez

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PHILADELPHIA -- The Hershey Co. would have to borrow heavily and look to its controlling shareholder, the Hershey Trust, for more than \$1 billion to help bankroll a bid for Cadbury P.L.C., according to published reports and experts.

Kraft Foods Inc. on Tuesday reached a revised agreement to acquire Cadbury for \$19.7 billion. Cadbury said it accepted the revised offer and considered it friendly.

Hershey has until Monday to disclose its intentions on a competing bid for Cadbury, British regulatory authorities said Tuesday.

"I certainly don't understand how they would pull this off," said Samuel Weaver, a finance professor at Lehigh University who resigned from Hershey Co. as director of financial planning and analysis in 1998. Weaver's job was analyzing acquisition targets for Hershey.

Hershey Co. spokesman Kirk Saville said Tuesday that as a matter of policy the company doesn't comment on merger speculation.

Wall Street seemed to think the new Kraft bid blew Cadbury out of Hershey's reach. Hershey has a stock-market capitalization of \$8.2 billion, so Kraft's offer is more than double what Hershey itself is worth.

Hershey stock on Tuesday jumped \$1.10 to \$37.35 after Kraft's new offer, indicating that investors thought Hershey's board of directors wouldn't risk topping Kraft.

Trust experts, meanwhile, think a Hershey-Cadbury deal would be bad for the Hershey Trust, which controls the Hershey Co. and finances a school for poor children in central Pennsylvania with Hershey Co. stock dividends.

A debt-heavy deal could jeopardize the dividend stream. Moreover, a Hershey-Cadbury deal would reverse a long-term trend of diversifying assets out of the chocolate-bar company.

Hershey Trust spokesman Tim Reeves had no comment.

The Hershey Trust contains the assets bequeathed by Milton S. Hershey to a school in his name for disadvantaged children. The school, in Derry Township, Pa., initially enrolled orphan boys but now accepts boys and girls. The school is considered the richest and largest residential school of its kind in the world and includes food, clothing and college tuition assistance for postgraduates.

The Hershey Trust's most recent nonprofit tax filing with the Internal Revenue Service shows that 30 percent to 35 percent of the trust's \$7.3 billion in assets are invested in the Hershey Co.

Assets other than the Hershey Co. include a for-profit entertainment company and real estate. The trust's most recent publicly available data is for year-end 2007.

An additional \$1 billion from the Hershey Trust invested into Hershey-Cadbury could boost the candy concentration in the trust portfolio to more than 50 percent, according to an Inquirer calculation.

This level would be lower than the 80 percent concentration in the early 1980s but far higher than what legal experts consider prudent for a philanthropy because of the threat of economic disaster or a Bernie Madoff-type scam.

"In the real world, people would get fired for this," said Robert Sitkoff, a Harvard University law professor and trust expert who has extensively studied the Hershey Trust. "What they should be doing is selling the company."

Jonathan Klick, a law professor at Pennsylvania State University who also has studied the Hershey Trust, said, "Anyone who has had Finance 101 would not structure the endowment this way. ... Not only are you not diversifying, you are adding more of the same businesses and adding debt on top of that."

Klick said he believed that the Hershey Trust shouldn't have more than 10 percent of its portfolio in the candy industry.

Others, though, have said that Hershey is a stable company with a long track record of investor returns.

A deal for Cadbury would be the exact opposite of what the Hershey Trust board attempted in 2002. Then the trust agreed to sell Hershey Co. to the Wm. Wrigley Jr. Co. -- in fact, to diversify the trust assets. But resident opposition and a political backlash led the Dauphin County courts, with the backing of then Pennsylvania Attorney General Mike Fisher, to halt the sale.

Hershey Trust board members who supported the sale were ousted and replaced with a new slate of directors, led by prominent statewide Republican Leroy Zimmerman.

Hershey sat out the global candy industry consolidation of the past decade and now is confined to the slow-growth U.S. market. Even if Hershey reached a deal to acquire Cadbury, former Hershey merger specialist Weaver doesn't know what Hershey would bring to the combined entity to justify paying a big financial premium for Cadbury.

Asked Weaver: "What does the Hershey management team know about marketing chocolates in India that executives in Cadbury don't already know?"