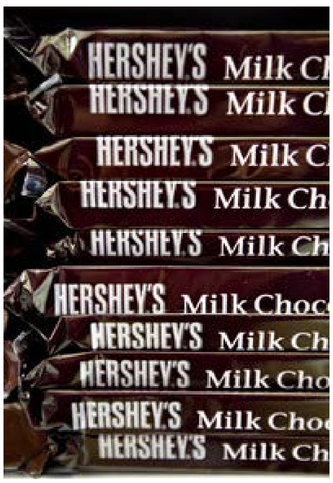
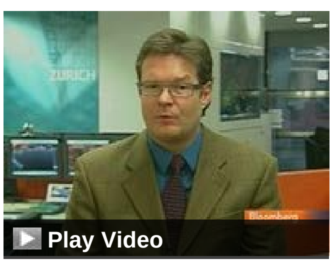
Hershey Meltdown Looms After Cadbury Clash With Trust (Update1)

By Zachary R. Mider and Duane D. Stanford - February 8, 2010 09:02 EST



Hershey's brand chocolate bars



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Jan. 19 (Bloomberg) -- Jon Cox, analyst at Kepler Capital Markets, talks with Bloomberg's Rishaad Salamat and Andrew Cleary about Cadbury Plc's agreement to an improved 11.9 billion-pound ($19.7 billion) offer from Kraft Foods Inc. Cox also discusses the role of a potential rival offer from Hershey Co. in the accord and the sentiment of Cadbury management.

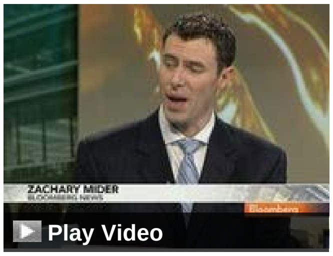
Feb. 8 (Bloomberg) -- Hershey Co. Chief Executive Officer David J. West didn't expect his Pennsylvania overseer to be in Mayfair's Stafford Hotel when he showed up for talks with Cadbury Plc last October.

Robert Reese, president of the trust that has controlled Hershey the past 92 years, had badgered West for months to merge with the U.K. chocolate maker. West was concerned that Reese was trying to undermine the Hershey CEO as he finally tried to negotiate a deal in London, according to people who participated in the merger discussions.

Hershey's failure to find a way to combine with Cadbury -- a traditional British company with a compatible culture -- is the story of two men who stood in each other's way on the same side of the $19 billion takeover lost to Northfield, Illinois - based Kraft Foods Inc. Their rift, as recounted in interviews with more than a dozen executives, board members, and advisers who spoke on the condition of anonymity, shows how Hershey missed its last chance to attain Cadbury's global scale, especially in the faster-growing emerging markets of Latin America and India.

Now West and Hershey are poised for a difficult endgame. "He has a fight on his hands," said Sean Egan, president of Egan-Jones Ratings Co. of Haverford, Pennsylvania. "There are some differences that need to be ironed out if the current management team is going to remain in place."

Hershey Co., Hershey Trust Co., and Cadbury declined to comment on their conversations. West, on a Feb. 2 conference call with analysts, said that even after a Kraft-Cadbury merger,



Feb. 8 (Bloomberg) -- Bloomberg Reporter Zachary Mider talks with Bloomberg's Jon Erlichman and Deirdre Bolton about the conflict at Hershey Co. between Chief Executive Officer David. J. West and Hershey Trust Co. President Robert Reese, that may have cost Hershey a chance to combine with Cadbury Plc.

"it's still a fragmented global category with opportunities out there to expand." The board affirmed its support for West more than once during its discussions over Cadbury, two people with knowledge of the matter said.

'More Formidable'

Hershey shares have fallen 38 percent during the past five years, compared with an 11 percent drop in the Standard & Poor's 500 Index and a 10 percent gain for the S&P's Consumer Staples Index.

"We are concerned with Hershey in the post Kraft-Cadbury world," said Chris Growe, an analyst at Stifel Nicolaus & Co. in St. Louis, in a research note last week. The merger "makes international growth for Hershey a much more formidable task." Hershey, which gets about 86 percent of its sales in the U.S., is expected to boost revenue 7 percent by 2011, compared with 11 percent for Cadbury, according to the median estimates of analysts surveyed by Bloomberg.

Prior Attempts

Hershey had weighed a combination with Cadbury, the maker of Dairy Milk chocolate and Trident chewing gum, in 2002 and 2007. Its latest round of discussions about Cadbury picked up in 2008, after Hershey lost the title of biggest U.S. confectionary maker with Mars Inc.'s $23 billion takeover of Wm. Wrigley Jr. Co. The Trust began pushing another merger effort, hiring bankers at Watch Hill Partners LLC, now part of FBR Capital Markets Corp.

Hershey's options were limited as the Trust's insistence on maintaining control of the company precluded a sale or a stock merger that would dilute its control. Company founder Milton Hershey gave the Trust his stock in 1918 to fund a school for disadvantaged children. The Trust now holds about 30 percent of the economic value of Hershey and 80 percent of the voting power.

Hershey stock accounted for about 40 percent of the Trust's $6.8 billion in assets as of Nov. 29, according to Trust spokesman Tim Reeves. Those funds help support about 1,800 boarders at the Milton Hershey School in pre-kindergarten through twelfth grade.

Cadbury Chairman Roger Carr cited the companies' "common values" last month when talking about Hershey's interest in a takeover. Cadbury calls itself a socially responsible company and has a history dating to 1824, when John Cadbury opened a tea and coffee shop in Birmingham, England.

Peanut Butter Cups

Leading the charge for a Cadbury takeover was Reese, 59, a former Hershey general counsel who peppers his speech with Latin phrases, people who know him say. A native of Hershey, Pennsylvania, the company's hometown, he is the scion of the family that created Reese's Peanut Butter Cups.

At Hershey, West, 46, was more hesitant about a Cadbury bid. A veteran of finance jobs at

Nabisco and later Hershey's chief financial officer, West is often seen around the office in a polo shirt and slacks rather than a suit. He drives a silver Subaru Outback.

West and his bankers at JPMorgan Chase & Co. argued that a takeover might jeopardize Hershey's financial stability and the investment-grade rating on its debt. Cadbury's market value at the end of 2008 was about 8.6 billion pounds ($12.5 billion), compared with $7.9 billion for Hershey.

Directors Resign

For months, the Trust prodded the company to reconsider its position, leading the board's independent directors to grow concerned the Trust would force the company to buy Cadbury over their objections. The Trust had acted unilaterally before, removing six Hershey directors in 2007 and saying it was displeased with the company's performance.

By August, the souring relationship with the Trust contributed to the resignation of directors Charles Strauss and Arnold Langbo from Hershey's board, said two people familiar with the directors' thinking.

Hershey said in a regulatory filing that the directors resigned over their objection to the creation of a "Finance and Risk Management" committee of the board that would oversee, among other things, acquisitions.

Hershey's talks about Cadbury grew more urgent the following month, when Kraft unveiled a bid for the U.K. chocolate maker. Hershey would be hard-pressed to win a bidding war with a company with more than seven times Hershey's sales and four times its market value.

Joint Bid?

The Trust bolstered its case for a bid by hiring former Goldman Sachs Group Inc. banker Byron Trott. Trott said he could raise billions of equity financing for Hershey to help pay for Cadbury -- a technique he used when he advised Wrigley in the Mars deal. Some of the money could come from the private-equity fund managed by the firm he'd recently founded, Chicago-based BDT Capital Partners. The Trust also brought in Bank of America Corp. to help finance a bid.

West continued to be skeptical, and advocated making an offer with a partner, such as Italy's Ferrero SpA, maker of Tic Tac candies, to share the debt burden of a bid.

Reese and Hershey Chairman James Nevels flew to London in October to meet with Cadbury Chairman Carr at the Stafford, a 17th-century landmark near Buckingham Palace.

When West flew to London a week later to meet with his counterpart at Cadbury, Todd Stitzer, a member of his team spotted Reese at the Stafford. Word got to Reese that West suspected him of negotiating behind his back. Reese later told Hershey officials he wasn't meeting with Cadbury at that time and was only passing through after visiting a daughter in Paris.

Independent Directors

As West and his management team grew more concerned about the Trust's contacts with Cadbury, Hershey's board members were worrying about their personal liability if the Trust forced a financially risky deal for Cadbury on the company.

On the suggestion of the company's management and its outside lawyers at Sullivan &

Cromwell LLP, the board put three directors -- the only three who were neither Trust members nor company officers -- in charge of the merger discussions. This panel included Thomas Ridge, the former U.S. Homeland Security secretary and Pennsylvania governor. Advising the new committee were Perella Weinberg Partners LP and Wachtell Lipton Rosen & Katz LLP.

West's and Reese's camps continued to work against each other, according to people on both sides. Hershey, exploring a joint bid with Ferrero, sought to enter an exclusivity agreement with its Italian partner that the Trust refused to support. The Trust pressed Hershey for weeks to begin sounding out credit- rating companies about a solo bid. The company did so only with about a week left to prepare a bid under U.K. takeover rules.

A spokesman for Ferrero declined to comment.

Compromise

In early January, the panel settled on a compromise, recommending the solo bid that the Trust had been advocating, while limiting the offer to about 825 pence a share, or 11.7 billion pounds, low enough to satisfy West's objective of maintaining the investment-grade credit rating.

Hershey floated the offer to Cadbury during the second week in January, only to have it rejected as too low. The U.K. company left the door open to more discussions, however, and West and his team headed to London the following weekend.

Hershey's effort was too little, too late. Irene Rosenfeld, Kraft's CEO, flew to London that Sunday night armed with a higher offer and, by the following day, reached a deal to buy Cadbury at 840 pence, plus a 10-pence special dividend.

"The fat chocolate lady, as it were, is singing," Jon Cox, an analyst at Kepler Capital Markets in Zurich, said in a Jan. 19 interview predicting Kraft had Cadbury sewed up.

Giving Up

Within Hershey, the Trust wasn't listening to that aria. Its advisers sketched out a bid proposal that would top Kraft's and presented it on Jan. 20 to the special committee of the board. That panel rejected it, and the board unanimously voted to give up the quest the same day.

In 2007, boardroom squabbles were followed by shakeups. Then- CEO Richard Lenny went into retirement at age 55, and West was elevated from chief operating officer to succeed him. Finding an eventual successor for West may be tougher for a company becoming known as much for its fissures as its Kisses.

"It's going to make it more difficult to attract talent because this shows again that Hershey's controlling shareholder doesn't operate like other shareholders," said Charles M. Elson, director of the John L. Weinberg Center for Corporate Governance at the University of Delaware. "The Trust seems to have agendas other than maximizing share value and that adds complexity to being the company's CEO."

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