

## HERSHEY FOODS CORPORATION

### MANAGEMENT'S DISCUSSION AND ANALYSIS

#### OPERATING RESULTS

The Corporation's sales decreased in 1999, following a record performance in 1998. During the two-year period, net sales decreased at a compound annual rate of 4%. The sales decrease reflected the divestiture of the Corporation's pasta business in January 1999 and reduced 1999 shipments in the United States of confectionery and grocery products, which more than offset higher sales for core confectionery and grocery brands in 1998. The reduction in shipments resulted primarily from difficulties in order fulfillment (customer service, warehousing, and shipping) encountered since the start-up of a new integrated information system and new business processes during the third quarter of 1999. The sales decrease was partially offset by incremental sales from the introduction of new confectionery products, and to a lesser extent, sales increases in the Canadian and Mexican markets.

The Corporation's income increased in 1999 reflecting the gain on the sale of the Corporation's pasta business. Excluding the \$165.0 million after-tax gain on the sale of the pasta business, net income decreased in 1999 following a record performance in 1998. During the two-year period, net income decreased at a compound annual rate of 6%. The decrease in net income reflected the divestiture of the pasta business and sales decline in 1999, and a lower gross margin over the two-year period, partly the result of higher costs associated with the order fulfillment difficulties noted above. These items were partially offset by lower levels of selling and marketing, administrative and interest expenses.

The following divestiture occurred during the period:

- January 1999—The completion of the sale of a 94% majority interest of the Corporation's U.S. pasta business to New World Pasta, LLC. The transaction included the *American Beauty*, *Ideal by San Giorgio*, *Light 'n Fluffy*, *Mrs. Weiss*, *P&R*, *Ronzoni*, *San Giorgio* and *Skinner* pasta brands, along with six manufacturing plants. In the first quarter of 1999, the Corporation received cash proceeds of \$450.0 million, retained a 6% minority interest and recorded a gain of approximately \$243.8 million before tax, \$165.0 million or \$1.17 per share—diluted after tax, as a result of the transaction.

#### Net Sales

Net sales decreased \$464.7 million or 10% in 1999 following an increase in 1998 of \$133.4 million or 3%. The decrease in 1999 was primarily a result of the divestiture of the Corporation's pasta business, resulting in a sales reduction of \$343.8 million, and sales decreases in the United States of core confectionery and grocery products. Sales of confectionery and grocery products declined in the first quarter of 1999 primarily as a result of the December 1998 buy-in on promotions of regular count and vending items. Sales decreases in the third and fourth quarters were primarily the result of problems encountered since the July start-up of new business systems and processes. These sales declines were partially offset by incremental sales from the introduction of new confectionery products, increased export sales in international markets and sales increases in the Corporation's Canadian and Mexican markets. The increase in 1998 was primarily a result of incremental sales from the introduction of new confectionery products and increased sales volume for core confectionery and grocery products in North America. These increases were offset somewhat by a decline in sales in the Corporation's Asian and Russian markets and the impact of currency exchange rates in the Canadian and Mexican markets, in addition to higher levels of confectionery unsalables and lower sales of pasta products.

#### Costs and Expenses

Cost of sales as a percent of net sales increased from 57.9% in 1997 to 59.2% in 1998, and to 59.3% in 1999. The decrease in gross margin in 1999 reflected lower profitability resulting from the mix of confectionery items sold in 1999 compared with sales during 1998, primarily related to lower sales of

the more profitable standard bars. Higher freight and distribution costs, reflecting increased costs related to the implementation of new business systems and processes and distribution center capacity constraints, and higher depreciation expense as a percent of sales, also contributed to the lower gross margin. These cost increases were offset partially by selling price increases in the Corporation's Canadian and Mexican markets and decreased costs for packaging materials and certain raw materials. The decrease in gross margin in 1998 was principally the result of higher costs for certain major raw materials, primarily milk and cocoa, labor and overhead, higher shipping and distribution costs and the mix of non-chocolate and chocolate confectionery items sold in 1998 compared to 1997. These cost increases were partially offset by lower costs for certain raw materials and improved manufacturing efficiencies, including significant improvements in plants acquired with the Leaf confectionery business in December 1996, from an affiliate of Huhtamäki Oy.

Selling, marketing and administrative expenses decreased by 9% in 1999, reflecting lower expenses resulting from the divestiture of the pasta business, reduced marketing expenses for core confectionery brands and lower administrative expenses. These decreases were offset partially by increased spending associated with the introduction of new products and international exports, in addition to higher amortization expense for capitalized software. Excluding the divestiture of the pasta business, advertising and promotion expense was essentially equal to the prior year as a percent of sales. Selling, marketing and administrative costs decreased by 1% in 1998, as reduced marketing expenses for existing brands, lower selling expenses in international markets and lower administrative expenses were only partially offset by higher marketing expenses associated with the introduction of new products.

During the first quarter of 1999, the Corporation changed its retiree medical plan to eliminate coverage for all eligible hourly employees under age 45, to be replaced by annual contributions into the Employee Savings Stock Investment and Ownership Plan (ESSIOP). The change applied primarily to U.S. hourly employees working in Pennsylvania. This change resulted in the recognition of a \$15.4 million pre-tax gain in 1999, excluding contributions to the ESSIOP. Effective December 1998, all U.S. full-time salaried employees, and all non-union hourly plant employees working outside Hershey, Pennsylvania under age 45 were eligible for the ESSIOP contributions, resulting in the recognition of a \$13.0 million pre-tax gain in 1998.

### **Interest Expense, Net**

Net interest expense in 1999 was \$11.4 million below the prior year, primarily as a result of lower short-term interest expense as a portion of the proceeds from the sale of the pasta business and positive cash flow was used to reduce short-term borrowings. Net interest expense in 1998 exceeded the prior year by \$9.4 million, primarily as a result of increased borrowings associated with the purchase of Common Stock from the Hershey Trust Company, as Trustee for the benefit of Milton Hershey School (Milton Hershey School Trust), partially offset by lower interest expense reflecting reduced average short-term borrowings.

### **Provision for Income Taxes**

The Corporation's effective income tax rate was 39.3%, 38.8% and 36.8% in 1997, 1998 and 1999, respectively. Excluding the provision for income taxes associated with the gain on the sale of the pasta business, the effective income tax rate was 39.0% in 1999. The rate decreased from 39.3% in 1997 to 38.8% in 1998 primarily due to changes in the mix of the Corporation's income among various tax jurisdictions.

### **Net Income**

Net income increased \$119.4 million in 1999, reflecting an after-tax gain of \$165.0 million on the sale of the Corporation's pasta business. Excluding the gain, net income decreased \$45.6 million or 13%

in 1999, following an increase of \$4.6 million or 1% in 1998. Excluding the gain on the sale of the pasta business, net income as a percent of net sales was 7.4% in 1999, 7.7% in 1998 and 7.8% in 1997.

## **FINANCIAL POSITION**

The Corporation's financial position remained strong during 1999. The capitalization ratio (total short-term and long-term debt as a percent of stockholders' equity, short-term and long-term debt) was 50% as of December 31, 1999 and 54% as of December 31, 1998. The ratio of current assets to current liabilities was 1.8:1 as of December 31, 1999, and 1.4:1 as of December 31, 1998. The lower capitalization ratio as of December 31, 1999, and the higher ratio of current assets to current liabilities primarily reflected the use of a portion of the proceeds from the sale of the pasta business to reduce short-term borrowings.

### **Assets**

Total assets decreased \$57.4 million or 2% as of December 31, 1999, primarily as a result of the divestiture of the pasta business and lower accounts receivable, substantially offset by increases in inventories and cash and cash equivalents.

Current assets increased by \$146.0 million or 13% reflecting increased inventories, cash and cash equivalents, prepaid expenses and other current assets. An increase in inventories of \$109.0 million primarily reflected higher raw material and finished goods inventories. The increase in cash and cash equivalents resulted from higher cash collections from customers in December compared to the prior year and year 2000 contingency plans. A decrease in accounts receivable reflected lower sales and increased collections from customers in December, as well as a reduction of accounts receivable with extended payment terms as of December 31, 1999.

As of December 31, 1999, accounts receivable included increased deductions from customer invoices and higher past due amounts as compared to the prior year. These increases were primarily the result of shipping, billing and processing difficulties encountered during the third and fourth quarters associated with the July start-up of the new integrated information system and new business processes. The Corporation has made substantial progress in resolving these problems, clearing open deductions and collecting past due receivables.

Property, plant and equipment was lower than the prior year primarily due to the divestiture of the pasta business and depreciation expense of \$135.6 million, partially offset by capital additions of \$115.4 million. The increase in other non-current assets was primarily associated with the capitalization of software.

### **Liabilities**

Total liabilities decreased by \$113.8 million or 5% as of December 31, 1999, primarily reflecting a reduction of short-term borrowings and the divestiture of the pasta business, partially offset by an increase in accrued income taxes. The decrease in short-term debt of \$136.7 million resulted from the use of a portion of the proceeds from the sale of the pasta business and positive cash flow to repay commercial paper borrowings. The increase in accrued income taxes of \$54.7 million primarily reflected the income tax provision on the gain on sale of the pasta business.

### **Capital Structure**

The Corporation has two classes of stock outstanding, Common Stock and Class B Common Stock (Class B Stock). Holders of the Common Stock and the Class B Stock generally vote together without regard to class on matters submitted to stockholders, including the election of directors, with the

Common Stock having one vote per share and the Class B Stock having ten votes per share. However, the Common Stock, voting separately as a class, is entitled to elect one-sixth of the Board of Directors. With respect to dividend rights, the Common Stock is entitled to cash dividends 10% higher than those declared and paid on the Class B Stock.

## **LIQUIDITY**

Historically, the Corporation's major source of financing has been cash generated from operations. The Corporation's income and, consequently, cash provided from operations during the year are affected by seasonal sales patterns, the timing of new product introductions, business acquisitions and divestitures, and price increases. Chocolate, confectionery and grocery seasonal and holiday-related sales have typically been highest during the third and fourth quarters of the year, representing the principal seasonal effect. Generally, seasonal working capital needs peak during the summer months and have been met by issuing commercial paper.

Over the past three years, cash requirements for share repurchases, capital expenditures, capitalized software additions and dividend payments exceeded cash provided from operating activities and proceeds from the sale of the pasta business by \$102.9 million. Total debt, including debt assumed, increased during the period by \$119.6 million. Cash and cash equivalents increased by \$56.7 million during the period.

The Corporation anticipates that capital expenditures will be in the range of \$150 million to \$170 million per annum during the next several years as a result of continued modernization of existing facilities and capacity expansion to support new products and line extensions. As of December 31, 1999, the Corporation's principal capital commitments included manufacturing capacity expansion, modernization and efficiency improvements.

In January 1999, the Corporation implemented the first phase of an enterprise-wide integrated information system in the United States. The first phase of system implementation included new business systems and processes related to purchasing, accounts payable, fixed assets, the general ledger, production reporting, and tracking of plant inventories. The start-up of the second phase of system implementation began in July 1999 and included systems and processes in the areas of sales order and billing, transportation planning and management, electronic data interchange communications with warehouses, finished goods inventories, accounts receivable and tracking of marketing promotions. As of December 31, 1999, approximately \$98.8 million of capitalized software and hardware and \$13.2 million of expenses were incurred for the enterprise-wide information system and related projects. Total commitments for these systems are expected to be approximately \$115 million to \$120 million, including incremental costs to resolve problems encountered with new business systems and processes. These expenditures were financed with cash provided from operations and short-term borrowings.

In July 1999, the Corporation entered into an operating lease agreement for an amount not to exceed \$65 million for the purpose of financing construction costs of a warehouse and distribution facility located on land owned by the Corporation near Hershey, Pennsylvania. Under the agreement, the lessor pays for the construction costs and thereafter leases the facility to the Corporation. The lease term is six years, including the construction period. The lease may be extended at the Corporation's option for up to four renewal periods of five years each. The lease provides for a substantial residual guarantee and includes an option to purchase the facility at original cost. The first phase of the distribution center is expected to open in the second quarter of 2000.

During 1999, 5,478,379 shares of Common Stock were repurchased for \$318.0 million under share repurchase programs, including 1,579,779 shares purchased from the Milton Hershey School Trust for \$100.0 million. Under share repurchase programs which began in 1993, a total of 15,339,498 shares of

Common Stock have been repurchased for approximately \$605.6 million. Of the shares repurchased, 528,000 shares were retired, 1,320,781 shares were reissued to satisfy stock options obligations, Supplemental Retirement Contributions and employee stock ownership trust (ESOP) obligations and the remaining 13,490,717 shares were held as Treasury Stock as of December 31, 1999. Additionally, the Corporation has purchased a total of 28,000,536 shares of its Common Stock to be held as Treasury Stock from the Milton Hershey School Trust for \$1.0 billion. As of December 31, 1999, a total of 41,491,253 shares were held as Treasury Stock and \$24.4 million remained available for repurchases of Common Stock under the program approved by the Corporation's Board of Directors in February 1999. In October 1999, the Corporation's Board of Directors approved an additional share repurchase program authorizing the repurchase of up to \$200 million of the Corporation's Common Stock.

In March 1997, the Corporation issued \$150 million of 6.95% Notes under a November 1993 Form S-3 Registration Statement. In August 1997, the Corporation filed another Form S-3 Registration Statement under which it could offer, on a delayed or continuous basis, up to \$500 million of additional debt securities. Also in August 1997, the Corporation issued \$150 million of 6.95% Notes due 2012 and \$250 million of 7.2% Debentures due 2027 under the November 1993 and August 1997 Registration Statements. Proceeds from the debt issuance were used to repay a portion of the short-term borrowings associated with the purchase of Common Stock from the Milton Hershey School Trust. As of December 31, 1999, \$250 million of debt securities remained available for issuance under the August 1997 Registration Statement. Proceeds from any offering of the \$250 million of debt securities available under the shelf registration may be used for general corporate requirements which include reducing existing commercial paper borrowings, financing capital additions and share repurchases, and funding future business acquisitions and working capital requirements.

As of December 31, 1999, the Corporation maintained a committed credit facility agreement with a syndicate of banks in the amount of \$500.0 million which could be borrowed directly or used to support the issuance of commercial paper. The Corporation has the option to increase the credit facility by \$1.0 billion with the concurrence of the banks. In December 1999, the short-term credit facility agreement was renewed for a total of \$200 million and the long-term committed credit facility agreement remained in effect for \$300 million, expiring in December 2002. The credit facilities may be used to fund general corporate requirements, to support commercial paper borrowings and, in certain instances, to finance future business acquisitions. The Corporation also had lines of credit with domestic and international commercial banks of \$25.0 million and \$23.0 million as of December 31, 1999 and 1998, respectively.

### **Cash Flow Activities**

Cash provided from operating activities totaled \$1.2 billion during the past three years. Over this period, cash used by or provided from accounts receivable and inventories has tended to fluctuate as a result of sales during December and inventory management practices. The change in cash required for or provided from other assets and liabilities between the years was primarily related to commodities transactions, the timing of payments for accrued liabilities, including income taxes, and variations in the funding status of pension plans.

Investing activities included capital additions and a business divestiture. Capital additions during the past three years included the purchase of manufacturing equipment, and expansion and modernization of existing facilities. In 1999, the Corporation's pasta business was sold for \$450 million in cash.

Financing activities included debt borrowings and repayments, payment of dividends, the exercise of stock options, incentive plan transactions and the repurchase of Common Stock. During the past three years, short-term borrowings in the form of commercial paper or bank borrowings were used to

fund seasonal working capital requirements, share repurchase programs and purchases of Common Stock from the Milton Hershey School Trust. The proceeds from the issuance of long-term debt were used to reduce short-term borrowings. During the past three years, a total of 15,802,718 shares of Common Stock have been repurchased for \$841.8 million, including 11,480,769 shares purchased from the Milton Hershey School Trust for \$600.0 million. Cash requirements for incentive plan transactions were \$57.5 million during the past three years, substantially offset by cash received from the exercise of stock options of \$52.6 million. Cash used by incentive plan transactions in 1997 and 1998 reflected purchases of the Corporation's Common Stock in the open market to repurchase Common Stock issued for stock options exercises. Beginning in early 1998, shares of treasury stock were reissued for stock options exercises.

## ACCOUNTING POLICIES AND MARKET RISKS ASSOCIATED WITH DERIVATIVE INSTRUMENTS

The Corporation utilizes certain derivative instruments, including interest rate swaps and forward agreements, foreign currency forward exchange contracts and commodity futures contracts, to manage interest rate, currency exchange rate and commodity market price risk exposures. The interest rate swaps and forward agreements, and foreign currency contracts are entered into for periods consistent with related underlying exposures and do not constitute positions independent of those exposures. Commodity futures contracts are entered into for varying periods and are intended and effective as hedges of anticipated raw material purchases. The Corporation does not hold or issue derivative instruments for trading purposes and is not a party to any instruments with leverage or prepayment features. In entering into these contracts, the Corporation has assumed the risk which might arise from the possible inability of counterparties to meet the terms of their contracts. The Corporation does not expect any losses as a result of counterparty defaults.

The information below summarizes the Corporation's market risks associated with long-term debt and derivative instruments outstanding as of December 31, 1999. This information should be read in conjunction with Note 1, Note 5, Note 7 and Note 8 to the Consolidated Financial Statements.

### Long-Term Debt

The table below presents the principal cash flows and related interest rates by maturity date for long-term debt as of December 31, 1999. The fair value of long-term debt was determined based upon quoted market prices for the same or similar debt issues.

	Maturity Date							Fair Value
	(In thousands of dollars except for rates)							
	2000	2001	2002	2003	2004	There-after	Total	
Long-term Debt	\$2,440	\$712	\$838	\$17,133	\$136	\$859,394	\$880,653	\$856,856
Fixed Rate	6.4%	2.0%	2.0%	4.4%	2.0%	7.2%	7.1%	

### Interest Rate Swaps and Forward Agreements

In order to minimize its financing costs and to manage interest rate exposure, the Corporation, from time to time, enters into interest rate swap agreements. In October 1999, the Corporation entered into an interest rate swap agreement to effectively convert \$200 million of 6.7% Notes Due 2005 (Notes) to variable rate debt. The interest rate swap agreement is cancelable at the sole discretion of the counterparty effective April 2, 2001. At the same time, the Corporation entered into forward interest rate agreements to fix the interest rate on the Notes at 5.8% through April 2, 2001. Subsequently, if the counterparty chooses not to cancel the agreement, the interest rate on the Notes would be variable based on the London InterBank Offered Rate (LIBOR) until expiration on October 1, 2005.

As of December 31, 1998, the Corporation had agreements outstanding with an aggregate notional amount of \$75.0 million maturing in September 1999 to effectively convert a portion of its floating rate commercial paper borrowings to fixed rate debt. As of December 31, 1998, interest rates payable were at a weighted average fixed rate of 6.3% and interest rates receivable averaging 5.2% were based on 30-day commercial paper composite rates. Any interest rate differential on interest rate swaps and forward agreements is recognized as an adjustment to interest expense over the term of each agreement. The Corporation's risk related to interest rate swap and forward agreements is limited to the cost of replacing such agreements at prevailing market rates. The potential loss in fair value of interest rate swaps and forward agreements resulting from a hypothetical near-term adverse change in market rates of ten percent was not material as of December 31, 1999 and 1998.

### **Foreign Exchange Contracts**

The Corporation enters into foreign exchange forward contracts to hedge transactions primarily related to firm commitments to purchase equipment, certain raw materials and finished goods denominated in foreign currencies, and to hedge payment of intercompany transactions with its non-domestic subsidiaries. These contracts reduce currency risk from exchange rate movements.

Foreign exchange forward contracts are intended and effective as hedges of firm, identifiable, foreign currency commitments. In accordance with Statement of Financial Accounting Standards No. 52, Foreign Currency Translation, these contracts meet the conditions for hedge accounting treatment and accordingly, gains and losses are deferred and accounted for as part of the underlying transactions. Gains and losses on terminated derivatives designated as hedges are accounted for as part of the originally hedged transaction. Gains and losses on derivatives designated as hedges of items which mature, are sold or terminated, are recorded currently in income.

As of December 31, 1999, the Corporation had foreign exchange forward contracts maturing in 2000 and 2001 to purchase \$18.0 million in foreign currency, primarily euros and British sterling, and to sell \$31.2 million in foreign currency, primarily Canadian dollars and Japanese yen, at contracted forward rates.

As of December 31, 1998, the Corporation had foreign exchange forward contracts maturing in 1999 and 2000 to purchase \$10.5 million in foreign currency, primarily British sterling and Dutch guilders, and to sell \$9.6 million in Japanese yen at contracted forward rates.

The fair value of foreign exchange forward contracts was estimated by obtaining quotes for future contracts with similar terms, adjusted where necessary for maturity differences. As of December 31, 1999 and 1998, the fair value of foreign exchange forward contracts approximated the contract value. The potential loss in fair value of foreign exchange forward contracts resulting from a hypothetical near-term adverse change in market rates of ten percent was not material as of December 31, 1999 and 1998.

### **Commodity Price Risk Management**

The Corporation's most significant raw materials include cocoa, sugar, milk, peanuts and almonds. The Corporation attempts to minimize the effect of future price fluctuations related to the purchase of these raw materials primarily through forward purchasing to cover future manufacturing requirements, generally for periods from 3 to 24 months. With regard to cocoa, sugar, corn sweeteners, natural gas and certain dairy products, price risks are also managed by entering into futures contracts. At the present time, active futures contracts are not available for use in pricing the Corporation's other major raw materials. Futures contracts are used in combination with forward purchasing of cocoa, sugar, corn sweetener, natural gas and certain dairy product requirements principally to take advantage of market fluctuations which provide more favorable pricing opportunities and to increase

diversity or flexibility in sourcing these raw materials and energy requirements. The Corporation's commodity procurement practices are intended to reduce the risk of future price increases, but also may potentially limit the ability to benefit from possible price decreases.

The cost of cocoa beans and the prices for the related commodity futures contracts historically have been subject to wide fluctuations attributable to a variety of factors, including the effect of weather on crop yield, other imbalances between supply and demand, currency exchange rates, political unrest in producing countries and speculative influences. Cocoa prices have declined recently as additional production, spurred by higher prices of the mid 1990's, has come on stream and as the economic difficulties in eastern Europe, particularly Russia, and Southeast Asia, have negatively impacted demand. During 2000, these negative demand influences could continue to keep cocoa futures prices contained. The Corporation's costs during 2000 will not necessarily reflect market price fluctuations because of its forward purchasing practices, premiums and discounts reflective of relative values, varying delivery times, and supply and demand for specific varieties and grades of cocoa beans.

### Commodities Futures Contracts

In connection with the purchasing of cocoa, sugar, corn sweeteners, natural gas and certain dairy products for anticipated manufacturing requirements, the Corporation enters into commodities futures contracts as deemed appropriate to reduce the effect of price fluctuations. In accordance with Statement of Financial Accounting Standards No. 80, Accounting for Futures Contracts, these futures contracts meet the hedge criteria and are accounted for as hedges. Accordingly, gains and losses are deferred and recognized in cost of sales as part of the product cost. Gains and losses on futures designated as hedges of anticipated purchases which are no longer likely to occur are recorded currently in income.

Exchange traded futures contracts are used to fix the price of physical forward purchase contracts. Cash transfers reflecting changes in the value of futures contracts are made on a daily basis and are included in other current assets or accrued liabilities on the consolidated balance sheets. Such cash transfers will be offset by higher or lower cash requirements for payment of invoice prices of raw materials and energy requirements in the future. Futures being held in excess of the amount required to fix the price of unpriced physical forward contracts are effective as hedges of anticipated purchases.

The following sensitivity analysis reflects the market risk of the Corporation to a hypothetical adverse market price movement of ten percent, based on the Corporation's net commodity positions at four dates spaced equally throughout the year. The Corporation's net commodity positions consist of the excess of futures contracts held over unpriced physical forward contracts for the same commodities, relating to cocoa, sugar, corn sweeteners and natural gas. Inventories, priced forward contracts and estimated anticipated purchases not yet contracted for were not included in the sensitivity analysis calculations. A loss is defined, for purposes of determining market risk, as the potential decrease in fair value or the opportunity cost resulting from the hypothetical adverse price movement. The fair values of net commodity positions were based upon quoted market prices or estimated future prices including estimated carrying costs corresponding with the future delivery period.

For the years ended December 31, In millions of dollars	1999		1998	
	Fair Value	Market Risk (Hypothetical 10% Change)	Fair Value	Market Risk (Hypothetical 10% Change)
Highest long position	\$147.7	\$14.8	\$134.9	\$13.5
Lowest long position	54.3	5.4	45.6	4.6
Average position (long)	111.0	11.1	76.3	7.6

Sensitivity analysis disclosures represent forward-looking statements which are subject to certain risks and uncertainties that could cause actual results to differ materially from those presently anticipated or projected. The important factors that could affect the sensitivity analysis disclosures include significant increases or decreases in market prices reflecting fluctuations attributable to the effect of weather on crop yield, other imbalances between supply and demand, currency exchange rates, political unrest in producing countries and speculative influences in addition to changes in the Corporation's hedging strategies.

## MARKET PRICES AND DIVIDENDS

Cash dividends paid on the Corporation's Common Stock and Class B Stock were \$136.7 million in 1999 and \$129.0 million in 1998. The annual dividend rate on the Common Stock was \$1.04 per share, an increase of 8% over the 1998 rate of \$.96 per share. The 1999 dividend represented the 25th consecutive year of Common Stock dividend increases.

On February 9, 2000, the Corporation's Board of Directors declared a quarterly dividend of \$.26 per share of Common Stock payable on March 15, 2000, to stockholders of record as of February 25, 2000. It is the Corporation's 281st consecutive Common Stock dividend. A quarterly dividend of \$.235 per share of Class B Stock also was declared.

Hershey Foods Corporation's Common Stock is listed and traded principally on the New York Stock Exchange (NYSE) under the ticker symbol "HSY." Approximately 128.6 million shares of the Corporation's Common Stock were traded during 1999. The Class B Stock is not publicly traded.

The closing price of the Common Stock on December 31, 1999, was \$47 <sup>7</sup>/<sub>16</sub>. There were 43,265 stockholders of record of the Common Stock and the Class B Stock as of December 31, 1999.

The following table shows the dividends paid per share of Common Stock and Class B Stock and the price range of the Common Stock for each quarter of the past two years:

	Dividends Paid Per Share		Common Stock Price Range*	
	Common Stock	Class B Stock	High	Low
1999				
1st Quarter	\$ .24	\$ .2175	\$64 <sup>7</sup> / <sub>8</sub>	\$54 <sup>1</sup> / <sub>8</sub>
2nd Quarter	.24	.2175	59 <sup>1</sup> / <sub>2</sub>	48 <sup>13</sup> / <sub>16</sub>
3rd Quarter	.26	.2350	61 <sup>7</sup> / <sub>16</sub>	48 <sup>1</sup> / <sub>2</sub>
4th Quarter	.26	.2350	54 <sup>3</sup> / <sub>16</sub>	45 <sup>3</sup> / <sub>4</sub>
Total	<u>\$ 1.00</u>	<u>\$ .9050</u>		
1998				
1st Quarter	\$ .22	\$ .2000	\$73 <sup>3</sup> / <sub>8</sub>	\$59 <sup>11</sup> / <sub>16</sub>
2nd Quarter	.22	.2000	76 <sup>3</sup> / <sub>8</sub>	67 <sup>3</sup> / <sub>16</sub>
3rd Quarter	.24	.2175	72 <sup>5</sup> / <sub>16</sub>	60 <sup>1</sup> / <sub>2</sub>
4th Quarter	.24	.2175	75 <sup>13</sup> / <sub>16</sub>	60 <sup>3</sup> / <sub>4</sub>
Total	<u>\$ .92</u>	<u>\$ .8350</u>		

\* NYSE-Composite Quotations for Common Stock by calendar quarter.

## **RETURN MEASURES**

### **Operating Return on Average Stockholders' Equity**

The Corporation's operating return on average stockholders' equity was 27.6% in 1999. Over the most recent five-year period, the return has ranged from 22.2% in 1995 to 36.0% in 1998. For the purpose of calculating operating return on average stockholders' equity, earnings is defined as net income, excluding the after-tax restructuring activities in 1995, the after-tax loss on the disposal of businesses in 1996 and the after-tax gain on the sale of the pasta business in 1999.

### **Operating Return on Average Invested Capital**

The Corporation's operating return on average invested capital was 14.8% in 1999. Over the most recent five-year period, the return has ranged from 17.8% in 1996 to 14.8% in 1999. Average invested capital consists of the annual average of beginning and ending balances of long-term debt, deferred income taxes and stockholders' equity. For the purpose of calculating operating return on average invested capital, earnings is defined as net income, excluding the after-tax restructuring activities in 1995, the after-tax loss on disposal of businesses in 1996, the after-tax gain on the sale of the pasta business in 1999, and the after-tax effect of interest on long-term debt.

## **YEAR 2000 ISSUES**

The Corporation completed its year 2000 testing and remediation programs in the third quarter of 1999. No significant year 2000 problems have been encountered with the Corporation's information technology (IT) and non-IT systems. The total cost of testing and remediation of the Corporation's IT and non-IT systems not being replaced by the integrated information system project was approximately \$6.0 million.

The Corporation also assessed year 2000 remediation issues relating to its major business partners. All of the Corporation's major customers have been contacted regarding year 2000 issues related to electronic data interchange. The Corporation also contacted all of its major suppliers of ingredients, packaging, facilities, logistics and financial services with regard to year 2000 issues. No significant year 2000 problems have been encountered with the Corporation's major business partners.

## **SAFE HARBOR STATEMENT**

The nature of the Corporation's operations and the environment in which it operates subject it to changing economic, competitive, regulatory and technological conditions, risks and uncertainties. In connection with the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, the Corporation notes the following factors which, among others, could cause future results to differ materially from the forward-looking statements, expectations and assumptions expressed or implied herein. Many of the forward looking statements contained in this document may be identified by the use of forward-looking words such as "believe," "expect," "anticipate," "should," "planned," "estimated," and "potential" among others. Factors which could cause results to differ include, but are not limited to: changes in the confectionery and grocery business environment, including actions of competitors and changes in consumer preferences; changes in governmental laws and regulations, including income taxes; market demand for new and existing products; raw material pricing; the Corporation's ability to fully remedy the problems and avoid the increased costs encountered since implementing changes to the customer service, warehousing, and order fulfillment processes and systems in the third quarter of 1999; the ability to restore customer service to historical levels; the effects service levels and other factors have on future customer demand; and the ability to complete construction and commence operations of new warehousing facilities on schedule.

**HERSHEY FOODS CORPORATION**  
**CONSOLIDATED STATEMENTS OF INCOME**

<b>For the years ended December 31,</b>	<b>1999</b>	<b>1998</b>	<b>1997</b>
<b>In thousands of dollars except per share amounts</b>			
<b>Net Sales</b>	<b><u>\$3,970,924</u></b>	<u>\$4,435,615</u>	<u>\$4,302,236</u>
<b>Costs and Expenses:</b>			
Cost of sales	<b>2,354,724</b>	2,625,057	2,488,896
Selling, marketing and administrative	<b>1,057,840</b>	1,167,895	1,183,130
Gain on sale of business	<b>(243,785)</b>	—	—
Total costs and expenses	<b><u>3,168,779</u></b>	<u>3,792,952</u>	<u>3,672,026</u>
<b>Income before Interest and Income Taxes</b>	<b>802,145</b>	642,663	630,210
Interest expense, net	<b><u>74,271</u></b>	<u>85,657</u>	<u>76,255</u>
<b>Income before Income Taxes</b>	<b>727,874</b>	557,006	553,955
Provision for income taxes	<b><u>267,564</u></b>	<u>216,118</u>	<u>217,704</u>
<b>Net Income</b>	<b><u>\$ 460,310</u></b>	<u>\$ 340,888</u>	<u>\$ 336,251</u>
<b>Net Income Per Share—Basic</b>	<b><u>\$ 3.29</u></b>	<u>\$ 2.38</u>	<u>\$ 2.25</u>
<b>Net Income Per Share—Diluted</b>	<b><u>\$ 3.26</u></b>	<u>\$ 2.34</u>	<u>\$ 2.23</u>
<b>Cash Dividends Paid Per Share:</b>			
Common Stock	<b>\$ 1.00</b>	\$ .920	\$ .840
Class B Common Stock	<b>.905</b>	.835	.760

The notes to consolidated financial statements are an integral part of these statements.

**HERSHEY FOODS CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**

December 31,	1999	1998
<b>In thousands of dollars</b>		
<b>ASSETS</b>		
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 118,078	\$ 39,024
Accounts receivable—trade	352,750	451,324
Inventories	602,202	493,249
Deferred income taxes	80,303	58,505
Prepaid expenses and other	126,647	91,864
Total current assets	1,279,980	1,133,966
<b>Property, Plant and Equipment, Net</b>	<b>1,510,460</b>	<b>1,648,058</b>
<b>Intangibles Resulting from Business Acquisitions</b>	<b>450,165</b>	<b>530,464</b>
<b>Other Assets</b>	<b>106,047</b>	<b>91,610</b>
Total assets	<b>\$ 3,346,652</b>	<b>\$ 3,404,098</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current Liabilities:</b>		
Accounts payable	\$ 136,567	\$ 156,937
Accrued liabilities	292,497	294,415
Accrued income taxes	72,159	17,475
Short-term debt	209,166	345,908
Current portion of long-term debt	2,440	89
Total current liabilities	712,829	814,824
<b>Long-term Debt</b>	<b>878,213</b>	<b>879,103</b>
<b>Other Long-term Liabilities</b>	<b>330,938</b>	<b>346,769</b>
<b>Deferred Income Taxes</b>	<b>326,045</b>	<b>321,101</b>
Total liabilities	2,248,025	2,361,797
<b>Stockholders' Equity:</b>		
Preferred Stock, shares issued: none in 1999 and 1998	—	—
Common Stock, shares issued: 149,506,964 in 1999 and 149,502,964 in 1998	149,507	149,503
Class B Common Stock, shares issued: 30,443,908 in 1999 and 30,447,908 in 1998	30,443	30,447
Additional paid-in capital	30,079	29,995
Unearned ESOP compensation	(22,354)	(25,548)
Retained earnings	2,513,275	2,189,693
Treasury—Common Stock shares, at cost: 41,491,253 in 1999 and 36,804,157 in 1998	(1,552,708)	(1,267,422)
Accumulated other comprehensive loss	(49,615)	(64,367)
Total stockholders' equity	1,098,627	1,042,301
Total liabilities and stockholders' equity	<b>\$ 3,346,652</b>	<b>\$ 3,404,098</b>

The notes to consolidated financial statements are an integral part of these balance sheets.

**HERSHEY FOODS CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

For the years ended December 31, In thousands of dollars	1999	1998	1997
<b>Cash Flows Provided from (Used by)</b>			
<b>Operating Activities</b>			
Net income	<b>\$ 460,310</b>	\$ 340,888	\$ 336,251
Adjustments to reconcile net income to net cash provided from operations:			
Depreciation and amortization	<b>163,308</b>	158,161	152,750
Deferred income taxes	<b>(8,336)</b>	82,241	16,915
Gain on sale of business, net of tax of \$78,769	<b>(165,016)</b>	—	—
Changes in assets and liabilities, net of effects from business divestiture:			
Accounts receivable—trade	<b>77,918</b>	(90,493)	(68,479)
Inventories	<b>(136,535)</b>	12,276	(33,538)
Accounts payable	<b>(8,742)</b>	10,005	12,967
Other assets and liabilities	<b>(55,224)</b>	(124,118)	85,074
Other, net	<b>—</b>	745	4,018
Net Cash Provided from Operating Activities	<b><u>327,683</u></b>	<u>389,705</u>	<u>505,958</u>
<b>Cash Flows Provided from (Used by)</b>			
<b>Investing Activities</b>			
Capital additions	<b>(115,448)</b>	(161,328)	(172,939)
Capitalized software additions	<b>(25,394)</b>	(42,859)	(29,100)
Proceeds from divestiture	<b>450,000</b>	—	—
Other, net	<b>13,526</b>	9,284	21,368
Net Cash Provided from (Used by) Investing Activities	<b><u>322,684</u></b>	<u>(194,903)</u>	<u>(180,671)</u>
<b>Cash Flows Provided from (Used by)</b>			
<b>Financing Activities</b>			
Net change in short-term borrowings	<b>(136,742)</b>	(36,543)	(217,018)
Long-term borrowings	<b>1,696</b>	—	550,000
Repayment of long-term debt	<b>(393)</b>	(25,187)	(15,588)
Cash dividends paid	<b>(136,728)</b>	(129,044)	(121,546)
Exercise of stock options	<b>18,878</b>	19,368	14,397
Incentive plan transactions	<b>—</b>	(22,458)	(35,063)
Repurchase of Common Stock	<b>(318,024)</b>	(16,151)	(507,654)
Net Cash (Used by) Financing Activities	<b><u>(571,313)</u></b>	<u>(210,015)</u>	<u>(332,472)</u>
Increase (Decrease) in Cash and Cash Equivalents	<b>79,054</b>	(15,213)	(7,185)
Cash and Cash Equivalents as of January 1	<b>39,024</b>	54,237	61,422
Cash and Cash Equivalents as of December 31	<b><u>\$ 118,078</u></b>	<u>\$ 39,024</u>	<u>\$ 54,237</u>
Interest Paid	<b>\$ 77,049</b>	\$ 89,001	\$ 64,937
Income Taxes Paid	<b>218,665</b>	123,970	181,377

The notes to consolidated financial statements are an integral part of these statements.

**HERSHEY FOODS CORPORATION**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

	Preferred Stock	Common Stock	Class B Common Stock	Additional Paid-in Capital	Unearned ESOP Compensation	Retained Earnings	Treasury Common Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
<b>In thousands of dollars</b>									
<b>Balance as of January 1, 1997</b>	\$ —	\$ 149,472	\$ 30,478	\$ 42,432	\$ (31,935)	\$ 1,763,144	\$ (759,695)	\$ (32,875)	\$ 1,161,021
Comprehensive income (loss)									
Net income						336,251			336,251
Other comprehensive income (loss):									
Foreign currency translation adjustments								(9,368)	(9,368)
Comprehensive income									326,883
Dividends:									
Common Stock, \$.84 per share						(98,390)			(98,390)
Class B Common Stock, \$.76 per share						(23,156)			(23,156)
Conversion of Class B Common Stock into Common Stock		13	(13)						
Incentive plan transactions				(879)					(879)
Exercise of stock options				(8,200)			(512)		(8,712)
Employee stock ownership trust transactions				499	3,194				3,693
Repurchase of Common Stock							(507,654)		(507,654)
<b>Balance as of December 31, 1997</b>	—	149,485	30,465	33,852	(28,741)	1,977,849	(1,267,861)	(42,243)	852,806
Comprehensive income (loss)									
Net income						340,888			340,888
Other comprehensive income (loss):									
Foreign currency translation adjustments								(18,073)	(18,073)
Minimum pension liability adjustments, net of tax benefit								(4,051)	(4,051)
Comprehensive income									318,764
Dividends:									
Common Stock, \$.92 per share						(103,616)			(103,616)
Class B Common Stock, \$.835 per share						(25,428)			(25,428)
Conversion of Class B Common Stock into Common Stock		18	(18)						
Incentive plan transactions				(985)					(985)
Exercise of stock options				(3,375)			16,590		13,215
Employee stock ownership trust transactions				503	3,193				3,696
Repurchase of Common Stock							(16,151)		(16,151)
<b>Balance as of December 31, 1998</b>	—	149,503	30,447	29,995	(25,548)	2,189,693	(1,267,422)	(64,367)	1,042,301
Comprehensive income (loss)									
Net income						460,310			460,310
Other comprehensive income (loss):									
Foreign currency translation adjustments								10,701	10,701
Minimum pension liability adjustments, net of tax benefit								4,051	4,051
Comprehensive income									475,062
Dividends:									
Common Stock, \$1.00 per share						(109,175)			(109,175)
Class B Common Stock, \$.905 per share						(27,553)			(27,553)
Conversion of Class B Common Stock into Common Stock		4	(4)						
Incentive plan transactions				2					2
Exercise of stock options				(458)			32,738		32,280
Employee stock ownership trust/benefits transactions				540	3,194				3,734
Repurchase of Common Stock							(318,024)		(318,024)
<b>Balance as of December 31, 1999</b>	<u>\$—</u>	<u>\$ 149,507</u>	<u>\$ 30,443</u>	<u>\$ 30,079</u>	<u>\$ (22,354)</u>	<u>\$ 2,513,275</u>	<u>\$ (1,552,708)</u>	<u>\$ (49,615)</u>	<u>\$ 1,098,627</u>

A-14

The notes to consolidated financial statements are an integral part of these statements.

**HERSHEY FOODS CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Significant accounting policies employed by the Corporation are discussed below and in other notes to the consolidated financial statements. Certain reclassifications have been made to prior year amounts to conform to the 1999 presentation.

**Principles of Consolidation**

The consolidated financial statements include the accounts of the Corporation and its subsidiaries after elimination of intercompany accounts and transactions.

**Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates, particularly for accounts receivable and certain current and long-term liabilities.

**Revenue Recognition**

Sales are recorded at the time products are shipped and risk of loss is transferred.

**Cash Equivalents**

All highly liquid debt instruments purchased with a maturity of three months or less are classified as cash equivalents.

**Commodities Futures Contracts**

In connection with the purchasing of cocoa, sugar, corn sweeteners, natural gas and certain dairy products for anticipated manufacturing requirements, the Corporation enters into commodities futures contracts as deemed appropriate to reduce the effect of price fluctuations. In accordance with Statement of Financial Accounting Standards No. 80, Accounting for Futures Contracts, these futures contracts meet the hedge criteria and are accounted for as hedges. Accordingly, gains and losses are deferred and recognized in cost of sales as part of the product cost. Gains and losses on futures designated as hedges of anticipated purchases which are no longer likely to occur are recorded in income currently.

**Property, Plant and Equipment**

Property, plant and equipment are stated at cost. Depreciation of buildings, machinery and equipment is computed using the straight-line method over the estimated useful lives.

**Intangibles Resulting from Business Acquisitions**

Intangible assets resulting from business acquisitions principally consist of the excess of the acquisition cost over the fair value of the net assets of businesses acquired (goodwill). Goodwill was \$431.7 million and \$508.0 million as of December 31, 1999 and 1998, respectively. The decrease in goodwill primarily reflected the divestiture of the Corporation's pasta business in January 1999.

Goodwill is amortized on a straight-line basis over 40 years. Other intangible assets are amortized on a straight-line basis over the estimated useful lives. The Corporation periodically evaluates whether events or circumstances have occurred indicating that the carrying amount of goodwill may not be recoverable. When factors indicate that goodwill should be evaluated for possible impairment, the Corporation uses an estimate of the acquired business' undiscounted future cash flows compared to the related carrying amount of net assets, including goodwill, to determine if an impairment loss should be recognized.

Accumulated amortization of intangible assets resulting from business acquisitions was \$121.6 million and \$132.3 million as of December 31, 1999 and 1998, respectively. The decrease in accumulated amortization reflected the divestiture of the Corporation's pasta business in January 1999.

### **Comprehensive Income**

In June 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 130, Reporting Comprehensive Income (SFAS No. 130). SFAS No. 130 establishes standards for reporting and display of comprehensive income and its components. SFAS No. 130 requires that an enterprise (a) classify items of other comprehensive income by their nature in a financial statement and (b) display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of a statement of financial position.

Results of operations for foreign entities are translated using the average exchange rates during the period. For foreign entities, assets and liabilities are translated to U.S. dollars using the exchange rates in effect at the balance sheet date. Resulting translation adjustments are recorded as a component of other comprehensive income (loss), "Foreign Currency Translation Adjustments."

A minimum pension liability adjustment is required when the actuarial present value of accumulated pension plan benefits exceeds plan assets and accrued pension liabilities, less allowable intangible assets. Minimum pension liability adjustments, net of income taxes, are recorded as a component of other comprehensive income (loss), "Minimum Pension Liability Adjustments, net of tax benefit."

Comprehensive income (loss) is reported on the Consolidated Statements of Stockholders' Equity and accumulated other comprehensive (loss) is reported on the Consolidated Balance Sheets.

### **Foreign Exchange Contracts**

The Corporation enters into foreign exchange forward contracts to hedge transactions primarily related to firm commitments to purchase equipment, certain raw materials and finished goods denominated in foreign currencies, and to hedge payment of intercompany transactions with its non-domestic subsidiaries. These contracts reduce currency risk from exchange rate movements.

Foreign exchange forward contracts are intended and effective as hedges of firm, identifiable, foreign currency commitments. Accordingly, gains and losses are deferred and accounted for as part of the underlying transactions. Gains and losses on terminated derivatives designated as hedges are accounted for as part of the originally hedged transaction. Gains and losses on derivatives designated as hedges of items which mature, are sold or terminated, are recorded currently in income. In entering into these contracts the Corporation has assumed the risk which might arise from the possible inability of counterparties to meet the terms of their contracts. The Corporation does not expect any losses as a result of counterparty defaults.

## **License Agreements**

The Corporation has entered into license agreements under which it has access to certain trademarks and proprietary technology, and manufactures and/or markets and distributes certain products. The rights under these agreements are extendible on a long-term basis at the Corporation's option subject to certain conditions, including minimum sales levels, which the Corporation has met. License fees and royalties, payable under the terms of the agreements, are expensed as incurred.

## **Research and Development**

The Corporation expenses research and development costs as incurred. Research and development expense was \$26.7 million, \$28.6 million and \$27.5 million in 1999, 1998 and 1997, respectively.

## **Advertising**

The Corporation expenses advertising costs as incurred. Advertising expense was \$164.9 million, \$187.5 million and \$202.4 million in 1999, 1998 and 1997, respectively. Prepaid advertising as of December 31, 1999 and 1998, was \$5.8 million and \$12.1 million, respectively.

## **Computer Software**

In 1997, the Corporation began capitalizing certain costs of computer software developed or obtained for internal use. The amount capitalized as of December 31, 1999 and 1998, was \$82.2 million and \$69.3 million, respectively. If such costs were capitalized in prior years, the effect would not have been material. Software assets are classified as other non-current assets and are amortized over periods up to five years. Accumulated amortization of capitalized software was \$15.1 million and \$2.8 million as of December 31, 1999 and 1998, respectively.

## **2. DIVESTITURE**

In January 1999, the Corporation completed the sale of a 94% majority interest of its U.S. pasta business to New World Pasta, LLC. The transaction included the *American Beauty*, *Ideal by San Giorgio*, *Light 'n Fluffy*, *Mrs. Weiss*, *P&R*, *Ronzoni*, *San Giorgio* and *Skinner* pasta brands, along with six manufacturing plants. In the first quarter of 1999, the Corporation received cash proceeds of \$450.0 million, retained a 6% minority interest and recorded a gain of approximately \$243.8 million before tax, \$165.0 million or \$1.17 per share—diluted after tax, as a result of the transaction. Net sales for the pasta business were \$29.3 million, \$373.1 million, and \$386.2 million for 1999, 1998 and 1997, respectively. Net income for the pasta business was \$1.5 million, \$25.9 million and \$25.2 million for 1999, 1998 and 1997, respectively.

## **3. RENTAL AND LEASE COMMITMENTS**

Rent expense was \$45.5 million, \$39.6 million and \$31.8 million for 1999, 1998 and 1997, respectively. Rent expense pertains to all operating leases, which were principally related to certain administrative buildings, distribution facilities and transportation equipment. In July 1999, the Corporation entered into an operating lease agreement for an amount not to exceed \$65 million for the purpose of financing construction costs of a warehouse and distribution facility located on land owned by the Corporation near Hershey, Pennsylvania. Under the agreement, the lessor pays for the construction costs and thereafter leases the facility to the Corporation. The lease term is six years, including the construction period. The lease may be extended at the Corporation's option for up to four renewal periods of five years each. The lease provides for a substantial residual guarantee and includes an option to purchase the facility at original cost. The first phase of the distribution center is expected to open in the second quarter of 2000. Future minimum rental payments under non-cancelable

operating leases with a remaining term in excess of one year as of December 31, 1999, were: 2000, \$18.5 million; 2001, \$19.7 million; 2002, \$18.9 million; 2003, \$18.3 million; 2004, \$18.1 million; 2005 and beyond, \$42.9 million.

#### **4. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES**

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133). SFAS No. 133 establishes accounting and reporting standards requiring that every derivative instrument be recorded in the balance sheet as either an asset or liability measured at its fair value. SFAS No. 133 requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement, and requires that a company must formally document, designate, and assess the effectiveness of transactions that receive hedge accounting.

SFAS No. 133 is effective for fiscal years beginning after June 15, 2000, but may be implemented as of the beginning of any fiscal quarter after issuance. Retroactive application is not permitted. SFAS No. 133 must be applied to (a) derivative instruments and (b) certain derivative instruments embedded in hybrid contracts that were issued, acquired, or substantively modified after December 31, 1997. Changes in accounting methods will be required for derivative instruments utilized by the Corporation to hedge commodity price, foreign currency exchange rate and interest rate risks. Such derivatives currently include, but are not limited to, commodity futures contracts, foreign exchange forward contracts, and interest rate swaps and forward agreements.

The Corporation anticipates the adoption of SFAS No. 133 as of January 1, 2001. As of December 31, 1999, net deferred losses on derivatives of approximately \$38.2 million after tax would have been reported as a component of other comprehensive loss and classified as accumulated other comprehensive loss on the consolidated balance sheets upon adoption of SFAS No. 133. The adoption of SFAS No. 133 is not expected to have a material impact on the Corporation's results of operations.

#### **5. FINANCIAL INSTRUMENTS**

The carrying amounts of financial instruments including cash and cash equivalents, accounts receivable, accounts payable and short-term debt approximated fair value as of December 31, 1999 and 1998, because of the relatively short maturity of these instruments. The carrying value of long-term debt, including the current portion, was \$880.7 million as of December 31, 1999, compared to a fair value of \$856.9 million based on quoted market prices for the same or similar debt issues. The carrying value of long-term debt, including the current portion, was \$879.2 million as of December 31, 1998, compared to a fair value of approximately \$1.0 billion.

As of December 31, 1999, the Corporation had foreign exchange forward contracts maturing in 2000 and 2001 to purchase \$18.0 million in foreign currency, primarily euros and British sterling, and to sell \$31.2 million in foreign currency, primarily Canadian dollars and Japanese yen, at contracted forward rates.

As of December 31, 1998, the Corporation had foreign exchange forward contracts maturing in 1999 and 2000 to purchase \$10.5 million in foreign currency, primarily British sterling and Dutch guilders, and to sell \$9.6 million in Japanese yen at contracted forward rates.

The fair value of foreign exchange forward contracts is estimated by obtaining quotes for future contracts with similar terms, adjusted where necessary for maturity differences. As of December 31, 1999 and 1998, the fair value of foreign exchange forward contracts approximated the contract value. The Corporation does not hold or issue financial instruments for trading purposes.

In order to minimize its financing costs and to manage interest rate exposure, the Corporation, from time to time, enters into interest rate swap agreements. In October 1999, the Corporation entered into an interest rate swap agreement to effectively convert \$200 million of 6.7% Notes Due 2005 (Notes) to variable rate debt. The interest rate swap agreement is cancelable at the sole discretion of the counterparty effective April 2, 2001. At the same time, the Corporation entered into forward interest rate agreements to fix the interest rate on the Notes at 5.8% through April 2, 2001. Subsequently, if the counterparty chooses not to cancel the agreement, the interest rate on the Notes would be variable based on the London InterBank Offered Rate (LIBOR) until expiration on October 1, 2005.

As of December 31, 1998, the Corporation had agreements outstanding with an aggregate notional amount of \$75.0 million maturing in September 1999 to effectively convert a portion of its floating rate commercial paper borrowings to fixed rate debt. As of December 31, 1998, interest rates payable were at a weighted average fixed rate of 6.3% and interest rates receivable averaging 5.2% were based on 30-day commercial paper composite rates. Any interest rate differential on interest rate swaps and forward agreements is recognized as an adjustment to interest expense over the term of each agreement. The Corporation's risk related to interest rate swap and forward agreements is limited to the cost of replacing such agreements at prevailing market rates.

## 6. INTEREST EXPENSE

Interest expense, net consisted of the following:

<b>For the years ended December 31,</b>	<b>1999</b>	<b>1998</b>	<b>1997</b>
<b>In thousands of dollars</b>			
Long-term debt and lease obligations	<b>\$66,323</b>	\$67,538	\$48,737
Short-term debt	<b>12,191</b>	23,657	32,284
Capitalized interest	<b>(1,214)</b>	(2,547)	(1,883)
Interest expense, gross	<b>77,300</b>	88,648	79,138
Interest income	<b>(3,029)</b>	(2,991)	(2,883)
Interest expense, net	<b><u>\$74,271</u></b>	<u>\$85,657</u>	<u>\$76,255</u>

## 7. SHORT-TERM DEBT

Generally, the Corporation's short-term borrowings are in the form of commercial paper or bank loans with an original maturity of three months or less. As of December 31, 1999, the Corporation maintained a committed credit facility agreement with a syndicate of banks in the amount of \$500.0 million which could be borrowed directly or used to support the issuance of commercial paper. The Corporation has the option to increase the credit facility by \$1.0 billion with the concurrence of the banks. In December 1999, the short-term credit facility agreement was renewed for a total of \$200 million and the long-term committed credit facility agreement remained in effect for \$300 million, expiring in December 2002. The credit facilities may be used to fund general corporate requirements, to support commercial paper borrowings and, in certain instances, to finance future business acquisitions.

The Corporation also maintains lines of credit arrangements with domestic and international commercial banks, under which it could borrow in various currencies up to approximately \$25.0 million and \$23.0 million as of December 31, 1999 and 1998, respectively, at the lending banks' prime commercial interest rates or lower.

The Corporation had combined domestic commercial paper borrowings, and short-term foreign bank loans against its credit facilities and lines of credit of \$209.2 million as of December 31, 1999, and

\$345.9 million as of December 31, 1998. The weighted average interest rates on short-term borrowings outstanding as of December 31, 1999 and 1998, were 5.8% and 5.2%, respectively.

The credit facilities and lines of credit were supported by commitment fee arrangements. The average fee during 1999 was less than .1% per annum of the commitment. The Corporation's credit facility agreements contain a financial covenant which requires that a specified interest and fixed charge ratio be maintained. These agreements are also subject to other representations and covenants which do not materially restrict the Corporation's activities. The Corporation is in compliance with all covenants included in the credit facility agreements. There were no significant compensating balance agreements which legally restricted these funds.

As a result of maintaining a consolidated cash management system, the Corporation maintains overdraft positions at certain banks. Such overdrafts, which were included in accounts payable, were \$28.3 million and \$57.0 million as of December 31, 1999 and 1998, respectively.

## 8. LONG-TERM DEBT

Long-term debt consisted of the following:

December 31,	1999	1998
<b>In thousands of dollars</b>		
6.7% Notes due 2005	<b>\$200,000</b>	\$200,000
6.95% Notes due 2007	<b>150,000</b>	150,000
6.95% Notes due 2012	<b>150,000</b>	150,000
8.8% Debentures due 2021	<b>100,000</b>	100,000
7.2% Debentures due 2027	<b>250,000</b>	250,000
Other obligations, net of unamortized debt discount	<b>30,653</b>	29,192
Total long-term debt	<b>880,653</b>	879,192
Less—current portion	<b>2,440</b>	89
Long-term portion	<b><u>\$878,213</u></b>	<b><u>\$879,103</u></b>

In October 1999, the Corporation entered into an interest rate swap agreement to effectively convert \$200 million of 6.7% Notes due 2005 to variable rate debt. The interest rate swap agreement is cancelable at the sole discretion of the counterparty effective April 2, 2001. At the same time, the Corporation entered into forward interest rate agreements to fix the interest rate on the Notes at 5.8% through April 2, 2001. Subsequently, if the counterparty chooses not to cancel the agreement, the interest rate on the Notes would be variable based on LIBOR until expiration on October 1, 2005.

Aggregate annual maturities during the next five years are: 2000, \$2.4 million; 2001, \$.7 million; 2002, \$.8 million; 2003, \$17.1 million; and \$.1 million in 2004. The Corporation's debt is principally unsecured and of equal priority. None of the debt is convertible into stock of the Corporation. The Corporation is in compliance with all covenants included in the related debt agreements.

## 9. INCOME TAXES

The provision for income taxes was as follows:

For the years ended December 31,	1999	1998	1997
<b>In thousands of dollars</b>			
Current:			
Federal	<b>\$256,054</b>	\$119,706	\$177,145
State	<b>15,998</b>	10,498	20,252
Foreign	<b>3,848</b>	3,673	3,392
Current provision for income taxes	<u><b>275,900</b></u>	<u>133,877</u>	<u>200,789</u>
Deferred:			
Federal	<b>(23,271)</b>	73,422	9,370
State	<b>16,280</b>	10,568	5,103
Foreign	<b>(1,345)</b>	(1,749)	2,442
Deferred provision for income taxes	<u><b>(8,336)</b></u>	<u>82,241</u>	<u>16,915</u>
Total provision for income taxes	<u><b>\$267,564</b></u>	<u>\$216,118</u>	<u>\$217,704</u>

The tax effects of the significant temporary differences which comprised the deferred tax assets and liabilities were as follows:

December 31,	1999	1998
<b>In thousands of dollars</b>		
Deferred tax assets:		
Post-retirement benefit obligations	<b>\$ 84,305</b>	\$ 87,954
Accrued expenses and other reserves	<b>103,232</b>	96,843
Accrued trade promotion reserves	<b>34,708</b>	28,118
Other	<b>23,054</b>	21,530
Total deferred tax assets	<u><b>245,299</b></u>	<u>234,445</u>
Deferred tax liabilities:		
Depreciation	<b>289,369</b>	308,074
Other	<b>201,672</b>	188,967
Total deferred tax liabilities	<u><b>491,041</b></u>	<u>497,041</u>
Net deferred tax liabilities	<u><b>\$245,742</b></u>	<u>\$262,596</u>
Included in:		
Current deferred tax assets, net	<b>\$ 80,303</b>	\$ 58,505
Non-current deferred tax liabilities, net	<b>326,045</b>	321,101
Net deferred tax liabilities	<u><b>\$245,742</b></u>	<u>\$262,596</u>

The following table reconciles the Federal statutory income tax rate with the Corporation's effective income tax rate:

For the years ended December 31,	1999	1998	1997
Federal statutory income tax rate	<b>35.0%</b>	35.0%	35.0%
Increase (reduction) resulting from:			
State income taxes, net of Federal income tax benefits	<b>2.3</b>	3.0	3.4
Non-deductible acquisition costs	<b>.6</b>	.9	.9
Utilization of capital loss carryforwards	<b>(.9)</b>	—	—
Other, net	<b>(.2)</b>	(.1)	—
Effective income tax rate	<b><u>36.8%</u></b>	<u>38.8%</u>	<u>39.3%</u>

In January 1999, the Corporation received a Notice of Proposed Deficiency from the Internal Revenue Service (IRS) related to the years 1989 through 1996. The most significant issue pertains to the Corporate Owned Life Insurance (COLI) program which was implemented by the Corporation in 1989. The IRS proposed an assessment for the disallowance of interest expense deductions associated with the underlying life insurance policies. The total impact of the disallowance was approximately \$60.4 million, including interest as of December 31, 1999. The Corporation may be subject to additional assessments for federal and state tax and interest payments for years subsequent to 1996. The Corporation believes that it has fully complied with the tax law as it relates to its COLI program. The Corporation filed a protest of the proposed deficiency with the Appeals section of the IRS in April 1999 and continues to vigorously defend its position on this matter.

## **10. PENSION AND OTHER POST-RETIREMENT BENEFIT PLANS**

The Corporation's policy is to fund domestic pension liabilities in accordance with the minimum and maximum limits imposed by the Employee Retirement Income Security Act of 1974 and Federal income tax laws, respectively. Non-domestic pension liabilities are funded in accordance with applicable local laws and regulations. Plan assets are invested in a broadly diversified portfolio consisting primarily of domestic and international common stocks and fixed income securities. Other benefits include health care and life insurance provided by the Corporation under two post-retirement benefit plans.

Effective December 31, 1998, the Corporation adopted Statement of Financial Accounting Standards No. 132, Employers' Disclosures about Pension and Other Post-Retirement Benefits (SFAS No. 132). The provisions of SFAS No. 132 revise employers' disclosures about pension and other post-retirement benefit plans. It does not change the measurement or recognition of these plans.

A summary of the changes in benefit obligations and plan assets as of December 31, 1999 and 1998 is presented below:

December 31,	Pension Benefits		Other Benefits	
	1999	1998	1999	1998
<b>In thousands of dollars</b>				
<b>Change in benefits obligation</b>				
Benefits obligation at beginning of year	\$ 692,422	\$602,081	\$ 251,040	\$ 206,695
Service cost	31,050	27,621	3,803	4,452
Interest cost	41,781	41,855	13,813	13,524
Amendments	16,404	(440)	(11,092)	(17,427)
Actuarial (gain) loss	(93,537)	72,944	(32,285)	54,698
Divestiture/Acquisition	(8,648)	—	—	(1,799)
Other	3,185	(2,440)	222	(228)
Benefits paid	(54,947)	(49,199)	(10,991)	(8,875)
Benefits obligation at end of year	<u>627,710</u>	<u>692,422</u>	<u>214,510</u>	<u>251,040</u>
<b>Change in plan assets</b>				
Fair value of plan assets at beginning of year	628,041	566,810	—	—
Actual return on plan assets	74,511	91,338	—	—
Divestiture	(5,993)	—	—	—
Employer contribution	6,253	20,634	10,991	8,875
Other	2,834	(1,542)	—	—
Benefits paid	(54,947)	(49,199)	(10,991)	(8,875)
Fair value of plan assets at end of year	<u>650,699</u>	<u>628,041</u>	<u>—</u>	<u>—</u>
Funded status	22,989	(64,381)	(214,510)	(251,040)
Unrecognized transition obligation	(308)	(91)	—	—
Unrecognized prior service cost	49,046	35,854	(24,842)	(33,202)
Unrecognized net actuarial (gain) loss	(105,839)	6,164	26,085	59,589
Intangible asset	—	(1,261)	—	—
Accumulated other comprehensive income	—	(6,750)	—	—
Prior service cost recognized due to curtailment	—	—	17,034	12,991
Unrecognized prior service cost due to amendment	—	—	(11,105)	(6,924)
(Accrued) benefits cost	<u>\$ (34,112)</u>	<u>\$ (30,465)</u>	<u>\$ (207,338)</u>	<u>\$ (218,586)</u>
<b>Weighted-average assumptions</b>				
Discount rate	7.5%	6.4%	7.5%	6.4%
Expected long-term rate of return on assets	9.5	9.5	N/A	N/A
Rate of increase in compensation levels	4.8	4.8	N/A	N/A

For measurement purposes, a 6% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2000 and future years.

As of December 31, 1999, for pension plans with accumulated benefit obligations in excess of plan assets, the related projected benefit obligation and accumulated benefit obligation were \$36.4 million and \$35.0 million, respectively, with no plan assets.

As of December 31, 1998, for pension plans with accumulated benefit obligations in excess of plan assets, the related projected benefit obligation, accumulated benefit obligation and the fair value of plan assets were \$81.1 million, \$66.9 million and \$22.7 million, respectively.

A minimum pension liability adjustment is required when the actuarial present value of accumulated plan benefits exceeds plan assets and accrued pension liabilities. In 1999, accrued pension

liabilities exceeded the actuarial present value of accumulated plan benefits because the discount rate used to determine the present value of accumulated benefits increased from 6.4% to 7.5% and a plan amendment shifted benefits from an unfunded pension plan to a funded plan. Accordingly, a minimum pension liability adjustment of \$4.1 million, initially recorded in other comprehensive income in 1998, was reversed in 1999, net of deferred income taxes of \$2.7 million.

A summary of the components of net periodic benefits cost for the years ended December 31, 1999 and 1998 is presented below:

For the years ended December 31, In thousands of dollars	Pension Benefits		Other Benefits	
	1999	1998	1999	1998
<b>Components of net periodic benefits cost</b>				
Service cost	\$ 31,050	\$ 27,621	\$ 3,803	\$ 4,452
Interest cost	41,781	41,855	13,813	13,524
Expected return on plan assets	(57,836)	(53,399)	—	—
Amortization of prior service cost	2,956	2,941	(2,293)	(2,986)
Recognized net actuarial loss	341	717	1,042	—
Other	—	—	54	9
Corporate sponsored plans	18,292	19,735	16,419	14,999
Multi-employer plans	698	1,571	—	—
Administrative expenses	287	796	—	—
Net periodic benefits cost	<u>\$ 19,277</u>	<u>\$ 22,102</u>	<u>\$ 16,419</u>	<u>\$ 14,999</u>

The Corporation has two post-retirement benefit plans. The health care plan is contributory, with participants' contributions adjusted annually, and the life insurance plan is non-contributory. During the first quarter of 1999, for all eligible employees under age 45, the Corporation provided annual contributions into the Employee Savings Stock Investment and Ownership Plan (ESSIOP) instead of providing coverage under the current retiree medical plan. This change resulted in the immediate recognition of a \$15.4 million pre-tax gain which is not included above as a component of net periodic benefits costs. The changes applied primarily to U.S. hourly employees working in Pennsylvania.

Effective December 1998, all U.S. full-time salaried employees, and all non-union hourly plant employees working outside Hershey, PA under age 45 were eligible for the ESSIOP contributions. This change resulted in the immediate recognition of a \$13.0 million pre-tax gain which is not included above as a component of net periodic benefits cost in 1998.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one percentage point change in assumed health care cost trend rates would have the following effects:

In thousands of dollars	1 Percentage Point Increase	1 Percentage Point (Decrease)
Effect on total service and interest cost components	\$ 954	\$ (829)
Effect on post-retirement benefit obligation	11,152	(9,999)

## 11. EMPLOYEE STOCK OWNERSHIP TRUST

The Corporation's employee stock ownership trust (ESOP) serves as the primary vehicle for contributions to its existing ESSIOP for participating domestic salaried and hourly employees. The ESOP was funded by a 15-year 7.75% loan of \$47.9 million from the Corporation. During 1999 and 1998, the ESOP received a combination of dividends on unallocated shares and contributions from the

Corporation equal to the amount required to meet its principal and interest payments under the loan. Simultaneously, the ESOP allocated to participants 159,176 shares of Common Stock each year. As of December 31, 1999, the ESOP held 980,992 allocated shares and 1,114,224 unallocated shares. All ESOP shares are considered outstanding for income per share computations.

The Corporation recognized net compensation expense equal to the shares allocated multiplied by the original cost of \$20 $\frac{1}{16}$  per share less dividends received by the ESOP on unallocated shares. Compensation expense related to the ESOP for 1999, 1998 and 1997 was \$1.6 million, \$1.0 million, and \$1.4 million, respectively. Dividends paid on unallocated ESOP shares were \$1.2 million in both 1999 and 1998 and \$1.3 million in 1997. The unearned ESOP compensation balance in stockholders' equity represented deferred compensation expense to be recognized by the Corporation in future years as additional shares are allocated to participants.

## **12. CAPITAL STOCK AND NET INCOME PER SHARE**

As of December 31, 1999, the Corporation had 530,000,000 authorized shares of capital stock. Of this total, 450,000,000 shares were designated as Common Stock, 75,000,000 shares as Class B Common Stock (Class B Stock), and 5,000,000 shares as Preferred Stock, each class having a par value of one dollar per share. As of December 31, 1999 a combined total of 179,950,872 shares of both classes of common stock had been issued of which 138,459,619 shares were outstanding. No shares of the Preferred Stock were issued or outstanding during the three-year period ended December 31, 1999.

Holders of the Common Stock and the Class B Stock generally vote together without regard to class on matters submitted to stockholders, including the election of directors, with the Common Stock having one vote per share and the Class B Stock having ten votes per share. However, the Common Stock, voting separately as a class, is entitled to elect one-sixth of the Board of Directors. With respect to dividend rights, the Common Stock is entitled to cash dividends 10% higher than those declared and paid on the Class B Stock.

Class B Stock can be converted into Common Stock on a share-for-share basis at any time. During 1999, 1998 and 1997, a total of 4,000 shares, 18,000 shares, and 13,000 shares, respectively, of Class B Stock were converted into Common Stock.

Hershey Trust Company, as Trustee for the benefit of Milton Hershey School (Milton Hershey School Trust), as institutional fiduciary for estates and trusts unrelated to Milton Hershey School, and as direct owner of investment shares, held a total of 12,929,073 shares of the Common Stock, and as Trustee for the benefit of Milton Hershey School, held 30,306,006 shares of the Class B Stock as of December 31, 1999, and was entitled to cast approximately 77% of the total votes of both classes of the Corporation's common stock. The Milton Hershey School Trust must approve the issuance of shares of Common Stock or any other action which would result in the Milton Hershey School Trust not continuing to have voting control of the Corporation.

During 1999, 5,478,379 shares of Common Stock were repurchased for \$318.0 million, including 1,579,779 shares of the Corporation's Common Stock purchased from the Milton Hershey School Trust for \$100.0 million. A total of 15,339,498 shares of Common Stock have been repurchased for approximately \$605.6 million under share repurchase programs which were approved by the Corporation's Board of Director's in 1993, 1996 and 1999. Of the shares repurchased, 528,000 shares were retired, 1,320,781 shares were reissued to satisfy stock options obligations, Supplemental Retirement Contributions and ESOP obligations and the remaining 13,490,717 shares were held as Treasury Stock as of December 31, 1999. In August 1997, the Corporation purchased 9,900,990 shares of its Common Stock to be held as Treasury Stock from the Milton Hershey School Trust for \$500.0 million and in August 1995, 18,099,546 shares were purchased from the Milton Hershey School Trust for \$500.0 million. A total of 41,491,253 shares were held as Treasury Stock as of December 31, 1999.

Basic and Diluted Earnings per Share were computed based on the weighted average number of shares of the Common Stock and the Class B Stock outstanding as follows:

<b>For the years ended December 31,</b>	<b>1999</b>	<b>1998</b>	<b>1997</b>
<b>In thousands except per share amounts</b>			
Net income	<b>\$460,310</b>	\$340,888	\$336,251
Weighted average shares—basic	<b>140,031</b>	143,446	149,174
Effect of dilutive securities:			
Employee stock options	<b>1,260</b>	2,008	1,727
Performance and restricted stock units	<b>9</b>	109	115
Weighted average shares—diluted	<b>141,300</b>	145,563	151,016
Net income per share—basic	<b>\$ 3.29</b>	\$ 2.38	\$ 2.25
Net income per share—diluted	<b>\$ 3.26</b>	\$ 2.34	\$ 2.23

For the year ended December 31, 1999, 1.8 million stock options were not included in the diluted earnings per share calculation because the exercise price was higher than the average market price of the Common Stock for the year and therefore, the effect would have been antidilutive.

### 13. STOCK COMPENSATION PLAN

The long-term portion of the Key Employee Incentive Plan (Incentive Plan), provides for grants of stock-based compensation awards to senior executives and key employees of one or more of the following: non-qualified stock options (fixed stock options), performance stock units, stock appreciation rights and restricted stock units. The Incentive Plan also provides for the deferral of performance stock unit awards by participants. As of December 31, 1999, 15.3 million shares were authorized for grants under the long-term portion of the Incentive Plan.

In 1996, the Corporation's Board of Directors approved a world-wide, broad-based employee stock option program, called HSY Growth. HSY Growth provides all eligible employees with a one-time grant of 100 non-qualified stock options. Under HSY Growth, over 1.2 million options were granted on January 7, 1997.

The Corporation applies Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees and related Interpretations, in accounting for the Incentive Plan and HSY Growth. Accordingly, no compensation cost has been recognized for its fixed stock option grants. Had compensation cost for the Corporation's stock-based compensation plans been determined based on the fair value at the grant dates for awards under the Incentive Plan and HSY Growth consistent with the method of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, the Corporation's net income and net income per share would have been reduced to the pro forma amounts indicated below:

<b>For the years ended December 31,</b>		<b>1999</b>	<b>1998</b>	<b>1997</b>
<b>In thousands of dollars except per share amounts</b>				
Net income	As reported	<b>\$460,310</b>	\$340,888	\$336,251
	Pro forma	<b>449,986</b>	329,621	330,710
Net income per share—Basic	As reported	<b>\$ 3.29</b>	\$ 2.38	\$ 2.25
	Pro forma	<b>3.21</b>	2.30	2.22
Net income per share—Diluted	As reported	<b>\$ 3.26</b>	\$ 2.34	\$ 2.23
	Pro forma	<b>3.18</b>	2.26	2.19

The fair value of each option grant is estimated on the date of grant using a Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in 1999, 1998 and 1997,

respectively: dividend yields of 1.4%, 1.6% and 1.9%, expected volatility of 23%, 21% and 20%, risk-free interest rates of 4.9%, 5.9% and 6.2%, and expected lives of 6.5 years, 6.5 years and 5.7 years.

### Fixed Stock Options

The exercise price of each option equals the market price of the Corporation's Common Stock on the date of grant. Under the Incentive Plan, options are granted in January and generally vest at the end of the second year and have a maximum term of ten years. Options granted under the HSY Growth program vest at the end of the fifth year and have a term of ten years.

A summary of the status of the Corporation's fixed stock options as of December 31, 1999, 1998, and 1997, and changes during the years ending on those dates is presented below:

Fixed Options	1999		1998		1997	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding at beginning of year	<b>7,665,270</b>	<b>\$38.91</b>	6,713,920	\$31.73	5,902,220	\$27.40
Granted	<b>197,450</b>	<b>\$59.24</b>	1,739,050	\$61.22	1,485,250	\$44.64
Exercised	<b>(701,596)</b>	<b>\$26.80</b>	(751,600)	\$25.78	(656,350)	\$21.94
Forfeited	<b>(255,200)</b>	<b>\$52.16</b>	(36,100)	\$52.61	(17,200)	\$33.06
Outstanding at end of year	<b><u>6,905,924</u></b>	<b><u>\$40.23</u></b>	<u>7,665,270</u>	\$38.91	<u>6,713,920</u>	\$31.73
Options exercisable at year-end	<b><u>4,015,624</u></b>	<b><u>\$29.78</u></b>	<u>4,480,670</u>	\$28.45	<u>3,013,670</u>	\$24.38
Weighted-average fair value of options granted during the year (per share)	<b><u>\$ 17.23</u></b>		<b><u>\$ 18.30</u></b>		<b><u>\$ 11.66</u></b>	

The following table summarizes information about fixed stock options outstanding as of December 31, 1999:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding as of 12/31/99	Weighted-Average Remaining Contractual Life in Years	Weighted-Average Exercise Price	Number Exercisable as of 12/31/99	Weighted-Average Exercise Price
\$17 <sup>1</sup> / <sub>16</sub> -26 <sup>1</sup> / <sub>2</sub>	<b>1,769,674</b>	3.6	\$23.86	<b>1,769,674</b>	\$23.86
\$33 <sup>1</sup> / <sub>16</sub> -44 <sup>1</sup> / <sub>2</sub>	<b>3,324,050</b>	6.4	\$37.64	<b>2,227,650</b>	\$34.26
\$49 <sup>1</sup> / <sub>8</sub> -63 <sup>1</sup> / <sub>16</sub>	<b>1,812,200</b>	8.1	\$60.96	<b>18,300</b>	\$56.25
\$17 <sup>1</sup> / <sub>16</sub> -63 <sup>1</sup> / <sub>16</sub>	<b><u>6,905,924</u></b>	6.1	\$40.23	<b><u>4,015,624</u></b>	\$29.78

### Performance Stock Units

Under the long-term portion of the Incentive Plan, each January the Corporation grants selected executives and other key employees performance stock units whose vesting is contingent upon the achievement of certain performance objectives. If at the end of three-year performance cycles, targets for financial measures of earnings per share, economic value added and free cash flow are met, the full number of shares are awarded to the participants. The performance scores can range from 0% to 150% of the targeted amounts. The compensation amount (credited to) charged against income for the performance-based plan was \$(1.9) million, \$6.6 million and \$9.1 million for 1999, 1998, and 1997, respectively. The compensation credit in 1999 resulted from a partial achievement of the current year

cycle objectives, expectation of partially achieving the target objectives for the 2000 cycle and the lower stock price. The compensation cost associated with the long-term portion of the Incentive Plan is recognized ratably over the three-year term based on the year-end market value of the stock. Performance stock units and restricted stock units granted for potential future distribution were as follows:

For the years ended December 31,	1999	1998	1997
Shares granted	<b>48,550</b>	48,150	95,250
Weighted-average fair value at date of grant	<b>\$59.48</b>	\$61.54	\$45.17

Deferred performance stock units, deferred directors' fees and accumulated dividend amounts totaled 383,366 shares as of December 31, 1999.

No stock appreciation rights were outstanding as of December 31, 1999.

#### 14. SUPPLEMENTAL BALANCE SHEET INFORMATION

##### Accounts Receivable—Trade

In the normal course of business, the Corporation extends credit to customers which satisfy pre-defined credit criteria. The Corporation believes that it has little concentration of credit risk due to the diversity of its customer base. Receivables, as shown on the consolidated balance sheets, were net of allowances and anticipated discounts of \$16.9 million and \$19.9 million as of December 31, 1999 and 1998, respectively.

##### Inventories

The Corporation values the majority of its inventories under the last-in, first-out (LIFO) method and the remaining inventories at the lower of first-in, first-out (FIFO) cost or market. LIFO cost of inventories valued using the LIFO method was \$469.2 million and \$342.9 million as of December 31, 1999 and 1998, respectively, and all inventories were stated at amounts that did not exceed realizable values. Total inventories were as follows:

December 31,	1999	1998
<b>In thousands of dollars</b>		
Raw materials	<b>\$270,711</b>	\$209,963
Goods in process	<b>49,412</b>	44,336
Finished goods	<b>365,575</b>	322,125
Inventories at FIFO	<b>685,698</b>	576,424
Adjustment to LIFO	<b>(83,496)</b>	(83,175)
Total inventories	<b><u>\$602,202</u></b>	<u>\$493,249</u>

## Property, Plant and Equipment

Property, plant and equipment balances included construction in progress of \$76.6 million and \$96.6 million as of December 31, 1999 and 1998, respectively. Major classes of property, plant and equipment were as follows:

<b>December 31,</b>	<b>1999</b>	<b>1998</b>
<b>In thousands of dollars</b>		
Land	\$ 50,830	\$ 30,871
Buildings	484,768	541,181
Machinery and equipment	<u>2,036,670</u>	<u>2,130,735</u>
Property, plant and equipment, gross	<b>2,572,268</b>	2,702,787
Accumulated depreciation	<u>(1,061,808)</u>	<u>(1,054,729)</u>
Property, plant and equipment, net	<b><u>\$ 1,510,460</u></b>	<b><u>\$ 1,648,058</u></b>

## Accrued Liabilities

Accrued liabilities were as follows:

<b>December 31,</b>	<b>1999</b>	<b>1998</b>
<b>In thousands of dollars</b>		
Payroll, compensation and benefits	\$ 98,527	\$ 87,666
Advertising and promotion	71,233	67,916
Other	<u>122,737</u>	<u>138,833</u>
Total accrued liabilities	<b><u>\$292,497</u></b>	<b><u>\$294,415</u></b>

## Other Long-term Liabilities

Other long-term liabilities were as follows:

<b>December 31,</b>	<b>1999</b>	<b>1998</b>
<b>In thousands of dollars</b>		
Accrued post-retirement benefits	\$194,563	\$206,345
Other	<u>136,375</u>	<u>140,424</u>
Total other long-term liabilities	<b><u>\$330,938</u></b>	<b><u>\$346,769</u></b>

## 15. SEGMENT INFORMATION

The Corporation operates in a single consumer foods line of business, encompassing the manufacture, distribution and sale of confectionery and grocery products. Consolidated net sales represented primarily sales of confectionery products. The Corporation's principal operations and markets are located in the United States. The Corporation also manufactures, markets, sells and distributes confectionery and grocery products in Canada and Mexico, imports and/or markets selected confectionery products in Japan, the Philippines, Korea and China, and markets confectionery products in over 90 countries worldwide.

Net sales and long-lived assets of businesses outside of the United States were not significant. Sales to Wal-Mart Stores, Inc. and Subsidiaries exceeded 10% of total net sales and amounted to approximately \$605.3 million, \$619.1 million and \$529.6 million in 1999, 1998 and 1997, respectively.

## 16. QUARTERLY DATA (Unaudited)

Summary quarterly results were as follows:

<b>Year 1999</b>	<b>First</b>	<b>Second</b>	<b>Third</b>	<b>Fourth</b>
<b>In thousands of dollars except per share amounts</b>				
Net sales	<b>\$ 945,152</b>	<b>\$853,239</b>	<b>\$1,066,695</b>	<b>\$1,105,838</b>
Gross profit	<b>382,988</b>	<b>340,443</b>	<b>432,653</b>	<b>460,116</b>
Net income	<b>224,670<sup>(a)</sup></b>	<b>50,055</b>	<b>87,578</b>	<b>98,007</b>
Net income per share—Basic <sup>(b)</sup>	<b>1.58</b>	<b>.36</b>	<b>.63</b>	<b>.71</b>
Net income per share—Diluted <sup>(b)</sup>	<b>1.57</b>	<b>.35</b>	<b>.62</b>	<b>.70</b>
<b>Year 1998</b>				
<b>In thousands of dollars except per share amounts</b>				
Net sales	<b>\$1,098,076</b>	<b>\$ 880,399</b>	<b>\$ 1,217,237</b>	<b>\$ 1,239,903</b>
Gross profit	<b>445,736</b>	<b>357,684</b>	<b>510,632</b>	<b>496,506</b>
Net income	<b>75,433</b>	<b>47,965</b>	<b>107,533</b>	<b>109,957</b>
Net income per share—Basic	<b>.53</b>	<b>.33</b>	<b>.75</b>	<b>.77</b>
Net income per share—Diluted <sup>(b)</sup>	<b>.52</b>	<b>.33</b>	<b>.74</b>	<b>.76</b>

(a) Net income for the first quarter and year 1999 included an after-tax gain on the sale of the Corporation's pasta business of \$165.0 million. Net income per share was similarly impacted.

(b) Quarterly income per share amounts do not total to the annual amounts due to changes in weighted average shares outstanding during the year.

## **RESPONSIBILITY FOR FINANCIAL STATEMENTS**

Hershey Foods Corporation is responsible for the financial statements and other financial information contained in this report. The Corporation believes that the financial statements have been prepared in conformity with generally accepted accounting principles appropriate under the circumstances to reflect in all material respects the substance of applicable events and transactions. In preparing the financial statements, it is necessary that management make informed estimates and judgments. The other financial information in this annual report is consistent with the financial statements.

The Corporation maintains a system of internal accounting controls designed to provide reasonable assurance that financial records are reliable for purposes of preparing financial statements and that assets are properly accounted for and safeguarded. The concept of reasonable assurance is based on the recognition that the cost of the system must be related to the benefits to be derived. The Corporation believes its system provides an appropriate balance in this regard. The Corporation maintains an Internal Audit Department which reviews the adequacy and tests the application of internal accounting controls.

The financial statements have been audited by Arthur Andersen LLP, independent public accountants, whose appointment was ratified by stockholder vote at the stockholders' meeting held on April 27, 1999. Their report expresses an opinion that the Corporation's financial statements are fairly stated in conformity with generally accepted accounting principles, and they have indicated to us that their audit was performed in accordance with generally accepted auditing standards which are designed to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The Audit Committee of the Board of Directors of the Corporation, consisting solely of non-management directors, meets regularly with the independent public accountants, internal auditors and management to discuss, among other things, the audit scopes and results. Arthur Andersen LLP and the internal auditors both have full and free access to the Audit Committee, with and without the presence of management.

## REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Stockholders and Board of Directors  
of Hershey Foods Corporation:

We have audited the accompanying consolidated balance sheets of Hershey Foods Corporation (a Delaware Corporation) and subsidiaries as of December 31, 1999 and 1998, and the related consolidated statements of income, cash flows and stockholders' equity for each of the three years in the period ended December 31, 1999, appearing on pages A-11 through A-30. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Hershey Foods Corporation and subsidiaries as of December 31, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1999 in conformity with generally accepted accounting principles.

*Arthur Andersen LLP*

New York, New York  
January 28, 2000

**HERSHEY FOODS CORPORATION**  
**ELEVEN-YEAR CONSOLIDATED FINANCIAL SUMMARY**

All dollar and share amounts in thousands except  
market price and per share statistics

	10-Year Compound Growth Rate	1999	1998	1997
<b>Summary of Operations</b>				
Net Sales	5.1 %	<b>\$3,970,924</b>	4,435,615	4,302,236
Cost of Sales	4.9 %	<b>\$2,354,724</b>	2,625,057	2,488,896
Selling, Marketing and Administrative	4.9 %	<b>\$1,057,840</b>	1,167,895	1,183,130
Non-recurring Credits/(Charges)(o)		<b>\$ 243,785</b>	—	—
Interest Expense, Net	13.8 %	<b>\$ 74,271</b>	85,657	76,255
Provision for Income Taxes	8.5 %	<b>\$ 267,564</b>	216,118	217,704
Income from Continuing Operations Before Accounting Changes	10.4 %	<b>\$ 460,310</b>	340,888	336,251
Net Cumulative Effect of Accounting Changes		<b>\$ —</b>	—	—
Net Income	10.4 %	<b>\$ 460,310</b>	340,888	336,251
Income Per Share:(a)				
From Continuing Operations Before Accounting Changes				
—Basic	13.2 %	<b>\$ 3.29(i)</b>	2.38	2.25
—Diluted	13.1 %	<b>\$ 3.26</b>	2.34	2.23
Net Cumulative Effect of Accounting Changes —Basic and Diluted		<b>\$ —</b>	—	—
Net Income—Basic	13.2 %	<b>\$ 3.29(i)</b>	2.38	2.25
Net Income—Diluted	13.1 %	<b>\$ 3.26</b>	2.34	2.23
Weighted Average Shares Outstanding—Basic(a)		<b>140,031</b>	143,446	149,174
Weighted Average Shares Outstanding—Diluted(a)		<b>141,300</b>	145,563	151,016
Dividends Paid on Common Stock	7.0 %	<b>\$ 109,175</b>	103,616	98,390
Per Share(a)	10.5 %	<b>\$ 1.00</b>	.920	.840
Dividends Paid on Class B Common Stock	10.5 %	<b>\$ 27,553</b>	25,428	23,156
Per Share(a)	10.5 %	<b>\$ .905</b>	.835	.760
Income from Continuing Operations Before Accounting Changes as a Percent of Net Sales		<b>7.4%(c)</b>	7.7%	7.8%
Depreciation	9.5 %	<b>\$ 135,574</b>	138,489	135,016
Advertising	3.1 %	<b>\$ 164,894</b>	187,505	202,408
Promotion	4.4 %	<b>\$ 395,849</b>	469,709	451,580
Payroll	4.6 %	<b>\$ 534,854</b>	563,045	524,827
<b>Year-end Position and Statistics</b>				
Capital Additions	(3.3)%	<b>\$ 115,448</b>	161,328	172,939
Total Assets	6.3 %	<b>\$3,346,652</b>	3,404,098	3,291,236
Long-term Portion of Debt	15.1 %	<b>\$ 878,213</b>	879,103	1,029,136
Stockholders' Equity	(.2)%	<b>\$1,098,627</b>	1,042,301	852,806
Operating Return on Average Stockholders' Equity(b)		<b>27.6%</b>	36.0%	33.4%
Operating Return on Average Invested Capital(b)		<b>14.8%</b>	17.4%	17.5%
Full-time Employees		<b>13,900</b>	14,700	14,900
<b>Stockholders' Data(a)</b>				
Outstanding Shares of Common Stock and Class B Common Stock at Year-end		<b>138,460</b>	143,147	142,932
Market Price of Common Stock at Year-end	10.2 %	<b>\$ 47<sup>7</sup>/<sub>16</sub></b>	62 <sup>3</sup> / <sub>16</sub>	61 <sup>15</sup> / <sub>16</sub>
Range During Year		<b>\$64<sup>7</sup>/<sub>8</sub>-45<sup>3</sup>/<sub>4</sub></b>	76 <sup>3</sup> / <sub>8</sub> -59 <sup>1</sup> / <sub>16</sub>	63 <sup>7</sup> / <sub>8</sub> -42 <sup>1</sup> / <sub>8</sub>

See Notes to the Eleven-Year Consolidated Financial Summary on page A-35.

1996	1995	1994	1993	1992	1991	1990	1989
3,989,308	3,690,667	3,606,271	3,488,249	3,219,805	2,899,165	2,715,609	2,420,988
2,302,089	2,126,274	2,097,556	1,995,502	1,833,388	1,694,404	1,588,360	1,455,612
1,124,087	1,053,758	1,034,115	1,035,519	958,189	814,459	776,668	655,040
(35,352)	151	(106,105)	80,642	—	—	35,540	—
48,043	44,833	35,357	26,995	27,240	26,845	24,603	20,414
206,551	184,034	148,919	213,642	158,390	143,929	145,636	118,868
273,186	281,919	184,219	297,233	242,598	219,528	215,882	171,054
—	—	—	(103,908)	—	—	—	—
273,186	281,919	184,219	193,325	242,598	219,528	215,882	171,054

1.77(j)	1.70(k)	1.06(l)	1.65(m)	1.34	1.21	1.19(n)	.95
1.75	1.69	1.05	1.65	1.34	1.21	1.19	.95
—	—	—	(.58)	—	—	—	—
1.77(j)	1.70(k)	1.06(l)	1.07(m)	1.34	1.21	1.19(n)	.95
1.75	1.69	1.05	1.07	1.34	1.21	1.19	.95
154,334	166,036	174,367	179,929	180,775	180,767	180,766	180,824
155,690	166,721	174,740	180,495	181,160	181,112	180,987	180,984
93,884	91,190	89,660	84,711	77,174	70,426	74,161(g)	55,431
.760	.685	.625	.570	.515	.470	.495(g)	.370
20,879	18,900	17,301	15,788	14,270	12,975	13,596(g)	10,161
.685	.620	.5675	.5175	.4675	.425	.445(g)	.3325
7.7%(d)	7.6%	7.3%(e)	7.4%(f)	7.5%	7.6%	7.2%(h)	7.1%
119,443	119,438	114,821	100,124	84,434	72,735	61,725	54,543
174,199	159,200	120,629	130,009	137,631	117,049	146,297	121,182
429,208	402,454	419,164	444,546	398,577	325,465	315,242	256,237
491,677	461,928	472,997	469,564	433,162	398,661	372,780	340,129
159,433	140,626	138,711	211,621	249,795	226,071	179,408	162,032
3,184,796	2,830,623	2,890,981	2,855,091	2,672,909	2,341,822	2,078,828	1,814,101
655,289	357,034	157,227	165,757	174,273	282,933	273,442	216,108
1,161,021	1,082,959	1,441,100	1,412,344	1,465,279	1,335,251	1,243,537	1,117,050
27.5%	22.2%	18.5%	17.8%	17.3%	17.0%	16.6%	16.1%
17.8%	17.1%	15.6%	15.0%	14.4%	13.8%	13.4%	13.2%
14,000	13,300	14,000	14,300	13,700	14,000	12,700	11,800
152,942	154,532	173,470	175,226	180,373	180,373	180,373	180,373
43 <sup>3</sup> / <sub>4</sub>	32 <sup>1</sup> / <sub>2</sub>	24 <sup>3</sup> / <sub>16</sub>	24 <sup>1</sup> / <sub>2</sub>	23 <sup>1</sup> / <sub>2</sub>	22 <sup>3</sup> / <sub>16</sub>	18 <sup>3</sup> / <sub>4</sub>	17 <sup>15</sup> / <sub>16</sub>
51 <sup>3</sup> / <sub>4</sub> -31 <sup>15</sup> / <sub>16</sub>	33 <sup>15</sup> / <sub>16</sub> -24	26 <sup>3</sup> / <sub>4</sub> -20 <sup>9</sup> / <sub>16</sub>	27 <sup>15</sup> / <sub>16</sub> -21 <sup>3</sup> / <sub>4</sub>	24 <sup>3</sup> / <sub>16</sub> -19 <sup>1</sup> / <sub>8</sub>	22 <sup>1</sup> / <sub>4</sub> -17 <sup>9</sup> / <sub>16</sub>	19 <sup>13</sup> / <sub>16</sub> -14 <sup>1</sup> / <sub>8</sub>	18 <sup>7</sup> / <sub>16</sub> -12 <sup>3</sup> / <sub>8</sub>

## Notes to the Eleven-Year Consolidated Financial Summary

- (a) All shares and per share amounts have been adjusted for the two-for-one stock split effective September 13, 1996.
- (b) Operating Return on Average Stockholders' Equity and Operating Return on Average Invested Capital have been computed using Net Income, excluding the 1993 Net Cumulative Effect of Accounting Changes, and the after-tax impacts of the 1990 Restructuring Gain, Net, the 1993 Gain on Sale of the Investment Interest in Freia Marabou a.s (Freia), the 1994 Restructuring Charge, the net 1995 Restructuring Credit, the 1996 Loss on Sale of Businesses, and the 1999 Gain on Sale of Business.
- (c) Calculated percent excludes the 1999 Gain on Sale of Business. Including the gain, Income from Continuing Operations Before Accounting Changes as a Percent of Net Sales was 11.6%.
- (d) Calculated percent excludes the 1996 Loss on Sale of Businesses. Including the loss, Income from Continuing Operations Before Accounting Changes as a Percent of Net Sales was 6.8%.
- (e) Calculated percent excludes the 1994 Restructuring Charge. Including the charge, Income from Continuing Operations Before Accounting Changes as a Percent of Net Sales was 5.1%.
- (f) Calculated percent excludes the 1993 Gain on Sale of Investment Interest in Freia. Including the gain, Income from Continuing Operations Before Accounting Changes as a Percent of Net Sales was 8.5%.
- (g) Amounts included a special dividend for 1990 of \$11.2 million or \$.075 per share of Common Stock and \$2.1 million or \$.0675 per share of Class B Common Stock.
- (h) Calculated percent excludes the 1990 Restructuring Gain, Net. Including the gain, Income from Continuing Operations Before Accounting Changes as a Percent of Net Sales was 7.9%.
- (i) Income Per Share from Continuing Operations Before Accounting Changes—Basic and Net Income Per Share—Basic for 1999 included a \$1.18 per share gain on the sale of the pasta business. Excluding the impact of this gain, Income Per Share from Continuing Operations Before Accounting Changes—Basic and Net Income Per Share—Basic would have been \$2.11.
- (j) Income Per Share from Continuing Operations Before Accounting Changes—Basic and Net Income Per Share—Basic for 1996 included a \$.23 per share loss on the sale of the Gubor and Sperlari businesses. Excluding the impact of this loss, Income Per Share from Continuing Operations Before Accounting Changes—Basic and Net Income Per Share—Basic would have been \$2.00.
- (k) Income Per Share from Continuing Operations Before Accounting Changes—Basic and Net Income Per Share—Basic for 1995 included a net \$.01 per share credit associated with adjustments to accrued restructuring reserves. Excluding the impact of this net credit, Income Per Share from Continuing Operations Before Accounting Changes—Basic and Net Income Per Share—Basic would have been \$1.69.
- (l) Income Per Share from Continuing Operations Before Accounting Changes—Basic and Net Income Per Share—Basic for 1994 included a \$.46 per share restructuring charge. Excluding the impact of this charge, Income Per Share from Continuing Operations Before Accounting Changes—Basic and Net Income Per Share—Basic would have been \$1.52.
- (m) Income Per Share from Continuing Operations Before Accounting Changes—Basic and Net Income Per Share—Basic for 1993 included a \$.23 per share gain on the sale of the investment interest in Freia. Excluding the impact of this gain, Income Per Share from Continuing Operations Before Accounting Changes—Basic would have been \$1.43.
- (n) Income Per Share from Continuing Operations Before Accounting Changes—Basic and Net Income Per Share—Basic for 1990 included an \$.11 per share Restructuring Gain, Net. Excluding the impact of this gain, Income Per Share from Continuing Operations Before Accounting Changes—Basic and Net Income Per Share—Basic would have been \$1.08.
- (o) Includes the Gain on Sale of Business in 1999; Loss on Sale of Businesses in 1996; Restructuring Credit in 1995; Restructuring Charge in 1994; Gain on Sale of Investment Interest in 1993 and Restructuring Gain, Net in 1990.

## OTHER STOCKHOLDER INFORMATION

### INVESTOR INFORMATION

#### Stockholders

As of December 31, 1999, Hershey Foods Corporation had outstanding 108,015,711 shares of Common Stock and 30,443,908 shares of Class B Common Stock.

Year	Year-End Common Stock and Class B Common Stock Stockholders	Approximate Annual Composite Trading Volume
<b>1999</b>	<b>43,265</b>	<b>128,557,000</b>
1998	44,364	78,955,000
1997	44,602	74,781,000
1996	42,483	47,002,000
1995	38,480	30,498,000

#### Stock Market Data

Hershey Foods Corporation's Common Stock is listed and traded principally on the New York Stock Exchange under the ticker symbol "HSY." Class B Common Stock is not listed for trading. The stock tables of most financial publications list the Corporation as "Hershey." Options on the Corporation's Common Stock are traded on the American Stock Exchange.

#### Common Stock Profile

1999 Calendar Quarter	Common Stock Price			Dividends Paid Per Share	
	High	Low	Close	Common Stock	Class B Stock
1st Quarter	\$64 <sup>7</sup> / <sub>8</sub>	\$54 <sup>1</sup> / <sub>8</sub>	\$56 <sup>1</sup> / <sub>16</sub>	\$.24	\$.2175
2nd Quarter	59 <sup>1</sup> / <sub>2</sub>	48 <sup>13</sup> / <sub>16</sub>	59 <sup>3</sup> / <sub>8</sub>	.24	.2175
3rd Quarter	61 <sup>7</sup> / <sub>16</sub>	48 <sup>1</sup> / <sub>2</sub>	48 <sup>11</sup> / <sub>16</sub>	.26	.235
4th Quarter	54 <sup>3</sup> / <sub>16</sub>	45 <sup>3</sup> / <sub>4</sub>	47 <sup>7</sup> / <sub>16</sub>	.26	.235

#### Dividend Policy

Dividends on Hershey Foods Corporation's Common Stock and Class B Common Stock are declared by the Board of Directors and normally are paid in March, June, September and December.

The dividend to be paid on the Common Stock on March 15, 2000, will be the 281st consecutive quarterly dividend paid by the Corporation. The dividend rate has been increased annually for 25 consecutive years. Historically, the Corporation has targeted approximately one-third of its income from continuing operations for dividends to stockholders.

## **Investor Services Program**

The Corporation, through its agent The Chase Manhattan Bank, offers an Investor Services Program. Features of the program include the ability to purchase initial shares of Hershey Foods Corporation Common Stock, as well as subsequent purchases, directly from our agent; dividend reinvestment on 10 shares or greater; automatic monthly deductions from a bank account for optional cash purchases; safekeeping of certificates; direct deposit of dividends; and an IRA option. For more information, contact:

The Chase Manhattan Bank  
c/o ChaseMellon Shareholder Services  
P.O. Box 3338  
South Hackensack, NJ 07606-1938  
(800) 851-4216

www.chasemellon.com  
To request enrollment materials,  
please call (800) 842-7629.

## **Stockholder Inquiries**

Questions relating to stockholder records, change of ownership, change of address and dividend payments should be sent to the Corporation's Transfer Agent, ChaseMellon Shareholder Services, whose address appears below.

## **Financial Information**

Security analysts, investment managers and stockholders should direct financial information inquiries to the Investor Relations contact listed below.

## **1999 Annual Report**

As in past years, we have published the 1999 Annual Report to Stockholders, consisting of Management's Discussion and Analysis and the Consolidated Financial Statements, as an appendix to the Corporation's Proxy Statement. While we have eliminated the glossy-style Annual Report (which contained the Letter to Stockholders now included with this publication), we have added a number of features to our corporate web site ([www.hersheys.com](http://www.hersheys.com)) which provide information about various aspects of the Corporation's business. We invite you to visit this site at your leisure.

## **STOCKHOLDER INFORMATION**

### **Executive Offices**

100 Crystal A Drive  
P. O. Box 810  
Hershey, PA 17033-0810  
(717) 534-4000

### **Transfer Agent and Registrar**

ChaseMellon Shareholder Services L.L.C.  
Overpeck Centre  
85 Challenger Road  
Ridgefield Park, NJ 07660  
[www.chasemellon.com](http://www.chasemellon.com)  
(800) 851-4216—Domestic Holders  
(201) 329-8660—Foreign Holders  
(800) 231-5469—Hearing Impaired

### **Independent Public Accountants**

Arthur Andersen LLP  
1345 Avenue of the Americas  
New York, NY 10105

### **Investor Relations Contact**

James A. Edris  
Director, Investor Relations  
100 Crystal A Drive  
P. O. Box 810  
Hershey, PA 17033-0810  
(717) 534-7556  
Email: [jedris@hersheys.com](mailto:jedris@hersheys.com)

### **Financial Information**

(800) 539-0261  
[www.hersheys.com](http://www.hersheys.com)

**www.hersheys.com**

Hershey Foods Corporation's web site provides access to a wide variety of information including products, recipes, news releases, a plant tour, and consumer information. A principal feature of the web site is the Investor Information section which contains general financial information (i.e., Hershey's corporate overview, Mission Statement, product information, financial fundamentals, and current stock quotes) and archived information (i.e., historical financial releases, annual reports, dividends and stock prices). The site also provides analyst presentations for those interested in a more in-depth review of the Corporation's operations as presented by senior management to the financial community. Another interesting feature is the "email alert," which allows users to receive automatic updates informing them when new items such as calendar events, presentations, dividends, annual reports and SEC documents are added to the site.

**www.chasemellon.com**

ChaseMellon Shareholder Services' web site offers tax reporting information; frequently asked tax questions; Dividend Reinvestment/Direct Stock Purchase Plan/Direct Deposit of Dividends enrollment materials; stock transfer instructions; account maintenance functions, such as address changes and Tax Identification Number changes; duplicate Forms 1099-DIV; account transcripts; dividend reinvestment statements; and an email address for general shareholder inquiries: shrrelations@chasemellon.com.

## **BOARD OF DIRECTORS**

As of March 13, 2000

Kenneth L. Wolfe  
Chairman of the Board and  
Chief Executive Officer

William H. Alexander  
Administrator  
Family Business Program  
The Wharton School of the  
University of Pennsylvania  
Philadelphia, PA

Robert H. Campbell  
Chairman of the Board and  
Chief Executive Officer  
Sunoco, Inc.  
Philadelphia, PA

C. McCollister Evarts, M.D.  
Chief Executive Officer  
The Milton S. Hershey  
Medical Center  
Senior Vice President for  
Health Affairs and Dean  
The Pennsylvania State  
University  
College of Medicine  
Hershey, PA

Bonnie Guiton Hill  
President and Chief  
Executive Officer  
The Times Mirror Foundation  
Senior Vice President  
*The Los Angeles Times*  
Los Angeles, CA

John C. Jamison  
Chairman of the Board  
Mallardee Associates  
Williamsburg, VA

Allan Z. Loren  
Executive Vice President and  
Chief Information Officer  
American Express Company  
New York, NY

Mackey J. McDonald  
Chairman of the Board,  
Chief Executive Officer and  
President  
VF Corporation  
Greensboro, NC

Michael F. Pasquale  
Executive Vice President  
and Chief Operating Officer

John M. Pietruski  
Chairman of the Board  
Texas Biotechnology  
Corporation  
Houston, TX

### **Audit Committee**

John C. Jamison, Chair  
William H. Alexander  
Allan Z. Loren  
Mackey J. McDonald

### **Committee on Directors and Corporate Governance**

John M. Pietruski, Chair  
William H. Alexander  
Bonnie Guiton Hill  
Kenneth L. Wolfe

### **Compensation and Executive Organization Committee**

Robert H. Campbell, Chair  
C. McCollister Evarts, M.D.  
John C. Jamison  
Mackey J. McDonald

### **Executive Committee**

Kenneth L. Wolfe, Chair  
Michael F. Pasquale