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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

# FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended **October 3, 2004**

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______to_______

Commission file number 1-183

## HERSHEY FOODS CORPORATION

100 Crystal A Drive
Hershey, PA 17033

Registrant's telephone number: **717-534-6799**

| State of Incorporation | IRS Employer Identification No. |
|---|---|
| **Delaware** | **23-0691590** |

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [ X ] No [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes [ X ] No [ ]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, $1 par value — 185,241,222 shares, as of October 22, 2004. Class B Common Stock, $1 par value — 60,842,192 shares, as of October 22, 2004.

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**HERSHEY FOODS CORPORATION**

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## PART I — FINANCIAL INFORMATION

**Item 1. Consolidated Financial Statements (Unaudited)**

**HERSHEY FOODS CORPORATION**
**CONSOLIDATED STATEMENTS OF INCOME**
**(in thousands except per share amounts)**

| | For the Three Months Ended | |
|---|---|---|
| | **October 3, 2004** | **September 28, 2003** |
| **Net Sales** | $ 1,254,508 | $ 1,191,019 |
| **Costs and Expenses**: | | |
| Cost of sales | 756,408 | 724,185 |
| Selling, marketing and administrative | 216,696 | 212,107 |
| Business realignment charge, net | -- | 8,564 |
| Gain on sale of business | -- | (8,330) |
| Total costs and expenses | 973,104 | 936,526 |
| **Income before Interest and Income Taxes** | 281,404 | 254,493 |
| Interest expense, net | 18,252 | 17,258 |
| **Income before Income Taxes** | 263,152 | 237,235 |
| Provision for income taxes | 96,923 | 86,263 |
| **Income before Cumulative Effect of Accounting Change** | 166,229 | 150,972 |
| Cumulative effect of accounting change, net of $4,933 tax benefit | -- | 7,368 |
| **Net Income** | $ 166,229 | $ 143,604 |
| **Earnings Per Share - Basic - Common Stock** | | |
| **Income before Cumulative Effect of Accounting Change** | $ .68 | $ .59 |
| **Cumulative Effect of Accounting Change** | -- | (.03) |
| **Net Income** | $ .68 | $ .57 |
| **Earnings Per Share - Basic - Class B Common Stock** | | |
| **Income before Cumulative Effect of Accounting Change** | $ .62 | $ .54 |
| **Cumulative Effect of Accounting Change** | -- | (.03) |
| **Net Income** | $ .62 | $ .51 |
| **Earnings Per Share - Diluted** | | |
| **Income before Cumulative Effect of Accounting Change** | $ .66 | $ .57 |
| **Cumulative Effect of Accounting Change** | -- | (.03) |
| **Net Income** | $ .66 | $ .55 |
| **Average Shares Outstanding-Basic - Common Stock** | 188,726 | 200,460 |
| **Average Shares Outstanding-Basic - Class B Common Stock** | 60,843 | 60,844 |
| **Average Shares Outstanding-Diluted** | 252,683 | 263,298 |
| **Cash Dividends Paid per Share:** | | |

| | | |
|---|---|---|
| Common Stock | $ .2200 | $ .1975 |
| Class B Common Stock | $ .2000 | $ .1788 |

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



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**HERSHEY FOODS CORPORATION**
**CONSOLIDATED STATEMENTS OF INCOME**
**(in thousands except per share amounts)**

| | For the Nine Months Ended | |
|---|---|---|
| | **October 3, 2004** | **September 28, 2003** |
| **Net Sales** | $ 3,161,285 | $ 2,993,296 |
| **Costs and Expenses:** | | |
| Cost of sales | 1,915,244 | 1,836,434 |
| Selling, marketing and administrative | 630,390 | 601,047 |
| Business realignment charge, net | -- | 12,449 |
| Gain on sale of business | -- | (8,330) |
| Total costs and expenses | 2,545,634 | 2,441,600 |
| **Income before Interest and Income Taxes** | 615,651 | 551,696 |
| Interest expense, net | 48,594 | 47,413 |
| **Income before Income Taxes** | 567,057 | 504,283 |
| Provision for income taxes | 146,464 | 184,269 |
| **Income before Cumulative Effect of Accounting Change** | 420,593 | 320,014 |
| Cumulative effect of accounting change, net of $4,933 tax benefit | -- | 7,368 |
| **Net Income** | $ 420,593 | $ 312,646 |
| **Earnings Per Share - Basic - Common Stock** | | |
| **Income before Cumulative Effect of Accounting Change** | $ 1.68 | $ 1.24 |
| **Cumulative Effect of Accounting Change** | -- | (.03) |
| **Net Income** | $ 1.68 | $ 1.21 |
| **Earnings Per Share - Basic - Class B Common Stock** | | |
| **Income before Cumulative Effect of Accounting Change** | $ 1.53 | $ 1.12 |
| **Cumulative Effect of Accounting Change** | -- | (.03) |
| **Net Income** | $ 1.53 | $ 1.09 |
| **Earnings Per Share - Diluted** | | |
| **Income before Cumulative Effect of Accounting Change** | $ 1.62 | $ 1.21 |
| **Cumulative Effect of Accounting Change** | -- | (.03) |
| **Net Income** | $ 1.62 | $ 1.18 |
| **Average Shares Outstanding-Basic - Common Stock** | 195,288 | 202,561 |
| **Average Shares Outstanding-Basic - Class B Common Stock** | 60,844 | 60,844 |
| **Average Shares Outstanding-Diluted** | 258,866 | 265,229 |
| **Cash Dividends Paid per Share:** | | |
| Common Stock | $ .6150 | $ .5250 |
| Class B Common Stock | $ .5575 | $ .4738 |

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



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**HERSHEY FOODS CORPORATION**
**CONSOLIDATED BALANCE SHEETS**
**(in thousands of dollars)**

| | October 3, 2004 | December 31, 2003 |
|---|---|---|
| **ASSETS** | | |
| **Current Assets:** | | |
| Cash and cash equivalents | $ 87,389 | $ 114,793 |
| Accounts receivable - trade | 484,197 | 407,612 |
| Inventories | 643,549 | 492,859 |
| Deferred income taxes | 18,024 | 13,285 |
| Prepaid expenses and other | 117,015 | 103,020 |
| Total current assets | 1,350,174 | 1,131,569 |
| **Property, Plant and Equipment, at cost** | 3,316,009 | 3,227,023 |
| Less-accumulated depreciation and amortization | (1,648,218) | (1,565,084) |
| Net property, plant and equipment | 1,667,791 | 1,661,939 |
| **Goodwill** | 377,762 | 388,960 |
| **Other Intangibles** | 38,222 | 38,511 |
| **Other Assets** | 352,774 | 361,561 |
| Total assets | $ 3,786,723 | $ 3,582,540 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| **Current Liabilities:** | | |
| Accounts payable | $ 154,890 | $ 132,222 |
| Accrued liabilities | 424,399 | 416,181 |
| Accrued income taxes | 19,924 | 24,898 |
| Short-term debt | 562,078 | 12,032 |
| Current portion of long-term debt | 979 | 477 |
| Total current liabilities | 1,162,270 | 585,810 |
| **Long-term Debt** | 968,956 | 968,499 |
| **Other Long-term Liabilities** | 394,933 | 370,776 |
| **Deferred Income Taxes** | 320,055 | 377,589 |
| Total liabilities | 2,846,214 | 2,302,674 |
| **Stockholders' Equity:** | | |
| Preferred Stock, shares issued: none in 2004 and 2003 | -- | -- |
| Common Stock, shares issued: 299,059,552 in 2004 and 149,528,776 on a pre-split basis in 2003 | 299,059 | 149,528 |
| Class B Common Stock, shares issued: 60,842,192 in 2004 and 30,422,096 on a pre-split basis in 2003 | 60,842 | 30,422 |
| Additional paid-in capital | 22,019 | 4,034 |
| Unearned ESOP compensation | (7,185) | (9,580) |
| Retained earnings | 3,351,860 | 3,263,988 |
| Treasury-Common Stock shares at cost: 113,822,530 in 2004 and 50,421,139 on a pre-split basis in 2003 | (2,774,636) | (2,147,441) |
| Accumulated other comprehensive loss | (11,450) | (11,085) |
| Total stockholders' equity | 940,509 | 1,279,866 |
| Total liabilities and stockholders' equity | $ 3,786,723 | $ 3,582,540 |

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

**HERSHEY FOODS CORPORATION**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(in thousands of dollars)**

| | For the Nine Months Ended | |
|---|---|---|
| | **October 3, 2004** | **September 28, 2003** |
| **Cash Flows Provided from (Used by) Operating Activities** | | |
| Net Income | $ 420,593 | $ 312,646 |
| Adjustments to Reconcile Net Income to Net Cash Provided from Operations: | | |
| Depreciation and amortization | 141,115 | 133,852 |
| Deferred income taxes | (58,749) | (6,387) |
| Business realignment initiatives | -- | 12,449 |
| Gain on sale of business | -- | (8,330) |
| Cumulative effect of accounting change | -- | 7,368 |
| Changes in assets and liabilities: | | |
| Accounts receivable - trade | (76,585) | (166,694) |
| Inventories | (139,190) | (60,965) |
| Accounts payable | 22,668 | (7,040) |
| Other assets and liabilities | 53,565 | (128,173) |
| Net Cash Flows Provided from Operating Activities | 363,417 | 88,726 |
| **Cash Flows Provided from (Used by) Investing Activities** | | |
| Capital additions | (144,794) | (130,811) |
| Capitalized software additions | (10,886) | (13,132) |
| Proceeds from business divestiture | -- | 20,049 |
| Net Cash Flows (Used by) Investing Activities | (155,680) | (123,894) |
| **Cash Flows Provided from (Used by) Financing Activities** | | |
| Net increase in short-term debt | 550,046 | 219,883 |
| Repayment of long-term debt | (604) | (7,600) |
| Cash dividends paid | (152,770) | (134,546) |
| Exercise of stock options | 67,096 | 37,217 |
| Incentive plan transactions | (81,933) | (48,432) |
| Repurchase of Common Stock | (616,976) | (299,252) |
| Net Cash Flows (Used by) Financing Activities | (235,141) | (232,730) |
| Decrease in Cash and Cash Equivalents | (27,404) | (267,898) |
| Cash and Cash Equivalents, beginning of period | 114,793 | 297,743 |
| Cash and Cash Equivalents, end of period | $ 87,389 | $ 29,845 |
| Interest Paid | $ 61,820 | $ 56,261 |
| Income Taxes Paid | $ 181,748 | $ 156,417 |

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





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

1. **BASIS OF PRESENTATION**

The accompanying unaudited consolidated financial statements include the accounts of Hershey Foods Corporation, its wholly-owned subsidiaries and entities in which it has a controlling financial interest (the "Company") after elimination of intercompany accounts and transactions. These statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine months ended October 3, 2004, are not necessarily indicative of the results that may be expected for the year ending December 31, 2004, because of the seasonal effects of the Company's business. Earnings per share for Income before Cumulative Effect of Accounting Change, Cumulative Effect of Accounting Change and Net Income for 2003 on the Consolidated Statements of Income may not be additive due to rounding differences resulting from calculations using weighted average shares outstanding during each period presented. For more information, refer to the consolidated financial statements and notes included in the Company's 2003 Annual Report on Form 10-K.

2. **STOCK SPLIT AND NET INCOME PER SHARE — BASIC**

On April 21, 2004, the Company's Board of Directors approved a two-for-one stock split to be effected in the form of a 100 percent stock dividend to stockholders of record on May 25, 2004. The Company's stockholders received one additional share for each share in their possession on that date. This did not change the proportionate interest a stockholder maintained in the Company. The additional shares were distributed on June 15, 2004. All shares and per share amounts set forth in this report have been adjusted for the two-for-one stock split. Cash Dividends Paid per Share for Common Stock and Class B Common Stock ("Class B Stock") on the Consolidated Statements of Income included in the Quarterly Report on Form 10-Q for the period ended July 4, 2004, were inadvertently not adjusted for the two-for-one stock split. After adjusting for the stock split, Cash Dividends Paid per Share for the Common Stock were $.1975 and $.1638 and for the Class B Stock were $.1788 and $.1475, respectively, for the three months ended July 4, 2004 and June 29, 2003. Cash Dividends Paid per Share for the Common Stock were $.395 and $.3275 and for the Class B Stock were $.3575 and $.295, respectively, for the six months ended July 4, 2004, and June 29, 2003.

Statement of Financial Accounting Standards No. 128, *Earnings per Share* ("SFAS No. 128"), provides guidance on the calculation and disclosure of earnings per share ("EPS"). SFAS No. 128 defines EPS as "the amount of earnings attributable to each share of common stock" and indicates that the objective of EPS is to measure the performance of an entity over the reporting period. In deliberations regarding the application of SFAS No. 128, the Emerging Issues Task Force ("EITF") of the Financial Accounting Standards Board ("FASB") reached a consensus requiring the use of the two-class method of computing EPS for those enterprises with participating securities or multiple classes of common stock through EITF Issue No. 03-6, Participating Securities and the Two-Class Method under FASB Statement No. 128, *Earnings per Share* ("EITF No. 03-6").

The Company has two classes of common stock, Common Stock and Class B Stock. With respect to dividend rights, the Common Stock is entitled to cash dividends ten percent higher than those declared and paid on the Class B Stock. Under EITF No. 03-6, the Class B Stock is considered a participating security requiring the use of the two-class method for the computation of net income per share – basic, rather than the if-converted method as previously used. The two-class computation method for each period reflects the cash dividends paid per share for each class of stock, plus the amount of allocated undistributed earnings per share computed using the participation percentage which reflects the dividend rights of each class of stock. Net income per share – basic reflects the application of EITF No. 03-6 and was computed using the two-class method for all periods presented. The shares of Class B Stock are considered to be participating convertible securities since the shares of Class B Stock are convertible on a one-for-one basis into shares of Common Stock. Net income per share — diluted has been computed using the if-converted method.

3. **EMPLOYEE STOCK OPTIONS AND OTHER STOCK-BASED EMPLOYEE COMPENSATION PLANS**

As of October 3, 2004, the Company had two stock-based employee compensation plans, the Key Employee Incentive Plan and the Broad Based Stock Option Plan, which are described in the Company's 2003 Annual Report on Form 10-K. In July 2004, the Company announced a worldwide stock option grant under the Broad Based Stock Option Plan which provided over 13,000 eligible employees with a grant of 100 non-qualified stock options. The stock options were granted at a price of $46.44 per share, have a term of ten years and will vest on July 19, 2009. The Company applies the recognition and measurement principles of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to*



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*Employees*, and related Interpretations in accounting for those plans. No stock-based employee compensation expense is reflected in net income for employee stock options since all stock options are granted at an exercise price equal to the market value of the underlying common stock on the date of grant. Compensation expense for performance stock units is recognized ratably over a period of up to seventy-two months based on the quarter-end market values of the stock. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation*, to stock-based employee compensation.

| | **For the Three Months Ended** | | **For the Nine Months Ended** | |
|---|---|---|---|---|
| | **October 3, 2004** | **September 28, 2003** | **October 3, 2004** | **September 28, 2003** |
| | **(in thousands of dollars except per share amounts)** | | | |
| Net Income, as reported | $ 166,229 | $ 143,604 | $ 420,593 | $ 312,646 |
| Deduct: Total stock-based employee compensation expense determined under fair value method, net of related tax effects | (3,712) | (3,999) | (9,803) | (11,659) |

| | | | | |
|---|---|---|---|---|
| Pro Forma Net Income | $ 162,517 | $ 139,605 | $ 410,790 | $ 300,987 |
| Net Income Per Share - Basic as reported: | | | | |
| Common Stock | $ .68 | $ .57 | $ 1.68 | $ 1.21 |
| Class B Stock | $ .62 | $ .51 | $ 1.53 | $ 1.09 |
| Net Income Per Share - Basic pro forma: | | | | |
| Common Stock | $ .67 | $ .55 | $ 1.64 | $ 1.17 |
| Class B Stock | $ .61 | $ .50 | $ 1.49 | $ 1.05 |
| Net Income Per Share - Diluted as reported | $ .66 | $ .55 | $ 1.62 | $ 1.18 |
| Net Income Per Share - Diluted pro forma | $ .64 | $ .53 | $ 1.59 | $ 1.13 |

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 the first nine months of 2004 and 2003, respectively: dividend yields of 2.0% and 2.0%; expected volatility of 26% and 28%; risk-free interest rates of 3.7% and 3.6%; and expected lives of 6.5 years and 6.4 years.

## 4. BUSINESS REALIGNMENT INITIATIVES

In July 2003, the Company announced a number of initiatives continuing its value-enhancing strategy. These initiatives included realigning the sales organization and streamlining the supply chain by divesting or eliminating certain non-strategic brands and products, and by production line rationalization.

As of December 31, 2003, the liability balance, primarily relating to charges for employee termination, sales office closing and relocation costs, was $8.8 million. Cash payments during the first nine months of 2004 reduced the liability balance to $4.4 million as of October 3, 2004. For more information on the business realignment initiatives recorded in 2003, refer to the consolidated financial statements and notes included in the Company's 2003 Annual Report on Form 10-K.



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## 5. INTEREST EXPENSE

Interest expense, net consisted of the following:

| | For the Nine Months Ended | |
|---|---|---|
| | **October 3, 2004** | **September 28, 2003** |
| | **(in thousands of dollars)** | |
| Interest expense | $ 52,326 | $ 50,068 |
| Interest income | (1,135) | (1,499) |
| Capitalized interest | (2,597) | (1,156) |
| Interest expense, net | $ 48,594 | $ 47,413 |

## 6. NET INCOME PER SHARE

In accordance with Statement of Financial Accounting Standards No. 128, *Earnings Per Share,* Basic and Diluted Earnings Per Share are computed based on the weighted-average number of shares of the Common Stock and the Class B Stock outstanding as follows:

| | **For the Three Months Ended** | | **For the Nine Months Ended** | |
|---|---|---|---|---|
| | **October 3, 2004** | **September 28, 2003** | **October 3, 2004** | **September 28, 2003** |
| | **(in thousands of dollars except per share amounts)** | | | |

| | | | | |
|---|---|---|---|---|
| Net Income | $ 166,229 | $ 143,604 | $ 420,593 | $ 312,646 |
| Weighted-average shares - Basic: | | | | |
| Common Stock | 188,726 | 200,460 | 195,288 | 202,561 |
| Class B Stock | 60,843 | 60,844 | 60,844 | 60,844 |
| Total weighted-average shares - Basic | 249,569 | 261,304 | 256,132 | 263,405 |
| Effect of dilutive securities: | | | | |
| Employee stock options | 2,938 | 1,908 | 2,586 | 1,722 |
| Performance and restricted stock units | 176 | 86 | 148 | 102 |
| Weighted-average shares - Diluted | 252,683 | 263,298 | 258,866 | 265,229 |
| Net Income Per Share - Basic: | | | | |
| Common Stock | $ .68 | $ .57 | $ 1.68 | $ 1.21 |
| Class B Stock | $ .62 | $ .51 | $ 1.53 | $ 1.09 |
| Net Income Per Share - Diluted | $ .66 | $ .55 | $ 1.62 | $ 1.18 |

Employee stock options for 18,375 shares and 64,150 shares were anti-dilutive and were excluded from the earnings per share calculation for the three months ended October 3, 2004 and September 28, 2003, respectively.

Employee stock options for 59,200 shares and 6,190,488 shares were anti-dilutive and were excluded from the earnings per share calculation for the nine months ended October 3, 2004 and September 28, 2003, respectively.



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## 7. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company accounts for derivative instruments in accordance with Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended. All derivative instruments currently utilized by the Company, including foreign exchange forward contracts and options, interest rate swap agreements and commodities futures contracts, are designated as cash flow hedges.

Net after-tax gains on cash flow hedging derivatives reflected in comprehensive income were $21.4 million and $13.1 million for the three-month and nine-month periods ended October 3, 2004, respectively. Net after-tax losses on cash flow hedging derivatives reflected in comprehensive income were $2.9 million and $22.8 million for the three-month and nine-month periods ended September 28, 2003, respectively. Net gains and losses on cash flow hedging derivatives were primarily associated with commodities futures contracts. Reclassification adjustments from accumulated other comprehensive income (loss) to income, for gains or losses on cash flow hedging derivatives, were reflected in cost of sales. Reclassification of gains of $9.4 million and $18.9 million for the three months and nine months ended October 3, 2004, respectively, were associated with commodities futures contracts. Prior year reclassifications for commodities futures contracts reflected gains of $14.8 million and $37.6 million for the three months and nine months ended September 28, 2003, respectively. Gains on commodities futures contracts recognized in cost of sales as a result of hedge ineffectiveness were approximately $.8 million before tax for the three months and nine months ended October 3, 2004. Pre-tax effects on income of cash flow hedging derivatives recognized in cost of sales as a result of hedge ineffectiveness were a loss of $.1 million and a gain of $.4 million for the three months and nine months ended September 28, 2003, respectively. No gains or losses on cash flow hedging derivatives were reclassified from accumulated other comprehensive income (loss) into income as a result of the discontinuance of a hedge because it became probable that a hedged forecasted transaction would not occur. There were no components of gains or losses on cash flow hedging derivatives that were recognized in income because such components were excluded from the assessment of hedge effectiveness.

As of October 3, 2004, the amount of net after-tax gains on cash flow hedging derivatives, including foreign exchange forward contracts and options, interest rate swap agreements and commodities futures contracts, expected to be reclassified into earnings in the next twelve months was approximately $16.1 million which were principally associated with commodities futures contracts. For more information, refer to the consolidated financial statements and notes included in the Company's 2003 Annual Report on Form 10-K.

## 8. COMPREHENSIVE INCOME

Comprehensive income consisted of the following:

| | For the Three Months Ended | | For the Nine Months Ended | |
|---|---|---|---|---|
| | **October 3, 2004** | **September 28, 2003** | **October 3, 2004** | **September 28, 2003** |
| | **(in thousands of dollars)** | | | |
| Net income | $ 166,229 | $ 143,604 | $ 420,593 | $ 312,646 |
| Other comprehensive income (loss): | | | | |

| | | | | |
|---|---|---|---|---|
| Foreign currency translation adjustments | 13,663 | (890) | 5,423 | 31,900 |
| Minimum pension liability adjustments, net of tax | -- | -- | -- | (2,092) |
| Gains (losses) on cash flow hedging derivatives, net of tax | 21,390 | (2,864) | 13,142 | (22,753) |
| Add: Reclassification adjustments, net of tax | (9,433) | (14,829) | (18,931) | (37,633) |
| Other comprehensive income (loss) | 25,620 | (18,583) | (366) | (30,578) |
| Total comprehensive income | $ 191,849 | $ 125,021 | $ 420,227 | $ 282,068 |



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The components of accumulated other comprehensive loss as shown on the Consolidated Balance Sheets are as follows:

| | Foreign Currency Translation Adjustments | Minimum Pension Liability Adjustments | Gains (Losses) On Cash Flow Hedging Derivatives | Accumulated Other Comprehensive (Loss) Income |
|---|---|---|---|---|
| | (in thousands of dollars) | | | |
| Balance as of December 31, 2003 | $ (38,137) | $ (1,178) | $ 28,230 | $ (11,085) |
| Current period credit, gross | 5,423 | -- | 20,462 | 25,885 |
| Income tax expense | -- | -- | (7,319) | (7,319) |
| Reclassification adjustments (charge), gross | -- | -- | (29,775) | (29,775) |
| Income tax benefit | -- | -- | 10,844 | 10,844 |
| Balance as of October 3, 2004 | $ (32,714) | $ (1,178) | $ 22,442 | $ (11,450) |

9. **INVENTORIES**

The majority of inventories are valued under the last-in, first-out (LIFO) method. The remaining inventories are stated at the lower of first-in, first-out (FIFO) cost or market. Inventories were as follows:

| | October 3, 2004 | December 31, 2003 |
|---|---|---|
| | (in thousands of dollars) | |
| Raw materials | $ 194,488 | $ 158,859 |
| Goods in process | 78,595 | 53,744 |
| Finished goods | 434,594 | 327,415 |
| Inventories at FIFO | 707,677 | 540,018 |
| Adjustment to LIFO | (64,128) | (47,159) |
| Total inventories | $ 643,549 | $ 492,859 |

The increase in raw material inventories as of October 3, 2004, reflected the seasonal timing of deliveries to support manufacturing requirements and higher ingredient costs in 2004. Finished goods inventories were higher as of October 3, 2004 to support seasonal sales and new product introductions in the fourth quarter of 2004.

10. **SHORT-TERM DEBT**

On July 28, 2004, the Company entered into a 364-Day Credit Agreement (the “Credit Agreement”) which established a credit facility with a syndicate of banks under which the Company may borrow up to $500 million with the option to increase borrowings by an additional $300 million with the concurrence of the lenders. In addition to the Credit Agreement, the Company also maintains short-term and long-term committed credit facilities (together the “Existing Facilities”) with the syndicate of banks in the amount of $400 million. The Company may increase borrowings under the Existing Facilities to $1.0 billion with the concurrence of the banks. Information about the Existing Facilities is contained in the Company’s Annual Report on Form 10-K for the year ended December 31, 2003.

11. **LONG-TERM DEBT**

In August 1997, the Company filed a Form S-3 Registration Statement under which it could offer, on a delayed or continuous basis, up to $500 million of additional debt securities and issued $250 million of 7.2% Debentures due 2027. As of October 3, 2004, $250 million of debt securities remained available for issuance under the August 1997 Registration Statement.

## 12. 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 October 3, 2004 and December 31, 2003, because of the relatively short maturity of these instruments. The carrying value of long-term debt, including the current portion, was





$969.9 million as of October 3, 2004, compared with a fair value of $1,102.7 million, an increase of $132.8 million, based on quoted market prices for the same or similar debt issues.

As of October 3, 2004, the Company had foreign exchange forward contracts and options maturing in 2004 and 2005 to purchase $44.1 million in foreign currency, primarily Canadian dollars and British sterling, and to sell $25.4 million in foreign currency, primarily Mexican pesos and 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 October 3, 2004, the fair value of foreign exchange forward contracts and options was an asset of $.5 million. As of December 31, 2003, the fair value of foreign exchange forward contracts and options was an asset of $1.6 million. The Company does not hold or issue financial instruments for trading purposes.

In order to minimize its financing costs and to manage interest rate exposure, the Company, from time to time, enters into interest rate swap agreements. In October 2003, the Company entered into interest rate swap agreements to effectively convert interest payments on long-term debt from fixed to variable rates. Interest payments on $200.0 million of 6.7% Notes due in October 2005 and $150.0 million of 6.95% Notes due in March 2007 were converted from the respective fixed rates to variable rates based on LIBOR. In March 2004, the Company terminated these agreements, resulting in cash receipts totaling $5.2 million, with a corresponding increase to the carrying value of the long-term debt. This increase will be amortized over the remaining term of the respective long-term debt as a reduction to interest expense.

In February 2001, the Company entered into interest rate swap agreements that effectively converted variable interest rate payments related to certain lease arrangements from a variable to a fixed rate of 6.1%. Any interest rate differential on interest rate swap agreements is recognized as an adjustment to interest expense over the term of each agreement. The fair value of interest rate swap agreements was a liability of $3.8 million and $5.2 million as of October 3, 2004 and December 31, 2003, respectively. The Company's risk related to interest rate swap agreements is limited to the cost of replacing such agreements at prevailing market rates.

## 13. PENSION AND OTHER POST-RETIREMENT BENEFIT PLANS

Components of net periodic benefits cost consisted of the following:

| | Pension Benefits | | Other Benefits | |
|---|---|---|---|---|
| | For the Three Months Ended | | For the Three Months Ended | |
| | October 3, 2004 | September 28, 2003 | October 3, 2004 | September 28, 2003 |
| | (in thousands of dollars) | | | |
| Service cost | $ 11,092 | $ 9,757 | $ 998 | $ 928 |
| Interest cost | 13,434 | 12,734 | 3,971 | 4,665 |
| Expected return on plan assets | (19,406) | (14,889) | -- | -- |
| Amortization of prior service cost | 1,044 | 1,121 | (389) | (412) |
| Amortization of unrecognized transition balance | 27 | (83) | -- | -- |
| Recognized net actuarial loss | 2,515 | 4,094 | (178) | 793 |
| Administrative expenses | 178 | 129 | -- | -- |
| Net periodic benefits cost | 8,884 | 12,863 | 4,402 | 5,974 |
| Loss due to special termination benefits | -- | 3,383 | -- | 539 |
| Total amount reflected in earnings | $ 8,884 | $ 16,246 | $ 4,402 | $ 6,513 |

Employer contributions of $1.1 million and $5.7 million were made during the third quarter of 2004 to the Company's pension plans and other benefits plans, respectively. In the third quarter of 2003, the Company contributed $111.6 million and $4.6 million to the Company's pension and other benefits plans, respectively. The increase in the expected return on plan assets in the third quarter of 2004 compared with the third quarter of 2003 primarily reflects the return on incremental employer contributions made during 2003.

The lower net periodic benefits cost related to other benefits as of October 3, 2004, was due primarily to the impact of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the “Act”) for employers that sponsor post-retirement health care plans that provide prescription drug benefits. The Federal subsidy to be provided by the Act



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will reduce net periodic benefits costs in 2004 by approximately $3.0 million of which $2.2 million was recognized in the third quarter. The impact of the Act lowered the accumulated post-retirement benefits obligation by approximately $19.0 million.

In 2003, the special termination benefits were related to the early retirement program which was a component of the 2003 business realignment initiatives, described more fully in Note 4, Business Realignment Initiatives. The early retirement program provided enhanced pension and retiree medical benefits with pre-tax costs of $3.4 million and $.5 million, respectively.

| | Pension Benefits | | Other Benefits | |
|---|---|---|---|---|
| | For the Nine Months Ended | | For the Nine Months Ended | |
| | October 3, 2004 | September 28, 2003 | October 3, 2004 | September 28, 2003 |
| | (in thousands of dollars) | | | |
| Service cost | $ 32,822 | $ 29,273 | $ 2,960 | $ 2,784 |
| Interest cost | 39,883 | 38,199 | 13,506 | 13,991 |
| Expected return on plan assets | (57,649) | (44,667) | -- | -- |
| Amortization of prior service cost | 3,120 | 3,365 | (1,179) | (1,240) |
| Amortization of unrecognized transition balance | 85 | (247) | -- | -- |
| Recognized net actuarial loss | 7,513 | 12,282 | 2,252 | 2,378 |
| Administrative expenses | 438 | 388 | -- | -- |
| Net periodic benefits cost | 26,212 | 38,593 | 17,539 | 17,913 |
| Loss due to special termination benefits | -- | 3,383 | -- | 539 |
| Total amount reflected in earnings | $ 26,212 | $ 41,976 | $ 17,539 | $ 18,452 |

Employer contributions of $2.5 million and $16.7 million were made during the first nine months of 2004 to the Company’s pension plans and other benefits plans, respectively. In the first nine months of 2003, the Company contributed $117.9 million and $14.8 million to the Company’s pension and other benefits plans, respectively. The increase in the expected return on plan assets in the first nine months of 2004 compared with the same period of 2003 primarily reflects the return on incremental employer contributions made during 2003. For 2004, there are no minimum funding requirements for the domestic plans and minimum funding requirements for the non-domestic plans are not material. For more information on the Company’s pension and other post-retirement benefit plans, refer to the consolidated financial statements and notes included in the Company’s 2003 Annual Report on Form 10-K.

In 2003, the special termination benefits were related to the early retirement program which was a component of the 2003 business realignment initiatives, described more fully in Note 4, Business Realignment Initiatives. The early retirement program provided enhanced pension and retiree medical benefits with pre-tax costs of $3.4 million and $.5 million, respectively.

## 14. SHARE REPURCHASES

On July 27, 2004, the Company purchased 11,281,589 shares of its Common Stock from Hershey Trust Company, as Trustee of the Milton Hershey School Trust, in a privately negotiated transaction. The Company paid $44.32 per share, or approximately $500 million, for the shares and fees of $1.4 million associated with the transaction financed principally by additional commercial paper borrowings.

In December 2002, the Company’s Board of Directors approved a share repurchase program authorizing the repurchase of up to $500 million of the Company’s Common Stock. Under this program, a total of 12,480,900 shares of Common Stock was purchased through October 3, 2004 for $445.0 million. As of October 3, 2004, a total of 113,822,530 shares were held as Treasury Stock and $55.0 million remained available for repurchases of Common Stock under the repurchase program.

## 15. INCOME TAXES

The Company’s provision for income taxes, accrued income taxes and deferred income taxes are based upon income, statutory tax rates, the legal structure of the Company and interpretation of tax laws. As a matter of course, the Company is regularly audited by Federal, state and foreign tax authorities. From time to time, these audits result in assessments of additional tax. The Company maintains reserves for such assessments. The reserves are determined based upon the Company's judgment of assessment risk and are adjusted, from time to time, based upon changing facts and circumstances, such as receiving audit assessments or clearing of an item for which a reserve has been established. A settlement of Federal tax audits for the 1999 and 2000 tax years, as well as the resolution of a number of state tax audit issues were concluded during the second quarter of 2004. Based upon the results of the audits, the income tax contingency reserves were adjusted resulting in a reduction of income tax reserves by $73.7 million, reflecting a reduction of the provision for income taxes by $61.1 million and a reduction to goodwill of $12.6 million. The income tax contingency reserve adjustments related primarily to acquisition and divestiture matters, as well as deductibility and timing of certain expenses and also included interest on potential assessments.

16. **PENDING ACCOUNTING PRONOUNCEMENTS**

In March 2004, the FASB issued an exposure draft of Proposed Statement of Financial Accounting Standards, *Share-Based Payment, an amendment of FASB Statements No. 123 and 95.* This proposed statement addresses the accounting for transactions in which an enterprise exchanges its valuable equity instruments for employee services. It also addresses transactions in which an enterprise incurs liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of those equity instruments in exchange for employee services. For public entities, the cost of employee services received in exchange for equity instruments, including employee stock options, would be measured based on the grant-date fair value of those instruments. That cost would be recognized as compensation expense over the requisite service period (often the vesting period). Generally, no compensation cost would be recognized for equity instruments that do not vest.

At a meeting held in October 2004, the FASB decided to defer, for public companies, the effective date of the proposed statement from fiscal years beginning after December 15, 2004, to periods beginning after June 15, 2005. The new standard would apply to awards granted, modified, or settled in cash on or after that date. Companies may choose from one of three methods when transitioning to the new standard, which may include restatement of prior annual and interim periods. The impact on earnings per share-diluted of expensing stock options will be dependent upon the final pronouncement issued by the FASB, the method to be used for valuation of stock options and the transition method determined by the Company. The total impact on an annualized basis could range from approximately $.06 to $.08 per share-diluted, assuming option grants continue at the same level as in 2003. For more information on the Company's stock-based employee compensation plans, refer to the consolidated financial statements and notes included in the Company's 2003 Annual Report on Form 10-K.





**Item 2. Management's Discussion and Analysis of Results of Operations and Financial Condition**

**Results of Operations — Third Quarter 2004 vs. Third Quarter 2003**

Net sales for the third quarter increased $63.5 million, or 5%, from 2003. Approximately two-thirds of the sales increase resulted from sales volume growth, especially within the United States, primarily reflecting the introduction of new products and limited edition items. The remainder of the sales increase resulted from net price realization reflecting higher selling prices and more efficient promotional spending compared with the third quarter of 2003. Net sales in the Company's Canadian business also increased, driven by the favorable impact of foreign currency exchange rates. Sales in the third quarter of 2004 were unfavorably affected by the divestiture of certain gum brands in September 2003, lower sales of remaining gum brands, and higher returns, discounts and allowances, relating primarily to the sales volume growth.

Cost of sales for the quarter increased $32.2 million, or 4%, from 2003 to 2004. The cost increase was primarily caused by the higher sales volume and higher raw material costs, principally associated with increased prices for cocoa and dairy products. The cost of sales increase was offset somewhat by reduced costs resulting from improved supply chain efficiencies primarily associated with lower costs for aged and obsolete inventories. Gross margin increased from 39.2% in 2003 to 39.7% in 2004. The margin expansion reflected improved price realization from price increases and weight reductions, as well as supply chain efficiencies. These margin improvements were partially offset by increases in raw material costs.

Selling, marketing and administrative expenses for the third quarter of 2004 increased 2% from the comparable period in 2003, primarily reflecting increased employee compensation costs, partially offset by lower advertising expense. Selling, marketing and administrative expenses declined from 17.8% of sales in 2003 to 17.3% in 2004.

Net interest expense in the third quarter of 2004 was $1.0 million higher than the comparable period of 2003, primarily reflecting higher short-term interest expense resulting from an increase in short-term borrowings to finance the purchase of 11,281,589 shares of Common Stock from Hershey Trust Company for approximately $500 million.

The effective income tax rate for the third quarter of 2004 was 36.8% compared with 36.4% for the third quarter of 2003, reflecting the best estimates of the expected effective income tax rates for the full-years. The increase in the effective income tax rate in 2004 reflected an expected change in the mix of the Company's income among various tax jurisdictions, particularly Puerto Rico. The third quarter 2003 rate reflected the effective tax rates on business rationalization and realignment initiatives and the gain on sale of business for the third quarter of 2003.

An after-tax charge of $7.4 million, or $.03 per share-diluted, was recorded in the third quarter of 2003 to reflect the cumulative effect of a change in accounting for the Company's leases of certain warehouse and distribution facilities.

Net income for the third quarter increased $22.6 million, or 16%, from 2003 to 2004, and net income per share-diluted increased $.11, or 20%. Income before the cumulative effect of the accounting change was $166.2 million for the third quarter of 2004 compared with $151.0 million for the third quarter of 2003, a 10% increase. Income per share-diluted before the cumulative effect of the accounting change was $.66 for the third quarter of 2004, 16% higher than in 2003. Income before the cumulative effect of the accounting change in 2003 included total net business realignment charges of $5.9 million after tax and an after-tax gain on the sale of certain gum brands of $5.7 million.

**Results of Operations — First Nine Months 2004 vs. First Nine Months 2003**

Net sales for the first nine months of 2004 increased $168.0 million, or 6% from the comparable period of 2003. Sales were positively impacted by favorable sales volume, especially within the United States, primarily reflecting strong sales of higher margin instant consumable items driven by the introduction of innovative new products and line extensions. The impact of higher selling prices compared with the first nine months of 2003 also contributed to the sales growth. Net sales of the Company's Canadian and Brazilian businesses also increased as a result of the impact of favorable foreign currency exchange rates, particularly in Canada, and increased sales volume. Sales were unfavorably affected by the divestiture of certain gum brands in September 2003, lower sales of remaining gum brands, and higher promotion allowances and returns, discounts and allowances, relating primarily to the sales volume growth. The results of the Company's Asian operations, particularly in China and Taiwan, continued to be below expectations through the first nine months of 2004, but were offset somewhat by sales increases in the Philippines and Japan, compared with the first nine months of 2003.

Cost of sales for the first nine months increased $78.8 million, or 4%, from the comparable period of 2003. The cost increase was primarily caused by higher sales volume and higher raw material costs, principally associated with increased cocoa prices. The cost of sales increase was partially offset by efficiency improvements in manufacturing and logistics operations and by reduced costs associated with aged and obsolete inventory in 2004. Gross margin increased from 38.6% in 2003 to 39.4% in





2004. The margin expansion reflected improved price realization as well as lower supply chain costs. These margin improvements were partially offset by increases in raw material costs.

Selling, marketing and administrative expenses for the first nine months of 2004 increased by 5% over the comparable period of 2003, primarily attributable to higher employee compensation costs as well as increased consumer promotion expenses. Selling, marketing and administrative expenses, as a percentage of sales, decreased from 20.1% for the first nine months of 2003 to 19.9% for the comparable period of 2004.

Net pre-tax business rationalization and realignment charges of $12.4 million recorded in the first nine months of 2003 were principally associated with costs pertaining to the realignment of the sales organization and impairment charges resulting from production line rationalization and the elimination of non-strategic brands and products.

Net interest expense in the first nine months increased $1.2 million, primarily reflecting higher short-term and fixed interest expense, partially offset by higher capitalized interest.

The effective income tax rates for the first nine months of 2004 and 2003 are not comparable because the Company's provision for income taxes was benefited by the $61.1 million adjustment to income tax contingency reserves recorded in the second quarter of 2004. The non-cash reduction of income tax expense resulted from the settlement of Federal tax audits for the 1999 and 2000 tax years, as well as the resolution of a number of state tax audit issues. Based upon the results of the audits, the income tax contingency reserves were adjusted, resulting in a reduction of $61.1 million in income tax expense. The income tax contingency reserve adjustments related primarily to acquisition and divestiture matters, as well as deductibility and timing of certain expenses and also included interest on potential assessments.

The effective income tax rate for the first nine months of 2004, excluding the impact of the adjustment, was 36.6%, compared with an effective income tax rate of 36.5% for the comparable period of 2003. The effective income tax rates for the first nine months of 2004 and 2003 reflect the best estimates of the expected effective income tax rates for the full years.

An after-tax charge of $7.4 million, or $.03 per share diluted, was recorded in the first nine months of 2003 to reflect the cumulative effect of a change in accounting for the Company's leases of certain warehouse and distribution facilities.

Net income was $420.6 million in the first nine months of 2004 compared with $312.6 million in the comparable period of 2003. Earnings per share-diluted for the first nine months of 2004 was $1.62, a 37% increase from $1.18 per share for the same period last year. Income before the cumulative effect of the accounting change was $420.6 million for the first nine months of 2004. Income per share-diluted before the cumulative effect of the accounting change was $1.62 for the first nine months of 2004, 34% higher than in 2003. Income before the cumulative effect of accounting change for 2004 was favorably impacted by the $61.1 million adjustment to Federal and state income tax contingency reserves, as discussed above. Income before the cumulative effect of the accounting change for the first nine months of 2003 included net business realignment charges of $8.3 million after tax and a gain on the sale of certain gum brands of $5.7 million after tax.

**Liquidity and Capital Resources**

Historically, the Company's major source of financing has been cash generated from operations. Domestic seasonal working capital needs, which typically peak during the summer months, generally have been met by issuing commercial paper. During the first nine months of 2004, the Company's cash and cash equivalents decreased by $27.4 million. Cash and cash equivalents on hand at the beginning of the period, cash provided from operations and short-term borrowings were sufficient to fund capital expenditures and capitalized software expenditures of $155.7 million, dividend payments of $152.8 million and the repurchase of 13.9 million shares of the Company's Common Stock for $617.0 million. On July 27, 2004, the Company purchased 11,281,589 shares of its Common Stock from Hershey Trust Company, as Trustee of the Milton Hershey School Trust, in a privately negotiated transaction. The Company paid $44.32 per share, or approximately $500 million, for the shares and fees of $1.4 million associated with the transaction. Cash provided from changes in other assets and liabilities was $53.6 million for the first nine months of 2004 compared with cash used by other assets and liabilities of $128.2 million for the same period of 2003. The variance from the prior year primarily reflects changes in pension assets and liabilities resulting from contributions to the Company's pension plans in 2003, a reduction in the use of cash from commodity transactions and cash provided from increases in liabilities related to incentive plans in 2004, partially offset by an increase in cash used from changes in accrued income taxes in 2004 compared with 2003. Cash used by deferred income taxes primarily reflects the $73.7 million reduction to deferred tax liabilities resulting from the adjustment to reserves for Federal and state income tax contingencies recorded in the second quarter of 2004 which offsets the non-cash impact of the adjustments to the provision for income taxes and goodwill.





Income taxes paid of $181.7 million during the first nine months of 2004 increased from $156.4 million for the comparable period of 2003. The payment of estimated income taxes in 2003 was reduced significantly as a result of deductions for pension plan contributions.

The ratio of current assets to current liabilities decreased to 1.2:1 as of October 3, 2004 from 1.9:1 as of December 31, 2003 primarily reflecting an increase in short-term borrowings. The Company's capitalization ratio (total short-term and long-term debt as a percent of stockholders' equity, short-term and long-term debt) was 62% as of October 3, 2004 and 43% as of December 31, 2003. The higher capitalization ratio in 2004 primarily reflected additional borrowings of $500 million to finance the purchase of Common Stock from the Hershey Trust Company and the related decrease in stockholders' equity as a result of the additional treasury stock.

On July 28, 2004, the Company entered into a 364-Day Credit Agreement (the "Credit Agreement") which established a credit facility with a syndicate of banks under which the Company may borrow up to $500 million with the option to increase borrowings by an additional $300 million with the concurrence of the lenders. In addition to the Credit Agreement, the Company also maintains short-term and long-term committed credit facilities (together the "Existing Facilities") with a syndicate of banks in the amount of $400 million. The Company may increase borrowings under the Existing Facilities to $1.0 billion with the concurrence of the banks. Information about the Existing Facilities is contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2003.

**Stock Split**

On April 21, 2004, the Company's Board of Directors approved a two-for-one stock split to be effected in the form of a 100 percent stock dividend to stockholders of record May 25, 2004. The Company's stockholders received one additional share for each share in their possession on that date. This did not change the proportionate interest a stockholder maintained in the Company. The additional shares were distributed on June 15, 2004. All shares and per share amounts have been adjusted for the two-for-one stock split.

**Safe Harbor Statement**

The nature of the Company'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 Company notes the following factors that, 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 "intend," "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; customer and consumer response to selling price increases; changes in governmental laws and regulations, including taxes; market demand for new and existing products; changes in raw material and other costs; pension cost factors, such as actuarial assumptions, market performance and employee retirement decisions; adequacy of the Company's bad debt reserve; the Company's ability to implement improvements to and reduce costs associated with the Company's supply chain; and the Company's ability to successfully implement its rationalization and realignment initiatives, as discussed in the Company's 2003 Annual Report on Form 10-K.





**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

The potential net loss in fair value of foreign exchange forward contracts and options and interest rate swap agreements of ten percent resulting from a hypothetical near-term adverse change in market rates was $.7 million as of December 31, 2003 and $.4 million as of October 3, 2004. The market risk resulting from a hypothetical adverse market price movement of ten percent associated with the estimated average fair value of net commodity positions decreased from $5.5 million as of December 31, 2003, to $2.7 million as of October 3, 2004. Market risk represents 10% of the estimated average fair value of net commodity positions at four dates prior to the end of each period.

**Item 4. Controls and Procedures**

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in the Company's reports filed or submitted under the Securities Exchange Act of 1934 (the "Exchange Act") is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the Company's reports filed under the Exchange Act is accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

As of the end of the period covered by this quarterly report, the Company conducted an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures, as required by Rule 13a-15 under the Exchange Act. This evaluation was carried out under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective. There have been no changes in the Company's internal control over financial reporting which could materially affect, or are reasonably likely to materially affect, internal control over financial reporting.

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## PART II — OTHER INFORMATION

**Items 1, 3, 4 and 5 have been omitted as not applicable.**

**Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds.**

**Issuer Purchases of Equity Securities***

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | (d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1) |
|---|---|---|---|---|
| | | | | (in thousands of dollars) |
| January 1 through February 1, 2004 | -- | -- | -- | $170,567 |
| February 2 through February 29, 2004 | 1,105,600 | $ 39.53 | 522,000 | $150,398 |
| March 1 through April 4, 2004 | 214,000 | $ 41.63 | -- | $150,398 |
| April 5 through May 2, 2004 | 194,600 | $ 44.81 | 74,600 | $147,060 |
| May 3 through May 30, 2004 | 2,187,400 | $ 44.57 | 1,531,400 | $ 78,739 |
| May 31 through July 4, 2004 | 220,400 | $ 44.35 | 84,600 | $ 74,982 |
| July 5 through August 1, 2004 | 11,281,589 | $ 44.32 | -- | $ 74,982 |
| August 2 through August 29, 2004 | 472,300 | $ 47.29 | 298,300 | $ 60,842 |
| August 30 through October 3, 2004 | 136,600 | $ 48.34 | 121,600 | $ 54,963 |
| Total | 15,812,489 | $ 44.20 | 2,632,500 | $ 54,963 |

*All shares and per share amounts have been adjusted for the two-for-one stock split effected in the second quarter of 2004.

(1) The Company’s Board of Directors approved a share repurchase program authorizing the repurchase of up to $500 million of the Company’s Common Stock in December 2002.



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**Item 6 — Exhibits**

The following items are attached and incorporated herein by reference:

(10) Material Contracts

a. Stock Purchase Agreement between Hershey Trust Company, as Trustee of the Milton Hershey School Trust, and Hershey Foods Corporation, dated July 27, 2004, is attached hereto as Exhibit 10.1.

b. 364 – Day Credit Agreement dated as of July 28, 2004, among Hershey Foods Corporation, the banks, financial institutions and other institutional lenders listed on the signature pages thereof, and Citibank, N.A., as administrative agent for the Lenders (as defined therein), Bank of America, N.A., as syndication agent, and Citigroup Global Markets, Inc. and Banc America Securities LLC, as joint lead arrangers and joint book managers, is incorporated by reference from Exhibit 10.1 to the Company's Current Report on Form 8-K, filed July 28, 2004.

(12) Statement showing computation of ratio of earnings to fixed charges for the nine months ended October 3, 2004 and September 28, 2003.

(31.1) Certification of Richard H. Lenny, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

(31.2) Certification of Frank Cerminara, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

The following item is furnished with this report:

(32) Certification of Richard H. Lenny, Chief Executive Officer, and Frank Cerminara, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.



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## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**HERSHEY FOODS CORPORATION**
**(Registrant)**

Date: November 10, 2004

By: /s/Frank Cerminara
Frank Cerminara
Senior Vice President,
Chief Financial Officer

By: /s/David W. Tacka
David W. Tacka
Vice President,
Chief Accounting Officer



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## EXHIBIT INDEX

| | |
|---|---|
| Exhibit 10.1 | Stock Purchase Agreement between Hershey Trust Company, as Trustee of the Milton Hershey School Trust, and Hershey Foods Corporation |
| Exhibit 12 | Computation of Ratio of Earnings to Fixed Charges |
| Exhibit 31.1 | Certification of Richard H. Lenny, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 31.2 | Certification of Frank Cerminara, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 32 | Certification of Richard H. Lenny, Chief Executive Officer, and Frank Cerminara, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

# STOCK PURCHASE AGREEMENT

This Agreement is made this 27th day of July, 2004, by and between Hershey Trust Company, a Pennsylvania corporation with its principal office located at 100 Mansion Road East, Hershey, Pennsylvania, as Trustee of the Milton Hershey School Trust (the "Trust"), and Hershey Foods Corporation, a Delaware corporation with its principal office located at 100 Crystal A Drive, Hershey, Pennsylvania (the "Corporation").

The Trust has offered to sell to the Corporation 11,281,589 shares of Common Stock, $1.00 par value per share, of the Corporation (the "Common Stock") for an aggregate price of $500,000,025. The Corporation has agreed to make the repurchase on the following terms and conditions. For clarity, this Agreement does not relate to the Corporation's Class B Common Stock, $1.00 par value per share.

In order to accomplish this transaction, the parties, each intending to be legally bound by execution of this Agreement, hereby agree as follows:

1. Sale and Purchase of Shares. The Trust hereby agrees to sell to the Corporation, and the Corporation hereby agrees to purchase from the Trust, 11,281,589 shares of Common Stock on the terms and conditions provided below.

2. Purchase Price. The purchase price per share of the Common Stock to be sold and purchased hereunder shall be $44.32 for an aggregate purchase price of $500,000,025.

3. Closing. The sale and purchase of the Common Stock shall be effective on July 27, 2004 (the "Closing"). Payment by wire transfer shall be made as soon as practicable on July 28, 2004. As soon as practicable on July 28, 2004, the Trust shall deliver to the Corporation a duly executed stock power for 11,281,589 shares of Common Stock and a certificate of incumbency for the officer or officers who executed the stock power.

4. Condition to Closing. The Office of the Attorney General of the Commonwealth of Pennsylvania shall have approved in writing in form satisfactory to both parties the transaction.

5. Representations of the Trust. The Trust warrants and represents to the Corporation as of the date hereof and at the time of the Closing that:

(a) Corporate Existence and Authority. Hershey Trust Company (i) is a corporation duly organized, presently subsisting and in good standing under the laws of the Commonwealth of Pennsylvania; (ii) has all requisite corporate power to execute, deliver and perform this Agreement; (iii) has taken or caused to be taken all necessary corporate and fiduciary action to authorize the execution, delivery and performance of this Agreement; and (iv) has received all required governmental consents to execute, deliver and perform this Agreement.

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(b) No Conflict. The execution and delivery of this Agreement by Hershey Trust Company does not, and the consummation of the transaction contemplated hereby, will not violate, conflict with or constitute a default under (i) its articles of incorporation or by-laws; (ii) the Deed of Trust of November 15, 1909, Milton S. and Catherine S. Hershey, settlors; (iii) any material agreement, indenture or other instrument to which it is a party or by which it is bound; or (iv) any material law, regulation, order, judgment or decree applicable to it.

(c) Validity and Enforceability. This Agreement has been duly executed and delivered by the Trust and is a valid and binding agreement of the Trust enforceable against it in accordance with its terms, except as may be limited by any applicable bankruptcy, insolvency, reorganization, moratorium, fraudulent conveyance or other laws affecting the enforcement of creditors' rights generally, and by general principles of equity.

(d) Common Stock. The Trust is the owner of all of the shares of Common Stock being sold and delivered by the Trust hereunder, and it will deliver to the Corporation, good and valid title to the Common Stock free and clear of any liens, claims related to title, restrictions, security interests and encumbrances of any kind (including, without limitation, any agreement, arrangements or understanding affecting transfer or voting of such shares of Common Stock).

6. Representations of the Corporation. The Corporation warrants and represents to the Trust as of the date hereof that:

(a) Corporate Existence and Authority. The Corporation (i) is a corporation duly organized, validly existing and in good standing under the laws of the State of Delaware; (ii) has all requisite corporate power to execute, deliver and perform this Agreement; and (iii) has taken all necessary corporate action to authorize the execution, delivery and performance of this Agreement.

(b) No Conflict. The execution and delivery of this Agreement does not, and the consummation of the transaction contemplated hereby, will not violate, conflict with or constitute a default under (i) the Corporation's Restated Certificate of Incorporation or by-laws; (ii) any material agreement, indenture or other instrument to which the Corporation is a party or by which the Corporation is bound; or (iii) any material law, regulation, order, judgment or decree applicable to the Corporation.

(c) Validity and Enforceability. This Agreement has been duly executed and delivered by the Corporation and is a valid and binding agreement of the Corporation enforceable against it in accordance with its terms, except as may be limited by any applicable bankruptcy, insolvency, reorganization, moratorium, fraudulent conveyance or other laws affecting the enforcement of creditors' rights generally, and by general principles of equity.

7. Additional Provisions. The parties further agree as follows:

(a) This Agreement shall be binding upon and inure to the benefit of the parties hereto, and their respective successors and assigns; provided, however, that this Agreement may not be assigned.

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(b) This Agreement shall be construed in accordance with the laws of the State of Delaware with respect to matters of corporate law and otherwise under the laws of the Commonwealth of Pennsylvania.

(c) This Agreement constitutes the entire agreement of the parties with regard to the sale and purchase of the shares of Common Stock provided for herein (any prior or contemporaneous undertakings or agreements being superseded hereby and merged herein) and may not be amended in any way except by an instrument executed by both parties.

(d) The representations and warranties contained in this Agreement shall survive the Closing.

(e) No brokerage fees or commissions will be payable as a result of the consummation of the transaction contemplated by this Agreement.

(f) Each party shall bear its own expenses and costs, including those of any advisors, relating to the performance of this Agreement.

(g) Each party hereto agrees to execute and deliver to the other party such other documents and to do such other acts or things, upon the reasonable request of the other party, for the purpose of carrying out the intent of this Agreement.

IN WITNESS WHEREOF, the parties by their authorized representatives have executed this Agreement.

HERSHEY FOODS CORPORATION

By: *_/s/ Richard H. Lenny_*
Richard H. Lenny
Chairman, President and Chief Executive Officer

HERSHEY TRUST COMPANY,
AS TRUSTEE OF THE
MILTON HERSHEY SCHOOL TRUST

By: *_/s/ Robert C. Vowler_*
Robert C. Vowler
President and Chief Executive Officer

**HERSHEY FOODS CORPORATION**
**COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES**
**(in thousands of dollars except for ratios)**
**(Unaudited)**

| | For the Nine Months Ended October 3, 2004 | For the Nine Months Ended September 28, 2003 |
|---|---|---|
| **Earnings:** | | |
| Income before income taxes | $ 567,057 | $ 504,283 |
| Add (deduct): | | |
| Interest on indebtedness | 49,729 | 48,912 |
| Portion of rents representative of the interest factor (a) | 7,240 | 10,113 |
| Amortization of debt expense | 335 | 335 |
| Amortization of capitalized interest | 2,685 | 2,901 |
| Earnings as adjusted | $ 627,046 | $ 566,544 |
| **Fixed Charges:** | | |
| Interest on indebtedness | $ 49,729 | $ 48,912 |
| Portion of rents representative of the interest factor (a) | 7,240 | 10,113 |
| Amortization of debt expense | 335 | 335 |
| Capitalized interest | 2,597 | 1,156 |
| Total fixed charges | $ 59,901 | $ 60,516 |
| **Ratio of earnings to fixed charges** | 10.47 | 9.36 |

NOTE:

(a) Portion of rents representative of the interest factor consists of all rental expense pertaining to operating leases used to finance the purchase or construction of warehouse and distribution facilities, and one-third of rental expense for other operating leases.

Exhibit 31.1

**CERTIFICATION**

I, Richard H. Lenny, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Hershey Foods Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 10, 2004

/s/ Richard H. Lenny
Richard H. Lenny
Chief Executive Officer

**CERTIFICATION**

I, Frank Cerminara, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Hershey Foods Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 10, 2004

/s/ Frank Cerminara
Frank Cerminara
Chief Financial Officer

**Certification**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officers of Hershey Foods Corporation (the "Company") hereby certify that the Company's Quarterly Report on Form 10-Q for the quarter ended October 3, 2004 (the "Report") fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 10, 2004

/s/ Richard H. Lenny
Richard H. Lenny
Chief Executive Officer

Dated: November 10, 2004

/s/ Frank Cerminara
Frank Cerminara
Chief Financial Officer

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.