Management CV

Update Note:
Hershey Company (HSY)
August 19, 2015

HSY: Challenging Recent M&A

Hershey's President & CEO, J.P. Bilbrey (58) recently became a triple titled executive after being named Chairman. We think he was already showing signs of being a dominant executive, garnering nearly 60% of the executive team's pay. Since our last report (click here), he has delivered reasonable growth, with most key operating metrics outpacing peers. We are concerned, however, that he has shifted the growth strategy to invest in businesses and new geographies, with an emphasis on Mexico, Brazil, India, and China. This includes an increased focus on M&A, and we think a recent acquisition in China has failed to live up to expectations. To top it off, we are cautious on the recent management turnover, including a new CFO who lacks relevant experience.

Management Changes We are concerned with the March hiring of Patricia Little (54) as CFO with responsibility for M&A and Corporate Development. She lacks industry experience, though we are even more concerned with her lack of M&A and integration experience given CEO Bilbrey's strategy shift. Little worked for Kelly Services as CFO for 7 years. Before that, she worked at Ford for 24 years in corporate and operational finance. President, International Bert Alfonso (57) retired at the end of June after only 2 years in the role. While his background was in finance having spent 6 years as CFO (2007 to 2013), we thought he showed good cost discipline running International. There does not appear to be a replacement, although Steven Schiller was named President, China and Asia, after being Regional President, AEMEA. Peter Horst joined in July as SVP, CMO. While he has a good marketing background, we think he is a poor skills fit as he mainly has financial industry experience (Capital One and Ameritrade).

Pay & Ownership Update Our main concern with the pay plan is the outsized pay of CEO Bilbrey. In FY14, his pay represented over 58% of the team's total. Since our previous report, weightings for the cash bonus metrics have become less favorable. They are now based 65% on financial goals (net sales, adjusted diluted EPS, and OCF) and 35% on individual goals, which are too subjective. Previously, it was a 75%/25% split. We continue to like the breakdown of long term pay, which is split evenly between performance shares (PSUs) and options. PSUs vest based on 3-year total shareholder return vs. a reasonable peer group, 3-year CAGR in adjusted EPS, and 3-year CAGR in organic net sales outside the U.S. and Canada. Last year, Bilbrey was paid $17.8 million, including: a $1.2 million as salary, a $1 million cash bonus, $8.1 million in equity, and $7.6 million in pension and other pay. The other 4 executives were paid a total of only $13.3 million. We like that Officers' and Directors' beneficial ownership has increased to 1% from 0.5% at the time of our previous report. Bilbrey has more than doubled the size of his holdings to 551k shares (0.3% of HSY). There has, however, been significant selling over the past 18 months, including Bilbrey's 197k shares (26% of his beneficial stake), President, North America Michele Buck (53) 47k shares (22% of her beneficial stake) and SVP Terence O'Day (65) 69k shares (34% of his beneficial stake). The weighted average strike of all options is 20% in-the-money at $77.44, providing good shareholder alignment.

Allocation Update We think CEO Bilbrey has been inconsistent and not particularly shareholder friendly in his capital allocation strategy. He has shown greater willingness to pursue M&A over the last few years, not always to positive effect. He acquired 80% of Shanghai Gold Monkey last September for $394 million. We are concerned that about $250 million of Goodwill was already written down in Q2 and that it has performed below management's expectations. Bilbrey slashed the 2015 sales forecast for the unit by 55% to $90 million. We think some issues should have been uncovered during due diligence, with Bilbrey specifically citing A/R collections. The remaining 20% of SGM was to be purchased on the 1st anniversary, but he said that has been pushed back to Q4'15, with the timing and terms to be re-determined. This year, KRAVE Pure Foods was acquired for $220 million in cash plus another potential $20 million. We note that KRAVE only had annual sales of $35 million. CFO Little has said her capital allocation priorities are consistent with her predecessor's. She will focus on growth, both organic and M&A. Next, she examines the dividend, which has been raised annually since 2010. She will then consider repurchases. In Q1'15, management repurchased $173 million. A new $250 million authorization was approved in February. *End*