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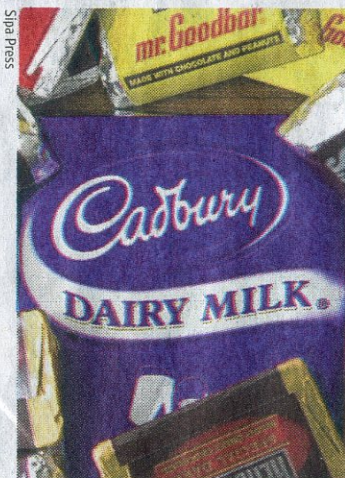
Financial Analysis and Commentary

Kraft Swaps Nest Egg for Cadbury

What's the difference between a good offer and a derisory one? In Cadbury's case: 14%. In recommending an 850-pence-a-share (\$13.89) offer from Kraft Foods, worth \$19 billion, Cadbury Chairman Roger Carr has bowed to U.S. investors and hedge funds that dominate the chocolate maker's register.

Unlike U.K. institutions, they were keener to take Kraft's cash and shares today than wait for Cadbury to realize its potential. At 13 times 2009 earnings before interest, tax, depreciation and amortization, Kraft's offer is at the low end of recent food deals. And a 14% bump from the original bid is small, especially as it partly reflects Kraft's share price rise since early September.

That said, Kraft has upped the cash component to 500 pence, to go with 340 pence in stock, and a 10-pence dividend. Kraft needs around \$11 billion to fund the bid. And it is no cash cow. While Kraft recently sold its frozen pizza business

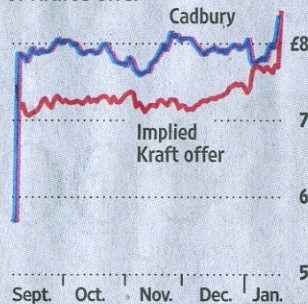


for \$3.7 billion, it had net debt of \$18 billion at the end of September. Free cash flow for the first nine months of 2009 was \$1.2 billion, but around \$940 million was from reduced capital expenditures and lower spending on raw material inventories, says research firm Behind the Numbers.

Those tailwinds will likely reduce, with sugar and milk

Sugar High

Cadbury's share price in London and implied value of Kraft's offer



Source: Thomson Reuters Datasream

prices up recently and Kraft spending \$1.3 billion to integrate Cadbury. Also, for all the extra financial leverage, Cadbury will do little for Kraft's U.S. growth. Hershey's agreement to produce and sell Cadbury chocolate in the U.S. should remain in place.

Cadbury and Kraft are a better match internationally, with opportunities for cross-selling

in convenience stores and supermarkets. Estimated annual cost savings are \$675 million in three years, over and above Cadbury's efficiency program. Taxed and capitalized, they are worth roughly \$4.7 billion, almost covering the \$6 billion premium Kraft offered above the undisturbed valuation.

Without a counterbid, Mr. Carr's bold talk about Cadbury's prospects and Kraft's "derisory" initial 745-pence bid could only go so far. He had nowhere to turn and would not have recommended Kraft's offer if he believed Hershey could offer a better price.

Kraft is raising its long-term growth targets by a percentage point to more than 5% for sales and by two points to between 9% and 11% for earnings per share. That should sugar the pill, not just for anxious Kraft shareholders, but also for Cadbury investors about to be served the snack-foods giant's stock.

—Matthew Curtin
and John Jannarone