**Financial Statements and Accompanying Notes**

The standard set of financial statements consists of: (1) a comparative income statement for three years, (2) a comparative balance sheet for two years, (3) a comparative statement of cash flows for three years, (4) a statement of retained earnings (or stockholders’ equity) for three years, and (5) a set of accompanying notes that are considered an integral part of the financial statements. The auditor’s report, unless stated otherwise, covers the financial statements and the accompanying notes. The financial statements and accompanying notes plus some supplementary data and analyses for Tootsie Roll Industries follow.

CONSOLIDATED STATEMENT OF

***Financial Position***

TOOTSIE ROLL INDUSTRIES, INC. AND SUBSIDIARIES

|  |  |  |  |
| --- | --- | --- | --- |
| ***Assets***  |  |  | December 31, |
|  |  | 2004 |  | 2003 |
| CURRENT ASSETS: |  |  |  |  |
| Cash and cash equivalents  |  | $56,989  |  | $84,084  |
| Investments |  | 32,369 |  | 86,961 |
| Accounts receivable trade, less allowances of  | 28,456 |  | 18,131 |
| Other receivables |  | 9,001 |  | 3,076 |
| Inventories: |  |  |  |  |
| Finished goods and work-in-process  | 37,384 |  | 28,969 |
| Raw materials and supplies |  | 21,393 |  | 17,117 |
| Prepaid expenses |  | 5,719 |  | 4,416 |
| Deferred income taxes  |  | 1,382 |  | 951 |
| Total current assets  |  | 192,693 |  | 243,705 |
| PROPERTY, PLANT AND EQUIPMENT, at cost: |  |
| Land  |  | 14,973 |  | 8,265 |
| Buildings  |  | 61,714 |  | 44,960 |
| Machinery and equipment  |  | 244,367 |  | 206,697 |
|  |  | 321,054 |  | 259,922 |
| Less—Accumulated depreciation  | 142,304 |  | 130,759 |
|  |  | 178,750 |  | 129,163 |
| OTHER ASSETS: |  |  |  |  |
| Goodwill  |  | 74,002 |  | 38,151 |
| Trademarks  |  | 193,342 |  | 79,348 |
| Investments  |  | 96,640 |  | 112,431 |
| Split dollar officer life insurance | 66,094 |  | 62,499 |
| Investement in joint venture  |  | 10,232 |  | — |
|  |  | 440,310 |  | 292,429 |
|  |  | $811,753  |  | $665,297  |

***Notes to Consolidated Financial Statements***

**NOTE 1—SIGNIFICANT ACCOUNTING**

**POLICIES:**

**Basis of consolidation**

The consolidated financial statements include the accounts of Tootsie Roll Industries, Inc. and its wholly-owned subsidiaries (the company), which are primarily engaged in the manufacture and sale of candy products. All significant intercompany transactions have been eliminated.

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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.

Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation.

**Revenue recognition and other accounting** **pronouncements:** Products are sold to customers based on accepted purchase orders which include quantity, sales price and other relevant terms of sale. Revenues are recognized when products

are delivered to customers and collectibility is reasonably assured. Shipping and handling costs of $31,795, $28,217 and $28,579 in 2004, 2003 and 2002, respectively, are included

in selling, marketing and administrative expenses. Accounts receivable are unsecured. Revenues from a major customer aggregated approximately 20.8%, 20.6% and 19.6% of total net sales during the years ended December 31, 2004, 2003 and 2002, respectively. In November 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 151, “Inventory Costs—an amendment to ARB No. 43, Chapter 4,” which amends guidance in accounting for abnormal amounts of idle facility expense. The company believes that the pronouncement is generally not applicable to the company’s operations and to the extent it may be applicable it is not expected to have a significant impact on the company’s consolidated financial statements.

**Cash and cash equivalents:** The company considers temporary cash investments with an original maturity of three months or less to be cash equivalents

**Investments:**

Investments consist of various marketable securities with maturities of generally up to four years. The company classifies debt and equity securities as either held to maturity, available for sale or trading. Held to maturity securities represent those securities that the company has both the positive intent and ability to hold to maturity and are carried at amortized cost. Available for sale securities represent those securities that do not meet the classification of held to maturity, are not actively traded and are carried at fair value. Unrealized gains and losses on these securities are excluded from earnings and are reported as a separate component of shareholders’ equity, net of applicable taxes, until realized. Trading securities relate to deferred compensation arrangements and are carried at fair value.

**Hedging activities:** From time to time, the company enters into commodities futures

contracts that are intended and effective as hedges of market price risks associated with the anticipated purchase of certain raw materials (primarily sugar). To qualify as a hedge, the company evaluates a variety of characteristics of these transactions, including the probability that the anticipated transaction will occur. If the anticipated transaction were not to occur, the gain or loss would then be recognized in current earnings. The company does not engage in trading or

other speculative use of derivative instruments. The company does assume the risk that counter parties may not be able to meet the terms of their contracts. The company does not expect any losses as a result of counter party defaults. The company’s derivative instruments are being accounted for as cash flow hedges and are recorded on the balance sheet at fair value. Changes therein are recorded in other comprehensive earnings and are reclassified to earnings in the periods in which earnings are affected by the hedged item. Substantially all amounts reported in accumulated other comprehensive earnings (loss) are expected to be reclassified to cost of goods sold. During the years ended December 31, 2004, 2003 and 2002, ineffectiveness related to cash flow hedges was not material.

**Inventories:**

Inventories are stated at cost, not to exceed market. The cost of substantially all of the company’s inventories ($54,794 and $42,735 at December 31, 2004 and 2003, respectively) has been determined by the last-in, first-out (LIFO) method. The excess of current cost over LIFO cost of inventories approximates $5,868 and $6,442 at December 31, 2004 and 2003, respectively. The cost of certain foreign inventories ($3,983 and $3,351 at December 31, 2004 and 2003, respectively) has been determined by the first-in, first-out (FIFO) method. Rebates, discounts and other cash consideration received from a vendor related to inventory purchases is reflected3 as a reduction in the cost of the related inventory item, and is therefore reflected in cost of sales when the related inventory item is sold.

**Property, plant and equipment:**

Depreciation is computed for financial reporting purposes by use of the straight-line method based on useful lives of 20 to 35 years for buildings and 5 to 20 years for machinery and equipment. Depreciation expense was $11,680, $11,379 and $12,354 in 2004, 2003 and 2002, respectively, including $744 relating to equipment disposals.

**Carrying value of long-lived assets:**

The company reviews long-lived assets to determine if there are events or circumstances indicating that the amount of the asset reflected in the company’s balance sheet may not be

recoverable. When such indicators are present, the company compares the carrying value of the long-lived asset, or asset group, to the future undiscounted cash flows of the underlying assets to determine if an impairment exists. If applicable, an impairment charge would be recorded to write down the carrying value to its fair value. The determination of fair value involves the use of estimates of future cash flows that involve considerable management judgment and are based

upon assumptions about expected future operating performance. The actual cash flows could differ from management’s estimates due to changes in business conditions, operating

performance, and economic conditions. No impairment charges were recorded by the company during 2004, 2003 or 2002.

**Postretirement health care and life insurance**

**benefits:**

The company provides certain postretirement health care and life insurance benefits. The cost of these postretirement benefits is accrued during employees’ working careers. The company also provides split dollar life insurance benefits to certain executive officers. The company records an asset equal to the cumulative insurance premiums that will be recovered upon the death of a covered employee(s) or earlier under the terms of the plan. Split dollar premiums paid were $3,620, $4,237 and $6,890 in 2004, 2003 and 2002,respectively.

**Intangible assets:**

The company accounts for intangible assets in accordance with SFAS No. 142, “Goodwill and Other Intangible Assets,” which was adopted by the company on January 1, 2002. In accordance with this statement, goodwill and intangible assets with indefinite lives are not amortized, but rather tested for impairment at least annually. All trademarks have been assessed by management to have indefinite lives because they are expected to generate cash flows indefinitely. The company has completed its annual impairment testing of its goodwill and trademarks during the fourth quarter of each of the years presented, and no impairment was found.

**Income taxes:**

Deferred income taxes are recorded and recognized for future tax effects of temporary differences between financial and income tax reporting. Federal income taxes are provided on the portion of income of foreign subsidiaries that is expected to be remitted to the U.S. and become taxable, but not on the portion that is considered to be permanently invested in the foreign subsidiary.

**Foreign currency translation:**

The company has determined the functional currency for each foreign subsidiary. The U.S. dollar is used as the functional currency where a substantial portion of the subsidiary’s business is indexed to the U.S. dollar or where its manufactured products are principally sold in the U.S. All other foreign subsidiaries use the local currency as their functional currency. Where the U.S. dollar is used as the functional currency, foreign currency translation adjustments are recorded as a charge or credit to other income in the statement of earnings. Where the foreign currency is used as the functional currency, translation adjustments are recorded as a separate component of comprehensive earnings (loss).

**Joint venture:**

The company’s 50% interest in two Spanish companies is accounted for using the equity method. The company records an increase in its investment in the joint venture to the extent of its share of the joint venture’s earnings, and reduces its investment to the extent of dividends received. No dividends were received during 2004.

**Comprehensive earnings:**

Comprehensive earnings includes net earnings, foreign currency translation adjustments and unrealized gains/losses on commodity hedging contracts and marketable securities.

**Earnings per share:**

A dual presentation of basic and diluted earnings per share is not required due to the lack of potentially dilutive securities under the company’s simple capital structure. Therefore, all earnings per share amounts represent basic earnings per share. The Class B Common Stock has essentially the same rights as Common Stock, except that each share of Class B Common

Stock has ten votes per share (compared to one vote per share of Common Stock), is not traded on any exchange, is restricted as to transfer and is convertible on a share-for share

basis, at any time and at no cost to the holders, into shares of Common Stock which are traded on the New York Stock Exchange.