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# New Coke: Bottlers Are Back

*Beverage Company Expanding Delivery Territories for Five of Its Independent Bottling Companies*

By MIKE ESTERL And PAUL ZIOBRO

Coca-Cola Co. likes to have its cake and eat it too.

That is why it sold its bottlers and then bought them back again. That is why it is now going back to the franchise model for distribution.

In a deal that would allow it to keep vast amounts of control over its business, Coke said it reached an agreement in principle to expand territorial distribution rights to five independent bottling partners. That would reduce Coke's direct control over its U.S. distribution only to about 75% from 80% currently. The company said more such deals are on the way as it backs out of the delivery business.

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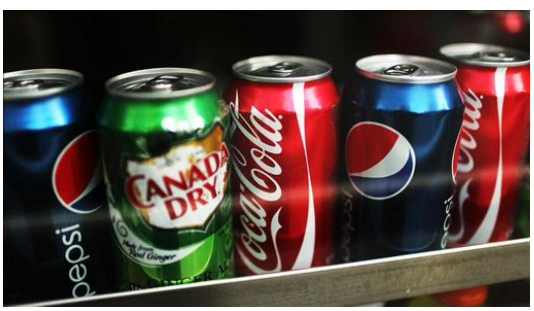


Do you know what the hottest new beverage is? MarketWatch's Rex Crum discusses this and other secrets the soda industry won't tell you. (Photo: Getty Images)

"You need to walk before you run," said Muhtar Kent, Coke's chief executive, in an interview, of the step-by-step approach.

In 2010, Coca-Cola Co. paid $12.3 billion to buy its biggest U.S. bottler in order to secure control of most production and distribution in its home market. Now, this latest approach will allow it to keep production of popular brands including Sprite, Powerade, Minute Maid and Coke in-house but gradually parcel out distribution once again.

The move is a delicate balancing act by Coke, which is trying to keep a tight grip on how its drinks are made and sold while shedding the capital-intensive business of maintaining delivery trucks, routes and warehouses. Coke also is seeking to boost sagging profit margins in the U.S., where soda consumption has fallen eight straight years.

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Coke's share price surged 5.7% Tuesday to close at $42.37 on the New York Stock Exchange as Wall Street applauded the model even as the company reported a decline in first-quarter profit and revenue.


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"Today's announcement gives a clear road map. A lot of uncertainty was lifted," said Bill Pecoriello, head of Consumer Edge Research.

The Atlanta-based company's move could prompt PepsiCo Inc., its main beverage rival, to speed up its own review of its operations. PepsiCo paid $7.8 billion in 2010 to acquire two large independent bottlers, also giving it direct control of most of its U.S. beverage manufacturing and distribution. PepsiCo has said it won't update investors on any potential structural changes before next year.

Both Coke and PepsiCo are searching for ways to pump up profits in the U.S. Coke said Tuesday that its first-quarter net income fell to $1.75 billion from $2.05 billion due to restructuring charges. Revenue fell 1% to $11.04 billion, hurt by two fewer selling days in the most-recent quarter. Coke said its North American soda volumes dipped 1% in the quarter.

Bloomberg News

Bottles of Sprite move along a conveyor belt at the Swire Coca-Cola bottling plant in Salt Lake City. Coke has about 70 small bottling partners.

Coke currently has about 70 small bottling partners manufacturing and delivering about 20% of its drinks in the U.S. Tuesday's announced deal would increase the scale of five of them: Coca-Cola Bottling Co. Consolidated,Coca-Cola Bottling Company United Inc., Swire Coca-Cola USA, Coca-Cola Bottling Co. High Country and Corinth Coca-Cola Bottling Works Inc. Financial terms weren't disclosed.

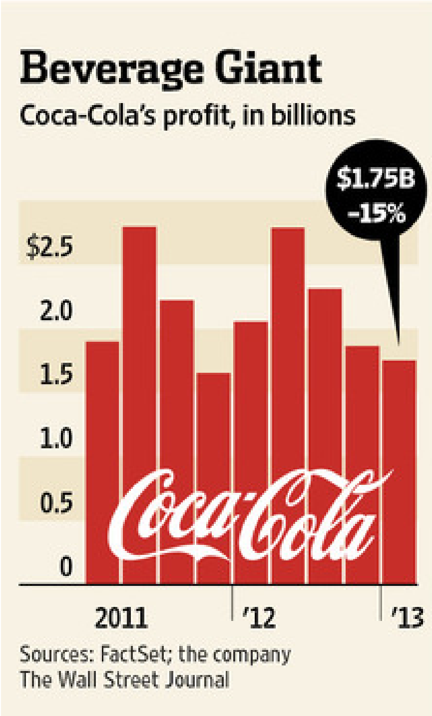
But unlike past distribution deals, some of which stretch back generations, Coke isn't giving the bottlers perpetual rights to the new territories. Instead, bottlers would be given 10-year licenses for any new real estate, which then need to be renewed. The initial deals with the five bottlers aren't expected to close until 2014.

Mr. Kent said a lot has changed since Coke began striking U.S. distribution deals for its famous cola roughly a century ago. At the time, territories were determined by how far horse-driven carriages could travel in a single day. The new distribution deals are "moving us into the 21st century," he added.

Selling off distribution rights could earn Coke a lot of cash. Consumer Edge Research estimates that the 80% share of U.S. distribution rights currently owned outright by Coke to be worth around $9.5 billion.

Coke isn't ready to surrender control over manufacturing, though, planning instead to further integrate bottling operations around the country. Manufacturing of Coke products currently is spread over hundreds of facilities.

Mr. Kent didn't rule out bottling partners taking stakes in a nationwide manufacturing company for Coke products at some point.




Analysts say distributing and bottling beverages typically have lower profit margins than concentrate sales. Coke's operating profit margins in North America dropped to 13.2% in 2012 from 21.4% in 2009, weighed down in part by the company's acquisition of Coca-Cola Enterprises Inc.'s U.S. bottling and distribution assets in 2010, according to Stifel Nicolaus analyst Mark Swartzberg.

Mr. Swartzberg said he wouldn't be surprised if Coke eventually also sells majority stakes in the manufacturing part of the business a few years down the road.

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