Coca-Cola's Independent Bottlers See Shifting Role

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NEW YORK (AP) — Coca-Cola has struck preliminary deals to begin handing back more of its U.S. distribution network to independent bottlers, a move that's expected to improve profit margins in its flagship market.

The world's biggest beverage maker, which makes Sprite, Dasani and Powerade, had purchased its biggest North American bottler in 2010 to make it easier to introduce new products and clean up the messy patchwork of factories that had been created over the decades. The idea was that the company would consolidate production and eventually refranchise the business.

"Over the past few months, it seemed like they were pushing out the refranchising later and later, and frankly it seemed like they didn't have a plan," said Ali Dibadj, an analyst with Bernstein Research.

The preliminary agreements give investors "an IOU" that the deal will get done sooner rather than later, he said. Coca-Cola said definitive agreements are expected by the end of the year, with closings expected in 2014.

The announcement came just minutes before Coca-Cola reported its first-quarter results, which topped Wall Street expectations as sales volume rose in emerging markets. Shares of Coca-Cola Co. rose nearly 6 percent to $42.37 and touched their highest point since the late 1990s.

In an interview, CEO Muhtar Kent noted that the company has been working to fix a production network in the U.S. that hadn't been "well thought out." For instance, he noted that many bottlers didn't have the capacity for making its non-carbonated beverages, which often resulted in third-party operators producing them.

Over the years, Kent said Coca-Cola has been bringing that production back in-house. In a call with analysts, he also noted that further improvements are in store, such as building new plants and consolidating others.

"There's room for costs to come down," Kent said. "There's room for efficiency to increase."

Although Coca-Cola is giving more distribution territories to bottlers in the new deals, the Atlanta company is holding onto its factories as it works to create a national production model more akin to those in other countries. Dibadj noted that the company will likely try to swap expanded territories for control of the remaining plants owned by bottlers.

A franchising model lowers overhead costs for Coca-Cola because it means regional bottlers take on the responsibilities for delivering drinks to retailers such as supermarkets and gas stations. Although Coca-Cola doesn't book beverage sales from franchised territories, it gets fees from the bottlers.

Coca-Cola says it has 69 independent bottlers. According to the industry tracker Beverage Digest, the deals announced Tuesday mean the company will end up handling about 74.5 percent of its U.S. bottling business, down from 79.4 percent.

Rival PepsiCo Inc., which bought two of its largest bottlers in 2010, has also been consolidating production and plans to provide an update on a potential restructuring of the unit early next year, with possibilities including refranchising or a spinoff of the business.

Coca-Cola declined to set a timeline for when it will complete its U.S. refranchising. But Kent noted that the U.S. market would come to represent some of its best practices in the world in four or five years.

"(Bottlers) won't have to worry about supply and production planning," said Steve Cahillane, who heads Coca-Cola's Americas division. Instead, he said the company would create a national strategy for the supply chain.

Meanwhile, Coca-Cola said global volume during its first quarter rose 4 percent, with Thailand, India and Russia posting strong gains. In its flagship North American market, volume rose 1 percent, fueled by growth in non-carbonated drinks such as Honest Tea and Simply Orange juice.

But soda declined 1 percent in the region, reflecting a continued movement away from soft drinks in developed countries such as the U.S.

For the three months ended March 29, the company said it earned $1.75 billion, or 39 cents per share. That's down from $2.1 billion, or 45 cents per share, a year earlier.

Not including one-time items such as restructuring charges, however, the company says it earned 46 cents per share. That's better than the 45 cents per share analysts expected.

Net revenue declined to $11.04 billion, from $11.14 billion a year ago, hurt by foreign currency exchange rates and two fewer selling days in the period. Analysts expected $10.97 billion, according to FactSet.