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E. Neville Isdell

Coke Tries to Pop Back In Vital Japan Market

**Country Accounts for 20% of Profit,
But Missteps, Sales Drop-Off Have
The Company Searching for the Fizz**
By CHAD TERHUNE
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[Coca-Cola](#) Co. has been showing signs of new fizz lately, but weak sales of canned coffee and bottled teas in Japan could sap its rebounding share price.

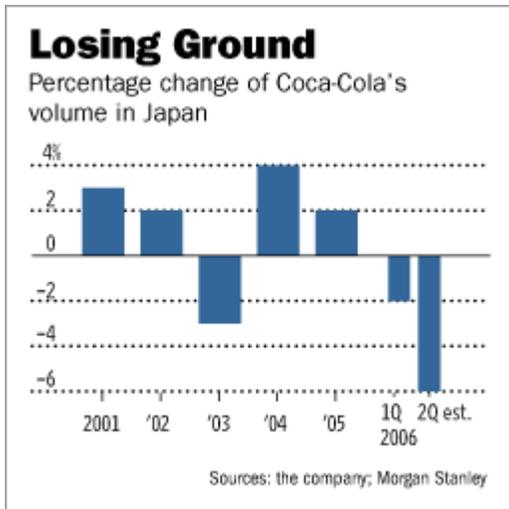
Coke sells drinks around the world, but Japan is one of its most important markets, generating roughly 20% of the company's annual profit. That is largely driven by its Georgia coffee brand, a popular pick-me-up since 1975 for office workers who buy the caffeinated drink from the country's ubiquitous vending machines.

The problem: A surprising sales decline in Japan during the first quarter hasn't been reversed, and some analysts worry that the downturn could persist for some time. A Georgia marketing campaign flopped and, in May, the Atlanta beverage company recalled more than two million bottles of Coca-Cola and other drinks contaminated with iron powder in Japan. Coke said there weren't any ill health effects from the manufacturing mishap.

Coke has been working hard to win back investor confidence after repeatedly missing its long-term growth targets. After taking over in 2004, Chairman and Chief Executive Neville Isdell wrote off last year as a "transition year." This year is the first test of whether Coke under Mr. Isdell can hit his goal of increasing annual operating profit by 6% to 8%. Coke defines the operating-profit goal as earnings before interest and taxes, on a currency-neutral basis.

Fredric Russell of Fredric E. Russell Investment Management Co. in Tulsa, Okla., with \$43 million in assets, sold his 60,000 shares in Coke in 2000 and remains hesitant until Coke bounces back in Japan. "I would take another look at Coke with two more good quarters. They need to prove it to me," Mr. Russell says.

Coke shares are up 8% so far this year, outpacing the 3.6% rise of the overall Dow Jones Industrial Average (of which it is a member), and rival [PepsiCo](#) Inc. But Coke's shares are down about 2% in the past five years, compared with Pepsi's stock, which is up about 35% for the same period. Coke stock, which long traded at a richer price/earnings ratio than Pepsi, now fetches about 19 times its estimated 2006 earnings, just under Pepsi's 20.6 trading multiple. At 4 p.m. in composite trading yesterday on the New York Stock Exchange, Coke was up 45 cents, or 1%, to \$43.63.



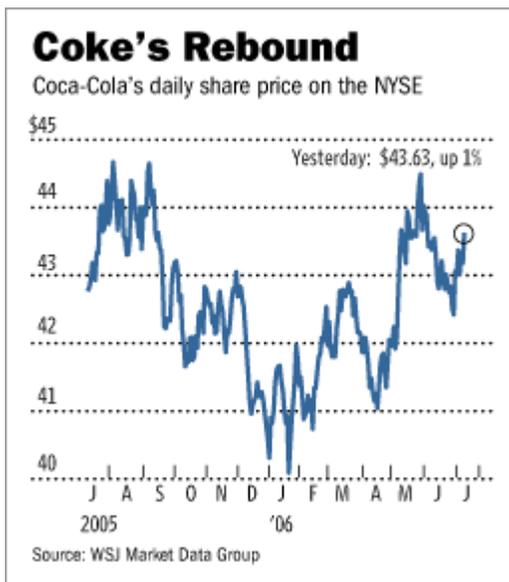
Mr. Isdell highlighted the stock's resurgence in a June 1 memo to employees marking his two-year anniversary on the job by noting that last year's rise of more than 2% in soft-drink volume was Coke's best since 2000. Mr. Isdell also is winning praise for pouring more into marketing, accelerating product innovation and improving employee morale.

But the Japanese sales downturn will keep Coke from reaching even the low end of its 6% to 8% target for operating-profit growth, predicts Judy Hong, an analyst at Goldman Sachs. She rates Coke's stock "neutral" and owns none. Her firm

does business with Coke.

Most bothersome to Ms. Hong are monthly sales reports from Coke bottlers in Japan indicating their market-share losses have expanded in the second quarter from a modest decline in the first quarter. As a result, she expects Coke's Japanese volume to fall 3% or more in the second quarter from a year earlier. "I don't think the improvement in Japan is coming in fast enough," she says.

The slide in Japan began after Coke launched a new marketing campaign and packaging for the canned Georgia coffee line last fall. It wanted to attract younger people to the brand because core consumers are aging. But the campaign turned off some loyal fans confused by more-colorful graphics and new flavors. Trying to fix the problem, Coke rolled out a new ad campaign in May featuring young and middle-age men in business suits enjoying Georgia coffee at work, while refocusing on core flavors such as Mocha Kilimanjaro and Emerald Mountain Blend.



Despite the poor results so far this year, Mr. Isdell predicted in April that Japan would return to growth in the second quarter. A Coke spokesman declined to comment on sales in Japan and the impact on overall profitability. The company is in the quiet period leading up to the announcement of second-quarter results next week. Georgia coffee accounts for about a third of Coke's volume in Japan and half its profit there.

Georgia coffee sales rebounded in May to flat versus a year earlier, up from an 8% decline during the first four months of the year, according to Bill Pecoriello, an analyst at

Morgan Stanley.

But he says sales volume for the coffee brand remained weak last month, and Coke's bottled teas, another major category, are struggling as well. Overall, Mr. Pecoriello estimates Coke's volume in Japan could decline by 6% in the second quarter. He rates Coke's stock the equivalent of a "hold." Morgan Stanley owns shares in the company and does business with Coke.

In addition to its troubles in Japan, Coke is struggling to increase soda sales in North America and northwest Europe, two other traditional profit engines, partly because of consumer concerns about obesity.

Still, some analysts expect strong results in Latin America, a lift from World Cup-driven business in Germany and a more-favorable currency environment to offset the drag from Japan. Analysts surveyed by Thomson Financial expect Coke to report second-quarter profit of about 72 cents a share, up from 68 cents a share a year earlier. Coke doesn't issue quarterly profit forecasts.

Donald Yacktman, president of Yacktman Asset Management Co. in Austin, Texas, with more than \$1 billion in assets, is confident Coke can overcome its problems in Japan and has doubled the size of his Coke stake to about 2.2 million shares since Mr. Isdell arrived two years ago.

"This is a classic, defensive stock that has already been beaten to a pulp," Mr. Yacktman said, referring to Coke's fall from its \$88 peak in 1998.

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