

SONOCO PRODUCTS CO
Form 10-Q
October 25, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 24, 2006

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File No. 0-516
SONOCO PRODUCTS COMPANY

Incorporated under the laws
of South Carolina

I.R.S. Employer Identification
No. 57-0248420

1 N. Second St.
Hartsville, South Carolina 29550
Telephone: 843/383-7000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock at October 20, 2006:

Common stock, no par value: 99,745,007

SONOCO PRODUCTS COMPANY
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Part I. FINANCIAL INFORMATION**Item 1. Financial Statements.**

SONOCO PRODUCTS COMPANY
CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)
(Dollars and shares in thousands)

	September 24, 2006	December 31, 2005*
Assets		
Current Assets		
Cash and cash equivalents	\$ 117,925	\$ 59,608
Trade accounts receivable, net of allowances	471,502	413,209
Other receivables	29,493	45,225
Inventories:		
Finished and in process	131,682	124,891
Materials and supplies	173,226	193,425
Prepaid expenses and other	51,912	49,142
	975,740	885,500
Property, Plant and Equipment, Net	952,725	943,951
Goodwill	601,327	573,903
Other Intangible Assets	73,615	73,037
Other Assets	475,785	505,349
Total Assets	\$ 3,079,192	\$ 2,981,740
Liabilities and Shareholders Equity		
Current Liabilities		
Payable to suppliers	\$ 326,661	\$ 265,219
Accrued expenses and other	248,819	230,641
Notes payable and current portion of long-term debt	105,069	124,530
Accrued taxes	5,361	96
	685,910	620,486
Long-Term Debt, Net of Current Portion	625,624	657,075
Pension and Other Postretirement Benefits	183,894	173,939
Deferred Income Taxes and Other	246,216	266,926
Commitments and Contingencies		
Shareholders Equity		
Common stock, no par value		
Authorized 300,000 shares 99,552 and 99,988 shares were issued and outstanding at September 24, 2006 and December 31, 2005, respectively	7,175	7,175
Capital in excess of stated value	394,383	418,668
Accumulated other comprehensive loss	(92,702)	(106,389)
Retained earnings	1,028,692	943,860
Total Shareholders Equity	1,337,548	1,263,314

Total Liabilities and Shareholders' Equity	\$ 3,079,192	\$ 2,981,740
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* The year-end condensed consolidated balance sheet data was derived from audited financial statements but does not include all disclosures required by generally accepted accounting principles.

See accompanying Notes to Condensed Consolidated Financial Statements

SONOCO PRODUCTS COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (unaudited)
(Dollars and shares in thousands except per share data)

	Three Months Ended		Nine Months Ended	
	September	September	September	September
	24,	25,	24,	25,
	2006	2005	2006	2005
Net sales	\$ 931,522	\$ 881,058	\$ 2,667,301	\$ 2,573,666
Cost of sales	749,954	717,666	2,155,531	2,101,214
Selling, general and administrative expenses	88,777	85,274	258,777	254,929
Restructuring charges (see Note 4)	1,064	4,275	5,983	18,460
Income before interest and income taxes	91,727	73,843	247,010	199,063
Interest expense	12,542	13,864	38,659	37,509
Interest income	(1,801)	(1,942)	(4,548)	(5,380)
Income before income taxes	80,986	61,921	212,899	166,934
Provision for income taxes	23,191	19,109	66,487	54,589
Income before equity in earnings of affiliates/minority interest in subsidiaries	57,795	42,812	146,412	112,345
Equity in earnings of affiliates/minority interest in subsidiaries	3,296	3,101	9,165	10,733
Net income	\$ 61,091	\$ 45,913	\$ 155,577	\$ 123,078
Average common shares outstanding:				
Basic	99,569	99,332	99,763	99,187
Diluted	101,011	100,413	101,176	100,260
Per common share				
Net income:				
Basic	\$ 0.61	\$ 0.46	\$ 1.56	\$ 1.24
Diluted	\$ 0.60	\$ 0.46	\$ 1.54	\$ 1.23
Cash dividends common	\$ 0.24	\$ 0.23	\$ 0.71	\$ 0.68

See accompanying Notes to Condensed Consolidated Financial Statements

SONOCO PRODUCTS COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)
(Dollars in thousands)

	Nine Months Ended	
	September	September
	24,	25,
	2006	2005*
Cash Flows from Operating Activities:		
Net income	\$ 155,577	\$ 123,078
Adjustments to reconcile net income to net cash provided by operating activities:		
Asset impairment		6,576
Depreciation, depletion and amortization	121,566	120,795
Non-cash share-based compensation expense	9,181	2,052
Equity in earnings of affiliates/minority interest in subsidiaries	(9,165)	(10,733)
Cash dividends from affiliated companies	6,151	4,342
(Gain) loss on disposition of assets	(4,650)	2,475
Tax effect of nonqualified stock options	9,868	1,187
Excess tax benefit of share-based compensation	(2,775)	
Deferred taxes	(761)	(16,048)
Change in assets and liabilities, net of effects from acquisitions, dispositions, and foreign currency adjustments:		
Receivables	(47,572)	(61,195)
Inventories	20,496	(23,609)
Prepaid expenses	475	(115)
Payables and taxes	60,516	(5,153)
Other assets and liabilities	11,960	16,949
Net cash provided by operating activities	330,867	160,601
Cash Flows from Investing Activities:		
Purchase of property, plant and equipment	(87,529)	(92,228)
Cost of acquisitions, exclusive of cash acquired	(40,017)	(2,160)
Proceeds from the sale of assets	19,157	6,867
Other, net	(2,328)	
Net cash used in investing activities	(110,717)	(87,521)
Cash Flows from Financing Activities:		
Proceeds from issuance of debt	31,474	24,241
Principal repayment of debt	(58,181)	(11,334)
Net increase (decrease) in commercial paper borrowings	(30,000)	(20,300)
Net increase in bank overdrafts	425	11,079
Excess tax benefit of share-based compensation	2,775	
Cash dividends - common	(70,749)	(67,257)
Repurchase of common shares	(82,668)	

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Common shares issued	44,384	13,605
Net cash used in financing activities	(162,540)	(49,966)
Effects of Exchange Rate Changes on Cash	707	(260)
Net Increase in Cash and Cash Equivalents	58,317	22,854
Cash and cash equivalents at beginning of period	59,608	117,725
Cash and cash equivalents at end of period	\$ 117,925	\$ 140,579

* Prior year's data have been reclassified to conform to the current year's presentation.

See accompanying Notes to Condensed Consolidated Financial Statements

SONOCO PRODUCTS COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

(unaudited)

Note 1: Basis of Interim Presentation

In the opinion of the management of Sonoco Products Company (the Company), the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to state fairly the consolidated financial position, results of operations and cash flows for the interim periods reported herein. Operating results for the three and nine months ended September 24, 2006, are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

With respect to the unaudited condensed consolidated financial information of the Company for the three and nine month periods ended September 24, 2006 and September 25, 2005 included in this Form 10-Q,

PricewaterhouseCoopers LLP reported that they have applied limited procedures in accordance with professional standards for a review of such information. However, their separate report dated October 25, 2006 appearing herein, states that they did not audit and they do not express an opinion on that unaudited financial information. Accordingly, the degree of reliance on their report on such information should be restricted in light of the limited nature of the review procedures applied. PricewaterhouseCoopers LLP is not subject to the liability provisions of Section 11 of the Securities Act of 1933 (the Act) for their report on the unaudited financial information because that report is not a report or a part of a registration statement prepared or certified by PricewaterhouseCoopers LLP within the meaning of Sections 7 and 11 of the Act.

Note 2: Acquisitions

During the nine months ended September 24, 2006, the Company acquired a tube and core business in Canada, which is included in the Tubes and Cores/Paper segment, a flexible packaging business in Texas, which is included in the Consumer Packaging segment, and a packaging fulfillment business in Illinois, which is included in the Packaging Services segment. The aggregate cost of these acquisitions was approximately \$40,000 in cash. In conjunction with these acquisitions, the Company recorded a preliminary fair value of assets acquired as follows: identifiable intangibles of approximately \$4,500, goodwill of approximately \$16,000 and other net tangible assets of approximately \$19,500. The Company has accounted for all of its acquisitions as purchases and, accordingly, has included their results of operations in consolidated net income from the date of acquisition.

On July 24, 2006, the Company and Ahlstrom Corporation, Finland (Ahlstrom), announced an agreement under which the Company would purchase Ahlstrom's 35.5 percent interest in Sonoco-Alcore, S.a.r.l., a joint venture formed in 2004 when the two companies combined their European tube, core and coreboard operations. This purchase, which was completed in October 2006, increased the Company's ownership in the operations from 64.5 to 100 percent and was made through a direct purchase arrangement which replaced the previously disclosed put/call option arrangement. The Company, as the majority interest holder, has accounted for the joint venture as an acquisition since its inception and, therefore, has been consolidating the results of the joint venture and reporting Ahlstrom's share as minority interest in its financial statements.

SONOCO PRODUCTS COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

(unaudited)

Note 3: Shareholders' Equity

Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share:

	Three Months Ended		Nine Months Ended	
	September 24, 2006	September 25, 2005	September 24, 2006	September 25, 2005
Numerator:				
Net income	\$ 61,091	\$ 45,913	\$ 155,577	\$ 123,078
Denominator:				
Average common shares outstanding	99,569	99,332	99,763	99,187
Dilutive effect of:				
Employee stock options	816	704	819	639
Contingent employee share awards	626	377	594	434
Dilutive shares outstanding	101,011	100,413	101,176	100,260
Reported net income per common share:				
Basic	\$ 0.61	\$ 0.46	\$ 1.56	\$ 1.24
Diluted	\$ 0.60	\$ 0.46	\$ 1.54	\$ 1.23

Stock options to purchase approximately 1,828,000 and 2,186,000 shares at September 24, 2006 and September 25, 2005, respectively, were not dilutive and, therefore, are excluded from the computations of diluted income per common share amounts. No adjustments were made to reported net income in the computations of earnings per share.

Stock Repurchases

In 2001, the Company's Board of Directors approved a stock repurchase program authorizing the repurchase of up to 5,000,000 shares of the Company's common stock, in addition to approximately 290,000 shares that were authorized for repurchase prior to 2001. Therefore, the Company had authorizations to repurchase approximately 5,290,000 shares of common stock as of December 31, 2005. From February 3, 2006, through April 4, 2006, the Company repurchased 2,500,000 shares of Sonoco common stock for approximately \$82,668. On April 19, 2006, the Company's Board of Directors rescinded all previously approved stock repurchase programs in conjunction with its approval of a new program, which authorizes the repurchase of up to 5,000,000 shares of the Company's common stock. No shares have been repurchased under this program.

Note 4: Restructuring Programs (Refer Also to Note 14: Subsequent Events)

In August 2003, the Company announced general plans to reduce its overall cost structure by \$54,000 pretax by realigning and centralizing a number of staff functions and eliminating excess plant capacity. Pursuant to these plans, the Company has initiated or completed 22 plant closings and has terminated approximately 1,120 employees. As of September 24, 2006, the Company had incurred cumulative pre-tax charges, net of adjustments, of approximately \$100,520 associated with these and other restructuring activities. The following table provides additional details of these net charges:

SONOCO PRODUCTS COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

(unaudited)

	Severance and Termination Benefits	Asset Impairment/ Disposal of Assets	Other Exit Costs	Total
Tubes and Cores/Paper Segment	\$ 37,255	\$ 16,009	\$ 16,058	\$ 69,322
Consumer Packaging Segment	11,183	5,084	5,874	22,141
Packaging Services Segment	333	¾	¾	333
All Other Sonoco	2,999	326	92	3,417
Corporate	5,094	¾	213	5,307
Cumulative Restructuring Charges, net of adjustments	\$ 56,864	\$ 21,419	\$ 22,237	\$ 100,520

The Company expects to recognize an additional pre-tax cost of approximately \$800 in the future associated with these activities, which is comprised entirely of other exit costs. Of the additional cost, approximately \$700 is related to the Tubes and Cores/Paper segment and approximately \$100 is related to the Consumer Packaging segment. During the three months ended September 24, 2006 and September 25, 2005, the Company recognized restructuring charges, net of adjustments, of \$1,064 (\$713 after tax) and \$4,275 (\$2,599 after tax), respectively. The current year charges relate primarily to the closure in previous quarters of two tube and core plants and a flexible packaging plant in the United States. The following table provides additional details of these net charges:

	Severance and Termination Benefits	Asset Impairment/ Disposal of Assets	Other Exit Costs	Total
2006 Third Quarter				
Tubes and Cores/Paper Segment	\$ (138)	\$ ¾	\$ 820	\$ 682
Consumer Packaging Segment	182	498	(302)	378
All Other Sonoco	4	¾	¾	4
Total	\$ 48	\$ 498	\$ 518	\$ 1,064
2005 Third Quarter				
Tubes and Cores/Paper Segment	\$ 815	\$ 500	\$ 2,059	\$ 3,374
Consumer Packaging Segment	(113)	¾	307	194
All Other Sonoco	707	¾	¾	707
Total	\$ 1,409	\$ 500	\$ 2,366	\$ 4,275

During the three months ended September 24, 2006 and September 25, 2005, the Company also recorded non-cash after-tax income in the amounts of \$142 and \$140, respectively, in order to reflect Ahlstrom's portion of restructuring costs that were charged to expense. This income, which resulted from the closure of certain plants that the Company contributed to Sonoco-Alcore, is included in Equity in earnings of affiliates/minority interest in subsidiaries in the

Company's Consolidated Statements of Income.

During the nine months ended September 24, 2006 and September 25, 2005, the Company recognized restructuring charges, net of adjustments, of \$5,983 (\$3,858 after tax) and \$18,460 (\$12,371 after tax), respectively. The current year charges relate primarily to the closure of two tube and core plants and a flexible packaging plant in the United States. The following table provides additional details of these net charges:

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SONOCO PRODUCTS COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

(unaudited)

	Severance and Termination Benefits	Asset Impairment/ Disposal of Assets	Other Exit Costs	Total
2006 Year to Date				
Tubes and Cores/Paper Segment	\$ 1,273	\$ 2	\$ 3,637	\$ 4,912
Consumer Packaging Segment	849	498	(280)	1,067
All Other Sonoco	4	¾	¾	4
Total	\$ 2,126	\$ 500	\$ 3,357	\$ 5,983
2005 Year to Date				
Tubes and Cores/Paper Segment	\$ 4,022	\$ 5,250	\$ 4,342	\$ 13,614
Consumer Packaging Segment	631	1,367	2,262	4,260
All Other Sonoco	627	(41)	¾	586
Total	\$ 5,280	\$ 6,576	\$ 6,604	\$ 18,460

During the nine months ended September 24, 2006 and September 25, 2005, the Company also recorded non-cash after-tax income in the amounts of \$363 and \$1,204, respectively, in order to reflect Ahlstrom's portion of restructuring costs that were charged to expense. This income, which resulted from the expected closure of certain plants that the Company contributed to Sonoco-Alcore, is included in Equity in earnings of affiliates/minority interest in subsidiaries in the Company's Consolidated Statements of Income.

The following table sets forth the activity in the restructuring accrual included in Accrued expenses and other on the Company's Condensed Consolidated Balance Sheets. Restructuring charges are included in Restructuring charges in the Condensed Consolidated Statements of Income, except for the restructuring charges applicable to equity method investments, which are included in Equity in earnings of affiliates/minority interest in subsidiaries, respectively.

	Severance and Termination Benefits	Asset Impairment/ Disposal of Assets	Other Exit Costs	Total
Liability, December 31, 2005	\$ 2,909	\$ ¾	\$ 7,007	\$ 9,916
New Charges	2,001	612	4,273	6,886
Cash payments	(3,675)	(296)	(4,775)	(8,746)
Asset impairment (noncash)	¾	(199)	(155)	(354)
Foreign Currency Translation	103	¾	89	192
Adjustments and disposal of assets	137	(117)	(923)	(903)