SONOCO PRODUCTS CO
Form 10-K
February 28, 2007

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

FORM 10-K

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

For the Fiscal Year Ended December 31, 2006

or

o **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, SC 29550
Telephone: 843/383-7000

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of exchange on which registered
No par value common stock	New York Stock Exchange, Inc.

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes þ No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes o No þ

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 þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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. (Check one):
Large Accelerated Filer þ Accelerated Filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No þ

The aggregate market value of voting common stock held by nonaffiliates of the registrant (based on the New York Stock Exchange closing price) on June 23, 2006, which was the last business day of the registrant s most recently completed second fiscal quarter, was $2,971,479,057. Registrant does not (and did not at June 23, 2006) have any

non-voting common stock outstanding.
As of February 21, 2007, there were 99,500,418 shares of no par value common stock outstanding.
Documents Incorporated by Reference
Portions of the Proxy Statement for the annual meeting of shareholders to be held on April 18, 2007, which statement shall be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Report relates, are incorporated by reference in Part III.

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Forward-looking Statements

Statements included in this Annual Report on Form 10-K that are not historical in nature, are intended to be, and are hereby identified as forward-looking statements for purposes of the safe harbor provided by Section 21E of the Securities Exchange Act of 1934, as amended. The words estimate, project, intend, expect, believe, consider, anticipate, objective, goal, guidance and similar expressions identify forward-looking statements. Forward-looking statements include, but are not limited to statements regarding offsetting high raw material costs; improved productivity and cost containment; adequacy of income tax provisions; refinancing of debt; adequacy of cash flows; anticipated amounts and uses of cash flows; effects of acquisitions and dispositions; adequacy of provisions for environmental liabilities; financial strategies and the results expected from them; continued payments of dividends; stock repurchases; and producing improvements in earnings. Such forward-looking statements are based on current expectations, estimates and projections about our industry, management s beliefs and certain assumptions made by management. Such information includes, without limitation, discussions as to guidance and other estimates, expectations, beliefs, plans, strategies and objectives concerning our future financial and operating performance. These statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict. Therefore, actual results may differ materially from those expressed or forecasted in such forward-looking statements. The risks and uncertainties include, without limitation:

Availability and pricing of raw materials;

Success of new product development and introduction;

Ability to maintain or increase productivity levels and contain or reduce costs;

International, national and local economic and market conditions;

Fluctuations in obligations and earnings of pension and postretirement benefit plans;

Ability to maintain market share;

Pricing pressures and demand for products;

Continued strength of our paperboard-based tubes and cores and composite can operations;

Anticipated results of restructuring activities;

Resolution of income tax contingencies;

Ability to successfully integrate newly acquired businesses into the Company s operations;

Currency stability and the rate of growth in foreign markets; use of financial instruments to hedge foreign currency, interest rate and commodity price risk;

Actions of government agencies and changes in laws and regulations affecting the Company;

Anticipated costs of environmental remediation actions;

Loss of consumer confidence; and

Economic disruptions resulting from terrorist activities.

The Company undertakes no obligation to publicly update or revise forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this Annual Report on Form 10-K might not occur.

References to our Web Site Address

References to our Web site address and domain names throughout this Annual Report on Form 10-K are for informational purposes only, or to fulfill specific disclosure requirements of the Securities and Exchange Commission s rules or the New York Stock Exchange Listing Standards. These references are not intended to, and do not, incorporate the contents of our Web sites by reference into this Annual Report on Form 10-K.

SONOCO PRODUCTS COMPANY AND CONSOLIDATED SUBSIDIARIES
PART I

Item 1. Business

(a) **General development of business**

The Company is a South Carolina corporation founded in Hartsville, South Carolina, in 1899 as the Southern Novelty Company. The name was subsequently changed to Sonoco Products Company (the Company or Sonoco). Sonoco is a manufacturer of industrial and consumer packaging products and a provider of packaging services, with 324 locations in 35 countries.

Information regarding the Company s acquisitions, dispositions, joint ventures and restructuring activities is provided in Notes 2 and 3 to the Consolidated Financial Statements on pages F-8 through F-14 of this Annual Report on Form 10-K.

(b) **Financial information about segments**

Information regarding the Company s reportable segments is provided in Note 15 to the Consolidated Financial Statements on pages F-35 through F-37 of this Annual Report on Form 10-K.

(c) **Narrative description of business**

Products and Services The following discussion outlines the principal products produced and services provided by the Company.

Consumer Packaging

The Consumer Packaging segment accounted for 35.7%, 35.4% and 35.9% of the Company s net sales in 2006, 2005 and 2004, respectively. The operations in this segment consist of 51 plants throughout the world. The products, services and markets of the Consumer Packaging segment are as follows:

	Products and Services	**Markets**
Rigid Packaging Paper	Round and shaped composite paperboard cans, paperboard pails, single-wrap paperboard packages, fiber cartridges	Food: snacks, nuts, cookies and crackers, confectionery, frozen concentrate, powdered beverages and infant formula, coffee, refrigerated dough, spices/ seasonings, nutritional supplements, pet food Nonfood: adhesives, caulks, cleansers, chemicals, lawn and garden, automotive, pet products
Rigid Packaging Plastic	Bottles, jars, tubs, cups, trays, squeeze tubes	Food: liquid beverage (noncarbonated), including functional beverage and ready-to-drink coffee, processed foods, sauces and pet foods, powdered beverages including coffee, snacks and nuts Nonfood: household chemicals, industrial chemicals, adhesives and sealants, personal care

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	Products and Services	Markets
Ends and Closures Plastic and Metal	Aluminum, steel and peelable membrane easy-open closures for composite, metal and plastic containers	Canned processed foods, coffee, beverage, powdered beverages and infant formula, snacks, nuts, nutritional supplements, spices/ seasonings, pet food and treats, and nonfood products
Printed Flexible Packaging	Flexible packaging made from thin-gauge, high value-added rotogravure, flexographic and combination printed film including high-performance laminations and rotogravure cylinder engraving	Confectionery and gum, hard-baked goods, coffee, retort, beverages, snack foods, pet food, home and personal care

Sonoco s rigid packaging paper products are the Company s second largest revenue-producing group of products and services, representing approximately 16%, 19% and 17% of consolidated net sales in 2006, 2005 and 2004, respectively.

Tubes and Cores/Paper

The Tubes and Cores/Paper segment accounted for 41.7%, 42.0% and 44.0% of the Company s net sales in 2006, 2005 and 2004, respectively. This segment serves its markets through 121 converting facilities on five continents. Sonoco s paper operations provide the primary raw material for the Company s fiber-based packaging. Sonoco uses approximately 65% of the paper it manufactures and the remainder is sold to third parties. This vertical integration strategy is supported by 26 paper mills with 37 paper machines and 51 recovered paper collection facilities throughout the world. In 2006, Sonoco had the capacity to manufacture approximately 1.8 million tons of recycled paperboard.

The products, services and markets of the Tubes and Cores/Paper segment are as follows:

	Products and Services	Markets
Tubes and Cores	Paperboard tubes, cores, roll packaging, molded plugs, supply-chain packaging services	Construction, film, flowable products, metal, paper mill, shipping and storage, tape and label, textiles, converters
Paper	Recycled paperboard, chipboard, tubeboard, lightweight corestock, boxboard, linerboard, specialty grades, recovered paper	Converted paper products, spiral winders, beverage insulators, displays, gaming, paper manufacturing

Sonoco s tubes and cores products and services are the Company s largest revenue-producing group of products and services, representing approximately 31%, 32% and 34% of consolidated net sales in 2006, 2005 and 2004, respectively.

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Packaging Services

The Packaging Services segment accounted for 12.5%, 12.9% and 10.2% of the Company s consolidated net sales in 2006, 2005 and 2004, respectively. The products, services and markets of the Packaging Services segment are as follows:

	Products and Services	Markets
Service Centers	Packaging supply chain management, including custom packing, fulfillment, scalable service centers and global artwork management	Personal care, baby care, beauty, healthcare, electronics, hosiery, pharmaceuticals and office supplies
Point-of-Purchase	Designing, manufacturing, assembling, packing and distributing temporary, semi-permanent and permanent point-of-purchase (P-O-P) displays, as well as contract packaging, co-packing and fulfillment services	Consumer packaged goods, including: personal care, beauty, healthcare, food confectionery, sporting goods, and home and garden products

All Other Sonoco

All Other Sonoco accounted for 10.1%, 9.7% and 9.9% of the Company s net sales in 2006, 2005 and 2004, respectively. In addition to the products and services outlined in each of the segments above, the Company produces the following products:

	Products and Services	Markets
Wire and Cable Reels	Baker steel, nailed wooden, plywood, recycled and poly-fiber reels	Wire and cable manufacturers
Molded and Extruded Plastics	Complete offering of product design, tool design and fabrication; manufacturing in both injection molding and extrusion technologies	Consumer and industrial packaging, food services, textiles, wire and cable, fiber optics, plumbing, filtration, automotive, medical, healthcare
Paperboard Specialties	Custom-printed Rixie coasters, Stancap® glass covers, other paper amenities	Hotels and resorts, casinos, country clubs, catering services, cruise lines, airlines, healthcare facilities, restaurants
Protective Packaging	Proprietary SonoPost® Technology, SonoBase Carrier	Household appliances, heating and air conditioning, lawn and garden

Systems, and through a partnership with Sonoco CorrFlex, the SonoPop display system. Services include Tier 1 supplier to several major manufacturers, on-site engineering for multiple customers, ISTA-certified lab testing facilities and providing customers with engineering, design and testing for all types of products and materials	including outdoor grills, furniture and office furnishings, automotive, promotional display and palletized distribution solutions

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Product Distribution Each of the Company s operating units has its own sales staff, and maintains direct sales relationships with its customers. Some of the units have service staff at the manufacturing facility that interacts directly with customers. The Tubes and Cores/Paper segment also has a customer service center located in Hartsville, South Carolina, which is the main contact point between its North American business units and their customers. Divisional sales personnel also provide sales management, marketing and product development assistance as needed. For those customers that buy from more than one business unit, the Company often assigns a single representative or team of specialists to handle that customer s needs. Product distribution is normally directly from the manufacturing plant to the customer, but in some cases, product is warehoused in a mutually advantageous location to be shipped to the customer as needed.

Raw Materials The principal raw materials used by the Company are recovered paper, paperboard, steel, aluminum and plastic resins. Raw materials are purchased from a number of outside sources. The Company considers the supply and availability of raw materials to be adequate to meet its needs.

Patents, Trademarks and Related Contracts Most inventions are made by members of Sonoco s development and engineering staff, and are important to the Company s internal growth. Patents have been granted on many inventions created by Sonoco staff in the United States and other countries. These patents are managed globally by a Sonoco intellectual capital management team through one of the Company s subsidiaries, Sonoco Development, Inc. (SDI). SDI globally manages patents, trade secrets, confidentiality agreements and license agreements. Some patents have been licensed to other manufacturers. Sonoco also licenses a few patents from outside companies and universities for business unit use. U.S. patents expire after 17 or 20 years, depending on the patent issue date. New patents replace many of the abandoned or expired patents.

A second intellectual capital subsidiary of Sonoco, SPC Resources, Inc., globally manages Sonoco s trademarks, service marks, copyrights and Internet domain names. Most of Sonoco s products are marketed worldwide under trademarks such as Sonoco[Ò], Sonotube[Ò], Safe-Top[Ò], Sealed Safe[Ò], Duro[Ò] and Durox[Ò]. Sonoco s registered Web domain names such as www.sonoco.com and www.sonotube.com provide information about Sonoco, its people and products. Trademarks and domain names are also licensed to outside companies where appropriate.

Seasonality The Company s operations are not seasonal to any significant degree, although the Consumer Packaging and Packaging Services segments normally report slightly higher sales and operating profits in the second half of the year, when compared to the first half.

Working Capital Practices The Company is not required to carry any significant amounts of inventory to meet customer requirements or to assure itself continuous allotment of goods, nor does it provide extended terms to customers.

Dependence on Customers On an aggregate basis, the five largest customers in the Tubes and Cores/Paper segment accounted for approximately 14% of that segment s sales and the five largest customers in the Consumer Packaging segment accounted for approximately 30% of that segment s sales. The dependence on a few customers in the Packaging Services segment is more significant as the five largest customers in this segment accounted for approximately 79% of that segment s sales.

Sales to Procter & Gamble, the Company s largest customer, represented approximately 12% of the Company s consolidated revenues in 2006. In addition, this concentration of sales volume resulted in a corresponding concentration of credit, representing approximately 10% of the Company s consolidated trade accounts receivable at December 31, 2006. No other customer comprised more than 5% of the Company s consolidated revenues in 2006 or accounts receivable at December 31, 2006.

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Backlog Most customer orders are manufactured with a lead time of three weeks or less. Therefore, the amount of backlog orders at December 31, 2006, was not material. The Company expects all backlog orders at December 31, 2006, to be shipped during 2007.

Competition The Company sells its products in highly competitive markets, which include paper, textiles, films, food, chemicals, pharmaceuticals, packaging, construction, and wire and cables. Each of these markets is primarily controlled by supply and demand. Additionally, these markets are influenced by the overall rate of economic activity. The Company manufactures and sells many of its products globally. The Company, having operated internationally since 1923, considers its ability to serve its customers worldwide in a timely and consistent manner a competitive advantage. The Company also believes that its technological leadership, reputation for quality and vertical integration are competitive advantages. Expansion of the Company s product line and global presence reflect the rapidly changing needs of its major customers, which demand high-quality, state-of-the-art, environmentally compatible packaging, wherever they choose to do business. It is important to be a low-cost producer in order to compete effectively. The Company is constantly focused on productivity improvements and other cost reduction initiatives utilizing the latest in technology.

Research and Development Company-sponsored research and development expenses totaled approximately $12.7 million in 2006, $14.7 million in 2005 and $15.4 million in 2004. Customer-sponsored research and development expenses were not material in any of these periods. Significant projects in Sonoco s Tubes and Cores/Paper segment during 2006 included efforts to design and develop new products for the construction industry and for the film and tape industries. In addition, efforts were focused on enhancing performance characteristics of the Company s tubes and cores in the textile, film and paper packaging areas, as well as on projects aimed at enhancing productivity. The Consumer Packaging segment continued to invest in development of specialty metal closures, flexible packaging enhancements and rigid plastic containers technology during 2006.

Compliance with Environmental Laws Information regarding compliance with environmental laws is provided in Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations under the caption Risk Management, on pages 27 and 28 and in Note 13 to the Consolidated Financial Statements on pages F-32 through F-33 of this Annual Report on Form 10-K.

Number of Employees Sonoco had approximately 17,700 employees worldwide as of December 31, 2006.

(d) **Financial information about geographic areas**

Financial information about geographic areas is provided in Note 15 to the Consolidated Financial Statements on page F-37 of this Annual Report on Form 10-K, and in the information about market risk in Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations under the caption Risk Management on pages 27 and 28 of this Annual Report on Form 10-K.

(e) **Available information**

The Company electronically files with the Securities and Exchange Commission (SEC) its annual reports on Form 10-K, its quarterly reports on Form 10-Q, its periodic reports on Form 8-K, amendments to those reports filed or furnished pursuant to Section 13(a) of the Securities Exchange Act of 1934 (the 1934 Act), and proxy materials pursuant to Section 14 of the 1934 Act. The SEC maintains a site on the Internet, www.sec.gov, that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. Sonoco also makes its filings available, free of charge, through its Web site, www.sonoco.com, as soon as reasonably practical after the electronic filing of such material with the SEC.

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Executive Officers of the Registrant

Name	Age	Position and Business Experience For the Past Five Years
Harris E. DeLoach, Jr.	62	Chairman of the Board, President and Chief Executive Officer since 2005. Previously President and Chief Executive Officer July 2000-April 2005; Chief Operating Officer April-July 2000; Sr. Executive Vice President, Global Industrial Products/Paper/Molded Plastics 1999-2000; Executive Vice President, High Density Film, Industrial Container, Fibre Partitions, Protective Packaging, Sonoco Crellin and Baker Reels 1996-1999. Joined Sonoco in 1985.
Jim C. Bowen	56	Sr. Vice President since 2002. Previously Sr. Vice President, Global Paper Operations 2000-2002; Vice President/General Manager Paper 1997-2000; Vice President, Manufacturing N.A. Paper 1994-1997; Director of Manufacturing 1993-1994. Joined Sonoco in 1972.
Allan V. Cecil	65	Retired from the Company effective February 28, 2007. Vice President, Investor Relations and Corporate Affairs from 1998 until his retirement. Previously Vice President, Investor Relations and Corporate Communications 1996-1998. Joined Sonoco in 1996.
Cynthia A. Hartley	58	Sr. Vice President, Human Resources since 2002. Previously Vice President, Human Resources 1995-2002. Joined Sonoco in 1995.
Charles J. Hupfer	60	Sr. Vice President, Chief Financial Officer and Corporate Secretary since April 2005. Previously Vice President, Chief Financial Officer and Corporate Secretary 2002-2005; Vice President, Treasurer and Corporate Secretary 1995-2002; Treasurer 1988-1995. Joined Sonoco in 1975.
M. Jack Sanders	53	Sr. Vice President, Global Industrial Products since October 2006. Previously Vice President, Global Industrial Products January 2006-October 2006; Vice President, Industrial Products N.A. 2001-2006; Division Vice President/General Manager, Protective Packaging 1998-2001; General Manager, Protective Packaging 1991-1998. Joined Sonoco in 1987.
Eddie L. Smith	55	Vice President, Industrial Products and Paper, Europe since November 2006. Previously Vice President, Customer and Business Development 2002-2006; Vice President/General Manager, Flexible Packaging 1998-2002; Division Vice

		President/General Manager, Flexible Packaging 1996-1998; Division Vice President, Consumer Products Europe 1994-1996. Joined Sonoco in 1971.
Charles L. Sullivan, Jr.	63	Executive Vice President since 2005. Previously Sr. Vice President 2000-2005; Regional Director, Cargill Asia/Pacific in 2000 and President, Cargill s Salt Division 1995-2000. Joined Sonoco in 2000.

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Item 1A. Risk Factors

Risk Factors Relating to Sonoco s Business

The Company is subject to environmental regulations and liabilities that could weaken operating results.

Federal, state, provincial, foreign and local environmental requirements, including the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), and particularly those relating to air and water quality, are significant factors in the Company s business and generally increase its costs of operations. The Company may be found to have environmental liability for the costs of remediating soil or water that is, or was, contaminated by the Company or a third party at various sites that are now, or were previously, owned, used or operated by the Company. Legal proceedings may result in the imposition of fines or penalties, as well as mandated remediation programs that require substantial, and in some instances, unplanned capital expenditures.

The Company has incurred in the past, and may incur in the future, fines and penalties relating to environmental matters, and costs relating to the damage of natural resources, lost property values and toxic tort claims. The Company has made expenditures to comply with environmental regulations and expects to make additional expenditures in the future. As of December 31, 2006, approximately $15.3 million was reserved for environmental liabilities. Such reserves are established when it is considered probable that the Company has some liability. The estimates represent the lower end of the estimated range of the amount of the Company s potential liability. In part because nearly all of the Company s potential environmental liabilities are joint and severally shared with others, the Company s maximum potential liability cannot be reasonably estimated. However, the Company s actual liability in such cases may be substantially higher than the reserved amount. Additional charges could be incurred due to changes in law, or the discovery of new information, and those charges could have a material adverse effect on operating results.

General economic conditions in the United States may change, having a negative impact on the Company s earnings.

Domestic sales accounted for approximately 64% of the Company s consolidated revenues. Even with the Company s diversification across various markets and customers, due to the nature of the Company s products and services, a general economic downturn could have an adverse impact on the Company s reported results.

Raw materials price increases may reduce net income.

Many of the raw materials the Company uses are commodities purchased from third parties. Principal examples are recovered paper, steel, aluminum and resin. Prices of these commodities are subject to substantial fluctuations that are beyond the Company s control and can adversely affect profitability. Many of the Company s long-term contracts with customers permit limited price adjustments to reflect increased raw material costs. Although these and other prices may be increased in an effort to offset increases in raw materials costs, such adjustments may not occur quickly enough, or be sufficient to prevent a materially adverse effect on net income and cash flow.

The Company may encounter difficulties integrating acquisitions, restructuring operations or closing or disposing of facilities.

The Company has made numerous acquisitions in recent years, and may actively seek new acquisitions that management believes will provide meaningful opportunities in the markets it serves. Acquired businesses may not achieve the expected levels of revenue, profit or productivity, or otherwise perform as expected.

Acquisitions also involve special risks, including, without limitation, the potential assumption of unanticipated liabilities and contingencies, and difficulties in integrating acquired businesses. While management believes that acquisitions will improve the Company s competitiveness and profitability, no assurance can be given that acquisitions will be successful or accretive to earnings.

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The Company has closed higher-cost facilities, sold non-core assets and otherwise restructured operations in an effort to improve cost competitiveness and profitability. Some of these activities are ongoing, and there is no guarantee that any such activities will not divert the attention of management or disrupt the ordinary operations of the Company. Moreover, production capacity, or the actual amount of products produced, may be reduced as a result of these activities.

Energy price increases may reduce net income.

The Company s manufacturing operations require the use of substantial amounts of electricity and natural gas, which may be subject to significant price fluctuations as the result of changes in overall supply and demand. Energy usage is forecasted and monitored, and the Company may, from time to time, use commodity futures or swaps in an attempt to reduce the impact of energy price increases. The Company cannot guarantee success in these efforts, and could suffer adverse effects to net income and cash flow should the Company be unable to pass higher energy costs through to its customers.

The Company may not be able to develop new products acceptable to the market.

The Company relies on new product development for organic growth within the markets it serves. If new products acceptable to the Company s customers are not developed in a timely fashion, growth potential may be hindered.

The Company may not be able to locate suitable acquisition candidates.

If significant acquisition candidates that meet the Company s specific criteria are not located, the Company s potential for growth may be restricted.

Conditions in foreign countries where the Company operates may reduce earnings.

The Company has operations throughout North and South America, Europe, Australia and Asia, with facilities in 35 countries. In 2006, approximately 36% of consolidated sales came from operations and sales outside of the United States. Accordingly, economic conditions, political situations, and changing laws and regulations in those countries may adversely affect revenues and income.

Foreign exchange rate fluctuations may reduce the Company s earnings.

As a result of operating globally, the Company is exposed to changes in foreign exchange rates. Generally, each of the Company s foreign operations both produces and sells in their respective local currencies. As a result, foreign-exchange transaction risk is not significant. However, the Company s reported results of operations and financial position could be negatively affected by exchange rates when the activities and balances of its foreign operations are translated into U.S. dollars for financial reporting purposes. The Company monitors its exposures and, from time to time, may use currency swaps and forward foreign exchange contracts to hedge certain forecasted transactions denominated in foreign currencies, foreign currency assets and liabilities or the net investment in foreign subsidiaries. To date, the extent to which the Company has hedged its net investments in foreign subsidiaries has been limited.

Item 1B. Unresolved Staff Comments

There are no unresolved written comments from the SEC staff regarding the Company s periodic or current 1934 Act reports.

Item 2. Properties

The Company s corporate offices are owned and operated in Hartsville, South Carolina. There are 106 owned and 72 leased facilities used by operations in the Tubes and Cores/Paper segment, 25 owned and 26 leased facilities used by operations in the Consumer Packaging segment, three owned and 17 leased facilities used by operations in the Packaging Services segment, and 20 owned and 27 leased facilities used by all other operations. Europe, the largest foreign geographic region, has 55 manufacturing locations.

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Item 3. Legal Proceedings

The Company has been named as a potentially responsible party (PRP) at several environmentally contaminated sites not owned by the Company. These regulatory actions represent the Company s largest potential environmental liabilities. All of the sites are also the responsibility of other parties. The Company s liability, if any, is shared with such other parties, but the Company s share has not been finally determined in most cases. In some cases, the Company has cost-sharing agreements with other PRPs with respect to a particular site. Such agreements relate to the sharing of legal defense costs or cleanup costs, or both. The Company has assumed, for purposes of estimating amounts to be accrued, that the other parties to such cost-sharing agreements will perform as agreed. It appears that final resolution of some of the sites is years away, and actual costs to be incurred for these environmental matters in future periods may vary from current estimates because of the inherent uncertainties in evaluating environmental exposures. Accordingly, the ultimate cost to the Company with respect to such sites cannot be determined. As of December 31, 2006 and December 31, 2005, the Company had accrued $15.3 million and $16.8 million, respectively, related to environmental contingencies. The Company periodically reevaluates the assumptions used in determining the appropriate reserves for environmental matters as additional information becomes available and, when warranted, makes appropriate adjustments.

The Company believes the issues regarding the Fox River, which are discussed in some detail below, currently represent the Company s greatest loss exposure for environmental liability. The Company also believes that all of its exposure to such liability for the Fox River is contained within its wholly owned subsidiary, U.S. Paper Mills Corp. (U.S. Mills). Accordingly, regardless of the amount of liability that U.S. Mills may ultimately have, Sonoco Products Company believes its potential pretax loss on account of Fox River issues is limited to U.S. Mills net worth, which was approximately $90 million at December 31, 2006.

As previously disclosed, U.S. Mills has been notified by governmental entities that it, together with a number of other companies, is a PRP for environmental claims under CERCLA and other statutes, arising out of the presence of polychlorinated biphenyls (PCBs) in sediments in the lower Fox River and in the bay of Green Bay in Wisconsin. U.S. Mills was named as a PRP because scrap paper purchased by U.S. Mills as a raw material for its paper making processes more than 30 years ago allegedly included carbonless copy paper that contained PCBs, some of which were included in wastewater from U.S. Mills manufacturing processes that was discharged into the Fox River. The Company acquired the stock of U.S. Mills in 2001, and the alleged contamination predates the acquisition. The Company was notified that it was a PRP, but responded that its only involvement was as a subsequent shareholder of U.S. Mills and, as such, has no responsibility.

The governmental entities making such claims against U.S. Mills and the other PRPs have been coordinating their actions, including the assertion of claims against the PRPs. Additionally, certain claimants have notified U.S. Mills and the other PRPs of their intent to commence a natural resource damage (NRD) lawsuit, but no such actions have been instituted.

A review of the circumstances leading to U.S. Mills being named a PRP and the current status of the remediation effort is set forth below.

In July 2003, U.S. Environmental Protection Agency (USEPA) and Wisconsin Department of Natural Resources (WDNR) issued their final cleanup plan (known as a Record of Decision, or ROD) for a portion of the Fox River. The ROD addressed the lower part of the Fox River and portions of Green Bay, where USEPA and WDNR (the Governments) estimate the bulk of the sediments that need to be remediated are located. In two portions of the lower part of the Fox River covered by the ROD Operable Units (OUs) 3 and 4 the Governments selected large-scale dredging as the cleanup approach. OU 3 is the section of the Fox River running downstream from Little Rapids to the DePere dam, and OU 4 runs from the DePere dam downstream to the mouth of the Fox River at Green Bay. U.S. Mills DePere plant is just below the DePere dam and, prior to 1972, discharged wastewater into the river downstream of the dam in OU 4. In the ROD, the Governments estimated that approximately 6.5 million cubic yards of sediment would be removed from OUs 3 and 4 at an estimated cost of approximately $284 million (approximately $26.5 million for OU 3 and

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approximately $257.5 million for OU 4). The Governments also identified capping the river bed with appropriate materials as a contingent remedy to be evaluated during the remedial design process. For Green Bay (OU 5), the Governments selected monitored natural attenuation as the cleanup approach at an estimated cost of approximately $40 million. The Governments also indicated that some limited dredging near the mouth of the river might be required, which would ultimately be determined during the design stage of the project. Earlier, in January 2003, the Governments had issued their ROD for the upper portions of the Fox River OUs 1 and 2. Combining the cost estimates from both RODs, it appeared that the Governments expected the selected remedies for all five OUs to cost approximately $400 million, exclusive of contingencies. In March 2004, NCR and Georgia-Pacific (G-P) entered into an Administrative Order on Consent (AOC) with the Governments to perform engineering design work for the clean up of OUs 2-5.

In the course of the ongoing design work, additional sampling and data analysis identified elevated levels of PCBs in certain areas of OU 4 near the U.S. Mills DePere plant (the OU 4 hotspot). In November 2005, the Governments notified U.S. Mills and NCR that they would be required to design and undertake a removal action that would involve dredging, dewatering and disposing of the PCB contaminated sediments from the OU 4 hotspot. In furtherance of this notification, on April 12, 2006, the United States and the State of Wisconsin sued NCR and U.S. Mills in the United States District Court for the Eastern District of Wisconsin in Milwaukee (Civil Action No. 06-C-0484). NCR and U.S. Mills agreed to a Consent Decree with the United States and the State of Wisconsin pursuant to which NCR and U.S. Mills were required to start removing contaminated sediment from the OU 4 hotspot no later than May 1, 2007. Although the defendants specifically did not admit liability for the allegations of the complaint, they are bound by the terms of the Consent Decree.

NCR and U.S. Mills reached agreement between themselves that each would fund 50% of the costs of remediation of the OU 4 hotspot, which the Company currently estimates to be between $24 million and $26 million for the project as a whole. Project implementation began in 2006, but most of the project cost is expected to be incurred in 2007. Although the funding agreement does not acknowledge responsibility or prevent either party from seeking reimbursement from any other parties (including each other), the Company accrued $12.5 million in 2005 as its estimate of the portion of costs that U.S. Mills expects to fund under the funding agreement.

The contract for the first phase of the NCR U.S. Mills remediation project with respect to the OU 4 hotspot has been awarded to a remedial contractor, and site preparation at the U.S. Mills plant (where the sediment will be dewatered) has commenced. The remediation will involve removal of sediment from the riverbed, dewatering of the sediment and storage at an offsite landfill.

The extent of U.S. Mills potential liability remains subject to many uncertainties and the Company periodically reevaluates U.S. Mills potential liability and the appropriate reserves based on current information. U.S. Mills eventual liability which may be paid out over a period of ten to twenty years will depend on a number of factors. In general, the most significant factors include: (1) the total remediation costs for the sites for which U.S. Mills might be found to have liability and the share of such costs U.S. Mills is likely to bear; (2) the total natural resource damages for such sites and the share of such costs U.S. Mills is likely to bear, and (3) U.S. Mills costs to defend itself in this matter.

At the time of the Company s acquisition of U.S. Mills in 2001, U.S. Mills and the Company estimated U.S. Mills liability for the Fox River cleanup at a nominal amount based on Government reports and conversations with the Governments about the anticipated limited extent of U.S. Mills responsibility, the belief, based on U.S. Mills prior assertions, that no significant amount of PCB-contaminated raw materials had been used at the U.S. Mills plants, and the belief that any PCB contamination in the Fox River, other than a de minimus amount, was not caused by U.S. Mills. It appeared at that time that U.S. Mills and the Governments would be able to resolve the matter and dismiss U.S. Mills as a PRP for a nominal payment. Accordingly, no significant reserve was established at the time. However, the Governments subsequently declined to enter into such a settlement. Nonetheless, until recently U.S. Mills continued to believe that its

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liability exposure was very small based on its continuing beliefs that no significant amount of PCB-contaminated raw materials had been used at the U.S. Mills plants and that any significant amount of PCB contamination in the section of the Fox River located adjacent to its plant was not caused by U.S. Mills.

In May/June 2005, U.S. Mills first learned of elevated levels of PCBs (the OU 4 hotspot) in the Fox River adjacent to its DePere plant. U.S. Mills, while still not believing its DePere plant was the source of this contamination, entered into the consent decree to remediate the OU 4 hotspot as discussed above.

In June 2006, U.S. Mills first received the results of tests it initiated on the U.S. Mills property that suggest that the DePere plant may have processed as part of its furnish more than the de minimus amounts of PCB-contaminated paper reflected in the records available to the Company. This information seemed to contradict the Company s previous understanding of the history of the DePere plant. Further testing of the site is continuing to attempt to determine the extent of this recently discovered contamination. Based on these most recent findings, it is possible that U.S. Mills might be responsible for a larger portion of the remediation than previously anticipated. The total estimated cost set forth in the ROD for remediation of OU 4 was approximately $257.5 million (the more recent Basis of Design Report estimate is at least $100 million higher) and the estimated cost of monitoring OU 5 was approximately $40 million. There are two alleged PRPs located in OU 4 (of which the smaller is the plant owned by U.S. Mills). It is possible that the owners of these two plants, together with the original generator of the carbonless copy paper, could be required to bear the substantial portion of the remediation costs of OU 4, and share with other PRPs the cost of monitoring OU 5. U.S. Mills has discussed possible remediation scenarios with other PRPs who have indicated that they expect U.S. Mills to bear an unspecified but meaningful share of the costs of OU 4 and OU 5.

In February 2007, USEPA and WDNR issued a general notice of potential liability under CERCLA and a request to participate in remedial action implementation negotiations relating to OUs 2 5 to eight PRPs, including U.S. Mills. The notice requests that the PRPs indicate their willingness to participate in negotiations concerning performance of the remaining elements of the remedial action for OUs 2 5 and the resolution of the government entities claims for unreimbursed costs and natural resource damages. The notice also indicates that, if USEPA and WDNR receive a good faith offer of settlement by April 1, 2007, they will seek to finalize an agreement by no later that July 15, 2007. U.S. Mills plans to discuss joint settlement proposals with other PRPs and may make a good faith offer of settlement either with or without other PRPs. The amount of any such offer has not been determined and will depend on U.S. Mills assessment of the level of its responsibility for the contamination and damages, the extent of insurance coverage, and the impact of a settlement on U.S. Mills resources and ongoing operations. U.S. Mills is currently evaluating all of its options and intends to vigorously defend against liability to the extent it deems it prudent and cost effective to do so.

Because U.S. Mills has not yet been able to estimate with any certainty the portion of the total remediation costs that it might have to bear, reserves to account for the potential additional liability have not been increased at this point. Since no formal claims for natural resource damages have been made, U.S. Mills does not have a basis for estimating the possible cost of such claims. Accordingly, reserves have not been increased for this potential liability. However, for the entire river remediation project, the lowest estimate in the Governments 2000 report on natural resource damages was $176 million.

In addition to its potential liability for OUs 4 and 5, U.S. Mills may have a contingent liability to Menasha Corporation to indemnify it for any amount for which it may be held liable in excess of insurance coverage for any environmental liabilities of a plant on OU 1 that U.S. Mills purchased from Menasha. Due to the uncertainty of Menasha s liability and the extent of the insurance coverage, U.S. Mills has not established a reserve for this contingency.

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U.S. Mills costs of defending itself in connection with environmental matters are expensed as incurred and are not included in the reserve.

The actual costs associated with cleanup of the Fox River site are dependent upon many factors and it is reasonably possible that remediation costs could be higher than the current estimate of project costs. Some, or all, of any costs incurred may be covered by insurance, or may be subject to recoupment from other parties, but no amounts have been recognized in the financial statements of the Company for such recovery. Given the ongoing remedial design work being conducted by NCR and U.S. Mills and the initial stages of remediation, it is possible there could be some additional changes to some elements of the reserve within the next year or thereafter, although that is difficult to predict.

In any event, because the discharges of hazardous materials into the environment occurred before the Company acquired U.S. Mills, and U.S. Mills has been operated as a separate subsidiary of the Company, the Company does not believe that it has any liability for the liabilities of U.S. Mills. Accordingly, as stated above, the Company does not believe that the effect of U.S. Mills Fox River liabilities on the Company would result in a pretax loss to the Company that would exceed the net worth of U.S. Mills, which was approximately $90 million at December 31, 2006.

Additional information regarding legal proceedings is provided in Note 13 to the Consolidated Financial Statements on pages F-32 and F-33 of this Annual Report on Form 10-K.

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable.

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PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company s common stock is traded on the New York Stock Exchange under the stock symbol SON. As of December 31, 2006, there were approximately 40,000 shareholder accounts. Information required by Item 201(d) of Regulation S-K can be found in Part III, Item 12 of this Annual Report on Form 10-K. The following table indicates the high and low sales prices of the Company s common stock for each full quarterly period within the last two years as reported on the New York Stock Exchange, as well as cash dividends declared per common share:

	High	Low	Cash Dividends
2006			
First Quarter	$34.75	$28.76	$.23
Second Quarter	$34.75	$29.45	$.24
Third Quarter	$34.75	$30.30	$.24
Fourth Quarter	$38.71	$33.10	$.24
2005			
First Quarter	$30.24	$25.58	$.22
Second Quarter	$29.13	$25.46	$.23
Third Quarter	$28.84	$25.79	$.23
Fourth Quarter	$30.64	$25.43	$.23

Item 5C. Issuer Purchase of Equity Securities

The Company did not purchase any of its securities during the fourth quarter of 2006.

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Item 6. Selected Financial Data

The following table sets forth the Company s selected consolidated financial information for the past five years. The information presented below should be read together with Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations, the Company s historical consolidated financial statements, and the Notes thereto. The selected statement of income data and balance sheet data are derived from the Company s Consolidated Financial Statements included in Item 8 to this Annual Report on Form 10-K.

(Dollars and shares in thousands except per share data)	**Years ended December 31**				
	2006	**2005**	**2004**	**2003**	**2002**
Operating Results[1]					
Net sales	$3,656,839	$3,528,574	$3,155,433	$2,758,326	$2,701,419
Cost of sales and operating expenses	3,310,751	3,232,590	2,897,046	2,549,726	2,455,357
Restructuring charges[2]	25,970	21,237	18,982	50,056	10,409
Interest expense	51,952	51,559	47,463	52,399	54,196
Interest income	(6,642)	(7,938)	(5,400)	(2,188)	(1,649)
Income before income taxes	274,808	231,126	197,342	108,333	183,106
Provision for income taxes[3]	93,329	84,174	58,858	37,698	65,075
Equity in earnings of affiliates/ minority interest, net of tax[4]	13,602	14,925	12,745	7,543	7,437
Income from continuing operations	195,081	161,877	151,229	78,178	125,468
Income from discontinued operations, net of income taxes				60,771	9,848
Net income available to common shareholders	$ 195,081	$ 161,877	$ 151,229	$ 138,949	$ 135,316
Per common share					
Net income available to common shareholders:					
Basic	$ 1.95	$ 1.63	$ 1.54	$ 1.44	$ 1.40
Diluted	1.92	1.61	1.53	1.43	1.39
Cash dividends common	.95	.91	.87	.84	.83
Weighted average common shares outstanding:					
Basic	100,073	99,336	98,018	96,819	96,373
Diluted	101,534	100,418	98,947	97,129	97,178
Actual common shares outstanding at December 31	100,550	99,988	98,500	96,969	96,380
Financial Position					
Net working capital	$ 282,974	$ 265,014	$ 282,226	$ 75,671	$ 104,671
Property, plant and equipment, net	1,019,594	943,951	1,007,295	923,569	975,368
Total assets	2,916,678	2,981,740	3,041,319	2,520,633	2,436,439
Long-term debt	712,089	657,075	813,207	473,220	699,346
Total debt	763,992	781,605	906,961	674,587	833,846

Shareholders equity	1,219,068	1,263,314	1,152,879	1,014,160	867,425
Current ratio	1.4	1.4	1.4	1.1	1.2
Total debt to total capital[5]	37.5%	35.7%	40.7%	36.4%	44.5%

[1] Operating results for 2004 through 2006 are not comparable to previous years due to the impact of the CorrFlex acquisition that occurred in May 2004 and the formation of the Sonoco-Alcore joint venture that occurred in November 2004. Operating results for 2002 have been restated to reclassify the High Density Film business, which was sold in 2003, as discontinued operations.

[2] 2006 data reflects net charges of $25,970 pretax, $21,330 after tax, for restructuring charges. 2005 data reflects net charges of $21,237 pretax, $14,343 after tax, for restructuring costs. 2004 data reflects net charges of $18,982 pretax, $16,154 after tax, for restructuring costs. 2003 data reflects net charges of $50,056 pretax,

$35,329 after tax, for restructuring costs. 2002 data reflects net charges of $10,409 pretax, $6,663 after tax, for restructuring costs.

[3] The provision for income taxes included $10,074 in 2005 related to the repatriation of foreign earnings under the American Jobs Creation Act of 2004 and ($9,693) associated with the closing of previous years examinations in 2004.

[4] 2006, 2005, 2004 and 2003 data includes the minority interest owner s portion of restructuring charges/(income) of $(416), $(1,260), $(1,778) and $1,455, respectively.

[5] Calculated as Total Debt divided by the sum of Total Debt, Shareholders Equity and Long-term Deferred Tax Liability.

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Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

Overview

2006 was a good year for both Sonoco and its shareholders. Sonoco achieved records in sales, net income and cash flow from operations and the Company s stock provided its shareholders with an annual total return of 33.2%. Sonoco s target is to provide shareholders with a double-digit average annual total return over time. To meet that target, the Company focuses on three major areas: driving profitable sales growth, improving margins, and leveraging the Company s strong cash flow and financial position.

Sales continued to grow in 2006 from new products and acquisitions, while the Company received a number of awards for packaging innovation. The Company recorded a third consecutive year of operating margin improvement driven by strong productivity gains and a continued focus on price management, cost reductions and the turnaround of under-performing operations. The Company s initiative to reduce working capital and the operational improvement helped boost cash flow to record levels.

The Company s primary growth drivers are acquisitions, geographic expansion, providing total packaging solutions for customers and new product development. In 2006, sales grew 3.6% over 2005, primarily due to increased selling prices throughout the Company, the favorable impact of foreign exchange rates and an increase in volume.

During 2006, the Consumer Packaging segment provided 45% of the total increase in revenue and Tubes and Cores/Paper provided 34%, while revenue in the Packaging Services segment was essentially unchanged. Businesses in All Other Sonoco provided the remaining 21% of the total revenue increase. The Company expects that, over the next several years, growth in the consumer-related portions of its business will outpace growth in the industrial-related portions. Higher volume accounted for 21% of the revenue increase in Consumer Packaging, 40% in Tubes and Cores/Paper and 54% in All Other Sonoco. Volume increases in the Packaging Services segment were more than offset by the impact of the 2005 divestiture of a folding cartons plant.

The acquisitions made in 2006 did not have a significant impact on sales, as two of the larger ones did not close until late in the fourth quarter. However, these acquisitions are expected to provide additional year-over-year sales in excess of $100 million in 2007. The purchase of the remaining 35.5% interest in the Sonoco-Alcore S.a.r.l. (Sonoco-Alcore) joint venture will not result in additional sales as it was previously consolidated in the Company s results. A reduction in sales resulting from the December 2005 sale of the folding cartons operation more than offset the positive impact of several smaller acquisitions made earlier in 2006.

The Company reported net income of $195.1 million for 2006, compared with $161.9 million for 2005. Earnings growth in 2006 resulted in large part from productivity improvements in virtually all of the Company s businesses along with price increases that effectively offset increases in the costs of labor, material, freight and energy. Volume growth had less impact on operating profits than its effect on sales due to a change in the mix of products sold. The change in mix is primarily attributable to increased sales of tissue and towel board in the Tubes and Cores/Paper segment and composite cans to the powdered infant formula market in the Consumer Packaging segment. Both of these products have lower margins relative to other products. In addition, $10.1 million of increased sales volume in the Packaging Services segment were on a pass-through basis and therefore generated no significant additional gross margin.

Operating margins, including both gross profit margin and net income margin, showed improvement over 2005 levels. Net income for 2006 included after-tax restructuring charges of $20.9 million, $7.8 million more than the $13.1 million net restructuring charges recorded in 2005. Net income for 2005 was negatively impacted by an after-tax charge of $7.6 million related to an environmental reserve at a subsidiary s paper

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operations in Wisconsin and additional tax expense of $10.1 million associated with the repatriation of foreign earnings.

Cash flow from operations reached a record $482.6 million in 2006. Cash flow was used to fund capital expenditures, make acquisitions, pay dividends, repurchase Company stock and make net payments on debt. To sustain strong cash flow, the Company emphasizes profitable growth, effective working capital management and capital expenditure control. A portion of key manager incentive compensation is tied to achieving a targeted return on net assets.

Restructuring Charges, Unusual Items and Other Activities

Restructuring Charges

During 2006, the Company recognized restructuring charges, net of adjustments, totaling $26.0 million ($21.3 million after tax) under two restructuring plans   the 2006 Plan and the 2003 Plan. Of this total amount, the Company recognized $17.5 million of restructuring charges, net of adjustments, under the 2006 Plan and $8.5 million, net of adjustments, under the 2003 Plan.

The 2006 Plan, approved in October 2006, initiated cost-reduction measures primarily focused on certain of the Company s international operations, principally centered around Europe. It calls for the closure of approximately 12 plant locations globally and the reduction of approximately 540 positions worldwide. These measures began in the fourth quarter of 2006 and are expected to be substantially complete by the end of 2007. The 2006 charges related primarily to the closures of a paper mill in France, two tube and core plants one in Canada and one in the United States, and a flexible packaging operation in Canada. The charges also include the closures of a wooden reels facility and a molded plastics operation in the United States as well as the impact of downsizing actions primarily in the Company s European tube and core/paper operations. The total pretax cost of the 2006 Plan is estimated to be approximately $35 million, most of which is related to severance and other termination costs; accordingly, the vast majority of the cost will result in the expenditure of cash.

The 2003 Plan, announced in August 2003, was designed to reduce the Company s overall operating cost structure by approximately $54 million by realigning and centralizing a number of staff functions and eliminating excess plant capacity. Pursuant to the 2003 Plan, the Company has initiated or completed 22 plant closings and has reduced its workforce by approximately 1,120 employees. Net charges recorded in 2006 related primarily to the closure of two tube and core plants and a flexible packaging operation in the United States, and an additional asset impairment charge resulting from a revision to the estimated sales proceeds of a previously closed paper mill located in the United States. These charges consisted of severance and termination benefits of $1.8 million, asset impairment charges of $2.6 million and other exit costs of $4.1 million, consisting of building lease termination charges and other miscellaneous exit costs. Through the end of 2006, the Company has recognized cumulative restructuring charges, net of adjustments, of $103.0 million under the 2003 Plan. Future restructuring charges to be incurred under this plan are expected to be minimal. With the exception of ongoing pension subsidies and certain building lease termination expenses, costs associated with the 2003 Plan are expected to be paid by the end of the 2007 using cash generated from operations.

During 2005, the Company recognized restructuring charges under the 2003 Plan of $21.2 million ($14.3 million after tax), net of adjustments primarily related to 11 plant closings in the Tubes and Cores/Paper segment and three plant closings in the Consumer Packaging segment. Restructuring charges recognized during 2005 consisted of severance and termination benefits of $6.2 million, asset impairment charges of $6.5 million and other exit costs of $8.5 million, consisting of building lease termination charges and other miscellaneous exit costs. Of the $6.5 million of asset impairment charges (related to the writeoff/down of assets associated with 11 plant closings), the Company recognized writeoffs/downs of impaired equipment of $5.9 million and writeoffs/downs related to facilities held for sale of $0.6 million. Impaired assets are valued at the lower of carrying amount or fair value, less estimated costs to sell, if applicable.

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During 2004, the Company recognized restructuring charges of $19.0 million ($16.2 million after tax), net of adjustments, primarily related to plant closings in the Tubes and Cores/Paper segment, the Consumer Packaging segment and in All Other Sonoco. Included in this amount is $2.2 million in restructuring charges, which resulted from a correction to previously reported financial statements at the Company s wholly owned subsidiary in Spain. Restructuring charges recognized during 2004 consisted of severance and termination benefits of $6.5 million, asset impairment charges of $6.2 million and other exit costs of $6.3 million, consisting of building lease termination charges and other miscellaneous exit costs.

The Company also recorded non-cash, after-tax income in the amount of $0.4 million in 2006, $1.3 million in 2005, and $1.8 million in 2006 to reflect a minority shareholder 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.

Acquisitions/Joint Ventures

The Company completed six acquisitions during 2006, and purchased the remaining 35.5% minority interest of its Sonoco-Alcore joint venture, at an aggregate cost of $227.3 million, all of which was paid in cash. Acquisitions in the Company s Tubes and Cores/Paper segment included the remaining 75% interest in Demolli Industria Cartaria S.p.A, an Italy-based tube and core/paper manufacturer; and a small tube and core manufacturer in Canada. Acquisitions made in the Consumer Packaging segment included a rotogravure printed flexible packaging manufacturer in Texas; a rigid paperboard composite container manufacturer located in Ohio; and Clear Pack Company, a manufacturer of thermoformed and extruded plastic materials and containers located in Illinois. In addition, the Company acquired a small packaging fulfillment business in Illinois, which is included in the Packaging Services segment. These acquisitions are expected to provide approximately $130 million in reported sales in 2007. Also in 2006, the Company purchased the remaining 35.5% interest in Sonoco-Alcore, a European tube, core and coreboard joint venture between the Company and Ahlstrom Corporation. Results for the Sonoco-Alcore joint venture, part of the Tubes and Cores/Paper segment, have been consolidated in the Company s results since its original formation in 2004; accordingly, no additional sales will result from the purchase of the remaining interest.

In 2005, the Company completed three minor acquisitions with an aggregate cost of $3.6 million, all of which were paid in cash.

The Company completed nine acquisitions during 2004 with an aggregate cost of $367 million, of which $267 million was paid in cash. The most significant acquisition in 2004 was CorrFlex Graphics, LLC, one of the nation s largest point-of-purchase display companies. The acquired business, which is known as Sonoco CorrFlex, LLC, is reflected in the Packaging Services segment. Acquisitions in the Company s Tubes and Cores/Paper segment included tube and core manufacturers in Australia, China and the United States. During the fourth quarter of 2004, the Company also completed a business combination with Ahlstrom Corporation, Helsinki, Finland (Ahlstrom), by which each of the companies respective European paper-based tube/core and coreboard operations were combined into a joint venture that operates under the name Sonoco-Alcore S.a.r.l. and is reflected in the Tubes and Cores/Paper segment. The Company contributed ownership positions in 25 tube and core plants and five paper mills to Sonoco-Alcore, and held a 64.5% interest in the joint venture. Ahlstrom, a leader in high-performance fiber-based materials serving niche markets worldwide, contributed 14 tube and core plants and one paper mill to Sonoco-Alcore, and held a 35.5% interest in the joint venture. As noted above, the Company acquired this remaining 35.5% interest during 2006. The Company accounted for this transaction as an acquisition and, therefore, consolidated the joint venture and reported Ahlstrom s ownership as minority interest in the Company s financial statements. The recognition of Ahlstrom s share of the joint venture s net income was included in Equity in earnings of affiliates/minority interest in subsidiaries in the Company s Consolidated Statements of Income until acquisition of the remaining minority interest was completed in 2006. Acquisitions in the Company s

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Consumer Packaging segment included a composite can manufacturer in Australia, a manufacturer of rotogravure cylinders in Canada and the remaining ownership interest in a manufacturer of rotogravure cylinders in Charlotte, N.C. The Company also acquired certain assets of a wooden reel refurbisher in Alabama, which are reported in All Other Sonoco.

Dispositions

In December 2005, the Company divested its single-plant folding cartons business for a note receivable of approximately $11.0 million, which was collected in early 2006. This transaction resulted in a gain of $2.4 million ($1.6 million after tax). The results of this business unit were immaterial to the Company s consolidated net income for all periods presented.

Other Special Charges, Income Items and Contingencies

During the fourth quarter of 2005, the United States Environmental Protection Agency (EPA) notified U.S. Paper Mills Corp. (U.S. Mills), a wholly owned subsidiary of the Company, that U.S. Mills and NCR Corporation (NCR), an unrelated company, would be held jointly responsible to undertake a program to remove and dispose of certain PCB-contaminated sediments at a particular site on the lower Fox River in Wisconsin. U.S. Mills and NCR reached agreement between themselves that each would fund 50% of the costs of remediation, which the Company currently estimates to be between $24 million and $26 million for the project as a whole. Project implementation began in 2006; however, most of the project costs are expected to be incurred in 2007. Although the agreement reached does not acknowledge responsibility or prevent either party from seeking reimbursement from any other parties (including each other), the Company accrued $12.5 million in 2005 as an estimate of the portion of costs that U.S. Mills expects to fund under the current agreement. The charges recognized for this environmental reserve are included in Selling, general and administrative expenses in the Company s Consolidated Statements of Income. The actual costs associated with cleanup of this particular site are dependent upon many factors, and it is reasonably possible that remediation costs could be higher than the current estimate of project costs. The Company acquired U.S. Mills in 2001, and the identified contamination predates the acquisition. Some or all of any costs incurred may be covered by insurance or be recoverable from third parties; however, there can be no assurance that such claims for recovery will be successful. Accordingly, no amounts have been recognized in the financial statements for such recovery.

In June 2006, U.S. Mills first received the results of tests it initiated on the U.S. Mills property that suggested that its DePere plant might have previously processed more than the de minimus amounts of PCB-contaminated paper reflected in the records available to the Company. This information seemed to contradict the Company s previous understanding of the history of the DePere plant. Further testing of the site is continuing to attempt to determine the extent of this recently discovered contamination. Based on these most recent findings, it is possible that U.S. Mills might be responsible for a larger portion of the remediation of the lower Fox River than previously anticipated. Governmental estimates of the costs for remediation of the lower Fox River are several hundred millions of dollars. The information currently available to the Company is insufficient to determine the probability or amount of liability that may be attributable to U.S. Mills. Accordingly, as of December 31, 2006, no additional reserve for the potential remediation costs of this site has been established. However, it is possible that U.S. Mills ultimate share of the liability could exceed its net worth of approximately $90 million, but Sonoco believes the net worth of U.S. Mills represents the maximum exposure to the Company s consolidated financial position from these environmental claims. For a more detailed discussion of the Fox River environmental matters, see Item 3. Legal Proceedings above.

During 2005, the Company repatriated $124.7 million from foreign subsidiaries under the provisions of the American Jobs Creation Act of 2004 (AJCA). Under this temporary incentive, a portion of the repatriated funds qualified for an 85% dividends-received deduction. Although the effective tax rate on the repatriated funds was lower than it would have otherwise been absent the AJCA, the repatriation resulted in the recognition of additional U.S. federal and state income taxes totaling $10.1 million.

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In 2004, the Company recognized charges of $5.6 million, for the future costs of new executive life insurance benefits established to replace key executive split-dollar life agreements. Due to regulatory changes, the Company was not able to maintain those split-dollar agreements and the replacement benefits for the affected employees have been provided to meet the intent and commitments of the previous program. Also in 2004, the Company incurred a $4.5 million charge related to a trade secrets dispute. The charges recognized for the new executive life insurance benefits and the trade secrets dispute are included in Selling, general and administrative expenses in the Company s Consolidated Statements of Income. Additionally, 2004 net income was positively affected by $9.7 million due to the recognition of certain tax benefits as a result of examination conclusions by the Internal Revenue Service (IRS) and state tax authorities.

During the fourth quarter of 2004, the Company determined that misstatements had been made in the financial statements of its wholly owned subsidiary in Spain, which consists of two tube and core plants. The primary impact of these misstatements was an underreporting of expenses over a six-year period totaling approximately $9.4 million, before and after tax, of which $2.2 million was related to restructuring charges as previously discussed. Of the remaining $7.2 million, approximately $1.6 million was associated with the first three quarters of 2004, approximately $1.3 million was associated with 2003, approximately $.3 million was associated with 2002, approximately $1.9 million was associated with 2001 and the remaining amount of approximately $2.1 million was associated with 2000 and prior. As the impact of these misstatements was not material to the reported results of any of the prior periods affected or to the period in which it was recorded, the Company recorded the charge in the fourth quarter of 2004.

Results of Operations 2006 versus 2005

Net income for 2006 was $195.1 million, compared with $161.9 million in 2005. The year-over-year increase is largely attributable to higher operating profits on improved productivity and increased selling prices. Gross profit margin improved to 19.3%, compared with 18.7% in 2005. Also contributing to the year over year net income improvement was the net effect of fewer special charges, which were discussed above.

Operating Revenue

Consolidated net sales for 2006 were $3.66 billion, a $128 million, or 3.6%, increase over 2005.

The components of the sales change were approximately:

($ in millions)	
Volume	$ 41
Selling price	51
Currency exchange rate	39
Acquisitions (net of dispositions)	(4)
Other	1
Total sales increase	$128

Prices were higher throughout the Company, with the exception of recovered paper operations, as the Company was able to implement price increases to offset the impact of higher costs of labor, energy, freight and materials. Company-wide volume, excluding service center revenue which was on a pass-through basis, increased slightly less than 1.0% from 2005 levels driven by increases in the Tubes and Cores/Paper and Consumer Packaging segments. Domestic sales were $2.3 billion, up 2.3% from 2005. International sales were $1.3 billion, up 6.2% over 2005, driven primarily by the impact of currency translation.

Costs and Expenses

In 2006, defined-benefit pension and postretirement expense increased $1.1 million to $44.1 million, versus $43.0 million in 2005. The Company expects these expenses to total approximately $34 million in 2007.

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This reduction will be partially offset by higher defined contribution plan costs. The return on assets of U.S.-based defined benefit plans was 13.9% in 2006 and 7.2% in 2005. Over time, investment returns on benefit plan assets impact the Company s cost of providing pension and postretirement benefits. The Company s U.S.-based qualified defined-benefit pension plan had a positive funded status of $9 million at year end. None of the Company s other defined benefit plans were fully funded as of December 31, 2006. The cumulative unfunded liability of these plans at December 31, 2006, was $229 million. The Company also sponsors the Sonoco Investment and Retirement Plan, a defined contribution pension plan, for its salaried and non-union U.S. employees who were hired on or after January 1, 2004. The Company makes an annual contribution of 4% of all eligible pay plus 4% of eligible pay in excess of the Social Security wage base. The Company s total expense under this defined contribution plan was $1.2 million in 2006 and $0.4 million in 2005. The Company expects the defined contribution expense to total approximately $5 million in 2007.

On January 1, 2006, the Company implemented certain changes to its U.S.-based retiree medical benefits plan. These changes included the elimination of a Company subsidy toward the cost of retiree medical benefits if certain age and service criteria were not met, as well as the elimination of Company-provided prescription drug benefits for the majority of its current retirees and all future retirees. These changes resulted in a reduction to the accumulated postretirement benefit obligation of $38 million, which is being amortized over a period of 4.6 years beginning in 2006. In addition, 2006 long-term disability expenses were favorably impacted by both a decrease in the number of employees receiving benefits and by a decrease in the amount of the average claim.

Selling, general and administrative expenses as a percentage of sales decreased to 9.8% during the year from 10.3% in 2005. Included in 2006 was an additional $4.1 million of stock-based compensation expense associated with the issuance of stock-settled stock appreciation rights. Recognition of this expense is required under Statement of Financial Accounting Standards No. 123(R), Share-Based Payment, which the Company adopted effective January 1, 2006. Expenses in 2005 included the previously mentioned $12.5 million U.S. Mills environmental charge.

Operating profits also reflect restructuring charges of $26.0 million and $21.2 million in 2006 and 2005, respectively. These items are discussed in more detail in the section above titled, Restructuring Charges, Unusual Items and Other Activities.

Research and development costs, all of which were charged to expense, totaled $12.7 million and $14.7 million in 2006 and 2005, respectively. Significant 2006 projects in Sonoco s Tubes and Cores/Paper segment included efforts to design and develop new products for the construction industry and for the film and tape industries. In addition, efforts were focused on enhancing performance characteristics of the Company s tubes and cores in the textile, film and paper packaging areas, as well as projects aimed at enhancing productivity. The Consumer Packaging segment continued to invest in development of specialty metal closures, flexible packaging enhancements and rigid plastic containers technology.

Interest expense totaled $52.0 million for the year ended December 31, 2006, compared with $51.6 million in 2005. The slight increase in 2006, compared with 2005, was due to higher average interest rates, substantially offset by lower U.S. and international debt levels. Interest income was $6.6 million in 2006, a decrease of $1.3 million, from the $7.9 million reported in 2005. The decrease was primarily due to the Company s repatriation of $124.7 million of accumulated offshore cash in December 2005 under the American Jobs Creation Act and the subsequent use of the repatriated cash to lower domestic debt.

The effective tax rate for continuing operations in 2006 was 34.0%, compared with 36.4% in 2005. Included in the effective tax rate for 2006 was the impact of a $5.3 million benefit associated with entering into favorable tax agreements with state tax authorities and closing state tax examinations for amounts less than originally anticipated. Partially offsetting this is a $4.9 million impact resulting from restructuring charges for which a tax benefit could not be recognized. The 2005 effective tax rate reflects an additional $10.1

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million of income tax expense associated with the repatriation of foreign earnings under the American Jobs Creation Act.

Operating Segments

Consolidated operating profits, also referred to as Income before income taxes on the Consolidated Statements of Income, are comprised of the following:

($ in millions)	**2006**	**2005**	**% Change**
Consumer Packaging Segment	$109.6	$103.5	5.9%
Tubes and Cores/Paper Segment	148.2	107.0	38.4%
Packaging Services Segment	39.2	44.8	(12.6)%
All Other Sonoco	49.1	40.6	20.9%
Restructuring and related impairment charges	(26.0)	(21.2)	(22.3)%
Interest expense, net	(45.3)	(43.6)	(3.9)%
Consolidated operating profits	$274.8	$231.1	18.9%

Segment results viewed by Company management to evaluate segment performance do not include restructuring and net interest charges. Accordingly, the term segment operating profits is defined as the segment s portion of Income before income taxes excluding restructuring charges and net interest expense. General corporate expenses, with the exception of restructuring charges, interest, and income taxes, have been allocated as operating costs to each of the Company s reportable segments and All Other Sonoco.

See Note 15 to the Company s Condensed Consolidated Financial Statements for more information on reportable segments.

Consumer Packaging Segment Results for this segment are presented as follows:

($ in millions)	**2006**	**2005**	**% Change**
Trade sales	$1,304.8	$1,247.5	4.6%
Segment operating profits	109.6	103.5	5.9%
Depreciation, depletion and amortization	55.1	56.3	(2.1)%
Capital spending	48.2	50.8	(5.2)%

Sales in this segment increased due to higher selling prices for composite cans, plastic packaging and closures, along with the impact of favorable exchange rates, as the dollar weakened against foreign currencies. Higher composite can volume was partially offset by reduced volume in flexible packaging and closures. Overall, volumes were up 1% in the segment. Domestic sales were approximately $925 million, up 3.5% from 2005, and international sales were approximately $380 million, up 7.4% from 2005.

Segment operating profits were favorably impacted by productivity and purchasing initiatives, while selling price increases were partially offset by increased costs of energy, freight, material and labor. Continued high startup costs at the Company s rigid plastics container plant in Wisconsin also dampened operating profits in the segment, as did operational issues and the loss of a customer at the closures plant in Brazil.

Significant capital spending included numerous productivity and customer development projects in the United States and Europe.

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Tubes and Cores/Paper Segment Results for this segment are presented as follows:

($ in millions)	**2006**	**2005**	**% Change**
Trade sales	$1,525.6	$1,482.1	2.9%
Segment operating profits	148.2	107.1	38.4%
Depreciation, depletion and amortization	85.9	83.7	2.5%
Capital spending	63.3	62.3	1.6%

The increase in sales was due to increased selling prices and volume in North American paper operations and Asia. The effect of favorable exchange rates also increased sales. Lower tube and core volume in most geographic segments partially offset these favorable factors. Overall volume in the segment, including the impact of acquisitions, increased by approximately 1%. Domestic sales increased approximately $15 million, or 1.9%, to $772.6 million and international sales increased approximately $29 million, or 4.0% to $753.0 million.

Segment operating profits increased due to productivity and purchasing initiatives along with higher selling prices, which offset increases in the costs of energy, freight, material and labor. Results in 2005 were impacted by a charge of $12.5 million related to an environmental claim at a subsidiary s paper operations in Wisconsin. See Other Special Charges, Income Items and Contingencies for a discussion of this claim. In addition, 2005 results included a $3.0 million non-restructuring asset impairment charge related to operations in Asia.

Significant capital spending included the modification of several paper machines, primarily in the United States, Mexico and Europe, and building of new tube and core plants in Asia.

Packaging Services Segment Results for this segment are presented as follows:

($ in millions)	**2006**	**2005**	**% Change**
Trade sales	$456.8	$455.9	.2%
Segment operating profits	39.2	44.8	(12.6)%
Depreciation, depletion and amortization	11.9	12.0	(0.4)%
Capital spending	3.4	4.9	(30.0)%

Sales in this segment were flat due to the December 2005 divestiture of a single-plant folding carton operation. Higher volumes and selling prices in the service centers more than offset lower volumes in point-of-purchase and fulfillment operations. Domestic sales decreased to $344.9 million, a 3.3% decrease, while international sales increased to $111.9 million, up 12.8%, primarily as a result of a new service center in Poland increasing output.

The decrease in segment operating profits is attributable to unfavorable changes in the mix of business and the impact of a $2.4 million gain on the sale of a carton facility in 2005. The service centers sales increase had very little impact on profits, as these sales were on a pass-through basis with no significant additional gross margin. Productivity and purchasing initiatives partially offset the unfavorable factors discussed above.

Capital spending included numerous productivity and customer development projects in the United States and Europe.

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All Other Sonoco Results for all other businesses not included in the segments above are presented as follows:

($ in millions)	**2006**	**2005**	**% Change**
Trade sales	$369.7	$343.2	7.7%
Segment operating profits	49.1	40.6	20.9%
Depreciation, depletion and amortization	12.0	11.1	8.3%
Capital spending	8.4	11.1	(24.2)%

Sales for All Other Sonoco increased due to price increases for all businesses, along with higher volumes in wire and cable reels and protective packaging. Domestic sales were $300.5 million, up 6.3% from 2005, and international sales were $69.2 million, an increase of 14.3%.

Operating profits in All Other Sonoco increased due primarily to manufacturing productivity and purchasing initiatives. The Company was able to recover increases in raw material costs, energy, freight and labor through higher selling prices. Although higher volume was a significant reason for the increased sales, operating profits did not benefit as changes in the mix of products resulted in lower profit margins.

Capital spending included investing in customer development projects in the United States and Europe for molded and extruded plastics, protective packaging and wire and cable reels.

Financial Position, Liquidity and Capital Resources

Cash Flow

Cash flow from operations totaled $482.6 million in 2006, compared with $227.4 million in 2005. One driver of this increase was lower contributions to the Company s pension plans, as only $10.5 million was contributed in 2006, versus $77.0 million in 2005. Increased earnings and working capital initiatives, resulting in year-over-year reductions in inventories and increases in accounts payable, also favorably impacted operating cash flows. The projected benefit obligation of the U.S. Defined Benefit Pension Plan was fully funded as of December 31, 2006. The Company froze participation for newly hired salaried and non-union hourly U.S. employees effective December 31, 2003. Based on the current actuarial estimates, the Company anticipates that the total 2007 contributions made to its benefit plans will be comparable to 2006 levels. However, no assurances can be made about funding requirements beyond 2007, as they will depend largely on actual investment returns and future actuarial assumptions.

Cash flows used by investing activities increased from $119.3 million in 2005 to $332.1 million in 2006. The Company invested $227.3 million in six acquisitions and the purchase of the remaining minority interest in a European tube, core and coreboard joint venture, in 2006. There were no significant acquisitions in 2005. Capital expenditures decreased by $5.8 million to $123.3 million in 2006 from $129.1 million in 2005. Capital expenditures in 2007 are expected to continue to be in the $130 million range. As part of its growth strategy, the Company is actively seeking acquisition opportunities and the level of acquisition spending in any given year will depend on the size and number of suitable candidates identified and the Company s success at closing the transactions.

Net cash used by financing activities totaled $125.7 million in 2006, compared with $165.6 million used in 2005. Cash dividends increased 5.1% to $94.7 million during 2006 and cash was used to make net payments on debt of $23.6 million. During 2006, the Company acquired 2.5 million shares of Sonoco common stock at a cost of $82.7 million and issued shares through the exercise of previously awarded stock options for proceeds of $74.4 million.

Current assets increased by $57.3 million to $942.8 million at December 31, 2006. This increase is largely attributable to higher levels of cash and to a higher balance of trade accounts receivable stemming from 2006 acquisitions. Current liabilities increased by $39.3 million to $659.8 million at December 31, 2006. This

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increase was due to higher accounts payable, accrued wages and taxes payable, partially offset by decreases in notes payable. The current ratio was 1.4 at December 31, 2006 and 2005.

Contractual Obligations

The following table summarizes contractual obligations at December 31, 2006:

		Payments Due In			
($ in millions)	**Total**	**2007**	**2008-2009**	**2010-2011**	**Beyond 2011**
Debt obligations	$ 764.0	$ 51.9	$ 0.6	$100.0	$ 611.5
Interest payments[1]	354.0	39.5	79.0	72.2	163.3
Operating leases	135.7	28.9	43.2	25.8	37.8
Environmental remediation (U.S. Mills)[3]	11.7	11.7			
Purchase obligations[2]	174.1	11.9	25.8	24.2	112.2
Total contractual obligations	$1,439.5	$143.9	$148.6	$222.2	$ 924.8

[1] Includes interest payments on outstanding fixed-rate, long-term debt obligations that do not have associated fair value hedges as well as financing fees on the backstop line of credit.

[2] Includes only long-term contractual commitments. Does not include short-term obligations for the purchase of goods and services used in the ordinary course of business.

[3] Environmental remediation

reserved in
2005.

Capital Resources

Debt decreased by $17.6 million to $764.0 million at December 31, 2006, as cash flows from operations were used to pay down debt.

The Company currently operates a commercial paper program totaling $350 million and has fully committed bank lines of credit supporting the program by a like amount. On May 3, 2006, the Company entered into an amended and restated credit agreement to extend its $350 million bank line of credit to a new five-year maturity. The amended and restated credit agreement also provides the Company the option to increase its credit line to $500 million subject to the concurrence of its lenders. The Company intends to indefinitely maintain line of credit agreements fully supporting its commercial paper program. At December 31, 2006, the amount of the Company s outstanding commercial paper was $89 million, compared to $30 million at December 31, 2005. Consistent with the maturity of the supporting line of credit, the Company classifies outstanding commercial paper balances as long-term debt.

One of the Company s primary growth strategies is growth through acquisitions. The Company believes that cash on hand, cash generated from operations, and the available borrowing capacity under its amended and restated credit agreement will enable it to support this strategy. Although the Company currently has no intent to do so, it may require additional financing in order pursue its growth strategy. Although the Company believes that it has excess borrowing capacity beyond its current lines, there can be no assurance that such financing would be available or, if so, at terms that are acceptable to the Company.

Effective December 31, 2006, the Company adopted the balance sheet recognition provisions of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans (FAS 158). FAS 158 requires companies to recognize the funded status of defined benefit plans on the balance sheet. Because FAS 158 is applied on a prospective basis, only the 2006 balance sheet is impacted by this change. Compared to what the balances would have otherwise been at December 31, 2006, applying FAS 158 reduced long-term assets by $260 million, increased total liabilities by $35 million, reduced long-term deferred tax liabilities by $114 million and reduced shareholders equity by $181.4 million. The majority of the impact relates to the Company s U.S. qualified retirement plan which, although in an over-funded position, had a significant prepaid expense balance primarily related to unrecognized actuarial losses that was required to be reclassified to equity on an after-tax basis.

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Shareholders equity decreased $44.2 million from December 31, 2005, to $1.22 billion at December 31, 2006. The decrease resulted mainly from net income of $195.1 million in 2006, stock option exercises of $82.7 million, and a foreign currency translation gain of $37.2 million, being more than offset by cash dividends of $94.7 million, the repurchase of $82.7 million of the Company s common stock, and a $181.4 million adjustment, net of tax, from the initial application of FASB Statement No. 158. Shareholders equity increased $110.4 million from December 31, 2004, to $1.26 billion at December 31, 2005. The increase resulted mainly from net income of $161.9 million in 2005 and stock option exercises of $37.4 million, reduced by dividends of $90.1 million, a foreign currency translation loss of $12.8 million, and minimum pension liability adjustments of $0.6 million.

During the first six months of 2006, the Company repurchased 2.5 million shares of Sonoco common stock for approximately $82.7 million. The shares were repurchased under an existing authorization to repurchase up to approximately 5.29 million shares. On April 19, 2006, the Company s Board of Directors rescinded all previously approved stock repurchase programs in conjunction with the approval of a new program, which authorizes the repurchase of up to 5.0 million shares of the Company s common stock. On February 7, 2007, the Company s Board of Directors, in anticipation of a planned 1.5 million share repurchase, authorized the reinstatement of those shares to its existing 5.0 million share authorization. On February 8, 2007, the Company completed the repurchase of 1.5 million shares of its common stock at a cost of $56.7 million; accordingly, 5.0 million shares remain available for repurchase. The Company did not repurchase any of its common stock in 2005.

Although the ultimate determination of whether to pay dividends is within the sole discretion of the Board of Directors, the Company plans to increase dividends as earnings grow. Dividends per common share were $.95 in 2006, $.91 in 2005 and $.87 in 2004. On February 7, 2007, the Company declared a regular quarterly dividend of $.24 per common share payable on March 9, 2007, to shareholders of record on February 23, 2007.

Off-Balance Sheet Arrangements

The Company had no material off-balance sheet arrangements at December 31, 2006.

Risk Management

As a result of operating globally, the Company is exposed to changes in foreign exchange rates. The exposure is well diversified as the Company s facilities are spread throughout the world, and the Company generally sells in the same countries where it produces. The Company monitors these exposures and may use traditional currency swaps and forward foreign exchange contracts to hedge a portion of the forecasted transactions that are denominated in foreign currencies, foreign currency assets and liabilities or net investment in foreign subsidiaries. The Company s foreign operations are exposed to political and cultural risks, but the risks are mitigated by diversification and the relative stability of the countries in which the Company has significant operations.

The Company is exposed to interest-rate fluctuations as a result of using debt as a source of financing its operations. When necessary, the Company uses traditional, unleveraged interest-rate swaps to manage its mix of fixed and variable rate debt to maintain its exposure to interest rate movements within established ranges. No such instruments were outstanding at December 31, 2006.

The Company is a purchaser of commodities such as recovered paper, energy, steel, aluminum and resin. The Company does not engage in material hedging activities, other than for energy, because there is usually a high correlation between the commodity cost and the ultimate selling price of its products. Commodities are generally purchased at market or fixed prices that are established with the vendor as part of the purchase process for quantities expected to be consumed in the ordinary course of business. On occasion, where the correlation between selling price and commodity price is less direct, the Company may enter into commodity futures or swaps to reduce the effect of price fluctuations.

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At the end of 2006, the Company had contracts outstanding to fix the costs of a portion of commodity, energy and foreign exchange risks for 2007 through June 2010. The swaps qualify as cash flow hedges under Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (FAS 133). As of December 31, 2006, the Company had swaps to cover approximately 8.0 million MMBTUs of natural gas. The hedged natural gas quantities at this date represent approximately 75%, 56%, 31%, and 6% of anticipated U.S. and Canadian usage for 2007, 2008, 2009 and 2010, respectively. The use of derivatives to hedge other commodities or foreign exchange was not material as of that date.

The fair market value of derivatives was a net unfavorable position of $3.2 million ($2.1 million after tax) and a net favorable position of $17.5 million ($11.2 million after tax) at December 31, 2006 and 2005, respectively. Derivatives having a favorable position are reflected as a component of Other Assets on the Company s Consolidated Financial Statements while those having an unfavorable position are reflected as a component of Other Liabilities. Derivatives are marked to fair value using published market prices, if available, or estimated values based on current price quotes and a discounted cash flow model. See Note 9 to the Consolidated Financial Statements for more information on financial instruments.

The Company is subject to various federal, state and local environmental laws and regulations concerning, among other matters, solid waste disposal, wastewater effluent and air emissions. Although the costs of compliance have not been significant due to the nature of the materials and processes used in manufacturing operations, such laws also make generators of hazardous wastes and their legal successors financially responsible for the cleanup of sites contaminated by those wastes. The Company has been named a potentially responsible party at several environmentally contaminated sites, both owned and not owned by the Company. These regulatory actions and a small number of private party lawsuits are believed to represent the Company s largest potential environmental liabilities. Accordingly, the Company has accrued $15.3 million (including $11.7 million associated with U.S. Mills) at December 31, 2006, compared with $16.8 million at December 31, 2005 (including $12.5 million associated with U.S. Mills), with respect to these sites. See Other Special Charges, Income Items and Contingencies above, Item 3 Legal Proceedings, and Note 13 to the Consolidated Financial Statements for more information on environmental matters.

Results of Operations 2005 versus 2004

Net income for 2005 was $161.9 million, compared with $151.2 million in 2004. This year-over-year increase in net income is largely attributable to higher operating profits in 2005, which increased primarily due to savings resulting from ongoing productivity and purchasing initiatives. The Company experienced a favorable price/cost relationship as sales price increases more than offset higher material costs, most notably in the Tubes and Cores/Paper segment. The full-year impact of acquisitions also contributed to earnings growth. Operating profits for 2005 were negatively impacted by higher energy, labor and freight costs, as well as startup costs associated with the Company s rigid plastic container plant in Wisconsin. Volume, excluding acquisitions, while contributing favorably to the sales growth, had a negligible impact on profits, as the change in the mix of products sold had an unfavorable effect on operating profits. In addition, approximately $24.8 million of the increased sales in the service centers were on a pass-through basis, with no significant gross margin, and therefore had very little impact on profits. Gross profit as a percentage of net sales was 18.7% in 2005, compared with 18.2% in 2004.

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Operating Revenue

Consolidated net sales for 2005 were $3.53 billion, versus $3.16 billion in 2004, resulting in an increase of approximately $373 million.

The components of the sales change were approximately:

($ in millions)

Volume	$100
Selling price	60
Currency exchange rate	43
Acquisitions	167
Other	3
Total sales increase	$373

Sales increased primarily due to the full-year impact of the CorrFlex acquisition and the Sonoco-Alcore joint venture, which increased sales by $80 million and $87 million, respectively. Company-wide volume, excluding the increased service revenue in the service centers, which was on a pass-through basis, was approximately 2.4% higher than 2004 levels, driven by increases in the Consumer Packaging and Packaging Services segments. Higher selling prices for rigid paper and plastic packaging, closures, North American tubes and cores, paperboard, wire and cable reels, and molded and extruded plastics, along with the favorable impact of exchange rates as the dollar weakened against foreign currencies, also contributed to the sales gain. Domestic sales were $2.3 billion, up 9.1% from 2004, and international sales were $1.2 billion, up 17.4% over 2004, driven primarily by the impact of a full-year of sales from Sonoco-Alcore and the impact of currency translation discussed above.

Costs and Expenses

During 2005, the Company experienced postretirement and defined-benefit pension expense of $43.0 million, versus $45.8 million in 2004, a decrease of $2.3 million. The market value of U.S. defined benefit pension plan assets increased approximately 7% in 2005 and 13% in 2004. Investment returns on assets held by the Company s benefit plans are used to lower the Company s cost of providing pension and postretirement benefits. Although there was no requirement under the Employee Retirement Income Security Act of 1974 to fund the U.S. defined benefit pension plan, the Company contributed $68.0 million to the plan during the year to maintain its fully funded status on an accumulated benefit obligation basis. Other pension plans in the Company were not fully funded as of December 31, 2005. These plans, including the Supplemental Executive Retirement Plan, and several international plans had accrued liabilities associated with their plans of $82.3 million and $51.3 million as of December 31, 2005, respectively. For 2005, the Company used 8.5% as its expected long-term rate of return for U.S. pension and postretirement benefit plan assumptions.

Selling, general and administrative expenses as a percentage of sales increased slightly during the year to 10.3% from 9.8% in 2004. Included in 2005 expenses was the $12.5 million expense of establishing an environmental reserve at the Company s subsidiary in Wisconsin, while 2004 costs included charges of $5.6 million pretax, which the Company incurred to recognize commitments to pay future costs associated with new executive life insurance benefits and a charge of approximately $4.5 million pretax associated with an unfavorable legal judgment that was entered against the Company.

As previously discussed, operating profits included $21.2 million and $19.0 million of restructuring charges in 2005 and 2004, respectively.

Research and development costs, all of which were charged to expense, totaled $14.7 million and $15.4 million in 2005 and 2004, respectively. Significant projects in the Company s Tubes and Cores/Paper segment during 2005 included efforts to design and develop a new generation of products for the construction industry, and to enhance performance characteristics of the Company s tubes and cores in the textile, film and paper packaging areas, as well as

projects aimed at enhancing productivity. The Consumer Packaging

segment continued to invest in development of specialty metal closures, flexible packaging enhancements and rigid plastic containers technology.

Net interest expense increased by approximately $1.5 million from $42.1 million in 2004 to $43.6 million in 2005. The increase in net interest expense resulted primarily from higher average interest rates, partially offset by decreased debt levels and increased interest income.

The effective tax rate in 2005 was 36.4%, compared with 29.8% in 2004. Included in the effective tax rate for 2005 was the impact of an additional $10.1 million expense associated with the repatriation of $124.7 million in foreign earnings under the American Jobs Creation Act. Included in the effective tax rate for 2004 was the impact of the recognition of tax benefits totaling approximately $9.7 million, resulting from the conclusions of examinations by the IRS and state tax authorities.

Operating Segments

Consolidated operating profits, which represent Income before income taxes on the Consolidated Statements of Income for 2005 and 2004, are comprised of the following:

($ in millions)	**2005**	**2004**	**% Change**
Consumer Packaging Segment	$103.5	$ 83.1	24.5%
Tubes and Cores/Paper Segment	107.0	113.0	(5.3)%
Packaging Services Segment	44.8	30.3	47.9%
All Other Sonoco	40.6	32.0	26.9%
Restructuring and related impairment charges	(21.2)	(19.0)	(11.6)%
Interest expense, net	(43.6)	(42.1)	(3.6)%
Consolidated operating profits	$231.1	$197.3	17.1%

Consumer Packaging Segment Results for this segment are presented as follows:

($ in millions)	**2005**	**2004**	**% Change**
Trade sales	$1,247.5	$1,132.1	10.2%
Segment operating profits	103.5	83.1	24.5%
Depreciation, depletion and amortization	56.3	59.4	(5.2)%
Capital spending	50.8	50.7	0.2%

Sales in this segment increased due to increased selling prices of closures, composite cans and plastic packaging. Higher volumes throughout the segment, but specifically in flexible packaging, also contributed significantly to the sales increases, as did the impact of favorable exchange rates, as the dollar weakened against foreign currencies. Overall, volumes were up nearly 5% in the segment. Domestic sales were approximately $894 million, up 6.6% from 2004, and international sales were approximately $353 million, up 20.6% from 2004.

Segment operating profits were favorably impacted by increased volumes, as well as productivity and purchasing initiatives, partially offset by increased costs of energy, freight and labor. Continued high startup costs at the Company s rigid plastics container plant in Wisconsin also reduced operating profits in the segment. Higher raw material costs, primarily steel and aluminum, were largely offset by increased selling prices.

Significant spending included numerous productivity and customer development projects in the United States and Europe. The closures business continued to invest in new capacity in Brazil to support increasing global demand.

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Tubes and Cores/Paper Segment Results for this segment are presented as follows:

($ in millions)	**2005**	**2004**	**% Change**
Trade sales	$1,482.1	$1,388.5	6.7%
Segment operating profits	107.1	113.0	(5.2)%
Depreciation, depletion and amortization	83.7	85.2	(1.8)%
Capital spending	62.3	59.4	4.9%

The increase in sales was due primarily to the recognition of a full-year s impact of the Sonoco-Alcore joint venture, which resulted in $86.6 million of higher sales. The impact of favorable exchange rates as the dollar weakened against foreign currencies along with increased selling prices, were partially offset by lower volume in North American and European tubes and cores. Volume, excluding the impact of the joint venture, declined approximately 2%, due primarily to declines in the textile and newsprint industries. Domestic sales decreased approximately $4 million, or .5%, to $758.0 million and international sales increased approximately $98 million, or 15.6% to $724.1 million. Segment operating profits were unfavorably impacted by a charge of $12.5 million related to an increase in the environmental reserve at a Company subsidiary s paper operations in Wisconsin; decreased volume, primarily in the textile and newsprint markets; and increased costs of energy, freight and labor. These increased costs were partially offset by year-over-year savings from productivity and purchasing initiatives, and a favorable price/cost relationship. A $5.6 million charge associated with an accounting adjustment from a wholly owned subsidiary in Spain, which was related to prior years, was recorded in 2004, as discussed above under Other Special Charges, Income Items and Contingencies, while 2005 results were impacted by a $3.0 million asset impairment charge related to operations in Asia.

This segment benefited by approximately $8.9 million from energy hedges in place during the period.

Significant capital spending included the rebuilding and modification of several paper mills, primarily in the United States, Mexico and Europe, and building new tube and core plants in Asia.

Packaging Services Segment Results for this segment are presented as follows:

($ in millions)	**2005**	**2004**	**% Change**
Trade sales	$455.9	$321.0	42.0%
Segment operating profits	44.8	30.3	47.9%
Depreciation, depletion and amortization	12.0	8.2	46.3%
Capital spending	4.9	3.3	48.5%

Sales in this segment increased primarily due to the recognition of a full-year s impact of the May 2004 acquisition of CorrFlex. In addition, higher volumes contributed $56.5 million to the increase in sales. Domestic sales increased to $356.7 million, a 43.9% increase, while international sales increased to $99.2 million, or 35.5%.

Although the increase in segment operating profits in this segment is largely attributable to the full-year s impact of the acquisition of CorrFlex, productivity and purchasing initiatives in the service centers also contributed to the improvement. Approximately $25 million of increased sales in the Company s service centers were on a pass-through basis and, therefore, had very little impact on profits. The impact of inflation partially offset the favorable variances discussed above.

Significant spending included numerous productivity and customer development projects in the United States and Europe.

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All Other Sonoco Results for all other businesses not included in the segments above are presented as follows:

($ in millions)	**2005**	**2004**	**% Change**
Trade sales	$343.2	$313.8	9.3%
Operating profits	40.6	32.0	26.9%
Depreciation, depletion and amortization	11.1	11.1	0.0%
Capital spending	11.1	6.4	73.4%

Sales for All Other Sonoco increased due to price increases for molded and extruded plastics, wire and cable reels, and protective packaging, along with higher volumes in wire and cable reels and protective packaging. Domestic sales were approximately $283 million, up 11.5% from 2004, and international sales were approximately $60 million, basically flat compared with the prior year.

Operating profits in All Other Sonoco increased primarily due to manufacturing productivity and purchasing initiatives and a favorable price/cost relationship, as the Company was able to recover increases in raw material costs, including lumber, resin and paper, via price increases to the customers. Although higher volume was a significant reason for the increased sales, operating profits were not impacted materially as changes in the mix of products resulted in lower profit margins.

Significant spending included investing in customer development projects in the United States and Europe for molded and extruded plastics, protective packaging and wire and cable reels.

Critical Accounting Policies and Estimates

Management s analysis and discussion of the Company s financial condition and results of operations are based upon the Company s Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States (US GAAP). The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities. The Company evaluates these estimates and assumptions on an ongoing basis, including but not limited to those related to inventories, bad debts, derivatives, income taxes, intangible assets, restructuring, pension and other postretirement benefits, environmental liabilities and contingencies and litigation. Estimates and assumptions are based on historical and other factors believed to be reasonable under the circumstances. The results of these estimates may form the basis of the carrying value of certain assets and liabilities and may not be readily apparent from other sources. Actual results, under conditions and circumstances different from those assumed, may differ from estimates. The impact and any associated risks related to estimates, assumptions and accounting policies are discussed in Management s Discussion and Analysis of Financial Condition and Results of Operations, as well as in the Notes to the Consolidated Financial Statements, if applicable, where such estimates, assumptions and accounting policies affect the Company s reported and expected financial results.

The Company believes the accounting policies discussed in the Notes to the Consolidated Financial Statements on pages F-7 through F-41 are critical to understanding the results of its operations. The following discussion represents those policies that involve the more significant judgments and estimates used in the preparation of the Company s Consolidated Financial Statements.

Impairment of Long-lived, Intangible, and Other Assets

Assumptions and estimates used in the evaluation of potential impairment may affect the carrying values of long-lived, intangible and other assets and possible impairment expense in the Company s Consolidated Financial Statements. The Company evaluates its long-lived assets (property, plant and equipment), definite-lived intangible assets, and other assets (including notes receivable and preferred stock) for impairment whenever indicators of impairment exist, or when it commits to sell the

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asset. If the sum of the undiscounted expected future cash flows from a long-lived asset or definite-lived intangible asset is less than the carrying value of that asset, an asset impairment charge is recognized. The amount of the impairment charge is calculated as the excess of the asset s carrying value over its fair value, which generally represents the discounted future cash flows from that asset, or in the case of assets the Company evaluates for sale, at fair value less costs to sell. A number of significant assumptions and estimates are involved in developing operating cash flow forecasts for the Company s discounted cash flow model, including markets and market share, sales volumes and prices, costs to produce, working capital changes and capital spending requirements. The Company considers historical experience, and all available information at the time the fair values of its assets are estimated. However, fair values that could be realized in an actual transaction may differ from those used to evaluate impairment. In addition, changes in the assumptions and estimates may result in a different conclusion regarding impairment.

Impairment of Goodwill

In accordance with Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (FAS 142), the Company evaluates its goodwill for impairment at least annually, and more frequently if indicators of impairment are present. FAS 142 requires that if the fair value of a reporting unit is less than its carrying value including goodwill, an impairment charge for goodwill must be recognized. The impairment charge is calculated as the difference between the implied fair value of the reporting unit goodwill and its carrying value.

The Company s reporting units are the same as its operating segments, as determined in accordance with FAS 131. Accordingly, these reporting units reflect the way the Company manages its business, and impairment testing at this reporting unit level reflects how the Company is managed overall. The components within these reporting units serve similar types of customers, provide similar services, and operate in similar regulatory environments. The benefits of goodwill are shared by each component.

In performing the impairment evaluation required by FAS 142, the Company estimates the fair value of each reporting unit and compares it to the carrying amount of that reporting unit. If the carrying amount of a reporting unit exceeds the fair value of that reporting unit, the Company compares the implied fair value of the reporting unit goodwill with the carrying amount of the reporting unit goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit to all of the assets (recognized and unrecognized), and liabilities of the reporting unit. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill. The excess, if any, of the carrying value over the implied fair value represents the amount of the impairment. That excess would be reflected as a loss on the income statement.

The Company uses a discounted cash flow model to estimate the fair value of each reporting unit. The Company considers historical experience and all available information at the time the fair values of its businesses are estimated. Key assumptions and estimates used in the cash flow model include discount rate, sales growth, margins and capital expenditures and working capital requirements. Fair values that could be realized in an actual transaction may differ from those used to evaluate the impairment of goodwill. In addition, changes in the assumptions and estimates may result in a different conclusion regarding impairment.

The annual evaluation of goodwill impairment that was completed during 2006 used forward-looking projections, including expected improvement in the results of certain reporting units, most notably, the European operations within the Tubes and Cores/Paper segment. The assessment of the relevant facts and circumstances is ongoing, and if actual performance in this reporting unit falls significantly short of the projected results, it is reasonably possible that a non-cash impairment charge would be required.

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Income Taxes

The Company records an income tax valuation allowance when the realization of certain deferred tax assets, net operating losses and capital loss carryforwards is not likely. These deferred tax assets represent expenses recognized for financial reporting purposes, which will result in tax deductions over varying future periods. Certain judgments, assumptions and estimates may affect the amounts of the valuation allowance and deferred income tax expense in the Company s Consolidated Financial Statements. Additionally, the Company periodically reviews assumptions and estimates of the Company s probable tax obligations using historical experience in tax jurisdictions and informed judgments.

Stock Compensation Plans

Effective January 1, 2006, the Company adopted the fair value method of accounting for share-based compensation arrangements in accordance with Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (FAS 123(R)), using the modified prospective method of transition. Using the modified prospective method, compensation expense is recognized beginning at the effective date of adoption of FAS 123(R) for all share-based payments (i) granted after the effective date of adoption and (ii) granted prior to the effective date of adoption and that remain unvested on the date of adoption. The Company had no unvested stock options outstanding at the date of adoption. The Company recognizes share-based compensation cost ratably over expected vesting periods.

In accordance with the adoption of FAS 123(R), the Company chose to adopt the short-cut method to determine the pool of windfall tax benefits as it relates to stock-based compensation.

Certain awards are in the form of contingent stock units where both the ultimate number of units and the vesting period are performance-based. The amount and timing of compensation expense associated with these performance-based awards are based on estimates regarding future performance using measures defined in the plan. In 2006, the performance measures consisted of Earnings per Share and Return on Net Assets Employed. Changes in estimates regarding the future achievement of these performance measures may result in significant fluctuations from period to period in the amount of compensation expense reflected in the Company s Consolidated Financial Statements.

The Company uses the binomial option-pricing model to determine the grant date fair value of its stock options and stock appreciation rights. The binomial option-pricing model requires the input of highly subjective assumptions. Management routinely assesses the assumptions and methodologies used to calculate estimated fair value of share-based compensation. Circumstan