

PLANETOUT INC
Form 10-Q
August 09, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q

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

For the quarterly period ended: June 30, 2006

or

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

For the transition period from _____ to _____

Commission File Number: 000-50879
PLANETOUT INC.

(Exact Name of Registrant as Specified in Its Charter)

DELAWARE

(State or Other Jurisdiction of Incorporation or
Organization)

94-3391368

(I.R.S. Employer Identification No.)

**1355 SANSOME STREET, SAN FRANCISCO,
CALIFORNIA**

(Address of Principal Executive Offices)

94111

(Zip Code)

(415) 834-6500

(Registrant's Telephone Number, Including Area Code)

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. ☒ Yes ☐ No

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

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

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

The number of shares outstanding of the registrant's Common Stock, \$0.001 par value, as of August 1, 2006 was 17,489,562.

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Form 10-Q
For the Quarter ended June 30, 2006

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PART I
FINANCIAL INFORMATION
PlanetOut Inc.

Item 1. Unaudited Condensed Consolidated Financial Statements**UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS****(in thousands, except per share amounts)**

	December 31, 2005	June 30, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 18,461	\$ 4,877
Restricted cash		4,793
Accounts receivable, net	6,030	7,839
Inventory	1,349	1,390
Prepaid expenses and other current assets	2,571	10,056
 Total current assets	 28,411	 28,955
Property and equipment, net	8,167	8,449
Goodwill	28,699	32,572
Intangible assets, net	10,909	12,934
Other assets	1,152	1,602
 Total assets	 \$ 77,338	 \$ 84,512
 LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,334	\$ 1,626
Accrued liabilities	2,750	3,316
Accrued restructuring		793
Deferred revenue, current portion	8,749	13,303
Capital lease obligations, current portion	309	293
Notes payable, current portion	222	2,446
Deferred rent, current portion	286	345
 Total current liabilities	 13,650	 22,122
Deferred revenue, less current portion	1,771	2,268
Capital lease obligations, less current portion	212	434
Notes payable, less current portion	7,075	4,716
Deferred rent, less current portion	1,578	1,477
 Total liabilities	 24,286	 31,017

Minority interest in consolidated subsidiaries		47
Stockholders' equity:		
Common stock: \$0.001 par value, 100,000 shares authorized, 17,248 and 17,340 shares issued and outstanding at December 31, 2005 and June 30, 2006, respectively	17	17
Additional paid-in capital	88,333	88,625
Note receivable from stockholder	(603)	
Accumulated other comprehensive loss	(123)	(136)
Accumulated deficit	(34,572)	(35,058)
Total stockholders' equity	53,052	53,448
Total liabilities and stockholders' equity	\$ 77,338	\$ 84,512

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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PlanetOut Inc.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)

	Three months ended June 30,		Six months ended June 30,	
	2005	2006	2005	2006
Revenue:				
Advertising services	\$ 2,566	\$ 7,318	\$ 3,958	\$ 12,665
Subscription services	5,172	6,321	10,025	12,591
Transaction services	332	2,656	752	8,612
 Total revenue	 8,070	 16,295	 14,735	 33,868
Operating costs and expenses: (*)				
Cost of revenue	2,320	6,872	4,445	16,302
Sales and marketing	2,532	4,427	4,988	8,371
General and administrative	1,615	3,078	2,863	6,158
Restructuring		834		834
Depreciation and amortization	848	1,300	1,668	2,524
 Total operating costs and expenses	 7,315	 16,511	 13,964	 34,189
Income (loss) from operations	755	(216)	771	(321)
Equity in net loss of unconsolidated affiliate	(16)		(25)	
Interest expense	(30)	(201)	(68)	(398)
Other income, net	313	110	552	280
 Income (loss) before income taxes and minority interest	 1,022	 (307)	 1,230	 (439)
Provision for income taxes	(12)		(41)	
Minority interest in gain of consolidated affiliate		(47)		(47)
 Net income (loss)	 \$ 1,010	 \$ (354)	 \$ 1,189	 \$ (486)
 Net income (loss) per share:				
Basic	\$ 0.06	\$ (0.02)	\$ 0.07	\$ (0.03)
Diluted	\$ 0.06	\$ (0.02)	\$ 0.07	\$ (0.03)

Weighted-average shares used to
compute net income (loss) per share:

Basic	17,092	17,315	17,015	17,288
Diluted	18,249	17,315	18,192	17,288

(*) Includes stock-based compensation (benefit) as follows (see Note 2):

Cost of revenue	\$ 15	\$ 1	\$ 27	\$ 6
Sales and marketing	18	1	25	2
General and administrative	109	(101)	66	(22)
Total stock-based compensation (benefit)	\$ 142	\$ (99)	\$ 118	\$ (14)

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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PlanetOut Inc.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Six months ended June 30,	
	2005	2006
Cash flows from operating activities:		
Net income (loss)	\$ 1,189	\$ (486)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,668	2,524
Provision for doubtful accounts	26	226
Restructuring		41
Stock-based compensation expense (benefit)	118	(14)
Amortization of deferred rent	224	(40)
Loss on disposal or write-off of property and equipment	(1)	21
Equity in net loss of unconsolidated affiliate	25	
Minority interest		47
Changes in operating assets and liabilities, net of acquisition effects and restructuring:		
Accounts receivable	(368)	(1,774)
Inventory		(41)
Prepaid expenses and other assets	289	(3,216)
Accounts payable	(1,384)	216
Accrued and other liabilities	690	528
Accrued restructuring		793
Deferred revenue	635	(1,311)
Net cash provided by (used in) operating activities	3,111	(2,486)
Cash flows from investing activities:		
Acquisitions, net of cash acquired		(5,403)
Purchases of property and equipment	(2,659)	(1,554)
Changes in restricted cash		(4,793)
Net cash used in investing activities	(2,659)	(11,750)
Cash flows from financing activities:		
Proceeds from exercise of common stock options and warrants	431	306
Proceeds from repayment of note receivable from stockholder		843
Principal payments under capital lease obligations and notes payable	(774)	(484)
Net cash provided by (used in) financing activities	(343)	665
Effect of exchange rate on cash and cash equivalents	(8)	(13)

Net increase (decrease) in cash and cash equivalents	101	(13,584)
Cash and cash equivalents, beginning of period	43,128	18,461
Cash and cash equivalents, end of period	\$ 43,229	\$ 4,877
Supplemental disclosure of noncash flow investing and financing activities:		
Property and equipment and related maintenance acquired under capital leases	\$ 34	\$ 651
Unearned stock-based compensation	\$ 399	\$

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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PlanetOut Inc.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 The Company

PlanetOut Inc. (the Company) is a leading global media and entertainment company serving the worldwide lesbian, gay, bisexual and transgender, or LGBT, community. The Company serves this audience through a wide variety of media properties, including leading LGBT-focused websites, such as Gay.com, PlanetOut.com, Advocate.com and Out.com, and magazines, such as *The Advocate*, *Out*, *The Out Traveler* and *HIVPlus*, among others. Through these media properties and other marketing vehicles, such as live events, the Company generates revenue from a combination of advertising, subscription and transaction services, including those obtained in the Company's acquisition in November 2005 of LPI Media, Inc. and related entities (LPI). The Company also expanded the number and scope of its subscription service offerings with this acquisition. In addition to premium subscriptions on its Gay.com and PlanetOut.com services, the Company offers its customers subscriptions to eight other online and print products and services.

Through the Company's acquisition in March 2006 of RSVP Productions, Inc. (RSVP), the Company also became a leading marketer of gay and lesbian travel and events, including cruises, land tours and resort vacations. The Company also offers its customers access to specialized products and services through its transaction-based websites, including Kleptomaniac.com and BuyGay.com, that generate revenue through sales of products and services of interest to the LGBT community, including fashion, video and music products. The Company generates transaction revenue from third-party websites and partners for the sale of products and services to its users as well as through newsstand sales of its various print properties.

Note 2 Basis of Presentation and Summary of Significant Accounting Policies

Unaudited Interim Financial Information

The accompanying unaudited condensed consolidated financial statements have been prepared and reflect all adjustments, consisting only of normal recurring adjustments, which in the opinion of management are necessary to state fairly the financial position and the results of operations for the interim periods. The balance sheet at December 31, 2005 has been derived from audited financial statements at that date. The unaudited condensed consolidated financial statements have been prepared in accordance with the regulations of the Securities and Exchange Commission (SEC), but omit certain information and footnote disclosures necessary to present the statements in accordance with generally accepted accounting principles. Results of interim periods are not necessarily indicative of results for the entire year. These unaudited condensed consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries and variable interest entities in which the Company has been determined to be the primary beneficiary. The Company recognizes minority interest for subsidiaries or variable interest entities where it owns less than 100% of the equity of the subsidiary. The recording of minority interest eliminates a portion of operating results equal to the percentage of equity it does not own. The Company discontinues allocating losses to the minority interest when the minority interest is reduced to zero. All significant intercompany transactions and balances have been eliminated in consolidation.

Reclassifications

Certain reclassifications have been made in the prior consolidated financial statements to conform to the current year presentation. These reclassifications did not change the previously reported net income or net income per share of the Company.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Significant estimates and assumptions made by management include, among others, the assessment of collectibility of accounts receivable, the determination of the

allowance for doubtful accounts, the determination of the reserve for inventory obsolescence, the determination of the fair market value of its common stock, the valuation and useful life of its capitalized software and long-lived assets and the valuation of deferred tax asset balances. Actual results could differ from those estimates.

Table of Contents***Restricted Cash***

Restricted cash consists of cash that is restricted as to future use by contractual agreements associated with irrevocable letters of credit relating to a lease agreement for one of the Company's offices in New York and relating to a lease agreement with a cruise line securing future deposit commitments required under that agreement.

Approximately \$2,050,000 of the restricted cash related to future deposit commitments will be applied against the commitments for future deposits during the remainder of 2006 and approximately \$2,583,000 of the restricted cash related to future deposit commitments will be applied against the commitments for future deposits in March 2007.

Inventory

Inventory consists of finished goods held for sale and materials related to the production of future publications such as editorial and artwork costs, books, paper, other publishing and novelty products and shipping materials. Inventory is stated at the lower of cost or market. Cost is determined using the weighted-average cost method for finished goods available for sale and using the first-in, first-out method for materials related to future production.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is calculated using the straight-line method over the estimated useful lives of the related assets ranging from three to five years. Leasehold improvements are amortized over the shorter of their economic lives or lease term, generally ranging from two to seven years. Maintenance and repairs are charged to expense as incurred. When assets are retired or otherwise disposed of, the cost and accumulated depreciation and amortization are removed from the accounts and any resulting gain or loss is reflected in the consolidated statements of operations in the period realized.

Leasehold improvements made by the Company and reimbursable by the landlord as tenant incentives are recorded by the Company as leasehold improvement assets and amortized over a term consistent with the above guidance. The incentives from the landlord are recorded as deferred rent and amortized as reductions to rent expense over the lease term. At December 31, 2005 and June 30, 2006, the balance of these leasehold improvement allowances was \$1,402,000. During the three months ended June 30, 2005 and 2006, the Company amortized \$47,000 and \$49,000, respectively, as a reduction of rent expense in the accompanying unaudited condensed consolidated statements of operations. During the six months ended June 30, 2005 and 2006, the Company amortized \$92,000 and \$97,000, respectively, as a reduction of rent expense in the accompanying unaudited condensed consolidated statements of operations. At December 31, 2005 and June 30, 2006, the deferred rent balance attributable to these incentives totaled \$1,179,000 and \$1,082,000, respectively. Future amortization of the balance of these tenant incentives is estimated to be \$96,000 for the six remaining months of 2006, \$194,000 each year for 2007 to 2011, and \$16,000 in 2012. At December 31, 2005 and June 30, 2006, the Company had receivable balances for tenant incentives of \$243,000 and zero, respectively, recorded under prepaid expenses and other current assets in the accompanying unaudited condensed consolidated balance sheets.

Internal Use Software and Website Development Costs

The Company capitalizes internally developed software costs in accordance with the provisions of American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 98-1, *Accounting for Costs of Computer Software Developed or Obtained for Internal Use* (SOP 98-1) and Emerging Issues Task Force (EITF) Abstract No. 00-02, *Accounting for Web Site Development Costs* (EITF 00-02). Capitalized costs are amortized on a straight-line basis over the estimated useful life of the software, generally three years, once it is available for its intended use. During the three months ended June 30, 2005 and 2006, the Company capitalized costs of \$573,000 and \$456,000, respectively, and recorded \$207,000 and \$339,000 of related amortization expense, respectively. During the six months ended June 30, 2005 and 2006, the Company capitalized costs of \$1,190,000 and \$779,000, respectively, and recorded \$381,000 and \$664,000 of related amortization expense, respectively. The capitalized costs for the three months ended June 30, 2005 and 2006 included \$316,000 and \$87,000, respectively, paid to external consultants for website development. The capitalized costs for the six months ended June 30, 2005 and 2006 included \$715,000 and \$202,000, respectively, paid to external consultants for website development.

Goodwill

The Company accounts for goodwill using the provisions of Statement of Financial Accounting Standards (SFAS) No. 142 (FAS 142), *Goodwill and Other Intangible Assets*. FAS 142 requires that goodwill be tested for

impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis and between annual tests in certain circumstances. The performance of the test involves a two-step process. The first step of the impairment test involves comparing the fair value of the Company's reporting unit with the reporting unit's carrying amount, including goodwill. The Company generally

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determines the fair value of its reporting unit using the expected present value of future cash flows, giving consideration to the market comparable approach. If the carrying amount of the Company's reporting unit exceeds the reporting unit's fair value, the Company performs the second step of the goodwill impairment test. The second step of the goodwill impairment test involves comparing the implied fair value of the Company's reporting unit's goodwill with the carrying amount of the unit's goodwill. If the carrying amount of the reporting unit's goodwill is greater than the implied fair value of its goodwill, an impairment charge is recognized for the excess. The Company determined that it has one reporting unit. The Company performed its annual test on December 1, 2005. The results of Step 1 of the goodwill impairment analysis showed that goodwill was not impaired as the estimated market value of its one reporting unit exceeded its carrying value, including goodwill. Accordingly, Step 2 was not performed. The Company will continue to test for impairment on an annual basis and on an interim basis if an event occurs or circumstances change that would more likely than not reduce the fair value of the Company's reporting unit below its carrying amounts.

Revenue Recognition

The Company's revenue is derived principally from the sale of premium online subscription services, magazine subscriptions, banner and sponsorship advertisements, magazine advertisements and transactions services. Premium online subscription services are generally for a period of one to twelve months. Premium online subscription services are generally paid for upfront by credit card, subject to cancellations by subscribers or charge backs from transaction processors. Revenue, net of estimated cancellations and charge backs, is recognized ratably over the service term. To date, cancellations and charge backs have not been significant and have been within management's expectations. The Company provides an estimated reserve for magazine subscription cancellations at the time such subscription revenues are recorded. In January 2006, the Company began offering its customers premium online subscription services bundled with magazine subscriptions. In accordance with EITF Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables* (EITF 00-21), the Company defers subscription revenue on bundled subscription service offerings based on the pro-rata fair value of the individual premium online subscription services and magazine subscriptions.

To date, the duration of the Company's banner advertising commitments has ranged from one week to one year. Sponsorship advertising contracts have terms ranging from three months to two years and also involve more integration with the Company's services, such as the placement of buttons that provide users with direct links to the advertiser's website. Advertising revenue on both banner and sponsorship contracts are recognized ratably over the term of the contract, provided that no significant Company obligations remain at the end of a period and collection of the resulting receivables is reasonably assured, at the lesser of the ratio of impressions delivered over the total number of undertaken impressions or the straight-line basis. Company obligations typically include undertakings to deliver a minimum number of impressions, or times that an advertisement appears in pages viewed by users of the Company's online properties. To the extent that these minimums are not met, the Company defers recognition of the corresponding revenue until the minimums are achieved. Magazine advertising revenues are recognized, net of related agency commissions, on the date the magazines are placed on sale at the newsstands. Revenues received for advertisements in magazines to go on sale in future months are classified as deferred advertising revenue.

Transaction service revenue generated from the sale of products held in inventory is recognized when the product is shipped, net of estimated returns. The Company also earns commissions for facilitating the sale of third party products and services which are recognized when earned based on reports provided by third party vendors or upon cash receipt if no reports are provided. In accordance with EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal Versus Net as an Agent*, the revenue earned for facilitating the sale of third party merchandise is reported net of cost as agent. This revenue is reported net due to the fact that though the Company receives the order and collects money from buyer, the Company is under no obligation to make payment to the third party unless payment has been received from the buyer and risk of return is also borne by the third party. The Company recognizes transaction service revenue from its event marketing and travel events services which include cruises, land tours and resort vacations, together with revenues from onboard and other activities and all associated direct costs of its event marketing and travel events services, upon the completion of events with durations of ten nights or less and on a pro rata basis for events in excess of ten nights.

Advertising

Costs related to advertising and promotion are charged to sales and marketing expense as incurred except for direct-response advertising costs which are amortized over the expected life of the subscription, typically a twelve month period. Direct-response advertising costs consist primarily of production costs associated with direct-mail promotion of magazine subscriptions. As of December 31, 2005 and June 30, 2006, the balance of unamortized direct-response advertising costs was \$173,000 and \$1,325,000, respectively, and is included in prepaid expenses and other current assets. Total advertising costs in the three months ended June 30, 2005 and 2006 were \$911,000 and \$875,000, respectively. Total advertising costs in the six months ended June 30, 2005 and 2006 were \$1,520,000 and \$1,786,000, respectively.

Table of Contents***Equity Incentive Plans***

The Company has equity incentive plans for directors, officers, employees and non-employees. Stock options granted under these plans generally vest over two to four years, are generally exercisable at the date of grant with unvested shares subject to repurchase by the Company and expire within 10 years from the date of grant. As of June 30, 2006, the Company has reserved an aggregate of approximately 3,241,000 shares of common stock for issuance under its equity incentive plans.

Stock-Based Compensation

On January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), *Share-Based Payment* (FAS 123R), that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for equity instruments of the enterprise. The statement eliminates the ability to account for share-based compensation transactions, as the Company formerly did, using the intrinsic value method as prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and generally requires that such transactions be accounted for using a fair-value-based method and recognized as expense in its consolidated statements of operations.

The Company adopted FAS 123R using the modified prospective method which requires the application of the accounting standard as of January 1, 2006. The Company's consolidated financial statements as of and for the six months ended June 30, 2006 reflect the impact of adopting FAS 123R. In accordance with the modified prospective method, the consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of FAS 123R.

Stock-based compensation expense recognized during the period is based on the value of the portion of stock-based payment awards that is ultimately expected to vest. Stock-based compensation expense recognized in the condensed consolidated statement of operations during the three and six months ended June 30, 2006 included compensation expense for stock-based payment awards granted prior to, but not yet vested, as of December 31, 2005 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS No. 148, *Accounting for Stock-based Compensation Transition and Disclosure (as amended)* (FAS 148) and compensation expense for the stock-based payment awards granted subsequent to December 31, 2005, based on the grant date fair value estimated in accordance with FAS 123R. As stock-based compensation expense recognized in the condensed consolidated statement of operations for the three and six months ended June 30, 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. FAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the pro forma information required under FAS 148 for the periods prior to 2006, we accounted for forfeitures as they occurred. When estimating forfeitures, the Company considers historic voluntary termination behaviors as well as trends of actual option forfeitures. In anticipation of the impact of adopting FAS 123R, the Company accelerated the vesting of approximately 720,000 shares subject to outstanding stock options in December 2005. The primary purpose of the acceleration of vesting was to minimize the amount of compensation expense recognized in relation to the options in future periods following the adoption by the Company of FAS 123R. Since the Company accelerated these shares, the impact of adopting FAS 123R was not material, to date, to the Company's results of operations.

Prior to the adoption of FAS 123R, the Company provided the disclosures required under FAS 123, as amended by FAS 148. Employee stock-based compensation expense recognized under FAS 123R was not reflected in the Company's results of operations for the three and six months ended June 30, 2005 for employee stock option awards that were granted with an exercise price equal to the market value of the underlying common stock on the date of grant.

The pro forma information for the three and six months ended June 30, 2005 required under FAS 123 was as follows (in thousands, except per share amounts):

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	Three months ended June 30, 2005	Six months ended June 30, 2005
Net income, as reported:	\$ 1,010	\$ 1,189
Add: Employee stock-based compensation expense included in reported net income, net of tax	141	118
Less: Total employee stock-based compensation expense determined under fair value, net of tax	(316)	(401)
Pro forma net income	\$ 835	\$ 906
Net income per share		
As reported basic	\$ 0.06	\$ 0.07
As reported diluted	\$ 0.06	\$ 0.07
Pro forma basic	\$ 0.05	\$ 0.05
Pro forma diluted	\$ 0.05	\$ 0.05

Prior to adopting FAS 123R, the Company presented all tax benefits resulting from the exercise of stock options as operating cash flows in its statement of cash flows. FAS 123R requires cash flows resulting from excess tax benefits to be classified as a part of cash flows from financing activities. Excess tax benefits are realized tax benefits from tax deductions for exercised options in excess of the deferred tax asset attributable to stock compensation costs for such options. During the three and six months ended June 30, 2006, the Company has not recognized a material amount of excess tax benefits for deductions of disqualifying dispositions of such options.

The Company calculated the fair value of each option award on the date of grant using the Black-Scholes option pricing model. The following assumptions were used for each respective period:

	Six months ended June 30, 2005	2006
Expected lives (in years)	5	7
Risk free interest rates	3.59 - 4.13%	4.32 - 4.57%
Dividend yield	0%	0%
Volatility	85%	75%

The Company's computation of expected volatility for the six months ended June 30, 2006 is based on a combination of historical and market-based implied volatility from other equities comparable to the Company's stock. The Company's computation of expected life in 2006 was determined based on historical experience of similar awards, giving consideration to the contractual terms of the stock-based awards, vesting schedules and expectations of future employee behavior. The interest rate for periods within the contractual life of the award is based on the U.S. Treasury yield curve in effect at the time of grant.

The following table summarizes activity under our equity incentive plans for the six months ended June 30, 2006 (in thousands, except per share amounts):

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	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at January 1, 2006	2,112	\$ 5.03		
Granted	48	9.08		
Exercised	(79)	3.85		
Cancelled	(73)	7.08		
Outstanding at June 30, 2006	2,008	5.10	3.95	\$ 3,824
Vested and expected to vest at June 30, 2006	1,997	5.07	3.92	\$ 3,749
Options exercisable at June 30, 2006	1,939	5.00	3.77	\$ 3,874

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted price of our common stock for the 1,040,000 options that were in the money at June 30, 2006. During the three and six months ended June 30, 2006, the aggregate intrinsic value of options exercised under our stock option plans was approximately \$144,000 and \$424,000, respectively. As of June 30, 2006, there was approximately \$926,000 of total unrecognized compensation related to unvested stock-based compensation arrangements granted under the Company's equity incentive plans. That cost is expected to be recognized over a weighted-average period of four years.

Restricted Stock Grants

In January 2006, the Company granted 2,500 shares of restricted stock to a certain employee at no cost to the employee. Each restricted stock share represents one share of the Company's common stock, with the same voting and dividend rights as the Company's other outstanding common stock. The restricted stock shares vest over a period of four years with 25% vested on the anniversary date of the grant and 1/48th vesting each month thereafter. Unearned stock-based compensation related to the restricted shares is determined based on the fair value of the Company's stock on the date of grant, which was approximately \$21,000 and will be amortized to expense on a straight-line basis over the vesting period of which approximately \$1,000 and \$2,000 was recognized during the three and six months ended June 30, 2006, respectively.

Pursuant to the Outside Director Compensation Program adopted by the board of directors in December 2005, each non-employee director received an automatic annual grant of 2,000 shares of restricted stock on June 14, 2006, the date of the Company's annual meeting of stockholders. A total of 10,000 shares of restricted stock were granted and will vest quarterly over a one year period from the date of grant with 25% of the restricted shares vesting on the first day after the date of grant on which the Company's trading window opens pursuant to the Company's Insider Trading Policy during each fiscal quarter, unless the trading window does not open during a quarter, in which case such restricted shares will vest on the last business day immediately preceding the 16th day of the last month of that quarter. Unearned stock-based compensation related to the restricted shares is determined based on the fair value of the Company's stock on the date of grant, which was approximately \$67,000 and will be amortized to expense on a straight-line basis over the vesting period of which zero was recognized during the six months ended June 30, 2006.

A summary of the status and changes of the Company's unvested shares related to its equity incentive plans as of and during the six months ended June 30, 2006 is presented below (in thousands, except per share amounts):

**Weighted
Average**

	Shares	Grant-Date Fair Value
Unvested at January 1, 2006		\$
Granted	13	6.98
Unvested at June 30, 2006	13	6.98
	9	

Table of Contents***Net Income (Loss) Per Share***

Basic income (loss) per share is computed by dividing net income (loss) by the sum of the weighted-average number of common shares outstanding during the period. Diluted net income (loss) per share gives effect to all dilutive potential common shares outstanding during the period. The computation of diluted net income (loss) per share does not assume conversion, exercise or contingent exercise of securities that would have an anti-dilutive effect on earnings. The dilutive effect of outstanding stock options and warrants is computed using the treasury stock method.

The following table sets forth the computation of basic and diluted net income (loss) per share (in thousands, except per share amounts):

	Three months ended June 30,		Six months ended June 30,	
	2005	2006	2005	2006
Numerator:				
Net income (loss)	\$ 1,010	\$ (342)	\$ 1,189	\$ (474)
Denominator:				
Weighted-average shares	17,092	17,315	17,015	17,288
Effect of dilutive securities:				
Dilutive common stock equivalents	1,157		1,177	
Dilutive potential common shares	1,157		1,177	
	18,249	17,315	18,192	17,288
Net income (loss) per share:				
Basic	\$ 0.06	\$ (0.02)	\$ 0.07	\$ (0.03)
Diluted	\$ 0.06	\$ (0.02)	\$ 0.07	\$ (0.03)

The potential shares, which are excluded from the determination of basic and diluted net income (loss) per share as their effect is anti-dilutive, are as follows (in thousands):

	Six months ended June 30,	
	2005	2006
Common stock options and warrants	741	2,008
Common stock subject to repurchase	2	
	743	2,008

Segment Reporting

The Company operates in one segment in accordance with SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information*, (FAS 131). Although the chief operating decision maker does review revenue

results across the three revenue streams of advertising, subscription and transaction services, financial reporting is consistent with the Company's method of internal reporting where the chief operating decision maker evaluates, assesses performance and makes decisions on the allocation of resources at a consolidated results of operations level. The Company has no operating managers reporting to the chief operating decision maker over components of the enterprise for which the separate financial information of revenue, results of operations and assets is available. Additionally, all business units that meet the quantitative thresholds of the standard also meet the aggregation criteria of the standard as well.

Event Marketing

In January 2006, the Company's subsidiary, PNO DSW Events, LLC, a joint venture, began its event marketing business. The subsidiary markets events which include a number of sub-events that occur over specific periods of four to eight days. EITF 00-21 addresses certain aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities and how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting. The Company's revenue recognition policies are in compliance with SEC Staff Accounting Bulletin No. 104, *Revenue Recognition*,

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EITF 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*, EITF 00-21 and EITF 01-14, *Income Statement Characterization of Reimbursements Received for Out-of-Pocket Expenses Incurred*. For the purposes of EITF 00-21, the Company considers the sub-events as part of a single accounting unit and recognizes the revenue and related direct costs upon completion of the final sub-event of the accounting unit.

Recognition of revenues and expenses are deferred until completion of the final sub-event of the respective defined accounting unit. As of June 30, 2006, the Company has recorded deferred revenue of \$7,000 related to event marketing and \$8,000 of prepaid direct costs of event marketing included in prepaid expenses and other current assets.

Variable Interest Entities

In December 2003, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. (FIN) 46 (revised December 2003) (FIN 46-R), *Consolidation of Variable Interest Entities*, which addresses accounting and disclosure requirements for variable interest entities (VIEs). FIN 46-R defines a VIE as a corporation, partnership, limited liability company, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting or similar rights sufficient to enable such investors to make decisions about an entity's activities or (b) has equity investors that do not provide sufficient financial resources to support the entity's activities without additional financial support from other parties. FIN 46-R requires a VIE to be consolidated by a company if the company is subject to, among other things, a majority of the risk or residual returns of the VIE. A company that consolidates a VIE is referred to as the *primary beneficiary* under FIN 46-R. In addition, FIN 46-R requires disclosure, but not consolidation, of those entities in which the Company is not the primary beneficiary but has a significant variable interest. The consolidation and disclosure provisions of FIN 46-R became effective for reporting periods ending after March 15, 2004.

Management has reviewed its operations to determine the entities that the Company is required to consolidate under FIN 46-R. As a result of this review, the Company has determined that its interest in PNO DSW Events, LLC, a joint venture, qualifies as a variable interest entity as defined in FIN 46-R and that the Company is the primary beneficiary of the joint venture. The Company entered into the joint venture in January 2006. Under the terms of the joint venture agreement, the Company contributed an initial investment of \$250,000 and acquired a 50% interest in the joint venture. Accordingly, the financial statements of the joint venture have been consolidated into the Company's condensed consolidated financial statements. The creditors of the joint venture have no recourse to the general credit of the Company. The minority interest's share of income for the three and six months ended June 30, 2006 totaled zero and \$47,000, respectively. The minority interest's share of accumulated income at December 31, 2005 and June 30, 2006 was zero and \$47,000, respectively.

Recent Accounting Pronouncements

In May 2005, the FASB issued SFAS No. 154 (FAS 154), *Accounting Changes and Error Corrections*, which replaces APB Opinion No. 20, *Accounting Changes*, and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements*, and changes the requirements for the accounting for and reporting of a change in accounting principle. FAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of FAS 154 in the three months ended March 31, 2006 did not have a material effect on the Company's results of operations, liquidity or capital resources.

In July 2006, the FASB issued FIN 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109* (FIN 48) which clarifies the accounting for uncertainty in income taxes recognized in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 is a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. If an income tax position exceeds a more likely than not (greater than 50%) probability of success upon tax audit, the company will recognize an income tax benefit in its financial statements. Additionally, companies are required to accrue interest and related penalties, if applicable, on all tax exposures consistent with jurisdictional tax laws. This interpretation is effective on January 1, 2007 for PlanetOut and the Company is currently in the process of evaluating the impact of this interpretation on its consolidated financial statements.

Note 3 Business Combinations, Goodwill and Intangible Assets***RSVP Productions Inc. Acquisition***

In March 2006, the Company acquired substantially all of the assets of RSVP, a leading marketer of gay and lesbian travel and events, including cruises, land tours and resort vacations. The purchase agreement entitles RSVP to receive potential additional earn-out payments of up to \$3,000,000 based on certain revenue and net income milestones for each of the years ending December 31, 2007 and December 31, 2008. These earn-out payments, if any, will be paid no later than March 15, 2008 and March 15, 2009,

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respectively, and may be paid in either cash or shares of the common stock of the Company, at the Company's discretion.

The preliminary purchase price allocation is as follows (in thousands):

Cash	\$ 1,289
Other current assets	4,987
Fixed assets, net	116
Definite lived intangible assets:	
Customer relationships	1,810
Indefinite lived intangible assets:	
Tradenames	940
Goodwill	3,982
Accounts payable and other current liabilities	(60)
Deferred revenue	(6,395)
 Total preliminary purchase price	 \$ 6,669

Supplemental consolidated information on an unaudited pro forma consolidated basis, as if the RSVP acquisition was completed at the beginning of the years 2005 and 2006, is as follows (in thousands, except per share amounts):

	Three months ended June 30,		Six months ended June 30,	
	2005	2006	2005	2006
	(Unaudited)		(Unaudited)	
Revenue	\$ 8,549	\$ 16,295	\$ 18,917	\$ 35,583
Net income (loss)	\$ 368	\$ (354)	\$ 690	\$ (986)
Basic income (loss) per share	\$ 0.02	\$ (0.02)	\$ 0.04	\$ (0.06)

Goodwill

The following table presents goodwill balances and the adjustments to the Company's acquisitions during the six months ended June 30, 2006 (in thousands):

Acquisition	December 31, 2005	Goodwill Acquired	Adjustments	June 30, 2006
Acquisitions prior to December 31, 2004	\$ 3,403	\$	\$	\$ 3,403
LPI	25,296		(109)	25,187
RSVP		3,982		3,982
	\$ 28,699	\$ 3,982	\$ (109)	\$ 32,572

Adjustments to goodwill during the six months ended June 30, 2006 resulted primarily from purchase price adjustments related to transaction costs and deferred revenue.

In accordance with FAS 142, goodwill is subject to at least an annual assessment for impairment, applying a fair-value based test. The Company conducts its annual impairment test as of December 1 of each year. Based on the Company's last impairment test as of December 1, 2005, the Company determined there was no impairment. There were no events or circumstances from that date through June 30, 2006 indicating that a further assessment was

necessary.

Intangible Assets

The components of acquired identifiable intangible assets are as follows (in thousands):

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	December 31, 2005			June 30, 2006		
	Gross		Net	Gross		Net
	Carrying	Accumulated	Carrying	Carrying	Accumulated	Carrying
	Amount	Amortization	Amount	Amount	Amortization	Amount
		(In thousands)			(In thousands)	
Intangible assets:						
Customer lists and user bases	\$ 8,678	\$ 3,469	\$ 5,209	\$ 10,488	\$ 4,194	\$ 6,294
Tradenames	8,040	2,340	5,700	8,980	2,340	6,640
Other intangible assets	726	726		726	726	
	\$ 17,444	\$ 6,535	\$ 10,909	\$ 20,194	\$ 7,260	\$ 12,934

Intangible assets subject to amortization consist primarily of customer lists and user bases with amortization periods of two to six years.

As of June 30, 2006, expected future intangible asset amortization is as follows (in thousands):

Fiscal Years:

2006 (remaining six months)	\$ 802
2007	1,423
2008	1,396
2009	1,257
2010	1,093
Thereafter	323
	\$ 6,294

Note 4 Other Balance Sheet Components

	December 31, 2005	June 30, 2006
	(In thousands)	
Accounts receivable:		
Trade accounts receivable	\$ 7,033	\$ 9,464
Less: Allowance for doubtful accounts	(259)	(441)
Less: Provision for returns	(744)	(1,184)
	\$ 6,030	\$ 7,839

In the three months ended June 30, 2005 and 2006, the Company provided for an increase in the allowance for doubtful accounts of \$20,000 and \$488,000 respectively, and wrote-off accounts receivable against the allowance for doubtful accounts totaling \$24,000 and \$519,000, respectively. In the six months ended June 30, 2005 and 2006, the Company provided for an increase in the allowance for doubtful accounts of \$26,000 and \$905,000 respectively, and wrote-off accounts receivable against the allowance for doubtful accounts totaling \$24,000 and \$723,000, respectively.

Prior to the acquisition of LPI in November 2005, the Company estimated a provision for returns of zero based on its historical returns. In the three months ended June 30, 2006, the Company provided for an increase in the provision for returns of \$1,178,000, and wrote-off accounts receivable against the provision for returns totaling \$1,114,000. In the six months ended June 30, 2006, the Company provided for an increase in the provision for returns of \$2,319,000, and wrote-off accounts receivable against the provision for returns totaling \$1,879,000.

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	December 31, 2005	June 30, 2006
	(In thousands)	
Inventory:		
Materials for future publications	\$ 415	\$ 347
Finished goods available for sale	1,019	1,139
	1,434	1,486
Less: reserve for obsolete inventory	(85)	(96)
	\$ 1,349	\$ 1,390

Prior to the acquisition of LPI in November 2005, the Company estimated a provision for obsolete inventory of zero based on its historical valuation of inventory. In the three months ended June 30, 2006, the Company provided for an increase in the provision for obsolete inventory of \$9,000, and wrote-off inventory against the reserve for obsolete inventory totaling \$3,000. In the six months ended June 30, 2006, the Company provided for an increase in the reserve for obsolete inventory of \$16,000, and wrote-off inventory against the reserve for obsolete inventory totaling \$5,000.

	December 31, 2005	June 30, 2006
	(In thousands)	
Prepaid expenses and other current assets:		
Prepaid expenses and other current assets	\$ 2,328	\$ 4,349
Deposits on leased voyages		5,707
Receivable from landlord for tenant improvement allowance, current portion (Note 2)	243	
	\$ 2,571	\$ 10,056

	December 31, 2005	June 30, 2006
	(In thousands)	
Property and equipment:		
Computer and network equipment	\$ 7,879	\$ 8,878
Furniture and fixtures	1,396	1,568
Computer software	2,523	2,625
Leasehold improvements	1,555	1,537
Capitalized software and website development costs	4,783	5,521
	18,136	20,129
Less: Accumulated depreciation and amortization	(9,969)	(11,680)
	\$ 8,167	\$ 8,449

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During the three months ended June 30, 2005 and 2006, depreciation and amortization expense of property and equipment was \$848,000 and \$899,000, respectively. During the six months ended June 30, 2005 and 2006, depreciation and amortization expense of property and equipment was \$1,668,000 and \$1,798,000, respectively.

	December 31, 2005	June 30, 2006
	(In thousands)	
Other assets:		
Other assets	\$ 921	\$ 926
Deposits on leased voyages		676
Interest on note receivable from stockholder (Note 5)	231	
	\$ 1,152	\$ 1,602

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	December 31, 2005	June 30, 2006
	(In thousands)	
Accrued liabilities:		
Accrued payroll and related liabilities	\$ 989	\$ 1,302
Other accrued liabilities	1,761	2,014
	\$ 2,750	\$ 3,316

Note 5 Related Party Transaction

In May 2001, the Company issued a promissory note to an executive of the Company for \$603,000 to fund the purchase of Series D redeemable convertible preferred stock. The principal and interest were due and payable in May 2006. Interest accrued at a rate of 8.5% per annum or the maximum rate permissible by law, whichever was less and was full recourse. The note was full recourse with respect to \$24,000 in principal payment and the remainder of the principal was non-recourse. The note was collateralized by the shares of common stock and options owned by the executive. Interest income of \$13,000 and zero was recognized in the three months ended June 30, 2005 and 2006, respectively. Interest income of \$26,000 and \$9,000 was recognized in the six months ended June 30, 2005 and 2006, respectively. In March 2006, the executive repaid the Company approximately \$843,000, representing approximately \$603,000 in principal and approximately \$240,000 in accrued interest, fully satisfying the repayment obligations.

Note 6 Notes Payable

In November 2004, the Company entered into a software maintenance agreement under which \$332,000 was financed with a vendor. This amount was payable in seven quarterly installments beginning in January 2005. The note was paid in full in June 2006.

In November 2005, the Company issued a note payable in connection with its acquisition of the assets of LPI in the amount of \$7,075,000 to the sellers, secured by the assets of SpecPub, Inc. (a subsidiary of the Company established to hold certain such assets) and payable in three equal installments of \$2,358,000 in May, August and November 2007. The note bears interest at a rate of 10% per year, payable quarterly and in arrears. For the three and six months ended June 30, 2006, the Company recorded interest expense on the note of \$177,000 and \$354,000, respectively, in the condensed consolidated statements of operations. As of June 30, 2006, \$2,358,000 is included in notes payable, current portion and \$4,716,000 is included in long-term notes payable.

In December 2005, the Company entered into a payment plan agreement with a vendor to finance a purchase of system software in the amount of \$82,000. This amount is payable in four quarterly installments beginning in January 2006. As of December 31, 2005 and June 30, 2006, \$82,000 and \$21,000, respectively, is included in notes payable, current portion.

In June 2006, the Company entered into a software maintenance agreement under which \$90,000 was financed with a vendor. This amount is payable in four quarterly installments beginning in July 2006. As of June 30, 2006, \$67,000 is included in notes payable, current portion.

Note 7 Commitments and Contingencies***Deposit Commitments***

The Company enters into leasing agreements with cruise lines which establish varying deposit commitments as part of the lease agreement prior to the commencement of the leased voyage. At June 30, 2006, the Company had deposits on leased voyages of \$5,707,000 included in prepaid expenses and other current assets, long-term deposits on leased voyages of \$676,000 included in other assets and commitments for future deposits of \$14,009,000, of which \$4,633,000 is secured by restricted cash pursuant to a contractual agreement associated with an irrevocable letter of credit. Approximately \$2,050,000 of the restricted cash will be applied against the commitments for future deposits during the remainder of 2006 and approximately \$2,583,000 of the restricted cash will be applied against the commitments for future deposits in March 2007.

Contingencies

The Company is not currently subject to any material legal proceedings. The Company may from time to time, however, become a party to various legal proceedings, arising in the ordinary course of business. The Company may also be indirectly affected by administrative or court proceedings or actions in which the Company is not involved but which have general applicability to the Internet industry. The Company is currently involved in the matter discussed below. However, the Company does not believe, based on current knowledge, that this matter is likely to have a material adverse effect on its financial position, results of operations or cash flows.

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In April 2002, the Company was notified that DIALINK, a French company, had filed a lawsuit in France against it and its French subsidiary, alleging that the Company had improperly used the domain names Gay.net, Gay.com and fr.gay.com in France, as DIALINK alleges that it has exclusive rights to use the word gay as a trademark in France. On June 30, 2005, the French court found that although the Company had not infringed DIALINK's trademark, it had damaged DIALINK through unfair competition.

The Court ordered the Company to pay damages of 50,000 (US \$63,000 at June 30, 2006), half to be paid notwithstanding appeal, the other half to be paid after appeal. The Court also enjoined the Company from using gay as a domain name for its services in France. In October 2005, the Company paid half the damage awarded as required by the court order and temporarily changed the domain name of its French website, from www.fr.gay.com to www.ooups.com, a domain name it has used previously in France. The Company has accrued the full damage award and in January 2006 appealed the French court's decision. DIALINK's reply brief to the Company's appeal is due to be filed by August 30, 2006.

Note 8 Restructuring

On June 29, 2006, the board of directors of the Company adopted and approved a reorganization plan to align the Company's resources with its strategic business objectives. As part of the plan, the Company consolidated its media and advertising services, e-commerce services and back-office operations on a global basis to streamline its operations as part of continued integration of its recently acquired businesses. The reorganization, along with other organizational changes, reduced the Company's total workforce by approximately 5%. Restructuring costs of approximately \$834,000, primarily related to termination benefits of approximately \$631,000 and the cost of closing redundant facilities of approximately \$203,000, were recorded during the three months ended June 30, 2006. The Company expects to be able to complete this restructuring in the third quarter of 2006, with certain payments continuing beyond the third quarter of 2006 in accordance with the terms of existing severance and other agreements and with some aspects of facilities consolidation potentially continuing into the fourth quarter of 2006.

The following is a summary of the restructuring activities:

	Initial Restructuring	Cash		Accrued Restructuring As of June 30, 2006
	Charges	Payments	Write-offs (In thousands)	
Termination benefits	\$ 631	\$	\$	\$ 631
Cost of closing redundant facilities	203		(41)	162
Total	\$ 834	\$	\$ (41)	\$ 793

Note 9 Subsequent Events

In July 2006, the Company entered into an amendment to a facility lease agreement to expand its facilities in Los Angeles and also entered into an agreement to sublease a portion of its facilities in New York. These transactions were executed as part of the Company's continued integration of its recently acquired businesses.

In July 2006, the Company granted 90,000 shares of restricted stock to the Company's newly appointed Chief Executive Officer pursuant to the employment agreement executed in June 2006. The shares will vest in four equal annual installments with 1/4th of the shares vesting following each of the anniversaries of the appointment.

In August 2006, the Company amended and restated the employment agreement with its President and Chief Operating Officer. Under the terms of this agreement, the Company increased the annual base compensation, provided for a retention bonus of \$280,000 payable if he is employed by the Company on December 31, 2006 and granted 40,000 shares of restricted stock. With respect to the restricted stock grant, 10,000 shares of restricted stock will vest in January 2007 and 5,000 shares of restricted stock will vest each July and January thereafter through January 2010.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion should be read in conjunction with the financial statements and related notes which appear elsewhere in this document. This discussion contains forward-looking statements that involve risks and uncertainties. In some cases, you can identify forward-looking statements by terminology including would, could, may, will, should, expect, intend, plan, anticipate, believe, estimate, predict, potential or continue, the negative of these terms or other comparable terminology. These statements are only predictions. Forward-looking statements include statements about our business strategy, future operating performance and prospects. You should not place undue reliance on these forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those discussed below and elsewhere in this document and in our Form 10-K filed for the year ended December 31, 2005.

Overview

We are a leading global media and entertainment company serving the worldwide lesbian, gay, bisexual and transgender (LGBT) community. Our products and services, including travel and events from RSVP Productions, Inc. (RSVP), and our network of media properties, including our flagship websites Gay.com and PlanetOut.com, and *The Advocate* and *Out* magazines, allow our members to connect with and learn about other members of the LGBT community around the world.

With our November 2005 acquisition of substantially all of the assets of LPI Media Inc. and related entities (LPI), we expanded the number and scope of our subscription service offerings. In addition to premium subscriptions to our Gay.com and PlanetOut.com services, we offer our customers subscriptions to eight other online and print products and services, as well as to various combined, or bundled, packages of these subscription services, including the leading LGBT-targeted magazines in the United States, *Out* and *The Advocate*. We believe *Out* magazine is the leading audited circulation magazine in the United States focused on the gay and lesbian community, while *The Advocate*, a pioneer in LGBT media since 1967, is the second largest. We believe these, and other properties acquired from LPI, allow us to better serve our business and consumer customers by expanding the platforms and content that we can provide them and to more cost-effectively promote our own products and services.

On March 4, 2006, we completed the purchase of substantially all of the assets of RSVP, a leading marketer of gay and lesbian travel and events, including cruises, land tours and resort vacations. Through RSVP, we will be able to offer specialized travel and event packages to the LGBT market. Typically, RSVP develops travel itineraries on land, at resorts, and on cruises, by contracting with third-parties who provide the basic travel services. To these basic services, RSVP frequently adds additional programming elements, such as special entertainers, parties and events, and markets these enhanced vacation packages to the gay and lesbian audience.

These acquisitions support our strategic plan of building a diversified global media and entertainment company serving the LGBT community, growing our revenue base and diversifying our revenue mix among advertising services, subscription services and transaction services.

On June 29, 2006, our board of directors adopted and approved a reorganization plan to align our resources with our strategic business objectives. As part of the plan, we consolidated our media and advertising services, e-commerce services and back-office operations on a global basis to streamline our operations as part of continued integration of our recently acquired businesses. The reorganization, along with other organizational changes, reduced our total workforce by approximately 5%. Restructuring costs of approximately \$0.8 million, primarily related to employee severance benefits of approximately \$0.6 million and facilities consolidation expenses of approximately \$0.2 million, were recorded during the three months ended June 30, 2006. We expect to be able to complete this restructuring in the third quarter of 2006, with certain payments continuing beyond the third quarter of 2006 in accordance with the terms of existing severance and other agreements and with some aspects of facilities consolidation potentially continuing into the fourth quarter of 2006.

Although we had positive net income in the year ended December 31, 2005, we had a net loss of \$0.5 million for the six months ended June 30, 2006 and we have incurred significant losses since our inception. As of June 30, 2006, we had an accumulated deficit of \$35.1 million. We expect to incur significant marketing, engineering and technology, and general and administrative expenses for the foreseeable future. As a result, we will need to continue

to grow revenue and increase our operating margins to regain and expand our profitability.

Results of Operations

The following table sets forth the percentage of total revenue represented by items in our condensed consolidated statements of operations:

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	Three months ended June 30,		Six months ended June 30,	
	2005	2006	2005	2006
	(As a percentage of total revenue; unaudited)			
Consolidated statements of operations data:				
Revenue:				
Advertising services	31.8%	44.9%	26.9%	37.4%
Subscription services	64.1	38.8	68.0	37.2
Transaction services	4.1	16.3	5.1	25.4
Total revenue	100.0	100.0	100.0	100.0
Operating costs and expenses:				
Cost of revenue	28.7	42.2	30.2	48.1
Sales and marketing	31.4	27.2	33.9	24.7
General and administrative	20.0	18.8	19.4	18.2
Restructuring		5.1		2.5
Depreciation and amortization	10.5	8.0	11.3	7.4
Total operating costs and expenses	90.6	101.3	94.8	100.9
Income (loss) from operations	9.4	(1.3)	5.2	(0.9)
Equity in net loss of unconsolidated affiliate	(0.2)		(0.2)	
Interest expense	(0.4)	(1.2)	(0.5)	(1.2)
Other income, net	3.9	0.6	3.9	0.8
Income (loss) before income taxes and minority interest	12.7	(1.9)	8.4	(1.3)
Provision for income taxes	(0.2)		(0.3)	
Minority interest in gain of consolidated affiliate		(0.3)		
Other receivables	64,561	41,351	728,887	105,912
Inventories:				
Finished and in process	196,204	(37,447)	158,757	
Total Assets	\$ 4,557,721	\$ 7,540	\$ 4,565,261	
Liabilities and Equity				
Current Liabilities				
Accrued expenses and other	283,355	5,215	288,570	
	999,970	5,215	1,005,185	
Deferred Income Taxes	74,073	604	74,677	

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Sonoco Shareholders' Equity			
Retained earnings	2,036,006	1,721	2,037,727
Total Sonoco Shareholders' Equity	1,707,066	1,721	1,708,787
Total Equity	1,730,060	1,721	1,731,781
Total Liabilities and Equity	\$ 4,557,721	\$ 7,540	\$ 4,565,261

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SONOCO PRODUCTS COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

(unaudited)

The following table summarizes the impact of the adoption of Topic 606 on the Company's Condensed Consolidated Balance Sheet as of April 1, 2018:

	April 1, 2018 As Reported	Adjustments	Balances without Adoption of Topic 606
Assets			
Current Assets			
Trade accounts receivable, net of allowances	756,102	(3,819)	) 752,283
Other receivables	91,319	(44,489)	) 46,830
Inventories:			
Finished and in process	155,417	40,070	) 195,487
Total Assets	\$4,653,069	\$ (8,238)	) \$4,644,831
Liabilities and Equity			
Current Liabilities			
Accrued expenses and other	278,380	(5,476)	) 272,904
	1,035,374	(5,476)	) 1,029,898
Deferred Income Taxes	72,303	(718)	) 71,585
Sonoco Shareholders' Equity			
Retained earnings	2,072,423	(2,044)	) 2,070,379
Total Sonoco Shareholders' Equity	1,772,163	(2,044)	) 1,770,119
Total Equity	1,796,456	(2,044)	) 1,794,412
Total Liabilities and Equity	\$4,653,069	\$ (8,238)	) \$4,644,831

The following table summarizes the impact of the adoption of Topic 606 on the Company's Condensed Consolidated Statement of Income for the three months ended April 1, 2018:

	Three Months Ended		Balances
	April 1, 2018 As Reported	Adjustments	without Adoption of Topic 606
Net sales	\$1,304,187	\$ (3,060)	) \$1,301,127
Cost of sales	1,053,585	(2,623)	) 1,050,962
Gross profit	250,602	(437)	) 250,165
Operating profit	110,098	(437)	) 109,661
Income before income taxes	97,034	(437)	) 96,597
Provision for income taxes	23,356	(114)	) 23,242
Income before equity in earnings of affiliates	73,678	(323)	) 73,355
Net income	74,925	(323)	) 74,602
Net income attributable to Sonoco	\$74,055	\$ (323)	) \$73,732

The following table summarizes the impact of the adoption of Topic 606 on the Company's Condensed Consolidated Statement of Comprehensive Income for the three months ended April 1, 2018:

	Three Months Ended		Balances
	April 1, 2018 As	Adjustments	without

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	Reported	Adoption of Topic 606
Net income	\$74,925 \$ (323)	\$74,602
Comprehensive income	104,772 (323)	104,449
Comprehensive income attributable to Sonoco	\$103,472\$ (323)	\$103,149

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SONOCO PRODUCTS COMPANY

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(Dollars in thousands except per share data)

(unaudited)

The following table summarizes the impact of the adoption of Topic 606 on the Company's Condensed Consolidated Statement of Cash Flows for the three months ended April 1, 2018:

	Three Months Ended	
	April 1, 2018 As Reported	Balances without Adjustments Adoption of Topic 606
Cash Flows from Operating Activities:		
Net income	\$74,925	\$ (323) \$ 74,602
Trade accounts receivable	(19,346)	182 (19,164)
Inventories	(17,814)	516 (17,298)
Accrued expenses	(229)	(261) (490)
Income taxes payable and other income tax items	17,183	(114) 17,069
Net cash provided by operating activities	119,765	— 119,765

Note 4: Acquisitions

On April 12, 2018, subsequent to quarter end, the Company completed the acquisition of Highland Packaging Solutions ("Highland"). Total consideration for this acquisition was \$150,000, including cash paid at closing of \$142,500 and a contingent purchase liability of \$7,500. Final consideration will also be subject to an adjustment for working capital, which is expected to be completed by the end of the third quarter of 2018. The contingent purchase liability is based upon a sales metric which the Company expects to meet and is payable in two installments. The first installment of \$5,000 is to be paid one year after the closing date and the second installment of \$2,500 is to be paid two years after the closing date. Highland manufactures thermoformed plastic packaging for fresh produce and dairy products from a single production facility in Plant City, Florida, providing total packaging solutions for customers that include sophisticated engineered containers, flexographic printed labels, and inventory management through distribution warehouses in the Southeast and West Coast of the United States. The Company financed the acquisition with proceeds from a new \$100,000 term loan, along with proceeds from existing credit facilities. As the acquisition of Highland was completed subsequent to the end of the quarter, the preliminary assessment of the fair values of the assets acquired and liabilities assumed in connection with the acquisition has not been completed. Accordingly, such amounts cannot yet be provided.

During the three-month period ended April 1, 2018, the Company finalized its valuations of the assets and liabilities acquired in conjunction with the 2017 acquisition of Packaging Holdings, Inc. and subsidiaries, including Peninsula Packaging LLC ("Packaging Holdings"), based on information obtained about facts and circumstances that existed as of the acquisition date. As a result, measurement period adjustments were made to the previously disclosed provisional fair values of Packaging Holding's net assets that decreased deferred tax assets by \$6,516, increased long-term debt by \$664, and increased goodwill by \$7,180. The adjustments were primarily related to a reduction in the Company's valuation of acquired tax loss carryforwards and the fair value of capital lease obligations.

Acquisition-related costs of \$545 and \$4,325 were incurred during the three months ended April 1, 2018 and April 2, 2017, respectively. Acquisition-related costs consist primarily of legal and professional fees and are included in "Selling, general and administrative expenses" in the Company's Condensed Consolidated Statements of Income.

SONOCO PRODUCTS COMPANY

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(Dollars in thousands except per share data)

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Note 5: Shareholders' Equity

Earnings per Share

The following table sets forth the computation of basic and diluted earnings per share (dollars and shares in thousands, except per share data):

	Three Months Ended April 1, April 2, 2018 2017	
Numerator:		
Net income attributable to Sonoco	\$74,055	\$53,733
Denominator:		
Weighted average common shares outstanding:		
Basic	100,396	100,112
Dilutive effect of stock-based compensation	500	868
Diluted	100,896	100,980
Net income attributable to Sonoco per common share:		
Basic	\$0.74	\$0.54
Diluted	\$0.73	\$0.53

Potentially dilutive securities are calculated in accordance with the treasury stock method, which assumes the proceeds from the exercise of all dilutive stock appreciation rights (SARs) are used to repurchase the Company's common stock. Certain SARs are not dilutive because either the exercise price is greater than the average market price of the stock during the reporting period or assumed repurchases from proceeds from the exercise of the SARs were antidilutive. These SARs may become dilutive in the future if the market price of the Company's common stock appreciates.

The average number of SARs that were not dilutive and therefore not included in the computation of diluted earnings per share during the three-month periods ended April 1, 2018 and April 2, 2017 was as follows (in thousands):

	Three Months Ended April 1, 2018	April 2, 2017
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Anti-dilutive stock appreciation rights	738	356
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No adjustments were made to net income attributable to Sonoco in the computations of earnings per share.

Stock Repurchases

On February 10, 2016, the Company's Board of Directors authorized the repurchase of up to 5,000 shares of the Company's common stock. A total of 2,030 were purchased in 2016. No shares were repurchased under this authorization during 2017 or during the three months ended April 1, 2018. Accordingly, a total of 2,970 shares remain available for repurchase at April 1, 2018.

The Company frequently repurchases shares of its common stock to satisfy employee tax withholding obligations in association with certain share-based compensation awards. These repurchases, which are not part of a publicly announced plan or program, totaled 78 shares in the three months ended April 1, 2018 at a cost of \$4,088, and 105 shares in the three months ended April 2, 2017 at a cost of \$5,539.

Dividend Declarations

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On February 14, 2018, the Board of Directors declared a regular quarterly dividend of \$0.39 per share. This dividend was paid on March 9, 2018 to all shareholders of record as of February 28, 2018.

On April 18, 2018, the Board of Directors declared a regular quarterly dividend of \$0.41 per share. This dividend is payable on June 8, 2018 to all shareholders of record as of May 11, 2018.

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SONOCO PRODUCTS COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

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Note 6: Restructuring and Asset Impairment

The Company has engaged in a number of restructuring actions over the past several years. Actions initiated in 2018 and 2017 are reported as “2018 Actions” and “2017 Actions,” respectively. Actions initiated prior to 2017, all of which were substantially complete at April 1, 2018, are reported as “2016 and Earlier Actions.”

Following are the total restructuring and asset impairment charges/(credits), net of adjustments, and gains on dispositions recognized by the Company during the periods presented:

	Three Months Ended	
	April 1, 2018	April 2, 2017
Restructuring/Asset impairment:		
2018 Actions	\$2,207	\$—
2017 Actions	405	2,304
2016 and Earlier Actions	451	1,807
Restructuring/Asset impairment charges	\$3,063	\$4,111
Income tax benefit	(685)	(1,298)
Less: Costs attributable to noncontrolling interests, net of tax	(5)	(2)
Restructuring/asset impairment charges attributable to Sonoco, net of tax	\$2,373	\$2,811

Pre-tax restructuring and asset impairment charges are included in “Restructuring/Asset impairment charges” in the Condensed Consolidated Statements of Income.

When recognizable in accordance with GAAP, the Company expects to recognize future additional charges totaling approximately \$1,800 in connection with previously announced restructuring actions. The Company believes that the majority of these charges will be incurred and paid by the end of 2018. The Company continually evaluates its cost structure, including its manufacturing capacity, and additional restructuring actions are likely to be undertaken.

2018 Actions

During 2018, the Company announced the closure of a flexible packaging plant in North Carolina and a global brand management facility in Canada (both part of the Consumer Packaging segment), a tubes and cores plant in Alabama (part of the Paper and Industrial Converted Products segment), and a protective packaging plant in North Carolina (part of the Protective Solutions segment). In addition, approximately 20 positions were eliminated in the first quarter of 2018 in conjunction with the Company's ongoing organizational effectiveness efforts.

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(Dollars in thousands except per share data)

(unaudited)

Below is a summary of 2018 Actions and related expenses by segment and by type incurred and estimated to be incurred through completion.

2018 Actions	First Quarter 2018	Estimated Total Cost
Severance and Termination Benefits		
Consumer Packaging	\$788	\$ 938
Display and Packaging	175	175
Paper and Industrial Converted Products	991	991
Protective Solutions	259	259
Corporate	223	223
Asset Impairment / Disposal of Assets		
Consumer Packaging	(14)	(14)
Protective Solutions	(272)	(272)
Other Costs		
Consumer Packaging	11	311
Paper and Industrial Converted Products	—	1,000
Protective Solutions	46	46
Total Charges and Adjustments	\$2,207	\$ 3,657

The following table sets forth the activity in the 2018 Actions restructuring accrual included in “Accrued expenses and other” on the Company’s Condensed Consolidated Balance Sheets:

2018 Actions	Severance and Termination Benefits	Asset Impairment/ Disposal of Assets	Other Costs	Total
Accrual Activity				
2018 Year to Date				
Liability at December 31, 2017	\$ —	\$ —	\$ —	\$ —
2018 charges	2,436	(286)	57	2,207
Cash receipts/(payments)	(259)	2,049	(10)	1,780
Asset write downs/disposals	—	(1,763)	—	(1,763)
Foreign currency translation	(4)	—	—	(4)
Liability at April 1, 2018	\$ 2,173	\$ —	\$ 47	\$ 2,220

Included in "Asset Impairment/Disposal of Assets" above is a net gain of \$272 resulting from the sale of a building and land relating to the closure of a protective packaging plant in North Carolina. The Company received proceeds of \$2,019 from the sale and wrote off assets of \$1,747.

The Company expects to pay the majority of the remaining 2018 Actions restructuring costs by the end of 2018 using cash generated from operations.

2017 Actions

During 2017, the Company announced the closure of an expanded foam protective packaging plant in the United States (part of the Protective Solutions segment) and five tubes and cores plants - three in the United States, one in Belgium, and one in China (all part of the Paper and Industrial Converted Products segment). In addition, approximately 255 positions were eliminated throughout 2017 in conjunction with the Company's ongoing organizational effectiveness efforts.

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(Dollars in thousands except per share data)

(unaudited)

Below is a summary of 2017 Actions and related expenses by segment and by type incurred and estimated to be incurred through completion.

	Three Months Ended		Total Incurred to Date	Estimated Total Cost
2017 Actions	April 1, 2018	April 2, 2017		
Severance and Termination Benefits				
Consumer Packaging	\$372	\$967	\$4,563	\$4,763
Display and Packaging	(8)	106	733	733
Paper and Industrial Converted Products	4	541	4,022	4,022
Protective Solutions	133	75	1,531	1,531
Corporate	—	456	452	452
Asset Impairment / Disposal of Assets				
Consumer Packaging	—	—	351	351
Display and Packaging	166	—	166	166
Paper and Industrial Converted Products	(665)	—	(760)	(760)
Protective Solutions	—	—	871	871
Other Costs				
Consumer Packaging	107	159	986	986
Display and Packaging	(348)	—	441	441
Paper and Industrial Converted Products	550	—	1,551	1,551
Protective Solutions	94	—	836	836
Corporate	—	—	(9)	(9)
Total Charges and Adjustments	\$405	\$2,304	\$15,734	\$15,934

The following table sets forth the activity in the 2017 Actions restructuring accrual included in “Accrued expenses and other” on the Company’s Condensed Consolidated Balance Sheets:

2017 Actions	Severance and Termination Benefits	Asset Impairment/ Disposal of Assets	Other Costs	Total
Accrual Activity				
2018 Year to Date				
Liability at December 31, 2017	\$ 3,889	\$ —	\$213	\$4,102
2018 charges	501	(499)	403	405
Cash payments	(1,727)	1,023	(501)	(1,205)
Asset write downs/disposals	—	(524)	—	(524)
Foreign currency translation	69	—	11	80
Liability at April 1, 2018	\$ 2,732	\$ —	\$126	\$2,858

Included in "Asset Impairment/Disposal of Assets" above is a gain of \$774 primarily related to the sale of a building and land from the closure of a tubes and cores plant in Iowa. The Company received proceeds of \$1,023 and wrote off assets of \$249.

“Other costs” consist primarily of costs related to plant closures including equipment removal, utilities, plant security, property taxes and insurance. The Company expects to pay the majority of the remaining 2017 Actions restructuring costs by the end of 2018 using cash generated from operations.

2016 and Earlier Actions

2016 and Earlier Actions are comprised of a number of plant closures and workforce reductions initiated prior to 2017. Charges for these actions in both 2018 and 2017 primarily relate to the cost of plant closures including severance, equipment removal, plant security, property taxes and insurance.

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The Company expects to recognize future pretax charges of approximately \$100 associated with 2016 and Earlier Actions.

Below is a summary of expenses/(income) incurred by segment for 2016 and Earlier Actions for the three-month periods ended April 1, 2018 and April 2, 2017.

	2018	2017
	First	First
2016 and Earlier Actions	Quarter	Quarter
Consumer Packaging	\$ 465	\$(26)
Display and Packaging	1	395
Paper and Industrial Converted Products	(33)	1,353
Protective Solutions	18	78
Corporate	—	7
Total Charges and Adjustments	\$ 451	\$ 1,807

The accrual for 2016 and Earlier Actions totaled \$2,189 and \$3,044 at April 1, 2018 and December 31, 2017, respectively, and is included in “Accrued expenses and other” on the Company’s Condensed Consolidated Balance Sheets. The majority of the liability associated with 2016 and Earlier Actions relates to unpaid severance and building lease termination costs and is expected to be paid by the end of 2018 using cash generated from operations.

Note 7: Accumulated Other Comprehensive Loss

The following table summarizes the components of accumulated other comprehensive loss and the changes in the balances of each component of accumulated other comprehensive loss, net of tax as applicable, for the three months ended April 1, 2018 and April 2, 2017:

	Gains and Losses on Cash Flow Hedges	Defined Benefit Pension Items	Foreign Currency Items	Accumulated Other Comprehensive Loss
Balance at December 31, 2017	\$ (641)	\$ (467,136)	\$(198,495)	\$ (666,272)
Other comprehensive income/(loss) before reclassifications	1,182	(1,145)	22,553	22,590
Amounts reclassified from accumulated other comprehensive loss to net income	(180)	6,962	—	6,782
Amounts reclassified from accumulated other comprehensive loss to fixed assets	45	—	—	45
Other comprehensive income/(loss)	1,047	5,817	22,553	29,417
Amounts reclassified from retained earnings to accumulated other comprehensive loss	\$ (176)	\$ —	\$ —	(176)
Balance at April 1, 2018	\$ 230	\$ (461,319)	\$(175,942)	\$ (637,031)
Balance at December 31, 2016	\$ 1,939	\$ (453,821)	\$(286,498)	\$ (738,380)
Other comprehensive income/(loss) before reclassifications	(2,626)	4,924	30,156	32,454
Amounts reclassified from accumulated other comprehensive loss to net income	(365)	6,375	—	6,010
Amounts reclassified from accumulated other comprehensive loss to fixed assets	42	—	—	42
Other comprehensive income/(loss)	(2,949)	11,299	30,156	38,506
Balance at April 2, 2017	\$ (1,010)	\$ (442,522)	\$(256,342)	\$ (699,874)

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"Other comprehensive income/(loss) before reclassifications" during the three months ended April 2, 2017, includes \$5,071 of "Defined Benefit Pension Items" related to the release of a portion of the valuation allowance on deferred tax assets related to the pension plan of a foreign subsidiary.

The following table summarizes the effects on net income of significant amounts reclassified from each component of accumulated other comprehensive loss for the three-month periods ended April 1, 2018 and April 2, 2017:

	Amount Reclassified from Accumulated Other Comprehensive Loss Three Months Ended		
Details about Accumulated Other Comprehensive Loss Components	April 1, 2018	April 2, 2017	Affected Line Item in the Condensed Consolidated Statements of Income
Gains and losses on cash flow hedges			
Foreign exchange contracts	\$810	\$1,040	Net sales
Foreign exchange contracts	(527)	(725)	Cost of sales
Commodity contracts	(58)	248	Cost of sales
	225	563	Income before income taxes
	(45)	(198)	Provision for income taxes
	\$180	\$365	Net income
Defined benefit pension items			
Amortization of defined benefit pension items ^(a)	(9,301)	(10,117)	Non-operating pension (income)/cost
	(9,301)	(10,117)	Income before income taxes
	2,339	3,742	Provision for income taxes
	\$(6,962)	\$(6,375)	Net income
Total reclassifications for the period	\$(6,782)	\$(6,010)	Net income

^(a)See Note 12 for additional details.

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The following table summarizes the before and after tax amounts for the various components of other comprehensive income/(loss) for the three-month periods ended April 1, 2018 and April 2, 2017:

	Three months ended April 1, 2018			Three months ended April 2, 2017		
	Before Tax Amount	Tax (Expense) Benefit	After Tax Amount	Before Tax Amount	Tax (Expense) Benefit	After Tax Amount
Foreign currency items	\$22,553	\$ —	\$22,553	\$30,156	\$ —	\$30,156
Defined benefit pension items:						
Other comprehensive income/(loss) before reclassifications	(1,145)	—	(1,145)	(147)	5,071	4,924
Amounts reclassified from accumulated other comprehensive income/(loss) to net income	9,301	(2,339)	6,962	10,117	(3,742)	6,375
Net other comprehensive income/(loss) from defined benefit pension items	8,156	(2,339)	5,817	9,970	1,329	11,299
Gains and losses on cash flow hedges:						
Other comprehensive income/(loss) before reclassifications	1,475	(293)	1,182	(4,048)	1,422	(2,626)
Amounts reclassified from accumulated other comprehensive income/(loss) to net income	(225)	45	(180)	(563)	198	(365)
Amounts reclassified from accumulated other comprehensive income/(loss) to fixed assets	45	—	45	42	—	42
Net other comprehensive income/(loss) from cash flow hedges	1,295	(248)	1,047	(4,569)	1,620	(2,949)
Other comprehensive income/(loss)	\$32,004	\$ (2,587)	\$29,417	\$35,557	\$ 2,949	\$38,506

Note 8: Goodwill and Other Intangible Assets

Goodwill

A summary of the changes in goodwill by segment for the three months ended April 1, 2018 is as follows:

	Consumer Packaging	Display and Packaging	Paper and Industrial Converted Products	Protective Solutions	Total
Goodwill at December 31, 2017	\$ 572,716	\$ 203,414	\$ 233,778	\$ 231,967	\$ 1,241,875
Foreign currency translation	1,528	—	1,940	354	3,822
Other	7,180	—	—	—	7,180
Goodwill at April 1, 2018	\$ 581,424	\$ 203,414	\$ 235,718	\$ 232,321	\$ 1,252,877

In the first three months of 2018, measurement period adjustments were made to finalize the fair values of the assets acquired and the liabilities assumed in the March 2017 acquisition of Packaging Holdings resulting in an increase in goodwill of \$7,180. See Note 4 for additional information.

The Company assesses goodwill for impairment annually and from time to time when warranted by the facts and circumstances surrounding individual reporting units or the Company as a whole. The Company completed its most recent annual goodwill impairment testing during the third quarter of 2017. As part of this testing, the Company analyzed certain qualitative and quantitative factors in determining goodwill impairment. The Company's assessments reflected a number of significant management assumptions and estimates including the Company's forecast of sales volumes and prices, profit margins, income taxes, capital expenditures and changes in working capital requirements.

Changes in these assumptions and/or discount rates could materially impact the Company's conclusions. Based on its assessments, the Company concluded that there was no impairment of goodwill for any of its reporting units. Although no reporting units failed the assessments noted above, in management's opinion, the reporting units having the greatest risk of a significant future impairment if actual results fall short of expectations are Display and Packaging, and Paper and Industrial Converted Products - Europe. Total goodwill associated with these reporting units

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was \$203,414 and \$97,065, respectively, at April 1, 2018. A large portion of projected sales in the Display and Packaging reporting unit is concentrated in several major customers, the loss of any of which could impact the Company's conclusion regarding the likelihood of goodwill impairment for the unit.

There have been no triggering events identified between the most recent annual impairment test and April 1, 2018. On April 20, 2018, the Company was advised by one of its Display and Packaging customers that its contract would not be renewed upon expiration on December 31, 2018. Annual sales under this contract have only been approximately \$12,000, or 2.4% of total sales for the reporting unit. However, due to the narrow excess of this reporting unit's estimated fair value over carrying value as of its most recent goodwill impairment test, management believes that as a result of this development it is probable that a goodwill impairment charge may be incurred. The Company is in the process of finalizing its quantitative analysis of the impact, but based on its current assessment of operating performance and assumptions regarding forecasts of the remainder of the Display and Packaging business, management estimates any such impairment charge will be less than \$20,000.

Other Intangible Assets

A summary of other intangible assets as of April 1, 2018 and December 31, 2017 is as follows:

	April 1, 2018	December 31, 2017
Other Intangible Assets, gross:		
Patents	\$21,956	\$ 21,957
Customer lists	499,970	497,634
Trade names	25,161	25,148
Proprietary technology	20,792	20,779
Land use rights	303	298
Other	1,743	1,740
Other Intangible Assets, gross	\$569,925	\$ 567,556

Accumulated Amortization:

Patents	(7,659)	(7,187)
Customer lists	(220,589)	(210,212)
Trade names	(4,930)	(4,427)
Proprietary technology	(13,645)	(13,192)
Land use rights	(50)	(47)
Other	(1,284)	(1,196)
Total Accumulated Amortization	\$(248,157)	\$(236,261)
Other Intangible Assets, net	\$321,768	\$ 331,295

Other intangible assets are amortized on a straight-line basis over their respective useful lives, which generally range from three to forty years. The Company has no intangible assets with indefinite lives.

Aggregate amortization expense was \$10,202 and \$7,211 for the three months ended April 1, 2018 and April 2, 2017, respectively. Amortization expense on other intangible assets is expected to total approximately \$43,400 in 2018, \$42,300 in 2019, \$39,900 in 2020, \$38,900 in 2021 and \$37,100 in 2022.

Note 9: Debt

On April 12, 2018, subsequent to quarter end, the Company entered into a \$100,000 term loan with Bank of America, N.A. The full amount was drawn from this facility on April 12, 2018, and the proceeds, along with proceeds from existing credit facilities, were used to fund the acquisition of Highland Packaging Solutions. The loan has a 364-day term and the Company has a one-time option to extend the term for an additional 364 days at its sole discretion. Interest is assessed at the London Interbank Offered Rate (LIBOR) plus a margin based on a pricing grid

that uses the Company's credit ratings. The current LIBOR margin is 110 basis points. There is no required amortization and repayment can be accelerated at any time at the discretion of the Company.

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(Dollars in thousands except per share data)

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Note 10: Financial Instruments and Derivatives

The following table sets forth the carrying amounts and fair values of the Company's significant financial instruments for which the carrying amount differs from the fair value.

	April 1, 2018		December 31, 2017	
	Carrying	Fair	Carrying	Fair
	Amount	Value	Amount	Value
Long-term debt, net of current portion	\$1,289,045	\$1,407,163	\$1,288,002	\$1,426,862

The carrying value of cash and cash equivalents, short-term debt and long-term variable-rate debt approximates fair value. The fair value of long-term debt is determined based on recent trade information in the financial markets of the Company's public debt or is determined by discounting future cash flows using interest rates available to the Company for issues with similar terms and maturities. It is considered a Level 2 fair value measurement.

Adoption of Accounting Standards Update 2017-12

The Company elected to early adopt Accounting Standards Update (ASU) 2017-12, "Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities," as of January 1, 2018. The impact of the adoption of ASU 2017-12 was the recognition of a \$176 increase in the Company's beginning retained earnings with an offsetting change in accumulated other comprehensive loss in order to remove previously recognized ineffectiveness losses on contracts outstanding as of the date of adoption. See Note 2 for additional information.

Cash Flow Hedges

At April 1, 2018 and December 31, 2017, the Company had derivative financial instruments outstanding to hedge anticipated transactions and certain asset and liability related cash flows. These contracts, which have maturities ranging to December 2019, qualify as cash flow hedges under U.S. GAAP. For derivative instruments that are designated and qualify as a cash flow hedge, the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings and is presented in the same income statement line item as the earnings effect of the hedged item. Gains and losses on the derivative instrument representing hedge components excluded from the assessment of effectiveness are recognized currently in current earnings and are presented in the same line of the income statement expected for the hedged item.

Commodity Cash Flow Hedges

The Company has entered into certain derivative contracts to manage the cost of anticipated purchases of natural gas and aluminum. At April 1, 2018, natural gas swaps covering approximately 6.0 million MMBTUs were outstanding. These contracts represent approximately 74% and 32% of anticipated U.S. and Canadian usage for the remainder of 2018 and 2019, respectively. Additionally, the Company had swap contracts covering 2,858 metric tons of aluminum, representing approximately 51% of anticipated usage for the remainder of 2018. The fair values of the Company's commodity cash flow hedges netted to a loss position of \$(1,826) at April 1, 2018, and \$(1,713) at December 31, 2017. The amount of the loss included in Accumulated Other Comprehensive Loss at April 1, 2018, that is expected to be reclassified to the income statement during the next twelve months is \$(1,303).

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Foreign Currency Cash Flow Hedges

The Company has entered into forward contracts to hedge certain anticipated foreign currency denominated sales, purchases, and capital spending forecast to occur in 2018. The net positions of these contracts at April 1, 2018 were as follows (in thousands):

Currency	Action	Quantity
Colombian peso	purchase	5,714,591
Mexican peso	purchase	538,032
Polish zloty	purchase	180,204
Canadian dollar	purchase	40,162
Russian ruble	purchase	24,491
Turkish lira	purchase	3,856
British pound	purchase	3,423
New Zealand dollar	sell	(464)
Australian dollar	sell	(1,240)
Euro	sell	(40,724)

The fair value of these foreign currency cash flow hedges related to forecasted sales and purchases netted to gain positions of \$1,837 at April 1, 2018 and \$620 at December 31, 2017. In addition, the Company has entered into forward contracts to hedge certain foreign currency cash flow transactions related to construction in progress. As of April 1, 2018 and at December 31, 2017, the net position of these contracts was \$295 and \$330, respectively. During the three months ended April 1, 2018, gains from these hedges totaling \$45 were reclassified from accumulated other comprehensive income and included in the carrying value of the related fixed assets acquired. For all cash flow hedges, gains of \$1,837 are expected to be reclassified from accumulated other comprehensive income to the income statement during the next twelve months. Also during the next twelve months, gains of \$295 are expected to be reclassified from accumulated other comprehensive income and included in the carrying value of the related fixed assets acquired.

Other Derivatives

The Company routinely enters into forward contracts or swaps to economically hedge the currency exposure of intercompany debt and existing foreign currency denominated receivables and payables. The Company does not apply hedge accounting treatment under ASC 815 for these instruments. As such, changes in fair value are recorded directly to income and expense in the periods that they occur.

The net positions of these contracts at April 1, 2018, were as follows (in thousands):

Currency	Action	Quantity
Colombian peso	purchase	5,868,637
Mexican peso	sell	(15,638)
Canadian dollar	sell	(59,117)

The fair value of the Company's other derivatives was in a gain position of \$171 and a loss position of \$(581) at April 1, 2018 and December 31, 2017, respectively.

SONOCO PRODUCTS COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

(unaudited)

The following table sets forth the location and fair values of the Company's derivative instruments at April 1, 2018 and December 31, 2017:

Description	Balance Sheet Location	April 1, 2018	December 31, 2017
Derivatives designated as hedging instruments:			
Commodity Contracts	Prepaid expenses	\$—	\$ 149
Commodity Contracts	Accrued expenses and other	\$(1,448)	\$ (1,417)
Commodity Contracts	Other liabilities	\$(378)	\$ (445)
Foreign Exchange Contracts	Prepaid expenses	\$2,964	\$ 2,232
Foreign Exchange Contracts	Accrued expenses and other	\$(832)	\$ (1,282)
Derivatives not designated as hedging instruments:			
Foreign Exchange Contracts	Prepaid expenses	\$833	\$ 90
Foreign Exchange Contracts	Accrued expenses and other	\$(662)	\$ (671)

While certain of the Company's derivative contract arrangements with its counterparties provide for the ability to settle contracts on a net basis, the Company reports its derivative positions on a gross basis. There are no collateral arrangements or requirements in these agreements.

Description

Description

The following tables set forth the effect of the Company's derivative instruments on financial performance for the three months ended April 1, 2018 and April 2, 2017:

Description	Amount of Gain or (Loss) Recognized in OCI on Derivatives	Location of Gain or (Loss) Reclassified from Accumulated OCI Into Income	Amount of Gain or (Loss) Reclassified from Accumulated OCI Into Income
-------------	---	--	--

Derivatives in Cash Flow Hedging Relationships:

Three months ended April 1, 2018

Foreign Exchange Contracts	\$ 1,646	Net sales	\$ 810
		Cost of sales	\$ (527)
Commodity Contracts	\$ (171)	Cost of sales	\$ (58)

Three months ended April 2, 2017

Foreign Exchange Contracts	\$ (2,692)	Net sales	\$ 1,040
		Cost of sales	\$ (725)
Commodity Contracts	\$ (1,356)	Cost of sales	\$ 248

Description	Location of Gain or (Loss) Recognized in Income Statement	Gain or (Loss) Recognized
-------------	---	---------------------------

Derivatives not Designated as Hedging Instruments:

Three months ended April 1, 2018

Foreign Exchange Contracts	Cost of sales	\$ —
	Selling, general and administrative	\$ 754

Three months ended April 2, 2017

Foreign Exchange Contracts	Cost of sales	\$	—	
	Selling, general and administrative	\$	(567)

SONOCO PRODUCTS COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

(unaudited)

Description	April 1, 2018	Cost of Revenue sales	April 2, 2017	Cost of Revenue sales
	Revenue		Revenue	
Total amount of income and expense line items presented in the Condensed Consolidated Statements of Income	\$810	\$(585)	\$1,040	\$(477)

The effects of cash flow hedging:

Gain or (loss) on cash flow hedging relationships in Subtopic 815-20:

Foreign exchange contracts:

Amount of gain or (loss) reclassified from accumulated other comprehensive income into net income

\$810 \$(527) \$1,040 \$(725)

Commodity contracts:

Amount of gain or (loss) reclassified from accumulated other comprehensive income into net income

\$— \$(58) \$— \$248

Note 11: Fair Value Measurements

Fair value is defined as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Fair value is a market-based measurement that is determined based on assumptions that market participants would use in pricing an asset or liability. A three-tier fair value hierarchy is used to prioritize the inputs in measuring fair value as follows:

Level 1 - Observable inputs such as quoted market prices in active markets;

Level 2 - Inputs, other than quoted prices in active markets, that are observable either directly or indirectly; and

Level 3 - Unobservable inputs for which there is little or no market data, which require the reporting entity to develop its own assumptions.

The following table sets forth information regarding the Company's financial assets and financial liabilities, excluding retirement and postretirement plan assets, measured at fair value on a recurring basis:

Description	April 1, 2018	Assets measured at NAV	Level 1	Level 2	Level 3
Hedge derivatives, net:					
Commodity contracts	\$ (1,826)	\$	—	\$(1,826)	\$ —
Foreign exchange contracts	\$ 2,132	\$	—	\$2,132	\$ —
Non-hedge derivatives, net:					
Foreign exchange contracts	\$ 171	\$	—	\$171	\$ —
Deferred compensation plan assets	\$ 266	\$	—	\$266	\$ —

Description	December 31, 2017	Assets measured at NAV	Level 1	Level 2	Level 3
Hedge derivatives, net:					
Commodity contracts	\$ (1,713)	\$	—	\$(1,713)	\$ —
Foreign exchange contracts	\$ 950	\$	—	\$950	\$ —
Non-hedge derivatives, net:					
Foreign exchange contracts	\$ (581)	\$	—	\$(581)	\$ —
Deferred compensation plan assets	\$ 268	\$	—	\$268	\$ —

SONOCO PRODUCTS COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

(unaudited)

As discussed in Note 10, the Company uses derivatives to mitigate the effect of raw material and energy cost fluctuations, foreign currency fluctuations and, from time to time, interest rate movements. Fair value measurements for the Company's derivatives are classified under Level 2 because such measurements are estimated based on observable inputs such as interest rates, yield curves, spot and future commodity prices and spot and future exchange rates.

Certain deferred compensation plan liabilities are funded by assets invested in various exchange traded mutual funds. These assets are measured using quoted prices in accessible active markets for identical assets.

The Company does not currently have any non-financial assets or liabilities that are recognized or disclosed at fair value on a recurring basis. None of the Company's financial assets or liabilities are measured at fair value using significant unobservable inputs. There were no transfers in or out of Level 1 or Level 2 fair value measurements during the three-month period ended April 1, 2018.

Note 12: Employee Benefit Plans

Retirement Plans and Retiree Health and Life Insurance Plans

The Company provides non-contributory defined benefit pension plans to certain of its employees in the United States and certain of its employees in Mexico and Belgium. The Company also sponsors contributory defined benefit pension plans covering the majority of its employees in the United Kingdom, Canada, and the Netherlands. In addition, the Company provides postretirement healthcare and life insurance benefits to a limited number of its retirees and their dependents in the United States and Canada, based on certain age and/or service eligibility requirements.

The Company froze participation in its U.S. qualified defined benefit pension plan for newly hired salaried and non-union hourly employees effective December 31, 2003. To replace this benefit, the Company provides non-union U.S. employees hired on or after January 1, 2004, with an annual contribution, called the Sonoco Retirement Contribution (SRC), to their participant accounts in the Sonoco Retirement and Savings Plan. The SRC is equal to 4% of the participant's eligible pay plus 4% of eligible pay in excess of the social security wage base. Also eligible for the SRC are former participants of the U.S. qualified defined benefit pension plan who elected to transfer out of that plan under a one-time option effective January 1, 2010.

On February 4, 2009, the U.S. qualified defined benefit pension plan was amended to freeze plan benefits for all active participants effective December 31, 2018. Remaining active participants in the U.S. qualified plan will become eligible for SRC contributions effective January 1, 2019.

The components of net periodic benefit cost include the following:

	Three Months Ended April 1, April 2, 2018 2017	
Retirement Plans		
Service cost	\$4,672	\$4,712
Interest cost	13,978	14,701
Expected return on plan assets	(23,209)	(20,838)
Amortization of prior service cost	249	231
Amortization of net actuarial loss	9,420	10,168
Net periodic benefit cost	\$5,110	\$8,974

Retiree Health and Life Insurance Plans

Service cost	\$79	\$84
Interest cost	111	120

Expected return on plan assets	(472)	(414)
Amortization of prior service credit	(126)	(127)
Amortization of net actuarial gain	(242)	(155)
Net periodic benefit income	\$(650)	\$(492)

SONOCO PRODUCTS COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

(unaudited)

The Company made aggregate contributions of \$4,573 and \$29,491 to its defined benefit retirement and retiree health and life insurance plans during the three months ended April 1, 2018 and April 2, 2017, respectively. The Company expects to make additional aggregate contributions of approximately \$20,000 to its defined benefit retirement and retiree health and life insurance plans over the remainder of 2018.

Sonoco Retirement Contribution (SRC)

The SRC, which is funded annually in the first quarter, totaled \$14,151 during the three months ended April 1, 2018, and \$14,066 during the three months ended April 2, 2017. No additional SRC contributions are expected during the remainder of 2018. The Company recognized expense related to the SRC of \$4,032 and \$3,871 for the three-month periods ended April 1, 2018 and April 2, 2017, respectively.

Note 13: Income Taxes

The Company's effective tax rate for the three-month period ending April 1, 2018, was 24.1% and its effective rate for the three-month period ending April 2, 2017, was 32.8%. The rate for the three-month period ending April 1, 2018 varied from the U.S. statutory rate due primarily to the new international tax regime of the U.S. as part of the enactment of the Tax Cuts and Jobs Act as well as the effect of state income taxes. The rate for the three-month period ending April 2, 2017 varied from the U.S. statutory rate due primarily to the favorable effect of certain international operations that were subject to tax rates generally lower than the U.S. rate.

On December 22, 2017, the SEC staff issued Staff Accounting Bulletin No. 118 ("SAB 118") to address the application of U.S. GAAP in situations where a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Tax Act. The Company recognized the provisional tax impacts related to deemed repatriated earnings and the revaluation of deferred tax assets and liabilities and included these amounts in its consolidated financial statements for the year ended December 31, 2017. The ultimate impact may differ from these provisional amounts, possibly materially, due to, among other things, additional analysis, changes in interpretations and assumptions the Company has made, additional regulatory guidance that may be issued, and actions the Company may take as a result of the Tax Act. No subsequent adjustments were made during the period ended April 1, 2018, to the provisional amounts recorded in December. Any such adjustments will be recorded to current tax expense in 2018 in the quarter the analysis is completed.

The Company and/or its subsidiaries file federal, state and local income tax returns in the United States and various foreign jurisdictions. With few exceptions, the Company is no longer subject to income tax examinations by tax authorities for years before 2012. The Company is currently under audit by the Internal Revenue Service for the 2012 and 2013 tax years.

The Company's reserve for uncertain tax benefits has increased by approximately \$1,000 since December 31, 2017, due primarily to an increase in reserves related to existing uncertain tax positions. The Company believes that it is reasonably possible that the amount reserved for unrecognized tax benefits at April 1, 2018 will decrease by approximately \$800 over the next twelve months. This change includes the anticipated increase in reserves related to existing positions offset by settlements of issues currently under examination and the release of existing reserves due to the expiration of the statute of limitations. Although the Company's estimate for the potential outcome for any uncertain tax issue is highly judgmental, management believes that any reasonably foreseeable outcomes related to these matters have been adequately provided for. However, future results may include favorable or unfavorable adjustments to estimated tax liabilities in the period the assessments are made or resolved or when statutes of limitation on potential assessments expire. Additionally, the jurisdictions in which earnings or deductions are realized may differ from current estimates. As a result, the Company's effective tax rate may fluctuate significantly on a quarterly basis. The Company has operations and pays taxes in many countries outside of the U.S. and taxes on those earnings are subject to varying rates. The Company is not dependent upon the favorable benefit of any one jurisdiction

to an extent that loss of those benefits would have a material effect on the Company's overall effective tax rate. As previously disclosed, the Company received a draft Notice of Proposed Adjustment ("NOPA") from the Internal Revenue Service (IRS) in February 2017 proposing an adjustment to income for the 2013 tax year based on the IRS's recharacterization of a distribution of an intercompany note made in 2012, and the subsequent repayment of the note over the course of 2013, as if it were a cash distribution made in 2013. In March 2017, the Company received a draft NOPA proposing penalties of \$18,000 associated with the IRS's recharacterization, as well as an Information Document Request

SONOCO PRODUCTS COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

(unaudited)

("IDR") requesting the Company's analysis of why such penalties should not apply. The Company responded to this IDR in April 2017. On October 5, 2017, the Company received two revised draft NOPAs proposing the same adjustments and penalties as in the prior NOPAs. On November 14, 2017, the Company received two final NOPAs proposing the same adjustments and penalties as in the prior draft NOPAs. On November 20, 2017, the Company received a Revenue Agent's Report ("RAR") that included the same adjustments and penalties as in the NOPAs. At the time of the distribution in 2012, it was characterized as a dividend to the extent of earnings and profits, with the remainder as a tax free return of basis and taxable capital gain. As the IRS proposes to recharacterize the distribution, the entire distribution would be characterized as a dividend. The incremental tax liability associated with the income adjustment proposed in the RAR would be approximately \$89,000, excluding interest and the previously referenced penalties. On January 22, 2018, the Company filed a protest to the proposed deficiency with the IRS, which will cause the matter to be referred to the Appeals Division of the IRS. The Company strongly believes the position of the IRS with regard to this matter is inconsistent with applicable tax laws and existing Treasury regulations, and that the Company's previously reported income tax provision for the year in question is appropriate. However, there can be no assurance that this matter will be resolved in the Company's favor. Regardless of whether the matter is resolved in the Company's favor, the final resolution of this matter could be expensive and time consuming to defend and/or settle. While the Company believes that the amount of tax originally paid with respect to this distribution is correct, and accordingly has not provided additional reserve for tax uncertainty, there is still a possibility that an adverse outcome of the matter could have a material effect on its results of operations and financial condition.

Note 14: Revenue Recognition

The Company adopted ASU 2014-09, "Revenue from Contracts with Customers," as of January 1, 2018. The impact of the adoption was the recognition of a \$1,721 increase in the Company's beginning retained earnings. See impact of adoption in Note 3 and additional discussion in Note 2 to these condensed consolidated financial statements.

The Company records revenue when control is transferred to the customer, which is either upon shipment or over time when the Company is entitled to payment and products are customer specific without alternative uses. The Company recognized over time revenue under the output method as goods are produced. Revenue that is recognized at a point in time is recognized when the customer obtains control of the goods. Customers obtain control either when goods are delivered to the customer facility, if the Company is responsible for arranging transportation, or when picked up by the customer's designated carrier. The Company enters into Master Supply Arrangements (MSA) with customers to provide services over specific time periods. Customers submit purchase orders with quantities and prices to create a contract for accounting purposes. Shipping and handling expenses are included in "Cost of Sales," and freight charged to customers is included in "Net Sales" in the Company's Condensed Consolidated Statements of Income.

The Company has rebate agreements with certain customers. These rebates are recorded as reductions of sales and are accrued using sales data and rebate percentages specific to each customer agreement. Accrued customer rebates are included in "Accrued expenses and other" in the Company's Condensed Consolidated Balance Sheets.

Payment terms under the Company's arrangements are short term in nature, generally no longer than 120 days. The Company does provide prompt payment discounts to certain customers if invoices are paid within a predetermined period. Prompt payment discounts are treated as a reduction of revenue and are determinable within a short period of the sale.

The following table sets forth information about receivables, contract assets and liabilities from contracts with customers. The balances of the contract assets and liabilities are located in "Other receivables" and "Accrued expenses and other" on the Condensed Consolidated Balance Sheets.

	January
April 1,	1, 2018
2018	As
	adjusted

Contract Assets	\$49,721	\$45,877
Contract Liabilities	\$(5,476)	\$(5,215)

SONOCO PRODUCTS COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

(unaudited)

Significant changes in the contract assets and liabilities balances during the period were as follows:

	April 1, 2018	January 1, 2018
		Adjusted

Contract Asset	Contract Liability	Contract Asset	Contract Liability
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Beginning Balance	\$45,877	\$(5,215)	\$—	\$—
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Revenue recognized that was included in the contract liabilities balance at the beginning of the period

Increases due to cash received, excluding

and recognized as revenue during the period

Transferred to receivables from contract assets recognized at the beginning

(261)	—	—	—
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—	—	—	—
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of				
the				
period				
Increase				
as				
a				
result				
of				
cumulative				
catch-up				
arising				
from				
changes				
in				
the—	—	45,877	(5,215)
estimate				
of				
completion,				
excluding				
amounts				
transferred				
to				
receivables				
during				
the				
period				
Impairment				
of	—	—	—	
contract				
asset				
Acquired				
as				
part				
of—	—	—	—	
a				
business				
combinations				
Ending				
Balance	\$49,721	\$(5,476)	\$45,877	\$(5,215)

Contract assets and liabilities are generally short in duration given the nature of products produced by the Company. Contract assets represents goods produced without alternative use for which the Company is entitled to payment with margin prior to shipment. Upon shipment, the Company is entitled to bill the customer, and therefore amounts included in contract assets will be reduced with the recording of an account receivable as they represent an unconditional right to payment. Contract liabilities represent revenue deferred due to pricing mechanisms utilized by the Company in certain multi-year arrangements. Generally the Company will defer revenue during the initial term of the arrangement, and will release the deferral over the back half of the contract term. The Company's reportable segments are aligned by product nature as disclosed in Note 15.

The following table sets forth information about revenue disaggregated by primary geographic regions, and timing of revenue recognition for the three-month period ended April 1, 2018. The table also includes a reconciliation of disaggregated revenue with reportable segments.

	Consumer Packaging	Display and Packaging	Paper and Industrial Converted Products	Protective Solutions
Primary Geographical Markets:				
United States	\$ 397,986	\$ 73,884	\$ 265,762	\$ 110,500
Europe	107,063	65,945	92,855	6,789
Canada	21,706	—	32,873	—
Other	87,097	2,829	69,163	13,735
Total	\$ 569,852	\$ 142,658	\$ 460,653	\$ 131,024

Timing of Revenue Recognition:				
Products transferred at a point in time	\$ 345,003	\$ 64,715	\$ 440,477	\$ 111,798
Products transferred over time	224,849	77,943	20,176	19,226
Total	\$ 569,852	\$ 142,658	\$ 460,653	\$ 131,024

SONOCO PRODUCTS COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

(unaudited)

Note 15: Segment Reporting

The Company reports its financial results in four reportable segments: Consumer Packaging, Display and Packaging, Paper and Industrial Converted Products, and Protective Solutions.

The Consumer Packaging segment includes the following products and services: round and shaped rigid containers and trays (both composite and thermoformed plastic); extruded and injection-molded plastic products; printed flexible packaging; global brand artwork management; and metal and peelable membrane ends and closures.

The Display and Packaging segment includes the following products and services: point-of-purchase displays; supply chain management services; retail packaging, including printed backer cards, thermoformed blisters and heat sealing equipment; and paperboard specialties, such as coasters and glass covers.

The Paper and Industrial Converted Products segment includes the following products: paperboard tubes and cores; fiber-based construction tubes and forms; wooden, metal and composite wire and cable reels and spools; and recycled paperboard, linerboard, corrugating medium, recovered paper and material recycling services.

The Protective Solutions segment includes the following products: custom-engineered, paperboard-based and expanded foam protective packaging and components; and temperature-assured packaging.

The following table sets forth net sales, intersegment sales and operating profit for the Company's reportable segments. "Segment operating profit" is defined as the segment's portion of "Operating profit" excluding restructuring charges, asset impairment charges, acquisition-related costs, and certain other items, if any, the exclusion of which the Company believes improves comparability and analysis of the financial performance of the business. General corporate expenses have been allocated as operating costs to each of the Company's reportable segments.

SEGMENT FINANCIAL INFORMATION

	Three Months Ended	
	April 1, 2018	April 2, 2017
Net sales:		
Consumer Packaging	\$569,852	\$482,181
Display and Packaging	142,658	114,635
Paper and Industrial Converted Products	460,653	442,502
Protective Solutions	131,024	133,006
Consolidated	\$1,304,187	\$1,172,324
Intersegment sales:		
Consumer Packaging	\$739	\$1,223
Display and Packaging	538	750
Paper and Industrial Converted Products	34,543	28,373
Protective Solutions	573	399
Consolidated	\$36,393	\$30,745
Operating profit:		
Segment operating profit:		
Consumer Packaging	\$61,088	\$59,460
Display and Packaging	1,732	3,222
Paper and Industrial Converted Products	39,781	26,850
Protective Solutions	10,680	10,931
Restructuring/Asset impairment charges	(3,063)	(4,111)
Other, net	(120)	(2,693)
Consolidated	\$110,098	\$93,659

SONOCO PRODUCTS COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

(unaudited)

Note 16: Commitments and Contingencies

Pursuant to U.S. GAAP, accruals for estimated losses are recorded at the time information becomes available indicating that losses are probable and that the amounts are reasonably estimable. As is the case with other companies in similar industries, the Company faces exposure from actual or potential claims and legal proceedings from a variety of sources. Some of these exposures, as discussed below, have the potential to be material.

Environmental Matters

The Company is subject to a variety of environmental and pollution control laws and regulations in all jurisdictions in which it operates.

Spartanburg

In connection with its acquisition of Tegrant in November 2011, the Company identified potential environmental contamination at a site in Spartanburg, South Carolina. The total remediation cost of the Spartanburg site was estimated to be \$17,400 at the time of acquisition and an accrual in this amount was recorded on Tegrant's opening balance sheet. Since the acquisition, the Company has spent a total of \$1,075 on remediation of the Spartanburg site. During previous years, the Company has increased its reserves for this site by a total of \$17 in order to reflect its best estimate of what it is likely to pay in order to complete the remediation. At April 1, 2018 and December 31, 2017, the Company's accrual for environmental contingencies related to the Spartanburg site totaled \$16,342 and \$16,504, respectively. The Company cannot currently estimate its potential liability, damages or range of potential loss, if any, beyond the amounts accrued with respect to this exposure. However, the Company does not believe that the resolution of this matter has a reasonable possibility of having a material adverse effect on the Company's financial statements.

Other environmental matters

The Company has been named as a potentially responsible party at several other environmentally contaminated sites. All of the sites are also the responsibility of other parties. The potential remediation liabilities are shared with such other parties, and, in most cases, the Company's share, if any, cannot be reasonably estimated at the current time. However, the Company does not believe that the resolution of these matters has a reasonable possibility of having a material adverse effect on the Company's financial statements. At April 1, 2018 and December 31, 2017, the Company's accrual for these other sites totaled \$3,389 and \$3,802, respectively.

Summary

As of April 1, 2018 and December 31, 2017, the Company (and its subsidiaries) had accrued \$19,731 and \$20,306, respectively, related to environmental contingencies. These accruals are included in "Accrued expenses and other" on the Company's Condensed Consolidated Balance Sheets.

Other Legal Matters

In addition to those matters described above, the Company is subject to other various legal proceedings, claims, and litigation arising in the ordinary course of business. While the outcome of these matters could differ from management's expectations, the Company does not believe the resolution of these matters has a reasonable possibility of having a material adverse effect on the Company's financial statements.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and shareholders Sonoco Products Company,

Results of Review of Financial Statements

We have reviewed the accompanying condensed consolidated balance sheet of Sonoco Products Company and its subsidiaries as of April 1, 2018, and the related condensed consolidated statements of income, comprehensive income and cash flows for the three-month periods ended April 1, 2018 and April 2, 2017, including the related notes (collectively referred to as the “interim financial statements”). Based on our reviews, we are not aware of any material modifications that should be made to the accompanying interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of the Company as of December 31, 2017, and the related consolidated statements of income, comprehensive income, changes in total equity and cash flows for the year then ended (not presented herein), and in our report dated February 28, 2018, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2017, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Basis for Review Results

These interim financial statements are the responsibility of the Company’s management. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB. We conducted our review in accordance with the standards of the PCAOB. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the PCAOB, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

/s/PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Charlotte, North Carolina
May 2, 2018

SONOCO PRODUCTS COMPANY

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Statements included in this Quarterly Report on Form 10-Q 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. In addition, the Company and its representatives may from time to time make other oral or written statements that are also "forward-looking statements." Words such as "estimate," "project," "intend," "expect," "believe," "consider," "plan," "strategy," "opportunity," "commitment," "target," "anticipate," "objective," "outlook," "forecast," "future," "re-envision," "assume," "will," "would," "can," "could," "may," "might," "aspires," "potential" thereof, and similar expressions identify forward-looking statements. Forward-looking statements include, but are not limited to, statements regarding:

- availability and supply of raw materials, and offsetting high raw material costs, including the impact of potential changes in tariffs;
- improved productivity and cost containment;
- improving margins and leveraging strong cash flow and financial position;
- effects of acquisitions and dispositions;
- realization of synergies resulting from acquisitions;
- costs, timing and effects of restructuring activities;
- adequacy and anticipated amounts and uses of cash flows;
- expected amounts of capital spending;
- refinancing and repayment of debt;
- financial strategies and the results expected of them;
- plans with respect to repatriation of off-shore earnings;
- financial results for future periods;
- producing improvements in earnings;
- profitable sales growth and rates of growth;
- market leadership;
- research and development spending;
- expected impact and costs of resolution of legal proceedings;
- extent of, and adequacy of provisions for, environmental liabilities;
- adequacy of income tax provisions, realization of deferred tax assets, outcomes of uncertain tax issues and tax rates;
- goodwill impairment charges and fair values of reporting units;
- future asset impairment charges and fair values of assets;
- anticipated contributions to pension and postretirement benefit plans, fair values of plan assets, long-term rates of return on plan assets, and projected benefit obligations and payments;
- expected impact of implementation of new accounting pronouncements;
- creation of long-term value and returns for shareholders;
- continued payment of dividends; and
- planned stock repurchases.

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, perceived opportunities, expectations, beliefs, plans, strategies, goals 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, uncertainties and assumptions include, without limitation:

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availability and pricing of raw materials, energy and transportation, including the impact of potential changes in tariffs, and the Company's ability to pass raw material, energy and transportation price increases and surcharges through to customers or otherwise manage these commodity pricing risks;

• costs of labor;

• work stoppages due to labor disputes;

• success of new product development, introduction and sales;

• consumer demand for products and changing consumer preferences;

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ability to be the low-cost global leader in customer-preferred packaging solutions within targeted segments;
 competitive pressures, including new product development, industry overcapacity, and changes in competitors' pricing for products;
 ability to maintain or increase productivity levels, contain or reduce costs, and maintain positive price/cost relationships;
 ability to negotiate or retain contracts with customers, including in segments with concentration of sales volume;
 ability to improve margins and leverage cash flows and financial position;
 continued strength of our paperboard-based tubes and cores and composite can operations;
 ability to manage the mix of business to take advantage of growing markets while reducing cyclical effects of some of the Company's existing businesses on operating results;
 ability to maintain innovative technological market leadership and a reputation for quality;
 ability to attract and retain talented and qualified employees, managers and executives;
 ability to profitably maintain and grow existing domestic and international business and market share;
 ability to expand geographically and win profitable new business;
 ability to identify and successfully close suitable acquisitions at the levels needed to meet growth targets, and successfully integrate newly acquired businesses into the Company's operations;
 the costs, timing and results of restructuring activities;
 availability of credit to us, our customers and suppliers in needed amounts and on reasonable terms;
 effects of our indebtedness on our cash flow and business activities;
 fluctuations in interest rates and our borrowing costs;
 fluctuations in obligations and earnings of pension and postretirement benefit plans;
 accuracy of assumptions underlying projections of benefit plan obligations and payments, valuation of plan assets, and projections of long-term rates of return;
 cost of employee and retiree medical, health and life insurance benefits;
 resolution of income tax contingencies;
 foreign currency exchange rate fluctuations, interest rate and commodity price risk and the effectiveness of related hedges;
 changes in U.S. and foreign tax rates, and tax laws, regulations, interpretations and implementation thereof;
 accuracy in valuation of deferred tax assets;
 accuracy of assumptions underlying projections related to goodwill impairment testing, and accuracy of management's assessment of goodwill impairment;
 accuracy of assumptions underlying fair value measurements, accuracy of management's assessments of fair value and fluctuations in fair value;
 ability to maintain effective internal controls over financial reporting;
 liability for and anticipated costs of resolution of legal proceedings;
 liability for and anticipated costs of environmental remediation actions;
 effects of environmental laws and regulations;
 operational disruptions at our major facilities;
 failure or disruptions in our information technologies;
 failure of third party transportation providers to deliver our products to our customers or to deliver raw materials to us;
 substantially lower than normal crop yields;
 loss of consumer or investor confidence;
 ability to protect our intellectual property rights;
 changes in laws and regulations relating to packaging for food products and foods packaged therein, other actions and public concerns about products packaged in our containers, or chemicals or substances used in raw materials or in the manufacturing process;
 changing climate, climate change regulations and greenhouse gas effects;
 .

actions of domestic or foreign government agencies and other changes in laws and regulations affecting the Company and increased costs of compliance;
international, national and local economic and market conditions and levels of unemployment; and
economic disruptions resulting from terrorist activities and natural disasters.

More information about the risks, uncertainties and assumptions that may cause actual results to differ materially from those expressed or forecasted in forward-looking statements is provided in the Company's Annual Report on Form 10-K

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under Item 1A - "Risk Factors" and throughout other sections of that report and in other reports filed with the Securities and Exchange Commission. In light of these various risks, uncertainties and assumptions, the forward-looking events discussed in this report might not occur.

The Company undertakes no obligation to publicly update or revise forward-looking statements, whether as a result of new information, future events or otherwise. You are, however, advised to review any further disclosures we make on related subjects, and about new or additional risks, uncertainties and assumptions, in our future filings with the Securities and Exchange Commission on Forms 10-K, 10-Q and 8-K.

COMPANY OVERVIEW

Sonoco is a leading provider of consumer packaging, industrial products, protective packaging and packaging supply chain services, with approximately 300 locations in 33 countries.

Sonoco competes in multiple product categories, with its operations organized and reported in four segments: Consumer Packaging, Display and Packaging, Paper and Industrial Converted Products, and Protective Solutions. The majority of the Company's revenues are from products and services sold to consumer and industrial products companies for use in the packaging of their products for sale or shipment. The Company also manufactures paperboard, primarily from recycled materials, for both internal use and open market sale. Each of the Company's operating units has its own sales staff and maintains direct sales relationships with its customers.

First Quarter 2018 Compared with First Quarter 2017

RECONCILIATIONS OF GAAP TO NON-GAAP FINANCIAL MEASURES

Measures calculated and presented in accordance with generally accepted accounting principles are referred to as GAAP financial measures. The following tables reconcile the Company's non-GAAP financial measures to their most directly comparable GAAP financial measures in the Company's Condensed Consolidated Statements of Income for each of the periods presented. These non-GAAP financial measures (referred to as "Base") are the GAAP measures adjusted to exclude (dependent upon the applicable period) restructuring charges, asset impairment charges, acquisition charges, specifically identified tax adjustments, pension settlement charges and certain other items, if any, the exclusion of which the Company believes improves comparability and analysis of the underlying financial performance of the business. More information about the Company's use of Non-GAAP financial measures is provided in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 under Item 7 - "Management's discussion and analysis of financial condition and results of operations," under the heading "Use of non-GAAP financial measures."

For the three months ended April 1, 2018				
Dollars in thousands, except per share data	GAAP	Restructuring/ Asset Impairment	Other Adjustments ⁽¹⁾	Base
Operating profit	\$110,098	\$ 3,063	\$ 120	\$113,281
Non-operating pension (income)/costs	(291)	—	—	(291)
Interest expense, net	13,355	—	—	13,355
Income before income taxes	97,034	3,063	120	100,217
Provision for income taxes	23,356	685	1,912	25,953
Income before equity in earnings of affiliates	73,678	2,378	(1,792)	74,264
Equity in earnings of affiliates, net of tax	1,247	—	—	1,247
Net income	74,925	2,378	(1,792)	75,511
Net (income) attributable to noncontrolling interests	(870)	(5)	—	(875)
Net income attributable to Sonoco	\$74,055	\$ 2,373	\$ (1,792)	\$74,636
Per diluted common share*	\$0.73	\$ 0.02	\$ (0.02)	\$0.74

*Due to rounding individual items may not sum across

⁽¹⁾Consists of a gain totaling \$1,975 from the effect of a change in the U.S. corporate tax rate on deferred tax adjustments, as well as a small insurance settlement gain, partially offset by acquisition-related costs.

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For the three months ended April 2, 2017

Dollars in thousands, except per share data	GAAP	Restructuring/ Asset Impairment	Other Adjustments ⁽¹⁾	Base
Operating profit	\$93,659	\$ 4,111	\$ 2,693	\$100,463
Non-operating pension (income)/costs	3,686	—	—	3,686
Interest expense, net	12,058	—	—	12,058
Income before income taxes	77,915	4,111	2,693	84,719
Provision for income taxes	25,539	1,298	(641)	26,196
Income before equity in earnings of affiliates	52,376	2,813	3,334	58,523
Equity in earnings of affiliates, net of tax	1,954	—	—	1,954
Net income	54,330	2,813	3,334	60,477
Net (income) attributable to noncontrolling interests	(597)	(2)	—	(599)
Net income attributable to Sonoco	\$53,733	\$ 2,811	\$ 3,334	\$59,878
Per diluted common share*	\$0.53	\$ 0.03	\$ 0.03	\$0.59

*Due to rounding individual items may not sum across

⁽¹⁾ Consists primarily of acquisition-related costs, partially offset by insurance settlement gains. Also includes net tax charges totaling \$1,434 primarily related to the settlement of a tax audit in Canada.

RESULTS OF OPERATIONS

The following discussion provides a review of results for the three months ended April 1, 2018 versus the three months ended April 2, 2017.

OVERVIEW

Net sales for the first quarter of 2018 increased 11.2% to \$1,304 million, compared with \$1,172 million in the same period last year. The increase in sales was the result of sales from businesses acquired in the last year, the positive impact of foreign exchange, and higher selling prices. Sales price increases primarily reflect higher raw material costs which the Company was able to pass through to customers.

Net income attributable to Sonoco for the first quarter of 2018 increased 37.8% to \$74.1 million, \$0.73 per diluted share, compared to \$53.7 million, \$0.53 per diluted share, reported for the same period of 2017. Current quarter net income includes after-tax, non-base charges totaling \$0.6 million. These charges consist primarily of restructuring and asset impairment charges and acquisition-related costs, partially offset by favorable deferred tax adjustments related to tax rate changes resulting from the enactment of the Tax Cuts and Jobs Act (Tax Act) and an insurance settlement gain. Results for the first quarter of 2017 include after-tax restructuring and asset impairment charges of \$2.8 million and after-tax acquisition and non-base tax charges of \$3.3 million. Adjusted for these items, first-quarter base net income attributable to Sonoco (base earnings) increased 24.6% to \$74.6 million, \$0.74 per diluted share, from \$59.9 million, \$0.59 per diluted share, in 2017.

The higher first quarter 2018 earnings were largely the result of a positive price/cost impact, particularly in the Company's Paper and Industrial Converted Products segment, as first-quarter selling prices to many of the segment's customers were reset during the fourth quarter of 2017 when old corrugated containers (OCC) prices were higher than they subsequently averaged during the first quarter of 2018, and as a result of price increases implemented on non-contract business in this segment. Strong manufacturing productivity in the Company's Consumer Packaging segment and lower restructuring, asset impairment charges, and costs related to acquisitions also contributed to the overall increase in earnings over the previous year's first quarter. These positive factors were slightly offset by higher management incentives as well as general wage and other inflation.

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OPERATING REVENUE

Net sales for the first quarter of 2018 increased \$132 million from the prior-year quarter.

The components of the sales change were:

	(\$ in millions)
Volume/mix	\$ 7
Selling prices	22
Acquisitions and Divestitures	61
Foreign currency translation and other, net	42
 Total sales increase	 \$ 132

COSTS AND EXPENSES

The Company's gross profit margin percentage increased to 19.2% this quarter compared to 19.0% in the prior-year quarter. The 20 basis point increase in gross profit margin was largely attributable to the favorable timing and direction of material price changes and improved manufacturing cost productivity, partially offset by wage and operating cost inflation. The translation impact of a weaker dollar increased reported cost of goods sold by approximately \$37 million compared to the first quarter of 2017.

Selling, general and administrative ("SG&A") costs for the quarter increased \$12.2 million, or 9.8%, year over year due primarily to SG&A expenses incurred by the operations of acquired businesses, higher management incentives and wage inflation.

First-quarter restructuring costs and asset impairment charges totaled \$3.1 million compared with \$4.1 million in the same period last year. Additional information regarding restructuring and asset impairment charges is provided in Note 6 to the Company's Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Net interest expense for the first quarter increased to \$13.4 million, compared with \$12.1 million during the first quarter of 2017. The increase was primarily due to higher average borrowings in the current-year quarter stemming from acquisition financing.

The effective tax rate on GAAP and base earnings in the first quarter of 2018 was 24.1% and 25.9%, respectively, compared with 32.8% and 30.9%, respectively, for last year's quarter. Although the Tax Act lowered the year-over-year effective tax rate on both GAAP and base earnings, it had a more meaningful impact on certain non-base items resulting in a larger decrease in the GAAP rate.

REPORTABLE SEGMENTS

The following table recaps net sales for the first quarters of 2018 and 2017 (\$ in thousands):

	Three Months Ended		
	April 1, 2018	April 2, 2017	% Change
Net sales:			
Consumer Packaging	\$569,852	\$482,181	18.2 %
Display and Packaging	142,658	114,635	24.4 %
Paper and Industrial Converted Products	460,653	442,502	4.1 %
Protective Solutions	131,024	133,006	(1.5)%
Consolidated	\$1,304,187	\$1,172,324	11.2 %

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Consolidated operating profits on the Company's Condensed Consolidated Statements of Income are comprised of the following (\$ in thousands):

	Three Months Ended		
	April 1, 2018	April 2, 2017	% Change
Operating profit:			
Segment operating profit:			
Consumer Packaging	\$61,088	\$59,460	2.7 %
Display and Packaging	1,732	3,222	(46.2)%
Paper and Industrial Converted Products	39,781	26,850	48.2 %
Protective Solutions	10,680	10,931	(2.3)%
Restructuring/Asset impairment charges	(3,063)	(4,111)	
Other, net	(120)	(2,693)	
Consolidated	\$110,098	\$93,659	17.6 %

The following table recaps restructuring/asset impairment charges attributable to each of the Company's segments during the first quarters of 2018 and 2017 (\$ in thousands):

	Three Months Ended	
	April 1, 2018	April 2, 2017
Restructuring/Asset impairment charges:		
Consumer Packaging	\$1,729	\$1,100
Display and Packaging	(14)	501
Paper and Industrial Converted Products	847	1,894
Protective Solutions	278	153
Corporate	223	463
Consolidated	\$3,063	\$4,111

Segment results viewed by Company management to evaluate segment performance do not include restructuring charges, asset impairment charges, acquisition-related charges, or certain other items, if any, the exclusion of which the Company believes improves the comparability and analysis of the ongoing operating performance of the business. Accordingly, the term "segment operating profit" is defined as the segment's portion of "operating profit" excluding those items. All other general corporate expenses have been allocated as operating costs to each of the Company's reportable segments.

Consumer Packaging

The Consumer Packaging segment includes the following products and services: round and shaped rigid containers and trays (both composite and thermoformed plastic); extruded and injection-molded plastic products; printed flexible packaging; global brand artwork management; and metal and peelable membrane ends and closures.

Segment sales increased 18.2% compared to the prior-year quarter due to acquisitions, higher selling prices and the positive impact of changes in foreign exchange rates.

Segment operating profit grew 2.7% compared to the prior-year quarter due to strong improvement in manufacturing productivity, a positive price/cost relationship, and the benefit of acquisitions, partially offset by a negative change in volume/mix, higher wages and operating costs. Higher sales volume/positive sales mix in global plastics and international composite can operations were more than offset by lower composite can volume in North America.

Segment operating margin declined to 10.7% in the quarter from 12.3% in 2017 due to higher operating costs, certain resin material inflation and changes in mix of business, including acquisitions.

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Display and Packaging

The Display and Packaging segment includes the following products and services: designing, manufacturing, assembling, packing and distributing temporary, semi-permanent and permanent point-of-purchase displays; supply chain management services, including contract packing, fulfillment and scalable service centers; retail packaging, including printed backer cards, thermoformed blisters and heat sealing equipment; and paper amenities, such as coasters and glass covers.

Sales for the quarter were up 24.4% compared to last year's quarter due primarily to volume growth from a new pack center near Atlanta and the positive impact of foreign exchange.

Segment operating profit decreased \$1.5 million, or 46.2%, largely due to inefficiencies and higher operating costs associated with the ramp up of production at the new pack center. Results from the new pack center nonetheless showed sequential quarterly improvement. The Company continues working to resolve these and other operational issues and remains optimistic that over time the pack center will be able to achieve efficiency and cost levels in line with expectations.

Paper and Industrial Converted Products

The Paper and Industrial Converted Products segment includes the following products: paperboard tubes and cores; fiber-based construction tubes and forms; wooden, metal and composite wire and cable reels and spools; and recycled paperboard, linerboard, corrugating medium, recovered paper and material recycling services.

Reported segment sales increased approximately 4.1% from the prior-year quarter due to the positive impact of foreign exchange and higher selling prices implemented to recover higher freight and other operating costs, partially offset by lower volume/mix. Volume/mix gains in wire and cable reels as well as North America and European paper operations were more than offset by declines in North America tube and core and recycling volumes.

Operating profit increased 48.2% over the prior year driven by a positive price/cost relationship across most of the segment, including continued improvement in the Company's corrugating medium operations. Segment operating margin improved 250 basis points to 8.6%.

Protective Solutions

The Protective Solutions segment includes the following products: custom-engineered, paperboard-based and expanded foam protective packaging and components; and temperature-assured packaging.

Segment sales for the quarter declined 1.5% year over year as the positive impact of foreign exchange and higher selling prices was offset by lower volume/mix, primarily in the segment's automotive components business.

Operating profits decreased 2.3% from the prior-year quarter due primarily to lower volume in automotive components. However, the segment's operating profits did improve sequentially as the segment is focused on reducing fixed costs in response to the lower automotive component volume. Segment operating margin was 8.2%, essentially flat with the prior-year quarter.

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OTHER ITEMS

Subsequent Events

New term loan

On April 12, 2018, the Company entered into a \$100 million term loan with Bank of America, N.A. The full amount was drawn from this facility on April 12, 2018, and the proceeds, along with proceeds from existing credit facilities, were used to fund the acquisition of Highland Packaging Solutions ("Highland"). The loan has a 364-day term and the Company has a one-time option to extend the term for an additional 364 days at its sole discretion. Interest is assessed at the London Interbank Offered Rate (LIBOR) plus a margin based on a pricing grid that uses the Company's credit ratings. The current LIBOR margin is 110 basis points. There is no required amortization and repayment can be accelerated at any time at the discretion of the Company.

Completion of acquisition

On April 12, 2018, the Company completed the acquisition of Highland. Total consideration for this acquisition was \$150 million, including cash paid at closing of \$142.5 million and a contingent purchase liability of \$7.5 million. Final consideration will also be subject to an adjustment for working capital, which is expected to be completed by the end of the third quarter of 2018. Highland manufactures thermoformed plastic packaging for fresh produce and dairy products from a single production facility in Plant City, Florida, providing total packaging solutions for customers that include sophisticated engineered containers, flexographic printed labels, and inventory management through distribution warehouses in the Southeast and West Coast of the United States. The Company financed the acquisition with proceeds from the new term loan, along with proceeds from existing credit facilities. Highland is expected to generate annual sales of approximately \$100 million in the Consumer Packaging segment.

Interim Goodwill Impairment Assessment

Information regarding the interim goodwill impairment assessment and potential charge to be recorded in the second quarter of 2018 is included in Note 8 to the Company's Condensed Consolidated Financial Statements, included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Critical Accounting Policies and Estimates

Income taxes

As previously disclosed, the Company received a draft Notice of Proposed Adjustment ("NOPA") from the Internal Revenue Service (IRS) in February 2017 proposing an adjustment to income for the 2013 tax year based on the IRS's recharacterization of a distribution of an intercompany note made in 2012, and the subsequent repayment of the note over the course of 2013, as if it were a cash distribution made in 2013. In March 2017, the Company received a draft NOPA proposing penalties of \$18 million associated with the IRS's recharacterization, as well as an Information Document Request ("IDR") requesting the Company's analysis of why such penalties should not apply. The Company responded to this IDR in April 2017. On October 5, 2017, the Company received two revised draft NOPAs proposing the same adjustments and penalties as in the prior NOPAs. On November 14, 2017, the Company received two final NOPAs proposing the same adjustments and penalties as in the prior draft NOPAs. On November 20, 2017, the Company received a Revenue Agent's Report ("RAR") that included the same adjustments and penalties as in the NOPAs. At the time of the distribution in 2012, it was characterized as a dividend to the extent of earnings and profits, with the remainder as a tax free return of basis and taxable capital gain. As the IRS proposes to recharacterize the distribution, the entire distribution would be characterized as a dividend. The incremental tax liability associated with the income adjustment proposed in the RAR would be approximately \$89 million, excluding interest and the previously referenced penalties. On January 22, 2018, the Company filed a protest to the proposed deficiency with the IRS, which will cause the matter to be referred to the Appeals Division of the IRS. The Company strongly believes the position of the IRS with regard to this matter is inconsistent with applicable tax laws and existing Treasury regulations, and that the Company's previously reported income tax provision for the year in question is appropriate. However, there can be no assurance that this matter will be resolved in the Company's favor. Regardless of whether the matter is resolved in the Company's favor, the final resolution of this matter could be expensive and time consuming to defend and/or settle. While the Company believes that the amount of tax originally paid with respect to this distribution is correct, and accordingly has not provided additional reserve for tax uncertainty, there is

still a possibility that an adverse outcome of the matter could have a material effect on its results of operations and financial condition.

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Financial Position, Liquidity and Capital Resources

Operating cash flows totaled \$119.8 million in the three months ended April 1, 2018 compared with \$67.4 million during the same period last year, an increase of \$52.4 million. A year-over-year increase in net income of \$20.6 million, and a decrease in year-to-date net pension and post-retirement contributions, net of plan expenses, of \$21.0 million drove the majority of the year-over-year change. Changes in tax accounts provided \$4.8 million more cash in the first three months of 2018 compared to 2017, driven by larger 2017 estimated tax payments attributable to events discrete to 2017.

Accounts Receivable consumed \$19.3 million in the first quarter of 2018 compared with \$10.0 million last year. Additionally, inventories consumed \$17.8 million in the first quarter of 2018 compared with \$9.8 million last year, reflecting the seasonal building of inventory at recently acquired businesses. Trade accounts payable provided \$10.3 million of cash during the three months ended April 1, 2018 while providing \$14.7 million in the same period last year. Although the first three months of both 2018 and 2017 saw increased rates of business activity following seasonal year-end slow downs, the first quarter of 2018 saw a greater increase in business activity compared to the increase in the first quarter of 2017, resulting in an increased use of cash year over year.

Decreases in accrued expenses used \$0.2 million of cash in the three months ended April 1, 2018 while using \$11.6 million in the same period last year. The greater use of cash in the prior year is primarily due to the payment of management incentives, the accruals for which were greater at the end of 2016 than the end of 2017. Changes in prepaid expenses and other assets and liabilities provided \$8.2 million of additional cash in 2018 compared to 2017, largely attributable to the collection of various other receivables outstanding at the end of 2017. Similar levels of miscellaneous receivable items were not outstanding at the end of 2016.

Cash used in investing activities was \$35.9 million in the three months ended April 1, 2018, compared with \$270.3 million in the same period last year, a lower year-over-year use of cash totaling \$234.4 million. The most significant driver of the decrease was the first quarter 2017 acquisition of Packaging Holdings for \$221.4 million. There was no acquisition spending in the first quarter of 2018. Capital spending was approximately \$9.1 million lower year over year. Capital spending for the remainder of 2018 is expected to total approximately \$180 million.

Cash used by financing activities totaled \$36.6 million in the three months ended April 1, 2018, compared with a provision of cash totaling \$154.0 million in the same period last year. The \$190.6 million year-over-year reduction is primarily due to proceeds from borrowings in the prior year for the acquisition of Packaging Holdings. The Company paid cash dividends of \$38.8 million during the three months ended April 1, 2018, an increase of \$2.0 million over the same period last year. Cash used to repurchase the Company's common stock was lower year over year by \$1.5 million. Total debt outstanding was \$1,464.6 million at April 1, 2018 compared with \$1,447.3 million at December 31, 2017.

The Company operates a \$350 million commercial paper program, supported by a \$500 million five-year revolving credit facility. In July 2017, the Company entered into a new credit agreement with a syndicate of eight banks for that revolving facility, together with a new \$250 million five-year term loan. The revolving bank credit facility is committed through July 2022. If circumstances were to prevent the Company from issuing commercial paper, it has the contractual right to draw funds directly on the underlying revolving bank credit facility. On April 12, 2018, in conjunction with the previously mentioned purchase of Highland Packaging Solutions, the Company entered into a new \$100 million 364-day term loan facility.

The Company continually explores strategic acquisition opportunities which may result in the additional use of cash. Given the nature of acquisitions, the timing and amounts of such utilization are not predictable. The Company expects that acquisitions requiring funding in excess of cash on hand would be financed using available borrowing capacity. Cash and cash equivalents totaled \$305.3 million and \$254.9 million at April 1, 2018 and December 31, 2017, respectively. Of these totals, approximately \$281.7 million and \$238.4 million, respectively, were held outside of the United States by the Company's foreign subsidiaries. Cash held outside of the United States is available to meet local liquidity needs, or for capital expenditures, acquisitions, and other offshore growth opportunities. Under prior law, cash repatriated to the United States was subject to federal income taxes, less applicable foreign tax credits. As the Company enjoys ample domestic liquidity through a combination of operating cash flow generation and access to

bank and capital markets borrowings, it has generally considered its offshore cash balances to be indefinitely invested outside the United States and had no plans to repatriate these cash balances. However, due to changes in U.S. tax laws as part of the enactment of the Tax Cuts and Jobs Act, beginning in 2018 repatriated cash will generally not be subject to federal income taxes; accordingly, the Company is considering opportunities to repatriate cash balances. The Company will

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finalize its analysis during 2018 and, as provided for in SAB 118, will make any necessary adjustments in the financial statements of future periods within the provided time frame, including a determination of our intentions with respect to undistributed earnings of international subsidiaries.

The Company uses a notional pooling arrangement with an international bank to help manage global liquidity requirements. Under this pooling arrangement, the Company and its participating subsidiaries may maintain either a cash deposit or borrowing position through local currency accounts with the bank, so long as the aggregate position of the global pool is a notionally calculated net cash deposit. Because it maintains a security interest in the cash deposits, and has the right to offset the cash deposits against the borrowings, the bank provides the Company and its participating subsidiaries favorable interest terms on both.

During the three months ended April 1, 2018, the Company reported a net increase in cash and cash equivalents of \$3.0 million due to a weaker U.S. dollar relative to certain foreign currencies, most notably the euro and Mexican peso.

Certain of the Company's debt agreements impose restrictions with respect to the maintenance of financial ratios and the disposition of assets. The most restrictive covenants currently require the Company to maintain a minimum level of interest coverage and a minimum level of net worth, as defined in the agreements. As of April 1, 2018, the Company's interest coverage and net worth were substantially above the minimum levels required under these covenants.

The Company anticipates making additional contributions to its pension and postretirement plans of approximately \$20 million during the remainder of 2018, which would result in total 2018 contributions of approximately \$39 million. Future funding requirements beyond the current year will vary depending largely on actual investment returns, future actuarial assumptions, and legislative actions.

Fair Value Measurements, Foreign Exchange Exposure and Risk Management

Certain assets and liabilities are reported in the Company's financial statements at fair value, the fluctuation of which can impact the Company's financial position and results of operations. Items reported by the Company at fair value on a recurring basis include derivative contracts and pension and deferred compensation related assets. The valuation of the vast majority of these items is based either on quoted prices in active and accessible markets or on other observable inputs.

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 operations are located throughout the world, and the Company generally sells in the same countries where it produces with both revenue and costs transacted in the local currency. The Company monitors these exposures and may use traditional currency swaps and forward exchange contracts to hedge a portion of 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, geopolitical and cultural risks, but the risks are mitigated by diversification and the relative stability of the countries in which the Company has significant operations.

Prior to July 1, 2015, the Company used Venezuela's official exchange rate to report the results of its operations in Venezuela. As a result of significant inflationary increases, and to avoid distortion of its consolidated results from translation of its Venezuelan operations, the Company concluded that it was an appropriate time to begin translating its Venezuelan operations at an alternative exchange rate. Accordingly, effective July 1, 2015, the Company began translating its Venezuelan operating results and all monetary assets and liabilities in Venezuela using the alternative rate known as the SIMADI rate (replaced in 2016 by the DICOM rate). At April 1, 2018, the carrying value of the Company's net investment in its Venezuelan operations was approximately \$1.8 million. In addition, at April 1, 2018, the Company's Accumulated Other Comprehensive Loss included a translation loss of \$3.6 million related to its Venezuelan operations which would need to be reclassified to net income in the event of a complete exit of the business or a deconsolidation of these operations.

At April 1, 2018, the Company had commodity contracts outstanding to fix the cost of a portion of anticipated raw materials and natural gas purchases. The total net fair market value of these instruments was an unfavorable position of \$(1.8) million and \$(1.7) million at April 1, 2018 and December 31, 2017, respectively. Natural gas and aluminum hedge contracts covering an equivalent of 6.0 million MMBTUs and 2,858 metric tons, respectively, were

outstanding at April 1, 2018. Additionally, the Company had various currency contracts outstanding to fix the exchange rate on certain anticipated foreign currency cash flows. The total market value of these instruments was a net favorable position of \$2.1 million and \$1.0 million at April 1, 2018 and December 31, 2017, respectively. These contracts qualify as cash flow hedges and mature within twelve months of their respective reporting dates.

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In addition, at April 1, 2018, the Company had various currency contracts outstanding to fix the exchange rate on certain foreign currency assets and liabilities. Although placed as an economic hedge, the Company does not apply hedge accounting to these contracts. The fair value of these currency contracts was a net favorable position of \$0.2 million at April 1, 2018 and a net unfavorable position of \$(0.6) million at December 31, 2017.

At April 1, 2018, the U.S. dollar had weakened against most of the functional currencies of the Company's foreign operations compared to December 31, 2017, resulting in a translation gain of \$22.6 million being recorded in accumulated other comprehensive loss during the three months ended April 1, 2018.

Restructuring and Impairment

Information regarding restructuring charges and restructuring-related asset impairment charges is provided in Note 6 to the Company's Condensed Consolidated Financial Statements, included in Part I, Item 1 of this Form 10-Q.

New Accounting Pronouncements

Information regarding new accounting pronouncements is provided in Note 2 to the Company's Condensed Consolidated Financial Statements, included in Part I, Item 1 of this Form 10-Q.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Information about the Company's exposure to market risk is discussed under Part I, Item 2 in this report and was disclosed in its Annual Report on Form 10-K for the year ended December 31, 2017, which was filed with the Securities and Exchange Commission on February 28, 2018. There have been no other material quantitative or qualitative changes in market risk exposure since the date of that filing.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Under the supervision, and with the participation, of our management, including our Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), we conducted an evaluation pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934, as amended, ("the Exchange Act") of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). Based on this evaluation, our CEO and CFO concluded that such controls and procedures, as of April 1, 2018, the end of the period covered by this Quarterly Report on Form 10-Q, were effective to ensure that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms. For this purpose, disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information that is required to be disclosed in the reports we file or submit under the Exchange Act is accumulated and communicated to the Company's management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There have been no changes in the Company's internal control over financial reporting occurring during the three months ended April 1, 2018, that materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

SONOCO PRODUCTS COMPANY

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

Information with respect to legal proceedings and other exposures appears in Part I - Item 3 - "Legal Proceedings" and Part II - Item 8 - "Financial Statements and Supplementary Data" (Note 14 - "Commitments and Contingencies") in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, and in Part I - Item 1 - "Financial Statements" (Note 16 - "Commitments and Contingencies") of this report.

Environmental Matters

The Company has been named as a potentially responsible party (PRP) at several environmentally contaminated sites not owned by the Company. 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 arrangements 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 is likely to 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, beyond what has been accrued at April 1, 2018, cannot be determined. As of April 1, 2018 and December 31, 2017, the Company had accrued \$19.7 million and \$20.3 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.

Other legal matters

Additional information regarding legal proceedings is provided in Note 16 to the Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q.

SONOCO PRODUCTS COMPANY

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares Purchased ¹	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs ²	(d) Maximum Number of Shares that May Yet be Purchased under the Plans or Programs ²
1/01/18 - 2/04/18	8,472	\$ 53.81	—	2,969,611
2/05/18 - 3/04/2018	69,032	\$ 52.44	—	2,969,611
3/05/18 - 4/01/2018	230	\$ 51.32	—	2,969,611
Total	77,734	\$ 52.59	—	2,969,611

A total of 77,734 common shares were repurchased in the first quarter of 2018 related to shares withheld to satisfy employee tax withholding obligations in association with certain share-based compensation awards. These shares were not repurchased as part of a publicly announced plan or program.

On February 10, 2016, the Company's Board of Directors authorized the repurchase of up to 5,000,000 shares of the Company's common stock. A total of 2,030,389 shares were repurchased under this authorization during 2016. No shares were repurchased during 2017 or during the three-month period ended April 1, 2018. Accordingly, a total of 2,969,611 shares remain available for repurchase at April 1, 2018.

Item 6. Exhibits.

Exhibit Index

10. Term Loan Agreement between Sonoco Products Company and Bank of America, N.A., dated April 12, 2018
15. Letter re: unaudited interim financial information
31. Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 and 17 C.F.R. 240.13a-14(a)
32. Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and 17 C.F.R. 240.13a-14(b)

The following materials from Sonoco Products Company's Quarterly Report on Form 10-Q for the quarter ended April 1, 2018, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets at April 1, 2018 and December 31, 2017, (ii) Condensed Consolidated Statements of Income for the three months ended April 1, 2018 and April 2, 2017, (iii) Condensed Consolidated Statements of Comprehensive Income for the three months ended April 1, 2018 and April 2, 2017, (iv) Condensed Consolidated Statements of Cash Flows for the three months ended April 1, 2018 and April 2, 2017, and (v) Notes to Condensed Consolidated Financial Statements.

SONOCO PRODUCTS COMPANY

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SONOCO PRODUCTS COMPANY
(Registrant)

Date: May 2, 2018 By: /s/ Barry L. Saunders
Barry L. Saunders
Senior Vice President and Chief Financial Officer
(principal financial officer)

/s/ James W. Kirkland
James W. Kirkland
Corporate Controller
(principal accounting officer)