Fidelity National Information Services, Inc.
Form 10-K
February 24, 2012
Table of Contents

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

Form 10-K

x	ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the fiscal year ended December 31, 2011
or	
o	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the transition period from to

Commission File No. 001-16427

Fidelity National Information Services, Inc.
(Exact name of registrant as specified in its charter)

Georgia (State or other jurisdiction of incorporation or organization)	37-1490331 (I.R.S. Employer Identification No.)
601 Riverside Avenue Jacksonville, Florida (Address of principal executive offices)	32204 (Zip Code)

(904) 438-6000
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class:	Name of Each Exchange on Which Registered:
Common Stock, par value $0.01 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None
(Title of Class)
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No o
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x
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 x No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements

incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

Large accelerated filer x Accelerated filer o Non-accelerated filer o Smaller reporting company o
(Do not check if a smaller reporting company)

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

As of June 30, 2011, the last business day of the registrant’s most recently completed second fiscal quarter, the aggregate market value of the registrant’s common stock held by nonaffiliates was $9,355,651,167 based on the closing sale price of $30.79 on that date as reported by the New York Stock Exchange. For the purposes of the foregoing sentence only, all directors and executive officers of the registrant were assumed to be affiliates. The number of shares outstanding of the registrant’s common stock, $0.01 par value per share, was 289,527,281 as of January 31, 2012.

The information in Part III hereof is incorporated herein by reference to the registrant’s Proxy Statement on Schedule 14A for the fiscal year ended December 31, 2011, to be filed within 120 days after the close of the fiscal year that is the subject of this Report.

FIDELITY NATIONAL INFORMATION SERVICES, INC.
2011 FORM 10-K ANNUAL REPORT
TABLE OF CONTENTS

EX-101 LABELS LINKBASE DOCUMENT
EX-101 PRESENTATION LINKBASE DOCUMENT

1

Table of Contents

Unless stated otherwise or the context otherwise requires, all references to “FIS,” “we,” the “Company” or the “registrant” are to Fidelity National Information Services, Inc., a Georgia corporation formerly known as Certegy Inc. (“Certegy”), which was the surviving legal entity in the Certegy Merger; all references to "Metavante" are to Metavante Technologies, Inc., and its subsidiaries, as acquired by FIS on October 1, 2009; all references to “eFunds” are to eFunds Corporation, and its subsidiaries, as acquired by FIS on September 12, 2007; all references to "Capco" are to The Capital Markets Company NV, as acquired by FIS on December 2, 2010; all references to “Old FNF” are to Fidelity National Financial, Inc., which owned a majority of the Company’s shares through November 9, 2006; all references to “FNF” are to Fidelity National Financial, Inc. (formerly known as Fidelity National Title Group, Inc. (“FNT”)), formerly a subsidiary of Old FNF but now an independent company that remains a related entity from an accounting perspective; and all references to “LPS” are to Lender Processing Services, Inc., a former wholly-owned subsidiary of FIS, which was spun-off as a separate publicly traded company on July 2, 2008.

PART I

Item 1. Business.

Narrative Description of the Business

FIS is a leading global provider dedicated to banking and payments technologies. With a long history deeply rooted in the financial services sector, FIS serves more than 14,000 institutions in over 100 countries. Headquartered in Jacksonville, Florida, FIS employs approximately 33,000 people worldwide and holds leadership positions in payment processing and banking solutions, providing software, services and outsourcing of the technology that drives financial institutions. FIS tops the 2011 annual FinTech 100 list and is a member of the Fortune 500 U.S. and of Standard and Poor’s (S&P) 500® Index.

On October 1, 2009, FIS completed the acquisition of Metavante. The resulting combination of solution suites strengthened our competitive position globally, generating substantial economies of scale and providing significant cross-sell opportunities. Metavante expanded the scale of FIS' core processing and payment capabilities, and added comprehensive trust and wealth management processing services as well as the NYCE Network, which joined the Company’s existing EFT offerings. In addition, Metavante added significant scale to our treasury and cash management offerings and provided an entry into the healthcare and government payments markets. These enhanced capabilities enable FIS to provide a selection of solutions to financial institutions across all asset sizes, and to a variety of non-financial organizations, both domestically and internationally. FIS is now well positioned in both the large and mid-tier bank segments, where the majority of IT spending occurs.

On December 2, 2010, FIS acquired Capco, a global business and technology consultancy dedicated solely to the financial services industry. Capco has broadened our capabilities to provide integrated consulting, technology and complex, large-scale transformation services.

On July 2, 2008, we completed the spin-off of our former lender processing services segment into a separate publicly traded company, Lender Processing Services, Inc., referred to as LPS. The results of operations of the lender processing services segment are reflected as discontinued operations for all periods preceding the spin-off.

General Development of the Business

Our business operations and organizational structure result from the February 1, 2006, business combination of FIS and Certegy (the “Certegy Merger”). FIS was viewed as the acquirer for accounting purposes, and our financial statements and other disclosures for periods prior to the Certegy Merger treat FIS as our predecessor company. Also, as a result of the Certegy Merger, the registrant's name changed from "Certegy Inc." to "Fidelity National Information Services, Inc." and our New York Stock Exchange trading symbol from "CEY" to "FIS." We are incorporated under the laws of the State of Georgia.

Our growth has been driven organically as well as through acquisitions, which have contributed critical applications that are complementary to or enhance existing offerings, including core banking solutions, outsourcing solutions for community banks, credit unions, and other financial institutions, item processing services, card issuer services, risk management solutions, EFT services, prepaid/gift card processing, as well as solutions for global organizations and for those domiciled outside of North America. These strategic transactions have enabled us to quickly broaden our available solution offerings, scale our operations, expand our customer base and strengthen our competitive position.

Table of Contents

Financial Information About Operating Segments and Geographic Areas

We report the results of our operations in four reporting segments: 1) Financial Solutions Group ("FSG"); 2) Payment Solutions Group ("PSG"); 3) International Solutions Group ("ISG"); and 4) Corporate and Other.

Competitive Strengths

We believe that our competitive strengths include the following:

- Leading Proprietary Technology — FIS has a significant number of high quality software applications and services that have been developed over many years with substantial input from our customers.
- Comprehensive, Integrated Business Solutions — FIS has the ability to use a wide range of applications and services to provide comprehensive business solutions for our customers. In addition, FIS is able to use the modular nature of our software applications and our ability to integrate many of our services with the services of others to provide customized solutions that respond to individualized customer needs. FIS also offers a wide range of flexible service arrangements for the deployment and support of our software, from traditional license and maintenance fee approaches to managed processing arrangements, either at the customer's site or at an FIS location.
- Excellent Relationship with Customers — A significant percentage of FIS' business with our customers relates to core processing applications and services, and the nature of this relationship allows us to develop close partnerships with these customers. As the breadth of FIS' service offerings expands, we have found that our access to key customer personnel is increasing, presenting greater opportunities for cross-selling.
- Strong Value Proposition for Customers — We understand the needs of our customers and have developed innovative services that can reduce their operating costs.

Strategy

Our mission is to achieve profitable growth through providing superior solutions to our customers. Our strategy to achieve this has been and will continue to be built on the following pillars:

- Solution Integration and Innovation — Continue to invest in internally developed applications and platforms. Enhancing and extending the functionality of our proprietary systems and developing new and innovative applications in response to market needs are essential elements to achieving our growth objectives.
- Superior Execution — Deliver value using industry best practices more economically than customers can perform the same services internally.
- Enterprise Sales — Leverage opportunities for cross-selling and up-selling to existing customers. FIS has built a centralized team of experienced sales personnel that capitalizes on these opportunities.
- Global Diversification — Continue to deploy resources in emerging global markets where we can achieve meaningful scale.
- Global Scale - Leverage client relationships and global distribution network to drive revenue growth. Leverage global scale to drive higher operating efficiency.
- Strategic Acquisitions — Focus on acquisitions that can bring new applications to existing markets we serve or provide entry into new markets. This strategy has allowed us to build a very broad solutions suite and will contribute to maintaining our competitive position going forward.
- Disciplined Capital Investment and Expense Management — Continue to drive operating efficiencies, thereby freeing resources for strategic innovation and global diversification efforts.

Revenues by Segment

The table below summarizes the revenues by our reporting segments (in millions):

Table of Contents

	2011	2010	2009
FSG	$2,076.8	$1,890.8	$1,260.0
PSG	2,492.2	2,478.1	1,741.9
ISG	1,177.6	917.0	724.3
Corporate & Other	(0.9)	(16.4)	(15.1)
Total Consolidated Revenues	$5,745.7	$5,269.5	$3,711.1

Financial Solutions Group

The focus of FSG is to provide the most comprehensive software and services for the core processing, customer channel, treasury, cash management, wealth management and capital market operations of our financial institution customers in North America. We service the core and related ancillary processing needs of North American banks, credit unions, automotive financial companies, commercial lenders, and independent community and savings institutions. FIS offers a broad selection of in-house and outsourced solutions to banking customers that span the range of asset sizes. FSG customers are typically committed under multi-year contracts that provide a stable, recurring revenue base and opportunities for cross-selling additional financial and payments offerings.

We employ several business models to provide our solutions to our customers. We typically deliver the highest value to our customers when we combine our software applications and deliver them in one of several types of outsourcing arrangements, such as an application service provider, facilities management processing or an application management arrangement. We are also able to deliver individual applications through a software licensing arrangement. Based upon the expertise gained through the foregoing arrangements, some clients also use us to manage their IT operations without providing any of our proprietary software.

Our solutions in this segment include:

- Core Processing and Ancillary Applications. Our core processing software applications are designed to run critical banking processes for our financial institution clients, including deposit and lending systems, customer management, and other central management systems. Our diverse selection of market-focused core systems enables FIS to effectively compete in a wide range of markets. We also offer a number of services that are ancillary to the primary applications listed above, including branch automation, back office support systems and compliance support. In addition, our wealth management services offer a set of Internet-enabled services to financial services providers that address the specific needs of the rapidly growing wealthy, affluent and emerging affluent markets, as well as commercial clients. These solutions address asset and liability aggregation, trust and investment account management, client and regulatory reporting, and employee retirement benefit services. We also offer an application suite that assists automotive finance institutions in evaluating loan applications and credit risk, and allows automotive finance institutions to manage their loan and lease portfolios.
- Channel Solutions. Our comprehensive suite of retail delivery applications enables financial institutions to integrate and streamline customer-facing operations and back-office processes, thereby improving customer interaction across all channels (e.g., branch offices, Internet, ATM, call centers). The FIS focus on consumer access has driven significant market innovation in this area, with multi-channel and multi-host solutions and a strategy that provides tight integration of services and a seamless customer experience. Our Consumer Electronic Banking and Business Internet Banking both provide an extensive set of cash management capabilities, enabling customers to manage banking and payments through the Internet, mobile devices, accounting software and telephone. Corporate Electronic Banking solutions provide commercial treasury capabilities including cash management services and multi-bank collection and disbursement services that address the specialized needs of corporate customers. FIS systems provide full accounting and reconciliation for such transactions, serving as the system of record and providing full regulatory compliance, risk assessment and fraud management tools.
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Decision and Risk Management Solutions. Our decision solutions offer a full spectrum of options that cover the account lifecycle from helping to identify qualified account applicants to managing mature customer accounts and fraud. Our applications include know-your-customer, new account decisioning, new account opening, account and transaction management, fraud management and collections. Our risk management services utilize our proprietary risk management models and data sources to assist in detecting fraud and assessing the risk of opening a new account or accepting a check at either the point-of-sale, a physical branch location, or through the Internet. Our systems utilize a combination of advanced authentication procedures, predictive analytics, artificial intelligence modeling and proprietary and shared databases to assess and detect fraud risk for deposit transactions for financial institutions.

Table of Contents

- Syndicated Loan Applications. Our syndicated loan applications are designed to support wholesale and commercial banking requirements necessary for all aspects of syndicated commercial loan origination and management.
- Global Commercial Services. Our global commercial services include solutions, both onshore and offshore, designed to meet the technology challenges facing principally U.S. based clients, large or small. Our technology solutions range in scope from consulting engagements to application development projects and from operations support for a single application to full management of information technology infrastructures. We also provide outsourcing teams to manage costs, improve operational efficiency, transform processes and deliver world-class customer service. There is an increased trend toward outsourcing in our customer base, thus expansion of these services represents one of FIS' growth drivers.

- Strategic Consulting Services. With the Capco acquisition, we broadened our capabilities to provide integrated consulting, technology and complex, large-scale transformation services. Capco specializes in banking; capital markets; wealth and investment management; finance, risk and compliance; and technology. Capco's North American operations are included in FSG.

Payment Solutions Group

PSG provides a comprehensive set of software and services for the EFT, card processing, item processing, bill payment, and government and healthcare payments processing needs of our customers in North America. PSG is focused on servicing the payment and electronic funds transfer needs of North American headquartered banks and credit unions, commercial lenders, independent community and savings institutions and healthcare and government institutions. PSG customers typically commit to multi-year contracts that provide recurring revenues based on underlying payment transaction volumes.

Our solutions in this segment include:

- Electronic Funds Transfer. Our electronic funds transfer and debit card processing businesses offer settlement and card management solutions for financial institution card issuers. We provide traditional ATM- and PIN-based debit network access and emerging real-time payment alternatives through NYCE. NYCE connects millions of cards and point-of-sale locations nationwide, providing consumers with secure, real-time access to their money. Also through NYCE, clients such as financial institutions, retailers and independent ATM operators can capitalize on the efficiency, consumer convenience and security of electronic real-time payments, real-time account-to-account transfers, and strategic alliances such as surcharge-free ATM network arrangements. We are also a leading provider of prepaid card services, which include gift cards and reloadable cards, with end-to-end solutions for development, processing and administration of stored-value programs.
- Item Processing and Output Services. Our item processing services furnish financial institutions with the equipment needed to capture data from checks, transaction tickets and other items; image and sort items; process exceptions through keying; and perform balancing, archiving and the production of statements. Our item processing services are utilized by more than 1,500 financial institutions and are performed at one of our eight item processing centers located throughout the U.S. or on-site at customer locations. Our extensive solutions include distributed (i.e., non-centralized) data capture, check and remittance processing, fraud detection, and document and report management. Customers encompass banks and corporations of all sizes, from de novo banks to the largest financial institutions and corporations. As part of our image solutions services, our Endpoint Exchange Network enables U.S. financial institutions to clear their check-based transactions by allowing for the exchange of check images between member institutions. We offer a number of output services that are ancillary to the primary solutions we provide, including print and mail capabilities and card personalization fulfillment services. Helping clients manage their documents, our CSF® Designer document composition software is used by many clients in various industries to furnish printed or electronically produced invoices and statements for customized customer communication. Our print and mail services offer complete computer output solutions for the creation, management and delivery of print and fulfillment needs.

We provide our card personalization fulfillment services for branded credit cards and branded and non-branded debit and prepaid cards.

Credit Card Solutions. More than 5,200 financial institutions utilize a combination of our technology and/or services to issue VISA®, MasterCard® or American Express® branded credit and debit cards or other electronic payment cards for use by both consumer and business accounts. Our services range from card production and activation to an extensive range of fraud management services to value-added loyalty programs designed to increase card usage and fee-based revenues. The majority of our programs are full service, including most of the operations and support necessary for an issuer to operate a credit card program. We do not make credit decisions for our card issuing customers, nor do we fund their receivables. In addition, our merchant card processing service provides everything a

Table of Contents

financial institution needs to manage its merchant card activities, including point-of-sale equipment, transaction authorization, draft capture, settlement, charge-back processing and reporting.

- Government and Healthcare Payments Solutions. FIS healthcare payments solutions facilitate the exchange of information and funds among patients, payers, providers and financial institutions. With Web-enabled tools, a Health Savings Account (HSA) platform, “multi-purse” benefit debit cards that cover multiple spending accounts with a single card and combined eligibility/payment cards, FIS enables consumers and third-party benefits administrators to have integrated benefit account management of HSAs, Flexible Spending Accounts (FSA), Health Reimbursement Agreements (HRA) and dependent care and transportation accounts. We also provide comprehensive, customized electronic service applications for government agencies, including Internal Revenue Service (IRS) payment services. We also facilitate the collection of state income taxes, real estate taxes, utility bills, vehicle registration fees, driver’s license renewal fees, parking tickets, traffic citations, tuition payments, court fees and fines, hunting and fishing license fees, as well as various business licenses.
- ePayment Solutions. We provide reliable and scalable bill publishing and bill consolidation technology for our customers, generating millions of monthly bills and servicing both billers and financial institution customers. Online bill payment functionality includes credit and debit card-based expedited payments. Our end-to-end presentment and payment solution provides an all-in-one solution to meet billers’ needs for the distribution and collection of bills and other customer documents. FIS also provides automated clearing house (ACH) processing.
- Check Authorization. Our check authorization business provides check risk management and related services to businesses accepting or cashing checks. Our services assess the likelihood (and often provide a guarantee) that a check will clear. Our check authorization system utilizes artificial intelligence modeling and other state-of-the-art technology to deliver accuracy, convenience and simplicity to retailers.

International Solutions Group

ISG provides local services to our customers in more than 100 countries around the world. The services delivered by FIS in these locations provide many of the same financial and payments solutions we offer in North America. We provide core banking applications, channel solutions, card and merchant services, item processing and check risk management solutions to financial institutions, card issuers and retailers.

Our international operations leverage existing applications and provide services for the specific business needs of our customers in targeted international markets. Services are delivered from 28 operations centers around the world. Our payment solutions services include fully outsourced card-issuer services and customer support, payment processing and switching services, prepaid and debit card processing, item processing, software licensing and maintenance, outsourced ATM management and retail point-of-sale check warranty services. Our financial solutions services include fully outsourced core bank processing arrangements, application management, software licensing and maintenance, facilities management and consulting services, including Capco's international operations.

ISG represented approximately 20% of total 2011 revenues, with potential for both growth in existing customer accounts and new account penetration. Management believes the greatest potential for growth is in the Western European, Latin American and Asian markets.

Corporate and Other Segment

The Corporate and Other segment consists of the corporate overhead costs that are not allocated to operating segments. These include costs related to human resources, finance, legal, accounting, domestic sales and marketing, merger and acquisition activity and amortization of acquisition-related intangibles and other costs that are not considered when management evaluates operating segment performance.

Sales and Marketing

We have an integrated team of experienced sales personnel with expertise in particular services and the needs of particular types of customers, e.g., financial institutions, other nonbanking customers, and international institutions. This organizational structure enables us to effectively bring relevant skills and knowledge to potential customers and to identify additional solutions for our existing customers, leveraging opportunities to cross-sell and up-sell. We target the majority of our potential customers via direct and/or indirect field sales, as well as inbound and outbound lead generation and telesales efforts.

Our global marketing strategy is to develop and lead the execution of the various business units' strategic plans in support

Table of Contents

of their revenue and profitability goals. Key components include thought leadership, consistent message development, internal and external communications, client conference content management, Web content creation and management, trade shows, demand generation campaign involvement and collateral development and management.

Beginning October 1, 2009, we entered into a comprehensive rebranding campaign to bring all of our software and services under one comprehensive set of trademarks, including FIS and NYCE, in support of our marketing strategy. Subsequent to its acquisition in 2010, Capco continues to use its brand because of the differentiated strategic nature of its consulting services.

Patents, Trademarks and Other Intellectual Property

The Company owns intellectual property including trademarks, trade names and patents that are important to its future success. We rely on a combination of contractual restrictions, internal security practices, patents and applicable law to establish and protect our software, technology and expertise worldwide. We rely on trademark law to protect our rights in those brands. While we intend to continue taking appropriate measures to protect our intellectual property rights, these legal protections and arrangements afford only limited protection, and there is no assurance that our competitors will not independently develop or license products, services, or capabilities that are substantially equivalent or superior to ours. In general, we own the proprietary rights necessary for the conduct of our business, although we do license certain items from third parties under arms-length agreements for varying terms.

Competition

Our primary competitors include internal technology departments within financial institutions and retailers, data processing or software development departments of large companies or large computer manufacturers, third-party payment processors, independent computer services firms, companies that develop and deploy software applications, companies that provide customized development, implementation and support services and companies that market software for the financial services industry. Some of these competitors possess substantially greater financial, sales and marketing resources than we do. Competitive factors impacting the success of our services include the quality of the technology-based application or service, application features and functions, ease of delivery and integration, ability of the provider to maintain, enhance, and support the applications or services, and price. We believe that we compete favorably in each of these categories. In addition, we believe that our financial institution industry expertise, combined with our ability to offer multiple applications, services and integrated solutions to individual customers, enhances our competitiveness against companies with more limited offerings. Specific competitors for both financial and payment solutions include Fiserv, Inc. and Jack Henry and Associates, Inc. In the core processing market, we also compete with Open Solutions, Inc., International Business Machines Corporation (IBM), Accenture Ltd., Alliance Data Systems Corporation, DST Systems, Harland Financial Solutions, Inc., SEI Investments Company, S1Corporation, SunGard Data Systems, Inc. and in certain non-U.S. markets, Alnova Technologies Corporation, Oracle Financial Services Software Limited (formerly known as I-Flex Solutions Limited), Misys plc, Infosys Technologies Limited and Temenos Group AG. Our competitors in the card services market include MasterCard Incorporated, Visa Inc., and third-party credit and debit card processors, such as First Data Corporation, Total System Services, Inc., HP Enterprise Services and Payment Systems for Credit Unions (PSCU). Competitors in the check risk management services market include First Data Corporation's TeleCheck Services division, Heartland Payments Systems, Inc., Total Systems Services, Inc. and Global Payments, Inc.

Research and Development

Our research and development activities have related primarily to the design and development of processing systems and related software applications and risk management platforms. We expect to continue our practice of investing an appropriate level of resources to maintain, enhance and extend the functionality of our proprietary systems and

existing software applications, to develop new and innovative software applications and systems in response to the needs of our customers, and to enhance the capabilities surrounding our outsourcing infrastructure. In
adht">1,764 114 3,289 5,167
Cash payments
(2,863) (3,870) (6,733)
Asset impairment (noncash)
3 3
Foreign Currency Translation
35 62 97
Adjustments and disposal of assets
314 (117) (445) (248)

Liability, June 25, 2006
$2,159 $ $6,043 $8,202

Other exit costs consist primarily of building lease termination charges and other miscellaneous exit costs.
The Company expects to pay the majority of the remaining restructuring costs, with the exception of ongoing pension subsidies and certain building lease termination expenses, by the end of the third quarter of 2006, using cash generated from operations.

Note 5: Comprehensive Income

The following table reconciles net income to comprehensive income:

	Three Months Ended		**Six Months Ended**	
	June 25, 2006	June 26, 2005	June 25, 2006	June 26, 2005
Net income	$ 49,342	$ 40,176	$ 94,486	$ 77,165
Other comprehensive income:				
Foreign currency translation adjustments	8,047	(9,200)	13,872	(15,765)
Changes in derivative financial instruments, net of income tax	(2,958)	261	(7,509)	4,420
Comprehensive income	$ 54,431	$ 31,237	$ 100,849	$ 65,820

SONOCO PRODUCTS COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)
(unaudited)

The following table summarizes the components of accumulated other comprehensive loss and the changes in accumulated other comprehensive loss, net of tax as applicable, for the six months ended June 25, 2006:

	Foreign Currency Translation Adjustment	Minimum Pension Liability Adjustment	Derivative Financial Instruments	Accumulated Other Comprehensive Loss
Balance at December 31, 2005	$ (59,833)	$ (57,737)	$ 11,181	$ (106,389)
Year-to-date change	13,872		(7,509)	6,363
Balance at June 25, 2006	$ (45,961)	$ (57,737)	$ 3,672	$ (100,026)

At June 25, 2006, the Company had commodity swaps outstanding to fix the costs of a portion of raw materials and energy. These swaps, which have maturities ranging from October 2006 to June 2009, qualify as cash flow hedges under Statement of Financial Accounting Standards No. 133 Accounting for Derivative Instruments and Hedging Activities (FAS 133). The fair market value of these commodity swaps was a favorable position of $5,770 ($3,672 after tax) and $17,470 ($11,181 after tax) at June 25, 2006 and December 31, 2005, respectively.

In January 2004, the Company entered into an agreement to swap the interest rate from fixed to floating on $100,000 of its $250,000 6.5% notes maturing in 2013. During June 2004, the Company entered into a similar agreement to swap the interest rates from fixed to floating on all of its newly issued $150,000 of 5.625% notes maturing in 2016. The fair market value of these interest rate swaps was an unfavorable position of $1,098 and a favorable position of $4,483, respectively, at December 31, 2005. During the six months ended June 25, 2006, the Company terminated both of its interest rate swaps. At the time of termination, the fair value of the interest rate swap related to the 6.5% notes was an unfavorable position of $3,048, and the fair value of the interest rate swap related to the 5.625% notes was a favorable position of $887. In accordance with FAS 133, interest expense is being adjusted by amortization of the gain and loss associated with these swap terminations over the remaining life of the related bonds. Termination of these swaps increased the Company s proportion of fixed rate debt, reducing its exposure to the effects of rising interest rates.

The cumulative tax benefit of the Minimum Pension Liability Adjustments was $26,746 at June 25, 2006 and December 31, 2005. Additionally, the deferred tax liability of Derivative Financial Instruments was $2,077 and $6,289 at June 25, 2006 and December 31, 2005, respectively. The tax effect on Derivative Financial Instruments for the three and six months ended June 25, 2006 was $1,652 and $4,212, respectively.

Note 6: Goodwill and Other Intangible Assets

Goodwill

A summary of the changes in goodwill for the six months ended June 25, 2006 is as follows:

	Tubes and Cores/Paper Segment	Consumer Packaging Segment	Packaging Services Segment	All Other Sonoco	Total
Balance as of December 31, 2005	$ 189,635	$ 170,383	$ 148,125	$ 65,760	$ 573,903
2006 Acquisitions	104	14,233	243		14,580
Adjustments	500	81			581
Foreign currency translation	4,167	3,165	69	(30)	7,371

Balance as of June 25, 2006	$	194,406	$	187,862	$	148,437	$	65,730	$ 596,435

SONOCO PRODUCTS COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)
(unaudited)

Other Intangible Assets

A summary of other intangible assets as of June 25, 2006 and December 31, 2005 is as follows:

	June 25, 2006		December 31, 2005	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Patents	$ 3,360	$ (3,170)	$ 3,378	$ (3,110)
Customer lists	86,927	(17,750)	81,026	(14,690)
Land use rights	6,492	(2,649)	6,011	(2,148)
Supply agreements	1,000	(448)	5,261	(4,619)
Other	7,891	(4,519)	6,703	(4,775)
Total	$ 105,670	$ (28,536)	$ 102,379	$ (29,342)

Intangible assets are amortized, usually on a straight-line basis, over their respective useful lives, which generally range from three to fifteen years. Aggregate amortization expense on intangible assets was $1,593 and $1,655 for the three months ended June 25, 2006 and June 26, 2005, respectively, and $3,398 and $3,502 for the six months ended June 25, 2006 and June 26, 2005, respectively. Amortization expense on the other intangible assets identified in the table above is expected to approximate $7,100 in 2006, $6,800 in 2007, $6,400 in 2008, $5,900 in 2009 and $5,700 in 2010.

Note 7: Dividend Declarations

On February 1, 2006, the Board of Directors declared a regular quarterly dividend of $0.23 per share. This dividend was paid March 10, 2006 to all shareholders of record as of February 17, 2006.

On April 19, 2006, the Board of Directors declared a regular quarterly dividend of $0.24 per share. This dividend was paid June 9, 2006 to all shareholders of record as of May 19, 2006.

Additionally, on July 19, 2006, the Board of Directors declared a regular quarterly dividend of $0.24 per share. This dividend is payable September 8, 2006 to all shareholders of record as of August 18, 2006.

Note 8: Stock Plans

The Company has a shareholder approved Key Employee Stock Plan (the Plan) under which common shares are reserved for sale to certain employees and nonemployee directors. The exercise price of stock appreciation rights (SARs) or stock options granted under the plans is the market value of the shares at the date of grant. There were 3,461,388 shares reserved for future grants at June 25, 2006.

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

Prior to January 1, 2006, the Company accounted for share-based employee compensation plans using the intrinsic value method of accounting in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25), and its related interpretations. Under the

SONOCO PRODUCTS COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)
(unaudited)

provisions of APB 25, no compensation expense was recognized when stock options were granted with exercise prices equal to or greater than market value on the date of grant.

Prior to the adoption of FAS 123(R), the Company presented all tax benefits resulting from share-based compensation as cash flows from operating activities in the condensed consolidated statements of cash flows. FAS 123(R) requires cash flows resulting from tax deductions in excess of the grant-date fair value of share-based awards to be included in cash flows from financing activities. This excess tax benefit of $1,871 related to share-based compensation in the first six months of 2006 has been included in cash flows from financing activities.

Stock Option Plans

Prior to January 1, 2006, the Company granted options that were generally exercisable one year after the date of grant or upon retirement and expire 10 years after the date of grant, although all options granted in 2005 vested immediately. This immediate vesting would have resulted in the recognition of most of the Company s stock-based employee compensation in the first quarter of 2005 under Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (FAS 123). The first six months of 2006 expense is not directly comparable to the proforma expense for the corresponding period of 2005 due to the vesting acceleration of 2005. However, the annual proforma expense that was reported for 2005 is not materially different from the annual expense that will be reported in 2006.

Under the modified prospective method of transition, the Company is not required to restate its prior period financial statements to reflect disclosures of its net income and earnings per share for the prior year period. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FAS 123 to stock-based employee compensation for the three and six months ended June 26, 2005:

	Three Months Ended June 26, 2005	**Six Months Ended** June 26, 2005
Net income, as reported	$ 40,176	$ 77,165
Add: Stock-based employee compensation cost, net of related tax effects, included in net income, as reported	720	1,426
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(753)	(5,624)
Proforma net income	$ 40,143	$ 72,967
Earnings per share:		
Basic as reported	$ 0.40	$ 0.78
Basic proforma	$ 0.40	$ 0.74
Diluted as reported	$ 0.40	$ 0.77
Diluted proforma	$ 0.40	$ 0.73

Stock Appreciation Rights

On January 31, 2006, the Company s Board of Directors approved the issuance of 760,650 stock-settled SARs to certain employees and non-employee directors under the Plan. The SARs were granted at the prevailing market price on the date of grant, and vest one year from the date of the grant and expire after 7 years.

The Company s Condensed Consolidated Financial Statements as of and for the three months and six months ended June 25, 2006 reflect the impact of FAS 123(R) with respect to these SARs. For purposes of calculating share-based compensation expense under FAS 123(R) for retiree-eligible employees, the service completion date is assumed to be the grant date; therefore, expense associated with share-based

SONOCO PRODUCTS COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)
(unaudited)

compensation to these employees is recognized at that time. Due to this recognition of expenses associated with share-based compensation to retiree-eligible employees, share-based compensation expense generally will be higher in the first quarter since the Company usually makes an annual grant in February. The effect of the change from applying the original provisions of FAS 123 is outlined in the table below:

	Three Months Ended June 25, 2006	**Six Months Ended** June 25, 2006
Income before income taxes	$(888)	$ (2,649)
Net income	(583)	(1,777)
Cash flow provided by operating activities	(243)	(1,871)
Cash flow used in financing activities	243	1,871
Earnings per share:		
Basic	(.01)	(.02)
Diluted	(.01)	(.02)

Share-based compensation expense recognized under FAS 123(R) is included in selling, general and administrative expense on the Condensed Consolidated Statements of Income.

As of June 25, 2006, there was $1,696 of total unrecognized compensation cost related to nonvested SARs. This cost will be recognized over the remaining weighted-average vesting period, which is approximately one year.

Method of Calculating Fair Values of Share-Based Compensation

The Company has computed the estimated fair values of all share-based compensation using the binomial option pricing model and has applied the assumptions set forth in the following table:

	Three and Six Months Ended June 25, 2006	June 26, 2005
Expected dividend yield	2.8%	3.5%
Expected stock price volatility	20.8%	26.2%
Risk-free interest rate	4.5%	3.8%
Expected life of options	4.0 years	4.5 years

The binomial option-pricing model requires the input of highly subjective assumptions. Management will continue to assess the assumptions and methodologies used to calculate estimated fair value of share-based compensation. Circumstances may change and additional data may become available over time that result in changes to these assumptions and methodologies, which could materially impact the Company s fair value determination.

The assumptions employed in the calculation of the fair value of share-based compensation expense for the three and six months ended June 25, 2006 were calculated as follows:

Expected dividend yield the Company s annual dividend divided by the stock price at the time of grant.

Expected stock price volatility based on historical volatility of the Company s common stock.

Risk-free interest rate based on the U.S. Treasury yield curve in effect at the time of grant.

Expected life of options   calculated using the simplified method as prescribed in Staff Accounting Bulletin No. 107, where the expected life is equal to the sum of the vesting period (1 year) and the contractual term (7 years) divided by two.

SONOCO PRODUCTS COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)
(unaudited)

The following table sets forth details about SARs and stock options granted, exercised or vested during the three and six months ended June 25, 2006 and June 26, 2005:

	Three Months Ended		Six Months Ended	
	June 25, 2006	June 26, 2005	June 25, 2006	June 26, 2005
Weighted-average grant date fair value of SARs and stock options granted	$ 5.59	$ 5.12	$ 5.86	$ 5.42
SARs and stock options granted	2,000	10,000	764,444	1,087,500
Total intrinsic value of options exercised	$1,583	$ 151	$ 13,477	$ 3,556
Weighted-average grant date fair value of stock options vested	$ 5.63	$ 5.54	$ 5.63	$ 5.54

Summary of Outstanding and Exercisable Options and SARs

The following tables summarize information about stock options and SARs outstanding and stock options exercisable at June 25, 2006:

	Options and SARs Outstanding		
Range of Exercise Prices	**Number Outstanding**	**Weighted-average Remaining Contractual Life**	**Weighted-average Exercise Price**
$17.25 - $23.80	2,730,779	5.1 years	$21.84
$23.86 - $27.31	3,002,476	6.5 years	$25.37
$27.35 - $37.10	2,815,763	4.2 years	$31.65
$17.25 - $37.10	8,549,018	5.3 years	$26.31

	Options Exercisable	
Range of Exercise Prices	**Number Exercisable**	**Weighted-average Exercise Price**
$17.25 - $23.80	2,730,779	$21.84
$23.86 - $27.31	3,002,476	$25.37
$27.35 - $37.10	2,048,069	$31.02
$17.25 - $37.10	7,781,324	$25.62

The activity related to the stock options and SARs is presented below:

	Weighted-	Weighted-average

	Options and SARs Outstanding	average Exercise Price	Aggregate Intrinsic Value	Remaining Contractual Life (Years)
Options outstanding and exercisable, December 31, 2005	9,373,305	$25.33		
Granted	764,444	$33.34		
Exercised	(1,580,591)	$23.89	$13,477	
Canceled	(8,140)	$24.59		
Outstanding at June 25, 2006	8,549,018	$26.31	$51,926	5.3 years
Options exercisable at June 25, 2006	7,781,324	$25.62	$47,427	4.9 years

SONOCO PRODUCTS COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)
(unaudited)

Performance-based Stock Plans

As of June 25, 2006 and December 31, 2005, the Company had outstanding awards in the form of contingent-share units granted to certain of its executives and other members of its management team. The performance vesting of the awards, which can range from 260,668 to 782,002 shares, is tied to growth in earnings and improved capital effectiveness over a three-year period. The 2004 awards are tied to performance targets through fiscal year 2006, and can range from 76,338 to 229,012 shares. The 2005 awards are tied to performance targets through fiscal year 2007, and can range from 85,050 to 255,150 shares. The 2006 awards are tied to performance through 2008 and can range from 99,280 to 297,840 shares. The Company s 2003 performance plan completed its three-year performance cycle on December 31, 2005, and participants to whom awards had previously been granted earned 99,005 shares of common stock based on meeting performance goals set by the plan. These shares were issued during the first quarter of 2006. Noncash stock-based compensation associated with these performance-based plans totaled $1,631 and $620 pretax for the three months and totaled $2,880 and $1,533 pretax for the six months ended June 25, 2006 and June 26, 2005, respectively. The adoption of FAS 123(R) did not materially change the expense recognition of these contingent share units. As of June 25, 2006, there was approximately $11,000 of total unrecognized compensation cost related to nonvested contingent share units issued under the performance-based plans. This cost is expected to be recognized over a weighted-average period of two years.

Restricted Stock Plan

Since 1994, the Company has granted one-time awards of contingent shares units to certain of the Company s executives. These awards vest over a five-year period with one-third vesting on the third, fourth and fifth anniversaries of the grant. An executive must be actively employed by the Company on the vesting date for shares to be issued. Once vested, these awards do not expire. As of June 25, 2006, a total of 355,964 contingent shares granted under this plan remained outstanding, 283,595 of which are vested. Noncash stock based compensation associated with these performance-based plans totaled $150 and $462 pretax for the three months and $212 and $644 for the six months ended June 25, 2006 and June 26, 2005, respectively. The adoption of FAS 123(R) did not materially change the expense recognition of these contingent share units. As of June 25, 2006, there was $1,300 of total unrecognized compensation cost related to nonvested contingent shares units issued under the restricted stock plan. This cost is expected to be recognized over a weighted-average period of four years.

The activity related to the contingent share units granted as performance-based and restricted stock is as follows:

	Nonvested	**Vested**	**Total Contingent Share Units**	**Value Per Share**
Outstanding, December 31, 2005	436,301	509,268	945,569	$23.48
Granted	254,500	5,911	260,411	$33.37
Exercised		(228,317)	(228,317)	($23.38)
Performance Adjustments/Other	(2,698)	(3,267)	(5,965)	($22.93)
Outstanding at June 25, 2006	688,103	283,595	971,698	$27.97

Note 9: Employee Benefit Plans

The Company provides non-contributory defined benefit pension plans for a majority of its employees in the United States, and certain of its employees in Mexico and Belgium, as well as postretirement healthcare and life insurance benefits to the majority of its retirees and their eligible dependents in the United States and Canada. The Company froze participation for newly hired employees in its traditional defined benefit pension plan for salaried and non-union hourly U.S. employees effective December 31,

SONOCO PRODUCTS COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)
(unaudited)

2003. The Company adopted a new defined contribution plan, which covers U.S. employees hired on or after January 1, 2004. The Company also sponsors contributory pension plans covering the majority of its employees in the United Kingdom and Canada.

The components of net periodic benefit cost include the following:

	Three Months Ended		Six Months Ended	
	June 25, 2006	June 26, 2005	June 25, 2006	June 26, 2005
Retirement Plans				
Service cost	$ 7,449	$ 6,638	$ 14,888	$ 13,218
Interest cost	16,103	15,044	32,076	30,119
Expected return on plan assets	(20,240)	(18,010)	(40,326)	(35,915)
Amortization of net transition obligation	153	144	303	299
Amortization of prior service cost	403	368	806	748
Amortization of net actuarial loss	7,106	5,725	14,076	11,430
Net periodic benefit cost	$ 10,974	$ 9,909	$ 21,823	$ 19,899
Retiree Health and Life Insurance Plans				
Service cost	$ 626	$ 1,021	$ 1,252	$ 2,041
Interest cost	1,365	2,049	2,730	4,099
Expected return on plan assets	(568)	(723)	(1,136)	(1,448)
Amortization of prior service cost	(2,257)	(1,540)	(4,515)	(3,080)
Amortization of net actuarial loss	1,534	1,356	3,068	2,711
Net periodic benefit cost	$ 700	$ 2,163	$ 1,399	$ 4,323

During the six months ended June 25, 2006, the Company made contributions of approximately $5,145 to its retirement and retiree health and life insurance plans. The Company anticipates that it will make additional contributions of approximately $4,900 in 2006.

Note 10: Debt

On May 3, 2006, the Company entered into an amended and restated credit agreement to extend its $350,000 bank line of credit supporting its commercial paper program to a new five-year maturity. The term of the line of credit allows commercial paper borrowings up to the maximum amount of the line of credit to be classified as long-term debt. The amended and restated credit agreement also provides the Company the option to increase its credit line to $500,000 subject to the concurrence of its lenders.

Note 11: New Accounting Pronouncements

In December 2004, the FASB issued FAS 123(R), which requires companies to expense the value of employee stock options and similar awards. Under FAS 123(R), share-based payment awards result in a cost that will be measured at fair value on the awards grant date, based on the estimated number of awards that are expected to vest. The Company adopted FAS 123(R) on January 1, 2006, using the modified prospective transition method, which does not require restating previous periods results. Further information regarding the impact of the adoption of FAS 123(R) is provided in Note 8 to the Company s Condensed Consolidated Financial Statements.

In July 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainties in Income Taxes (FIN 48). The Company is currently evaluating the impact that the new standard is expected to have upon its implementation in the first quarter of 2007.

SONOCO PRODUCTS COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)
(unaudited)

Note 12: Financial Segment Information

Sonoco reports its results in three segments, Consumer Packaging, Tubes and Cores/Paper and Packaging Services. Certain smaller operations are reported as All Other Sonoco.

The Consumer Packaging segment includes the following products: round and shaped rigid packaging, both composite and plastic; printed flexible packaging; and metal and plastic ends and closures.

The Tubes and Cores/Paper segment includes the following products: high-performance paper and composite paperboard tubes and cores; fiber-based construction tubes and forms; recycled paperboard; linerboard; and recovered paper.

The Packaging Services segment provides the following products and services: point-of-purchase displays; packaging fulfillment; contract packing; brand artwork management; and supply chain management.

All Other Sonoco represents the activities and businesses of the Company s consolidated subsidiaries that do not meet the aggregation criteria outlined in Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information (FAS 131), and therefore, cannot be combined with other operating segments into a reportable segment. All Other Sonoco includes the following products: wooden, metal and composite reels; molded and extruded plastics; custom-designed protective packaging; and paper amenities, such as coasters and glass covers.

The following table sets forth net sales, intersegment sales and operating profit for the Company s three reportable segments and All Other Sonoco. Operating profit at the segmental level is defined as Income before interest and income taxes on the Company s Condensed Consolidated Statements of Income adjusted for restructuring charges, which are not allocated to the financial segments.

FINANCIAL SEGMENT INFORMATION

	Three Months Ended		**Six Months Ended**	
	June 25, 2006	June 26, 2005	June 25, 2006	June 26, 2005
Net Sales:				
Consumer Packaging	$ 327,538	$ 312,369	$ 625,839	$ 589,224
Tubes and Cores/ Paper	386,661	367,926	725,149	721,081
Packaging Services	106,898	111,639	203,565	216,377
All Other Sonoco	95,913	86,236	181,226	165,926
Consolidated	$ 917,010	$ 878,170	$ 1,735,779	$ 1,692,608
Intersegment Sales:				
Consumer Packaging	$ 981	$ 685	$ 2,106	$ 1,842
Tubes and Cores/ Paper	22,231	21,129	43,197	40,191
Packaging Services	36	60	38	113
All Other Sonoco	9,536	9,277	18,690	17,126
Consolidated	$ 32,784	$ 31,151	$ 64,031	$ 59,272
Income before income taxes:				
Consumer Packaging Operating Profit	$ 26,332	$ 24,541	$ 52,156	$ 46,873

Tubes and Cores/ Paper Operating Profit	37,222	26,521	64,740	51,757
Packaging Services Operating Profit	8,570	10,738	17,698	21,337
All Other Sonoco Operating Profit	13,239	10,086	25,608	19,438
Restructuring charges	(2,564)	(9,143)	(4,919)	(14,185)
Interest, net	(12,517)	(10,812)	(23,370)	(20,207)
Consolidated	$ 70,282	$ 51,931	$ 131,913	$ 105,013

SONOCO PRODUCTS COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)
(unaudited)

Note 13: Commitments and Contingencies

The Company is a party to various legal proceedings incidental to its business and is subject to a variety of environmental and pollution control laws and regulations in all jurisdictions in which it operates. As is the case with other companies in similar industries, the Company faces exposure from actual or potential claims and legal proceedings. The Company cannot currently determine the final outcome of the proceedings described below or the ultimate amount of potential losses. Pursuant to Statement of Financial Accounting Standards No. 5, Accounting for Contingencies (FAS 5), management records accruals for estimated losses at the time that information becomes available indicating that losses are probable and that the amounts are reasonably estimable. Accrued amounts are not discounted. Although the level of future expenditures for legal and environmental matters cannot be determined with any degree of certainty, it is management s opinion that such costs, when finally determined, will not have an adverse material effect on the consolidated financial position of the Company.

Environmental Matters

The Company has been named as a potentially responsible party at several environmentally contaminated sites not owned by the Company. These regulatory actions represent the Company s largest potential environmental liabilities. All of the sites are also the responsibility of other parties. The Company s liability, if any, is shared with such other parties, but the Company s share has not been finally determined in most cases. In some cases, the Company has cost-sharing agreements with other potentially responsible parties with respect to a particular site. Such agreements relate to the sharing of legal defense costs or clean-up 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. Accordingly, the ultimate cost to the Company with respect to such sites cannot be determined. As of June 25, 2006 and December 31, 2005, the Company had accrued $16,262 and $16,789, respectively, related to environmental contingencies. Actual costs to be incurred for these environmental matters in future periods may vary from current estimates because of the inherent uncertainties in evaluating environmental exposures.

On April 12, 2006, the United States and the State of Wisconsin sued NCR Corporation (NCR) and a wholly owned subsidiary of the Company, Sonoco-U.S. Mills, Inc., (U.S. Mills) in the United States District Court for the Eastern District of Wisconsin in Milwaukee (Civil Action No. 06-C-0484). NCR and U.S. Mills agreed to a Consent Decree with the United States and the State of Wisconsin. Pursuant to this Consent Decree, NCR and U.S. Mills would start removing contaminated sediment no later than May 1, 2007 at a contaminated area of the Fox River, a site just below the De Pere Dam. Although the defendants specifically did not admit liability for the allegations of the complaint, they are bound by the terms of the Consent Decree.

NCR and U.S. Mills have reached agreement between themselves that each would fund 50% of the costs of remediation, which the Company currently estimates to be between $25,000 and $30,000 for the project as a whole. Project implementation will begin in 2006, but most of the project cost is expected to be incurred in 2007. Although the funding agreement does not acknowledge responsibility or prevent either party from seeking reimbursement from any other parties (including each other), the Company accrued $12,500 in 2005 as an estimate of the portion of costs that U.S. Mills expects to fund under the funding agreement. The actual costs associated with cleanup of this particular site are dependent upon many factors and it is reasonably possible that remediation costs could be higher than the current estimate of project costs.

In June 2006 U.S. Mills became aware of the potential for further liability along a larger stretch of the lower Fox River. Although it has not accepted any liability nor entered into any cost sharing agreements with interested parties, U.S. Mills is in the early stages of reviewing this new information and cannot reasonably estimate the amount of its liability, if any, at this time. Accordingly, no additional reserve for potential remediation costs has been recognized by U.S. Mills at June 25, 2006. Although U.S. Mills

SONOCO PRODUCTS COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)
(unaudited)

liability could exceed its net worth, Sonoco Products Company believes its maximum exposure is limited to the equity position of U.S. Mills which is approximately $80 million as of June 25, 2006, excluding any tax benefits that may further reduce the net charge.

Some, or all, of any costs incurred may be covered by insurance, or be subject to recovery from other parties, but no amounts have been recognized in the financial statements of the Company for such recovery. There can be no assurance, however, that such claims for recovery will be successful. The Company acquired U.S. Mills in 2001, and the alleged contamination predates the acquisition.

Income Taxes

The Company is subject to ongoing examinations by tax authorities of the jurisdictions in which it operates. The Company regularly assesses the status of these examinations and the potential for adverse outcomes to determine the adequacy of the provision for income and other taxes. The Company believes that adequate provision has been made for tax adjustments that are probable as a result of any examination. While the status of the Company s ongoing tax examinations is constantly changing due to new tax law developments, statute expirations and other factors, the Company does not expect the outcome of any tax examination to have a material effect on its consolidated financial position, results of operations or cash flows.

The effective tax rate for the three and six months ended June 25, 2006 was 34.2% and 32.8%, respectively, compared to 31.4% and 33.8%, respectively, for the corresponding periods in 2005. The effective tax rate for the quarter ended June 26, 2005, was lower than normal primarily due to a tax benefit of approximately $2,000 from the recognition of deferred tax assets in Mexico for which a valuation allowance was no longer required. The effective tax rate for the six months ended June 25, 2006, was lower than the corresponding period in 2005 primarily as a result of adjustments to state tax accruals related to favorable state tax rulings and audit assessments. These adjustments, totaling approximately $4,000, occurred primarily in the first quarter.

Note 14: Subsequent Events

On July 24, 2006, the Company and Ahlstrom Corporation, Finland (Ahlstrom), announced an agreement under which the Company will acquire Ahlstrom s 35.5 percent interest in Sonoco-Alcore, S.a.r.l., a joint venture formed in 2004 when the two companies combined their European tube, core and coreboard operations. The purchase, which will increase the Company s ownership in the operations from 64.5 to 100 percent, will be through a direct purchase arrangement which replaces the previously disclosed put/call option arrangement. It is expected to be completed in this year s third quarter, pending certain regulatory approvals. The Company, as the majority interest holder, has accounted for the joint venture as an acquisition since its inception and, therefore, has been consolidating the results of the joint venture and reporting Ahlstrom s share as minority interest in its financial statements.

Report of Independent Registered Public Accounting Firm

To the Shareholders and Directors of Sonoco Products Company:

We have reviewed the accompanying condensed consolidated balance sheet of Sonoco Products Company as of June 25, 2006, and the related condensed consolidated statements of income for the three-month and six-month periods ended June 25, 2006, and June 26, 2005 and the condensed consolidated statements of cash flows for the six-month periods ended June 25, 2006 and June 26, 2005. These interim financial statements are the responsibility of the Company s management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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 Public Company Accounting Oversight Board, 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.

Based on our review, we are not aware of any material modifications that should be made to the accompanying condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2005, and the related consolidated statements of income, changes in shareholders equity and cash flows for the year then ended, management s assessment of the effectiveness of the Company s internal control over financial reporting as of December 31, 2005 and the effectiveness of the Company s internal control over financial reporting as of December 31, 2005; and in our report dated February 27, 2006, we expressed unqualified opinions thereon. The consolidated financial statements and management s assessment of the effectiveness of internal control over financial reporting referred to above are not presented herein. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2005, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP
Charlotte, North Carolina
July 27, 2006

SONOCO PRODUCTS COMPANY

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

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

availability and pricing of raw materials;

success of new product development and introduction;

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

international, national and local economic and market conditions;

fluctuations of obligations and earnings of pension and postretirement benefit plans;

ability to maintain market share;

pricing pressures and demand for products;

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

anticipated results of restructuring activities;

resolution of income tax contingencies;

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

currency stability and the rate of growth in foreign markets;

use of financial instruments to hedge foreign currency, interest rate and commodity price risk;

liability for remediation of environmental problems;

actions of government agencies;

loss of consumer confidence; and

economic disruptions resulting from terrorist activities.

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

SONOCO PRODUCTS COMPANY
Results of Operations

Second Quarter 2006 Compared with Second Quarter 2005

Company Overview

Net sales for the second quarter of 2006 were $917 million, compared to $878 million for the second quarter of 2005. The components of the sales change were:

($ in millions)

Volume	$16
Selling price	13
Currency exchange rate	11
Acquisitions/Divestitures	(1)
Total sales increase	$39

Company-wide sales volumes during the second quarter of 2006 were up approximately 2% over the same period in 2005. The volume increase due to acquisitions was basically offset by the impact of the fourth quarter of 2005 divestiture of a single-plant folding cartons operation.

On October 1, 2005, the Procter & Gamble Company s (P&G) acquisition of The Gillette Company (Gillette) became effective, and Gillette became a wholly owned subsidiary of P&G. Consequently, sales to P&G represented more than 10% of the Company s net sales during the three and six months ended June 25, 2006.

Income before income taxes for the second quarter increased from $51.9 million in 2005 to $70.3 million in 2006. Despite higher year-over-year material costs, the Company was able to produce a positive relationship between the year-over-year change in selling prices and the year-over-year change in material costs (price/cost relationship) during the second quarter of 2006, due primarily to the impact of price increases. In addition, income before income taxes increased due to ongoing productivity and purchasing initiatives along with improved results from the Company s European paper-based tube/core and coreboard operations. During the second quarter of 2005, results were unfavorably impacted by the national paper strike in Finland that resulted in the shutdown of the Company s paper and tube and core facilities in the area. Continued increases in energy, freight and labor costs partially offset these favorable variances. The higher sales volume had little impact on earnings, due to unfavorable shifts in the mix within the individual businesses of each segment. Income before income taxes included pretax charges in connection with the Company s previously announced restructuring actions of approximately $3 million and $9 million for the second quarter of 2006 and 2005, respectively. These restructuring charges were not allocated to the operating segments. Net interest expense for the second quarter of 2006 increased to $12.5 million, compared with $10.8 million for the same period in 2005. This increase was due primarily to an increase in interest rates, partially offset by a decrease in average debt balances.

The Company expects a slight increase in volume during the third quarter of 2006 due primarily to the normal seasonality that occurs in the Consumer Packaging segment. The Company also anticipates that the price/cost relationship will be relatively neutral and that productivity improvements will be partially offset by year-over-year increases in the cost of labor, freight and energy.

The effective tax rate for the quarter ended June 26, 2006 was 34.2%, compared to 31.4% for the quarter ended June 27, 2005. This increase is primarily due to a tax benefit, recognized in 2005, in the amount of approximately $2 million from the recognition of deferred tax assets in Mexico for which a valuation allowance was no longer required.

Equity in earnings of affiliates/minority interest in subsidiaries for the second quarter of 2006 totaled approximately $3.1 million compared with approximately $4.5 million for the second quarter of 2005. This decrease was due primarily to higher minority interest associated with improved results in the Sonoco-Alcore business.

Reportable Segments

The Company reports results in three segments, Consumer Packaging, Tubes and Cores/ Paper and Packaging Services. All Other Sonoco represents the activities and businesses of the Company s consolidated subsidiaries that do not meet the aggregation criteria outlined in Statement of Financial Accounting Standards No. 131, Disclosures about Segments

22

SONOCO PRODUCTS COMPANY

of an Enterprise and Related Information (FAS 131) and therefore cannot be combined with other operating segments into a reportable segment.

Operating profit at the segmental level is defined as the segments portion of Income before income taxes on the Company s Condensed Consolidated Statements of Income, adjusted for restructuring charges and net interest expense. Because segmental results are computed based on the manner in which the Company s management reviews financial results, restructuring and net interest charges are not considered in the calculation of operating profit. General corporate expenses, with the exception of restructuring charges, interest and income taxes, have been allocated as operating costs to each of the Company s reportable segments and All Other Sonoco. See Note 12 to the Company s Condensed Consolidated Financial Statements for more information on reportable segments.

Consumer Packaging Segment

The Consumer Packaging segment includes the following products: round and shaped rigid packaging, both composite and plastic; printed flexible packaging; and metal and plastic ends and closures.

Net sales of the Consumer Packaging segment for the second quarter of 2006 totaled approximately $328 million, compared to approximately $312 million in the second quarter of 2005. This increase was due primarily to increased selling prices in composite cans, closures and flexible packaging as well as a favorable impact of foreign exchange rates. Increased volume in composite cans was basically offset by lower volumes in flexible packaging.

Operating profit, as defined above, for the Consumer Packaging segment in the second quarter of 2006 was approximately $26 million, up from approximately $25 million for the same period in 2005. This increase resulted primarily from higher selling prices as well as reduced costs related to on-going productivity initiatives. These favorable impacts were partially offset by rising costs for materials, energy, freight and labor.

Tubes and Cores/Paper Segment

Effective December 31, 2005, the Company changed the name of the Engineered Carriers and Paper segment to Tubes and Cores/Paper because the term tubes and cores is more generally understood than engineered carriers in the businesses included in this segment. Its products include: high-performance paper and composite paperboard tubes and cores; fiber-based construction tubes and forms; recycled paperboard; linerboard; and recovered paper.

Net sales of the Tubes and Cores/Paper segment for the second quarter of 2006 totaled approximately $387 million, compared to approximately $368 million in the second quarter of 2005. This increase was due primarily to higher volumes, mainly in global paper operations, higher selling prices of tubes and cores and the favorable impact of foreign exchange rates.

Operating profit, as defined above, for Tubes and Cores/Paper segment in the second quarter of 2006 was approximately $37 million, up from approximately $27 million for the same period in 2005. The increase in operating profit is primarily due to cost reductions resulting from productivity and purchasing initiatives and a favorable price/cost relationship. These improvements were partially offset by higher energy, freight and labor costs.

Packaging Services Segment

The Packaging Services segment provides the following products and services: point-of-purchase displays; packaging fulfillment; contract packing; brand artwork management; and supply chain management.

Net sales of the Packaging Services segment for the second quarter of 2006 totaled approximately $107 million, compared to approximately $112 million in the second quarter of 2005. This decrease is primarily due to year-over-year reduction in point-of-purchase display and rework activity, lower volume in certain European Service Centers, as well as the loss of sales from a single plant folding carton operation which was sold at the end of 2005.

Operating profit, as defined above, for the Packaging Services segment was approximately $9 million in the second quarter of 2006, compared to approximately $11 million for the same period in 2005. This decrease was primarily due to lower volumes, partially offset by productivity improvements and cost containment.

SONOCO PRODUCTS COMPANY

<u>All Other Sonoco</u>

All Other Sonoco includes the following products: wooden, metal and composite reels for wire and cable packaging; molded and extruded plastics; custom designed protective packaging; and paper amenities, such as coasters and glass covers.

Net sales of All Other Sonoco for the second quarter of 2006 totaled approximately $96 million, compared to approximately $86 million in the second quarter of 2005. This increase was primarily due to higher selling prices and volumes in wire and cable reels along with volume gains in protective packaging.

Operating profit, as defined above, for All Other Sonoco was approximately $13 million in the second quarter of 2006, compared to approximately $10 million for the same period in 2005. This increase resulted primarily from the impact of higher selling prices along with on-going productivity initiatives.

June 2006 Year-to-Date Compared with June 2005 Year-to-Date

Company Overview

Net sales for the first six months of 2006 were $1,736 million, compared to $1,693 million for the first six months of 2005.

The components of the sales change were:

($ in millions)

Volume	$19
Selling price	18
Currency exchange rate/Other	11
Acquisitions/Divestitures	(5)
Total sales increase	$43

Selling prices increased in the majority of the Company s business units during the first six months of 2006, with the only notable exception being the North American recovered paper operations. Company-wide sales volumes during the first six months of 2006 were up approximately 1% over the same period in 2005. The net impact of several small acquisitions and the Company s divestiture of a single-plant folding cartons operation was minimal.

Income before income taxes totaled approximately $132 million in the first six months of 2006, compared to approximately $105 million for the same period in 2005. This increase was due primarily to a favorable price/cost relationship and reduced costs resulting from ongoing productivity and purchasing initiatives. These increases were partially offset by increased costs of freight, labor and energy. Income before income taxes included pretax charges in connection with the Company s previously announced restructuring actions of approximately $5 million and $14 million for the first six months of 2006 and 2005, respectively. These restructuring charges were not allocated to the operating segments. Net interest expense increased by approximately $3 million due to higher interest rates partially offset by lower average debt levels.

The effective tax rate for the six months ended June 25, 2006 was 32.8%, compared to 33.8% for the six months ended June 26, 2005. This decrease was primarily due to adjustments to certain state tax accruals related to favorable state tax rulings and audit settlements.

Equity in earnings of affiliates/minority interest in subsidiaries for the first six months of 2006 totaled approximately $5.9 million compared with approximately $7.6 million for the first six months of 2005. This change was due primarily to the impact on higher minority interest associated with increased profitability at the Sonoco-Alcore joint venture.

Reportable Segments

<u>Consumer Packaging Segment</u>

Net sales of the Consumer Packaging segment for the first six months of 2006 totaled approximately $626 million, compared to approximately $589 million in the first six months of 2005. This increase was due primarily to increased volumes and selling prices in global composite cans; increased selling prices of closures and flexible packaging; and the favorable impact of foreign exchange rates. Partially offsetting these improvements were volume declines in closures and flexible packaging.

SONOCO PRODUCTS COMPANY

Operating profit, as defined above, for the Consumer Packaging segment in the first six months of 2006 was approximately $52 million, up from approximately $47 million for the same period in 2005. This increase resulted primarily from reduced costs related to on-going productivity and purchasing initiatives as well as a favorable price/cost relationship. These favorable impacts were partially offset by increased costs for energy, freight and labor, and an unfavorable shift in the mix of business within the segment.

Tubes and Cores/Paper Segment

Net sales of the Tubes and Cores/ Paper segment for the first six months of 2006 totaled approximately $725 million, slightly higher than approximately $721 million in the first six months of 2005. The impact of increased volume, primarily in global paper operations; increased selling prices in North American tubes and cores; and the favorable impact of foreign exchange rates, were nearly offset by decreased selling prices of recovered paper and continued weak demand in European and North American tube and core operations.

Operating profit, as defined above, for the Tubes and Cores/Paper segment in the first six months of 2006 was approximately $65 million, up from approximately $52 million for the same period in 2005. Operating profit improved as the result of productivity improvements, cost reductions resulting from restructuring actions, and a favorable price/cost relationship, mainly resulting from price increases in paperboard, tubes and cores in North America and Europe. Partially offsetting these improvements were continued cost increases for energy, freight and labor, along with an unfavorable shift in the mix of the business in the segment.

Packaging Services Segment

Net sales of the Packaging Services segment for the first six months of 2006 totaled approximately $204 million, compared to approximately $216 million in the first six months of 2005. This decrease was due to the loss of sales resulting from the sale of a single-plant folding cartons operation as well as decreased volume. Fulfillment sales and point-of-purchase displays sales were unusually strong in the first half of 2005, and while lower in the first half of 2006, are at or near management s expectations and are expected to improve during the second half.

Operating profit, as defined above, for the Packaging Services segment was approximately $18 million in the first six months of 2006, compared to approximately $21 million for the same period in 2005. This decrease can be attributed primarily to the impact of lower volumes, partially offset by increased productivity and a favorable price/cost relationship.

All Other Sonoco

Net sales of All Other Sonoco for the first six months of 2006 totaled approximately $181 million, compared to approximately $166 million in the first six months of 2005. This increase was primarily due to higher selling prices and increased volume in wire and cable reels and protective packaging.

Operating profit, as defined above, for All Other Sonoco was approximately $26 million in the first six months of 2006, compared to approximately $19 million for the same period in 2005. This increase resulted primarily from on-going productivity and purchasing initiatives, a favorable price/cost relationship and higher volumes in protective packaging. Partially offsetting these positive factors were increased costs for energy, freight and labor.

Financial Position, Liquidity and Capital Resources

The Company s financial position remained strong during the first six months of 2006. Total debt decreased by approximately $5 million to $777 million from $782 million at December 31, 2005. The decrease was due primarily to the repayment of approximately $24 million of Brazilian Real denominated debt offset partially by an $18 million increase in commercial paper. Outstanding commercial paper totaled $48 million and $30 million at June 25, 2006 and December 31, 2005, respectively.

For the first six months of 2006, cash flows from operations totaled approximately $161 million, compared with approximately $68 million for the same period in 2005. This increase of approximately $93 million was primarily the result of reduced working capital requirements and improved profitability. The working capital improvement was due primarily to unusually strong sales in the latter part of the fourth quarter of 2005, which were collected during the first

SONOCO PRODUCTS COMPANY

quarter of 2006. In addition, Company-wide working capital initiatives related to inventory and accounts payable improved operating cash flow in the first six months of 2006, compared with the first six months of 2005.

During the first six months of 2006, the Company repurchased 2.5 million shares of Sonoco common stock for approximately $83 million. The shares were repurchased under an existing authorization to repurchase up to approximately 5.29 million shares. On April 19, 2006, the Company s Board of Directors rescinded all previously approved stock repurchase programs in conjunction with its approval of a new program, which authorizes the repurchase of up to 5.0 million shares of the Company s common stock. This new repurchase program does not have a specific expiration date and no shares have been repurchased under this program. Currently, the Company has no plans to purchase additional shares of its common stock.

During the six months ended June 25, 2006, the Company received cash proceeds of approximately $32 million from the issuance of common stock, which related to the exercise of stock options, and collected $14.5 million in notes receivable related to the sale of certain assets in December 2005. In addition, during the six months ended June 25, 2006, the Company funded capital expenditures and acquisitions of approximately $59 million and $40 million, respectively, and paid dividends of approximately $47 million.

In January 2004, the Company entered into an agreement to swap the interest rate from fixed to floating on $100 million of its $250 million 6.5% notes maturing in 2013. During June 2004, the Company entered into a similar agreement to swap the interest rates from fixed to floating on all of its newly issued $150 million of 5.625% notes maturing in 2016. During the six months ended June 25, 2006, the Company terminated both of its interest rate swaps. Termination of these swaps increased the Company s proportion of fixed rate debt, reducing its exposure to the effects of rising interest rates. At the time of termination, the fair value of the interest rate swap related to the 6.5% notes was an unfavorable position of approximately $3.0 million, and the fair value of the interest rate swap related to the 5.625% notes was a favorable position of approximately $0.9 million. In accordance with Statement of Financial Accounting Standards No. 133 Accounting for Derivative Instruments and Hedging Activities (FAS 133), interest expense is being adjusted by amortization of the gain and loss associated with these swap terminations over the remaining life of the related bonds.

On May 3, 2006, the Company entered into an amended and restated credit agreement to extend its $350,000 bank line of credit supporting its commercial paper program to a new five-year maturity. The term of the line of credit allows commercial paper borrowings up to the maximum amount of the line of credit to be classified as long-term debt. The amended and restated credit agreement also provides the registrant the option to increase its credit line to $500,000 subject to the concurrence of its lenders.

At June 25, 2006, the Company had commodity swaps outstanding to fix the costs of a portion of raw materials and energy. These swaps, which have maturities ranging from October 2006 to June 2009, qualify as cash flow hedges under FAS 133. The fair market value of these commodity swaps was a favorable position of $5.7 million ($3.7 million after tax) and $17.5 million ($11.2 million after tax) at June 25, 2006 and December 31, 2005, respectively.

Restructuring and Impairment

During the fourth quarter of 2005, the Company began an in-depth review of its global Tubes and Cores/Paper operations. This review, which is expected to be completed in the third quarter of 2006, is intended to examine the Company s served markets in this segment (principally textiles, paper and film) and address issues such as market growth, capacity, technology and competition. Depending upon the conclusions reached, a further restructuring of operations may result. Further information regarding the Company s existing restructuring programs is provided in Note 4 to the Company s Condensed Consolidated Financial Statements.

SONOCO PRODUCTS COMPANY

New Accounting Pronouncements

Information regarding new accounting pronouncements is provided in Note 11 to the Company s Condensed Consolidated Financial Statements.

Environmental

The Company has been named as a potentially responsible party (PRP) at several environmentally contaminated sites not owned by the Company. These regulatory actions represent the Company s largest potential environmental liabilities. All of the sites are also the responsibility of other parties. The Company s liability, if any, is shared with such other parties, but the Company s share has not been finally determined in most cases. In some cases, the Company has cost-sharing agreements with other potentially responsible parties with respect to a particular site. Such agreements relate to the sharing of legal defense costs or clean-up costs, or both. The Company has assumed, for purposes of estimating amounts to be accrued, that the other parties to such cost-sharing agreements will perform as agreed. It appears that final resolution of some of the sites is years away, and actual costs to be incurred for these environmental matters in future periods may vary from current estimates because of the inherent uncertainties in evaluating environmental exposures. Accordingly, the ultimate cost to the Company with respect to such sites cannot be determined. As of June 25, 2006 and December 31, 2005, the Company had accrued $16,262 and $16,789, respectively, related to environmental contingencies. The Company periodically reevaluates the assumptions used in determining the appropriate reserves for environmental matters as additional information becomes available and, when warranted, makes appropriate adjustments.

The Company believes the issues regarding the Fox River, which are discussed in some detail below, currently represent the Company s greatest loss exposure for environmental liability. The Company believes that all of its exposure to such liability for the Fox River is contained within its wholly-owned subsidiary, Sonoco-U.S. Mills, Inc. (U. S. Mills). Accordingly, regardless of the amount of liability that U. S. Mills may ultimately have, Sonoco Products Company believes its potential loss on account of Fox River issues is limited to U. S. Mills net worth, which was approximately $80 million at June 25, 2006.

As previously disclosed, U.S. Mills has been notified by governmental entities that it, together with a number of other companies, is a PRP for environmental claims under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) and other statutes, arising out of the presence of polychlorinated biphenyls (PCBs) in sediments in the lower Fox River and in the bay of Green Bay in Wisconsin. U.S. Mills was named as a PRP because scrap paper purchased by U.S. Mills as a raw material for its paper making processes more than 30 years ago allegedly included carbonless copy paper that contained PCBs, some of which were included in wastewater from U.S. Mills manufacturing processes which was discharged into the Fox River. The Company acquired the stock of U.S. Mills in 2001, and the alleged contamination predates the acquisition. The Company was notified that it was a PRP, but responded that its only involvement was as a subsequent shareholder of U.S. Mills and, as such, has no responsibility. The governmental entities making such claims against U.S. Mills and the other PRPs have been coordinating their actions, including the assertion of claims against the PRPs. Additionally, certain claimants have notified U.S. Mills and the other PRPs of their intent to commence a natural resource damage (NRD) lawsuit, but no such actions have been instituted.

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

In July 2003, USEPA and Wisconsin Department of Natural Resources (WDNR) issued their final clean-up plan (known as a Record of Decision, or ROD) for a portion of the Fox River. The ROD addressed the lower part of the Fox River and portions of Green Bay, where USEPA and WDNR (the Governments) estimate the bulk of the sediments that need to be remediated are located. In two portions of the lower part of the Fox River covered by the ROD Operable Units (OUs) 3 and 4 the Governments selected large-scale dredging as the clean-up approach. OU 3 is the section of the Fox River running downstream from Little Rapids to the DePere dam, and OU 4 runs from the DePere dam downstream to the mouth of the Fox River at Green Bay. U.S. Mills plant is below the DePere dam and, prior to 1972, discharged wastewater into the river downstream of the dam in OU 4. In the ROD, the Governments estimated that approximately 6.5 million cubic yards of sediment would be removed from OUs 3 and 4 at an estimated cost of approximately $284 million (approximately $26.5 million for OU 3 and approximately $257.5 million for OU 4). The

SONOCO PRODUCTS COMPANY

Governments also identified capping the river bed with appropriate materials as a contingent remedy to be evaluated during the remedial design process. For Green Bay (OU5), the Governments selected monitored natural attenuation as the clean-up approach at an estimated cost of approximately $40 million. The Governments also indicated that some limited dredging near the mouth of the river might be required, which would ultimately be determined during the design stage of the project. Earlier, in January 2003, the Governments had issued their ROD for the upper portions of the Fox River OUs 1 and 2. Combining the cost estimates from both RODs, it appeared that the Governments expected the selected remedies for all five OUs to cost approximately $400 million, exclusive of contingencies. In March 2004, NCR and Georgia-Pacific (G-P) entered into an Administrative Order on Consent (AOC) with the Governments to perform engineering design work for the clean up of OUs 2-5.

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

NCR and U.S. Mills reached agreement between themselves that each would fund 50% of the costs of remediation of the OU4 hotspot, which the Company currently estimates to be between $25 million and $30 million for the project as a whole. Project implementation will begin in 2006, but most of the project cost is expected to be incurred in 2007. Although the funding agreement does not acknowledge responsibility or prevent either party from seeking reimbursement from any other parties (including each other), the Company accrued $12.5 million in 2005 as its estimate of the portion of costs that U.S. Mills expects to fund under the funding agreement.

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

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

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

In May/June 2005, U.S. Mills first learned of elevated levels of PCB s (the OU4 hotspot) in the Fox River adjacent to its DePere plant. U.S. Mills, while still not believing its DePere plant was the source of this contamination, entered into the consent decree to remediate the OU4 hotspot as discussed above.

SONOCO PRODUCTS COMPANY

In June 2006, U.S. Mills first received the results of tests it initiated on the U.S. Mills property that suggest that the plant may have previously processed more than the de minimus amounts of PCB contaminated paper reflected in the records available to the Company. This information seemed to contradict the Company s previous understanding of the history of the DePere plant. Further testing of the site is continuing to attempt to determine the extent of this recently discovered contamination. Based on these most recent findings, it is possible that U.S. Mills might be responsible for a larger portion of the remediation than previously anticipated. The total estimated cost set forth in the ROD for remediation of OU 4 was approximately $257.5 million (the more recent Basis of Design Report estimate is considerably higher) and the estimated cost of monitoring OU 5 was approximately $40 million. There are two alleged PRPs located in OU 4 (of which the smaller is the plant owned by U.S. Mills). It is possible that the owners of these two plants, together with the original generator of the carbonless copy paper, could be required to bear the substantial portion of the remediation costs of OU 4, and share with other PRPs the cost of monitoring OU5. U.S. Mills is currently evaluating all of its options and intends to vigorously defend against liability to the extent it deems it prudent and cost-effective to do so.

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

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

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

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

In any event, because the discharges of hazardous materials into the environment occurred before the Company acquired U.S. Mills, and U.S. Mills has been operated as a separate subsidiary of the Company, the Company does not believe that it has any liability for the liabilities of U.S. Mills. Accordingly, as stated above, the Company does not believe that the effect of U.S. Mills Fox River liabilities on the Company would result in a loss to the Company that would exceed the net worth of U.S. Mills, which was approximately $80 million at June 25, 2006.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Information about the Company s exposure to market risk was disclosed in its Annual Report on Form 10-K for the year ended December 31, 2005, which was filed with the Securities and Exchange Commission on February 27, 2006. There have been no 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 principal executive officer and principal financial officer, we conducted an evaluation pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934 of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based on this evaluation, our principal executive officer and principal financial

SONOCO PRODUCTS COMPANY

officer concluded that such controls and procedures, as of the end of the period covered by this Quarterly Report on Form 10-Q, were effective.

Changes in Internal Controls

The Company is continuously seeking to improve the efficiency and effectiveness of its operations and of its internal controls. This results in refinements to processes throughout the Company. However, there has been no change in the Company s internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

See discussion under the heading of Environmental in Management s Discussion and Analysis of Financial Condition and Results of Operations.

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	(d) Maximum Number of Shares that May Yet be Purchased under the Plans or Programs[2]
3/27/06 4/30/06	367,400	$ 33.82	367,400	2,790,000
Total	367,400	$ 33.82	367,400	2,790,000[3]

1 All purchases were made in open-market transactions.

2 In 2001, the Company s Board of Directors approved a stock repurchase program authorizing the repurchase of up to 5,000,000 shares of the Company s common stock, in addition to approximately 290,000 shares

that had previously been authorized for repurchase prior to 2001.

3 These shares remained available for repurchase until April 19, 2006 under the programs described above. However, on April 19, 2006, the Company s Board of Directors rescinded these two programs in conjunction with its approval of a new program, which authorizes the repurchase of up to 5,000,000 shares of the Company s common stock. This new repurchase program does not have a specific expiration date and no shares have been repurchased under this program.

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

Incorporated by reference to Item 4 of Part II of the Company s Quarterly Report on Form 10-Q for the quarter ended March 26, 2006.

Item 6. Exhibits.

Exhibit 10 Amended and Restated Credit Agreement
Exhibit 15 Letter re: unaudited interim financial information

Exhibit 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)

Exhibit 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)

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: July 27, 2006

By: /s/ Charles J. Hupfer
Charles J. Hupfer
Senior Vice President and Chief Financial Officer
(principal financial officer)

By: /s/ Barry L. Saunders
Barry L. Saunders
Staff Vice President and Corporate Controller
(principal accounting officer)

31

SONOCO PRODUCTS COMPANY
EXHIBIT INDEX

Exhibit Number	Description
10	Amended and Restated Credit Agreement
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)