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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Sonoco First Quarter 2018 Earnings Conference Call. (Operator Instructions) And as a reminder, this conference may be recorded.

I would now like to turn the conference over to Mr. Roger Schrum, Vice President of Investor Relations. Sir, you may begin.

Roger P. Schrum - *Sonoco Products Company - Corporate VP of IR & Corporate Affairs*

Thank you, Sabrina. Good morning, everyone, and welcome to Sonoco's investor conference call to discuss our 2018 first quarter financial results.

Joining me today are Rob Tiede, President and Chief Executive Officer; and Barry Saunders, Senior Vice President and Chief Financial Officer.

A news release reporting our financial results was issued before the market opened today and is available on the Investor Relations section of our website at sonoco.com. In addition, we will be referencing a presentation on our first quarter results, which also was posted on our Investor Relations site this morning.

Before we go further, let me remind you that today's call and presentation contains a number of forward-looking statements based on current expectations, estimates and projections. These statements are not guarantees of future performance and are subject to certain risks and uncertainties. Therefore, actual results may differ materially.

Furthermore, today's presentation includes the use of non-GAAP financial measures, which management believes provides useful information to investors about the company's financial condition and results of operations. Further information about the company's use of non-GAAP financial measures, including definitions as well as reconciliations of those measures to the most closely related GAAP measure, is also available in the Investor Relations section of our website.

Now with that, let me turn it over to Barry.

Barry L. Saunders - *Sonoco Products Company - Senior VP & CFO*

Thank you, Roger. I'll begin on Slide 3. We'll see that earlier this morning, we reported first quarter earnings per share on a GAAP basis of $0.73 and base earnings of $0.74, which is at the high end of our guidance range of $0.69 to $0.75, all of which compares to base earnings of $0.59 for the same period last year. The differences between GAAP and base earnings are discussed in our press release but are not very significant this quarter.

So looking briefly at our base income statement on Slide 4. The first thing I want to point out is that due to the implementation of the new accounting standards, we will now be presenting the nonservice components of the pension cost in a separate line below operating income. For those of you familiar with the technicalities of pension accounting for defined benefit plans, those nonservice costs would be interest cost on the pension obligation, amortization of actuarial gains and losses, all been netted against the assumed return on pension plan asset.

As you see here, the amount of such nonservice cost nets to essentially nothing this year, actually income of $291,000, but represented cost of $3.7 million in 2017.

You might recall that we were expecting pension expense to be lower this year, and it is in the nonservice components due to the strong asset performance last year as well as the impact of the voluntary contribution we made in October.

Also mentioned that for your convenience, we are providing we are providing recasted 2017 financial statements to reflect this new format in both an 8-K that will be filed today and will be available on our website.

So starting back with the top line of income statement. You see sales were $1,304,000,000, up $132 million over the prior year due to the impact of acquisitions made last year, higher overall selling prices, higher volume and the favorable impact of translation. And you'll see all that quantified in the sales bridge in just a moment.

Gross profit was $250.6 million, $27.6 million above the prior year, due most notably to the favorable price/cost and the impact of acquisitions, but you'll see more details of the drivers and the operating profit bridge in just a moment. While the gross profit margin percent improved to 19.2%.

Selling, general and administrative and other income and expense items was $137.3 million, which is up right at $15 million from last year, due most notably to the impact of acquisitions and other cost changes, all then resulting in base operating profit of $113.3 million, up $12.8 million from the prior year. And again, you'll see all the drivers of the change in the operating profit bridge.

Below operating profit, you see the impact of the nonservice pension costs, as I previously described. Interest of $13.4 million was $1.3 million higher than last year due to the impact of acquisition financing. Income taxes are right at $26 million or essentially unchanged as the impact of the notably higher pretax profit was essentially offset by a lower effective tax rate of 25.9% due to the impact of the Tax Act.

You might recall that at our year-end update, we mentioned that we thought the effective tax rate on base earnings would be in the range of 26% to 27%. And although there is still some moving pieces in the analysis, we now believe that it will be at the bottom end of that range.

Equity and affiliates, when combined with minority interest, was $400,000, down almost $1 million from last year. Thus ending up with base earnings of $74.6 million or $0.74 per share.

Before moving on, this is a good point to mention that we did implement the new and long anticipated revenue recognition accounting guidance that you've all heard so much about. And as expected, it had very little impact on Sonoco.

In fact, the transition to the standard only had a $2 million impact on opening retained earnings, and the impact on earnings in the first quarter itself was only $200,000.

There are a few balance sheet line items that's impacted by the standard inventory and other receivables in particular. But in summary, a whole lot of effort put into the adoption of the guidance with no notable impact on our financial results.

In looking at the sales bridge on Slide 5, you see volume was higher by 6/10 of a percent for the company as a whole.

I will mention that with our accounting calendar, we did have one less day in this year's first quarter, which could have had an impact of 1% or so. But given the uncertainty of exactly how much impact one day might have had, the numbers shared today are simply the actual year-over-year change.

To spend a bit more time talking about volume by segment. Consumer Packaging volume was essentially flat as just over a 2% growth in plastics and a 1% improvement in flexibles was offset by global composite can and metal end sales being down right at 2%.

Display and Packaging volume was up right at 15%, due most notably to the battery packaging operation. Paper and Industrial Converted Products volume was down 1.2% before considering the impact of the day difference as a 3% decline in global tube and core sales was partially offset by global paper sales being up 2% and our reels business having a particularly strong quarter with volume up 11%.

And lastly, Protective Solutions volume was down 2% due to continued weakness on the transportation components business, which was off 8%, while temperature-assured packaging and Consumer Packaging were essentially flat for the quarter.

Moving over to price. You see that prices were higher year-over-year by $22 million, driven by price increases, both to cover higher material costs as well as our other efforts to push through noncontract increases. We'll talk more about pricing as well as the cost side of the equation in just a few minutes, including the impact of OCC movements.

Acquisitions added $61 million to the top line, all in the Consumer Packaging segment coming from last year's Peninsula Packaging and Clear Lam acquisitions. The Peninsula Packaging acquisition was completed towards the end of March last year, so this is the last quarter it will appear in the acquisition column. And exchange and other was positive by $41 million, driven by the weaker dollar.

Turning to the operating profit bridge on the next slide. You see the slightly higher volume when combined with mix actually reduced earnings by right at $5 million. You might recall from the sales bridge that the greatest volume improvement was in the Display and Packaging segment where the margin is much lower than our traditional manufacturing business and, therefore, did not cover the lost earnings on lower volume in some of the other businesses.

Price/cost, including the benefit of procurement productivity, was very, very favorable this quarter, up right at $23 million. Most of the favorable variance is in the Paper and Industrial Converted Products segment, driven by several factors. The first simply being the movement of OCC prices after contractual price reset.

If you were to look at the chart in the appendix, with the history of OCC prices in the south, you would see that in the first quarter last year, many contractual selling prices reset at December 2016 price of $120 per ton, then our actual cost moved higher throughout the first quarter, averaging $152 per ton.

While this year, many contracts reset the December price of $115 per ton and then our cost moved lower in the quarter, averaging $107 over the 3 months.

You can see that prices moved down another $10 in April from the March price, which again represented another reset point. And we're expecting OCC to drop by another $10 or so in May, so we should have some price/cost tailwind in the second quarter as well.

But in addition to simply the timing of OCC movement, it's also important to understand that we have been successful in raising prices on tubes and cores and paper on a global basis with all regions of the world reporting a favorable year-over-year spread.

Even in Europe, where pricing has been difficult for many years, the paper systems have tightened up, allowing for price increases to stick. We have certainly seen improvement on pricing in corrugated medium as well.

The impact of acquisitions, Peninsula and Clear Lam, added right at $2 million to operating earnings. Manufacturing productivity was positive by $6 million for the quarter, with notably solid performance in the Consumer Packaging segment in both composite cans in North America and Europe and in flexibles.

Paper and Industrial Converted Products productivity was very light, where productivity was even slightly negative in their tube and core operations in the U.S. and Canada, driven by the deleveraging associated with the lower volume as well as the continued impact of implementing plant consolidation plans.

And we did see some turnaround in productivity in Protective Solutions this quarter when it had been running negative.

And lastly, the change in all other on a year-over-year basis was unfavorable by $13 million, which is essentially in line with what you would expect from normal nonmaterial inflation. Otherwise, the benefit of translation, which added right at $4 million to operating income as well as some fixed cost productivity, was largely offset by the continued ramp-up at the battery packaging center and other miscellaneous cost increases.

On Slide 7, you find our results by segment, where you see that Consumer Packaging sales were up 18%, due most notably to the impact of acquisitions, while operating profit improved by only 3% due to the lower operating profit margins on acquisition sales as well as the impact of a shift in the mix of business in this segment, resulting in an operating profit margin of 10.7% as compared to 12.3% in the same period last year.

Display and Packaging sales were up 24% due to the battery pack center activity and, to a lesser extent, exchange rate impact, but operating profit was down $1.5 million due to the startup issues at that location. Although down from the prior year, this has improved from the loss we reported in the fourth quarter for this segment as a whole, and we expect to continue the improvement as we move through the year.

Paper and Industrial Converted Products sales were up 4% due to higher selling prices and the impact of translation, partially offset by the lower volume, but operating profit improved by $13 million due to very favorable price/cost with the price operating profit margin up to 8.6% versus 6.1% in the prior year.

And finally, Protective Solutions sales were down slightly with a similar decrease in operating profit, and operating profit margin remaining flat at 8.2%. All the spending with total company sales up just under 11% and our operating profit improving by almost 13% and the company-wide operating profit margin improving to 8.7%.

Looking forward on Slide 9. You see our outlook for the second quarter and the balance of the year. Starting with the full year, we are updating our guidance on the top and bottom side by $0.06, bringing the full year range to $3.22 to $3.32 per share. $0.04 is coming directly from a lower expected tax rate, again, down from 27% to 26%, and the balance mostly from the expected accretion from the completion of the recently announced Highland acquisition.

For the second quarter, we are forecasting base earnings to be in the range of $0.83 to $0.89, which includes the impact of lower effective tax rate as well as the fact that much of the accretion from the Highland acquisition is in the second quarter due to the seasonality of that business. And our outlook includes the benefit of previously mentioned price/cost benefit as a result of OCC prices falling off from the March levels.

Turning from earnings to cash flow on Slide 9. You see we had a very solid quarter from a cash flow perspective, generating cash from operations of $119.8 million, up $52 million over the same quarter last year. The increase was driven by higher net income, a higher noncash addback for depreciation and amortization, lower pension contributions and some other favorable operating impacts, partially offset by higher use of working capital, which was driven by a pickup of activity in the quarter as well as the impact of the seasonality of the businesses we acquired last year.

We spent $36 million in capital. And after paying dividends of $39 million, we had free cash flow of $45 million versus a negative $18 million in the same period last year. The cash flow generation in the quarter was largely as expected and our free cash flow target for the year is unchanged and continues to be in the range of $180 million to $200 million.

Speaking of dividends, you might have seen that yesterday, our Board of Directors declared a $0.41 per share quarterly common stock dividend, a 5.1% increase from the previous quarterly dividend of $0.39 per share, representing the 36th consecutive year that Sonoco has grown common stock dividend and the 372nd consecutive quarter, dating back to 1925 that the company has paid dividends to shareholders. On an annualized basis, this provides the yield of approximately 3.3% based on the closing stock price.

That completes my financial review for the quarter and will now turn it over to Rob for some additional comments.

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

Thanks, Barry, and good morning.

Let me give you my take on the first quarter, then speak about our recently completed acquisition of Highland Packaging and conclude with the review of our opportunities and challenges for the rest of 2018.

I can tell you, I was pleased by our team's efforts in the first quarter as we achieved record first quarter results with our top line and our bottom line growing double digits. This was the third consecutive quarter Sonoco has achieved record base earnings results, which I believe clearly demonstrates the strength of our balance portfolio of Consumer and Industrial-related businesses.

Our Consumer Packaging segment grew sales double digits, primarily due to acquisitions, and our operating profit grew just over 4%. Margins were somewhat compressed during the quarter due to higher operating and logistics costs, material inflation, particularly resin, and a negative mix of business. However, we do expect margins to improve as the year progresses.

As an example, our new flexible packaging acquisition, Clear Lam, was experiencing a slower seasonal period of the year and the fresh berry harvest was delayed due to colder weather than normal. Growers are telling us that the harvest will be strong in the second quarter and, overall, the season looks good.

In addition, resin prices were up 10% to 15% year-over-year in the quarter, and some have increased going into the second quarter. We have increased prices through contractual pass-through mechanisms and by direct price increases.

So while we're somewhat behind the price/cost curve, we fully expect to catch up later in the year.

Switching to our global Paper and Industrial Converting segment, we reported our strongest first quarter in 10 years, with operating profit rising 48% and operating margins improving 250 basis points.

We had a strong operating performance in our industrial businesses, particularly in our global paper operations, and we continue to benefit from a positive price/cost relationship as recovered paper prices continued to be weak.

While our 2 largest segments, Consumer Packaging and Paper and Industrial Converted Products, made up 79% of our sales and 89% of our operating profits in our first quarter, we are working very hard to improve the performance of our 2 smaller segments, Protective Solutions and Display and Packaging.

After experiencing disappointing results in 2017 as market conditions for these businesses dramatically changed, we were pleased to see solid sequential improvement in each business during the first quarter.

Protective Solutions results were slightly lower year-over-year as we continue to experience volume weakness in our automotive components business. As we have mentioned, this business is heavily weighted to producing components for cars versus stronger selling trucks and SUVs.

We are in the midst of rightsizing our plants to match the level of business activity in pursuing dunnage and other molded EPS foam business to help offset the reduced volume. That said, our paper-based Consumer/Protective business continues to perform exceptionally well and our ThermoSafe business has new business commercializing during the year, which should improve results.

Our Display and Packaging segment operating profit was down slightly year-over-year in the first quarter. But sequentially, operating profit in this segment was up about $5.8 million from the fourth quarter.

As we stated last quarter, much of the issue we are facing surrounds the ramp-up of the new pack center operation near Atlanta. Our new leadership team is driving rapid improvement in the business, but we still have work to do to get this business to a level of acceptable performance.

Finally, we are also pleased with the improvement in cash flow from operations and free cash flow in the first quarter. In fact, it was the strongest cash flow and free cash flow performance since Q1 2013.

Linking a portion of management incentives to improving working capital is clearly driving improved performance, particularly in accounts receivable.

As I'm sure you saw last week, we closed on the acquisition of Highland Packaging, a Plant City, Florida-based leading thermoformer serving the fresh fruit, vegetable and egg markets. This strategic acquisition further complements our strategy to be a leading producer of packaging, serving the fast growing perimeter of the supermarket.

Highland provides Sonoco with 3 important strategic capabilities. First, when combined with our Peninsula Packaging business, we will have approximately $300 million in annual sales of thermoformed packaging, serving the fresh produce and dairy markets, including leading market positions serving berries, fresh-cut produce, salads and whole fruit. In addition, Highland provides us a strong position in the important Florida produce market, complementing our existing positions in Southern California, the Pacific Northwest and Mexico.

Finally, Highland places us into the attractive egg packaging market, where per capita consumption set a 20-year record in 2017, expanding to 275 eggs per person per year. If you multiply that by 330 million people in the United States, you can see there is tremendous opportunity for Highland's more sustainable clear PET packaging.

Overall, I would tell you we're off to a good start to 2018. We're projecting a strong second quarter as our Consumer Packaging segment will begin to benefit from the Highland acquisition. We also expect a strong second quarter performance from our Paper and Industrial Converted Products segment as we believe demand should remain solid, and we expect to continue to benefit from a favorable price/cost relationship.

Because of this outlook, along with our expectations for a lower effective tax rate, we are comfortable raising our full year base earnings guidance by $0.06 per share and now target year-over-year base earnings to improve more than 17%. But we still have work to do to meet our growth and margin improvement targets for the year. Inflationary cost pressures in freight, labor, energy and material cost, particularly resin, are requiring us to drive recovery through price increases in many of our businesses. Finally, we must continue to turn around our Display and Packaging and Protective Solutions segment. But overall, we remain confident our blend of paper, polymer and protective packaging businesses will continue to produce consistent earnings, improve returns and provide greater rewards for our shareholders, including the 5% increase to dividends we announced yesterday.

Let me take just one last minute to recognize Barry as he will be honored tonight by the University of South Carolina as one of the 4 distinguished alumni of the university's Moore's School of Business. Barry is being recognized along with a current pro football player and 2 other corporate executives for their outstanding contributions to their business, their community and, of course, the university. Barry, congratulations for this honor, and I understand you are in great company with the likes of Harris DeLoach, our Chairman, as well as other Sonoco leaders who have been recognized as USC distinguished alumni.

For those of you who might ask, Barry graduated from USC with a Bachelor of Science degree in accounting in 1981 and later earned an MBA in '89. I also understand that Barry's son and daughter were not that interested in going to the dinner until they found out that a pro football player would be present.

Congratulations, Barry.

And with that, operator, I will turn it over to you to review the question-and-answer procedure.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question will come from the line of George Staphos with Bank of America Merrill Lynch.

George Leon Staphos - *BofA Merrill Lynch, Research Division - MD and Co-Sector Head in Equity Research*

Barry, congratulations to you on your award presentation tonight. I hope it goes well. I had 2 questions. One, broadly on consumer and then one just on OCC and effectively what's in your guidance. So on consumer, can you help us understand how well you believe you're getting traction on what's been the last several years' worth of efforts on innovation and more customer-centric product innovation, the new product development center that you have in Hartsville relative to the volume numbers that you saw? And kind of the related question there, what's been going on such that mix was somewhat negative? I'm guessing it's just composite cans were down, but was there anything else going on in terms of the mix? That's broadly question one. Question two, is your expectation of OCC being down again in May in your 2Q guidance? If so, what's the number? If not, could you correct that?

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

Thanks, George. Yes, with respect to the innovation inside consumer, if I remember this correctly, we've got -- last year, we had about $44 million of new products that were driven through the innovation center, and we're projecting that to be directionally about $65 million for 2018. And so the other measure that we look at is simply the number of customer visits, and that continues to surprise us but not really anymore because we're -- we just have a lot of customers coming down with some challenges that they're asking us to participate with them in and help them figure out how to win both around the perimeter, but also more importantly, into the center of the store. And then on the mix question that you had asked, yes, cans globally were strong. However, in North America, cans were down, and it was the normal set of culprits. There would be refrigerated dough, there would be powdered beverage and concentrate -- I'm sorry, our frozen concentrate. The rest of the business performed as we expected. And in terms of the expectations, we also had one less day in the quarter, and I think Barry referenced that in saying that was directly about a 1% impact, but it's pretty hard to identify specifically what shipments will happen on one day. As it relates to your question on OCC. The guidance does reflect the expectation of that drop of $5 to $10 in the month of May.

George Leon Staphos - *BofA Merrill Lynch, Research Division - MD and Co-Sector Head in Equity Research*

Okay. Rob, if I could, just to clarify from the prior answer. So the mix effect that was negative, if I'm remembering correctly, that is largely being attributed to composite cans being down in North America. And then relating all the growth in visits and the innovation center revenue generation, you're happy with the traction you're getting from those relative to the way that it's translating to the volume growth. I guess you said the 2% in plastics and the 1% in flexibles. Correct on both of those?

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

Yes.

Operator

And our next question will come from the line of Edlain Rodriguez with UBS.

Edlain S. Rodriguez - *UBS Investment Bank, Research Division - Director and Equity Research Associate, Chemicals*

So big picture question. I mean, can you talk a little more about what you've seen in terms of the mix in the portfolio, the changes that you are making in terms of shifting to higher growth plastics and how that should eventually improve like the mix of the portfolio? And also, can you talk about the pipeline for the types of bolt-on acquisitions you're focusing on?

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

Sure, Edlain. Let me talk to the plastic acquisitions that we've made, it's really a shift to the perimeter of the store, which is where we've seen a fundamental shift occur in terms of how people eat. And so our focus is around -- basically around what we call fresh and natural, but it's about just fresh and natural foods. It's about how can we come alongside the growers, how do we provide not only thermoformed constructs but how do we also bring alongside some flexible capabilities that really give our customers a lot more optionality. And it's about preserving shelf life. So we've seen growth. I think I'm right on this. It's probably in the range of 6% to 9% growth on the perimeter of the store in comparison to what we've traditionally seen and where we grew up in the middle of the store.

Edlain S. Rodriguez - *UBS Investment Bank, Research Division - Director and Equity Research Associate, Chemicals*

And in terms of the pipeline?

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

Oh, yes, I'm sorry. Yes, I would say -- let me answer it this way. I mean, what we've always said is our focus is for us to put disproportionate amount of dollars towards flexible packaging, our thermoformed, and expand where it makes good sense for us on the industrial side, specifically in the emerging markets. So our activity in the M&A space is as robust as it's ever been.

Edlain S. Rodriguez - *UBS Investment Bank, Research Division - Director and Equity Research Associate, Chemicals*

Good. And one last one. Looking at the margin profile of Display and Packaging, how core is that business for you? And if it is, how long are you willing to wait to see a turnaround in there?

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

Yes, let me answer that question in this way. That business needs to be fixed, and we've talked about that. We've got a significant pack center that we were starting up. That went from 0 to 100 in 160 days, and we brought in 600 people. We have to train them up. We brought in new lines, and we will continue to bring in lines into that facility probably through the beginning of the third quarter, but we've seen significant sequential improvement. You saw us go from a loss of $4 million to income of about $1.6 million. We still have a long ways to go. Our focus right now is fixing that business.

Operator

And the next question will come from the line of Adam Josephson from KeyBanc.

Adam Jesse Josephson - *KeyBanc Capital Markets Inc., Research Division - Director and Senior Equity Research Analyst*

Rob, I hope you're feeling okay.

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

No. Allergies, they're killing me.

Adam Jesse Josephson - *KeyBanc Capital Markets Inc., Research Division - Director and Senior Equity Research Analyst*

Sorry. Well, all the best of luck to you in your new role. Three unrelated questions. One on M&A. I know you're just asked a little bit about that. What do you consider your optimal leverage ratio? And what is your willingness to go up significantly given where we are in the cycle for a major transaction?

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

Well, I'll answer it this way. We've always said that we want to maintain an investment grade, but for the right transaction. First of all, it's got to fit through the strategic lens. For the right transaction, would we go outside that as long as -- and the answer is yes as long as we had a very clear path within a prescribed time frame to deleverage and get us back into investment-grade ratings. So it really would depend on the deal and what all pertains to it and then as well there's other options with respect to if the right deal were there to supplement that leverage.

Adam Jesse Josephson - *KeyBanc Capital Markets Inc., Research Division - Director and Senior Equity Research Analyst*

Sure. One, the obligatory OCC one for me. You just -- I think you said down another $5 or $10 in May. We know we're at decade low prices already. Are you -- do you have any solid views to where we are here? Is there -- do you subscribe to this lower for longer view that just because of China's ever-tightening standards somehow, they'll be able to supply themselves with fiber longer term and they won't need the amount of OCC that they have historically? It's such a confusing issue as to how they're supplying themselves with the necessary fiber. I was just hoping you could opine a little bit on that.

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

Yes. That's a great question, Adam. Lower for longer. First of all, what does longer mean? I think the last time that I gave a forecast as to where OCC was going, I think I was wrong the next day. But here's what we do believe to be true. We do believe that it's going to -- I believe it's going to go down at least that $5 to $10 -- excuse me. And then we do expect to see some upward movement typically in Q3. Will it be significant? I don't know that it'll be significant. I think the next release of the import permits comes in June. So I do expect to see some form of increase starting in July, moving up that way. But as I think about China in totality, I think about the thirst of those new machines that are going in and the magnitude of input that has to go in there. I've got to believe that over a period of time, we're going to see them come back into the marketplace. I just -- I can't get my head wrapped around how they're not going to do that.

Adam Jesse Josephson - *KeyBanc Capital Markets Inc., Research Division - Director and Senior Equity Research Analyst*

Sure. And I'll give you easier one on resin. There are widespread expectations, as you're aware, that polyethylene is going down. And if not April, then shortly thereafter, just given the significant P/E capacity that's coming on this year. What is embedded in your guidance along those lines? And forgive me if I missed this earlier, but are you of the belief that there'll be a significant decline in P/E prices in the next few months?

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

Yes. I would tell you -- let me answer the thought on P/E. Do I believe it will come down? I think the answer is yes for the reason you just described, but a lot of that capacity has been building or has been built and was planned to be built for the export market. And I think what's going to come into play on this is what the tariffs will ultimately -- how they'll come into play with China and will we find ourselves somewhat awash in polyethylene and what grades? So I do expect it to come down slightly to being flat, and that's really what we built into our forward look. We saw a slight decrease and then really a flattening out.

Adam Jesse Josephson - *KeyBanc Capital Markets Inc., Research Division - Director and Senior Equity Research Analyst*

And just last one on consumer, Rob. Did you -- and forgive me if I -- again if I missed this, was the result below your expectations and for a particular reason, if indeed it was below your expectation in the quarter?

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

Yes. Let me answer it this way, Adam. The one thing that stood out in consumer for me was we knew that we were chasing resin. And the other big cost factor was freight. But the other play here was I did expect -- I was -- or maybe you said -- hope is not a strategy, but I was expecting that we would be shipping more fresh produce packaging out in the quarter. We're now seeing it really roll out into the second quarter. That was weather-related. And then the other one is on the -- we knew that Q1 for Clear Lam is a slower quarter for them. And I'd expected some of the synergies that we had put in place identified that they would have accelerated through in the first quarter. What I do think will happen if some of that will leak into the latter part of the year and into early 2019. Clearly identified, will happen. I think it was a timing-related issue.

Operator

And the next question will come from the line of Ghansham Panjabi with Baird.

Ghansham Panjabi - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

First off, congrats, Barry. And Rob, I also hope you feel better soon. I guess first off, on paper, you pointed towards a better environment as it relates to your success in pricing. Can you maybe expand on those comments as it relates to what exactly is going on in the U.S. and Europe? And then also given the pricing and lower OCC, will price/cost be a bigger year-over-year variance for 2Q on a year-over-year basis for that segment?

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

Yes. So I would tell you that our mill system is full in the U.S. Our mill system is full in Europe. And right now, we don't see that letting up. And so that's, quite frankly, what's driving our bullishness.

Ghansham Panjabi - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

And the 2Q variance year-over-year for that segment?

Barry L. Saunders - *Sonoco Products Company - Senior VP & CFO*

In terms of the year-over-year variance, I don't think you would expect quite as much variance because again, on a year-over-year basis, last year we had prices resetting and then cost going up. While this year in the first quarter, we had prices resetting at a higher level then going down. And you don't see that same magnitude of variance when you look at the second quarter last year versus this year.

Ghansham Panjabi - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay. And then just kind of going back to consumer. I know you've kind of touched on this qualitatively. But how should we think about margins themselves progressing as the year unfolds? Obviously, there's a lot of complications with freight. Oil has moved up quite a bit recently, that could put some pressure in your cost base as well. But how should we think of that baseline for operating margins for that segment as the year unfolds?

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

I think what we've always said is our expectation was consumer in its natural state was going to be somewhere between 10% and 11% overall. I would expect to see us obviously recover the resin that we've been chasing over the balance of the year. And then it really comes down to what the volume ultimately is going to be through our customer base. But I would expect us just to be in that 10% to 11% range.

Ghansham Panjabi - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay. And just one final one on Protective and the weakness in autos, which has continued for many quarters now. Are there any adjacent markets that you can deploy some of those assets towards? I'm just trying to figure out what the strategy is for that to offset what seems to be a shift in the market away from you.

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

Yes, I mean -- yes. Are there some other markets that you can participate and utilize your equipment? I think, clearly, the answer is yes. But what we've said is we need to get our arms wrapped around that portion of the business and assess what the long-term prognosis of the automotive space is for us. So we've been pretty crystal clear with respect to that.

Operator

And next question will come from the line of Chip Dillon with Vertical Research.

Clyde Alvin Dillon - *Vertical Research Partners, LLC - Partner*

And I just want to point out, I think that Charlie preceded Barry. And congratulations, Barry, but I think it took a North Carolina guy to, hopefully, smooth the path for your time as CFO, which is certainly going very well. So congratulations. Anyway, I had to stick that in there. My first question has to do with the -- I guess, just to hone in on the -- in paper and industrial converting, I know there's been some ups and downs with the corrugated medium machine. And I just didn't know -- if you could update us as we think about '18 versus '17, it would seem -- I'm assuming you do use some recycled fiber. I think it's semichemical there. And with prices up and at least with -- so far OCC being down at least through midyear, I would expect that, that could be a material factor at least in the first half in terms of year-over-year improvement. I mean, could that be a number that's in the millions of dollars, pennies per share per quarter at least for the first half, maybe even into the third quarter?

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

Yes. Rodger's here with me. Why don't I turn it over to you?

Rodger D. Fuller - *Sonoco Products Company - SVP of Paper/Industrial Converting Americas, Reels & Display and Packaging*

Rodger Fuller. Thanks, Rob. Yes, Chip, it's -- obviously, the situation on #10 is much better year-over-year. What we saw in this quarter was about a $4 million improvement on that machine. So as you said, if semichem uses some OCC, pricing is firm and then we've got the next $50 rolling in, in the next month or so. So it's good today.

Clyde Alvin Dillon - *Vertical Research Partners, LLC - Partner*

Is there any prospect of getting a long-term offtake agreement for that machine? Does that look like a possibility at this point? Or is that not something you're seeking?

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

Yes. It is something we're seeking, and it's something that we're -- we've been working very diligently on.

Clyde Alvin Dillon - *Vertical Research Partners, LLC - Partner*

Okay, got you. And then next question, well, actually, I think on the OCC thing, you were mentioning how you think it tightens in the second half. I guess you have an eye on the fact that in China, the price there is 5x where it is everywhere else. So it would seem like something's got to give there. But when we look at the M&A footprint, I know you talked about this and your goal to stay investment grade, Rob. But if you think about the portfolio, is there -- are we likely to see some businesses possibly divested in the next 2 to 3 years as you assess the portfolio? I know from time to time, the company has gotten out of certain things. Are you totally happy with where you sit with the portfolio or -- and you might not want to name names -- or could there be divestitures in the future, especially if it helps you get bigger in things you want to get bigger in?

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

So Chip, let me answer the question this way. I -- because I play hockey growing up with 3 periods, and as I think about our overall look and where we, as a company, want to be, we're probably at the end of the first period going into the first intermission. I'm not trying to be coy. But part of what we've talked about is we said where we want to invest in flexibles and thermoforming and where it makes good sense for us to broaden our footprint on the industrial side, especially in the emerging markets. That's where our disproportionate focus will be, and we'll pursue those opportunities. And if required, then we'll -- we have to look at other things in terms of how to finance that.

Clyde Alvin Dillon - *Vertical Research Partners, LLC - Partner*

Okay, great. And then the last quick one for Barry, just on the accounting change for pension. You mentioned how it actually had a small -- you would've looked a little bit better if you hadn't made the change at least in the segments because of the way you'll -- you actually made some money in the first quarter. But as you think about the year as a whole and next year, is there a noticeable impact that you would anticipate based on where interest rates are, et cetera?

Barry L. Saunders - *Sonoco Products Company - Senior VP & CFO*

Well, certainly, again, pension expenses, very hard to predict because of all the impacts of asset returns and interest rates themselves and so forth, so we haven't even started to provide any update on where we think that could possibly move in, in 2019. But it is true that -- fair to say that most of the volatility from pension expense does, in fact, come from the nonservice components, so it will now be all isolated for you below operating profit.

Operator

The next question will come from the line of Scott Gaffner with Barclays.

Scott Louis Gaffner - *Barclays Bank PLC, Research Division - Director and Senior Analyst*

When I look at the full year earnings guidance, right, excluding the acquisition and the change in the tax rate relatively unchanged, it feels like maybe price/cost is a little bit better and volumes are a little bit weaker. Would you say that's the case in how you're thinking about the year now?

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

Yes. Maybe for the first quarter, we saw that volumes were a little lighter. Again, remember, one less day. And then -- I'm sorry, Scott, just -- I'm having trouble hearing. So just tell me what the other question was around...

Scott Louis Gaffner - *Barclays Bank PLC, Research Division - Director and Senior Analyst*

Sure. No. Just it feels like price/cost is better for the year and volumes are weaker for the year, if you triangulate on the base...

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

Yes, I'm not sure that the volumes are weaker for the year at all. I -- and price/cost has been positive. And as Barry referenced, we'll see some more of that in Q2. But in light -- in terms of where we're going and what we've laid out in terms of the increase, the -- it's really driven by -- as Barry said earlier, it's around tax and the accretion of Highland. And it's still very early in the year for us to get ahead of our skis.

Scott Louis Gaffner - *Barclays Bank PLC, Research Division - Director and Senior Analyst*

Okay. So are you saying you still think you can grow volumes in 2018 at about a 2% rate?

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

That is what I am saying.

Scott Louis Gaffner - *Barclays Bank PLC, Research Division - Director and Senior Analyst*

Okay. And then when we think about -- from a free cash flow perspective and our working capital perspective, the decline in OCC, are there any significant benefits from a decline in OCC for -- on the working capital line?

Barry L. Saunders - *Sonoco Products Company - Senior VP & CFO*

We certainly would have seen some of that in the first quarter with the lower pricing, and that was one of the reasons we didn't see any more of an increase in working capital than we did with the increased activity that I previously mentioned and some of the seasonality of the acquisitions, which added to working capital year-over-year. So we did see some of the recovery that we talked about last year as one of the thing -- one of the reasons that it was going up. So...

Operator

And the next question will come from the line of Mark Wilde with BMO Capital Markets.

Mark William Wilde - *BMO Capital Markets Equity Research - Senior Analyst*

I'm going to see if I can get us back on that one question guideline. Rob, I wondered if you guys could just talk a little bit about what you're seeing in terms of changes that are going on in the recycling markets right now in response to these Chinese export markets and what changes you guys might be making in particular.

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

The changes in terms of the recycling markets that we're seeing? If I think about our plastics business, clearly, we are a significant user of ARPAC. If I think about what we're doing in terms of our recycling business, specifically, we're making investments to help clean, if you will, the loose paper. We're making investments in our mill system so that we can take advantage of more loose paper, but that's really the focus that we've got. The -- and then from -- on the plastic side, the angst that I always have is margins are fairly thin in these businesses. And these guys just want to make sure that they're financially stable, so we're monitoring that closely.

Mark William Wilde - *BMO Capital Markets Equity Research - Senior Analyst*

Okay. And are you seeing a lot of recyclables just actually end up in landfills these days because of all those kind of upheaval in the market or not?

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

I see. Right now, it's pretty moderate in terms of change that we've seen or at least that I've seen.

Operator

And the next question will come from the line of Brian Maguire with Goldman Sachs.

Brian P. Maguire - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

I was hoping I could come back to Scott's question on the guidance. I guess the $0.06 raise is explained by the taxes and the acquisition. And I think you say in volumes would be fairly consistent. It sounds like OCC is maybe a good guy versus the original view. Just wondering what the offsets are there. And I guess I heard freight and logistics from you a couple of times, just wondering if you could maybe dial in on that one and if there are any other offsets you're seeing and are those headwinds getting any worse or are they sort of flattened out versus where you were in 1Q?

Barry L. Saunders - *Sonoco Products Company - Senior VP & CFO*

Yes, certainly. I think the point you're talking about other nonmaterial inflation is probably one of the most relevant. When you look at freight, we talked about the fact that we did have some offsets from resin in the first quarter. So those would be the -- really the -- some of the bigger drivers of the offset from maybe the more favorable pure price material cost change.

Brian P. Maguire - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

And just recent trends in those costs. Are they -- in resin, we can sort of track. But just freight, are -- you think we sort of reached a plateau there, or are you still seeing those rates kind of rise even here in April?

Barry L. Saunders - *Sonoco Products Company - Senior VP & CFO*

Well, [with the like], they've pretty much plateaued at this point, of course. Just -- they're up about 14% year-over-year when you look across a blended freight basket. So it is pretty significant, but we're not expecting those to change dramatically going forward.

Brian P. Maguire - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

Okay. And then just switching gears. Rob, I think a couple of times you mentioned some -- it sounds like more just weather-related issues at Clear Lam and you expect to get back on track there. But I just wondered, in general, if you could kind of comment how the recent acquisitions have been performing and the integration success you've been having and just kind of overall how pleased have you been with their performance, and does that give you any more or less confidence to try and handle more deals going forward or are you pretty much kind of on track with what you expected?

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

I would tell you that the acquisitions performed as we expected through 2017. And quite frankly, the operational activity in Peninsula, notwithstanding the weather, was on track with what we had expected. The one -- and in terms of the integration process, that has been going fairly well. With respect to Clear Lam, Clear Lam was less impacted by weather. It's just Q1 is their slowest time of year. And it's a fairly significant ramp up once it goes into Q2 and Q3. And that's just a function of time of year as well. They did have a strong fourth quarter building ahead for a customer's product launch. So I think that also came into play in our first quarter. That should be back into a normal sequence of events as we start into the second quarter. Well, let me rephrase. It is back into the normal sequence of events as we've gotten into the second quarter. So I am pleased with the way the teams work together. I think we've got a good process in terms of how we integrate these deals. We've been involving that over the course of the last number of years. So I'm very comfortable with our folks being able to bring acquisitions into the fold.

Brian P. Maguire - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

Okay. Just one last one for Barry. The higher basis point kind of the booked tax rate, does that also flow through to cashes or are you expecting roughly the same cash tax rate as before?

Barry L. Saunders - *Sonoco Products Company - Senior VP & CFO*

No. We would expect that to flow through cash flow as well. So with that change to our earnings estimate, we would expect it to be pushing towards the upper end of the range in the cash flow guidance that we provided.

Operator

And the next question comes from the line of Gabe Hajde with Wells Fargo Securities.

Gabrial Shane Hajde - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

Just a couple of questions. And I think, Rob, you've mentioned making some investments to incorporate more loose paper. Really -- I guess the question is, can you give us a time line on something like that? I mean, is this more exploratory at this point or doing some preliminary engineering work or are you guys putting wrenches on machines to make it happen? And then if there's any way to sort of quantify whether it's from incremental investment or true EBITDA that you might expect to see out of that type of exercise. And then I guess, sort of third, would that be lumped into normal ongoing productivity type initiatives to offset nonmaterial inflation or something that we would kind of count on as being above and beyond, if that makes sense?

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

Sure. So let me try to run these all together. We -- what we've done is we've made a strategic decision to invest $60 million to $70 million into our mill system. So the wrenches are already touching equipment, but it's going to be a -- if I look at this from a holistic standpoint, this is going to be a 3-year journey as we go through the paper mill system in -- here in North America. And so it's investing in our best-in-class machines. It's really use -- how do we optimize our mill system and how do we bring in lower cost materials along the way. Our expectation when all of this is said and done, over the course of the next 3 years, is we should see an improvement somewhere in the 200 to 250 basis points in our paper system. And so our expectation is that, that should generate somewhere in the range of $25 million of EBITDA improvement over the next 3 years.

Gabrial Shane Hajde - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

That hits all the points. The last thing I'd ask you about would be sort of our thoughts on looking at scanner data, and some folks have pointed to the coming of Easter as well as maybe some stock-ups in and around some weather-related events in the first quarter. Can you comment at all? It sounded like the acquired businesses are sort of performing a little bit better in the volume front here in the early April, but more specifically the composite can business. Just thoughts, expectations around volume trajectory there early in April.

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

What we have seen in terms of just general volume is consistent with what we were seeing in the first quarter. So that -- I'll tell you that's -- and that's not a bad thing because we have seen a slight rebound in some U.S. package food companies. We started to see that in the fourth quarter. We saw little bit of that in the first quarter. So that's our experience as of right now.

Operator

And the next question will come from the line of Steve Chercover with D.A. Davidson.

Steven Pierre Chercover - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

So I understand and applaud your efforts to grow around the perimeter of the supermarket. Maybe this is a West Coast perspective, but I'm getting concerned about the amount of plastic in my life. So what would happen if consumers shun plastic? And I think you said that PET is sustainable. Maybe you can elaborate on that.

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

Yes. It's a fully recyclable material. So when you think about the product that we're putting fresh produce in, it's 100% recycled. Does that answer your question or...

Steven Pierre Chercover - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

Yes. I mean, that answers the sustainable. Assuming people will recycle properly. But what happens if there's more of a backlash against plastic in general?

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

Sure. Let me -- I don't mean to change the narrative here. But I think that clearly, sustainability and recyclability is incredibly important. At the end of the day, I absolutely believe flexibles, the plastic constructs have a great sustainability story. And I do believe that we're going to see a recycling technology be able to take multilayer films and pull those apart. That technology is underway. I think the more relevant question that needs to be asked, as we're talking about this, is around food waste. And how do we reduce food waste? Because when you think about where is the big issue, the big issue is 70% of all freshwater that's consumed goes into agriculture, 30% of all energy goes into agriculture. And yet we waste incredible amounts of food between field and us as consumers. And I think that the plastics industry needs to tell the story. I absolutely believe that a lot of what we're seeing is emotionally charged. It's not necessarily fairly presented. But at the end of the day, if we're wasting -- I think the number in the U.S. is $168 billion of food a year, that is morally wrong. And as we think about it here at Sonoco, we're -- we want to find a way to help solve this problem. And that is around providing solutions to provide further shelf life to food not only here in North America but help around the world. And I think that's part of the story that needs to be told. It's not the solution, but it's definitely part of the solution, and that's how we look at it. The issues that we're seeing in Europe, will they play out here in North America? Of course. But I think we, as an industry, need to make sure that we're also making sure that everybody understands the benefits associated with these materials because you can't wrap something in paper and hope that it's going to stay -- maintain its shelf life for 30 days or 60 days.

Steven Pierre Chercover - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

Fair enough. No. I mean, that's a very valid point about food waste. All right. Well, best of luck in your new role from a fellow hockey player.

Operator

(Operator Instructions) And our next question will come from the line of George Staphos with Bank of America Merrill Lynch.

George Leon Staphos - *BofA Merrill Lynch, Research Division - MD and Co-Sector Head in Equity Research*

I just want to come back to the topic that Steve had tabled relative to plastics in a narrative, Rob. And we had talked about this with you at our conference not too long ago. And a lot of the issue is perception, right? So from what you're seeing and, frankly, given your role as a leading plastic packaging company, what are you doing? What do you think the industry is doing next to change that narrative? Because, yes, you're quite right, you can't wrap everything in paper and assume it will stay fresh. But if the consumer doesn't care or doesn't understand that, then it doesn't really matter what the reality is relative to the perception. So how is the industry broadly, from what you can see, beginning to change that narrative? And I have a follow-up.

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

Sure. Great question, George. The -- I do think that the industry is starting to come together through various associations and where -- when I think about the Flexible Packaging Association now starting to talk with some other associations to say how do we come together as one voice, we're clearly seeing it from other companies. Barry comes to mind in terms of how they've gone out and talked about being plastic ambassadors. So I think that voice is starting to gain some momentum. And we're going to have to come together in that fashion. That -- it's going to require some money to get that narrative out there and make sure that we're educating people appropriately and taking away some of just the emotionally charged visuals that we all see. Let me give you a visual. When I think of food waste, 800 million people out there not -- waking up every day and not having the amount of caloric intake that they need to sustain life. And we're showing pictures of a bird with a bag on it. I'm not trying to be flippant here, but I think it's something that we need to really sit down and talk about and make sure that people really understand the value of plastic. And so coming back to what I said, I think that momentum is starting inside the -- it's starting with companies, but it's got to be more than companies. And it can't just be us. It's got to be the petrochemical industry, the plastics industry in totality. It's got to be the CPGs that need to come to the party on this as well.

George Leon Staphos - *BofA Merrill Lynch, Research Division - MD and Co-Sector Head in Equity Research*

Fair enough. My last one is just a two-part question on volume. Can you talk about what you thought the weather effect was in the first quarter in terms of volume in consumer or maybe even, more importantly, earnings? And then tube and core volumes being down in North America, if I remember it correctly. Help me understand what -- how that played out in light of what's been on -- obviously, relatively good overall volume trend in some of the more important paper markets. I remember your relative market shares in some of the markets, but I thought you had improved on some of those as well over time. So with that, I'll turn it over and wish you good luck in the quarter.

Robert C. Tiede - *Sonoco Products Company - CEO, President & Director*

Thanks, George. With respect to weather -- let me answer the question this way. Between weather and some of the nonmaterial-related costs that we incurred that we're chasing, I think that cost us a couple of pennies in the quarter. With respect to the tube and core volume, if I think about it this way, half of that volume went away as a result of just paper mills going away, which we fully expected. The other half was what we fully expected in terms of our optimization plan. And as we're doing that optimization plan, we also are very targeted with respect to markets and customers. And we did, in fact, see growth in the focused markets that we said we want to grow our tube and core volume in.

Operator

Thank you. This does conclude the question-and-answer session today. I would like to turn the call back over to Mr. Roger Schrum for further remarks.

Roger P. Schrum - *Sonoco Products Company - Corporate VP of IR & Corporate Affairs*

Thank you again, Sabrina. Let me again thank each of you who joined us today. We appreciate your interest in the company. And as always, if you have any further questions, please don't hesitate to contact us. That concludes the call.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program. You may all disconnect. Everyone, have a great day.
