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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to Sonoco's Third Quarter 2018 Earnings Conference Call. (Operator Instructions) As a reminder, today's conference is being recorded. I'd now like to introduce your host for today's conference, Mr. Roger Schrum, Vice President of Investor Relations for Sonoco. Sir, please go ahead.

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

Thank you, Liz. Good morning, and welcome to Sonoco's investor conference call to discuss our 2018 third 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 website at sonoco.com. In addition, we will reference a presentation on our third quarter results, which was also posted on our website this morning.

Before we go further, let me remind you that today's call and presentations contain 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 on 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 will begin on Slide 3 where you see that earlier this morning, we reported third quarter earnings per share on a GAAP basis of $0.72 and base earnings per share of $0.86, which was within our guidance of $0.82 to $0.88 and compares favorably to base earnings of $0.76 for the same period last year. You will hear several references to Hurricane Florence today. But let me begin by saying that based on our best estimate, the impact of the hurricane, including the related flooding of our largest paper mill complex, which is here in Hartsville, negatively impacted base earnings by roughly $0.04 per share in the quarter. This $0.04 was associated with lost sales, unabsorbed fixed cost and our $1 million insurance deductible. We also incurred excess operating cost in the quarter related to the storm, estimated to be just under $4 million, and spent roughly the same amount on property and equipment. But all of such was taken to the balance sheet and netted against a $10 million payment that we received from our insurance carrier in the third quarter to cover such cost. We expect the negative impact on earnings per share in the fourth quarter to be an additional $0.02 to $0.03, again, associated with lost sales. We have not assumed any recovery from business interruption insurance this year due to the uncertainty of the timing. But we do expect to eventually recover all but the $1 million deductible over time.

I will mention that we did benefit from a lower effective tax rate on base earnings than what was considered in our guidance with a favorable impact of just less than $0.03 in the quarter, which partially offset the impact of the storm.

In terms of other notable transactions in the quarter, we did reach agreement with a customer to exit the dedicated packaging operation in Fairburn, Georgia, where we have reported for several quarters to be dealing with challenging results at that location. Costs associated with exiting that location represent the majority of what is included in restructuring and asset impairment charges, which were $0.16 in total for the quarter, partially offset by a net $0.02 of nonbase income items, primarily tax related.

Looking briefly at our base income statement on Slide 4. Starting with the top line, you see sales were $1,365,000,000, up $40 million over the prior year due primarily to the impact of the Highland acquisition and higher volume. And you'll see all of that quantified in the sales bridge in just a moment. Gross profit was $259.6 million, $6.8 million above the prior year, due to several factors including positive price/cost and the impact of acquisitions.

Selling, general and administrative and other income and expense items was $135.6 million, were unfavorable year-over-year by $8.6 million driven largely by the acquisition, normal inflation and higher management accruals, thus resulting in operating profit of $124 million, $1.9 million below last year. And again, you'll see all of the drivers of the change in operating profit in the bridge in just a moment.

Below operating profit, you see the impact of nonservice pension income of $120,000 this year, which compares to nonservice expense of $2.7 million last year. Interest of $14.5 million was $900,000 higher than last year due primarily to higher interest rates but also due to increased short-term debt, reflecting the impact of acquisitions. Income taxes of -- right at $25.9 million were notably lower than last year even though pretax profits were essentially unchanged due to the lower effective tax rate, which was 23.6% for the quarter, most of which is associated with the Tax Act but also some benefit from stock-based compensation and the release of certain tax reserves.

Equity and affiliates, when combined with minority interest, was $3.6 million, up $1.7 million from last year due to higher earnings in our Conitex-Sonoco joint venture. This will be the last quarter we report earnings from that JV in equity and affiliates, as on October 1, we completed the buyout of the partners' interest in this business, thus ending up with base earnings of $87.4 million or $0.86 per share.

In looking at the sales bridge on Slide 5, you see volume was higher $25 million or 1.9% for the company as a whole with the overall volume being driven by an increase in activity in the Display and Packaging segment. Consumer Packaging volume was down 0.7% where some growth in flexibles was more than offset by lower global composite can volume and plastics volume being down year-over-year as well.

Volume in the Paper and Industrial Converted Products segment was essentially flat, reflecting the impact of the lost sales from the hurricane and would have otherwise been up about 1% for the segment as a whole. And sales in Protective Solutions were down just under 1%.

So moving over on the bridge to price. You see that prices were higher year-over-year by $6 million driven by price increases both to cover higher material cost as well as other efforts to push through noncontract increases, with much of the higher prices in the consumer segment. Prices were actually lower in the Paper and Industrial Converted Products segment due to lower OCC prices but would have been even more negative without the favorable impact of price increases on non-OCC indexed accounts, and you'll hear more about trends related to OCC movements when we discuss price/cost in just a moment.

Moving over to acquisitions. You see an impact on the top line of $31 million, all in the Consumer Packaging segment, mostly from the Highland acquisition completed in April of this year as well as a few extra weeks from last year's Clear Lam flexibles acquisition, which reached the 1-year anniversary in July. And finally, exchange and other was negative by $22 million driven by the dollar being slightly stronger this year.

Moving on to the operating profit bridge on Slide 6. You see the higher volume when combined with the impact of mix added $1 million to earnings. In the sales bridge, I mentioned the volume improvement was in the Display and Packaging segment where the margin is much lower than our other traditional manufacturing businesses. And we also had some negative mix in and between some of our other businesses as well.

Price/cost, including the benefit of procurement productivity, was very favorable this quarter, up $22 million, essentially all in the Paper and Industrial Converted Products segment.

There's a slide on Page 13 in the appendix, which shows the trends in OCC prices where you see the average OCC prices were $182 last year in the third quarter versus $88 this year. Although some of our contracts also reset at a lower level driven by the lower OCC prices, those that are based on market paper indices, such as tan bending chip, are actually higher year-over-year. And we have been successful in implementing price increases on noncontract business. We've also certainly seen improvement on pricing in corrugating medium as well. I will point out that we've seen margin expansion from price/cost in our industrial businesses in all regions of the world driven by tight core board capacity globally.

The impact of acquisitions added $1 million to earnings, essentially all this coming from Highland, with the drop-through reflecting the normal seasonality of this business.

Moving over to manufacturing productivity. You see it was negative by $2 million with some operating issues across several businesses. Starting with Consumer Packaging segment, plastics had some operational issues in our thermoforming operations and we had some issues in flexibles as well.

Productivity was also weak in the Paper and Industrial Converted Products segment as we had negative productivity in the tube and core business in the United States and Canada related to ongoing consolidation activities, and we had some negative productivity in reels due to inefficiencies from a significant increase in activities in that business.

So in summary, fair to say a very difficult quarter operationally across many businesses for various reasons.

The change in all other on a year-over-year basis was unfavorable by $24 million. Normal inflation accounted for about $14 million but we also incurred unrecovered cost from the impact of the hurricane, higher management incentive accruals, some higher depreciation in the consumer businesses and last year's quarter included some miscellaneous income gains as well. It's also worth pointing out that the translation of earnings in foreign currencies were negative this quarter by about $2 million.

Moving on to Slide 7. You find our results by segment where you see that Consumer Packaging sales were up 6% due most notably to the impact of acquisitions, while operating profits were down almost 19% driven by the mix of business, both between and within businesses, including the lower drop-through on acquisition sales, the lack of manufacturing productivity that did not offset nonmaterial inflation as well as continued rising material inflation on resins, films and freight with operating profit margin percent dropping to 9.3%.

Display and Packaging sales were up 22% due to the Atlanta pack center activity, although operating profit improved in other parts of the business with the margin improving slightly to 2.2%.

Paper and Industrial Converted Products sales were changed by 4% due most notably to the lower selling prices associated with the part of the business with OCC contractual resets. But overall, very favorable price/cost resulted in a $10 million improvement in operating profit with the operating profit margin up to 11.6% versus 9% last year.

And finally, Protective Solutions sales were down almost 3% but the operating profit fell off by 8% due to the deleveraging in the top line combined with some higher operating cost, all thus ending with total company sales up 3% but operating profit down slightly and the company-wide operating profit margin dropping to 9.1%.

Moving to Slide 8. You find our outlook for the fourth quarter where we are forecasting base earnings to be in the range of $0.75 to $0.81. This assumes no significant change in underlying economic activity but does reflect the normal seasonal slowdown in the latter part of the quarter. It also assumes no significant change in material cost and reflects another $0.02 or so from the residual impact of the flood, again, without anticipating any business interruption insurance recovery in the quarter and does have about $0.01 built in for the Conitex acquisition. The guidance assumes an effective tax rate of 25% on base earnings in the fourth quarter, bringing our full year effective tax rate on base earnings to 25.5%. This brings our full year guidance to $3.28 to $3.34 per share, tightening our previously issued full year guidance but at the midpoint is down slightly, which can be directly attributable to the impact of the flood, which, again, is prior to any business interruption recovery.

Moving from earnings to cash flow on Slide 9. You see that we had another solid quarter, bringing our year-to-date cash flow from operations to $451 million versus $281 million during the same 9 months of last year. This improved operating cash flow came from several factors, including higher net income, higher depreciation and amortization, lower pension contributions, better working capital results, collection of some miscellaneous receivables and a higher net change in accrued expenses.

In addition, our year-to-date free cash flow was $219 million compared to $26 million in the same period last year, with these results driven by strong operating cash flow that I've just described and lower net capital expenditures, which now reflects the benefit of $17 million in proceeds from the sale of certain fixed assets from the exiting of the Atlanta pack center.

Based on these actual results and our fourth quarter outlook, we are increasing our full year estimate of cash flow from operations by $10 million to a range of $580 million to $600 million and are projecting our free cash flow to be higher by $40 million with the updated range being $230 million to $250 million.

That completes my overview for the quarter, and now we'll turn it over to Rob for some additional comments.

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

Thanks, Barry. While I want to spend my time talking about our performance in the third quarter and year-to-date, let me start with Hurricane Florence. I can't tell you how proud and grateful we all are of the hundreds of Sonoco associates and even retirees who went above and beyond to restore our paper mill operations in Hartsville along with other affected operations following the unprecedented flooding from the storm. To be honest, when Florence passed over the Carolinas on September 13 and 14, we thought only the coastal areas had been impacted. But it became very clear by Sunday morning, the 15, we would be facing flooding beyond what we've ever experienced.

To put the flooding into context, during a 48-hour period, we were forced to release in excess of 7.2 billion gallons of water from our dam on Black Creek or face overtopping the structure. That amount of water is equivalent to filling a 1 square mile swimming pool, 30 feet deep.

On Slide 10 in our presentation, you'll see pictures of the flooding and cleanup efforts along with some of the key statistics regarding the restoration. The storm temporarily idled operations on all 7 of our paper machines here in Hartsville and impacted operations at several recycling, tube and core, Protective Solutions and thermoforming plants in Virginia, North Carolina and South Carolina. Up to 350 restoration contractors worked alongside about 500 mill associates and maintenance crews to perform the largest cleanup, restoration and repair operation in our 120-year history. We gathered and hauled off hundreds of truckloads of debris, repaired and mostly replaced 500 large motors and performed countless electrical and mechanical repairs to get our paper machines back online. Through these extraordinary efforts, all operations were back in full production by the first week of October, which was weeks before our early estimates.

Our mill operation in Hartsville lost approximately 22,300 tons of URB and corrugated medium production during the third quarter outage. As Barry mentioned, we do have casualty and business interruption insurance, and we believe our lost production, damages and other excess costs will be covered excluding the deductible.

It's also important to point out that despite the impact of the storm, our Paper and Industrial Converted Products segment had a very strong quarter, with operating profit up 23% and margins improving by 260 basis points. Fortunately, Hurricane Michael had a relatively minor impact on our operations last week with only minor power interruptions and some flooding. However, we understand all too well the impact the storm of this magnitude can have on a business, a community and the people who have to live through the aftermath. Our hearts and prayers go out to the people of Florida, Georgia, the Carolinas and Virginia who have been impacted by these storms.

Now let me talk about the third quarter performance in our other businesses and where we stand to meet our targets for 2018. Overall, we produced a solid quarter, hitting just above the midpoint of our guidance despite the impacts of the hurricane, accelerating inflation and sluggish demand in some of our consumer-served markets.

I reviewed the hurricanes. So let me focus on the impact of inflation and the performance of our consumer business. Like many companies, we continue to see inflationary cost pressures from higher materials, particularly resins along with freight, energy and other operating costs. Because of this inflation, we are being forced to drive cost recovery through proactive price increases in many of our businesses. The lag in recovery is impacting our Consumer Packaging businesses, specifically in rigid plastics and flexibles. However, we also faced weaker-than-expected volume in some rigid plastic businesses and some operational issues in both our flexibles and thermoforming plastic businesses, which impacted productivity. Directionally, we believe unanticipated inflation, tariffs and other operating costs in our consumer business cost us $0.03 to $0.04 a share in Q3 versus Q2 of this year.

In addition, changes in mix of business contributed to a decline in the consumer segment's operating margin. We are continuing to target operating margins in the Consumer Packaging segment in the 10% to 12% range. So we have work to do in improving productivity and driving cost recovery. We will eventually catch up on the material inflation through price increases and contractual cost recovery in the fourth quarter and into 2019.

In addition, we better understand the operational issues in flexibles and thermoforming and have dedicated teams addressing people and process changes, which we expect to turn around operational performance in Q4 and into 2019.

Now let me switch gears and talk about our Display and Packaging segment. After nearly a year, we were beginning to see signs of improvement at the previously mentioned packaging center in Atlanta. However, it became clear we could not achieve an acceptable margin and we exited the contract and the facility at the end of the quarter. We are now focused on our base display business in the U.S. and our packaging operations internationally, both of which are profitable operations. I'll add that we have been awarded new business in our more traditional display activity in the U.S., which should help us drive improved results into 2019.

Finally, operating profit from our Protective Solutions business was down in the quarter as our temperature-assured packaging business produced record results, which was offset by slower consumer-molded foam and paper-based packaging results. Overall, despite storms, inflation and some self-inflicted operational issues, we have achieved record year-to-date sales, base earnings, cash flow and free cash flow along with year-over-year improved EBITDA margins. This solid performance, along with proceeds from the asset sales associated with exiting the Atlanta pack center, is driving us to increase our 2018 free cash flow to $230 million to $250 million, which is after paying an expected $165 million in dividends to our shareholders. Also, at the end of the quarter, we acquired the remaining 70% interest in the Conitex-Sonoco joint venture, along with the composite can plant in Spain from Texpack, Inc. for $143 million. Because of our strong balance sheet and cash position, we funded this acquisition primarily from available cash.

We are extremely excited about this acquisition as we see further opportunity to grow our existing global Paper and Industrial Converted Products business through this combination, especially in faster-growing emerging markets in Asia where we will be adding both papermaking and converting operations while more than doubling our current annual sales in the region.

In closing, we remain bullish in 2018 and are on track to meet our growth and margin improvement targets.

Sonoco is a resilient company with a 120-year track record of overcoming obstacles through our strong, diversified mix of industrial, consumer and protective packaging businesses. We expect a solid fourth quarter and are projecting a year-over-year improvement in full year base earnings of 17% to 20% and, as mentioned, a significant improvement in cash flow from operations and free cash flow.

Operator, would you please review the question-and-answer procedures?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Ghansham Panjabi with Baird.

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

Congrats on getting Florence -- the impact from Florence behind you. I'm sure that was very, very tough on the organization. I guess, the first question relates to Consumer Packaging segment and the margin deterioration we've seen sort of sequentially throughout 2018. Do you expect margins to be up on a year-over-year basis in '19? And obviously, you've cycled through high raw material cost inflation and transportation cost, but do you anticipate recovering the lost profitability by 2019? Or would that depend on some level of decline in raw materials?

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

Yes. Ghansham, first of all, thanks for the comment around Florence and all the things that our people did to get us back on track. It's much appreciated. With respect to the consumer margins, I do expect us to drive recovery. We've been chasing inflation really since the fourth quarter of last year or Hurricane Harvey. And we did think that some of the material prices would decline after things settled down, but we did not see that. And there's a whole raft of reasons for that. But I do expect that we will claw back a lot of the inflation that we saw in freight, resin, aluminum, et cetera. The self -- and I would then -- let me just give a little more color around the margin because I think the other thing is the self-inflicted cost that impacted us this quarter, I think we will get those issues resolved. And then, of course, as we bring in some additional volume in the business, the volume/mix impact will have an impact on the margins. But I do expect if we didn't have the inflation or caught up with inflation and didn't have the shop floor negative impact that we'll have to work through, we should be in that 10% to 12% margin. Sorry for the long...

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

That's helpful. And then just for my second question on protective. 3Q volumes varied quite a bit depending on the market. Can you just give us a bit more color on the various end markets? It looks like autos -- the autos end market bounced back a bit, which I assume relates to the easier comparison from a year ago. And also, how should we sort of think about volumes as we cycle into 2019, especially with what seems to be a little bit choppier macro?

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

Certainly. On the protective side, if I break it into 3 components, yes, we did see a little bit of a bounce back with the automotive side. Our ThermoSafe business, our temperature-assured business, had a very strong quarter. In fact, it was record sales and record earnings for that business. And that comes on the heels of all of the announced new vaccines coming out and us getting our proportionate share of that as the leader in that space, and we expect to see that to continue. What we did see on the protective side, specifically our paper business, we did see a bit of a slowdown as a result of some of our customers trying to raise prices into the retail trade. And we did see some slowed down activity there. But as I look into the fourth quarter, they're projecting increased activity to the tail end of this quarter. So more to come with respect to that.

Operator

Our next question comes from Edlain Rodriguez with UBS.

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

Quick question on Tubes & Cores. I mean, volumes there continued to trend downward. Like are you satisfied with the results there? Like is pull in the portfolio part of the ongoing strategy of that price and thus volume that you pursue?

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

Yes. I would tell you that part of that is clearly by design as we roll out our strategy, which we've talked about in terms of who are we best able to serve. If I take a look at -- maybe get a little more granular in the Tubes & Cores, clearly, we are seeing very strong performance in the paper sector, which you would expect given what's going on in paper today. But there has been a -- if I think about the decline, I would say 75% of the decline is what we anticipated based on the strategy. And I think about 25% of the decline is really predicated on customers making a choice based on what we believe the value is that we're bringing and what they're prepared to pay.

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

Okay. That makes sense. And one quick one on the M&A pipeline, like the outlook. Like what are you seeing out there? Are you still interested? Are you seeing opportunities there?

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

Yes. There are -- our activity in assessing the market and looking at opportunities for us to fulfill our strategy is -- stays consistent. I think there are things there. I think we've probably talked about are we in the top of the ninth of a 9-inning baseball game with rising interest rates. Will we start to see a bit of a change occur? We're keeping our finger on the pulse of that, but we're looking at opportunities. Yes.

Operator

Our next question comes from George Staphos with Bank of America Merrill Lynch.

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

And echoing the earlier comment from Ghansham, great performance for everyone in recovering from the storm. I guess, I want to spend a couple of questions on volume trends. And Rob, it sounds like most of the volume slippage in consumer was related to your customers kind of raised pricing and not necessarily getting the hoped-for demand outcome in the quarter. What are you seeing as you're exiting 3Q and into fourth quarter have -- to the extent that you can comment and have visibility, have your customer volumes recovered? Have your volumes recovered? Any incremental color here would be helpful.

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

Sure. I'm going to break it down a little bit, George. I think that as we get into fourth quarter, I do expect our can volume to move forward a little more robustly, which is typically the case for the fourth quarter on the can side. Our flexibles business has done well where it's projected to continue to drive some of the growth. We talked a little bit about operational issues, that had an impact, and that had to do with consolidating some facilities and also bringing in equipment into another facility -- brand-new equipment to displace a number of older machines. And so I expect the volume to be -- continue to be robust on the flexibles side. And then on the plastics side, if I think about -- if you think about it in terms of the market perimeter of the store, Q3 is the slow time. We're between this and rebuild season. And so I expect the volume to be down in that segment. And then in one other portion of our business, George, we did see some market share loss to a different format, and the customer's assessing whether that format is going to be acceptable in the marketplace and is capable of running through their operations. So I do expect to see volume pickup in the perimeter of the store. Flexibles, we've talked about. And cans, we've talked about. What I don't know the answer to is, is this change in format, whether that is a short-term or a longer-term issue for us.

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

Okay. And just to clarify, the picking up that you're talking about, some of this is seasonal. So ultimately, though, you were talking about what we normally would focus on, which is year-on-year performance. Is that correct, Rob?

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

Yes. And there is definitely the seasonal part as it relates to the increase going from Q3 to Q4. Correct.

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

Okay. A couple quick ones again on volume. If you can break down what kind of trend you saw within tube and core volumes either geographically and within North America, if you can go quickly by product line. And in product -- in Protective Solutions, should we be concerned at all that we're seeing a little bit of a volume decline here? Obviously, one of your peers called out recently some volume issues that they were seeing. Is this the beginning of maybe a slowdown? Or do you think it's really just related to your pricing actions?

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

Great question. So let me start with the tube and core, and then I'll come back to protective. If I walk around the globe in tube and core, starting in Europe, we have the typical impact of August. So August always has a drain on the year. We have started some of the same activity that we put in place here in North America as it relates to assessing where we best provide value. And so that body of work has started there. And so we are respectfully exiting some volume, and it's based on realizing the value that we bring. If I look at North America, as I mentioned earlier, the paper side of things continues to be very robust. If I look at the big other segments, the other 3 big segments, textile, specialty, films and all other, called tape and other, the specialty side, we did see some declines over the course of the quarter. And I don't know, George, whether it is the start of a slowdown or it's an anomaly. It's too early for us to call. If I take a look at the protective side and specifically the paper-based constructs, which is really geared towards the white goods, I think that we saw a slowdown with some of our customers largely because they went very aggressively into the market with increased prices on metal as it relates to the tariffs that they were feeling. And I believe some of that, their shortfall was made up by other companies' products. So too early for me to become an economist here and give you an outlook.

Operator

Our next question comes from Scott Gaffner with Barclays.

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

Just echo what everybody else had said on your performance after the hurricane, a herculean effort to get up so quickly.

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

Thank you, Scott.

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

No problem, Rob. As far as the capacity expansions that you mentioned, I think it was within Tubes & Cores in the emerging markets. Can you talk about those? Is that expansion with existing customers? Are you seeing anything -- I guess, there's been a lot of concern around emerging market trends recently. Anything that concerns you as you make those expansions into those markets?

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

No. I think -- I mean the vast majority of that, Scott, is coming with the Conitex acquisition. So they've got an established team and facilities in place. And really, the -- as I look down the road, the big win for us is not only the presence -- broadening our presence in China and specifically Southeast Asia, but also having the ability to self source paper from the region as we pick up 3 paper mills, 2 in Indonesia and 1 in China, that help our position in Asia. So we're excited with the team. Obviously, we just closed at the beginning of the quarter, but we've been working on the transition work over the last couple of months and the folks have hit the ground running.

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

Okay. And then when I think about some of the commentary on consumer margins being below where you would expect them to be, I mean, in some ways, I guess, the Paper and Industrial Converted margins are well ahead of where they have been the last 5 or 6 years. And the last time they were this high, I guess, it was right before the recession. I mean, is there anything as we move into 2019 and 2020 excluding the recession that makes you feel like the Paper and Industrial Converted margins are not sustainable on a go-forward basis at this level?

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

Yes. I think if I look at the -- well, a couple of things have occurred. If you recall, we've been very choiceful in investing in some very focused capital for our paper mill system. And so we do expect between now and 2020 that, that will have some positive improvement. I think we've shared in the past that we expect it to drive directionally $25 million of additional EBITDA. If I take a look at the expectation of our tube and core with the work that we're doing, again, barring any recession, we do expect to see some margin improvement with respect to that. Now we've also been the benefactor of some price/cost, and we'll see that come down to some degree. So if you're asking, are we going to stay at the margins that we're at in the industrial side? I'd love to say yes, but I don't think that's realistic. If I look at the consumer side and I look at specifically as it relates to Q3, I'll call it the self-inflicted wound of operational performance, which we're in the process of fixing and getting us back on par with our inflation, our margins should have been in that 11% -- somewhere between 11% and 12% this quarter. Again, I'm giving you the good stuff. But if we're able to do that, that's right in line with where we would expect the consumer side to be.

Operator

Our next question comes from Mark Wilde with Bank of Montréal.

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

Rob, the move out of Atlanta, can you just help us kind of sequentially and maybe even kind of year-on-year in thinking about the benefits as we move into the fourth quarter and then into '19?

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

Yes. I think the -- if I go quarter, if you will, Q3 to Q4, Mark, we should see an improvement somewhere in the range of $2.5 million to $2.75 million as it relates to, if you will, quarter-over-quarter improvement. If I think about what it cost us over the first 9 months, I think it was directionally somewhere between $0.05 and $0.06 was the negative impact as it relates specifically to that Atlanta facility.

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

Okay. And just, Rob, you came from the displays business. I think it's what originally brought you into Sonoco. I'm just kind of curious, with this Atlanta situation, what did you guys miss?

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

That's a great question. I think a couple of things. As I think about the issue, I think that -- and I won't go into all the detail, but I think we underestimated the complexity of the operation. What I mean by that is in terms of just getting completed specs and also really understanding what Duracell was trying to achieve, and that was -- I think they also had significantly underestimated the complexity and risk of the change in their supply chain network. So it was a combination of both of us missing some things, and that's the takeaway.

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

Okay. Right. And then just one other issue kind of with this, just as you've been growing in kind of flexibles, as you've been growing in some of the perimeter of the store, like the produce packaging and everything, you're making a big move into plastics at a time when there's in some parts of the world kind of a backlash against plastic packaging. So can you just talk about how you think about that issue and how you try to protect kind of Sonoco on that issue as you go forward?

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

Sure. We're paper, we're plastics and we're rigid -- or we're films and we're rigid plastics. I'm somewhat material-agnostic, as material-agnostic as one could be. But I'm not diverting the question. The way I'm looking at this is what is the long-term play, and the long-term play is about food preservation. And as I think about food preservation, the polymer constructs, I still believe is going to be part of the solution in a significant way for all kinds of different reasons, and I'd be happy to talk about those offline. But as we look at it, a lot of what we do is not single use. And what we do have today in the perimeter store is completely recyclable. It's PET and it uses -- directionally 75% to 80% across all of the products is already recycled content. So I think we've got a pretty good story to tell as it relates to that. And part of it -- and I think, you've raised this, and I think George has raised this in the past, is what are we collectively doing to educate the consumer base. And I think that body of work is really now starting to catch hold where it's not just the converting industry. It's also the petrochemical industry as well as some of the CPGs getting involved.

Operator

Our next question comes from Adam Josephson with KeyBanc Capital.

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

Rob, I think George asked about the consumer volume issue earlier, and forgive me if I didn't understand you entirely correctly. But you're talking about some composite can weakness. I don't know to what extent that's a substitution away from composite cans. But -- and there's also been some center-of-the-store weakness separate from any composite can share losses. So can you just help me broadly understand what you experienced in 3Q? How much of it was just broader -- broad spending weakness? And how much was composite cans losing share to other substrates?

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

Yes. In fact, if I look at units, and maybe I didn't say it very well, in terms of composite can units, we were actually up around the globe in the third quarter over third quarter last year. A lot of that had to do with mix, but we did see some strong growth in some segments. And where we did see the weakness, Adam, was in the normal culprits. It was in the concentrated orange juice. It was in the powdered beverage where we've been seeing it for some time. And what I was saying about the fourth quarter is fourth quarter actually tends to get a little busier for us in some of the segments because of holidays and because of the change in weather. So you think about those, et cetera. And we do expect to see the normal seasonal growth there. If I think about where did we see some of the weakness in the consumer side, that was really on the plastics side were 2 examples that I gave, one being a transition of a product -- a portion of a product into an alternative construct that's being tested in the market. And the second is it is the typical slow time for us as it relates specifically to the perimeter of the store. We're between, if you will, ramping up and harvest time. So Q3 is typically cleanup time for both what I'll call the Peninsula and the Highland operations.

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

And just one clarification on that. I think the change in construct, stand-up plastic pouches have been gaining share and most forms of plastic packaging have been gaining share. So why would someone -- why would a customer be switching out of plastic?

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

It was specifically thermoforming, and they're trying a fiber-based construct.

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

Got it. Okay. And then Scott asked the question about the sustainability of the industrial margins, and I think rightfully so. I mean, the margins are at the highest they've been since, I think, '07, right before the downturn. I know OCC costs are very low and the URB market is very tight right now. So I assume the historic strength in margins will continue at least into 4Q and perhaps into 1Q as well. But what do you think is different this time compared to 10 years ago? We went into the recession. Your industrial lead, that went way, way down. If we go into another downturn, what gives you confidence that you won't have a similar experience this time?

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

Yes. I mean, if I think about it from a URB standpoint, I just think the market overall is a lot tighter and a lot more disciplined. And I think the other piece that we're seeing is while we're consuming about half of what we produce in the URB side, certainly, there's a number of consumer-related products that we've seen some very nice growth in. So that's on the URB side. #10, that dynamic hasn't changed. We're still in the process of dealing with and looking for, if you will, a take-out partner. So from a papermaking standpoint, we're the benefactor of a very tight market. And you guys see all kinds of things happening in the marketplace today. We're still very full, and we'll continue to work that way. But ultimately, for us, we still need to have them find that take-out partner, and we have ongoing discussions with respect to that.

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

Okay. And just one. I'm sure you're dying for me to ask you an OCC question. So I'll oblige you. Many Chinese companies have been making, obviously, substantial investments in the U.S. paper market of late, building recycle pulp lines, converting machines to containerboard, et cetera, et cetera. What do you think it'll mean in terms of the draw on OCC in this country and what implications it could have for OCC prices here short term and long term?

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

Okay. That's -- I would be very disappointed if you didn't ask that question. So I'll tell you what I believe to be true. And as you know, every time I say this, I'm wrong. So I believe that and what we built into our outlook, Adam, is that it will remain flat at directionally $90 a ton for the balance of this year as I look out into next year. And there's a potential that it might drop slightly at the end of the fourth quarter but not enough that I think it's going to move the needle. And then as we look out into next year, it's too early for me to talk about next year because I'm just trying to get through the fourth quarter, but I'll give you my thoughts when we're together in New York.

Operator

Our next question comes from Brian Maguire with Goldman Sachs.

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

I apologize if I missed this. But I think it seemed like the overall EBIT outlook was pretty similar to last quarter, but the free cash flow guidance is up $40 million. I think you talked about maybe $17 million from the sale of the pack center. But I was wondering if there were any other components you could kind of break out to help bridge that.

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

Certainly, Brian. As we mentioned, we're expecting cash from operations to be up about $10 million, and that's really just due to just miscellaneous adjustments to our estimate on that. But the real driving factor is the fact that we're expecting net capital spending, which reflects the value of any proceeds from asset sales to be lower now by about $30 million, most of that -- of which is associated with selling the assets at the Atlanta pack center. So it's really just those 2 components that's causing the increase in our expectations for improved free cash flow.

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

Okay. Got it. And then just one question on the paper industrial margins, sort of following up on a couple of questions that have already been asked there. But just wondered if you could break out the year-over-year improvement between how much of it came from price/cost versus how much you think is more structural on the customer optimization strategy you've been working on.

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

Yes. It's fair to say the improvement that we're really seeing in that segment is mostly associated with the favorable price/cost spreads, again, which is due more -- it's not only due to lower OCC prices overall, but it's also the impact of how we've been successful in passing prices through for noncontract businesses in North America, also the benefit of the tan bending chip index being up year-over-year. But I'm also making the point that for once, this is a global perspective where we've really seen favorable price/cost in all regions of the world due to the tight URB markets globally.

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

Okay. And last one for me. Just I think the last quarter you talked about the second half tariff impact of around $7 million to $9 million. Is that still the expectation? And also, do you think you can still recover that through price increases? Or is there -- you talked about some competitive intensity in the industry and some of your customers are trying to pass on prices. Do you think you can still recover that tariff impact through price increases?

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

Yes, Brian. That number still holds in terms of our expectations. Will there be a lag in terms of the recovery? Yes. Is it our expectation that we will fully recover that? The answer is yes.

Operator

Our next question comes from Gabe Hajde with Wells Fargo.

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

I echo everyone's commentary about recovering from a large storm that was, I'm sure, very stressful. I want to try to attack maybe the OCC question a little bit differently. I saw a unique stat in a trade publication indicating that OCC exports on a tonnage basis were, in fact, up, I don't know, around 20%, 21% or something like that. And I can't imagine that domestic consumption is, in fact, down given robust utilization rates in containerboards. So I'm guessing that sort of the fulcrum might be mixed paper usage and the fact that it's effectively free. Can you talk about just given your sort of vertical integration, your collection efforts on that front, recycling operations, to what extent maybe you guys are increasing usage of mixed paper and maybe other folks in the industry and how long that might persist?

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

Yes. So let me start with what we're doing. We got ahead of this a while back in terms of making investments in our recycling side to really get after cleaning up the mixed paper. I think we collect directionally 200,000 tons a year. We've also been making investments in our mill systems so that they can take in more of the mixed paper and get the yield that we expect out of that. I want to make sure that I understood the other portion of your question. Your concern was about more being exported, and was that what you were referring?

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

No. Just that OCC exports are up this year to the tune of 21%. And when I look at, like I said, domestic containerboard utilization rates, obviously, they're very high, which would seem to suggest that OCC consumption domestically is also up but yet prices are down. And so my logic or my thought process is that maybe folks are supplementing with mixed paper across the industry because there's no upward tension on OCC prices.

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

Yes. I'm not sure that I've got a good answer for you with respect to that because we're not seeing some of what you just described. We -- in terms -- I just want to make I understand the question.

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

Gabe, I would just -- this is Roger, by the way. I would just say that what we're seeing is that most of this activity -- of increased activity in export is principally driven by year-end type of activity because permits are running, people are trying to get the last tons that are available through their permits to go into the Chinese market and others. And there is some anticipation of new permits coming out as well. So we think it's more related to the timing associated to that circumstance than any true increased volume that's in the market. We did see an increase in volume activity in the quarter in our recycling operations. So again, we understand that, but there's still a tremendous amount of material in the marketplace. There's still -- as you know, there's still a lot of mixed paper that's not going into the mill system, that's going into landfill because there's little, if no value. So we think it's more of a timing-related issue.

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

Okay. The other one on composite cans. I mean, you guys were building out a couple of lines globally. And I'm just trying to understand maybe there's some pipeline fill and inventory adjustments going on. Might that be the case? And can you maybe provide a little insight as to expectations for that -- for volume?

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

Sure. The answer is we're not filling the pipeline yet because the lines are just going in. In fact, we're in the process of installing the line right now in South Africa, and the other lines for Brazil have not yet arrived. The building is getting to the point of completion, so ready to accept those lines. So we haven't seen the benefit of those lines just yet.

Operator

Our next question comes from Chip Dillon with Vertical Research.

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

(technical difficulty)

including the proceeds from the sale of the Atlanta facility. Should we assume that's in the tens of millions of dollars as that offset? And also, does it have any implication for what you think that CapEx will be next year? Should that number go up because you won't have any asset sales?

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

Chip, we lost you here. Could you go through that again? I'm sorry.

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

Okay. Sorry. Can you hear me okay now?

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

I can hear you now. Yes.

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

Okay. Sorry, guys. No, just on the lower CapEx. You mentioned it's technically a CapEx number minus what you expect to get for the Atlanta pack center, which I assume you're selling. If you could just -- I would assume that the sales price is in the tens of millions. And should we also expect CapEx to go back up to near where you were guiding at earlier this year when you look at 2019?

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

Yes, Chip. We specifically said in the quarter, it was favorable by about $17 million in terms of the net proceeds from the selling of those dedicated assets. There will be a little bit more of that, that runs over into the fourth quarter. So again, that is the primary reason that our net cap spending number is down. We haven't finished the roll-up for 2019 in terms of what we actually think our capital spending will be. But it is fair to say just roughly we'll be back in that $200 million, $220 million range. But we'll come back to you with more information about that at our Investors' Day in early December.

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

Okay. And you guys have owned, I think, Highland and Clear Lam for probably about 1 year or so. How are those businesses performing now that they've been in your quiver for quite a while? And are they meeting, exceeding or matching expectations?

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

Yes. So Highland, we've actually owned for a little over a quarter, I think. So I think you're referencing Peninsula.

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

I meant Peninsula. Yes.

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

Yes. So a couple of things. One is we're in the process of doing some consolidation work, which was contemplated when we bought the facilities in Peninsula. And so that work's underway, and that will be completed. From a synergistic standpoint, we're running a little bit behind what we know that we'll be able to achieve. So some work left to be done there. And on the Clear Lam side, performance-wise -- what I'll call operational performance-wise, it's doing what we expected. We did lose some business out of that facility, but that will be replaced. And in terms of the products in the product development, it's -- they're certainly performing the way we expected. In fact, when I think about all of the new products across the company, we're on track to drive about $70 million of new product sales this year, which is better than last year, and that's as a result of having some of these acquisitions in place.

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

Got you. And one last quick one. On the medium machine, which I think you guys have had -- you've been running pretty fully versus, say, 2 years ago, could you just give us an update as to -- is that product mostly going domestically or overseas? And how do you find the relative attractiveness of those markets? Again, this is not a core business of yours, but it seems like the industry's been running very hard to try to take advantage of what apparently are good prices overseas.

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

Yes. I would tell you, Chip, probably directionally, it's about 50-50 in terms of domestic and export. But our long-term prognosis as it relates to that machine hasn't changed from what we've talked about before.

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

Which would be to try to find another partner, I would imagine?

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

Correct. Correct.

Operator

Our next question comes from Steve Chercover with D.A. Davidson.

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

So sorry to ask a question about Consumer Packaging so late in the call. But I was also looking at the, I guess, the trends in profitability. From a longer term -- and there has been erosion over the last few years. And I'm just wondering, is the mix getting less lucrative with the growth? Or is it strictly the price/cost relationship?

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

I think it's both. I think in terms of volume/mix, there's clearly a different margin profile in some of the business. And some of it is, quite frankly, I mean, the impact of the inflation that we're facing, and we'll get that back. But I also have every expectation that as we grow in some of the space, as we've demonstrated in the past, that we've been able to grow the margins to an acceptable level. But again, I don't want to mislead in any way, shape or form. Expectation is that we -- in the consumer side, it's a 10% to 12% margin business, some years better, some years little less, but it should be in that range.

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

Understood. And a quick question on Conitex, please. So for the $143 million, will you be consolidating approximately $170 million in sales or no? I was also hoping -- so how is it reported now?

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

Yes. Currently, through the third quarter, the earnings from that joint venture, our share of those earnings were just picked up in equity and affiliates. Going forward, we'll be reflecting their financials on a consolidated basis into ours. So we'll be reflecting sales roughly of $270 million or so on an annual basis in the Paper and Industrial Converted Products segment.

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

Okay. I thought -- so yes, and I appreciate the update on what the annual run rate is of sales. But I thought that a portion of the revenues would be in Paper and Industrial and some would be in Consumer Packaging in Europe. So could you give us that split?

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

Well, just obviously, it's a very small composite can operation in Europe that would be part of the consumer business. So it's really insignificant. Essentially all of this from -- to the industrial side.

Operator

We have a follow-up question from the line of George Staphos of Bank of America Merrill Lynch.

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

I know it's late in the quarter, so I'll make it quick and I'll ask them in sequence. First of all, when we look at Paper and Industrial Converted Products, I understand that trying to project additional price/cost benefit into 2019 is very difficult to do one way or another with precision. But if we assumed flat pricing and flat raws, which may be is unrealistic but just to have a frame of reference, why would your margins decline next year, Rob, from where they are this year? I mean, that was kind of the implication you left me with, anyway, in terms of answering one of the prior questions. I think it was Adam's question. Why wouldn't you at least be flat if there's no further price/cost benefit going forward? And then in thermoforming, it seems to me that -- and perhaps I'm wrong, and please correct me if I am, that you have some ongoing operational issues there. Is there anything that systematically you're finding you need to fix whether it's within Peninsula, Highland or Clear Lam? And how do you go about doing that in 2019?

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

Sure. On the thermoforming side, no, I don't think there's anything systematic in terms of the issues. I think we just got some shop floor and some consolidation issues that we need to address. And we've got the right team in place, and I have every confidence that they'll be able to fix that situation. In the perfect world, George, I wouldn't argue with you with respect to if everything stays flat, there's no inflation, all the inputs stay the same, there's no reason for our margins not to remain the same. But I know that we deal in the real world, and we'll have fluctuations. I don't know if that's the answer you're looking for, but it's the reality that we face.

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

Yes. I just want to make sure we're not missing something mechanically as regards specifically price/cost and really price versus OCC recovered paper. But that was great.

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

No, if I didn't answer appropriately the first time, my bad. Sorry.

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

It's probably on me, Rob, probably on me.

Operator

And I'm showing no further questions in queue at this time. I'd like to turn the call back to Mr. Schrum for closing remarks.

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

Thank you, again, Liz. Sonoco will be hosting its annual breakfast meeting with the financial community on Friday, December 7, in the Billiard Room at the New York Palace Hotel, which is at 455 Madison Avenue. If you come early, you'll be able to get one of New York's best-served breakfasts, and then we'll start breakfast at 7:30 a.m. And presentations will begin just before 8:00 a.m. Rob and our executive leadership team will provide a number of business and strategy updates. And Barry and his financial team will provide a first look at our financial targets for 2019 as well as an update on our 2020 vision target. There will be plenty of time, of course, for your questions. And as always, we'll be mindful for your time, and we should be completed by around 9:30 a.m. Invitations for the event will be going out this afternoon. And for those interested in attending should contact the company through my trusted assistant, Robin Hayter, either by phone or by email. And those who cannot attend in person can join us, the meeting, via webcast at sonoco.com under the Investor Relations section.

Again, let me thank everyone for joining 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. Thank you, again.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program, and you may now disconnect. Everyone, have a great day.
