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# Quad/Graphics, Inc. (QUAD)

Q1 2021 Earnings Call

## CORPORATE PARTICIPANTS

**Katie Krebsbach**

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**J. Joel Quadracci**

*Chairman, President & Chief Executive Officer, Quad/Graphics, Inc.*

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good morning, ladies and gentlemen, and welcome to the Quad's First Quarter 2021 Conference Call. During today's call, all participants will be in a listen-only mode. [Operator Instructions]

A slide presentation accompanies today's webcast and participants are invited to follow along advancing the slides themselves. To access the webcast follow the instructions posted in the earnings release. Alternatively, you can access the slide presentation in the investor's section of Quad's website under Events & Recent Presentations link. Please note that this event is being recorded.

I would now like to turn the conference call over to Katie Krebsbach, Quad's Investor Relations Lead. Katie, please go ahead.

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**Katie Krebsbach**

*Investor Relations Lead, Quad/Graphics, Inc.*

Thank you, operator, and good morning, everyone. With me today are Joel Quadracci, Quad's Chairman, President and Chief Executive Officer; and Dave Honan, Quad's Executive Vice President and Chief Financial Officer. Joel will lead off today's call with a business update and Dave will follow with a summary of Quad's first quarter 2021 financial results, followed by Q&A.

I would like to remind everyone that this call is being webcast and forward-looking statements are subject to Safe Harbor provisions as outlined in our quarterly news release and in today's slide presentation on slide 2.

Quad's financial results are prepared in accordance with generally accepted accounting principles. However, this presentation also contains non-GAAP financial measures, including adjusted EBITDA, adjusted EBITDA margin, free cash flow, and debt leverage ratio. We have included in the slide presentation reconciliations of these non-GAAP financial measures to GAAP financial measures. Finally, a replay of the call and the slide presentation will be available on the Investors section of quad.com shortly after our call concludes today.

I will now hand over the call to Joel.

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**J. Joel Quadracci**

*Chairman, President & Chief Executive Officer, Quad/Graphics, Inc.*

Thank you, Katie, and good morning, everyone. We are very pleased with our first quarter performance. Our team achieved a third consecutive quarter of improvement in the net sales trend since the height of the pandemic. We also recorded several new wins in our agency and print segments that will drive long-term growth. When

combined with our disciplined approach to cost management and ongoing productivity improvements, we increased our adjusted EBITDA margin and drove higher cash flow as compared to the first quarter of 2020. This strong performance helped us continue to pay down debt to protect the health of our balance sheet.

On slide 3, we show our competitive advantages that are further accelerating our position as a marketing solutions partner and creating more value for our clients. These advantages reflect our commitment to integrated marketing platform excellence, innovation and culture and social purpose. Our integrated marketing platform is unique and continues to resonate with clients as it helps them reduce the complexity of working with multiple agency partners and vendors, increase efficiencies through process optimization and content production and improve marketing spend effectiveness across all media channels, especially through our leading data analytics capabilities.

We provide our clients with unmatched scale for onsite services and expanded subject matter expertise in marketing strategy, such as customer insights and data analytics, creative solutions, media deployment, including industry leading print and distribution capabilities, and marketing management services. Our dedicated client service teams make it easy to access our 24/7 always-on a global platform.

Our strategic transformation as a marketing solutions partner was validated again this week through our ranking as number 15 on the world's largest agency companies list compiled annually by Ad Age. We continue to strengthen and expand our marketing consulting, creative, technology and data analytics capabilities through continuing to add talent including experts in consumer research and engagement, further optimizing our sales structure to accelerate revenue growth including expansion of new verticals like consumer technology and making ongoing investments in innovative solutions that drive client value. For example, we recently expanded our partnership with Package InSight an organization that uses data and analytics to help better understand the drivers of consumer engagement and their purchasing journey.

Now Quad clients have the ability to test brand creative concepts and quantitatively assess their impact on consumer interactions in a real life retail setting at our lab in Greenville, South Carolina. We will help expand Package Insight's current research in brand packaging to include digital, in-store, direct marketing and all brand channels. Another way we innovate is through leading analytics capabilities that help our clients confidently allocate every marketing dollar where they matter most.

For example, our award-winning digital agency, Rise Interactive, helps clients increase the effectiveness of their marketing spend through Connex, a proprietary technology that provides on-demand cross-channel insights, proactive intelligence and automated optimization. With the click of a button, clients can do campaign response in real time, and Rise team members can make immediate adjustments across channels to maximize budget allocations and business outcomes. Through this innovation, we were able to help a mature e-commerce retailer, using paid search to scale revenue at three times the rate of spend.

Through our commitment to platform excellence and innovation, we now perform work for leading brands across foundational and high growth market verticals, as shown on slide 4. These brands admired for the trust and loyalty they have built with their customers that place their trust in us to help solve their most urgent marketing challenges. As a result, we have been able to expand our relationship into higher value and higher margin areas of their businesses. This is particularly important as these brands shift their efforts to emerge from the pandemic from a position of strength.

I would like to share some examples that illustrate how clients have come to rely on us as their trusted marketing solutions partner. The first example shown on slide 5 reinforces how we're able to help brands and marketers produce at the speed and scale required to compete effectively in today's fast changing market.

A leading global apparel company found itself in a situation where it needed an entirely new approach to photo and video content for its broad array of product lines, due to an increase in demand as people started spending more time at home during the pandemic. The company wanted to capitalize on the market shift to comfort clothing, not only to meet increased demand from existing customers, but also to reach new customers at a time when they were seeing a 5x increase in online search traffic.

The company constantly turned to Quad, knowing our integrated marketing platform has the necessary depth and breadth of talent, creative vision and flexible execution to fulfill its needs. We performed against the highly truncated timeline that included capturing hundreds of new images and video content for four different brands in just 25 days. Due to the resounding success of our work, we were able to renew an existing agreement for related services, and are now in position to expand the scope of our agency services with this high growth well known brand.

The second example I'd like to share with you today illustrates how we have become a trusted partner to retailers, both online and offline, to help carry out their most important strategic initiatives. In the wake of the pandemic, this includes initiatives by brick-and-mortar retailers to engage customers through experiences.

As shown on slide 6, a large national retailer, turned to us to execute its launch for a new high profile beauty shopping experience. A store within a store concept featuring dozens of premier beauty brands, all of which needed their vision represented consistently and on brand within a dedicated space. The retailer was familiar with Quad's ability to manage complexity, and leveraged our integrated marketing platform to deliver hundreds of thousands of high quality and store signs and displays quickly. As our client expands this critical strategic effort across the US, we expect to grow our relationship, helping it to refine its vision for the experience and produce assets for execution among other areas of opportunity.

An ancillary benefit of this level of trust from this leading retailer is we now have direct relationships with the beauty brands involved in the program, and are actively working to expand our relationships with each of them. In fact, several brands already have engaged us for a variety of marketing solutions, including strategy, creative, and digital services, and direct mail production.

On slide 7, we circle back to commitment to culture and social purpose, a commitment that goes back to our company's founding 50 years ago. Our strong culture and values include an enduring focus on social and environmental matters, and the benefits that this focus brings to the company and the communities we serve.

For example, we have always focused on reducing environmental impact of our business operations, including significant efforts to improve the energy efficiency of our manufacturing operations. Our onboarding work recently garnered a Wisconsin Focus on Energy Excellence Award for driving down carbon emissions through energy saving upgrades to facilities and operations.

In addition, at this time of heightened awareness about social issues, we have elevated our commitment to diversity, equity, and inclusion, not only because it is the right thing to do, but it is also a business imperative that we ensure we attract and retain the talent we need to successfully compete and grow.

In 2020, we launched the Learning and Development Program for employees as part of a more comprehensive and sustainable DEI strategy. We also expanded our employee-led Business Resource Groups.

As we look to the future, we're focused on further operationalizing diversity, equity, inclusion into everything we do at Quad, as well as across the marketing and advertising industries as a whole. For example, Quad and my family's Foundation, the Windhover Foundation, are making a three-year \$1 million commitment to expand The BrandLab to the Milwaukee community. Through this investment, we will introduce local students from diverse ethnic and socio economic backgrounds, to career opportunities in advertising and marketing and generate jobs.

Rise Interactive, our digital agency just announced its partnership in a new strategic effort to bring more diverse talent to Chicago [indiscernible] (00:11:15). Rise will lead the charge for a pro bono digital marketing campaign for this important effort called Destination 312.

Before I turn the call over to Dave, I want to thank our employees for their continued hard work and dedication. You've been resilient in the face of ongoing and unprecedented challenges, and thank you for being there for each other and managing through disruption in its many forms to continue to serve our clients well. As the economy continues its recovery, Quad will remain nimble so that we can adapt to changes in the demand landscape. We are confident in our team, our strategy, and our future as a marketing solutions partner to our clients.

With that, I'll now turn the call over to Dave.

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## David J. Honan

*Chief Financial Officer & Executive Vice President, Quad/Graphics, Inc.*

Thanks, Joel, and good morning, everyone. Slide 8 provides a snapshot of our first quarter financial results. As Joel mentioned, we delivered strong operational and financial results to start the year. We achieved a third consecutive quarter of improvement and the net sales decline rate, since the height of the pandemic impact on our business in Q2 of 2020, including new business wins for our agency and print segments. These wins, combined with our disciplined approach to cost management and ongoing productivity improvements drove higher adjusted EBITDA margin and higher free cash flow compared to the prior year.

The strong free cash flow generated in the first quarter in combination with proceeds from asset sales enabled us to reduce net debt by \$61 million, which included \$11 million of cash generated from the sale of a vacant facility. The ongoing review and realignment of our manufacturing platform allows us to redeploy capital to further accelerate our transformation as a marketing solutions partner and reduce debt.

Net sales were \$706 million in the first quarter, down 14% from the same period in 2020, primarily due to the economic impact of the COVID-19 pandemic and ongoing print industry volume pressures. However, the first quarter decline represents a third quarter of sequential improvement in our net sales decline rate since Q2 of 2020.

Adjusted EBITDA was \$66 million in the first quarter as compared to \$75 million in 2020 while adjusted EBITDA margin improved to 9.3% in the first quarter as compared to 9.2% in 2020. The variance in adjusted EBITDA to prior year reflects a 14% net sales decline and \$18 million of non-recurring benefits realized in 2020 including a \$12 million benefit from a change in vacation policy and a \$6 million benefit in the cost of workers' compensation claims from improved production safety procedures. These impacts were partially offset by savings from cost reduction initiatives. Adjusted EBITDA margin improved 15 basis points from cost savings initiatives more than offsetting the relative percentage decline in net sales.

Free cash flow was \$56 million in 2021, an increase of \$40 million from 2020 primarily due to higher net cash provided by operating activities driven by working capital improvements and a \$12 million decrease in capital expenditures.

Slide 9 includes a summary of our debt capital structure as of March 31st. We reduced net debt in the quarter by \$61 million, and as a result, our debt leverage improved to 3.24 times compared to 3.35 times at the end of 2020. While this leverage ratio is above our long-term targeted leverage range of 2 times to 2.5 times, we expect to further improve our debt leverage ratio to be at or near 3.0 times by the end of 2021.

As of March 31st, our blended interest rate was 4.9% and we maintained our strong liquidity position with up to \$463 million in unused borrowing capacity under our revolving credit agreement and \$81 million of cash on hand. Quad's nearest debt maturity is our 7% senior unsecured notes due May of 2022, which has \$239 million outstanding. We are currently reviewing whether we will pursue refinancing the unsecured notes during the coming year or choose to pay off the balance at or prior to maturity with ample liquidity under our \$500 million revolving credit agreement, which matures in January of 2024 and available cash on hand.

As we consider our financial outlook for 2021, we are both optimistic and confident. We expect to see further positive momentum in our net sales trend as our clients continue to embrace our marketing solutions in a strengthening economy. We expect full-year net sales to continue to improve and end the year in a range of flat to down the low-single-digit percentage as compared to 2020. And as previously mentioned, we expect to generate strong cash flow from operations and asset sales to further reduce our debt leverage to be at or near 3.0 times by the end of 2021.

For the second quarter, we expect to increase net sales by 10% to 13% as compared to Q2 of 2020. However, we anticipate that margins will be somewhat pressured in the second quarter compared to the previous year as Q2 of 2020 represented the quarter with the most temporary cost reductions implemented to partially offset the 38% net sales decline at the height of the pandemic impact on Q2 of last year.

During the second quarter of 2020, we took swift action to implement significant temporary cost reductions and cash savings resulting in temporary cost savings, which ultimately reached approximately \$325 million on an annualized basis. These cost reduction activities included initiating furloughs, temporary wage reductions and hiring freezes and temporarily suspending production at several of our manufacturing facilities. We worked diligently over the past year to convert a majority of those temporary cost savings into permanent savings. And as a result, the second quarter of 2021 will benefit from the earnings impact of the 10% to 13% increase in our year-over-year net sales. But that increase will be offset by the nonrecurring nature of the temporary cost savings initiatives for which those costs were subsequently reinstated to support increased client demand.

As the acceleration in client demand for our marketing solutions continues, we remain focused on our financial objectives of driving earnings and increased margins to revenue growth as well as effective cost management and productivity improvements. In addition, we expect to generate strong free cash flow along with cash generated from asset sales to further reduce debt. All of these efforts will help strengthen our balance sheet and liquidity to ensure we have the financial flexibility to continue to accelerate and scale our strategy as a marketing solutions partner while driving shareholder value.

With that, I'd like to turn the call back to Katie who will facilitate the Q&A session.

## QUESTION AND ANSWER SECTION

**Katie Krebsbach**

*Investor Relations Lead, Quad/Graphics, Inc.*

A

Thank you, Dave. We compiled questions in advance of today's call, and therefore, we will not ask for callers to enter the queue. Thank you to everyone who submitted questions in advance. We have three top questions that were submitted. The first question relates to what we are seeing in our core end markets. Specifically it asks, can you speak to the trends you are seeing in Quad's business segments and end markets as the economy reopens. And as a follow up, which of those end markets are fully back and which are still slower to come back, if any?

**J. Joel Quadracci**

*Chairman, President & Chief Executive Officer, Quad/Graphics, Inc.*

A

Thanks, Katie. And I'll start with retail inserts we've been pretty consistent over time referring to this segment as the one that's had the greatest decline and one that has experienced resets and probably will continue to experience some resets. But we're – right now the industry seeing about a negative 30% in the first quarter versus last year. We're evolved in line with that and maybe a little bit better. But I will also remind people that the retail industry provides a lot of revenue upstream and downstream throughout our whole portfolio of product lines as evidenced by a couple of the examples I've shared whether that's in-store signage up to media planning and placement to social media et cetera. And so while we deal with the decline of newspaper inserts, which has a little bit to do also with the carrier being the newspaper that also got hit pretty hard this past year, we do offer a lot of other opportunities to grow business with the retail insert group and are seeing that the retail industry in general.

Publications were actually right now it looks like for the quarter the industry's off about 12%, but we're off only about 2% in volume and that's heavily due to segment share wins that we've been experiencing. And when I turned to the catalog market, the industry right now as the recent Catalog forecasts suggest is off about 11% for Q1, we're actually up 3%. And again much of that comes from having some clients that are performing better than most as well as segment share wins.

Direct mail and our commercial division is about in line with the industry trends, which is about off about 11% but that will continue to see a comeback as we get into the next several quarters based on some of the pipeline and some of the conversations that you hear out there on the marketplace. And then, packaging is actually a great bright spot for us as we continue to build the strength there. And we referenced the example of helping packagers with analytics to better figure out how to display their brand in stores, but we're actually up about 8% in that segment, which is fairly in line with the rest of the industry.

And so, I'd say that to the question about which ones kind of fully come back obviously can see that the catalog world has done well for us again because some of the clients we have had fared better than many. So, it's a quality of clients that we have. But also I think you're going to start seeing more and more direct to consumer folks entering the waters in direct mail and in catalog. And of course publications there's a lot of tried and true talent – titles out there and you do see a decline in the area, but again we have from a segment standpoint we've done a nice job with that. Katie?

**Katie Krebsbach**

*Investor Relations Lead, Quad/Graphics, Inc.*

A

Great. Thanks, Joel. Appreciate the detail there. Okay. Our second question is for Dave. Dave, can you provide an update on Quad's plan for the 2022 senior unsecured notes, and do you plan to start a refinancing process this year?

**David J. Honan**

*Chief Financial Officer & Executive Vice President, Quad/Graphics, Inc.*

A

Sure. Absolutely, Katie. Our continued financial focus on margin improvement and cash flow as we talked about in our prepared remarks as well as substantial and ample liquidity that we have whether it's through unused revolver capacity or significant cash on hand continues to give us a lot of flexibility and optionality as it relates to these upcoming notes, and again as a reminder, this \$239 million that's coming due for these notes in May of 2022. So we're continuing to look at a number of options, which would include refinancing those notes or simply just paying them off at or before maturity. And so, we'll continue to work on that optionality, and we'll let you know as shareholders our decision on that as that gets made.

**Katie Krebsbach**

*Investor Relations Lead, Quad/Graphics, Inc.*

A

Okay. Great. Thanks for the update, Dave. Our final question is regarding Quad's outlook for the remainder of the year. It reads, how should we think about Quad's participation in the economic recovery? And do you expect to see top line start to rebound as the year progresses?

**David J. Honan**

*Chief Financial Officer & Executive Vice President, Quad/Graphics, Inc.*

A

Sure. And, Joel, let me just start off just again just reiterating our guidance because we tried to address some of this economic recovery in the guidance we not only gave for the full-year but specifically for Q2 as we expect to continue to see further momentum in our net sales trend as our clients can further embrace our marketing solutions. And as the economy gets closer to its pre-pandemic levels, especially for agency companies like ourselves. So as I mentioned in my prepared remarks we expect to see the full-year of 2021 net sales to continue to improve and end the year between flat and down low single digits as compared to 2020. And we continue to see really nice sequential improvement as we talked about from the height of the pandemic's impact on our net sales in Q2 of last year where we were down 38%. And it's improved sequentially until this last quarter where we were down only 14%. And then as we give guidance for Q2, we expect to see an increase in net sales for our second quarter of somewhere between 10% and 13%. So, that's just a reminder of our guidance. Joel?

**J. Joel Quadracci**

*Chairman, President & Chief Executive Officer, Quad/Graphics, Inc.*

A

Yeah. And as far as the year has progressed here clearly the economy's heated up quite a bit with expectations in the 6%-plus range for GDP growth. And a lot of clients are re-kicking in traditional marketing as stores open up, but have also really accelerated their use of all different mixes of media. And I think you've got to think about things kind of getting thrown out into a little bit of disarray this past year as people who stayed at home and companies were trying new ways to market. And now the pendulum is going to try and swing and find a new medium.

Where that ends, we don't know. But certainly other things are playing out such as Apple's new implementation of their privacy technology where cookies really go away. So, the long story short is businesses are seeing a comeback and we expect to continue to help them with how they can sell more stuff using the analytics work that we can provide them along with executing on their plans in an integrated way. So, while that may not for instance drive a huge retail insert program come back, we do think that there'll be some comeback there. But we're seeing

a lot of demand in all the different other areas. So we expect that through the rest of the year, we'll see some pretty interesting things, especially as it relates to what we formally call their 3.0 strategy, which is really helping marketers of all sorts to market their product in all channels combined. So, with that, I feel pretty good about our position in the industry as well as our position within the marketing mix in terms of helping these clients navigate these new waters.

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**Katie Krebsbach**

*Investor Relations Lead, Quad/Graphics, Inc.*

A

Great. Thank you both. Well this concludes the Q&A portion of today's call. And now I would like to turn the call back to Joel for closing remarks.

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**J. Joel Quadracci**

*Chairman, President & Chief Executive Officer, Quad/Graphics, Inc.*

Thank you, Katie. And thank you everyone for joining today's call. I want to close by reiterating my thanks to our employees for their continued hard work and agility. I'm confident in our team, in our strategies and in our future as a marketing solutions partner that helps certain brands and marketers solve their marketing and process challenges. We will continue to closely monitor the pandemic and its impacts on our clients and we'll adjust our priorities to support our financial objectives that make Quad made quite a compelling long term investment. Thank you and have a good day. We look forward to speaking with you again next quarter.

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**Operator:** And the conference is now concluded. Thank you for attending today's presentation. You may now disconnect your lines at this time.

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