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Quad/Graphics, Inc. (QUAD)

Q2 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen. Welcome to Quad Second Quarter 2020 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 this morning's earning release. Alternatively, you can access the slide presentation on the Investors section of Quad's website under the Events & Recent Presentations (sic) [Events & Presentations] (00:41) link. Following today's presentation, the conference call will be opened for questions. [Operator Instructions] Please also note this event is being recorded.

And at this time, I'd like to turn the conference call over to Katie Krebsbach, Investor Relations Lead. Katie, please go ahead.

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 second quarter 2020 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.

J. Joel Quadracci

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

Thank you, Katie. And good morning, everyone. Our second quarter performance was strong and reflects the resiliency of our business and our team's ability to aggressively and effectively respond to crisis such as the COVID-19 pandemic. We continue to proactively address a significant reduction in client demand by realigning our cost structure to match lower volumes while also driving continued productivity improvements and protecting the health of our balance sheet. Notably, we achieved higher profit margins for the quarter, and on a year-to-date basis generated positive cash flow and continued to pay down debt.

Turning to slide 3. Throughout the quarter, we carried out our business continuity plan in response to the pandemic with a focus on maintaining the health and well-being of our employees, providing high-quality, on-time delivery for our clients, and ensuring the long-term financial health of the company. As you will recall in the first quarter within a very short timeframe, we shifted 3,700 administrative employees to work from home to support social distancing. We will continue our work-from-home policy until we feel it is safe for all employees.

For our production employees who work in our manufacturing facilities, we continue to focus on our safe-at-work program which includes daily temperature checks, protocols for social distancing and mask wearing, and procedures for cleaning and sanitizing workstations, equipment, and common areas. Our program also includes frequent employee communications and ongoing education around how to stay healthy both inside and outside of work.

Our dedicated COVID-19 rapid response team continues to monitor and manage all suspected and confirmed cases of the coronavirus throughout the company and is responsible for transitioning impacted employees to self-quarantine, performing rigorous contact tracing, and reporting out daily metrics so we can understand the real-time impact of COVID-19 on our workforce. To date, the number of confirmed possible cases at Quad remains relatively low and has not negatively impacted operations. We believe transmission of the virus is primarily happening outside of work in social settings.

We also continue to take actions to protect the company's long-term financial health. During the quarter, we saw significant volume decline in certain product categories as our customers reacted to the rapid closure of much of the economy. Similar to the first quarter, we took aggressive actions to reduce cost and drive productivity improvement to protect the health of our balance sheet and preserve cash flow and liquidity.

Within the first three weeks of the pandemic, we achieved $250 million in annualized cost savings and increased that savings to $325 million over time. We were able to act aggressively and successfully, thanks to our deep experience managing through industry and economic disruptions including our longstanding approach to treat almost all costs as variable.

As we look to the future, our Quad 3.0 strategy provides us with the right tools, talent and platform to exit the COVID-19 pandemic from a position of strength and return our focus on driving long-term growth. We believe we will be poised to generate revenue and subsequently the cash required to take advantage of value-creating opportunities that will further offset organic print decline through expansion into higher margin products and services.

Throughout the pandemic, we have continued to grow print segment share and recently secured several large multiyear contracts with a combined value of more than $100 million over the contract terms. These contracts include two multi-brand catalog marketers as well as multinational home goods retailer. We expect to continue to grow our print segment share in the near-term, thanks to our operational and financial stability, dependable high-quality, on-time performance, and ongoing investment in our platform.

We also have continued to advance our strategic transformation as a marketing solutions partner by maintaining our focus on the areas outlined in slide 4. These include optimizing our product portfolio to focus the company on the greatest revenue-generating opportunities, investing in talent and technology to drive new business and further expand our offerings, and innovating new integrated solutions that help our clients simplify their executional requirements to deliver content and campaigns more efficiently and effectively.

On July 1, we completed the sale of our Versailles, Kentucky book manufacturing facility to CJK Group, the first step in our previously announced strategic decision to divest of Quad's book business. We are very happy to have found a great home for the talented team in Versailles and thank them for their professionalism throughout the sale process.

We continue to make progress on the potential sale of our remaining two East Coast book plants. As a reminder, within the last 12 months, we have also divested our Omaha folding carton plant and sold Transpak, our heavy-duty industrial wood crating business, to further intensify our focus on our Quad 3.0 strategy.

I am pleased to share that we recently strengthened our leadership team at Periscope, our Minneapolis-based integrated marketing agency, with the addition of Cari Bucci-Hulings as Agency President. Cari is a result-oriented growth-minded leader who has deep experience in building strong service offerings, cultures and creative communities. We look forward to her experience, energy and fresh perspective she will bring to Periscope as an important part of Quad's integrated marketing platform.

I'm also pleased to share that we recently strengthened our data analytics and business insights team, adding several senior level experts to help clients interpret their customer and third-party data to achieve more effective, personalized, and measurable results. A key area of focus is expanding our Accelerated Insights virtual testing platform to help clients measure the impact of marketing programs across multiple media including online, packaging, in-store, direct mail and catalog.

As clients rethink how they go-to-market as a result of the pandemic, we are front and center helping them reengineer their campaign and content creation workflows. The current and future marketplace will require more nimble content creation teams and greater iteration of content to improve market performance. Quad is a market leader in client on-sites for marketing services and our expertise makes us an attractive partner for clients looking to improve efficiencies and speed to market, while reducing head count among other fixed and variable costs.

We have found that our client on-sites are the fastest and most successful way to grow revenue within our existing client base. On a trailing 12-month basis, we have increased the number of on-sites by nearly 20% and now manage approximately 90 on-sites across the US with our single largest engagement employing more than 100 of our own people. These on-sites provide a wide range of services including, but not limited to, campaign origination, photography and videography, copywriting, project management, and media planning and buying across all channels.

On slide 5, we show an example of how we have successfully changed the client's perception of our company, growing our on-site services in support of its evolving marketing needs. Several years ago, we established an onsite presence at this national retailer of home, yard, farm and animal supplies for page production of its weekly inserts which we had been printing for more than 20 years. We evolved the onsite engagement into a strategic partnership by observing and listening to the client's needs. As the company has expanded its e-commerce site and digital marketing, we have been there to support its efforts providing onsite talent for copywriting, graphic design, and digital marketing. We expect to expand our on-site services with an overall value to this client as it continues to execute on its growth strategy.

On slide 6, we're showing another example of how we are solving our clients' marketing and process challenges using the power of our end-to-end packaging solutions which seamlessly integrate all client packaging requirements from sophisticated audience segmentation through design, pre-media, printing, and logistics worldwide.

We believe our offering is unique and market changing because it is truly integrated and includes Periscope's high-end marketing and packaging pre-media services as well as Quad's award-winning packaging production executed at our own plant or through a global network of suppliers complemented by Quad's expert logistics solutions.

Earlier this year, we introduced our end-to-end packaging solutions to a national retailer of aftermarket parts. Our engagement, like many, started with a workflow audit that quickly paved the way for more strategic conversations with the client for our own packaging quality and consistency, and brand management for its private label or own brands.

After learning about Quad's deep marketing resources and subject matter expertise, the retailer engaged us for a brand packaging audit that determine how its own brands are performing against others in the marketplace. Soon, we will begin providing adaptive design in previous services that previously had been performed inconsistently by various packaging printers around the world. The client also has asked us to oversee global print management to ensure product quality and consistency and on-time production. As we grow our partnership with this client, we plan to introduce our visual merchandising, content creation, loyalty program and instore solutions.

On slide 7, we show an example of our client technology solutions that advanced data management and personalization. Recently, we helped MYMOVE, a subsidiary of Red Ventures, to create a first of its kind sales platform to help connect its advertisers with people who have just moved.

This platform empowers MYMOVE to create precise audiences and personalization experiences in new mover welcome kit offering highly effective advertising placements for retailers, grocers, telecom providers, D2C brands, and home delivery services. Quad processes tens of thousands of these mailings daily on our state-of-the-art digital press platform. MYMOVE turned to Quad when it wanted to totally reinvent the marketing services it offers to its customers to a higher level of versioning and customization.

After an in-depth discovery process, which included key input from MYMOVE senior leaders, we created a solution not only manages data for print products, but also lays the foundation for nonprint channels in the future. Because of our innovation, MYMOVE consolidated all of its printed technology solutions with Quad, recently awarding us an exclusive five-year multimillion-dollar contract.

Our ability to solve their go-to-market constraints was the key to securing this agreement. MYMOVE has now engaged us for other marketing solutions including business process optimization, digital workflow tools, accelerated insights virtual testing, and on-site creative services. MYMOVE loves the solutions we are providing backed by consistent high-quality, on-time execution. In the words of Ken Pecca, Print Innovation and Operations Director, MYMOVE was looking to innovate, and Quad was the only vendor that leaned in with fresh-thinking and solutions-oriented innovation. Quad was the only vendor that proactively changed the current state. Thank you, Quad.

As you can see, through these client examples, our Quad 3.0 strategy differentiates us from other printers and marketing agencies. We are focused on solving our clients' marketing and process challenges and our solutions help clients reduce complexity and costs while improving marketing spend effectiveness and profitability. Because we have always made it a priority to build relationships at all levels within client's organization, we can better understand, anticipate, and solve their problems. As we move forward, we will continue to streamline and integrate our offerings even more cohesively and grow the number and value of products and services we offer to clients.

Before I turn the call over to Dave, and as captured on slide 8, I want to recognize and thank all of our employees for their tremendous efforts and sacrifices during this unprecedented time. As we look forward, we will continue to closely monitor the COVID-19 pandemic and its impact on our clients and the worldwide economy, and adjust our priorities accordingly to support our financial objectives. At the same time, we will continue to keep our employees safe while serving our clients' evolving needs.

At this time of heightened awareness about social issues, particularly as it pertains to persistent racial injustice and inequality, Quad has committed additional focus and resources to our diversity, equity, inclusion efforts. We want Quad to be a place where people – all people feel welcome and are able to attain their career goals. To this end, we will build on the foundation we have in place as we take additional proactive steps to achieve a workforce that reflects the communities where we live and work and the clients who trust us with their business; ensure that procedures, processes and distribution of resources are impartial, fair and just for all; create a safe and open environment where all Quad employees can bring their truest and best selves to work every day and better broadcast the things we do well for our employees and all the services we provide in the workplace.

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

David J. Honan

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

Thanks, Joel. And good morning, everyone.

Slide 9 provides a snapshot of our second quarter financial results. Our second quarter operating and cash performance was strong as we generated positive free cash flow and reduced net debt in the quarter despite the significant net sales impact from the pandemic. We continue to prioritize the health and well-being of our employees, while protecting Quad's financial health, providing great service to our clients and winning new work due to our Quad 3.0 strategy.

We remain focused on aligning our cost structure to lower net sales as we reduce costs at a higher percentage of their net sales decline. In this way, we were able to protect the health of our balance sheet through continued debt reduction and liquidity preservation to ensure that we have the financial flexibility to navigate COVID-19 and continue to advance our transformation as a marketing solutions partner. We also continue to optimize our product portfolio, as Joel mentioned, by completing the sale of one of our three book manufacturing facilities on July 1 as part of our overall plan to exit the book business.

Net sales in the quarter we're $585 million, down 38% from 2019. The sales decline was primarily due to the economic impact of the COVID-19 pandemic, ongoing print industry volume and pricing pressures, and a negative 2% impact from the divestiture of our Omaha packaging plant in January of 2020. On a year-to-date basis, net sales were $1.4 billion, down 26% as compared to 2019. The sales decline is primarily due to the economic impact from the COVID-19 pandemic, ongoing print industry volume and pricing pressures, and a negative 1% impact from divestiture.

We shared on our last earnings call that we began to see customer demand substantially weakened in mid-March due to the impact of the COVID-19 pandemic. This trend continued into the second quarter as net sales decreased 38% during the quarter. The largest monthly sales decline occurred in May of that quarter with improvement on into June and July. Almost our entire customer base has been impacted, but none more severely than brick-and-mortar retailers.

Big box retailers and grocery stores reduced their print programs especially in the retail insert category as the extraordinary demand for essential items early on in the pandemic impacted product availability and promotions. Meanwhile, other retailers, such as department stores, completely suspended print programs as their locations were temporarily closed in response to the state shelter-at-home orders.

The impact was not limited to just retailers, as marketers decreased catalog and direct mail advertising in the financial, telecom, auto and travel segment as consumers stayed home and reduced spending in these categories. Finally, magazine publishers saw pressure on print advertising and reduced the number of pages per issue, and in some cases combined summer monthly issues together resulting in less magazines produced by Quad.

We expect improvement in the rate of net sales decline over the next two quarters as retailers return to print in their seasonal sales peak. However, visibility continues to be poor and further pandemic-related impacts could change our expectations for an improvement in the overall rate of net sales decline. Given this lack of visibility, we've withdrawn financial guidance.

Adjusted EBITDA was $60 million in the second quarter of 2020, as compared to $81 million in 2019, and adjusted EBITDA margin improved to 10.2% as compared to 8.5%. The adjusted EBITDA variance primarily reflects the impact of the sales decline, partially offset by savings from cost reduction initiatives. As a result of significant cost savings, adjusted EBITDA margin grew by 170 basis points in the quarter versus 2019 more than offsetting the relative percentage decline in net sales.

Adjusted EBITDA for the six months ended June 30 was $135 million, as compared to $159 million in 2019, while adjusted EBITDA margin improved to 9.6% in 2020 as compared to 8.3% in 2019. The adjusted EBITDA variance to prior year primarily reflects the impact from a 26% decline in net sales, an $11 million decrease in paper byproduct recoveries, and a $7 million increase in hourly production wages due to strategic investments made to increase starting wages that have favorably impacted productivity throughout our platform. These declines were partially offset by cost savings from productivity initiatives, a $9 million net noncash benefit from a change in vacation policy, and a $6 million net reduction in workers' compensation reserves from improved production safety initiatives at our facilities.

As a result of these cost savings initiatives, year-to-date adjusted EBITDA margin grew by 130 basis points over 2019. Year-to-date free cash flow increased by $79 million compared to 2019 due to strong working capital management, a $37 million decrease in capital expenditures, and the aggressive implementation of cost savings actions. As a reminder, the company historically generates the majority of its free cash flow in the fourth quarter of the year.

As shown on slide 10, a key driver of the adjusted EBITDA margin and free cash flow improvement was the aggressive action taken to align our cost structure to offset the lower demand for print due to COVID-19. These cost savings were implemented early on to control costs, conserve cash, and protect liquidity. It included reductions in head count by over 1,100 employees, a temporary employee furlough program with company-paid medical benefits, temporary salary reductions for more than 1,200 employees from April through the beginning of

August including a 50% salary reduction for our CEO and a 35% salary reduction for named executive officers. Board of director fees will reduce by 50% upon their recommendation to coincide with the timing of salary reductions for our leaders.

Permanent closure of our Taunton, Massachusetts plant, manufacturing facility furloughs were the effects of the pandemic impacted our ability to operate, suspension of all domestic and international travel, capital expenditure reductions which we expect will reduce cash spend by $50 million in 2020 versus 2019, and the suspension of the company's quarterly dividend, in action that conserves approximately $8 million of cash each quarter. We remain committed to paying a dividend over the long-term and will seek to resume a dividend as our operating environment stabilizes.

All told, since the pandemic began, we've temporarily reduced costs by $325 million on an annualized basis including reducing our largest cash cost category, wages, by nearly one-third of pre-pandemic levels. I'm extremely proud of the Quad team for the speed and agility of their reaction to this pandemic. This agility was key to conserving cash and liquidity in this unprecedented time of uncertainty. It helped ensure a stronger financial position as of June 30.

Some of these savings are temporary in nature and will be evaluated as to when they can be reinstated or whether they become permanent based on the level of recovery in net sales. We remain disciplined in our approach to align our cost to sales and remain confident in our transformation strategy to take advantage of new opportunities as the marketing solutions partner as well as productivity improvements from the long-term investments in employees and automation.

Slide 11 includes a summary of our debt capital structure as of June 30. We reduced net debt by $125 million over the last 12 months due to strong free cash flow and $40 million in cash proceeds from the sale of our Omaha packaging facility. We ended the second quarter with a debt leverage ratio of 3.18 times as compared to 3.12 times at December 31, 2019. While this ratio is above our long-term targeted leverage range of 2 times to 2.5 times, we're pleased with the overall progress we've made to reduce our net debt levels and maintain a consistent overall leverage with the end of last year despite the economic impact of the pandemic. Our primary use of cash will continue to be debt reduction.

During the second quarter we proactively amended our senior secured credit facility primarily to widen the leverage ratio covenant by an estimated [ph] 0.75 times to 1 times (25:21) full turn of leverage through the third quarter of 2021. As part of this amendment, we reduced the revolver capacity which was previously expanded in 2019 in preparation for its subsequently terminated acquisition from $800 million to $500 million. The credit facilities maturity remains January of 2024 and Quad's next nearest debt maturity is the 7% senior unsecured notes due May of 2022. We ended the second quarter with $365 million of availability for future borrowings under the amended covenant.

As of June 30, our blended interest rate is 4.9%, and our debt capital structure was 63% fixed and 37% floating. We maintain significant liquidity at June 30, including $70 million of cash on hand, and up to $465 million in unused capacity under our revolving credit agreement.

We believe our available liquidity, strong lender relationships, our agile approach to cost management, and our ability to help clients now and after the pandemic as a result of our Quad 3.0 strategy will help provide substantial financial flexibility to adjust to the current uncertainty in our operating environment. We'll continue to take the necessary actions to respond effectively to the rapidly evolving pandemic.

And now, I'd like to turn the call back to our operator who will facilitate taking your questions. Jamie?

QUESTION AND ANSWER SECTION

Operator: Ladies and gentlemen, at this time, we will begin the question-and-answer session. [Operator Instructions] And our first question today comes from [ph] Jamie Clement from Clement & Company (27:26). Please go ahead with your question.

Q

Hey, guys. Good morning. Can you hear me okay?

J. Joel Quadracci
Chairman, President & Chief Executive Officer, Quad/Graphics, Inc.

A

Yeah. Hey, [ph] Jamie (27:34). How are you?

David J. Honan
Chief Financial Officer & Executive Vice President, Quad/Graphics, Inc.

A

Good morning, [ph] Jamie (27:35).

Q

Hey. So, can you take us through kind of the cadence between March to April, April to May, May to June, et cetera, et cetera, in terms of what you were hearing from customers as it relates to virus and demand and that sort of thing, and kind of on the flip side how you all reacted to that?

J. Joel Quadracci
Chairman, President & Chief Executive Officer, Quad/Graphics, Inc.

A

Yeah. I mean, you can imagine in second half of March, it was a hard shot for many people. The economy in the second quarter basically dropped by a third, which is obviously a big number. And when you think about some of the big retailers out there that literally closed stores for quite a period of time, we saw the biggest reduction in volume coming from retail inserts. And that was – while the economy was down 33%, it was off about 55%. And not surprising, because if the stores aren't there, you're not going to try and drive traffic.

Furthermore, even though print still drives online revenue, they were also doing what we were doing, which is conserve the balance sheet and really cut costs as fast as possible to weather the storm. And so, we saw the bulk of it there. When we think about catalogs and direct mail, they were off about the same as the economy, about 33% plus or minus. And remember, some retailers are also catalogers. So, I'd say that some of the impact came from retailers ceasing or suspending catalogs.

It's kind of interesting. I mean, packaging continue to do well. Our in-store group continued to do well. And as we look forward, we think that catalog, packaging, in-store, all those things will – and direct mail will start to heal themselves as people get back to normalcy. Again, visibility is horrible right now, but I'm a little bit comforted that big retailers and small retailers had taken upon themselves to demand that people wear masks as they go into the store because they don't think there's much of an appetite to close the economy again.

But that being said, we did see a lot of fits and starts. Some people looked at the economy as a chance to maybe stop doing print retail inserts on into the future and quickly reverse themselves. We had one who did that and only two weeks later totally reinstated it because they found that their dataset was way too small. And so, we continue to have fits and starts on how people are looking at media channel.

And again, I think go forward, people are just trying to figure out what's going to happen now, all the various states that are seeing the spikes that are going on. And I think what I'm so proud of is our ability to kind of manage to what those volumes will be in the future. But again, I think we can't state it enough, our ability to kind of treat all costs as, almost all costs as variable has allowed us to really slam the brakes when we need to.

And as Dave said, there was a lot of sacrifice involved. We had over 1,200 employees who took wage cuts. We furloughed a lot of people. We made a lot of furloughs permanent. And ultimately, this company, because of the industry we're in, knows how to react, and we will continue to be able to do that regardless of what direction our customers go.

Does that help?

Q

Yeah. Yeah. Absolutely. And I appreciate that. [ph] I still want (31:05) ask a question. I imagine through the challenges of the last couple of months that some of your customers are obviously looking to cut costs and outsource some functions that obviously Quad can handle better than they can and probably and most certainly reduce costs. First is, is that logic sense? Second of all, is there a specific kind of customer where that discussion has been more common or has it been across the board?

J. Joel Quadracci
Chairman, President & Chief Executive Officer, Quad/Graphics, Inc.

A

Yeah. I mean, we've been pretty consistent about 3.0 and what it means. And I said in the script, we've increased the number of on-sites that we do by 20% to 90 and it wasn't that long ago when [ph] I – well think (31:48) I was talking about [ph] 65 or 70 (31:50). And so, what we felt that people were already kind of going down this route of rethinking how they create content and execute upon it, that they all have a lot of legacy costs that not only eat up cost but also take time to execute on the media landscape. And so, now, I think that given that a lot of companies sort of shut down or partially shut down sending people home, what we're seeing is a greater willingness to think more aggressively about what don't you bring back as a marketer.

I mean, ultimately most of our customers are merchandisers and they strategize on how to sell that merchandise. But when you get to the execution of it, there's a lot of costs that they incur that they have to manage in the ups and downs of labor as a fixed cost versus variable. And so, a lot of what we're seeing is people really engaging on, okay, how can someone like Quad who can handle execution across all channel sort of take the cost out for me. And ultimately, what they really are looking for, too, is how do they execute quicker and make sure that all the different channels are very integrated together because if you're really going to surround the consumer in a 360-degree view, you have to make sure that you're doing things very quickly from content execution to deployment.

Again, I went through the hundred million dollars of segment win that we had recently, and that many of those – most of all – all those were basically 3.0 wins that resulted in a lot of revenue was from print as well. And so, yeah, we're looking at this as a big opportunity. And right now, we don't [indiscernible] (33:41) more processes in terms of acquisitions. What we're really acquiring right now is really good talent, and there's a lot of talent available right now.

Q

Yeah. And, Joel, I appreciate the comment about the fixed versus variable. And, Dave, I assure you I will get to you in a moment. But, Joel, from a competitive standpoint, obviously, big competitor, Chapter 11 filing, that kind of thing, smaller competitors from my understanding, there are more to come particularly, it sounds like on the West Coast. Can you kind of give a little bit of color about kind of what you're hearing from customers? And obviously, we have a situation. We have competitors that are challenged maybe as they go through a period of cost cutting, and then ultimately that turns into maybe some market share gains for Quad and that sort of thing. Can you kind of give us a sense of where you see the industry right now?

J. Joel Quadracci
Chairman, President & Chief Executive Officer, Quad/Graphics, Inc.

A

Yeah. Look, I mean, it's no secret that the industry has been a tough industry, and that's driven a bunch of consolidation over time. But ultimately, what we look at it is we're really competing with the big agencies now, and all the different things that our customers are trying to do is really provide an integration of all the marketing aspects that they need. And, by the way, that always drives a lot of print. So, print isn't disappearing. It's gone through decline, but it's very hard to execute for the clients when they're looking for much more when you're just a printer, and we recognized that quite a while ago, which is a big reason why we've followed what our customers want, and that's the 3.0 execution.

Q

I appreciate that. Dave, if I could turn to you. Obviously, the revenue and demand decline is what it is. But obviously, the margin performance of the quarter, one of your stronger ones in recent years, can you kind of talk a little bit more about – and Joel alluded to this, but can you talk a little bit more about kind of how you view the cost structure of Quad from a fixed versus variable perspective?

David J. Honan
Chief Financial Officer & Executive Vice President, Quad/Graphics, Inc.

A

Yeah. Absolutely. Joel touched on it, but when we saw what was coming with the pandemic, there was just a lot of uncertainty in most of our customer base, our vendor base, and we just moved very quickly at that point in time. And that's really stemmed in the lean enterprise environment that our operating team has established at Quad.

That strong lean enterprise just really teaches you foundationally that treat every cost as a variable cost so that you can adjust really rapidly to changing conditions. And in the print industry, where a bulk of our revenue base is, you have to operate that way. And so, at year in, year out, this is the way this company is [ph] kind of (36:46) built, its [ph] foundational (36:47), its belief. And so, really going after our cost structure right away in order to preserve cash because we're intent of continuing to deleverage even through these difficult times and keep a lot of liquidity in the structure that Joel referenced to be able to take advantage of opportunities that come out of economic disruption. So that we believe that will keep us on strategy as we continue to innovate and provide great new products and services and talent for our customers.

Go ahead, Joel.

David J. Honan
Chief Financial Officer & Executive Vice President, Quad/Graphics, Inc.

A

Yeah. And I'd say, [ph] Jamie (37:21), the other thing is we always say, hope is not an operating strategy. And when you get into a crisis like a pandemic, we've learned that slamming the brakes hard quickly is the right way to go. And if you go too far, you can always build it back. But that has the benefit of getting you out of the crisis mode quicker. So, you think about the pandemic when everyone entered it, everyone's in crisis mode and for a long period of time. But if you slam the brakes hard upfront, even though you're still in the crisis, your team can kind of switch gears and not feel like you're in crisis mode, and that's where we were able to continue to focus on moving the transformation forward and winning signature.

David J. Honan
Chief Financial Officer & Executive Vice President, Quad/Graphics, Inc.

A

As it relates to cash generation, and that's really important for us now and that goal for deleveraging. I touched on a few points in my prepared comments about things we're doing around cash generation and it starts with foundationally what we just talked about in addressing costs from a very – and making – treating all costs as if they're variable to drive good cash flow despite an overall decline in the dollars of EBITDA.

We're a seasonal business. And I think if there's a mixed blessing in all this, is the most impact that hit us was during our seasonal low point. We're optimistic as is some of my commentary about some improvement in the rate of decline in sales moving forward as we reach our seasonal peak, which is our customer seasonal peak for promotional activities. So, I think some of the volume decline hitting us during our seasonal low point actually gives us some optimism as we look to the future. Again, very cloudy, but we see as economy continues to gradually reopen and re-establish itself, we can see volume and cash flow pressures lessen as the year goes on.

The other thing – and we mentioned it on our last call, but I think it's really important when you look at our ability to deleverage, is the CARES Act had some important provisions in it, one, which is pretty well-known which is just the deferral of Social Security payroll tax into 2021 and 2022, that's had a nice impact for us. But also the ability under the tax law to carry back net operating losses in the years where the statutory rate was 35% versus our current 21%. We filed our 2019 return, and we expect to see, based on the CARES Act provisions, well over a $40 million impact – positive impact to our cash flow once those refunds come in for the rest of the year. So, the CARES Act has actually had a very significant impact for us this year. Some of that is deferred into next year, into 2022. But the ability to carry back NOLs is a big deal for companies like us.

Q

Dave, appreciate that. And Joel, last one, e-commerce, Brad Jacobs, the CEO of XPO Logistics, which is big transportation and logistics provider for a lot of e-commerce folks, can you – and I know this has been a trend over the last couple of years for you guys, can you kind of give us a refresher in terms of how your conversations with e-commerce customers and that kind of stuff have gone around the catalog as being an integral piece of kind of the...

J. Joel Quadracci
Chairman, President & Chief Executive Officer, Quad/Graphics, Inc.

A

Sure.

Q

...the e-commerce marketing puzzle?

J. Joel Quadracci
Chairman, President & Chief Executive Officer, Quad/Graphics, Inc.

A

Yeah. I'll just remind you that the original catalogers, the L.L.Beans of this world were the original multichannel marketers. They were primarily in catalog. But when dot-com came along, they have discovered that print really drove a lot of their traffic as they tried to experiment with pulling back on print. And so, we've had significant e-commerce companies that we're engaged with rediscover print. And it's interesting because when they do, they're amazed at the responsiveness especially at a time where the digital space is very crowded and going through lots of change where their responsiveness has actually gone down.

And so, you're seeing it with a lot of the direct-to-consumer guys, but some significant e-commerce companies are rediscovering it and rediscovering it quickly. And from a 3.0 standpoint, they don't necessarily come with the legacy knowledge base of how to execute on it. And so, that's where they really rely on the services we have that we've built on 3.0, whether it's on-site dealing with content creation as well as the execution that – and then also learning how to take the data they have from online and using print to personalize, which for many of them, is a whole new experience in the legacy channels. So, it's an interesting thing that's going on, and I think we'll continue to see that segment grow.

Q

Appreciate your time as always.

J. Joel Quadracci
Chairman, President & Chief Executive Officer, Quad/Graphics, Inc.

A

Okay. Thank you, [ph] Jamie (42:25).

David J. Honan
Chief Financial Officer & Executive Vice President, Quad/Graphics, Inc.

A

Thank you, [ph] Jamie (42:25).

J. Joel Quadracci
Chairman, President & Chief Executive Officer, Quad/Graphics, Inc.

A

Operator?

Operator: And ladies and gentlemen, at this time, I'm showing additional questions. I'd like to turn the conference call over to management for any closing remarks.

J. Joel Quadracci
Chairman, President & Chief Executive Officer, Quad/Graphics, Inc.

[ph] All right (42:36). Thank you. And thank you everyone for joining today's call. I just want to close by thanking and again, and recognizing our employees for their hard work and sacrifices during this incredibly disruptive time.

You really have my sincere appreciation for the work you do each and every day to create a better way for our clients and ourselves. In short, you are amazing. And thank you for all you do. Have a good day, everybody.

Operator: Ladies and gentlemen, with that, we will conclude today's conference call. We thank you for joining today's presentation. You may now disconnect your lines.