

03-May-2023

Quad/Graphics, Inc. (QUAD)

Q1 2023 Earnings Call

CORPORATE PARTICIPANTS

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Quad's First Quarter Conference Call. During today's call, all participants will be in 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 on the Investors section of Quad's website under the Events & Recent Presentations link.

After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note, this event is being recorded.

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

Katie Krebsbach

Manager-Investor Relations, 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 Tony Staniak, Quad's Chief Financial Officer. Joel will lead today's call with a business update, and Tony will follow with a summary of Quad's first quarter 2023 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, adjusted diluted earnings per share, free cash flow, net debt 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.

Joel Quadracci

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

Thank you, Katie. And good morning, everyone. Beginning on slide 3, I am pleased to report we continue to experience positive momentum in our business, achieving an eighth consecutive quarter of top line growth. Net sales increased 3% in the quarter due to higher print product sales in the United States and in Mexico, and also increased Agency Solutions sales as clients continue to embrace Quad's unique integrated marketing offering.

We also grew adjusted EBITDA by \$11 million or 24% in the quarter due to increased profitability from net sales growth, improved manufacturing productivity, and savings from cost reduction initiatives. Economic uncertainty has prompted some clients to take a more conservative approach to the start of the year and, in many instances, reallocate where they invest their marketing dollars. Our integrated marketing offering easily supports these shifts in marketing spend to maximize results.

We were able to offset softness in offerings such as national magazines while leaning into growth opportunities and other offerings like agency solutions, packaging, and in-store. We have flexibility and agility to pivot and meet changing client needs.

In the current economic environment, we continue our longstanding disciplined approach to managing all aspects of our business, including treating all costs as variable, and aligning our cost structure with revenue opportunities. At the same time, we are aggressively pushing forward on our growth strategy as a marketing experience or MX company that services marketers' needs from end to end, solving their biggest marketing challenges.

Turning to slide 4, our leadership as an MX company was validated once again last week through our ranking on the world's largest agency companies list compiled annually by Ad Age. This year, Quad ranks number 14, up two spots from our number 16 ranking in 2022. We're also proud to share that once again Quad just received top-tier designation as a Microsoft Elite Agency Partner and Google Premier Partner through our digital marketing agency Rise Interactive.

On slide 5, we show Quad's three key growth drivers, delivering integrated service excellence, accelerating market penetration, and evolving our culture as an MX company. Integrated service excellence is at the core of who we are and what we do. We continue to build on our uniqueness as a marketing experience company that helps brands reimagine their marketing to be more streamlined, impactful, flexible and frictionless.

Our integrated offering provides all the resources our clients need to plan, create, deploy, measure, and optimize their marketing efforts across all media channels, offline and online. As a result, we reduced the complexities of working with multiple agency partners and vendors, and increased the efficiencies of marketing processes. We do all this while maximizing the effectiveness of our clients' marketing efforts through our ability to target and reach the right audiences, scale resources efficiently, increase speed to market, and optimize media performance.

Turning to slide 6, to accelerate market penetration, we are focused on growing awareness that better marketing is built on Quad. We're gaining visibility with new brands and new verticals, including blue-chip companies, through our participation in industry events. For example, we recently participated in Shoptalk for retailers and SPC Impact, the Sustainable Packaging Coalition spring event, where we connected with brands and marketers about their marketing challenges and how Quad could solve these challenges.

In June, we will return to the Cannes Lions International Festival of Creativity, where we'll showcase our better marketing is built on Quad, share our innovation story, and strengthen relationships with marketing decision-makers from around the world.

Amid these efforts, we also continue to host events focused on specific timely topics of interest to our clients. For example, last week, we hosted our 23rd [indiscernible] (00:06:28) Conference with approximately 300 clients participating. The event focused on knowledge sharing and solutioning around delivering print cost effectively to the right audience.

As we evolve our culture as an MX company, we are leveraging our longstanding maker culture as a distinct talent advantage. At Quad, our employees are empowered to not only envision solutions, but also create or make them in support of our work to expertly guide brands through every effort intended to drive action from consumer awareness and trust to brand preference and purchase as shown on slide 7. We will continue to capitalize on all aspects of our distinctive maker culture to differentiate Quad as the workplace for the marketing industry's best talent.

Turning to slide 8, we show an example of how we're helping brands and marketers successfully solve their marketing challenges with their integrated marketing offering. Jelmar, a respected leader in the wholesale cleaning products industry and well-known for its CLR and Tarn-X brands, recently was seeking a trusted partner for brand-building work. The company wanted us to review and enhance its strategy for engaging consumers, especially digital natives, as it attempted to extend the equity of its flagship cleanser to a portfolio of CLR branded products.

Our team presented comprehensive creative and media strategy for engaging audiences across channels, including linear TV, over-the-top streaming, programmatic, search, social, and CLR's website. Our work is just now getting under way to provide consumer strategy, brand identity, creative positioning, and campaign execution, as well as cross-channel media management and customer experience.

A key feature of our digital media solution is our proprietary Connex technology, which will allow Jelmar to not only be able to uncover performance trends by audience, creative, production, and location, but also identify specific growth opportunities, and take immediate actions minute by minute to accelerate media performance. We are pleased to be supporting Jelmar's efforts to ignite its brand and drive demand as its marketing agency of record.

On slide 9, we show another example of how better marketing is built on Quad. Recently, a senior care services provider invited our Rise Interactive digital marketing agency to bid on three separate RFPs for media planning and placement, search engine optimization, and web development. The company was surprised and delighted to learn we could expertly address all these needs through our integrated offering, and do not have to coordinate efforts with multiple vendors, something the company did not believe was possible.

As we engaged with the company, we learned it also needed help with branding and creative execution, and we won that work, too, along with niche services such as talent management rights. With our assistance, the client is benefiting from our ability to help rebuild enrollment, build category awareness, overcome negative misconceptions, reach qualified audiences within specific ZIP codes using hyperlocal media strategy, and find the right message and media to connect with geographically and culturally different audiences using our proprietary Connections Planning tool.

Our client is extremely pleased with our results, which include driving more leads than it has ever before experienced. We are glad to be a trusted partner to this client, and look forward to introducing our other integrated services, including direct marketing and expanded audience targeting.

As we move forward with our strategy, I have great confidence in our team and continue to be enthusiastic about our growth opportunities as an MX company that provides a better way to solve marketers' biggest challenges, which drives revenue across all of our offerings.

Before I turn the call over to Tony, I'd like to thank our employees for their continued hard work and commitment to performing well for our clients while we proactively manage all aspects of our business for long-term strength and stability.

I will now turn the call over to Tony for the financial review.

Anthony C. Staniak

Chief Financial Officer, Quad/Graphics, Inc.

Thanks, Joel. And good morning, everyone. On slide 10, we show our diverse revenue mix. During the first quarter, our net sales increased 3% from the first quarter of 2022, driven by growth in our Mexico operations, catalogs and our agency solutions offerings. These increases were partially offset by expected organic declines in large-scale print, as well as reduced sales from the December 2022 divestiture of our Argentina operations. Despite the organic decline in large-scale print, we continue to gain segment share, including winning Reader's Digest, the fourth largest circulation magazine in the United States.

Slide 11 provides a snapshot of our first quarter 2023 financial results. We started the year strong with adjusted EBITDA of \$60 million in the first quarter of 2023, a 24% increase as compared to \$49 million in the first quarter of 2022, and adjusted EBITDA margin improved from 6.5% to 7.9%. The increase in adjusted EBITDA was due to increased profitability from net sales growth, improved manufacturing productivity and savings from cost reduction initiatives. Adjusted diluted earnings per share increased to \$0.15 in the first quarter of 2023, as compared to \$0.04 in the first quarter of 2022, primarily due to higher adjusted net earnings.

Earnings per share were also benefited by the company's repurchase of more than 5% of our total outstanding common stock since the second quarter of 2022 for \$10.3 million. Free cash flow was negative \$79 million in the first quarter of 2023, a \$43 million decrease compared to 2022, primarily due to the timing of working capital and \$29 million in capital expenditures to invest in our platform for further sales growth and automation efficiencies. As a reminder, the company historically generates the majority of its free cash flow in the fourth quarter of the year, and expects \$50 million to \$90 million of free cash flow in 2023.

Slide 12 includes a summary of our debt capital structure. Net debt increased by \$87 million to \$632 million at March 31, 2023, as compared to \$545 million at December 31, 2022. And the debt leverage ratio increased 23 basis points to 2.39 times at the end of the first quarter. The increase in net debt and the debt leverage ratio was primarily due to the investments in working capital, talent and equipment to enable continued sales growth. We are expecting to achieve the low-end of our long-term targeted debt leverage range of 2 to 2.5 times by the end of 2023.

As of March 31, our blended interest rate was 6.6%, a 2-point increase from 4.6% a year ago. To mitigate the impact of the rising interest rate environment, we entered into two interest rate collar agreements effective February 1, 2023. Including interest rate swaps, our debt is 53% floating, and 47% fixed. We maintained our strong liquidity with up to \$321 million of availability under our revolving credit agreement, as well as \$9 million of cash on hand. Our nearest significant debt maturity is \$88 million occurring in January 2024, with the majority of our debt maturities not due until late 2026.

We reaffirm our 2023 guidance as shown on slide 13. We are pleased with our first quarter net sales growth as clients continue to embrace our innovative and integrated marketing offering. However, due to continued macroeconomic concerns, we expect lower print volumes during the remainder of the year. Adjusted EBITDA and free cash flow will be lower in the first half of 2023 compared to the second half of 2023 due to the seasonality of the business and increased capital expenditures. The majority of our capital expenditures will occur in the first half of the year, so we can benefit from these investments in the second half of the year during our peak seasonal period.

Slide 14 includes our key investment highlights as we continue to build on our growth momentum as a marketing experience company. We believe that Quad is a compelling long-term investment, and we remain focused on growing net sales and driving profitability through continued diversification of our revenue and clients in the higher-margin offerings.

With our expanded offerings, there is a significant addressable revenue opportunity with both our large base of existing clients as well as new clients. We will also generate strong free cash flow, and use it to reduce net debt to achieve the low-end of our long-term target leverage range of 2 to 2.5 times by the end of 2023. We expect net debt to be approximately \$470 million by the end of the year, representing a \$564 million or 55% reduction in debt since January 1, 2020 when our debt was over \$1 billion.

And with the significant debt reduction, we will further strengthen what we believe is an industry-leading financial foundation that provides us the flexibility to strategically deploy capital, including scaling the growing parts of our business, such as agency solutions and targeted print, while returning capital to shareholders to drive shareholder value.

With that, I'd like to turn the call back to our operator for questions.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions]

Anthony C. Staniak

Chief Financial Officer, Quad/Graphics, Inc.

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Sorry, operator. Do we have any questions in the queue?

Operator: We do not have any questions in the queue at this time. [Operator Instructions]

Joel Quadracci

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

Okay, operator. It looks like people are making it easy on us today. And so, with that – this is Joel. I just want to thank everyone for joining today's call. And I want to close by reiterating my confidence in our team and our strategy, and our future as a marketing experience company. Our integrated marketing offering continues to be a competitive differentiator and a key driver behind our company's overall organic growth.

With that, thank you again, and have a good day. We look forward to speaking with you again next quarter.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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