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Quad/Graphics, Inc. (QUAD)

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to Quad's Fourth Quarter and Full-Year 2023 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 on the Investors section of Quad's website under the Events and 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 call 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 fourth quarter and full-year 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 delivered solid 2023 results, meeting our guidance across all metrics. Our results included adjusted EBITDA above the midpoint of our guidance range and adjusted EBITDA margin consistent with 2022, despite an 8% decline in annual net sales, created by a significant postal rate increase that was well above the rate of inflation, ongoing economic uncertainty, especially in early 2023, and the impact of elevated interest rates on our financial services sector, leading to reduced direct mail budgets. I will share more detail on our net sales breakdown shortly.

We ended 2023 with strong free cash flow that was near the high-end of our guidance range and used our cash generation to further strengthen our balance sheet, reducing our net debt leverage to 2 times, our lowest leverage level since 2017. Since January 1, 2020, we have paid off $564 million in debt, a 55% reduction over four years. Through 2023, we also continued to return capital to shareholders through share repurchases. We will continue to be opportunistic in terms of our future share repurchases. And as we announced last week, we have reinstated a quarterly dividend of $0.05 per share.

We remain confident in our ability to address business impacts, including long-term expected organic declines in large-scale print due to our well-established and disciplined approach to managing all aspects of our business. This includes treating all costs as variable, aligning our cost structure to revenue opportunities, and optimizing our print manufacturing platform by consolidating work into plants where we can achieve the greatest manufacturing efficiencies and subsequently selling assets no longer required for business operations. At the same time, we continue to aggressively push forward on our growth strategy as a marketing experience or MX company.

The three pillars of our growth strategy are outlined on slide 4 and include delivering integrated service excellence, which we achieve by focusing on solving problems, removing pain points and sources of friction from the marketing process, and providing transparency on clients' marketing expenditures, accelerating market penetration in key verticals and product lines with the greatest expansion opportunities, and continuing to leverage our unique company culture, which is based on honesty and transparency to grow as an MX company.

On slide 5, we show how we continue to make progress in our revenue diversification strategy into higher value, higher margin offerings. Between 2018 and 2023, integrated solutions and targeted print increased as a portion of total net sales and now represent 63% of net sales, an increase from five years ago when they accounted for 54% of net sales. Our integrated solutions include agency solutions, while targeted print comprises catalogs, direct mail, packaging, and in-store signage and displays; large scale print, which includes retail inserts, magazines, and directories and continues to decrease as a percentage of total net sales due to organic declines. The increase in our international locations is primarily driven by stronger sales in Latin America, especially in Mexico, a strategic extension of our US platform.

Moving on to slide 6, we achieved client service excellence and distinct competitive advantage through our suite of flexible, scalable, and connected MX solutions. These solutions span every facet of the marketing journey from offline to online, across creative production and media, and supported by data-driven intelligence and state-of-theart technology. We tailor each of these solutions to client objectives driving cost efficiencies, improving speed to market, strengthening marketing effectiveness, and delivering value on investments.

Quad's data-driven intelligence solutions empower smarter decisions to maximize marketing effectiveness and generate quantifiable impact, while our client facing AI-driven technology solutions remove friction in the marketing process by helping clients connect marketing strategy, global content creation, analytics and personalized communications across online and offline channels. We have long employed artificial intelligence and robotic process automation and cognitive insights and continue to explore new ways to apply generative AI across internal workflows and client-facing solutions.

Our creative solutions help clients increase engagement with their brands to accelerate business growth, support all channels through every step of the creative process, including strategy, brand design, campaign ideation, pre-media, adaptive design, and content creation.

As far as production, Quad offers a wide range of production solutions for deploying content to all channels, offline and online. This is a major point of differentiation among our competitive set. Traditional agencies or agency holding companies develop creative and then outsource production, while traditional consulting firms provide strategy and then outsource implementation. Quad, however, is able to strategize, create, and execute all campaign elements across all channels using our own internal resources, providing a more efficient marketing experience for our clients, and a better experience for the consumer.

And lastly, for our media solutions, we provide strategic omnichannel media planning and placement, managing hundreds of millions of dollars of media billings annually. All our media solutions prioritize transparency and neutrality, so our clients could feel confident that their media spend is supported by the best data, platform, and partners for their unique needs to generate measurable impact.

As I shared with you on last quarter's call, Joshua Lowcock, a well-respected and experienced leader in global media and data, joined Quad as President of Media. Since joining us a few short months ago, he has quickly set about implementing the next evolution of our audience targeting and media engagement offering, which will improve our competitiveness and drive revenue growth. This next evolution aligns our data and analytics offering with our media and planning offering as shown on slide 7.

By doing this, we are integrating audience identification abilities anchored on Quad's proprietary household data offering with planning and measurement across all forms of client media; online, offline, in-home, or in-store. The value to our clients will be superior audience identification and fully integrated planning, placement, and measurement to optimize spend in almost real time. This integrated offering is the foundation of a new Quad Media offering, grounded in our unique household insights and data capability that we will be bringing to market soon.

Another area in which we are strategically investing is retail media networks. Earlier this month, we announced our acquisition of DART Innovation, an in-store digital media solutions provider to further build on our retail expertise and offerings, as shown on slide 8. With DART's capabilities and technology, we aim to revolutionize the shopping experience for retailers, consumer packaged goods companies, and consumers by delivering targeted promotions on digital screens right at the store shelf, the most critical moment in the purchasing decision. The strategic investment expands and seamlessly integrates into our suite of MX solutions and enables an integrated consumer purchasing journey across home, online, and in-store. Retailers are highly interested in our offerings in this space, and we are already leveraging DART's capabilities to launch the first phase of our rollout with the same mark companies, the largest private grocery retailer on the West Coast.

Turning to slide 9, we also continue to innovate solutions in our core print business, especially postage optimization programs, to help offset ongoing significant postal rate increases. Postage makes up the largest portion of cost for our print clients as compared to paper and manufacturing. The US Postal Service continues to pursue what we believe is a flawed strategy of implementing enormous postal hikes in attempt to make up for billions of dollars in annual losses. This strategy is driving away the very volume that supports its existence. In the last year alone, mail volumes have plummeted by 11 billion pieces, according to the USPS data. This is primarily due to the cumulative effect of postal rate hikes. We expect to see additional volume reductions if this unsound strategy is not fixed, as our clients cannot continue to absorb massive rate increases, some of which have totaled as much as 57% over the last three years, more than triple the rate of inflation.

We are urging swift action to preserve the affordability of the printed mail channel before potentially has to undergo a massive taxpayer bailout. We have been working with members of Congress, White House staff, and our client base to moderate these increases. This effort is important as the postal service is at the core of a $1.9 trillion mailing industry that provides family-supporting jobs for 7.9 million Americans and is the backbone for a large portion of the private sector. We will share updates on our efforts to address this crisis, including the launch of a new dynamic postal optimization program at our 23rd Postal Conference next month.

Turning to slide 10, we are pleased to show how we're growing our presence with well-known brands with a particular focus on commerce, which includes retail, consumer packaged goods and direct to consumer, financial services, health, and publishing. These reputable, well-known brands include Amazon, Walmart, Red Bull, American Express, Abbott Labs and more and are all admired for their excellence and the loyalty they have built with consumers. We take great pride in knowing they trust us to help deliver in their marketing vision.

On slide 11, we show an example of how we are using our connected solutions to improve consumer response rates and revenue for leading brands and marketers. Wolverine Worldwide, one of the world's leading marketers and licensors of branded footwear and apparel, including Merrell, Saucony and Wolverine, had used direct mail successfully for many years, but over time started seeing a decline in its effectiveness. The company had considered reducing or altogether eliminating direct mail to focus exclusively on digital campaigns for growing and strengthening consumer connections. We partnered with Wolverine Worldwide to optimize its direct marketing performance, conducting pre-market testing, and integrated campaign support. We used Accelerated Marketing Insights, our proprietary pre-market testing platform, to research different messages and creative treatments for consumer preference and to build an audience-influenced messaging hierarchy. Our testing included multiple variables in more than 1,400 different combinations to assemble the optimum content and design for a challenge our direct mail piece to outperform existing content already in market.

We also leveraged Informed Delivery, a US Postal Service solution that lets consumers preview upcoming mail deliveries and email to send digital challenger ads to the same target audience online and via social media. The results were exceptional. Year-over-year, we were able to help Wolverine achieve nearly double its response rate. The client also doubled conversion rates, thanks to more effective, digital, creative and messaging, accomplishing twice the click through rate and increasing sales, an incredible 261% per buyer. We look forward to continue to work with Wolverine to increase engagement between its brands and consumers to accelerate business growth.

On slide 12, we show an example of how our flexible, scalable, and connected solutions are helping Rural King, a farm and home retailer with 135 stores across 13 states, increase marketing efficiency and effectiveness. We have been steadily expanding our relationship with Rural King since 2016 when we started printing its retail ad inserts. Soon thereafter, we added media planning and placement for our inserts, eventually become the retailer's full media agency of record in 2020. Since then, we have expanded our relationship to include creative development and execution for all channels, including linear and connected TV, radio, display, YouTube and social; robust data and analytic solutions, including the use of our proprietary tool for optimizing cross-channel marketing spend; a custom dashboard for tracking real-time channel performance and media mix modeling services that transparently detail marketing return on investment; and our proprietary content management system that enables content at scale across marketing channels.

Rural King also uses our data and analytics capabilities to conduct brand health measurement, tracking perception and reputation among consumers along with performance in the marketplace. Our data and analytics expertise is important to Rural King, as our – is our integrated service approach, which includes a single point of contact for all Quad services. This offering removes the complexity of working with multiple vendors and partners, enabling Rural King to focus on delivering the best consumer experience. We value our relationship and look forward to continue to partner on new initiatives, including brand positioning work this spring.

Turning to slide 13, for more than 52 years, Quad has worked to create positive, sustainable impact at our company and in the communities where we live and work. Recently, our work on our two notable recognitions. Quad was a finalist in the Greater Good Awards presented by Digiday, Glossy, Modern Retail and WorkLife for our ongoing support of social causes, including staff empowerment, extracurricular programs, and community partnerships. And members of our Corporate Responsibility team were recently recognized by Milwaukee-based Uplifting Impact for their efforts to advance inclusive leadership at Quad.

Before I turn the call over to Tony, I would like to thank our employees for their commitment to performing well for our clients, while we proactively manage all aspects of our business for long-term strength and stability. I have great confidence in our team and continue to be enthusiastic about our growth opportunities as an MX company.

I'll now turn the call over to Tony for a financial review.

Anthony C. Staniak

Chief Financial Officer, Quad/Graphics, Inc.

Thanks, Joel, and good morning, everyone. Slide [Technical Difficulty] (00:18:06) snapshot of our fourth quarter and full-year 2023 financial results. Net sales were $788 million in the fourth quarter of 2023, down 11% from 2022. For the full year, net sales were $3 billion, down 8% from 2022. The net sales decline was primarily due to lower print, paper, and logistics sales, as well as the 2022 divestiture of our Argentina print operations. Trade volumes were negatively impacted by ongoing external headwinds, including significant postal rate increases, economic uncertainty, and the effect of elevated interest rates on specific clients.

Adjusted EBITDA was $66 million in the fourth quarter of 2023, as compared to $79 million in the fourth quarter of 2022. And adjusted EBITDA margin declined to 8.3% in the fourth quarter of 2023, compared to 8.9% in the fourth quarter of 2022. For the full year, adjusted EBITDA was $234 million in 2023, compared to $252 million in 2022. However, adjusted EBITDA margin improved from 7.8% to 7.9%. The decrease in full-year adjusted EBITDA was primarily due to $11 million of lower pension income, as well as the impact of lower sales, partially offset by benefits from improved manufacturing productivity and savings from cost reduction initiatives.

Adjusted diluted earnings per share was $0.23 in the fourth quarter of 2023, as compared to $0.41 in the fourth quarter of 2022. For the full year, adjusted diluted earnings per share was $0.52 in 2023, compared to $0.89 in 2022. The decline was primarily due to lower adjusted net earnings and was partially offset by the positive impact from share repurchases. In the fourth quarter, we continue to return capital to shareholders through share repurchases. And since the second quarter of 2022, we have repurchased 5.9 million shares or approximately 11% of our outstanding shares for a total purchase price of $23 million.

Free cash flow was $77 million in 2023, compared to $94 million in 2022. The decline in free cash flow was primarily due to an $11 million increase in capital expenditures as we continue to invest in innovation and automation initiatives. During 2023, we invested $71 million in capital expenditures to drive efficiencies.

In addition to free cash flow, we also continue to generate significant cash from asset sales as shown on slide 15. During the five-year period from 2020 to 2024, we expect we will generate over $700 million of free cash flow and proceeds from asset sales. These sales include divestitures of certain non-core portions of our business, as well as sales of property, plant, and equipment from closed facilities such as our Merced, California print building that we sold in 2023 for net proceeds of $19 million. Beginning in the fourth quarter of 2023 and into the first quarter of 2024, we have announced the closure of an additional four owned facilities, from which we will generate greater proceeds from asset sales.

This strong cash generation fuels our capital allocation strategy, as shown on slide 16. Our capital allocation priorities include using free cash flow and cash proceeds from asset sales to invest in scaling our offerings as a marketing experience company such as the acquisition of DART, continued debt reduction, and return capital to shareholders. As announced last week on February 16, our board of directors reinstated a quarterly dividend of $0.05 per share or $0.20 per share on an annualized basis. We are pleased to return capital to shareholders through the quarterly dividend, and we also expect to continue to be opportunistic in terms of our future share repurchases.

We show our commitment to debt reduction on slide 17. As part of our multi-year debt reduction strategy, at the end of 2023 we reduced net debt by $564 million, a 55% reduction from over $1 billion of debt we had on January 1, 2020, and we reached 2.0 times debt leverage, which was the low end of our previous long-term targeted leverage range. We intend to further reduce debt leverage to approximately 1.8 times by the end of 2024. We also are lowering our targeted debt leverage range by a quarter turn to now be 1.75 times to 2.25 times.

Slide 18 includes a summary of our debt capital structure. At the end of 2023, our net debt was $470 million, our blended interest rate was 6.9%, and our debt was 44% floating and 56% fixed. In early 2024, we generated $53 million of cash by successfully increasing the commitment with one of our banks to add $25 million to our term loan and by entering into $28 million of leases for two large printing presses instead of purchasing those presses outright. We then used our revolving credit facility and cash on hand to repay an $88 million term loan in maturity and at the same time, the total capacity under our revolving credit facility decreased by $90 million to $343 million. With the step down in debt complete, our next nearest significant debt maturity is now in November of 2026.

On slide 19, we have included our 2024 financial guidance. Annual net sales are expected to decline 5% to 9% compared to the prior year. The decline in net sales is primarily due to expected organic declines in certain product lines, heightened by significant postal rate increases. In addition, our net sales guidance will be impacted by the ending of a longstanding relationship with a large grocery client. Our relationship with this client concludes at the end of this month and represented approximately 3% of our 2023 net sales. While the loss of any client is disappointing, our revenue is highly diversified with no single client representing more than 5% of our annual revenue. We have a large base of over 2,700 clients that provides sales growth opportunities as we continue to expand our offerings as a marketing experience company.

Full-year 2024 adjusted EBITDA is expected to be between $205 million and $245 million, with $225 million at the midpoint of that range, representing a $9 million decline from 2023 adjusted EBITDA, but a 28 basis point improvement in adjusted EBITDA margin to 8.2% due to benefits from improved manufacturing productivity and savings from cost reduction initiatives. These cost reduction initiatives include the closures of our Sacramento, California; Effingham and Bolingbrook, Illinois; and Saratoga Springs, New York facilities, as well as other labor reductions in production and SG&A. These decisions, while difficult, are expected to result in $60 million of annual cost savings.

From a quarterly perspective, we anticipate our lowest adjusted EBITDA to be in the first quarter of 2024 as the benefits from the cost reduction actions will reach their full annualized amount late in the second quarter of 2024. We then expect improved adjusted EBITDA in the second half of 2024 due to the full benefit of the restructuring actions combined with higher sales during our seasonal production peak. We expect 2024 free cash flow to be in the range of $50 million to $70 million, with $60 million at the midpoint of that range, representing a $17 million decline compared to 2023. In 2024, free cash flow will be most impacted by higher restructuring payments, particularly in the first half of the year due to the recent plant closures and other labor actions. The higher restructuring payments and the reduction in cash flow from lower net sales will be partially offset by improvements in working capital, lower interest payments due to our debt reduction, and lower capital expenditures.

Capital expenditures are expected to be in the range of $60 million to $70 million, approximately $6 million lower than 2023 at the midpoint of our 2024 guidance range. We expect our free cash flow to be augmented by cash proceeds from asset sales, the extent of which will be based on the timing of selling the buildings that we recently announced for closure. With our strong cash generation, we will continue to prioritize debt reduction and expect to further reduce our net debt leverage ratio to be approximately 1.8 times by the end of 2024, near the low end of our new long-term targeted net debt leverage range of 1.75 times to 2.25 times.

Slide 20 includes our key investment highlights as we continue to build on our momentum as a marketing experience company. We believe the Quad is a compelling long-term investment made even more compelling with the recently announced quarterly dividend. And we remain focused on growing net sales and driving higher profitability through continued diversification of our revenue and clients, with our expanded offerings as a marketing experience company, including investments in new offerings such as in-store digital promotions with the DART acquisition. There is a significant addressable revenue opportunity with both our large base of existing clients as well as new clients.

In addition, our successful multi-year debt reduction strategy, including achieving 2.0 times debt leverage at the end of 2023, provides us increased flexibility in capital allocation. Our focus on debt reduction will not change as that is in the best interest of Quad and its shareholders, as we reduce interest costs in this high interest rate environment and further strengthen what we believe is an industry-leading financial foundation. While continuing to reduce debt, we also now have the capital flexibility to add to the ways we provide returns to shareholders with the reinstatement of the quarterly dividend.

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] The first question comes from Kevin Steinke of Barrington Research Associates. Please go ahead.

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

Morning, Kevin.

Kevin Mark Steinke
Analyst, Barrington Research Associates, Inc. Q

Hi, good morning.

Anthony C. Staniak
Chief Financial Officer, Quad/Graphics, Inc. A

Hi, Kevin.

Kevin Mark Steinke
Analyst, Barrington Research Associates, Inc. Q

Good morning. Good morning. Well, thanks for taking the questions and nice job on the fourth quarter results and getting to the low end of your prior leverage ratio range and also was good to see you reduce the targeted range going forward. But I wanted to start out by asking about just the sales outlook as you think about 2024, you mentioned expected organic declines in certain product categories. Maybe just touch on which categories you're expecting the decline and the factors behind that, you talked about interest rates, economics, uncertainty, as well as the postage rate increases. And then as well, can you just kind of touch on what you saw in the various categories in the fourth quarter as well as full-year 2023?

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

Yeah. I think probably – Kevin, this is Joel. The best way for me to kind of walk through that is start with 2023 and we'll kind of go forward with what we can say. And we always talk about large-scale printers where we continue to expect organic decline, especially in retail inserts and it's been a double-digit clip for many years. And that's just one of those lines that we just manage. And we manage it – we manage it down and get great free cash flow from that. So, it's a manageable process.

The thing that happened in 2023 at the beginning of the year, I'd say two themes. One would be economic uncertainty. We were hearing that from our clients. I think everyone was hearing it around the world and that definitely sort of muted a little bit how they were sharing with us their 2023 plans. You could see it being built in. The other part was significant interest rate increases, like as you know and we're that really impacted us hard was on direct mail because we had a pretty big exposure to the financial segment, including one main player exiting the consumer banking business. And so, with large interest rates, you saw a very big pullback in direct mail and especially amongst consumer lending services. So, that's what impacted that.

The second theme that I would say is really important is that the post office decided they were going to – they did a early increase in the first part of the year, but decided to go forward with significant increase in the middle of the year with the combined 10% to 14% increase in our clients biggest cost. Clients did not expect the second one. And so they had already locked in their budgets for the year. And so, whenever this happens, again, it's the biggest cost, we saw the second half significantly decline specifically in catalog and direct mail as a result of the postage increase. This was not digital disruption. This was a significant above inflation increase by the post office.

And so, what happens is they reduced their prospecting mailing pretty significantly right away to make up for it. You have your catalogs, you sell out your existing customers, then you have names you went to try and get customers. Whenever there's a big out of whack increase like this, it's typically a pullback in that and that we saw that the second quarter. I think that when we looked at catalogs for the year, sales was off about 6% year-to-date, but that would be very heavily backend loaded where we saw the decline.

As I roll forward and think about 2024, the post office has announced another significant increase. They just passed along about a 4%, 4.5% couple of weeks back, but they're planning on going forward with a 10% in July. This is absolutely in our belief not a sound strategy because marketing mail is one of the backbones for making the rest of the post office work. And as everyone knows, no one's going to let the post office go away. So, I'm not concerned about losing the ability to distribute through the post office, but everyone should be concerned and that's where we're working with Congress, the White House, et cetera.

Everyone should be concerned that there's going to – they're heading towards a major taxpayer bailout or takeover because right now, postage is what funds the post office by its own. And so, it doesn't make sense. I mean, it's literally triple the inflation rate of what they're trying to do. Over 57% increase in the largest cost in the last three years, it makes no economic sense for anybody. We have that built into our guidance. We put in more expected organic decline due to postage into our guidance. We hope that it changes, but we're managing as if it goes through.

Also, I hinted towards we are about to roll out a major product. We've for many years innovated around doing a lot of work for the post office. And years back, the post office incented our customers to skip most of the post office to give big discounts. And so, we do that in the form of what we call core mailing and skipping a lot of the infrastructure and doing the work for the post office. We've got a new product coming out that potentially could help save people 10% to 20% of their postage costs. So, while not offsetting this inexplicable increase that the post office is doing, but at least helping to make it manageable. And – but I'll reiterate that's built back in.

From an interest rate standpoint on the direct mail side, I'd say we're starting to see some of the core financial segment coming back, maybe not in personal lending, but I'm also seeing people who may have pulled away from direct mail starting to come back in. And we've got several conversations that are very promising because the strength of direct mail, it works. And you've got also a decrease in the effectiveness of digital going on with the deprecation of cookies, et cetera. And so, everyone's looking at the full media mix to try and optimize it, and they're not going to be ignoring print.

Does that make sense, Kevin?

Kevin Mark Steinke
Analyst, Barrington Research Associates, Inc.
Q

Yeah, absolutely. Yeah, that was great color. So, as I think about 2024, it really from your comments, it feels like, it's more – the expected decline is more weighted towards the postal rate increases than perhaps economic uncertainty. Is that fair to say?

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

A

That's the way we're looking at it. I'll remind you, though, that large scale print, we continue to expect double-digit decline and that's what we've been saying for years. But in the areas like catalogs, direct mail, that would be accurate.

Kevin Mark Steinke
Analyst, Barrington Research Associates, Inc.

Q

Okay. And you mentioned working with the government and perhaps trying to reverse or slow this trend of increasing rates. I don't know, obviously, as one of the largest mailers in the US, you probably have their ear a bit. I mean, I don't know, there's – they're getting a lot of pushback, I would suppose, from other large mailers and just wondering what you think your level of influence is or the industry's level of influence. And do you have any sense...

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

A

Yeah.

Kevin Mark Steinke
Analyst, Barrington Research Associates, Inc.

Q

...as to whether they were surprised by these volume declines or they, I mean, what they're thinking is after seeing these volume declines, I guess.

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

A

What we've been told is they don't believe in something called elasticity, that volume declines are because of digital disruption. And if you talk to a lot of mailers out there, they say we went through a lot of the digital disruption, but we still use catalog and direct mail in our mix and that this particular era is about this huge increase in cost. I mean, it would be like telling me that my biggest cost of labor is going to go up 57%. And I have no ability to pass that on to my customers because most of the world is stuck at raising prices somewhere in the CPI range. It's just the math doesn't work.

Now, no one single person can influence this, but we speak on behalf of a lot of different mailers. We work in conjunction with the C21, which is made up of a lot of different groups. I've testified in front of Congress multiple times as we got the post office huge relief just a couple of years ago after working on a bill for 10 years. They save billions of dollars by not having to prefund retirement, healthcare, and things like that. And – but the downside was as they got released from having to cap their postal rates at the same rate that everybody else in the world is capped at, at about CPI and no one thought they would go to extreme levels like this. And it just logically doesn't make sense. You don't run a business this way.

So, we're hitting it. But I will also tell you, there's a lot of big players out there in the non-profit world. Non-profits are getting killed by this. And you think about the AARPs of this world, but there's a lot of other players who do a lot of their own lobbying that you will see a lot of is – right now there's a lot of people screaming and ultimately it's getting Congress' attention and hopefully the board of governors who oversee it to bring some rational behavior to bear. And again, it's not going to go away. But I think that they should be worried about a massive taxpayer takeover, which no one wants because there's too much of that going on.

Kevin Mark Steinke
Analyst, Barrington Research Associates, Inc.

Q

All right. That's helpful. Thank you. I just also wanted to touch on you mentioned there the loss of a long time grocery client, maybe just what happened there.

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

A

Yeah.

Kevin Mark Steinke
Analyst, Barrington Research Associates, Inc.

Q

And if you – how you would expect to maybe kind of backfill that over time.

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

A

Yeah. We will work to backfill. I hate losing clients. This client, we did a lot of complex things for across multiple services. And the two things I'll just say on it is that we need to get paid for what we do. We're not asking to have the world, but we have to get paid for what we do with all these complex services we do. And I'll also say that this customer is also managing through some very significant complexities of their own. So, I'll leave it at that.

Kevin Mark Steinke
Analyst, Barrington Research Associates, Inc.

Q

Understood. I mean, yeah, that's kind of what I was thinking maybe you touch on is perhaps the profitability wasn't there. So, maybe it's not as significant or large of an impact to your profitability is perhaps your revenue.

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

A

Yeah. I just think it's just so important for my employees and my shareholders that as we invest in all these things, that we get paid a fair price. That's all we ask, get paid for a huge benefit we're giving people by providing all this integration, postal savings, all the different things that we do. And so, sometimes that results in answer you don't like. But the best answers for the long term of my company.

Kevin Mark Steinke
Analyst, Barrington Research Associates, Inc.

Q

Understood. Great. So, I also wanted to talk about agency solutions, your end to end marketing solutions and the demand you're seeing there. I think you mentioned a strong business pipeline. So, maybe what you're seeing on that front if that continues to be resilient in kind of these uncertain economic times.

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

A

Yeah. I'd say that the pipelines are actually it's heating up nicely, because remember, we just relaunched our brand a year ago and a lot of this is about opening up the aperture to clients we never had access before. And so, we really weren't direct to CPG and things like that. We weren't always in the agency space or viewed as it of providing media solutions. And so, we really ramped that up this past year. I mean, a couple of years ago, I'd never tell you – I'd never thought I'd be telling you that we're redesigning the brand look titled as Pro V1. When you look at what we shared about Wolverine today, think of this as a flywheel. It's not just an agency solution I want to win. It's I want to win the relationship. And any entry point is a great entry point. So, Wolverine, we entered and were able to suddenly offer them quite a few different products and services to solve their problem.

I'd like to see if we enter into a creative space with someone that suddenly then we're talking about how – for packaging, for instance, how does then that package appear on in-store. Let's talk to our in-store people. by the way, with our retail media network we're launching, as we start to help manage your media spend, we'd love to take the data that comes out of the retail media network to sell CPGs on advertising within the store with eyeballs, but then using the data that we get out of that experience to further go after new audience. And so, think of this all as a big flywheel that's speeding up and it's creating a lot of revenue and will create revenue across a lot of the print channels as well, especially in targeted print and I think Wolverine is a great example of that.

Kevin Mark Steinke
Analyst, Barrington Research Associates, Inc.

Q

Okay, great. So, when I think about the sales guidance and adjusted EBITDA guidance ranges for 2024, as you mapped those out, what are some of the factors that maybe gives you the high end or the low end of those ranges as you think about how the year might play out?

Anthony C. Staniak
Chief Financial Officer, Quad/Graphics, Inc.

A

I think, I mean – this is Tony, Kevin. I think on the revenue perspective, from the economy standpoint, we've assumed kind of the similar economic environment to how it is today going to last throughout 2024. To the extent that the economic environment substantially improved and the marketing spend thus would improve along with it, we could benefit from that on the sales side.

On the EBITDA side, I'd say we're going to continue to look at how we can improve productivity. We did a lot of that in 2023, but we're still continuing to work on that in 2024. And the benefits of automation that we've just put in with a couple of large wide web presses that we put into the United States, we're putting one into Mexico this month, and those can all provide profitability improvement for us. And then, I think it comes back to what Joel said about the flywheel and how that can just continue to generate sales from print leading to agency or respectively agency to print.

Kevin Mark Steinke
Analyst, Barrington Research Associates, Inc.

Q

And then, the one last point on the revenue side is what I've been talking about the wild card is a bit of how does this postal thing play out? Do they hold steady on their strategy or do – other thoughts come into play that correct that?

Anthony C. Staniak
Chief Financial Officer, Quad/Graphics, Inc.

A

Kevin, I would just say on the guidance, we're happy with the fact that we're maintaining profitability despite these revenue pressures that you're hearing from us with the postal rates. So, even resulting in slightly improved adjusted EBITDA margin as we are improving the profitability on the margin. So, happy about that.

Kevin Mark Steinke
Analyst, Barrington Research Associates, Inc.

Q

No, absolutely. Yes. As I looked at the guidance that that clearly stood out to me, essentially flattish profitability kind of it within that range or at the midpoint despite the projected sales decline. So, maybe just a couple more here. Just on any more commentary on DART Innovation, just in terms of size or purchase price quantitatively or qualitatively and any other color commentary on what that brings to you?

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

A

Yeah. It was – from the size of the deal, it's not a large deal, but it's an important one. That team has been around for several years working with a very large retailer currently that they've deployed in for several years now. The exciting thing is, is that we brought to the table this opportunity with [indiscernible] (00:46:52) leadership are veterans in the grocery business. They know the business. They know it well. They know us. They trust us. And the fact is, is we're already launching on a roll out with them to test in their stores for hopefully a bigger rollout as well as with other retailers. So, this is a very important step, because if you follow the world of media, retail media networks is a huge conversation right now to the point where you just saw Walmart buy Vizio to try and leapfrog into this space in their own stores. And so for us, it's a real opportunity to help the people who are of the girth and size of Walmart to actually be able to play in the same as they are and get control of that all-important data of what happens within the store.

Anthony C. Staniak
Chief Financial Officer, Quad/Graphics, Inc.

A

Yeah. I think it's kind of exciting that take Quad's relationships, which got to the very highest level of retailers, combine that with DART's offering of what they have assembled and we think there's significant possibility of scale. And it ties in, quite frankly, with the discussions we're already having with physical in-store signage and now digital in-store signage rounding out our offerings to that group of retailers.

Kevin Mark Steinke
Analyst, Barrington Research Associates, Inc.

Q

Right. And then lastly, I'd just like to ask about reinstating the dividend. Certainly, that was a welcome I think and just maybe the thought process that went into your decision to reinstate the dividend.

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

A

Well, I think first and foremost, the sustainability of it, as we've wanted to come back to that point, we're very careful about the balance sheet. I think we've proven ourselves that we've really done a great job of focusing on paying down debt to very low levels and we'll continue to do that. But we feel that launching a dividend at this size is very sustainable for us. What we love to revisit it in the future, of course, and we will to see if we can do more. But at this point, we like this as a great sustainable starting point. Tony?

Anthony C. Staniak
Chief Financial Officer, Quad/Graphics, Inc.

A

Yeah. And I'll add, Kevin, we – Quad was a long time dividend payer that was – it's important to us to reward our shareholders. And so, at the beginning of COVID, we stopped the dividend. It was the right prudent decision at the time. We focused on debt down to the low end of that range our previous range of 2.0 times and now to Joel's point it can revisit turning this back on and providing that to shareholders, so happy to be able to do that.

Kevin Mark Steinke
Analyst, Barrington Research Associates, Inc.

Q

Okay, great. Thanks for all the commentary. I'll turn it back over.

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

A

Thanks, Kevin. Operator?

Operator: [Operator Instructions] The next question comes from Barton Crockett of Rosenblatt. Please go ahead.

Barton Crockett
Analyst, Rosenblatt Securities, Inc.

Q

Okay.

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

A

Hi, Barton.

Barton Crockett
Analyst, Rosenblatt Securities, Inc.

Q

Thanks for – good morning. Good morning. Thanks for taking my question here. And then you guys have covered a lot from the presentation and the Q&A. But just stepping back, I mean, one thing I would appreciate kind of your perspective on Joel is, I think the real opportunity for your shares is to get back to a place of revenue growth. And what would it take to get there? I mean, do you need as kind of a prerequisite for that, the postal service to go to normalized kind of price, CPI price growth versus the outsized growth? Does that have to happen or is there a world where you can grow revenues again even if the postal service continues down the road that it's laid out?

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

A

Yeah. I mean, we're going to continue to grow revenue through all the other services. I mean, in-store, year-to-date, was up 12% at the end. So, that's an example of how we're doing that and that comes from some of that multi-feature relationship that we do with people. Certainly more rational thinking in the post office would significantly help. And in fact, if you didn't have that type of increase last year, we were feeling really good about sort of that flip point of having to deal with organic decline versus new revenue coming in. And so, where are we there yet? No, but we're edging that direction. And then, with this surprise where people got caught, like I said, in the second half, we saw that significant reaction to it.

I think the question, if the post office keeps their trajectory, the customers will have to be very smart about how they manage through it with other cost initiatives in trying to pass on to our customers and so, how that plays out will be seen. But I feel good about our ability to manage through it. I mean, when I saw the postal increase happen last year, we closed a significant 40-year plant of ours that I had a very close relationship with for many years. I pulled forward closing that because of the postal increase just to make sure we can manage ahead of it and consolidate. And so, that's what we mean when we say we treat all costs as variable. If we see something happen on volume in core traditional lines, we know how to react to it.

But at the same time, we'll continue to grow all the other offerings, which will impact things like catalog, direct mail packaging, in-store and agency. So – but when you get that one time surprise, there's a big reaction that typically happens. And I hope even as they go forward, I'd hope to see that moderate. But it certainly puts some of the onus – a lot of onus on the customer base to be able to figure that out. But the bottom line is its catalog works, direct mail works. So, it's an important part of the go-forward media mix for people, because that media mix landscape is a challenging one. You still have to sell your product.

Barton Crockett
Analyst, Rosenblatt Securities, Inc.

Q

Okay. All right. I appreciate that. Now, I guess, though, if you look at kind of some of the question marks around the longer term revenue trajectory, I understand your guidance for this year, but even after this year there's some unknowns. To what degree should we expect you guys to continue to reduce debt? I know your next maturity is 2026, but there could be an argument if revenue pressures continue for some time to keep producing debt, how do you guys kind of feel about that?

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

A

Yeah. I think you have to look at debt levels of leverage in conjunction with the business you're in and your ability to manage challenges. In a growth business, people would say we're underleveraged. In a business like this, I think we're being very prudent because of those unknowns. And I will – I will tell you we will continue to pay down debt until I see something different and that's why I like the balance of a sustainable dividend we're doing, being able to still opportunistically look at share repurchases, but I want to see that same question answered. And therefore, we want to continue to keep paying debt down, which is why we changed our guidance on the leverage range.

Anthony C. Staniak
Chief Financial Officer, Quad/Graphics, Inc.

A

Yeah.

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

A

Tony?

Anthony C. Staniak
Chief Financial Officer, Quad/Graphics, Inc.

A

And Barton, I mean, we have – you heard this when we went through the slides, but roughly speaking, 50% of our debt is fixed, 50% of it is floating interest rate. And so with the rates where they are right now, in addition to just being prudent on debt leverage, to Joel's point, it saves real money, as we can pay down debt and then use that lower interest spend, use the cash from that to put it into growth of the company. We still dedicate 2% of our revenue to capital expenditures. Some of that's maintenance. But there's also large presses that we're putting in in automation to continue to make things more efficient and more technology spend as we continue to innovate. So, you'll see us move money in that direction, lowering debt helps in that regard and happy to do dividend.

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

A

And another thing, Barton, if you look back at where we come from in our strategy, when we started playing a consolidator in the core business that where the product lines were shrinking, it was about managing good, strong free cash flow by making sure you put work in the most efficient plants and then squeezing down the platform as volume went down. So, it's not just the cash isn't just on a regular basis, isn't just from your free cash flow. It's from expected sales of those assets that you close and sell as the organic decline happened. And so, the two of them have resulted in that huge ability to pay down debt. I mean, we went through a pandemic and we're still paying down debt. That's because we treated all costs as variable and closed plants as the volume dictated it. And so, that ability is there to manage what goes to us. But meanwhile, this flywheel of all the other services and driving other large invoices in print will continue to go.

Barton Crockett
Analyst, Rosenblatt Securities, Inc.

Q

Okay. That's very helpful. Thank you, guys.

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

A

You're welcome. Thank you, Barton.

Anthony C. Staniak
Chief Financial Officer, Quad/Graphics, Inc.

A

Thanks, Barton.

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

A

Operator?

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to Joel Quadracci for closing remarks.

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

Okay. Thank you, everyone, for joining today's call. I just want to close by reiterating my confidence in our team, in our strategy, and in our future as a marketing experienced company. Our pipeline for new business remains strong, thanks to our unique offering, and we will continue to prioritize growth in verticals and product lines with the greatest expansion opportunities while managing all aspects of our business for long-term strength and stability and shareholder value creation.

So, with that, we look forward to speaking to you next quarter.

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