

Quad/Graphics, Inc.
Form 10-Q
October 31, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
 1934

For the quarterly period ended September 30, 2018

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
1934

For the transition period from _____ to _____
Commission File Number 001-34806

QUAD/GRAPHICS, INC.

(Exact name of registrant as specified in its charter)

Wisconsin

39-1152983

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

N61 W23044 Harry's Way, Sussex, Wisconsin 53089-3995 (414) 566-6000

(Address of principal executive offices) (Zip Code) (Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company) Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date.

Class Outstanding as of October 26, 2018

Class A Common Stock 38,115,225

Class B Common Stock 13,556,858

Class C Common Stock —

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PART I — FINANCIAL INFORMATION

ITEM 1. Condensed Consolidated Financial Statements (Unaudited)

QUAD/GRAPHICS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share data)

(UNAUDITED)

	Three Months Ended		Nine Months Ended	
	September 30, 2018	2017	September 30, 2018	2017
Net sales				
Products	\$826.7	\$856.9	\$2,431.2	\$2,530.6
Services	202.4	148.5	580.9	436.6
Total net sales	1,029.1	1,005.4	3,012.1	2,967.2
Cost of sales				
Products	683.6	679.1	2,013.2	2,024.9
Services	148.1	105.7	437.6	306.0
Total cost of sales	831.7	784.8	2,450.8	2,330.9
Operating expenses				
Selling, general and administrative expenses	92.4	107.5	278.5	310.4
Depreciation and amortization	59.1	58.3	173.6	175.5
Restructuring, impairment and transaction-related charges	5.3	8.0	40.6	22.5
Total operating expenses	988.5	958.6	2,943.5	2,839.3
Operating income	40.6	46.8	68.6	127.9
Interest expense	18.3	17.8	54.0	53.6
Net pension income	(3.1)	(2.6)	(9.3)	(7.8)
Loss on debt extinguishment	—	—	—	2.6
Earnings before income taxes and equity in (earnings) loss of unconsolidated entity	25.4	31.6	23.9	79.5
Income tax expense (benefit)	3.1	11.8	(3.9)	26.8
Earnings before equity in (earnings) loss of unconsolidated entity	22.3	19.8	27.8	52.7
Equity in (earnings) loss of unconsolidated entity	(0.2)	—	(0.7)	0.8
Net earnings	22.5	19.8	28.5	51.9
Less: net loss attributable to noncontrolling interests	(0.9)	—	(0.8)	—
Net earnings attributable to Quad/Graphics common shareholders	\$23.4	\$19.8	\$29.3	\$51.9
Earnings per share attributable to Quad/Graphics common shareholders				
Basic	\$0.47	\$0.40	\$0.59	\$1.05
Diluted	\$0.46	\$0.38	\$0.57	\$1.01
Dividends declared per share	\$0.30	\$0.30	\$0.90	\$0.90
Weighted average number of common shares outstanding				
Basic	49.3	49.5	50.0	49.4
Diluted	51.1	51.5	51.8	51.6

See accompanying Notes to Condensed Consolidated Financial Statements (Unaudited).

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QUAD/GRAPHICS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in millions)

(UNAUDITED)

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
Net earnings	\$22.5	\$19.8	\$28.5	\$51.9
Other comprehensive income (loss)				
Translation adjustments	0.7	3.5	(9.3)	14.9
Interest rate swap adjustments	1.0	0.3	6.1	(0.4)
Other comprehensive income (loss), before tax	1.7	3.8	(3.2)	14.5
Income tax impact related to items of other comprehensive income (loss)	(0.3)	(0.2)	(1.5)	0.1
Other comprehensive income (loss), net of tax	1.4	3.6	(4.7)	14.6
Total comprehensive income	23.9	23.4	23.8	66.5
Less: comprehensive loss attributable to noncontrolling interests	(0.9)	—	(0.8)	—
Comprehensive income attributable to Quad/Graphics common shareholders	\$24.8	\$23.4	\$24.6	\$66.5

See accompanying Notes to Condensed Consolidated Financial Statements (Unaudited).

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QUAD/GRAPHICS, INC.
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (in millions)
 (UNAUDITED)

	September 30, 2018	December 31, 2017
ASSETS		
Cash and cash equivalents	\$ 6.3	\$ 64.4
Receivables, less allowances for doubtful accounts of \$27.7 million at September 30, 2018, and \$28.9 million at December 31, 2017	553.0	552.5
Inventories	354.5	246.5
Prepaid expenses and other current assets	57.6	45.1
Total current assets	971.4	908.5
Property, plant and equipment—net	1,284.5	1,377.6
Goodwill	55.5	—
Other intangible assets—net	121.7	43.4
Equity method investment in unconsolidated entity	3.6	3.6
Other long-term assets	97.1	119.3
Total assets	\$ 2,533.8	\$ 2,452.4
LIABILITIES AND SHAREHOLDERS' EQUITY		
Accounts payable	\$ 432.0	\$ 381.6
Accrued liabilities	282.7	316.7
Short-term debt and current portion of long-term debt	42.3	42.0
Current portion of capital lease obligations	5.1	5.6
Total current liabilities	762.1	745.9
Long-term debt	1,015.9	903.5
Capital lease obligations	11.1	13.7
Deferred income taxes	44.0	41.9
Other long-term liabilities	187.4	225.0
Total liabilities	2,020.5	1,930.0
Commitments and contingencies (Note 8)		
Shareholders' equity		
Preferred stock	—	—
Common stock, Class A	1.0	1.0
Common stock, Class B	0.4	0.4
Common stock, Class C	—	—
Additional paid-in capital	857.9	861.1
Treasury stock, at cost	(56.6) (52.8
Accumulated deficit	(175.0) (162.9
Accumulated other comprehensive loss	(132.0) (124.4
Quad/Graphics' shareholders' equity	495.7	522.4
Noncontrolling interests	17.6	—
Total shareholders' equity and noncontrolling interests	513.3	522.4
Total liabilities and shareholders' equity	\$ 2,533.8	\$ 2,452.4

See accompanying Notes to Condensed Consolidated Financial Statements (Unaudited).

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QUAD/GRAPHICS, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (in millions)
 (UNAUDITED)

	Nine Months Ended September 30,	
	2018	2017
OPERATING ACTIVITIES		
Net earnings	\$28.5	\$51.9
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	173.6	175.5
Employee stock ownership plan contribution	22.3	—
Impairment charges	16.0	1.0
Amortization of debt issuance costs and original issue discount	2.6	2.7
Loss on debt extinguishment	—	2.6
Stock-based compensation	12.3	13.0
Gain from property insurance claims	(18.3)	(5.0)
Gain on the sale or disposal of property, plant and equipment	(10.7)	(7.3)
Deferred income taxes	(0.5)	15.5
Equity in (earnings) loss of unconsolidated entity	(0.7)	0.8
Changes in operating assets and liabilities—net of acquisitions	(178.5)	(71.0)
Net cash provided by operating activities	46.6	179.7
INVESTING ACTIVITIES		
Purchases of property, plant and equipment	(85.0)	(61.6)
Proceeds from the sale of property, plant and equipment	22.3	22.9
Proceeds from property insurance claims	14.5	5.0
Loan to an unconsolidated entity	—	(5.0)
Acquisition of businesses—net of cash acquired	(71.4)	—
Net cash used in investing activities	(119.6)	(38.7)
FINANCING ACTIVITIES		
Proceeds from issuance of long-term debt	0.3	375.0
Payments of long-term debt	(27.8)	(424.3)
Payments of capital lease obligations	(4.9)	(5.9)
Borrowings on revolving credit facilities	1,830.0	525.7
Payments on revolving credit facilities	(1,691.1)	9550.4
Payments of debt issuance costs and financing fees	—	(4.7)
Purchases of treasury stock	(36.7)	(3.8)
Proceeds from stock options exercised	4.1	2.4
Equity awards redeemed to pay employees' tax obligations	(9.0)	(5.9)
Payment of cash dividends	(47.5)	(46.5)
Other financing activities	—	(4.1)
Net cash provided by (used in) financing activities	16.6	(142.5)
Effect of exchange rates on cash and cash equivalents	(1.7)	(0.3)
Net decrease in cash and cash equivalents	(58.1)	(1.8)
Cash and cash equivalents at beginning of period	64.4	19.2

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Cash and cash equivalents at end of period	\$6.3	\$17.4
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See accompanying Notes to Condensed Consolidated Financial Statements (Unaudited).

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QUAD/GRAPHICS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2018

(In millions, except share and per share data and unless otherwise indicated)

Note 1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements for Quad/Graphics, Inc. and its subsidiaries (the "Company" or "Quad/Graphics") have been prepared by the Company pursuant to the rules and regulations for interim financial information of the United States Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been omitted pursuant to such SEC rules and regulations. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated annual financial statements as of and for the year ended December 31, 2017, and notes thereto included in the Company's latest Annual Report on Form 10-K filed with the SEC on February 21, 2018.

The Company is subject to seasonality in its quarterly results as net sales and operating income are higher in the third and fourth quarters of the calendar year as compared to the first and second quarters. The fourth quarter is typically the highest seasonal quarter for cash flows from operating activities due to the reduction of working capital requirements that reach peak levels during the third quarter. Seasonality is driven by increased magazine advertising page counts, retail inserts, catalogs and books primarily due to back-to-school and holiday-related advertising and promotions. The Company expects this seasonality impact to continue in future years.

The financial information contained herein reflects all adjustments, in the opinion of management, necessary for a fair presentation of the Company's results of operations for the three and nine months ended September 30, 2018 and 2017. All of these adjustments are of a normal recurring nature, except as otherwise noted. All intercompany transactions have been eliminated in consolidation. These unaudited condensed consolidated financial statements include estimates and assumptions of management that affect the amounts reported in the condensed consolidated financial statements. Actual results could differ from these estimates.

Revenue Recognition

On January 1, 2018, the Company adopted Accounting Standards Update 2014-09, "Revenue from Contracts with Customers" ("Topic 606"), which provides revised guidance on recognizing revenue from contracts with customers. The Company adopted Topic 606 using the modified retrospective approach and applied the guidance to those contracts which were not completed as of January 1, 2018. This means that Topic 606 has been applied to the 2018 financial statements and disclosures going forward, but that prior period financial statements and disclosures reflect the revenue recognition standard of Topic 605, Revenue from Contracts with Customers. See Note 2, "Revenue Recognition," for additional accounting policy and transition disclosures.

Pension Plans

On January 1, 2018, the Company adopted Accounting Standards Update 2017-07 "Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost" ("ASU 2017-07"), which provides revised guidance on how to present the components of net pension income in the statement of operations. The Company has adopted ASU 2017-07 retrospectively and has utilized the practical expedient that permits the use of the amounts disclosed in previous filings for net pension income as the estimation

basis for the presentation of the prior comparative periods. There are no service costs associated with the Company's pension plans due to their frozen status.

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QUAD/GRAPHICS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2018

(In millions, except share and per share data and unless otherwise indicated)

The effects of the adjustments to the condensed consolidated statements of operations as a result of the adoption of ASU 2017-07 for the three and nine months ended September 30, 2017, are as follows:

	Three Months Ended September 30, 2017			Nine Months Ended September 30, 2017		
	As Previously Reported	Adjusted for ASU 2017-07	As Adjusted	As Previously Reported	Adjusted for ASU 2017-07	As Adjusted
Net sales	\$1,005.4	\$ —	\$1,005.4	\$2,967.2	\$ —	\$2,967.2
Cost of sales	784.8	—	784.8	2,330.9	—	2,330.9
Operating expenses						
Selling, general and administrative expenses	104.9	2.6	107.5	302.6	7.8	310.4
Depreciation and amortization	58.3	—	58.3	175.5	—	175.5
Restructuring, impairment and transaction-related charges	8.0	—	8.0	22.5	—	22.5
Total operating expenses	956.0	2.6	958.6	2,831.5	7.8	2,839.3
Operating income	49.4	(2.6)	46.8	135.7	(7.8)	127.9
Interest expense	17.8	—	17.8	53.6	—	53.6
Net pension income	—	(2.6)	(2.6)	—	(7.8)	(7.8)
Loss on debt extinguishment	—	—	—	2.6	—	2.6
Earnings before income taxes and equity in (earnings) loss of unconsolidated entity	\$31.6	\$ —	\$31.6	\$79.5	\$ —	\$79.5

See Note 13, "Employee Retirement Plans," for the components of net pension income for the three and nine months ended September 30, 2018 and 2017.

Furthermore, the effects of the adjustments to the consolidated statements of operations as a result of the adoption of ASU 2017-07 for the years ended December 31, 2017 and 2016, are as follows:

	Year Ended December 31, 2017			Year Ended December 31, 2016		
	As Previously Reported	Adjusted for ASU 2017-07	As Adjusted	As Previously Reported	Adjusted for ASU 2017-07	As Adjusted
Net sales	\$4,131.4	\$ —	\$4,131.4	\$4,329.5	\$ —	\$4,329.5
Cost of sales	3,259.4	—	3,259.4	3,394.8	—	3,394.8
Operating expenses						
Selling, general and administrative expenses	413.4	10.4	423.8	454.6	12.1	466.7
Depreciation and amortization	232.5	—	232.5	277.1	—	277.1
Restructuring, impairment and transaction-related charges	61.2	(0.8)	60.4	80.6	(7.0)	73.6
Total operating expenses	3,966.5	9.6	3,976.1	4,207.1	5.1	4,212.2
Operating income	164.9	(9.6)	155.3	122.4	(5.1)	117.3
Interest expense	71.1	—	71.1	77.2	—	77.2
Net pension income	—	(9.6)	(9.6)	—	(5.1)	(5.1)

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Loss (gain) on debt extinguishment	2.6	—	2.6	(14.1) —	(14.1)
Earnings before income taxes and equity in (earnings) loss of unconsolidated entity	\$91.2	\$ —	\$91.2	\$59.3	\$ —	\$59.3	

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QUAD/GRAPHICS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2018

(In millions, except share and per share data and unless otherwise indicated)

Note 2. Revenue Recognition

The Company recognizes its products and services revenue based on when the transfer of control passes to the customer or when the service is completed and accepted by the customer.

The effects of the adjustments to the December 31, 2017 consolidated balance sheet for the modified retrospective adoption of Topic 606, were as follows:

	December 31, 2017 As Reported	Topic 606 Adjustments	Opening Balance at January 1, 2018
Prepaid expenses and other current assets	\$ 45.1	\$ 2.3	\$ 47.4
Other long-term assets	119.3	2.0	121.3
Deferred income taxes	41.9	1.1	43.0
Accumulated deficit	(162.9)	3.2	(159.7)

The adoption of Topic 606 did not have a material effect on the consolidated financial statements. In adopting Topic 606, the timing of recognition changed for certain variable consideration paid to customers and costs to obtain contracts with customers.

Revenue Disaggregation

The following table provides information about disaggregated revenue by the Company's operating segments and major products and services offerings:

	United States Print and Related Services	International	Total
Three months ended September 30, 2018			
Catalog, publications, retail inserts, books and directories	\$ 577.1	\$ 76.6	\$653.7
Direct mail and other printed products	159.2	7.7	166.9
Other	6.0	0.1	6.1
Total Products	742.3	84.4	826.7
Logistics services	106.8	4.4	111.2
Imaging, marketing services and other services	91.2	—	91.2
Total Services	198.0	4.4	202.4
Total Net Sales	\$ 940.3	\$ 88.8	\$1,029.1

Three months ended September 30, 2017

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Catalog, publications, retail inserts, books and directories	\$ 598.1	\$ 87.3	\$685.4
Direct mail and other printed products	149.8	6.8	156.6
Other	14.6	0.3	14.9
Total Products	762.5	94.4	856.9
Logistics services	96.7	4.7	101.4
Imaging, marketing services and other services	47.1	—	47.1
Total Services	143.8	4.7	148.5
Total Net Sales	\$ 906.3	\$ 99.1	\$1,005.4

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QUAD/GRAPHICS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2018

(In millions, except share and per share data and unless otherwise indicated)

Revenue Disaggregation (Continued)

	United States Print and Related Services	International	Total
Nine months ended September 30, 2018			
Catalog, publications, retail inserts, books and directories	\$1,697.1	\$ 246.4	\$1,943.5
Direct mail and other printed products	443.9	23.7	467.6
Other	19.7	0.4	20.1
Total Products	2,160.7	270.5	2,431.2
Logistics services	308.2	14.0	322.2
Imaging, marketing services and other services	258.7	—	258.7
Total Services	566.9	14.0	580.9
Total Net Sales	\$2,727.6		