

Quad/Graphics, Inc.  
Form 10-Q  
May 03, 2017  
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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 March 31, 2017

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 April 28, 2017

Class A Common Stock 37,787,351

Class B Common Stock 14,198,464

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 March 31,	
	2017	2016
Net sales		
Products	\$854.3	\$897.3
Services	144.3	145.2
Total net sales	998.6	1,042.5
Cost of sales		
Products	682.4	704.0
Services	98.7	99.5
Total cost of sales	781.1	803.5
Operating expenses		
Selling, general and administrative expenses	96.0	119.0
Depreciation and amortization	58.7	78.1
Restructuring, impairment and transaction-related charges	9.2	28.9
Total operating expenses	945.0	1,029.5
Operating income	\$53.6	\$13.0
Interest expense	18.2	20.7
Loss (gain) on debt extinguishment	2.6	(14.1 )
Earnings before income taxes and equity in loss of unconsolidated entity	32.8	6.4
Income tax expense	6.7	1.7
Earnings before equity in loss of unconsolidated entity	26.1	4.7
Equity in loss of unconsolidated entity	0.7	0.9
Net earnings	\$25.4	\$3.8
Earnings per share		
Basic	\$0.52	\$0.08
Diluted	\$0.49	\$0.08
Dividends declared per share	\$0.30	\$0.30
Weighted average number of common shares outstanding		
Basic	49.1	47.6
Diluted	51.5	48.5

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 March 31,	
	2017	2016
Net earnings	\$25.4	\$3.8
Other comprehensive income		
Translation adjustments	7.7	8.4
Interest rate swap adjustments	0.4	—
Other comprehensive income, before tax	8.1	8.4
Income tax expense related to items of other comprehensive income	—	—
Other comprehensive income, net of tax	8.1	8.4
Comprehensive income	\$33.5	\$12.2

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

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

	March 31, 2017	December 31, 2016
<b>ASSETS</b>		
Cash and cash equivalents	\$6.5	\$ 9.0
Receivables, less allowances for doubtful accounts of \$52.4 million at March 31, 2017, and \$53.5 million at December 31, 2016	505.1	563.6
Inventories	269.0	265.4
Prepaid expenses and other current assets	50.9	54.4
Restricted cash	3.8	10.2
Total current assets	835.3	902.6
Property, plant and equipment—net	1,487.2	1,519.9
Intangible assets—net	55.4	59.7
Equity method investment in unconsolidated entity	3.1	3.6
Other long-term assets	89.9	84.3
Total assets	\$2,470.9	\$ 2,570.1
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Accounts payable	\$304.4	\$ 323.5
Amounts owing in satisfaction of bankruptcy claims	2.1	2.3
Accrued liabilities	289.5	356.7
Short-term debt and current portion of long-term debt	71.6	84.7
Current portion of capital lease obligations	7.2	7.4
Total current liabilities	674.8	774.6
Long-term debt	1,006.4	1,019.8
Unsecured notes to be issued	0.9	5.4
Capital lease obligations	17.6	18.9
Deferred income taxes	38.6	35.3
Other long-term liabilities	271.9	274.6
Total liabilities	2,010.2	2,128.6
Commitments and contingencies (Note 7)		
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	897.9	912.4
Treasury stock, at cost	(97.4	) (113.3
Accumulated deficit	(196.7	) (206.4
Accumulated other comprehensive loss	(144.5	) (152.6
Total shareholders' equity	460.7	441.5
Total liabilities and shareholders' equity	\$2,470.9	\$ 2,570.1

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)

	Three Months Ended March 31,	
	2017	2016
<b>OPERATING ACTIVITIES</b>		
Net earnings	\$25.4	\$3.8
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	58.7	78.1
Impairment charges	0.4	16.7
Amortization of debt issuance costs and original issue discount	0.9	1.1
Loss (gain) on debt extinguishment	2.6	(14.1 )
Stock-based compensation	6.0	5.2
Gain on sale or disposal of property, plant and equipment	(3.7 )	(1.4 )
Deferred income taxes	3.2	(2.7 )
Equity in loss of unconsolidated entity	0.7	0.9
Changes in operating assets and liabilities	(30.9 )	25.0
Net cash provided by operating activities	63.3	112.6
<b>INVESTING ACTIVITIES</b>		
Purchases of property, plant and equipment	(23.4 )	(26.2 )
Proceeds from the sale of property, plant and equipment	10.8	2.5
Proceeds from insurance	3.0	—
Transfers from restricted cash	6.3	—
Loan to an unconsolidated entity	(5.0 )	—
Net cash used in investing activities	(8.3 )	(23.7 )
<b>FINANCING ACTIVITIES</b>		
Proceeds from issuance of long-term debt	375.0	18.4
Payments of long-term debt	(384.0)	(115.4)
Payments of capital lease obligations	(2.1 )	(1.3 )
Borrowings on revolving credit facilities	67.0	293.6
Payments on revolving credit facilities	(83.8 )	(258.5)
Payments of debt issuance costs and financing fees	(4.6 )	(0.1 )
Bankruptcy claim payments on unsecured notes to be issued	(4.1 )	—
Purchases of treasury stock	—	(8.8 )
Sale of stock for options exercised	1.3	—
Equity awards redeemed to pay employees' tax obligations	(5.9 )	(1.4 )
Payment of cash dividends	(16.8 )	(15.4 )
Other financing activities	—	(0.6 )
Net cash used in financing activities	(58.0 )	(89.5 )
Effect of exchange rates on cash and cash equivalents	0.5	0.1
Net decrease in cash and cash equivalents	(2.5 )	(0.5 )
Cash and cash equivalents at beginning of period	9.0	10.8
Cash and cash equivalents at end of period	\$6.5	\$10.3



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 MONTHS ENDED MARCH 31, 2017

(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, 2016, and notes thereto included in the Company's latest Annual Report on Form 10-K filed with the SEC on February 22, 2017.

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 months ended March 31, 2017 and 2016. 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.

## Note 2. Restructuring, Impairment and Transaction-Related Charges

The Company recorded restructuring, impairment and transaction-related charges for the three months ended March 31, 2017 and 2016, as follows:

	Three Months Ended March 31, 2017 2016	
Employee termination charges	\$2.9	\$4.9
Impairment charges	0.4	16.7
Transaction-related charges	0.8	0.6
Integration costs	—	0.1
Other restructuring charges	5.1	6.6
Total	\$9.2	\$28.9

The costs related to these activities have been recorded in the condensed consolidated statements of operations as restructuring, impairment and transaction-related charges. See Note 18, "Segment Information," for restructuring, impairment and transaction-related charges by segment.

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QUAD/GRAPHICS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
FOR THE THREE MONTHS ENDED MARCH 31, 2017

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

Restructuring Charges

The Company began a restructuring program in 2010 related to eliminating excess manufacturing capacity and properly aligning its cost structure. The Company has announced a total of 37 plant closures and has reduced headcount by approximately 11,400 employees since 2010. The Company recorded the following charges as a result of plant closures and other restructuring programs:

Employee termination charges of \$2.9 million and \$4.9 million were recorded during the three months ended March 31, 2017 and 2016, respectively. The Company reduced its workforce through facility consolidations and involuntary separation programs.

There were no integration costs recorded during the three months ended March 31, 2017. Integration costs of \$0.1 million were recorded during the three months ended March 31, 2016, related to costs for the integration of acquired companies.

Other restructuring charges of \$5.1 million were recorded during the three months ended March 31, 2017, which consisted of the following: (1) \$3.2 million of lease exit charges primarily related to the closures of the Huntington Beach, California; and Manassas, Virginia plants; (2) \$1.2 million of equipment and infrastructure removal costs from closed plants; and (3) \$0.7 million of vacant facility carrying costs, net of a \$3.7 million gain from the sale of the East Greenville, Pennsylvania and Marengo, Iowa plants. Other restructuring charges of \$6.6 million were recorded during the three months ended March 31, 2016, which consisted of the following: (1) \$4.0 million of vacant facility carrying costs; (2) \$2.5 million of equipment and infrastructure removal costs from closed plants; and (3) \$0.1 million of lease exit charges.

The restructuring charges recorded were based on plans that have been committed to by management and were, in part, based upon management's best estimates of future events. Changes to the estimates may require future restructuring charges and adjustments to the restructuring liabilities. The Company expects to incur additional restructuring charges related to these and other initiatives.

Impairment Charges

The Company recognized impairment charges of \$0.4 million during the three months ended March 31, 2017, for machinery and equipment no longer being utilized in production as a result of facility consolidations, as well as other capacity reduction restructuring activities.

The Company recognized impairment charges of \$16.7 million during the three months ended March 31, 2016, which consisted of the following: (1) \$12.1 million of land and building impairment charges related to the Atglen, Pennsylvania plant closure; and (2) \$4.6 million of impairment charges primarily for machinery and equipment no longer being utilized in production as a result of facility consolidations, including Atglen, Pennsylvania; Augusta, Georgia; and East Greenville, Pennsylvania, as well as other capacity reduction restructuring activities.

The fair values of the impaired assets were determined by the Company to be Level 3 under the fair value hierarchy (see Note 11, "Financial Instruments and Fair Value Measurements," for the definition of Level 3 inputs) and were

estimated based on internal discounted cash flow estimates, quoted market prices where available and independent appraisals, as appropriate. These assets were adjusted to their estimated fair values at the time of impairment.

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## QUAD/GRAPHICS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
FOR THE THREE MONTHS ENDED MARCH 31, 2017

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

## Transaction-Related Charges

The Company incurs transaction-related charges primarily consisting of professional service fees related to business acquisition and divestiture activities. The Company recognized transaction-related charges of \$0.8 million and \$0.6 million during the three months ended March 31, 2017 and 2016, respectively. The transaction-related charges were expensed as incurred in accordance with the applicable accounting guidance on business combinations.

## Restructuring Reserves

Activity impacting the Company's restructuring reserves for the three months ended March 31, 2017, was as follows:

	Employee Termination Charges	Impairment Charges	Transaction-Related Charges	Integration Costs	Other Restructuring Charges	Total
Balance at December 31, 2016	\$ 7.6	\$ —	\$ 0.1	\$ 1.1	\$ 10.4	\$19.2
Expense	2.9	0.4	0.8	—	5.1	9.2
Cash payments	(2.9 )	—	(0.5 )	—	(3.0 )	(6.4 )
Non-cash adjustments	—	(0.4 )	—	—	—	(0.4 )
Balance at March 31, 2017	\$ 7.6	\$ —	\$ 0.4	\$ 1.1	\$ 12.5	\$21.6

The Company's restructuring reserves at March 31, 2017, included a short-term and a long-term component. The short-term portion included \$15.3 million in accrued liabilities (see Note 12, "Accrued Liabilities and Other Long-Term Liabilities") and \$1.0 million in accounts payable in the condensed consolidated balance sheets as the Company expects these reserves to be paid within the next twelve months. The long-term portion of \$5.3 million is included in other long-term liabilities (see Note 12, "Accrued Liabilities and Other Long-Term Liabilities") in the condensed consolidated balance sheets.

## Note 3. Intangible Assets

The components of intangible assets at March 31, 2017, and December 31, 2016, were as follows:

	Weighted Average Amortization Period (Years)	March 31, 2017			December 31, 2016		
		Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Finite-lived intangible assets:							
Trademarks, patents, licenses and agreements	7	\$21.9	\$(10.1 )	\$ 11.8	\$21.7	\$(9.3 )	\$ 12.4
Capitalized software	5	6.6	(6.3 )	0.3	6.4	(6.2 )	0.2
Acquired technology	5	6.1	(6.1 )	—	6.1	(6.1 )	—
Customer relationships	6	459.9	(416.6 )	43.3	459.4	(412.3 )	47.1
Total finite-lived intangible assets		\$494.5	\$(439.1 )	\$ 55.4	\$493.6	\$(433.9 )	\$ 59.7

The gross carrying amount and accumulated amortization within intangible assets—net in the condensed consolidated balance sheets at March 31, 2017, and December 31, 2016, differs from the value originally recorded at acquisition due to impairment charges recorded and the effects of currency fluctuations since the purchase date.

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## QUAD/GRAPHICS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
FOR THE THREE MONTHS ENDED MARCH 31, 2017

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

Intangible assets are evaluated for potential impairment whenever events or circumstances indicate that the carrying value may not be recoverable. There were no impairment charges recorded on intangible assets for the three months ended March 31, 2017 and 2016.

Amortization expense for intangible assets was \$4.5 million and \$20.1 million for the three months ended March 31, 2017 and 2016, respectively. The estimated future amortization expense related to intangible assets as of March 31, 2017, was as follows:

	Amortization Expense
Remainder of 2017	\$ 13.7
2018	17.4
2019	12.8
2020	7.6
2021	2.8
2022 and thereafter	1.1
Total	\$ 55.4

## Note 4. Inventories

The components of inventories at March 31, 2017, and December 31, 2016, were as follows:

	March 31, December 31,	
	2017	2016
Raw materials and manufacturing supplies	\$ 156.0	\$ 142.4
Work in process	42.1	45.3
Finished goods	70.9	77.7
Total	\$ 269.0	\$ 265.4

## Note 5. Property, Plant and Equipment

The components of property, plant and equipment at March 31, 2017, and December 31, 2016, were as follows:

	March 31, December 31,	
	2017	2016
Land	\$ 125.5	\$ 126.2
Buildings	929.6	935.4
Machinery and equipment	3,602.3	3,574.4
Other <sup>(1)</sup>	195.0	191.5
Construction in progress	51.7	59.5
Property, plant and equipment—gross	\$4,904.1	\$ 4,887.0
Less: accumulated depreciation	(3,416.9 )	(3,367.1 )
Property, plant and equipment—net	\$ 1,487.2	\$ 1,519.9



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(1) Other consists of computer equipment, vehicles, furniture and fixtures, leasehold improvements and communication-related equipment.

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QUAD/GRAPHICS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

FOR THE THREE MONTHS ENDED MARCH 31, 2017

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

The Company recorded impairment charges of \$0.4 million and \$16.7 million for the three months ended March 31, 2017 and 2016, respectively, to reduce the carrying amounts of certain property, plant and equipment no longer utilized in production to fair value (see Note 2, "Restructuring, Impairment and Transaction-Related Charges," for further discussion on impairment charges).