



State of the Industry Report

2018

Print is off to a running start in 2018—an Olympic year and a mid-term election year, which means a double boost for print. Printing Industries of America’s view for the print industry is strong with growth potential foreseen on multiple fronts. This ***State of the Industry*** report focuses on the macroeconomic forecast, micro trends, market opportunities, outside policy influences, and how print companies can leverage each of these dynamics to succeed in 2018.

EXECUTIVE SUMMARY

- For 2018, print sales should increase at a relatively robust pace, but slightly below the overall rate of economic growth or in the range of 1.5 to 2.5 percent.
- What about printers’ bottom lines? If the economy performs as forecast, we anticipate the profit rate may rise slightly to around 3.2 percent. If the economy stumbles, the average profit rate would drop to 2 percent or less.
- Our current impression is that the expected corporate tax reform will add significant bounce to an already accelerating economy. The triple forces of tax reform, deregulation, and global tailwinds should keep the American economy robust over the next 12 months.
- Print processes that will grow relatively faster over the next 12 months include:
 - Inkjet—wide-format and production inkjet, wide-format digital, and inkjet digital toner-based.
- Print market segments likely to grow at relatively higher rates than other sectors in 2018 are:
 - Packaging and specialty packaging, labels and wrappers, signage, direct mail, and point of purchase.
- Public policy influences that may affect the print economy in 2018 include:
 - Tax, trade, infrastructure, postal and paper, and labor/employee benefits policy, along with the regulatory framework at federal and state levels.
- A list of ways that your company can begin to leverage opportunities and prepare for the challenges that lay ahead in 2018.

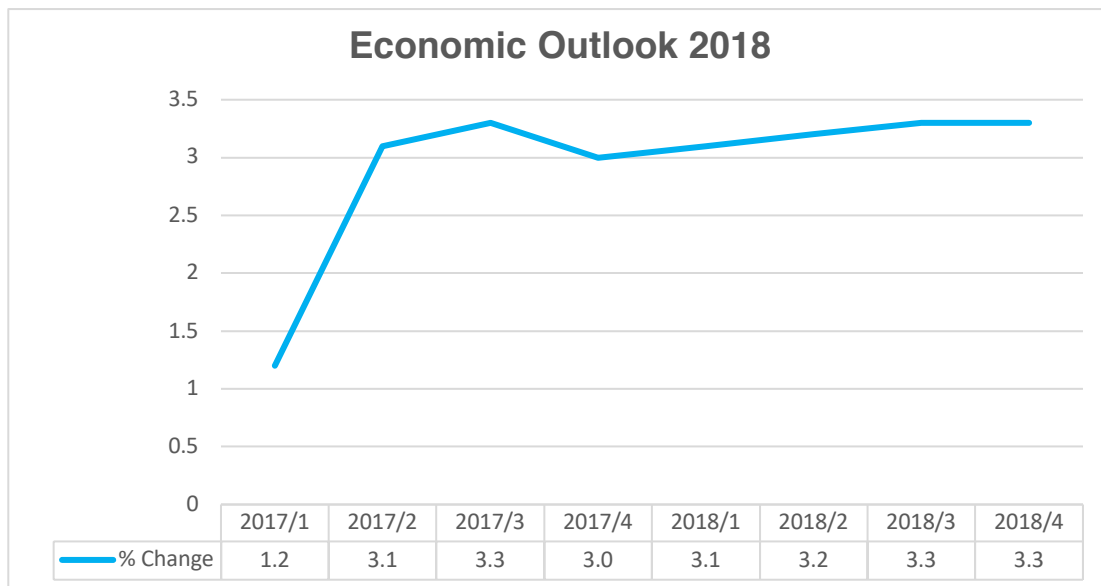
ECONOMIC OUTLOOK

Macroeconomic and Business Environment

Our current view is that the expected corporate tax reform will add significant bounce to an already accelerating economy as a result of deregulation and the added strength of the global economy. The triple forces of tax reform, deregulation, and global tailwinds should keep the American economy robust over the next 12 months. We expect real or inflation-adjusted growth to equal or exceed 3 percent for each quarter. To grow at such a sustained pace, the economy needs additional labor and capital. The capital injection will come from a lower corporate tax rate plus a territorial tax basis, allowing transfer of foreign earnings repatriated back to the United States. The increase in labor supply should come from an elastic response to more job openings and higher wages.

The Trend for Aggregate 2018 Print Sales

For 2018, print sales should increase at a relatively robust pace, but slightly below the overall rate of economic growth (in the range of 1.5 to 2.5 percent). This velocity would align with print's tendency to perform best in a mature recovery phase of the business cycle.

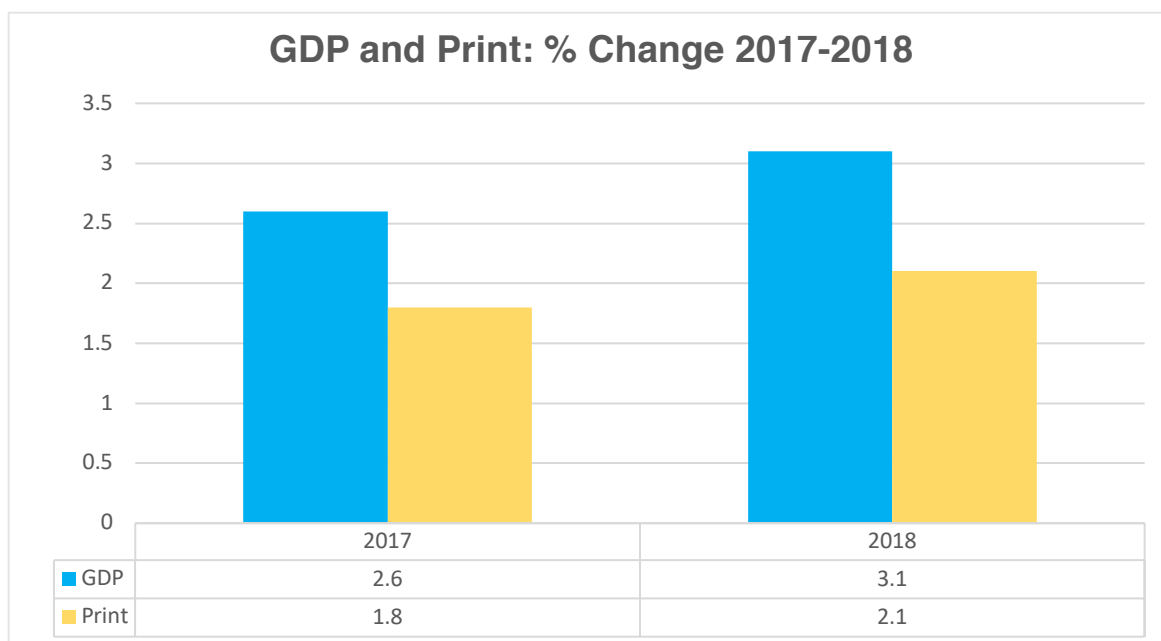


2018 Print Markets

Print will, of course, generally track with the economy in 2018. Over the last few years, most printers that survived the Great Recession have seen their sales recover, although it has taken a few years. The typical printer that managed to survive the recession still took a severe hit in sales between 2008—2010—a sales decline of almost \$300,000. On the plus side, survivors' sales swelled by over \$500,000 in the recovery phase of the cycle.

On an annual percentage change basis, total sales of the average surviving printer (since many printers did not survive the recession) dropped by almost 10 percent in 2009 before stabilizing in 2010. Since the end of the recession, the average printer has experienced single-digit positive sales increases each year.

What about printers' bottom lines? Over the last decade, the average printer's before-tax income as a percent of sales has been around 3 percent. If the economy performs as forecast, we expect the profit rate may rise slightly to around 3.2 percent. If the economy stumbles, the average profit rate would drop to 2 percent or less.



Key Micro-Market Trends in Print

Within this overall sales and profit pattern there will be some key micro-trends. These include:

Profit Leaders Outshine Profit Challengers – While the economy and overall print trends are important, historically some printers always outperform others. PIA's *Dynamic Ratios* program indicates that printers that achieve profit-leading rankings do so consistently. That is, achieving high profits is not a random occurrence, but is achieved through strategic and operational excellence. Similarly, printers in the profit-challenger category typically remain in that category. This is not to say that printers that change their ways—improve themselves strategically and operationally—cannot move from profit challengers to profit leaders. They can, but the pattern will remain the same—about a quarter of printers will be high-profit printers and the remainder will basically break even.

Print Processes Winners – The current trends regarding print processes will continue in 2018 regardless of what happens to the economy and overall print markets. Print processes that will grow fastest (relatively speaking) over the next 12 months include:

- Inkjet—both wide-format and production
- Wide-format digital and inkjet
- Digital toner-based

Fast Growing Print Market Segments – The current trends for specific print market segments will also continue over the next one to two years. These print market segments will likely grow at relatively higher rates than other sectors:

- Packaging and specialty packaging
- Labels and wrappers
- Signage
- Direct mail
- Point of purchase

PUBLIC POLICY OUTLOOK

Neither economic conditions nor print operations can escape the sometimes unpredictable outside influences of Washington, D.C. and global politics. Key public policy dynamics to watch in 2018 include:

Tax Policy – Following the once-in-a-generation tax policy overhaul in 2017, printing companies will spend 2018 learning the finer points of the legislation and how to best take advantage of tax law changes (while avoiding any pitfalls due to a lack of understanding or planning). Certain provisions, namely full expensing of capital equipment and individual provisions including those affecting S-Corps, sunset in 10 years. Expect to see nascent efforts to lay the groundwork for future extension of those popular provisions. Certainly, printing companies of various sizes and geographic locations will be impacted differently, so it will be important for companies to work with a tax professional to wade through the new law.

And while print may have breathed a well-deserved, collective sigh of relief as the 100-year old advertising deduction was preserved in the final tax bill, certain verticals remain targets of legislative efforts to end tax deductions for advertising as a means to address other issues. For example, legislation has been introduced focusing on advertising and packaging in “junk food” marketed to children and on pharmaceutical advertising directed to consumers. These bills are not expected to generate support in 2018, but could be lying in wait for a potential change in party control of the Senate, House, or eventually White House.

Trade Policy – “America First” is the Trump Administration's rallying cry, but the definition means different things to different audiences. This is the policy area on which there is the most divergence between Trump and Senate Republicans, as evidenced by lawmakers taking differing stances with the Administration and Commerce Department on high-profile trade cases targeting specific products, including paper. Moreover, the President's views on NAFTA and other trade deals appear to be morphing on a regular basis. Raw materials and print manufacturing inputs are currently (in the case of groundwood paper) or potentially in these trade policy crosshairs.

Regulatory Reform – While it lost out to the media drama of tax reform, one of the biggest policy stories in 2017 was the aggressive deregulation efforts of the Trump Administration. Rollbacks or freezes on regulations long concerning the print industry occurred at EPA, OSHA, National Labor Relations Board, and more. EPA Administrator Scott Pruitt has been especially active in reversing Obama-era regulations concerning energy and environmental policy. On the flip side, there is anecdotal evidence that state regulatory agencies may become more assertive in the environmental space in reaction to Washington, D.C. Printers also need to be cognizant of the fact that the industry remains a top-tier priority for OSHA inspections due to injury rates of worksite amputations. Finally, expect the business community at large to seek an approach to “smarter regulation”, which balances the need to protect workers and the environment while not curtailing facility expansion and growth.

Infrastructure – Washington is anticipating a major Trump Administration initiative focusing on a comprehensive transportation overhaul. President Trump, a self-proclaimed “Builder-in-Chief,” reportedly has a personal passion for the issue, particularly in the area of reforming and streamlining permitting processes. Highways, bridges, air, and rail are all expected to be part of this plan. Infrastructure policy has the potential to be a bright spot of bipartisanship in a mid-term election year; the controversy, of course, will be over how to fund such improvements. While not a policy issue directly impacting printing companies, manufacturers and customers moving materials and finished products should be aware of any cost implications emanating from new proposals in 2018.

Postal & Paper Policy – Postal rates and print's economic performance are inextricably linked. In 2018, the hot postal action will center on the Postal Regulatory Commission (PRC)'s 10-year rate review, which was mandated by postal reform legislation passed in 2006. The PRC is charged with examining if the current system that caps postage rates and ties increases to the Consumer Price Index is able to adequately fund the US Postal Service (USPS). Already, the PRC has released initial findings calling for rate hikes. While Congress is not in the business of legislating postal rates, it is in a position to make statutory changes to financially modernize the USPS. Passage of narrowly crafted, bipartisan-supported postal reform legislation could stop the bleeding on USPS' balance sheet long enough to affect the PRC's concurrent rate review process. Additionally, various legislative proposals to address consumer choice in receiving

paper billing, information, and services by government agencies and regulated entities, such as telecom, utility, and water companies, have been and will continue to be introduced at both the federal and state levels.

Labor Policy & Employee Benefits – Immigration reform will continue to dominate the political and policy scene, with some aspects of it affecting labor policy. Whether Congress passes targeted DACA (aka "Dreamers") legislation coupled with border security (aka "The Wall") or if a comprehensive solution will find the required bipartisan support remains to be seen. Workforce issues and expanded vocational education and apprenticeships funding will be another issue of interest in 2018.

Finally, policy makers will continue to address tweaks to the Affordable Care Act after the Republican "repeal and replace" effort failed spectacularly in 2017. Deferring certain tax provisions, such as the so-called Health Insurance Tax, is a pattern Congress is likely to continue this year. President Trump's executive order directing the Department of Labor to pursue the allowance of Association Health Plans as a means to provide greater access and affordability to the small business sector will attempt to address the headache of ever-increasing health insurance premiums for printing companies offering employer-sponsored health benefits.

OPPORTUNITIES AND CHALLENGES

As you have seen, the economic, public policy, and political environments will be challenging, yet full of potential in 2018. Here are some ways that your company can begin to prepare for the road ahead:

1. Plan for the worst but be ready to capitalize on opportunities. There is no doubt that the risk of an economic downturn is rising. At the same time, there is also increased opportunity for the economy to break out of the tepid recovery and accelerate. What to do? Educate and energize your management team and entire workforce to the possible economic and print market scenarios for the coming year. Remind them that the end of the year is the time to think about what went right, what went wrong, and what needs to change for next year in their areas of responsibility. Additionally, remember that increased risk is not a reason to delay or eliminate investments. While the risks are high, the rewards are also high.

2. Make time for strategic thinking and defining your business. Strategic thinking is always imperative for success but it is even more important in a changing environment. When it comes to strategy in the printing industry, printers should address the dual issues of product/service focus and value-added ancillary services. Financial performance typically correlates with specialization by a printed product or vertical market. Also, diversification into various ancillary services usually correlates to higher profits. Printers need to rethink where they are in this process and consciously define their own business models.

3. Take a fresh look at pricing, estimating, and utilizations. Increased profits result from some combination of lower costs, higher prices, and/or increased sales. Too often, printers focus on costs and sales and ignore pricing and utilization rates. Profit leaders have higher profits for two core reasons—lower costs or higher prices. Develop a more nuanced and complete view of the relationships between costs, price, and utilization rates. The fact that a typical printing job is composed of 40 percent fixed costs and 60 percent variable costs provides printers with a lot of discretion in pricing.

4. Focus on education and training. Printers can gain a competitive advantage in human resources management. Profit-leading printers have a much stronger focus on human resources management, particularly training and education. Implement a high performance work system:

- Be all-inclusive in benefits, awards, profit sharing, and bonuses. Employees should perceive equity in sharing gains in good years and pains in bad years.
- Be transparent in sharing information on financial status, business plans, strategies, etc.
- Develop knowledgeable workers. Invest in education and training opportunities for employees.
- Link performance and reward. Reward employees based on individual performance, their team's performance, and the firm's performance.

5. Pay more attention to people costs. The profit gap between profit leaders (printers in the top 25 percent of profitability) and profit challengers (the remaining 75 percent) averages 10 percentage points—a whopping difference of \$1 million in profits for a \$10-million-a-year printer. Since roughly 40 cents of every dollar of a typical printer's sales is expended on people (wages, salaries, benefits, and payroll taxes), managing people and their costs is a key determinant of profitability. Profit leaders are able to use less labor per sales dollar because they abide by the classic dictum of substituting capital for labor. Profit-leading printers employ an average of more than \$15,000 in net assets per factory worker compared to average printers.

6. Prepare for tighter labor markets, higher compensation costs, and tougher recruiting. Finally, the most likely possible economic and print market scenarios point to significantly tighter labor markets. For printers, this means be prepared for:

- Increased wages and salaries to hold on to your workforce
- More labor turnover as employees take advantage of the increased job openings
- Tougher recruiting to fill vacancies

7. Take advantage of any tax law changes. As noted above, tax policy changes in 2018 will be more significant than in past years. Profit leaders can not afford to "Turbo Tax" their way through the new provisions. Congress is likely to make minor technical corrections to tax policy in 2018, and the Internal Revenue Service will issue guidance on tax law applicability throughout the year. Keep an eye on any changes to both

personal and corporate tax laws and evaluate your business practices accordingly. Be ready to take advantage of changes in investment and depreciation rules, pass-through options, and other aspects of tax changes. Don't wait until the end of the year to see how your business might be impacted.

At Printing Industries of America we will continue to focus on providing our members with the programming and services they need to maneuver in the coming dynamic environment.

Be sure to visit www.printing.org to view the latest trends, tips, and topics published by the Center for Print Economics & Management and Government Affairs Department.