

At long last, we appeared to see some upward momentum towards the end of 2011. But, everything is relative and this is not to say that we aren't still very vulnerable to the same world economic fluctuations and general macroeconomic conditions that have been plaguing us for most of 2011. Indeed, at a recent economic forum in Arizona, the overall consensus was that better times are ahead but that the United States is years from a noticeable recovery.

During the third quarter, the Bureau of Economic Analysis reported that GDP grew by 2.5%. (This figure was subsequently revised downward to 2.0%). Although far from exceptional, even the revised forecast was enough to alleviate most economists' fears that a double dip recession is on the horizon. While this represents improvement over the prior periods, economic growth continues to be lackluster and there remains little to portend optimism that a significant expansion is near.

With unemployment still high at approximately 9.0%, more homes in foreclosure and the overall economic outlook remaining dim, consumer confidence remains a problem. Concerns about business conditions, the labor market and income prospects actually increased in October. The Consumer Confidence Index came in at 39.8 on October 25th, down from 46.4 at the end of September. Also in October, the Situation Index (a component of the Consumer Confidence Index) declined for the sixth consecutive month, as pessimism about the current economic environment continues to grow. In general, consumer confidence has returned to levels last seen during the 2008-2009 recession.

So, what does all this mean? As we enter in December of 2011, the *Consensus Forecasts - USA* believes that real GDP will increase at a seasonally adjusted rate of 1.6% during the fourth quarter of 2011 and 1.8% in early 2012. They believe we will not see more meaningful growth until 2017ish, when GDP growth will average 2.4%. As already indicated, most believe that we won't enter into a double dip recession; however, the recovery will be very gradual and anemic.

Now, as to the graphic arts industry...we also see mixed results. We continue to see many companies that are more effective today than they were even a year ago and, as a result, have seen margin enhancement. That, however, doesn't mean all is rosy, as organic, top line growth is very hard to come by.

According to Dr. Joe Webb, U.S. commercial printing shipments in September of 2011 were \$7.4 billion, representing a slight increase of \$22.0 million (0.3%) on a current dollar basis compared to September of 2010. On an inflation-adjusted basis however, shipments for September of 2011 were down \$266 million (-3.5%) compared to the prior year. Similarly, for the first three quarters of 2011, shipments were up 0.2% compared to 2010, but down -2.8% after inflation adjustment. What this shows is that, once again, the industry is tracking GDP growth - but at even a slower pace.

This doesn't mean that we won't see printers succeed in this difficult market. We continue to see many printers that have developed specialties in niche markets that are not competing at commodity type pricing levels. Dr. Joe Webb recently discussed four characteristics in the industry are prevalent among today's strong performers: digital communication capabilities; a workforce that understands the role of print as specialty communications; the ability to invest in technologies that will enhance productivity and lower costs; and a record of good financial management.

For the most part, a glance of the performance of the publicly traded companies involved in the printing industry indicated a lot of mixed news. On the one hand, all six of the segments we analyze experienced a decrease in their stock prices over the prior six months. This is not too surprising given the wild fluctuations in the public stock markets that we have already discussed. On the other hand, earnings showed improvement, with nearly 80% generating positive net income in the most recent quarter compared with 85% in early 2011 - indicating that cost savings initiatives and other profit enhancement strategies have been working.

As usual, the positive (and negative) was not universal. Certain segments fared better than others:

Packaging and Converting

This segment was very impressive from an earnings perspective again this quarter, as all of the companies but one (**Owens Illinois**) generated positive net income. On a more specific level, however, the numbers look even better in that sixteen of the seventeen (94%) of the individual stocks generated positive net income in the most recent quarter, the highest of the segments analyzed. This segment also generated the smallest decline in its median stock price within the past six months of 14.80%.

The segment is currently trading at a price-earnings (P/E) ratio of 14.7 times, which is above the overall average of 14.0 and is the fourth highest of the segments analyzed.

Paper & Forest Products

This segment also yielded mixed results in the past quarter, with only one of the companies reporting net losses. It experienced a 14.85% decrease in stock prices within the past six months, with all but one (Sappi) generating movement in the negative direction. The segment has an overall P/E of 15.6 times, above the overall average of 14.0 and was the highest of the segments analyzed. This is dramatic improvement over the last period analyzed, when the median P/E was only 10.0 times. The best performers on a P/E basis were **Plum Creek Timber Co.**, **Potlatch** and **Weyerhaeuser**.

Print Based Companies

Overall, this segment continues to underperform but showed some signs of encouragement. It traded at the second lowest P/E ratios (10.6 times) of any of the other segments. The median per share stock price decreased by 26.80%, which is tied for the highest decline (along with Publishing companies) of all of the segments examined. It also had the third highest percentage of companies generating net losses during the most recent quarter (16%) but, compared with 21% three months ago, this demonstrated improvement. There were notable standouts, however, with **Innerworkings** and **VistaPrint** trading at P/E/ multiples of 28.9 and 17.9 times, respectively.

Business Services

Four of the five companies in this segment reported positive net income this quarter and generated, on average, a P/E multiple of 13.4 times - the third highest of all of the segments analyzed but still below the overall median of 14.0 times. In addition, the median stock price decreased by 16.10% over the prior six months, the fourth largest decline of the segments analyzed.

Publishing

Publishing companies appears to have been one of the weakest segments this quarter. It traded at the lowest P/E ratios (10.3 times) and 31% of the companies reported net losses, the same as last quarter. This segment generated a decline in stock prices of 26.80% over the prior six months, worse than the average of 19.95%.

The strongest performers in terms of P/E multiples were **Washington Post**, **Scholastic Corp.** and **McGraw-Hill**. The lowest was **McClatchy**, at 3.4 times.

Industry Suppliers

This segment continued to face significant challenges, as 29% generated net losses during the most recent quarter as compared to 26% last quarter. This was the second highest loss generator of all the segments examined. In addition, stock prices decreased by 23.80% over the prior six months. That said, the segment traded at a relatively healthy P/E of 15.3 times (compared to the overall average of 14.0 times). Many of these companies appear to be trading at abnormally high P/E multiples, which may indicate either an optimism of future improvement. On the other hand, the high multiples may be a sign that the stock prices don't yet reflect the reduced earnings level and may be due for a correction.

Summary

In the past, the printing industry has largely tracked GDP trends, and this "recovery" seems to be no exception. On a positive note, we are beginning to see growth again and positive, upward development. On a more negative note, the growth is occurring at a snail's pace and economists aren't expecting it to change anytime soon. That means that printers will need to continue searching for new ways to grow and maximize efficiencies.