



## R&I Sector Reports: Rating the Printing Industry

### General View

According to the Ministry of Economy, Trade and Industry's Statistics Table of the Report by Enterprise 2003, Census of Manufacturers, there are approximately 16,000 printing and printing-related businesses in Japan. Of these, however, only 10 companies hire 1,000 or more employees, and there are only two companies which hire 5,000 or more employees. Much like Gulliver in the land of the Lilliputians, the structure of the printing industry in Japan is characterized by a small number of giants among a myriad of small entities which developed naturally in the course of individual businesses responding efficiently to various and sundry demands with services of varying quality, quantity and delivery dates.

The printing industry can be broadly divided into three areas: publication printing which includes books and magazines, commercial printing which includes promotional material such as catalogues and fliers, and miscellaneous printing which includes securities and cards. In publication printing, the number of individual books printed may fluctuate from one year to the next, but included in this sector are series and periodical publications for which in many cases a consistent circulation can be secured over a long period of time with little fluctuation in demand. A further characteristic of the industry that must not be overlooked is that once a printing company receives an order, there is less likelihood than in other industries of a customer switching to another printer. Furthermore, while commercial printing is to some extent vulnerable to trends in economic conditions, it has a customer base which includes various industries, so it is not likely to be inordinately affected by trends in a particular industry. Therefore, another characteristic of the industry is the relatively stable demand in publication printing and commercial printing.

However, the traditional printing market for paper media printing has peaked out as a result of the increasing penetration of electronic media and the diversity of entertainment in recent years. As a result, competition to secure orders in this sector of the market is becoming increasingly severe. In this respect, publicly listed midsize and larger printing companies including Japan's two leaders in the industry, Dai Nippon Printing and Toppan Printing, developed high value-added services in the paper media business from a relatively early stage by strengthening their planning and proposal expertise, by launching into IC Card production and data print services (DPS), and by promoting business diversification. Areas of diversification include production of materials for daily living and electronics materials such as color filters for liquid crystal displays and photo masks for semiconductors. In an environment where it is becoming increasingly difficult to generate profits in the paper media printing business, these diversified businesses in some cases are becoming sources of income supporting the company overall. On the whole, (1) the rapid pace of technological innovation, (2) strong pressure from customers to reduce cost prices, and (3) the ongoing need for printing companies to undertake major

#### Main Indicators

- Composition of operating income by business area
- Volatility of operating income by business area
- Equity capital ratio
- Balance of net debt and operating funds
- Default ratio of sales receivable

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capital investment are resulting in operational risk which is incomparable with risk carried by traditional paper media printing and, consequently, there is a pressing need to change the way in which operational risk in the printing industry is viewed.

## Rating Points for the Printing Industry

### **Paying attention to the composition of earnings by business area**

While we may refer to printing companies in a general sense, the industry is made up of enterprises of varying natures. In some companies, the majority of earnings are still derived from printing operations while in others diversified businesses are boosting earnings as earnings in printing are maintained. There are also companies where secondary business generated from printing has taken over as the mainstay of the company's earnings. However, because profitability and risk vary markedly depending on the nature of the businesses a company engages in, it is first necessary to ascertain the composition of a company's earnings by business area, trends in those businesses over a period of time, and their volatility.

### **Securing superior customers is the key to stability in the printing business**

The printing business is a relatively stable business. In publication printing, once business transactions are established with a customer, orders can generally be obtained for a relatively long period. Therefore, securing a sound base of excellent customers is a key factor. In commercial printing where economic trends will affect performance to a certain extent, attention needs to be paid to whether a business can enhance its position in the industry by strengthening its expertise in planning and proposals rather than earnings fluctuations in the short term. In addition, many companies procure their own paper, so another important point warranting attention is trends in price negotiations with paper manufacturers. When it comes to IC cards and DPS, printing companies handle the end users' personal information. Because of this, there is a tendency for business to become concentrated in printing companies with established reputations in information security management. This is particularly so for the financial industry where IC cards and DPS are closely related. Consequently, there is an increasing tendency toward polarization of printing companies that can and cannot hope to secure business in these areas.

### **Paying attention to technical innovation and earnings fluctuation risk in electronics materials**

In the electronics materials business where the speed of technical innovation is rapid, even a company that creates competitive products and temporally maintains a competitive edge in the industry may be overcome by rivals if it does not have the ability to keep developing and producing forefront products. Staying ahead in the competition in the printing industry requires a company to invest more in research and development and in capital investment than its competitors do. However, if a company is unable to recover its investment in the short term, it will not be able to undertake investment at the next stage. Whether or not a company has the required level of cash flow generation for new investment will make a difference in the evaluation of a company.

Even if a company takes the lead among material manufacturers, price competition in end products such as LCD TVs and semiconductors is intense, so material manufacturers are pressured into lowering their prices. There are also many cases where pressure to reduce cost prices is spurred by end product manufacturers who produce materials in-house. There is relatively strong volatility in earnings for electronics parts and significant operational risk. Attention must be paid to the fact that, as earnings in paper media printing have reached

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saturation point and as dependence on electronics materials for profits increases, their overall risk is rising.

### **Determining whether the financial base is being maintained in line with operational risk**

The operations of all of the printing companies have been stable, so there have been no incidences of companies posting enormous losses. Equity capital is also continuing to increase. Therefore, although the expansion into diversified businesses is resulting in an increase in risk-bearing assets, companies have appropriate risk resilience. On the other hand, there is no denying that the role of equity capital as a risk buffer is increasing in importance. It is absolutely essential to check a company's equity capital ratio to determine if the financial base is being maintained at a level appropriate to the operational risk. In recent years there have been a number of publishing companies with poor performance and many incidences of irrecoverable sales receivable. R&I calculates a company's exposure on the basis of its bad debt ratio and determines whether there is adequate risk resilience.

In the printing industry, business operations take place domestically and the burden of capital investment is light. As a result, many printing companies succeed in keeping their net debt within the range of operating funds and their financial composition is fundamentally sound. However, if a company's businesses requiring large-scale ongoing capital investment increases, it is important to determine whether investment funds can be repaid through cash flow generation. Therefore, the evaluation of a business which can maintain high cash flow generation and provide for capital investment funds in an ongoing manner through internal funds will improve.

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