

FINAL TRANSCRIPT

Indigo Books & Music Inc.

First Quarter Results

Event Date/Time: August 5, 2014 — 5:00 p.m. E.T.

Length: 25 minutes

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to Indigo Books & Music Inc. First Quarter Results Conference Call.

At this time, all lines are in listen-only mode. Following the presentation, we will conduct a question-and-answer session. Instructions will be provided at that time for you to queue up for a question. If anyone has any difficulties hearing the conference, please press *, 0 for Operator assistance at any time.

I would like to remind everyone that this call is being recorded on August 5, 2014.

I would now like to turn the conference over to Ms. Janet Eger. Please go ahead.

Janet Eger — Vice President of Public Affairs, Indigo Books & Music Inc.

Good afternoon, everyone, and thank you for joining us to review Indigo's first quarter FY '15 results. My name is Janet Eger, and I'm the Vice President of Public Affairs. Joining us from Indigo today are the Chief Executive Officer, Heather Reisman, and Chief Financial Officer, Laura Carr.

Regarding the materials for this conference call, we issued the press release after market close today, which can be found at indigo.ca and on SEDAR.

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This conference call will be recorded and archived in the Investor Relations section of the Indigo website. A playback of the call will also be available by telephone until 11:59 p.m. on August 13, 2014.

As most of you are aware, as a matter of course we do not offer forward guidance. However, for governance purposes I would like to read the Safe Harbor statement.

This conference call could contain forward-looking statements. All statements, other than statements of historical fact included in this conference call that address activities, events, or developments that Indigo expects or anticipates will or may occur in the future, are forward-looking statements.

These statements are based on certain assumptions and analysis made by Indigo in light of its experience, analysis, and its perception of historical trends, current conditions, and expected future developments, as well as other factors it believes are appropriate in the circumstances. However, whether actual results and developments will conform to the expectations and predictions of Indigo is subject to a number of risks and uncertainties, including the general economic, market, or business conditions; competitive actions by other companies; changes in laws or regulations; and other factors, many of which are beyond Indigo's control.

Consequently, all of the forward-looking statements made during this conference call are qualified by these cautionary statements, and there can be no assurance that results or

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developments anticipated by Indigo will be realized, or even if substantially realized that they will have the expected consequences to, or effects on Indigo.

Any forward-looking statements made during this conference call reflect the views of management only as of the date hereof, and are presented for the purposes of assisting Indigo's shareholders and analysts in understanding Indigo's financial position, objectives and priorities, and anticipated financial performance as at and for the periods ended on the dates presented, and may not be appropriate for other purposes.

Indigo does not undertake to update any forward-looking statement made during this conference call, except as required under applicable securities legislation.

At this time I would like to outline the agenda for today's call. First, Heather Reisman will offer opening remarks and comment on the Company's performance for the quarter, then Laura Carr will review the Q1 results. At the completion of Laura's remarks, the Company will open the call to analysts and to investors to take your questions.

I would now like to turn the call over to Ms. Heather Reisman.

Heather Reisman — Chief Executive Officer, Indigo Books & Music Inc.

Thanks, Janet. Good afternoon, everyone, and thank you for your joining us so late in the afternoon.

We've been asked by several investors to share with them the latest news on our transformation, and for this reason we've decided to introduce a quarterly investor conference call.

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When there was just two or three of you who wanted to talk to us it was kind of easy to handle. Now it looks like there's a few more of you.

Announcing our first quarter results today, we are pleased actually to see that our transformation strategy is really starting to gain traction with our customers. Our vision of becoming the world's first cultural department store continues to guide us as we transform both the physical and digital customer experience. And I have been talking to some of you about this for a couple of years.

We have seen meaningful revenue growth, 5.4 percent this quarter, even though we are operating four fewer stores.

Books and book lovers will always be, and I say this all the time, they're always at the core, and therefore it is exciting to report that we actually are seeing growth in books for the first time since fiscal 2010. Not particularly related to hits, but I think a combination of things that we are doing to connect our customers with what we feel is well worth reading.

When reviewing the industry data and competition comparatives, it is frankly reassuring after all this time to see that we are, in fact, outperforming industry trends as far as we understand them in North America and in Europe.

The investments we have made in product development and customer experience are also driving growth in our lifestyle, paper, toy, and electronics categories. As well as growing the top line,

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and Laura will talk to you more about this, we are improving product margins to deliver sustainable growth in the future, and we are still early in this process, for sure.

EBITDA has improved 7.1 million year over year, and while a loss in this quarter is typical—we always do in this business—we are encouraged that our efforts to grow the top line and improve profitability are showing real positive results.

During the quarter, we launched two American Girl specialty boutiques in our Yorkdale Toronto store and in our Robson Vancouver store. I think I've shared this before, but I'll say again we've been delighted with the customer response to these new stores, and we're excited to announce that we'll be opening another American Girl boutique in Ottawa before Christmas. And we have a couple of others planned for opening close to the holiday season.

We continue to review opportunities to expand the business, and we'll get back to you when we have further announcements specifically regarding the store locations. But we do see real growth in the market for this initiative.

While the results we are announcing this quarter are very positive and they do show that we're starting to turn the corner, I say this all the time, there's still much work to be done to drive the business forward and achieve what we see as the full potential of the vision that we set.

We remain focused on improving the underlying productivity and profitability of the business, while ensuring that we don't compromise our need to invest, test, learn, make mistakes, innovate, and grow the business for the long term.

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Retail in general continues to be very dynamic and consumers' needs and demands are changing at a rapid pace. Having been in the transformation for a couple of years now, we feel we're in a good place to continue to evolve and to meet these needs and to really, as I say, begin to leverage some of the investments we've made.

I'd now like to hand this over to our CFO, Laura Carr. She can take you through specific results, and then I'm available for questions.

Laura Carr — Chief Financial Officer, Indigo Books & Music Inc.

Thank you, Heather, and good afternoon, everybody. I will now take you through our results for the 13 weeks ended June 28, 2014, which were announced earlier today. Comparatives will be provided for the 13-week period ended June 29, 2013.

Revenue for the quarter was \$180.8 million, which was 5.4 percent, or \$9.3 million higher than the same period last year. This revenue growth was achieved despite operating five fewer superstores and two fewer small format stores. On a comparable store basis, retail revenues were up 8.3 percent in superstores and up 1.9 percent in small format stores.

Sales in the online channel, which include sales from our in-store kiosks and mobile applications, increased by 14 percent year over year.

On the other revenue line we saw a slight decrease of \$0.6 million driven by lower loyalty income from irewards membership fees and lower gift card breakage.

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On the other revenue line we saw a slight decrease—sorry. The significant revenue growth during the quarter was partly driven by a timing shift of the Easter holiday, launch events for two American Girl specialty boutiques, and closing down sales in two superstore locations. The majority of the growth came from underlying business improvement in the retail and digital channels.

Looking at the sales mix and as Heather has already mentioned, books grew in the quarter for the first time since fiscal 2010. The growth came from both retail and digital channels. This growth was not the result of major hit titles. Indeed, in the same quarter last year we had some major hits with Dan Brown's "Inferno" and Khaled Hosseini's "And the Mountains Echoed". This year we've seen the benefit of the teen hit "The Fault in Our Stars" by John Green, which also has benefitted from the release of the movie.

We've experienced double-digit growth in our lifestyle, paper, toys, and electronic categories. Paper benefitted from the store investments we made in all of our superstores prior to the holiday period last year, and from the growth in our proprietary product lines. Electronics is benefitting from the launch of 37 Indigo Tech stores last year, which are the store-within-store concept for a range of highly curated personal tech products.

As you can see from our product line disclosures, revenues from general merchandise categories grew to 27.4 percent of total revenues compared to 21.9 percent in the prior period; reflected our intended strategy of offering our customers a wider range of life-enriching products and experiences that complement our core book offerings.

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Cost of sales increased \$1.5 million to 100.8 million for the 13-week period, driven by higher revenues. On a percentage basis, cost of sales decreased, leading to a gross margin improvement of 2.1 percent to 44.2 percent margin.

Improving margins is one of our key strategic focus areas, and whilst we are seeing margin improvements in most merchandise categories, some of this margin improvement is due to the timing of markdowns taken for the summer clearance sales.

Cost of operations increased by \$0.6 million to \$67 million. The increase was primarily driven by higher online operating costs in line with increased revenues. Store operating costs were marginally up versus the prior year, as a result of higher labour costs not being fully offset by reduced occupancy cost of operating fewer stores. On a percentage basis, cost of operations was 37.1 percent this year compared to 38.7 percent last year. The improvement of 1.6 percent was the result of increased revenues.

Looking at selling and administration expenses, they were broadly flat year over year at \$20.3 million. As a percentage of revenues, that percentage decreased by 0.6 percent to 11.2 percent as a result of higher revenues.

As Heather mentioned, EBITDA has improved by \$7.1 million to a loss of \$7.3 million for the period compared to a loss of \$14.4 million for the same period last year. The improvement was primarily driven by higher revenues and improved product margins as previously described.

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Loss before income taxes improved by \$6.9 million to a loss of \$14 million compared to a loss before income taxes of 20.9 million in the prior period. There was no income tax recovery this year compared to an income tax recovery of \$5.8 million in the prior period.

In fiscal 2014, the Company took a valuation allowance of \$11.6 million against the gross value of deferred tax assets. The valuation allowance was driven by the accounting rules under IAS 12 income taxes, which requires management to review its future estimate of probable future taxable income. There has been no change to management's future estimate, and therefore we have not created any additional tax assets during the quarter.

The results of this change in tax recovery is that the Company recorded a net loss for the period of \$14 million, or \$0.55 loss per share, compared to a net loss of \$15 million, or a loss of \$0.59 per share in the prior period.

Moving to the balance sheet. We ended the quarter with \$150.7 million of cash and no external borrowings. Cash has decreased \$40.7 million in the same period last year, primarily due to over \$30 million of capital investments made to drive the Company's transformational strategy and \$5.6 million of dividend payments. We utilized \$6.9 million of cash during the 13-week period, which included 2.1 million of cash for use in operating activities and \$4.2 million of capital expenditure.

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Total inventories were \$213.2 million at the period end, an increase of \$6.2 million on the same period last year, primarily driven by increased lifestyle inventories to support the double-digit growth of those categories.

We have not announced a dividend payment with these results, and our intention remains to utilize our existing cash balances to support the ongoing transformation.

This concludes my prepared remarks, and at this point we would like to open the call to questions.

Q&A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session for investors and analysts only. Should you have a question, please press *, followed by 1 on your touch-tone phone. You will hear a three-tone prompt acknowledging your request, and your questions will be polled in the order that they are received. Should you wish to decline from the polling process, please press *, followed by 2. If you are using a speakerphone, please lift your handset before pressing any keys. One moment, please, for your first question.

Your first question comes from Bob Gibson from Octagon. Please go ahead.

Bob Gibson — Octagon

Good afternoon.

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Heather Reisman

Hi, Bob. How are you?

Bob Gibson

I'm good. Thanks for holding this call.

Heather Reisman

Okay.

Bob Gibson

Can you give us some idea of store openings and closings for the year?

Heather Reisman

Okay.

Bob Gibson

What you're thinking?

Heather Reisman

Yeah. Just before I deal with that, I just want to add one thing to Laura's wonderful report in case it raises any question. Laura noted that in other revenue that our loyalty income was down. Because loyalty is so important to us, I just want to put this in the proper context.

As you know, a couple of years ago we launched a free loyalty program, so we now have two elements to the program. We have a pay, our Indigo irewards, which is pay, and then our Plum

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program, which is free. And this—we have a natural migration of people from pay membership to free, which was actually the intent of the direction we wanted to go.

So in case there's any question about that, overall loyalty membership in total for Indigo is up and loyalty participation in our stores is up, so to me this is an important indicator of the brand. And I just want to share that.

On the stores, we only announce, Bob, even though I know why you want to know this, we only announce when we're actually ready to do something. I can tell you we are actively engaged in looking at our portfolio and making decisions about what is the best way to leverage our existing assets and build on them moving forward. At the moment we don't have any announcements to make.

Bob Gibson

Okay. Can you give me...

Heather Reisman

I know that you would like more, but it's just always our policy. When we're ready to open we will mention it.

Bob Gibson

Okay. American Girl. Can you give me some thoughts as to your speed of the rollout? Why? Where? The time it takes to convert a store to put American Girl in? Any colour you can give?

Heather Reisman

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Sure. So we're adopting the same philosophy basically as American Girl does in the US, which is a careful rollout of the brand very specifically in markets where we know it will thrive. In some cases we know there are markets that we want to go to, but it means we need a little bit more space in the store. We're negotiating with landlords. In some cases we want to do some fundamental renovation in the store, so in total the relationship has been a smashing success beyond even both of our highest expectations.

And we have every intention of meaningfully increasing the amount of American Girl shops that we have, but there are things that have to happen each time we choose to open. So right now we're opening in Ottawa. We are looking actively at what we're going to be doing in at least four other cases, but we're just not ready to announce them right now. And in total we see that there is significant more opportunity to grow this, let's just say that.

Bob Gibson

Okay. Great. And I'm quite amazed that books have finally turned around. Any colour on that? Is it...

Heather Reisman

Look, I...

Bob Gibson

Big sellers?

Heather Reisman

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I—as Laura said, this happened despite the fact that the only big book was a teen book, so limited market. Not like when you have a book that is a huge adult market book. I think this is one of those things where we know that the curve has levelled off right now for e-books, but I would not want anyone to think that I don't believe that there will still be demand on—pressure on this business. We see a nice trend. We think there's opportunity to become the best book sellers possible, but I don't want to say more than that. We'll sort of take it quarter by quarter.

Bob Gibson

Okay. Great. Thank you very much.

Heather Reisman

Okay.

Janet Eger

Thank you, Bob. Operator, may we have the next questioner please?

Operator

Yes. Your next question comes from David McFadgen from Cormark Securities. Please go ahead.

David McFadgen — Cormark Securities

Oh hi; a couple of questions. So when you look at the general merchandise line, it was up pretty strong in the quarter. It was up 32 percent. If you x out American Girl, or you just exclude that

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revenue line in there, was the rest of the general merch up above 15 percent kind of where it's been tracking?

Heather Reisman

Yeah.

David McFadgen

Okay. So I'm just, Heather, I'm just a little curious why you wouldn't have another GTA store before Christmas? Is it just been logistics and negotiating with landlords...

Heather Reisman

I think this one needs—I mean we don't announce these specifically, but the general merchandise business was up a little bit more than that.

David McFadgen

Okay.

Heather Reisman

But yeah, it's just logistics. This is a long-term play for us, so it would be nice to have it before, but as it turns out we have some pretty good idea of where we want to put these and it's just a question of logistics.

David McFadgen

Okay. Is there a possibility that you could get one in before Christmas? Or...

Heather Reisman

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The only store that we're announcing before Christmas that we know for sure we're doing is Ottawa.

David McFadgen

Okay. Okay. So I was also a little surprised about the improvement in the same-store sales growth for small format stores. What was the driver there?

Heather Reisman

We have added some smaller amount, but some amount of our general merchandise to their stores, particularly in our paper program and a lot of our proprietary paper program, and that's been extremely well received.

David McFadgen

Okay. And then just on the books growth, was it about 1 percent in the quarter?

Heather Reisman

We don't break it out...

Laura Carr

We don't break it out specifically, but yeah, it definitely grew. And just going back to the general merchandise point, it was more than 25 percent growth.

David McFadgen

Excluding American Girl?

Laura Carr

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Yes.

David McFadgen

Okay. Okay. So that's kind of been up from the recent trend. What would that be attributed to?

Heather Reisman

Just better— I mean the product's going to keep getting better, right? We're developing our own product, we're building the relationship with the customer so, David, we've discussed this over time. I've always said that this was a marathon and not a sprint, and I think we're going to continue to see quarter by quarter or and then year over year with some ups and downs constant improvement. The product will get better, the margins will get better, the customer connection to it will improve, but it's part of the journey.

David McFadgen

Okay.

Laura Carr

Plus I think we also invested in improving all of our stores...

Heather Reisman

Presentation...

Laura Carr

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Presentation last year before holidays, and we're seeing the benefit of that now on every line (phon).

David McFadgen

Mm-hmm. Okay. And then do you think that you could actually grow cash this fiscal year?

Laura Carr

Well, we don't give a forward forecast. I think...

Heather Reisman

Don't give a forward forecast. We don't give a forward forecast.

Laura Carr

Yeah.

David McFadgen

Okay

Heather Reisman

Let's just say, isn't that the ambition of all companies?

David McFadgen

Okay.

Heather Reisman

That would be our ambition.

David McFadgen

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Okay. And then lastly just on the SG&A, I noticed it was flat in the quarter...

Heather Reisman

I just want to say, I don't know if anybody else is listening—sorry, David, I know it's David. I just want to say I don't know if anybody's ever listening, but when we grew cash by too much, all the analysts ever asked is what were we going to do to spend it?

David McFadgen

Yeah. Well, I'm sure everybody would love to see you grow cash. That's a nice problem to have. But I noticed the SG&A in the quarter was flat year over year. I know you don't provide guidance, but can you provide some commentary on that line? Do you think that line will continue to be flat for the year overall?

Heather Reisman

I think he's asking for guidance. We don't do guidance. It's just another way of asking for guidance, Bob (sic) (David). We're just not going to do it.

David McFadgen

Okay. All right...

Heather Reisman

I think we understand that the name of the game is to improve productivity and that our ambition is to return the Company to the level of profitability it once enjoyed and maybe even

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better, but it's certainly to return it to. So that's a deep focus of the Company, but we need to keep in mind that at this stage we're still learning and growing and investing. And so it's a balance.

Janet Eger

Thank you, David.

David McFadgen

Okay. Thanks.

Operator

Thank you. Ladies and gentlemen, as a reminder should you have a question, please press *, followed by 1.

Janet Eger

Okay. So thank you, everyone, for your time and attention today. We appreciate you calling in, and look forward to reconnecting on a quarterly basis. Our second quarter results will be announced on or around November 4, 2014.

Thank you again for your support, and good afternoon.

Heather Reisman

Thanks, Janet.

Operator

Ladies and gentlemen, this concludes your conference call today. We thank you for participating, and ask that you please disconnect your lines.

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