



Indigo Books & Music Inc.

Fiscal 2023 Second Quarter Results Call

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CORPORATE PARTICIPANTS

Craig Loudon

Indigo Books & Music Inc. — Chief Financial Officer and Executive Vice President, Supply Chain

Peter Ruis

Indigo Books & Music Inc. — Chief Executive Officer

CONFERENCE CALL PARTICIPANTS

David McFadgen

Cormark Securities — Analyst

PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the Indigo Books & Music Inc., financial year 2023 Q2 analyst conference call.

This call is being recorded today, Thursday, November 10, 2022.

I would now like to turn the conference over to Craig Loudon. Please go ahead.

Craig Loudon — Chief Financial Officer, Indigo Books & Music Inc.

Good morning and thank you for joining us to review Indigo's Fiscal 2023 second quarter results. My name is Craig Loudon, and I'm the Chief Financial Officer of Indigo.

Regarding the materials for this conference call, we issued the press release yesterday. It can be found at *indigo.ca* and on SEDAR. The 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 November 17th.

This conference call may contain forward-looking statements, and to the extent that it does, we refer you to our cautionary statement regarding forward-looking statements in the press release and the MD&A for this quarter.

We were pleased to announce last quarter that Heather Reisman, Indigo's founder and Chief Executive Officer, has now been appointed Executive Chair. Heather will continue to drive Indigo's vision and growth strategy while also remaining deeply involved in the business. We welcome Peter Ruis, our President over the past 20 months, as our new Chief Executive Officer. Peter will be instrumental to our

future success and upholding the key values that have proudly been central to Indigo for the past 25 years.

I would now like to turn the call over to Peter.

Peter Ruis – Chief Executive Officer, Indigo Books & Music Inc.

Good morning, everyone, and thank you for joining us.

First off, I would like to thank you, Craig, for that warm introduction. I'm honoured and delighted to be taking on this new role, and would like to pay tribute to Heather's 25 years of creating and running this incredible brand. I look forward to our new partnership as we shape the future of Indigo.

I'm excited to share that Indigo delivered strong top-line performance this quarter with sales of \$236 million. This is compared to \$239 million in the prior year, which included a one-time benefit of \$17 million from the renegotiation of our partnership with a café vendor. Looking specifically at merchandise sales, which is the total of retail and online revenue, Indigo delivered a record high of any second quarter in the Company's history.

The general merchandise side of the business achieved the highest ever sales outside of a holiday quarter. We delivered double-digit growth in the baby and lifestyle product categories, including home and wellness, reinforced by the continued success of Indigo's proprietary brands, including OUI, NÓTA™ and LOVE & LORE®. The growth in this business demonstrates the value of the Company's continued investment in our carefully selected and diverse product assortment.

Our print business continues to show resilience and we saw growth in fiction categories this quarter, fueled by a younger demographic of readers.

Indigo, like the wider retail industry, continues to operate in a challenging macroeconomic environment, which has caused supply chain disruptions, significant increases in fuel prices and other inflationary pressures. Unfortunately, much of the benefit of Indigo's strong top-line performance has been tempered by these economic factors. We're working hard to manage these pressures while we continue grow our business.

We have a lot of other exciting news I would like to share with you.

We are once again investing in our retail network. We have two new concept stores on the horizon; a new downtown Ottawa location in the Rideau Centre, and a location in downtown Toronto at The Well, which is one of the largest developments in Canada. These stores will introduce a reinvigorated retail concept that we know our customers will love.

This quarter, we celebrated Indigo's 25th birthday. We proudly partnered with some of Canada's top culture markers, from authors to an astronaut, to learn how they live their Life on Purpose. We had celebrated across the country and released a limited-edition collection of 25 iconic books, with an exclusive cover design by Canadian artists.

As part of the celebration, the Indigo Love of Reading Foundation announced a goal to raise and donate \$25 million over the next ten years to support children's literacy in high need communities across Canada. Indigo will be supporting the Love of Reading Foundation by contributing to their goal through cash and in-kind service donations. The pandemic has led to a significant decline in learning for many children, and we are proud to support this important initiative.

We also recently publicly released our annual Climate Report. We have some big goals in the Company anchored around becoming net zero by 2035, and we are proud of the progress we have made over the past year.

We're about to enter our important holiday sales season. Our teams have worked very hard to source a thoughtfully curated assortment to help bring magic to our customers' holiday season. We look forward to what the holidays have in store.

I would now like to ask Craig to provide a more detailed financial perspective on the quarter.

Craig Loudon — Chief Financial Officer, Indigo Books & Music Inc.

Thank you, Peter.

The results we are discussing are for the 13 weeks ended October 1, 2022. Comparative figures reference the 13 weeks ended October 2, 2021.

In the second quarter, the Company generated revenue of \$236 million compared to \$239 million for the same period last year. As Peter mentioned, the prior year included a one-time benefit of \$17 million from the renegotiation of our partnership with a café vendor.

Merchandise sales, which includes total retail and online sales and excludes other revenues, were a record high of any second quarter for the Company. The general merchandise business achieved the highest ever sales outside of a holiday quarter, demonstrating the Company's success at scaling this important business line.

As a result of social distancing and the government mandated capacity constraints in stores in the prior year, we believe that comparable sales are not currently meaningful to evaluate performance. Instead, we have focused on total revenue.

Sales in the retail channel increased by \$11 million or 7% to \$170 million for the quarter compared to \$160 million for the same period last year. For the first time since the onset of the COVID-19 pandemic, retail sales have exceeded the last comparable pre-pandemic quarter. This was achieved

despite the impact of reduced traffic, which while showing continued signs of improvement, remained challenged compared to pre-pandemic levels.

The online channel has maintained momentum, with sales of \$54 million for the quarter. This remains 84% above the comparable pre-pandemic quarter. The online channel continues to be a key area of growth and investment for the Company.

Overall, we continue to see the impact of the current macroeconomic environment on costs. Cost of sales increased by \$12 million to \$141 million for the quarter compared to \$129 million in the prior year. Excluding the impact of online shipping costs, cost of sales increased by \$10 million to \$129 million for the quarter. As a percentage of total revenue, this represents an increase to 55% compared to 50% in the second quarter of the prior year. The prior-year rate was positively impacted by the previously mentioned one-time benefit of \$17 million. Macroeconomic conditions throughout the quarter have had an adverse effect on cost of sales, including an incremental \$2 million of international freight costs, as well as other additional inflationary pressures. The penetration of promotions has also increased since the pandemic when the Company had elevated full price sell through rates. Online shipping costs increased by \$2 million to \$12 million for the 13-week period ended October 1, 2022 driven by the elevated cost of fuel and associated delivery surcharges.

Overall, operating, selling and administrative costs increased by \$5 million to \$89 million for the quarter compared to \$84 million in the prior year. This was driven by increased spending on marketing initiatives and costs associated with advancing the online channel. The Company also did not benefit from COVID-19 support in the current quarter compared to \$2 million recognized in the same period last year.

Adjusted EBITDA decreased by \$21 million to a loss of \$11 million for the quarter compared to earnings of \$11 million in the same period last year. The prior year results benefited from the one-time payment of \$17 million on the renegotiation with a café vendor and \$2 million of external COVID-19 support, as discussed. These items also impacted the net loss position, which decreased \$19 million to a net loss of \$16 million (or \$0.57 net loss per common share) for the quarter compared to net earnings of \$3.5 million (or a \$0.13 net earnings per common share) in the prior year.

We are excited about our top-line performance this quarter, which demonstrates the customers' affinity for the Indigo brand. However, we are working in a difficult macroeconomic environment. Our teams have been working hard to manage these pressures to allow us to continue on our trajectory of long-term sustainable growth and shareholder value.

A key focus to mitigate risk this year has been purchasing inventory further in advance of the holiday sales season. With industry-wide shipping delays, this was a key tactic to ensure that we have a robust general merchandise assortment for our customers and continue to be their key gifting destination.

To help manage the seasonal nature of working capital, Indigo drew \$20 million on our related party credit facility this quarter. Indigo has no other outstanding debt and we continue to deploy capital prudence to maintain a strong financial position.

At this point, we would like to open the call for any questions.

Q & A

Operator

Thank you, sir.

Your first question will come from David McFadgen of Cormark Securities.

David McFadgen — Analyst, Cormark Securities

Yes, hi everyone. A couple of questions. Just looking at the cash balance, I was surprised that it's as low as it is. I think it's the lowest I've ever seen it since you guys divested yourself of Kobo. I'm just kind of wondering what your outlook is for cash flows, thinking that the cash would, at the end of this fiscal year be kind of similar to what it was in the prior year. What are your thoughts around that?

Craig Loudon — Chief Financial Officer, Indigo Books & Music Inc.

Sure. David, I can take that one. It's Craig. Yes, so at the end of this quarter it was lower than we've seen in the past. I think the biggest thing we've done was we brought in inventory quite early. The Port of Vancouver had been taking almost three weeks at times for ships to dock and there's been another ten day to two week delay at the railheads in BC. So, inventory definitely hit and needed to be paid for sooner for the holiday period than in past years. So that was an intentional decision. It is still our plan by year-end to have cash roughly in line with last year. Obviously, that is somewhat dependent on the economic outlook. I think last time I said it would be slightly higher. But certainly, we're still targeting for it being in line with last year.

But yes, inventory was definitely higher at quarter end, building to the holiday, than in the past. Last year we were certainly being more cautious given there was still risk of closures. In fact, last year, the two weeks before Christmas pretty much nobody was out physically, and luckily we kept inventory much tighter last year.

David McFadgen — Analyst, Cormark Securities

Okay. So just on that, what is your sort of read so far into the quarter, particularly, given it seems like, from what I can see, we're in the midst of a recession or heading into a recession. Just wondering what your outlook is there for December, at least what you can tell so far.

Peter Ruis – Chief Executive Officer, Indigo Books & Music Inc.

Hi David, it's Peter. I honestly think it's too early to tell. We're just coming into the Christmas quarter. It's a slightly different pattern this year in terms of the fact that customers have obviously been out and about for a bit. There isn't the same COVID concern. So I think it's generally too early to tell. We still have high hopes for a very strong holiday period. We're just kicking into it now. The full assortment is out there. The Christmas windows are up. The music's in the store. So, I think we'll begin to see the energy and excitement over the next month.

David McFadgen — Analyst, Cormark Securities

Okay. So currently in this quarter and then the previous quarter to that, you know, you're dealing with higher inflation and that's hit the margins. Are there any efforts underway that would control costs outside of that to shore up profitability?

Craig Loudon — Chief Financial Officer, Indigo Books & Music Inc.

Yes, absolutely. We have made some adjustments to operating costs for the upcoming holiday period. In the more mid-term, we're absolutely working on addressing that. I mean, some of these things have been difficult to adjust to in the short-term. The fuel surcharges on direct-to-consumer shipping

and also shipping to the stores have been difficult to get around. We have made some carrier changes as a result, which will help.

I think the other thing, you mentioned was margins. We did see in the second quarter that consumers are definitely skewing towards deal product, and that had part of the impact on the margins. But as the fresh product is arriving for holiday, that does change the outlook on that.

So, a lot of activity around that. I would say some of the inflation, like I mentioned on the last call, some of it's permanent, like labour, but other items like inbound freight, we absolutely see that coming down. The volumes out of China are lighter. The challenge for holiday is that the product did come in at those elevated freight rates, but in future quarters as new product arrives it will be landing at lower freight rates, which at one point were five times historical levels. Now I would say we're down to about 1.5 times historic levels.

So that will help in future quarters. But it just does take a while for these things to work through the system.

David McFadgen — Analyst, Cormark Securities

Okay. And then I was looking at the announcement that you made earlier about Adidas. I think this is the first time that you're talking apparel at Indigo, in fact. What is the outlook there? Are you planning on growing the apparel inventory in the store?

Craig Loudon — Chief Financial Officer, Indigo Books & Music Inc.

Sorry. David, you cut out there. Could you just repeat the last bit of that question?

David McFadgen — Analyst, Cormark Securities

Yes. So I was looking at your announcement that you made earlier with Adidas. So I think this is the first time that you have apparel in store. Just wondering, is the plan to increase the selection or quantity of apparel that you'll have in store.

Peter Ruis – Chief Executive Officer, Indigo Books & Music Inc.

David, it's not the first time we had apparel in store. We've consistently run very small elements of fitnesswear, particularly as you come into December/January, and we've run obviously for a long time, loungewear and pajamas. It's a very, very targeted offer. It's predominantly in kids and accessories. So it's things like caps, backpacks. We have an exclusive lock in with Adidas and LEGO. So there's an Adidas/LEGO collection. We're obviously one of the biggest retailers of LEGO in Canada, and there is some baby and young kidswear that fits into LEGO.

So, it's really just an extension of the type of product we've had before, but with a brand we know our customers like.

David McFadgen — Analyst, Cormark Securities

Okay. All right. Okay, that's it for me. Thank you.

Craig Loudon — Chief Financial Officer, Indigo Books & Music Inc.

Thanks, David.

Operator

At this time, there are no other questions. I will turn the conference back to Craig Loudon for any closing remarks.

Craig Loudon — Chief Financial Officer, Indigo Books & Music Inc.

Thank you for your time and attention today. We appreciate you calling in and look forward to reconnecting on a quarterly basis. Our third quarter results will be announced on or around February 9th. Thank you again for your support and have a great day.

Operator

Ladies and gentlemen, this does conclude your conference call for this morning. We would like to thank you all for participating and ask that you please disconnect your lines.