

FINAL TRANSCRIPT

Indigo Books & Music Inc.

Second Quarter Results Conference Call

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CORPORATE PARTICIPANTS

Janet Eger

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

Laura Carr

Indigo Books & Music Inc. — Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Bob Gibson

PI Financial — Analyst

David McFadgen

Cormark Securities — Analyst

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the Indigo Books & Music Second Quarter Results Conference Call. At this time, all lines are in listen-only mode.

Following the presentations, we will conduct a question-and-answer session.

And if at any time during this call you require immediate assistance, please press *, 0 for the Operator.

Note that this call is being recorded, Tuesday, November 8, 2016.

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

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

Good afternoon, and thank you for joining us to review Indigo's second quarter fiscal 2017 results. My name's Janet Eger, and I'm the Vice President of Public Affairs. Joining us from Indigo today is the Chief Financial Officer, Laura Carr.

Regarding the materials for this conference call, we issued the press release after market closed today, which 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 11:59 p.m. Eastern Time on November 15, 2016.

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

I'd like to now turn the call over to Laura Carr.

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

Thank you, Janet, and good evening, everybody. I'm just going to make some general comments that normally Heather would make—unfortunately, Heather couldn't join us this evening—and then I will go through a more detailed review of the financials.

We're really pleased to be announcing another quarter of meaningful revenue growth. Even if you just look at the comps that we posted this time last year, this is a really good news story.

We're now having three years of continuous quarterly revenue growth, which is very positive. This quarter we saw growth in both our retail and our digital channels, in our general merchandise businesses, and in our core book business.

Our traffic and conversion rates continue to improve, and we are proud to say that our net promoter score, which we think's a key measure of our brand strength, increased to a best-in-class 71.

We have received fantastic feedback on our new format store at Sherway Gardens in Toronto. The store continues to perform above our expectations, and we are looking forward to rolling out this concept further across our network.

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November 8, 2016 — 5:00 p.m. E.T.

Indigo Books & Music Inc. Second Quarter Results Conference Call

There is real momentum and great energy in the business, and we're in a great position moving forward into our critical holiday season. We're poised for continued future growth.

So now I'm going to talk in a bit more detail about the financials, and then open the call to any questions.

The results that we're discussing tonight are for the 13 weeks ended October 1, 2016, and comparative figures have been provided for the 13 weeks ended September 26, 2015.

For the second quarter revenue was \$217 million, which was 11 million more than last year despite operating three fewer stores. Revenue growth was 5.4 percent, which was meaningful, as I mentioned, if you consider the strength of the growth posted in the comparable prior-year period.

Total comparable sales, including online, were up 5.1 percent for the quarter. Comparable retail store sales for the quarter increased by 3.8 percent in superstores and 4.9 percent in small-format stores.

These improvements were driven by continued double-digit growth in our general merchandise categories and low single-digit growth in our core book business, driven by the sales of Harry Potter and the Cursed Child, partly offset by the declining trend for adult colouring books. The second quarter revenue from general merchandise categories grew to 32.6 percent of the total compared to 30.3 percent last year.

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For the quarter, margin dollars increased by 4.1 million as a result of higher revenues. Margin rates decreased by 0.5 percent as a result of higher discounts in the current quarter, mainly driven by promotional discounting of the Harry Potter hit title and higher markdowns in general merchandise.

Our operating, selling, and administration costs increased by 3.4 million this quarter compared to the same quarter last year. Operating costs for retail and online increased by 2.6 million due to increased sales volumes and higher wage rates. Overall, EBITDA has improved by \$0.7 million, driven by higher revenue.

The second quarter net loss of 1.2 million represents a 0.6 million improvement compared to the same quarter last year. This improvement was driven by the EBITDA increase.

On a fiscal year-to-date basis, revenue increased by 19.4 million or 5 percent to \$410 million compared to \$391 million for the same period last year. Year to date, total comparable sales, including online, increased by 6.1 percent while comparable retail store sales increased 5.6 percent in superstores and increased 6.2 percent in the small-format stores.

On a year-to-date basis, EBITDA decreased by 3.2 million to a 1.4 million loss compared to a 1.8 million profit in the same period last year. However, in the same period last year the Company received a onetime net proceed of 4.5 million relating to an exit of a lease, without which last year's EBITDA would have been a loss of 2.7 million. So on an adjusted basis our EBITDA has improved by 1.3 million.

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Just turning to the balance sheet. We ended the quarter with 184 million in cash, which represents an \$8 million increase from Q2 last year, an increase that's driven by improved working capital.

At this point, I'd like to take any questions.

Janet Eger

Thank you, Laura. To ask a question, please press *, 1. Operator?

Q&A

Operator

Thank you. Ladies and gentlemen, indeed if you do have a question, please press *, followed by 1 on your touch-tone phone. Note that your questions will be taken in the order received. And should you wish to withdraw your request, you will need to press *, followed by 2. And if you're using a speakerphone, please lift the handset before pressing any keys.

And your first question will be from Bob Gibson at PI Financial. Please go ahead.

Bob Gibson — PI Financial

Good afternoon.

Laura Carr

Hi, Bob. Welcome back.

Bob Gibson

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Thanks. Can you give me a little colour on this declining trend in adult colouring books?

Laura Carr

Yeah. I think we've talked before about last year we really did get on top of this trend in a big way. And I think we're still selling a lot of colouring books. I just think the trend is obviously not as it was.

So we still sold some, but it has declined against last year, but those sales are basically replaced by Harry Potter this year.

Bob Gibson

Okay. The pop-up store that you're making permanent, can I get some colour on that one?

Laura Carr

The pop-up store? Which one's that?

Bob Gibson

You said you're making a—decided to operate a previously opened pop-up store on a permanent basis.

Laura Carr

Is that in the press release?

Bob Gibson

Yeah. In the overview of the first paragraph. Okay. Well, maybe we can look at that off-line.

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Laura Carr

Sorry, I'll take it off-line. Yeah. I'm not sure what that one is.

Bob Gibson

Okay. Construction was only \$3.1 million. I was expecting to see that number be much bigger than last year. Can we get any colour on is that a couple of stores refurbishing? Or what is that?

Laura Carr

Yeah. That's basically we've done some small-format stores and some minor work. As you know and we've talked about, we are embarking on a much more aggressive renovation program, which will commence in January of 2017, so you'll see sort of the capital spend increase as of January onwards.

Bob Gibson

Okay. Great. And I guess lastly, can we talk about reading socks?

Laura Carr

Yeah. Well, we can talk about the fuller (phon) designs, but reading socks are still doing well. They're back in stores for this quarter, our holiday season. They're a fixed key item and going well.

Bob Gibson

Okay. Great. Thank you very much.

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Laura Carr

Thanks, Bob.

Operator

Thank you. Next question will be from David McFadgen at Cormark Securities. Please go ahead.

David McFadgen — Cormark Securities

Oh hi, Laura.

Laura Carr

Hi.

David McFadgen

So a couple of questions; when are you going to start to really roll out the Sherway store concept? Is that not until next year, like January 2017 calendar?

Laura Carr

Yeah. I think what we want to do is make sure that we can execute this program with excellence, so we've been busy building the capabilities to make it roll out in a significant fashion.

We are delighted with the Sherway performance, and it continues to trend around 28 percent higher than the Chapters store that it effectively replaced at Queensway, which gives us really positive information for the future model.

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So yeah, we've got an aggressive rollout program starting in January, and then you should hopefully see the results of that in next year's result.

David McFadgen

So there won't be any new store renovations on this Sherway concept in this calendar year then?

Laura Carr

In this calendar year, no.

David McFadgen

Okay.

Laura

As we enter into the holiday season, I mean we're now in blackout from a construction period because we obviously have a high-trading period now—

David McFadgen

Mm-hmm.

Laura Carr

—and we'll pick back up as soon as we can in January.

David McFadgen

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Okay. So can you share with us some metrics on the Sherway store? I think that store was doing very large non-book revenue as a percentage of its total revenue. Can you give us any metrics there?

Laura Carr

Yeah. So the mix in the Sherway store, the general merchandise is about 51 percent of the total sales. And the store that it replaced, Queensway, that was about a 40 percent general merchandise.

So the really positive news is that books are growing in Sherway, but the mix is still skewing towards general merchandise, because the general merchandise growth is so much higher. And I think what we feel is that when you actually demonstrate the sort of—it's not really a new assortment—but the expanded assortment with the right fixtures, the customers really understand what we're doing. And it's showing because the general merchandise growth is really phenomenal.

David McFadgen

Okay. So the other question I have is if you look at the SG&A if you exclude the FX swings, it's down year over year Q2 to Q2.

Laura Carr

Yeah.

David McFadgen

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Is that kind of something we could expect going forward that you keep chipping away at the cost structure there on the SG&A?

Laura Carr

Yeah. We will always continue to chip at the cost structure. Last year we did have some big FX gains because we were holding quite a lot of US cash on the balance sheet as we were going through some tumultuous times with the US dollar.

Now we've entered into a bit more of a hedging program, so those gains we don't have as much US cash on the balance sheet, and you can see this year the gain was only 0.8. I think last year it was 2.4, so that did have an impact.

But yeah, we're constantly focused on the cost structure, as well as obviously focused on growing the top line.

David McFadgen

Mm-hmm. Okay. Now can you give us any outlook for how the Christmas quarter is setting up? Anything at all?

Laura Carr

I think the stores are set; they look great. The customers like our product. I think Q3 is our major quarter, it's a great quarter, so we feel very confident. There's a lot of energy in the business.

Employee engagement is high; the metrics are good. So we feel good, but yeah, I can't give you an outlook.

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**David McFadgen**

Okay. Can you ... Even though some companies don't provide guidance, you know, revenue, EBITDA, and net earnings, and so on, they will provide a CapEx outlook. Would you be able to give us one for your fiscal 2018 year?

Laura Carr

I think the—and Heather's talked about this before—she believes firmly, and so do I, that we're fairly prudent, so we won't be spending more than our EBITDA. But we are obviously entering into a program of much more intense renovations in our physical stores, and we're making enhancements to our digital platforms.

So you will see that capital increase, but not beyond EBITDA. But you know, David, that we've got significant cash on the balance sheet, so we're in a very strong cash position.

David McFadgen

Mm-hmm. Mm-hmm. Okay. Okay. That's it for me. Thank you.

Laura Carr

Thanks so much.

Operator

Thank you. Ladies and gentlemen, if there are any additional questions, please press *, followed by 1.

And at this time, we have no further questions.

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**Janet Eger**

Very good. 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 7, 2017.

Thank you again for your support. Have a good day.

Operator

Thank you. Ladies and gentlemen, this does indeed conclude your conference call for today. Once again, thank you for attending, and at this time we do ask that you please disconnect your lines.

Have yourselves a lovely evening.

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