

FINAL TRANSCRIPT

Indigo Books & Music Inc.

Third Quarter Results Conference Call

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CORPORATE PARTICIPANTS

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Heather Reisman

Indigo Books & Music Inc. — Chief Executive Officer

Laura Carr

Indigo Books & Music Inc. — Chief Financial Officer

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CONFERENCE CALL PARTICIPANTS

Bob Gibson

PI Financial — Analyst

David McFadgen

Cormark — Analyst

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Indigo Books & Music Third Quarter Results Conference Call. Note that at this time all lines are a listen-only mode, but following the presentation we will conduct a question-and-answer session.

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

Note that this call is being recorded on Wednesday, February 8, 2017.

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

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

Good morning, and thank you for joining us to review Indigo's third quarter fiscal 2017 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; Chief Financial Officer, Laura Carr; and Craig Loudon, SVP of Business Finance.

As previously announced, Mr. Loudon will be taking on the role of interim Chief Financial Officer with effect from February 9th when Laura Carr is leaving the Company.

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

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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. on February 15, 2017.

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 related to this quarter and year.

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

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

Thanks, Janet. As Janet mentioned, Laura Carr will be moving back to London, England with her family, and we wish her well on her journey. We thank her for her work and wish her well with her family in her next endeavour. She's been great support for us and we'll miss her, but we know England will be so happy to have her back.

To the third quarter. We know in general that this was a very challenging season for retailers, but we were pleased to see solid revenue growth, particularly on top of the previous year's double-digit growth. It makes these results particularly pleasing for us not only that the quarter was so strong the year before, but that there were no particular strong hits this year.

Third quarter last year same-store sales were up by over 15 percent. This year we see total growth of about 4.5 percent.

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It was an unusual holiday season. We started well through Halloween, very strong October, and then what we feel was a kind of post-election malaise and then a very strong finish.

We had very good growth online, and that notwithstanding the fact that we had some fulfillment issues; that is the demand was more than we had capability for. So we even tamped down some of the demand.

On balance, we feel the results are good particularly in the environment we live in. There's not a lot to say.

The trends are continuing as they have been; very strong performance in general merchandise. And we still have about flat growth in books against a massive, massive hit last year in colouring. So we feel that is a reflection of what we've been seeing all along, and that is that physical books remain quite strong. With consumers e-books declined again, which is further reinforcement of the core of the business.

There's tremendous energy in the team, there's lots going on, and I'm happy now to hand it over to Laura.

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

Thank you, Heather, and good morning, everybody. The results that we are discussing today are for the 13 weeks ended December 31, 2016. The comparative figures have been provided for the 13 weeks ended December 26, 2015.

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For the third quarter revenue was \$400 million, which was \$17 million higher than last year despite us operating three fewer stores. Total revenue growth grew by 4.5 percent, which as Heather mentioned, on top of last year's total revenue growth of 12.9 percent the growth is notable.

Total comparable sales, including online, were up 3.8 percent for the quarter. Comparable retail store sales for quarter increased by 3.1 percent in superstores and decreased by 0.8 percent in small format stores.

Growth continued to be driven by general merchandise, notably in the lifestyle categories. The core trade book business remained essentially flat as the business cycled over last year's trend for adult colouring books, but declined in the other noncore print categories.

Third quarter revenue from general merchandise categories grew to 43.2 percent of the total compared to 39.5 percent last year. For the quarter, margin dollars increased by 8 million and margin rate increased by 0.1 percent due to greater sell-through of full-priced goods compared to last year.

Operating, selling, and administration costs increased by \$4 million compared to the same quarter last year, and the increase was driven mainly by higher sales volume and the distribution centre costs.

Overall, our EBITDA improved by 4 million for the quarter, driven by higher revenue.

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Third quarter net earnings of \$40 million included a \$14.5 million noncash tax expense. Last year the Company reversed a previously recorded valuation allowance, which resulted in a 2.1 million net tax income recovery.

On a pretax basis, third quarter net earnings were 54.4 million this year compared to 50.7 million last year. The improvement was driven by the EBITDA increase.

On a fiscal year-to-date basis, revenue has increased by 36.5 million, or 4.7 percent, to \$810.3 million compared to 773.8 million for the same period last year. Our year-to-date total comparable sales, including online, increased by 4.9 percent. Comparable retail store sales increased 4.4 percent for superstores and 2.6 percent in small format stores.

Year-to-date EBITDA has increased by 0.7 million to 54.8 million compared to 54.1 million in the same period last year. However, last year the Company received onetime net proceeds of \$4.5 million related to the exiting of a lease without which the prior-year's EBITDA would have been 49.6 million. Therefore, excluding the onetime lease proceeds from last year, the year-over-year improvement in EBITDA would be 5.2 million.

Turning to the balance sheet, which remains strong, we ended the quarter with 316.3 million, which represents a 4 million increase from Q3 last year.

And finally, because I've mentioned this quite a few times, we were very pleased with our Sherway Gardens new concept store performance. Sherway Gardens store in Toronto continued to perform well in Q3. The revenues were up 34 percent compared to the Queensway store that it

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replaced. And the penetration of general merchandise products was significant at 63 percent, which not only was the highest in the chain, but also represented a significant increase to the Queensway store where the general merchandise penetration last year was 48 percent for the same period.

At this point, we'd like to now open the call for any questions.

Thanks.

Heather Reisman

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

Operator?

Q&A

Operator

Certainly. As mentioned, ladies and gentlemen, please press *, 1 if you do have a question.

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

Bob Gibson — PI Financial

Good morning, everyone.

Laura Carr

Morning, Bob.

Craig Loudon — Senior Vice President Business Finance, Indigo Books & Music Inc.

Morning.

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**Bob Gibson**

Laura, enjoy England and, Craig, we'll try to be kind to you on your next call.

Craig Loudon

All right. Thank you.

Laura Carr

Thanks, Bob.

Bob Gibson

Okay. You say you're starting renovating four superstores. Can you give us some idea of what you expect for the full year?

Heather Reisman

Yes. We have approximately 10 stores, 10 – 11 stores on the drawing board before the holidays. This is a program that we are starting now, and we intend to invest in our entire fleet over the next couple of years. So it'll just be a rolling program.

The only thing is that we don't do any actual renovation in the third quarter, as you could imagine. So this will just be a—we started in the fourth quarter of this year, it'll continue in the first and second quarter, and then we'll pick it up again in the fourth quarter next year.

Bob Gibson

Okay. And will you be renovating any of the smaller formats?

Heather Reisman

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Yes. There are some. We are actually going to be converting some of the smaller formats into the small Indigo concept that we've been developing, which includes a—well, obviously the core book, but a curated assortment of gift and paper.

And we're finding that that's working very well in the markets where they play the role and that there's not a, in many cases, if there's not an Indigo store right in the local trade area.

Bob Gibson

Okay. You said there—

Heather Reisman

Of course we connect it our online so they get the larger offering at the same time.

Bob Gibson

Okay. You said there was some stabilization challenges in the warehouse. Is that over with? Or might there still be some issues?

Heather Reisman

Well, the—first of all, it's stable now; it's completely stable now. But the size of the growth that we're anticipating, the changes that we implemented are just not sufficient for the size of the growth.

So yes, it's stable now, but we will be making some much more fundamental investments because we feel that there's enormous opportunity for us in online growth.

Bob Gibson

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Okay. Excellent. And I guess lastly, do you have a CapEx budget for this year?

Heather Reisman

We don't specifically announce our CapEx budget.

Bob Gibson

Okay. Great. Thanks very much.

Heather Reisman

But what we can tell you is that we are careful with our capital spending, and we always try and earn a good return on it.

Bob Gibson

Always.

Heather Reisman

Okay. Thanks, Bob.

Operator

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

David McFadgen — Cormark

Yes. Hi. I'll just start with a couple of clarifications. So when you talk about the 10 to 11 stores on the drawing board, are those all Sherway-concept stores?

Heather Reisman

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They're all iterations of Sherway Gardens, yes. They're not all two-storey, so some things will be different, but these will get pretty full renovations, yes.

David McFadgen

So similar to Sherway?

Heather Reisman

Mm-hmm.

David McFadgen

Okay. Can you give us any idea of store traffic in the quarter? How it was, up or down?

Heather Reisman

You know what? I can't remember what that number was.

Laura Carr

Yeah. I can. So it was marginally down in retail, marginally. But we had very significant traffic to our online. So overall from a customer basis total traffic was up, but retail physical stores was slightly down.

However, we did pretty well on conversion, so we converted the traffic that we had and then saw an increase in those sales in-store.

David McFadgen

So if the in-store traffic was marginally down in the quarter, then can we conclude that the average spend per purchase per customer was up?

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**Heather Reisman**

David, I think you've been on our calls long enough to know what information we provide and what we don't.

David McFadgen

Okay.

Heather Reisman

I don't think we ever comment on average spend. In total, traffic to Indigo was up—

David McFadgen

Oh, okay.

Heather Reisman

—like in total. So customers—some customers choose to shop online. But I don't think we ever comment on average spend of customers.

David McFadgen

Okay. I thought you were tracking—

Heather Reisman

Business did grow, but you have to realize what's happening today is that there are shifts, right?

David McFadgen

Mm-hmm.

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**Heather Reisman**

So if online goes up, to some extent sometimes a customer will do all of their shopping. As we mentioned it earlier on, we think because we deliberately tamped down some of our online in order to ensure all our customers would 100 percent get the service that they required we might have seen even a little more online.

And I think in general what people in retail are seeing is that there is a decision on the part of customers; some customers are just choosing to do their shopping online.

David McFadgen

Mm-hmm. Mm-hmm. Okay.

Heather Reisman

I mean we've had traffic up, I think, all through for quite some time, but this Christmas I think we said it was, I don't know, 0.5 point; just very marginal.

David McFadgen

Mm-hmm.

Heather Reisman

Very marginal, but it was down. So I think that's what you're seeing. If you want to take a trend from this, it's the huge opportunity we're seeing in being able to shop both channels.

David McFadgen

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Mm-hmm. So given the online business is growing nicely, can you comment at all just directionally whether the margins are improving? Or flat? Or down sequentially for online?

Heather Reisman

Laura, I don't know what you comment on here, so let me turn this over to you.

Laura Carr

Yeah. We don't separate the channels out on a margin basis. But I mean yes, things are all tracking positively in terms as the business that moves to online the margins are certainly improving.

David McFadgen

Okay. Okay. I think that's it for me. Thank you.

Heather Reisman

Okay. Thank you, David.

Operator

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

Janet Eger

Okay. Thank you for your time and attention today. We appreciate you calling in, and look forward to reconnecting on a quarterly basis.

Our full year results will be announced on or around May 30, 2017.

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Thank you again for your support, and have a good day.

Heather Reisman

Thanks, everybody.

Operator

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

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