

FINAL TRANSCRIPT

Indigo Books & Music Inc.

Second Quarter Results Conference Call

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CORPORATE PARTICIPANTS

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Indigo Books & Music Inc. — Chief Financial Officer

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PRESENTATION

Operator

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

Following the presentation, we will conduct a question-and-answer session. If at any time during this call you require immediate assistance, please press *, 0 for the Operator.

This call is being recorded on Thursday, November 2, 2017.

I would now like to turn the conference over to Hughes Simard. Please go ahead.

Hughes Simard — Chief Financial Officer, Indigo Books & Music Inc.

Good morning, everyone, and thank you for joining us to review our second quarter fiscal 2018 results. My name is Hughes Simard, and I'm the CFO. And Heather Reisman, our Chair and CEO, will be joining us also in a few minutes.

Regarding the materials for this conference call, we issued the press release after market close yesterday evening, and 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 11:59 p.m. Eastern Time on November the 9th.

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

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Now why can't I get into the call? Hello?

Hugues Simard

Oh. Oh, there you are.

Heather Reisman

Okay. Yeah. Okay. Go ahead.

Hugues Simard

Good morning.

Heather Reisman

Go ahead, Hugues. Just to tell you I'm here.

Hugues Simard

Okay. Great. Great. Good to have you.

Heather Reisman

Great.

Hugues Simard

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.

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November 2, 2017 — 9:00 a.m. E.T.

Indigo Books & Music Inc. Second Quarter Results Conference Call

I would now like to review our financial results. The results we are discussing are for the 13 weeks ended September 30th of this year. Comparative figures have been provided for the 13 weeks ended October 1, 2016.

We are pleased to announce another quarter of meaningful revenue growth. Following our strong first quarter, we once again achieved a company record for the highest ever second quarter to date. This marks our 16th straight quarter of top-line growth.

For the second quarter, revenue was \$224.5 million, which was \$7.6 million more than last year. Revenue growth was 3.5 percent above, which is remarkable considering the blockbuster title release last year.

Total comparable sales, including online, were up 2.8 percent for the quarter. Comparable retail store sales for the quarter increased by 2 percent in superstores, while small-format stores declined 4 percent, as last year's Harry Potter release had a greater impact on total comparable sales in that format. Online sales grew by 15.1 percent in the quarter.

We continued to see double-digit growth in general merchandise, with Lifestyle and Toys performing particularly well.

The core trade book business remains healthy, showing growth over last year after adjusting for the aforementioned Harry Potter event.

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Margin dollars increased by \$2 million due to higher sales volume in retail and online and higher gift card breakage. Product margin actually increased in the quarter, but net margin declined slightly, 0.6 percent, due to timing differences associated with shrink and vendor support.

Operating, selling, and administration costs increased by \$6.5 million compared to last year, largely driven by higher sales volume, as well as significant investments in our digital, online, new-store development, and marketing to fuel our future sales growth.

Overall, adjusted EBITDA decreased by \$4.5 million for the quarter, driven by higher operating costs as a result of, as I just said, increased sales volume and investments to support our strategic projects. Consequently, net loss for the second quarter was 4.7 million compared to a net loss of 1.2 million last year.

On a fiscal year-to-date basis, revenue increased by \$20.8 million, or 5.1 percent, to \$430.8 million compared to \$410 million for the same period last year. Year-to-date total comparable sales, which includes online sales, increased 4.4 percent while year-to-date comparable retail store sales increased 2.6 percent for the superstores and increased 0.7 percent in the small formats.

Year to date, adjusted EBITDA improved by \$1.4 million, driven by higher revenue, partially offset by higher operating costs and investments that I spoke about earlier to support our strategic projects.

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Our balance sheet continues to be very strong. We ended the quarter with cash and short-term investments of \$171 million, and our assets totalled 628.2 million, an increase of 19.6 million from last year. And I'd point out that we still have no debt on the balance sheet.

We continued in this quarter to roll out our new store concept, completing five new stores in this quarter. These new reimagined stores, which reflect our transformation from a traditional book store to a cultural department store for book lovers, are showing exceptional results with an average 16 percent revenue growth. Based on these very convincing results, we will embark upon a major capital investment program to redevelop our retail network.

Subsequent to quarter close, we also acquired a distribution facility in Calgary. This is a great transaction for us, as it provides us with a state-of-the-art, readily available, and ideally located facility to support our future growth across the country, and more specifically to serve Western Canada more efficiently.

Finally, we're very excited to announce that we will be opening our first cultural department store in the United States. In an effort to test the largest retailing market in the world, we will bring our unique assortment and life-enriching experience to the renowned mall at Short Hills in New Jersey.

We will try to replicate the success that we're having in Canada, which is due to creating that joyful and addictive omnichannel experience, as well as creating the ultimate community for book lovers.

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Just before turning to questions, I'd like to say that we are very, very proud of these results, which show not only good operational performance, but also wise and timely investments to fuel our long-term top-line and bottom-line growth in both of our channels. Our entire team is engaged and energized as we enter, as you know, our busiest time of the year and the most important for us, which is the critical holiday season.

At this point unless, Heather, you'd like to add a few words, I'd like to turn it open for the questions.

Heather Reisman

No, that's fine. Thank you, Hugues.

Q&A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press the *, followed by the 1 on your touch-tone phone. If you are using a speakerphone, please lift the handset before pressing any keys.

And your first question is from Bob Gibson from PI Financial. Bob, please go ahead.

Bob Gibson — PI Financial

Good morning

Hugues Simard

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Good morning, Bob.

Heather Reisman

Good morning, Bob.

Bob Gibson

Okay. So the United States, this is great. Can you give me some colour on what you're thinking? Is it just going to be this one store? Or how should we be thinking this?

Heather Reisman

We're going to do probably three, four, five stores over the next 24 months, and test the market response to the concept. And then if we experience what we think we're going to be seeing, then we'll look at further growth. But we'll definitely open a couple before making major commitments.

Bob Gibson

Okay. And this looks like it might have been in a former Saks store, which was 100,000 square feet. Will that be the size of the—

Heather Reisman

You're exactly right. We are in that former space. But no, we are taking about 30,000 square feet.

Bob Gibson

Okay. Perfect. Thank you so much. And the Calgary DC—

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**Heather Reisman**

Mm-hmm.

Bob Gibson

—what kind of costs should I be looking at initially to set the thing up? And then what kind of savings are you envisioning?

Heather Reisman

Well, first of all, we're fortunate to acquire the facility at an extremely beneficial cost because we bought this in a bankruptcy sale, but there'll be software investments to—integrated into our own system. And we never announce the specifics, but they'll be a couple of million, for sure, but we don't say exactly how much, but—

Bob Gibson

Okay.

Heather Reisman

—it'll be a manageable amount. It will give us very significant additional capacity.

Bob Gibson

Okay. Heather, last year we had reading socks. What we going to have this year?

Heather Reisman

You'll definitely get more reading socks because those were highly successful. And they are continuing to be successful. But we really have fantastic—it just looks like it—based on the

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product, it looks like it should be a very successful holiday season, really successful holiday season. There's lots and lots of wonderful things.

Bob Gibson

Great. I'll jump back in the queue. Thank you.

Heather Reisman

Thanks, Bob. (Unintelligible).

Hugues Simard

Thanks, Bob.

Operator

Thank you. And your next question is from David McFadgen from Cormark. David, please go ahead.

David McFadgen — Cormark Securities

Oh, great. Thank you. A couple of questions. Heather, could you share with us any metrics that you would be looking at where the US store would have to surpass where you would give the green light to get more aggressive on an expansion?

Heather Reisman

Well, we would want them to be as successful as our stores here. And I think if—every time we do a store we model out what we would like its performance to be. We have pretty simple, but straightforward goals for sales per square foot, bottom-line contribution, customer ... obviously

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customer affection for the brand, and as we do here for any store we do a reinvest in, and as soon as we see that that's happening, then we'll know that our experience resonates.

We've had so many developers come to see us from the US expressing their belief in the concept, so we're cautious but we're optimistic.

David McFadgen

Mm-hmm.

Heather Reisman

But we would want them to do as well as they do here.

David McFadgen

Okay. Would the initial investment in the store be similar to the investment of a store in Canada?

Heather Reisman

Yeah. Yeah.

David McFadgen

Okay. And then once the Calgary data centre is fully up and running and integrated, do you expect to realize any synergies from this new centre?

Heather Reisman

Synergies in terms of?

David McFadgen

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In terms of cost. Like if you looked at your cost structure before the data centre, this new—not data centre, this new distribution—

Hugues Simard

Distribution, yeah.

Heather Reisman

Yeah.

David McFadgen

—centre. And then after would the cost be lower?

Heather Reisman

Supply chain cost, will supply chain cost be lower?

David McFadgen

Yeah.

Heather Reisman

Excuse me. So sure, shipping costs to our western stores, the cost of shipping from the west to the west is obviously lower, so we should get some synergies there. And our ability to serve our customers, both our stores and our online customers, will be improved. So that should drive some benefits in that respect.

But some of that—so yes, we definitely believe some, although we're still modelling exactly all elements of it. But some of the savings which are clearly there will be offset by the fact

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that we will now have inventory in two locations. That said, we were at the point where our existing capability in Toronto—

Hugues Simard

Mm-hmm, yeah.

Heather Reisman

—needed expansion in any case, so we for sure would have had to expand. So net-net, we are cautiously optimistic that there will be synergies after offsetting for the cost associated with additional revenue.

David McFadgen

Okay.

Heather Reisman

And it should be very good for service to the customers, which by definition should drive more sales and again contribute.

David McFadgen

Mm-hmm. Mm-hmm. Okay. And prior to this quarter I know that Indigo has believed or you believed that there were costs that could be taken out of the system to keep SG&A flat or lower, and then this quarter we saw an increase on the SG&A line. So that increase, do you think that's going to continue into Q3 and Q4 this year?

Heather Reisman

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So the two main reasons—the two reasons, not main—the two main—Hugh, you can jump in—but the two—

Hugues Simard

Yes.

Heather Reisman

—significant reasons for the SG&A increase was we were renovating five stores. Five stores. And that, of course, there's the combination of the operating costs associated with renovating stores in place and some sales loss during the renovation time when you still have the costs associated with it. So that was part of it. But the biggest part was we did some supply chain capability expansion. We doubled the size of our online DC—

Hugues Simard

Yeah.

Heather Reisman

—this quarter, and there was investment in doing that which we—operational expense in doing that entire expansion. And that was some meaningful cost there. So those two things, those are onetime costs relative to that.

That said, when we go in next year we're going to accelerate our store renovation program; that'll have some impact on costs.

David McFadgen

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So given you—

Heather Reisman

But we're constantly looking. We're investing. Indigo's at a important sort of flection point where we've been testing things for the last couple of years, developing things, developing a perspective, and now we see the market's response. So we're going to move into an investment phase, which we think is going to give us very meaningful long-term advantages.

So that's what you saw this time. You saw supply chain investment—

Hugues Simard

Mm-hmm.

Heather Reisman

—and you saw store development investment. In day-to-day we've actually cut costs in some things, and we continue to look for ways to take cost out of the day-to-day or to look for synergies when we advance new things.

Hugues Simard

Yeah. And if I may add to that, David, the home office, other than what Heather has talked about, and the support functions costs are actually down this quarter.

Heather Reisman

Yeah. Exactly.

Hugues Simard

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So it's a true investment in what Heather has said, and on our online operations to make sure that we keep building the experience—

Heather Reisman

Oh, right. I forgot that one, Hugues. We made a big investment in online operations.

Hugues Simard

Yeah. Yeah.

Heather Reisman

Excuse me. We forgot that.

Hugues Simard

Absolutely.

Heather Reisman

Those are the investments.

Hugues Simard

Yeah.

David McFadgen

So the supply chain and the online investments will continue obviously; they wouldn't be onetime in nature. That's like an added cost structure going forward, right, in the anticipation of growth, no?

Heather Reisman

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Well, the supply chain at this moment, the costs on the Toronto-based ones are now done.

We've now got the growth—

Hugues Simard

Correct.

Heather Reisman

—we need for some period of time. But the digital ones will continue. And there are other—yes, the digital ones will continue. There are other areas—

Hugues Simard

Yes.

Heather Reisman

—where costs, as Hugues says, we are taking costs out.

Hugues Simard

Yeah.

David McFadgen

So seems like you're going to be renovating, retooling more stores in your next fiscal year.

Is that true? Can you give us an idea on the magnitude versus this year?

Heather Reisman

We have not finalized our plan yet.

David McFadgen

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Okay.

Heather Reisman

But we'll do a good number of stores next year.

David McFadgen

Okay. Okay. Okay. That's it for me. Thanks.

Heather Reisman

Great.

Operator

Thank you.

Hugues Simard

Operator, are there any other questions?

Operator

At this time, there are no further questions. I will turn it back over to you.

Hugues Simard

Thank you. So I thank everyone who joined in this morning. And I appreciate your time and attention, and we look forward to reconnecting on a quarterly basis.

Our third quarter results will be announced on or around the 7th of February, 2018, of course, and we'll be speaking then.

So thank you again, and have a good day.

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Heather Reisman

Thanks, Hugues. I'll be in the office shortly. Thanks.

Hugues Simard

Thank you, Heather. Bye-bye.

Operator

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

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