

## **FINAL TRANSCRIPT**

### **Indigo Books & Music Inc.**

#### **Q3 Investor and Analyst Conference Call**

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## CORPORATE PARTICIPANTS

### **Hugues Simard**

*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 evening, ladies and gentlemen, and welcome to the Indigo Books & Music Q3 Investor and Analyst Conference Call. At this time, all lines are in listen-only mode.

Following the presentation, we will conduct a question-and-answer session with investors and analysts only.

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

This call is being recorded on Tuesday, February 6, 2018.

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

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

Thank you, and good evening, everyone. Thank you for joining us to review Indigo's third quarter fiscal 2018 results. My name is Hugues Simard, and I'm the Chief Financial Officer of Indigo. Our Chief Executive Officer, Heather Reisman, is unfortunately unable to join us today.

Regarding the materials for this conference call, we issued the press release after market close today. It can be found at [indigo.ca](http://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 February the 13th of this year.

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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 statement regarding forward-looking statements in the press release and the MD&A related to this quarter and year.

I will make a few comments and then open the lines to answer your questions. The results we are discussing are for the third quarter, the 13 weeks ended December 30, 2018 (sic). Comparative figures have been provided for the 13 weeks ended December 31st of the year before.

For the third quarter, we are happy to announce another record quarter of revenue growth, our seventeenth straight quarter of top-line growth and, let's remember, comping a strong holiday performance last year. Third quarter revenues were 433.3 million, which was \$33 million more than last year, an 8.2 percent revenue growth, fuelled by broad growth across all channels and product categories.

Total comparable sales, including online, were up 7.9 percent for the quarter, driven by equally impressive online growth and in-store results. Comparable retail stores sales for the quarter increased by 4.9 percent in superstores and by 2.3 percent in our small-format stores. Online sales grew by 26.4 percent.

We continued to see double-digit growth in General Merchandise, with Lifestyle and Toys performing remarkably well, being close to 20 percent.

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The core trade book business remains healthy, showing growth over last year due to the release of several popular titles, as opposed to last year, as you'll remember, more of a blockbuster in the Harry Potter that was continuing in Q3.

Margin dollars increased by \$11.9 million due to higher sales volumes in retail and online and higher plum breakage, but margin rate experienced a decline of 0.6 percent. The downward pressure on margin was the result of a higher penetration of our online channel, which by nature is slightly lower margin and more promotional during this holiday season.

Operating, selling, and administration costs increased by \$6 million compared to last year, largely driven by higher sales volume, as well as investments in our distribution centres to support profitable growth. However, total costs decreased as a percentage of sales.

Overall, adjusted EBITDA increased by \$6 million for the quarter, driven by top line growth, which was partially offset by a lower margin rate, as discussed earlier, and increased operating costs across the Company to support our growth.

Our net earnings for the second quarter (sic) were 42.6 million, up 2.6 million from last year.

On a fiscal year-to-date basis, revenue increased by 53.8 million or 6.6 percent, to 864.1 million compared to 810.3 million for the same period last year.

Year-to-date total comparable sales, which include online sales, increased 6.2 percent— that's on a year-to-date basis—while comparable retail stores increased 3.8 percent for superstores and increased 1.5 percent in small-format stores.

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Year to date, adjusted EBITDA improved 7.8 million, driven by higher revenue partially offset by higher operating costs and investments to support strategic projects as we discussed previously.

Our balance sheet continues to be very strong. We ended the quarter with cash and short-term investments of 308 million. Our total assets totalled 734.6 million, an increase of 126 million from last year, and we still have no debt.

We're very proud of these results and very happy with another strong holiday season, a testament to the strength of our brand and to the passion and engagement of our entire team.

Looking ahead. As our reimagined stores continue to perform exceptionally well, we will be accelerating the rollout of the new concept over the coming months, including the renovation of our Bay & Bloor store down here in Toronto and the opening of a new flagship in downtown Vancouver.

We will also continue to invest in online, to keep adding functionalities and improving the digital experience, and also, we will open a new distribution centre in Calgary. So quite a busy plan ahead with many initiatives on the go, which will lead to significant growth and productivity improvements.

At this point, we would like to open the call for any questions that you may have.

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## Q&A

### Operator

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Thank you. Ladies and gentlemen, should you have a question, please press \*, followed by 1 on your touch-tone phone. If you're using a speakerphone, please lift your handset before pressing any keys. One moment, please, for your first question.

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

**Bob Gibson — PI Financial**

Good afternoon, Hugues.

**Hugues Simard**

Hi, Bob. How are you?

**Bob Gibson**

I'm good. Accelerated rollout. Can you give us some little colour on that? Maybe how many stores this year?

**Hugues Simard**

Well, as you know, we kind of put that on hold for Q3, which is our big quarter, as we always do because we want to focus on operations. Now we are starting again. So for Q4 of this—so ending this fiscal '18, we're going to be working on a few stores, and then about another 20 stores for the next fiscal year. So there'll be a little bit north of 20 stores being renovated over the next 12 months.

**Bob Gibson**

Okay. And any colour on US expansion?

**Hugues Simard**

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That is still in the plans. As we had announced, I think, at last time that we had signed a lease in New Jersey, this is still in the plans. We are working—this is one of the stores on which we are currently working on design. We are looking at other opportunities and other locations in the US as well, but nothing really to add at this point.

I think our plans have not changed. We are, as we've said, we are committed to testing the US market and to opening a few stores, three or four stores in the next 24 months or thereabouts. So we're still proceeding and going ahead with it.

**Bob Gibson**

Okay. And Casper nap pods ...

**Hugues Simard**

Yep.

**Bob Gibson**

Supposedly you've got seven—they're in seven locations now. What do you think the potential might be?

**Hugues Simard**

Well, right now, it's more of a commercial agreement until we get more data on this. I think the potential—I mean, we think the potential is very strong, is very high. It fits well with our wellness—the development of our wellness area and Sleep Well (phon) and all of our either books or other products that are related. So strategically, we think it fits well. We'll see how this goes.

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I mean right now, it's more of a—people get a coupon and when they visit the pods in our largest stores, and then they can buy them online. We'll have to see how that evolves, but we're monitoring, I should say, the interest very closely, and so far it's been working well.

**Bob Gibson**

Okay. And then lastly, can I get an update on the distribution facility in Calgary?

**Hugues Simard**

Well, we had announced, right, we purchased that as part of the Sears process late last year. So we have occupancy, like we have access to it now, and we are now adding some equipment in it. And obviously, there's significant IT to be added as well. And we're looking in a few months to be testing and sort of “soft launching it” in the spring, to be ready for the fall period.

**Bob Gibson**

So you think it'll be ready for Christmas?

**Hugues Simard**

Well, that's the plan. Yeah.

**Bob Gibson**

Okay. Great. Thanks so much.

**Hugues Simard**

Thanks, Bob. See you soon.

**Operator**

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Thank you. Your next question is from David McFadgen from Cormark Securities. David, please go ahead.

**David McFadgen** — Cormark Securities

Hi. Just following up on some questions on the expansion of the new stores.

**Hugues Simard**

Yeah.

**David McFadgen**

Seems like there's an echo on the line here. So how many do you think you will have renovated for your fiscal 2018 year, given you're going to do 20 in fiscal 2019?

**Hugues Simard**

Well, we've already—let's see. We've already renovated about six, right? Am I getting this right? Yeah. And we are working on a few more. So I don't know. I mean, our fiscal year, if that's your question, is going to end at the end of March, right? So I don't think we'll deliver any further stores by the end of this fiscal year, but work is starting, and we're going to deliver about 20 or thereabouts over the next fiscal year.

**David McFadgen**

Okay. Do you have the team in place? Because obviously to go from 6 to 20 is quite a lift. Right? Quite a lot of growth there.

**Hugues Simard**

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Yes. Yes. Yes. But we wanted to see the performance of these first few that we had opened in different markets and really refine our designs and everything that, our concept a little bit. And so now that we're—I mean, the results are really outstanding for all the stores that we've renovated. So we're ready to go, and we're going to be doing this right. I mean, it's not a race. We will do this right. But we are in a position to accelerate now, and we're looking forward to a very interesting top-line pickup in the months after the opening.

**David McFadgen**

So the 20 stores for fiscal 2019, does that include the US expansion as well?

**Hugues Simard**

Yeah. But the US—well, yes. It does. But the US expansion at this point, as I said, I mean we are looking at only a few stores, maybe two to three stores over the next 24 months. So there's probably only one or two stores in that number that I quoted you.

**David McFadgen**

Mm-hmm.

**Hugues Simard**

For fiscal '19 I mean.

**David McFadgen**

And so if you look out into fiscal 2020, I know it's a little ways away, but do you think that you would still be doing this new store concept in Canada for fiscal 2020?

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**Hugues Simard**

I'm sorry, your question—if we would still be rolling out this new concept in fiscal 2020? Is that what you're asking?

**David McFadgen**

Yeah. Would you still have Canadian stores to do in fiscal 2020 possibly?

**Hugues Simard**

Oh yeah. Oh yes. For sure. Yes, for sure. As you know, we have more than 80 large formats. And having done, let's say, 20-some-odd after fiscal '19, I mean we will still have quite a few. And the plan right now is to obviously continue to refine our designs and our concept as we go along, but to certainly to continue to renovate because I mean the results are there. And we believe that the return on this investment is very high. So we will definitely—it is plan right, but we will definitely continue.

**David McFadgen**

So good. Is it possible that you could retrofit/renovate every single large format store in Canada?

**Hugues Simard**

I mean, right now we are starting with the stores that give us the biggest bang for our buck obviously. But why not? I mean, this certainly is—the plan is to really reimagine our large format network, and it would make sense to apply this concept to most of them certainly.

**David McFadgen**

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Okay. So going back to the quarter, if you look at the revenue growth, obviously, it's quite strong, quite good. I'm just wondering how much of that has been driven by these new store concepts versus just growth across the entire chain of stores.

**Hugues Simard**

Well, right now as our new renovated stores, there is six of them. So there is obviously some growth coming from it because every store is performing really, really well. That being said, with only six stores having been done, it's not a huge contribution yet, but as we roll this out, this is going to become very material.

I mean, don't forget that as we are rolling it out, there is a period of—how would I call it—of disturbance as well. Right? Because as we renovate stores, there is a negative impact on our sales as we renovate these stores. So at first, we will have some pickup, but the pickup will accelerate as we renovate more stores and the sales pickup start outweighing the disturbance I'll call it.

**David McFadgen**

So in the past, the EBITDA has covered CapEx.

**Hugues Simard**

Yeah.

**David McFadgen**

You're going to do 20 stores next year. Do you envision EBITDA covering CapEx?

**Hugues Simard**

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Not necessarily. I mean, we have a very strong balance sheet. We believe very strongly in the renovation and reimagining of these stores. So it has been this company's approach, and we will continue to be very prudent in our investments. But it would certainly make sense for us to temporarily, maybe over a year or two, to invest a little more than our EBITDA in these projects that bring in a very high return on capital.

**David McFadgen**

So when you talk about a high return on capital from these new stores, can you tell us what that return in capital is that you're seeing? Is it 15, 20 percent? Is it double digits? Is it over 20? Any indication there?

**Hugues Simard**

It certainly is double digits. High double digits. Well, yeah. I mean double digits in the—not in the very low double digits, but I'd rather not quote. I don't think we've quoted this, and I'm not comfortable quoting a specific number. But in the numbers that you've thrown out, depending on the store because some of our larger stores have maybe a higher return in some cases than some of the smaller stores. But we're definitely talking about more than double digits. And in certain cases, very high return on capital investment.

**David McFadgen**

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Okay. So if you just look at your SG&A line in the past, you've always thought that it was possible to lower the SG&A line, look for efficiencies, and so on. Is that still your belief that you could maybe reduce your SG&A going forward?

**Hugues Simard**

Yes, absolutely. It is still our belief, and this is something that we must continuously work on. There'll be temporary periods of, call them investments, but certainly long term there's no change in that approach and we will continue to work on that for sure.

**David McFadgen**

And this is my last question is when do you expect the New Jersey store to open?

**Hugues Simard**

Well, we had announced sometime this year. As you know, we tend not to open stores past September. So right now, the plan is to—I mean, we're looking at sometime late summer, I'll call it.

**David McFadgen**

Okay. All right. Thank you.

**Hugues Simard**

All right. Thank you, David.

**Operator**

Thank you. Ladies and gentlemen, as a reminder, should you have a question, please press

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There are no further questions at this time. Please proceed.

**Hugues Simard**

Okay. Thank you very much, everybody, for accommodating us on this later- than-usual time. And thank you for your attention today. We appreciate you calling in and discussing our results with us.

We look forward to reconnecting next quarter. Our annual results will be announced on or around May 29th of this year. So thank you again for your support, and have a good evening.

**Operator**

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

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