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Indigo Books & Music Inc.

Second Quarter 2019 Analyst Call

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Length: 14 minutes

CORPORATE PARTICIPANTS

Craig Loudon
Indigo Books & Music Inc. — Chief Financial Officer and Executive Vice President

Heather Reisman
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 and Music Q2 Analyst 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 star, zero for the Operator.

This call is being recorded on Thursday, November 7, 2019.

I would now like to turn the conference over to your host, Mr. Craig Loudon, Chief Financial Officer. Please go ahead, sir.

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

Good morning and thank you for joining us to review Indigo's second quarter Fiscal 2020 results. My name is Craig Loudon, and I'm the Chief Financial Officer. Joining us from Indigo today is the Chief Executive Officer, Heather Reisman.

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 11:59 p.m. Eastern Time, on November 14, 2019.

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

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

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

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

In the context of a highly competitive and dynamic retail landscape, we are keenly focused on our customer, on lowering our cost infrastructure and protecting cash and capital. During the quarter, we repatriated our entire proprietary design studio to Toronto under the leadership of Nathan Williams. We are excited about Nathan's creative direction, the evolution of which will be seen in product landing in stores this coming spring and summer.

We also launched our paid membership program, plum Plus. An early indication is that this program will be very well received by Indigo customers. We are also strategically moving to be far less promotional, an action that will take some top line away, but will increasingly deliver bottom-line results.

I would now like to hand it over to Craig to speak to the financial results in detail.

Craig Loudon

The results we're discussing are for the 13 weeks ended September 28, 2019. Comparative figures have been provided for the 13 weeks ended September 29, 2018. As a reminder, we began reporting under IFRS 16, the new leasing standard in the first quarter. Our financials, on a reported basis and discussed today, include the adoption of IFRS 16. However, we have also provided certain metrics for Fiscal 2020, excluding the impacts of the new standards to assist with your analysis.

Revenue was $203.4 million for the quarter, which was $12.9 million less than the second quarter last year. The top-line decline was a result of strong competitive pressures and the Company's planned efforts to reduce promotions to improve profitability. Top-line results were impacted by softer consumer spending in the non-essential market space and the mature general merchandise assortment in recent months which contributed to the downward trend experienced in the second quarter.

We are making improvements to the assortment to meaningfully change course and have begun to see some positive momentum through the back-to-school season. The strategic reduction of promotional campaigns resulted in higher full price sell-throughs and a margin rate improvement of 1.3 percent for the period.

Total comparable sales, including online, decreased 8 percent. Comparable retail store sales for the quarter decreased by 7.4 percent at superstores and 5.7 percent in small-format stores, primarily as a result of the Company's planned efforts to reduce promotions.

The online channel comparable sales decreased by 12.2 percent for the quarter. The impact of reducing promotional activity was more significant in the online channel as ecommerce consumer behavior is more driven by price sensitivity. The merchandising strategy has also been refined to remove low price, low margin items which historically drove traffic and sales at the expense of profitability once the channel’s fulfillment expenses were considered.

While online and print sales were impacted by the elimination of the Every Book Ships for Free campaign that ran in the second quarter of Fiscal 2019, overall these efforts have led to contribution improvements in the online channel. Overall, operating, selling, and administration costs decreased by $19.9 million compared to last year. Excluding the IFRS 16 impact, these expenses decreased by $3 million, primarily due to the reduction in sales volumes and increased productivity across the Company’s distribution centres.

This was partially offset by a meaningful increase in the Company's cost base from net new superstores opened in Fiscal 2019 as part of the Company's retail transformation, and timing differences associated with expenses.

For the quarter, Adjusted EBITDA increased by $17.3 million. Excluding the IFRS 16 impact, Adjusted EBITDA increased by $0.4 million. Higher Adjusted EBITDA was driven by the margin and operating cost improvement achieved which outpaced the impact of tempered sales.

Net loss for the second quarter was $20.5 million compared to a net loss of $19.1 million last year. The impact of adopting IFRS 16 for the quarter was an earnings improvement of $0.3 million. This increase in the net loss position is a result of the broader competitive environment and higher amortization in the current period as a result of the Company's executed capital investment program in Fiscal 2019.

Capital investment in the second quarter of Fiscal 2020 was $3.8 million compared to $25.6 million for the same period last year. The decrease is congruent with the completion of the Company's capital investment program in Fiscal 2019, as mentioned, to implement changes across Indigo's retail outlets, digital platforms, and supply chain facilities. Additionally, the Company will meet its capital expenditure target of $20 million for this year, a significant reduction from prior years.

The Company launched a cost-cutting initiative at the beginning of this year targeting $20 million to $25 million in cost savings. Speaking to the first half of Fiscal 2020 and excluding impact of IFRS 16, for the 26 weeks ended September 28, 2019 our concentrated efforts have resulted in a reduction of operating, selling, administrative and other expenses of $9 million compared to prior year’s cost base. While this reduction has been partly offset by costs associated with the net new stores, and some one-time expenses associated with the move of the Company's New York office to Toronto, this is reflective of the Company's commitment to future profitability.

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

Q & A

Operator

Thank you. Ladies and gentlemen, if you do have a question, please press star, followed by one on your touchtone phone. You will hear a three-tone prompt acknowledging your request. If you decide to remove your question, please press star followed by two. We do ask that if you're using a speakerphone to please lift the handset before pressing any keys.

Your first question comes from David McFadgen at Cormark Securities. Please go ahead.

David McFadgen — Cormark Securities

Hi. Just a couple of questions. Heather, we're into the all-important quarter, Q3; I was just wondering how you're feeling about your merchandise product line, is it reinvigorated much, or is there still a lot more work to do?

Craig Loudon

Hi, David, it's Craig Loudon. Heather unfortunately had to step out of the room, but I will take your questions. We're feeling good about holiday, I think as we've mentioned before though, Nathan has arrived to lead our product development efforts and the bulk of the output from that activity will not hit until spring, summer of next year. However, he did put his mark to the best extent he could on holiday. We're feeling good about holiday, and it's a natural time for traffic and people to head to Indigo, so certainly, we're feeling good about this time period.

David McFadgen

Okay. Obviously, you've seen some same-store sales decline so far this year. I'm not trying to get you to commit to any guidance or anything, but do you think you could actually result in a flat same-store sales in Q3 or is that—

Craig Loudon

Again, I don't think—we don't provide that kind of forward guidance, but based on what we said in prior calls, have said in a lot of the release material, we do believe last year we were far too promotional. We also had a lot of mark-down goods, particularly in Q3. If you remember, we had the store development program that ran late and a lot of product that couldn't set in those stores and later had to be cleared. I would expect that we will not keep up with that pace of sales; however, you will see strength in the margin rate and the margin line.

David McFadgen

Okay.

Craig Loudon

That's intentional. So that you understand that is our strategy: we believe we were, I shouldn’t say chasing sales, but in the end because of the amount of product and the disruption with the store renovation, we would not want to keep up with that pace given how it happened.

David McFadgen

Right. Okay. So far this year, you guys have burned through a fair bit of cash, more than I would have expected. I was just wondering do you think that's going—I mean, obviously, Q3 you have a big cash inflow, but when you're looking out to the end of Q4, I mean, how you feeling about your—the cash balance going forward?

Craig Loudon

We feel we will end with a good cash balance. I'm not— when you say we've gone through cash, I mean, our CAPEX has been very low, as we reported in the documentation. I think what you're seeing is the natural progression of the seasonality. This is always our lowest time period of cash in the year. We'll see it come back up in Q3 and I think at year end, we should have a reasonable cash balance. Again, I'm not going to throw a number out there. We also think we've got room to come down in inventory to—particularly in the off season to improve that cash position. But I think people will be pleased where that went.

David McFadgen

Okay. Let's say, things go a little worse than expected or say things go a lot worse than expected and you chew through a fair bit of cash, do you have bank lines in place right now that you can draw on if you needed to?

Craig Loudon

We do not at the moment, but we have other contingencies in place if needed. Obviously, we do have a majority shareholder and do have other ways to raise cash if needed. But we don't anticipate that would be required whatsoever in the next year.

David McFadgen

Okay. Then, I noticed that you saw—after Q2 that you sold your equity stake in Calendar Club.

Craig Loudon

Correct.

David McFadgen

I think it was only for $1.8 million. I thought that was incredibly low. I was just wondering how you came to that valuation.

Craig Loudon

Well, I think, yes, we'll talk about that. That was a subsequent event, so we'll talk about that more in the next quarter. But I think if you look at what it generated last year versus, generally, we were financing that business, I don't see how you would come up with a larger valuation than that. Last year, I think our share of earnings was something like $800,000, yet the financing was often millions of dollars of cash, so the risk versus reward, and frankly the amount of time that it was taking for us. I think it’s a great little business, don't get me wrong for our partners to continue on with it, but also just the amount of time it took from our Management team in this retail environment, it was just not worth focusing on, better to focus on our core business.

David McFadgen

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

Craig Loudon

Okay, thanks, David.

Operator

Thank you. Ladies and gentlemen, as a reminder, if you would do have a question, please press star, followed by one on your touchtone phone.

And at this time, Mr. Loudon, it appears that we have no other questions, sir, so please proceed.

Craig Loudon

Thank you. 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 6, 2020. Thank you again for your support and 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. At this time, we do ask that you please disconnect your lines. Enjoy the rest of your day.