FINAL TRANSCRIPT

Indigo Books & Music Inc.

Q1 Analyst Conference Call

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Length: 16 minutes

CORPORATE PARTICIPANTS

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

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

CONFERENCE CALL PARTICIPANTS

Bob Gibson
PI Financial — Analyst

Sid Dilawari
Cormark Securities — Analyst

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to Indigo Books and Music Q1 analyst conference call. At this time, all lines are in a listen-only mode. But 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.

Note that the call is being recorded on Wednesday, August 14, 2019.

I now would 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 first 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 August 21, 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.

On our last analyst call, we noted the industry headwinds that challenged our fiscal 2019 results. Many of these pressures do remain present. That said, we have strategically moved to be far less promotional. While this tempers sales, it is already showing some positive results in the margin. Trajectory on margin will drive us back into a profitable position.

We are also working on a number of initiatives that will impact the growth potential of the business, and while we are doing that, we remain extremely focused on cost management and productivity initiatives.

I think it is worth noting that while there has been pressure on the business, our market share in the book business remained very strong, confirming that the Indigo customer is remaining with us.

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

Craig Loudon

Thank you, Heather. The results we are discussing are for the 13 weeks ended June 29, 2019. Comparative figures have been provided for the 13 weeks ended June 30, 2018.

This is our first quarter reporting under IFRS 16, the new leasing standard. The Company's financial performance in the first quarter was materially impacted by the adoption of IFRS 16. 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 $192.6 million for the quarter, which was $12.8 million less than the first quarter last year. The top-line decline was a result of a deliberate shift to reduce promotional and discounting activity to improve profitability. This focus on profitability, and continued focus on disciplined inventory management, resulted in higher full price sell-throughs and a margin rate improvement of 0.8 percent for the period.

The Company’s fiscal results continue to be impacted by softer consumer spending in the nonessential market space, and the mature general merchandise assortment generating lower demand. There is an inherent time-to-market life cycle related to changes in our assortment that we are working through to meaningfully change course, and will provide a further update in the coming months.

Total comparable sales, including online, decreased 7.6 percent. Comparable retail store sales for the quarter decreased by 6.5 percent at superstores and 2.4 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 14.8 percent for the quarter. The reduction in promotional activity had a larger impact on the online channel, given that the online customer has a stronger price sensitivity. Additionally, while we continue to expand the breadth of products offered in the online channel, we refined our assortment of low-value, low-margin items to improve probability.

Gross profit decreased by $4 million, driven by lower revenue, partially offset by margin rate improvements. Overall, operating, selling, and administration costs decreased by $17.1 million compared to last year. Excluding the IFRS 16 impact, these expenses decreased by $0.5 million, primarily due to the Company’s cost-cutting initiatives and improvements in underlying operating performance, partially offset by higher severance costs associated with a reorganization of our workforce, which began in the fourth quarter of last year.

For the quarter, adjusted EBITDA increased by $13.1 million. Excluding the IFRS 16 impact, adjusted EBITDA decreased by $3.5 million. Lower adjusted EBITDA was driven by lower sales as a result of the Company's strategic shift toward lower commercial activity and a laser focus on profitability, partially offset by the margin rate improvements achieved. Consequently, net loss for the first quarter was $19.1 million compared to a net loss of 15.3 million last year. The impact of adopting IFRS 16 for the quarter was an earnings improvement of $0.5 million.

Capital investment in the first quarter of fiscal 2020 was $5.3 million compared to $22.9 million for the same period last year. The decrease was a result of the completion of the Company's intensive capital investment plan in fiscal 2019, to implement changes across Indigo's retail outlets, as well as investments in digital and the supply chain.

We are absorbing the significant changes implemented last year and will hold off on further investment until we've assessed the customer's response to these initiatives. We ended the quarter with $90.3 million in cash and short-term investments while having no debt.

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

Q&A

Operator

Thank you, sir. Ladies and gentlemen, if you do have any questions, please press *, followed by 1 on your touch-tone phone. And if you're using a speakerphone, you will need to lift the handset first. Should you decide to withdraw your request, you will need to press *, followed by 2. Ladies and gentlemen, please go ahead and press *, 1 now if you have any questions.

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

Craig Loudon

Hello, Bob?

Bob Gibson — PI Financial

Wonder if I could get any colour on what his thoughts are?

Craig Loudon

Sorry, we missed, Bob, what you said. It was cut off.

Bob Gibson

Okay. Nate, your new Chief Creative Officer?

Craig Loudon

Oh. Nathan Williams, yes.

Bob Gibson

So any colour on what he's thinking? Or what he's doing?

Craig Loudon

I think, Heather, would you like to—

Heather Reisman

Yeah. Hi, Bob. How are you?

Bob Gibson

Good.

Heather Reisman

Good. So you know he's only been in the job for a couple of weeks, and so he's got a large ambition for the Company, but I think we're going to have to give, you know, it usually takes about a nine-month cycle, minimum, to start to see what the evolution in the product is. We have products still in the pipeline that he will be able to influence somewhat. But the real new rollout of his product will be approximately nine months from now.

Bob Gibson

Okay. Great. The New Jersey store; it's almost been a year. Any colour on what you're thinking?

Heather Reisman

Yep. I think—in terms of doing more stores, you mean?

Bob Gibson

Mm-hmm.

Heather Reisman

Yeah. Because we're doing all this work on sort of revising our assortment, we're going to hold off any more new stores in this year. We're going to really look to advance the overall presentation to the customer. And once that happens, we'll be in a better position to look at what our US strategy is. We're not pulling away from the ambition at all. We just feel it is extremely important to get this sort of refocus of the core verticals to really do what we want them to do.

Bob Gibson

Okay. And maybe a little colour on where you think the consumer is now versus last quarter and their sort of shopping patterns?

Heather Reisman

Yeah. Look, there's no question that the intensity with which Amazon is in the market is huge. And we have several categories that are up against them—books, toys, to some extent, some of the home office stuff that we do. So is that having some impact in general in the Canadian economy? Yes. It's having an impact. Consumer—other than that, other than the way they will approach online shopping, I don't have a huge amount to say. We are seeing our customers come in, but they're spending a bit less. So if that's some indication.

It’s hard for us to tell, to really comment, because we have so cut back on promotional activity, which we needed to do. And I don’t know if you remember last year, but the delay in the store program, that we had a lot of extra goods, that meant we had to promote them to move them through the stores we had. And customers get used to that. And we just—we didn’t buy inventory that way this year. So our customers are coming in; they’re buying a bit less. That’s what we see.

As we take away all of that low-priced stuff, it has some impact on our sales. Are we saying this just because the customer’s cutting back? I think it’s more because we’ve cut the—more because we’ve cut the promotions back. We’ve got to live through it this year. We just have to live through it.

Bob Gibson

Okay. Great.

Heather Reisman

So really, I can’t say—they’re coming in. So, yeah, I’m hesitant to say that it’s a consumer problem, frankly, if that’s what you’re asking.

Bob Gibson

Right. Okay. Perfect.

Craig Loudon

Yeah, Bob…

Heather Reisman

Yeah.

Craig Loudon

Yeah, Bob. Just a little more colour, though, on the sales margin trade-off. We're actually quite, quite pleased with the way that worked out, that in the end, that sales decline probably cost us something like 8 million in margin dollars, yes (unintelligible)—

Heather Reisman

You're talking about the online sales? Yeah.

Craig Loudon

No, just even overall—

Heather Reisman

Yeah.

Craig Loudon

Like 8 million in margin from sales, but we made up 6 million in margin rate performance.

Heather Reisman

Mm-hmm. Mm-hmm.

Craig Loudon

So we're actually quite pleased with that trade-off, because that also allows us to keep operating costs down through driving less volume through the network.

Bob Gibson

Okay. Great. Thanks so much.

Craig Loudon

Thanks, Bob.

Operator

Thank you. Next question will be from Sid Dilawari at Cormark Securities. Please go ahead.

Sid Dilawari — Cormark Securities

Yeah. Hi. Good morning.

Craig Loudon

Good morning.

Sid Dilawari

I guess just a follow-up on online sales. When we checked last quarter, just stacking you guys up against Amazon, your book pricing with the discounting was pretty similar to Amazon. But I believe with the reduced discounting activity, you guys are probably a little bit more expensive than Amazon—

Heather Reisman

Sorry. With what? I just didn't hear your question.

Sid Dilawari

Prices (phon) were reduced—

Heather Reisman

Our prices stacked up against Amazon, but?

Sid Dilawari

But now with reduced discounting activity, do you guys still stack up well against Amazon in terms of books?

Heather Reisman

Yeah. We didn't change any discounting on the books. The books are exactly the way they were. We've always been pretty much at parity with Amazon on where they are, in fact at parity with Amazon, you know, to the best of our knowledge, on where they are. Where we reduced the discounting was on a lot of general merchandise product.

Sid Dilawari

Okay.

Heather Reisman

So books, we're still at parity. And for the most part, on toy, we try and be at parity as well. Occasionally, they'll do something below cost. We just aren't prepared to do that. But on what we consider to be mass product, we recognize that in the market, the consumer is going to expect pricing to be the same as Amazon.

Sid Dilawari

Right.

Heather Reisman

So—

Craig Loudon

And, Sid, just to be clear, the discounting comment also relates to retail. So last year, given that some of our challenges with late renovations, we had a lot of marked-down product in our physical retail stores, and that is not the case this year. In fact, inventory's down $16 million year over year, and that's predominantly a general merchandise decrease in inventory.

Sid Dilawari

Right. Okay. And then just a quick one on retail sales, since we're talking about it. How are the newly renovated stores performing? Are the margins coming in as expected? Or is the softer discretionary spending kind of impacting the top line of these stores as well?

Craig Loudon

I think it's a mix and it's location specific. Like any time you engage in any real estate activity, we have some that are knocking it absolutely out of the park, and we're thrilled. We have some that are meeting expectations, and some that are below. But again, it's really case specific. For example, our Bay-Bloor store continues to struggle, but that's mainly because the Manulife Centre is still under construction, and it's very hard to access and it's been ripped apart for some time. We're hoping the end is sight—the end is near on that, and that we'll be able to get back to normal. But so it's really site-specific.

Sid Dilawari

Right. And then in terms of EBITDA for the full year, should we be expecting to see a normalized EBITDA for this year? Or is that sort of a fiscal '20/'21 event?

Craig Loudon

As I'm sure—yeah. You work with David. We always tell—

Sid Dilawari

Yeah.

Craig Loudon

—tell David that we don't provide forward guidance on that. I think what we're saying is we still see some headwinds, but I think that's all we're going to say on that point at this juncture.

Sid Dilawari

Okay. And then I guess just last one for me. I notice a 40 million cash burn for the quarter. Can you provide some colour on that? Should we be expecting similar cash burn throughout fiscal '20? Or is that just sort of a onetime item?

Craig Loudon

I think what you're looking at is from quarter to quarter. I think you'll find year over year is more meaningful. That is a general pattern in our business, just as post-holiday, as vendors get paid, this tends to be a lower point of cash during the year. Year over year, yes, cash is down, but we've spoken to that on past calls. That was related to last year's renovation activity. But no, as we stated on our last call, our goal this year for capital investment is to be under $20 million, and that is still our plan.

Sid Dilawari

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

Craig Loudon

Okay. Thank you.

Operator

Thank you. Ladies and gentlemen, as a reminder, if you do have a question, please press *, followed by 1 on your touch-tone phone.

And at this time, Mr. Loudon, it appears we have no other questions, so I would like to turn the call back over to you, sir.

Craig Loudon

Thank you for your time and attention today. We appreciate you calling in and look forward to reconnecting on a quarterly basis. Our second quarter results will be announced on or around November 5th. Thank you again for your support, and have a great day.

Operator

Thank you, sir. 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. Enjoy the rest of your day.