

Indigo Books & Music Inc.

First Quarter Fiscal 2021 Financial Results

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CORPORATE PARTICIPANTS

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Indigo Books & Music Inc. — Chief Financial Officer

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CONFERENCE CALL PARTICIPANTS

David McFadgen

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Indigo Books & Music Financial Year 2021 Q1 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 need assistance, please press star zero for the operator. This call is being recorded on Friday, August 7, 2020.

I would now like to turn the conference over to Craig Loudon. Please go ahead.

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

Good morning and thank you for joining us to review Indigo's first quarter fiscal 2021 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 sections of the Indigo website. A playback of the call will also be available by telephone until 11:59 p.m. Eastern Time on August 14, 2020.

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.

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

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

Good morning, everyone.

With COVID-19 fully impacting all of us, Indigo, like so many others, faced truly unique demands this quarter. For the better part of the quarter, our entire retail network was required to close with some stores only able to open at the end of May and much of the network not open until into June and even then with curtailed hours.

Fully responding to this new environment, the organization adapted fantastically and took decisive action in a number of areas to address both this quarter and what we see as the continuing impact of the COVID environment right through the holiday period and beyond. I'm pleased to share that notwithstanding the closures of 200 stores across the country, our customers remained extremely loyal to our brand, allowing us to capture and support record high online business through *indigo.ca* and to see better than expected retail sales when we did open.

During this time, not only have our loyal customers further embraced our digital experience, but we've captured a significant new audience, driving meaningful customer acquisition and loyalty membership sign-ups. This will be important to us as we move through the rest of this year. This elevated engagement, as I noted, did carry through when we did finally open our stores.

During the quarter we accelerated key efforts, which will be implemented in this current Q2 period, and these are designed to position us to fully and safely serve our customers during the holiday

period, including a robust click-and-collect capability and Instacart service. We also continue to access productivity and cost opportunities through our operation recharge initiative and we worked effectively with our landlord community to share some of the burden of COVID. All of this, coupled with a balance sheet with cash and no outstanding debt, will allow us to emerge from this crisis stronger than ever.

I now turn it over to Craig.

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

Thank you, Heather.

The results we are discussing are for the 13 weeks ended June 27, 2020. Comparative figures have been provided for the 13 weeks ended June 29, 2019.

Revenue was \$135.1 million for the quarter, which was \$57.5 million less than the first quarter last year. The top line decline reflects a 73.8% decline in the retail channel due to temporary store closures as a result of the ongoing COVID-19 pandemic. This was partially blunted by exceptional growth in the online channel, with online revenue up threefold or 214% compared to last year.

Despite experiencing strong headwinds in the retail channel due to COVID-19, the company performed better than expected, accomplishing several sales days where total revenue was up to last year. This was buoyed by demand growth in core categories that supported reading, wellness, and at-home learning and entertainment, partially offset by a decline in impulse-led categories more sought after by consumers shopping in physical retail.

All retail stores were closed at the beginning of the quarter. The company began a phased reopening on May 19, 2020 with 120 stores reopened by the end of May and all but one of its 182 stores reopened by the end of the quarter. As a result of temporary store closures from COVID-19 and strict social distancing requirements limiting capacity in stores upon reopening, we believe that comparable sales, which in the past has been a key performance indicator, is no longer meaningful to evaluate performance. Instead, we're focused on total revenue, as discussed, as well as online growth and reopened store sales trends, which I will offer some colour on.

The online channel experienced exceptional growth for the quarter with traffic and conversion up 99% and 96%, respectively, during store closures. This was driven by a lift in demand for core categories, as discussed, loyal customers further embracing the company's online channel during mandated stay-at-home orders, and a significant influx of customers new to *indigo.ca*. Paramount to the success of the online channel was our ability to successfully manage peak online volumes while maintaining social distancing in our distribution centers. Demand in the online channel has moderated but remained strong through the reopening of physical retail.

The retail channel alleviated some pressure from online fulfillment centres during store closures through the launch of curbside pickup. This acceleration of the company's digital roadmap to deliver contactless pickup also speaks to the tremendous efforts and agility of our team. Upon reopening, retail store sales tracked at approximately 72% of last year's sales. Although traffic has not made a full recovery, conversion and average transaction values increased year over year as more customers visited stores with the intention of making a purchase.

The margin rate for the quarter decreased 15.3% compared to the first quarter last year. The decrease in margin rate was primarily a function of increased shipping cost due to a higher penetration of online sales.

Overall operating, selling and administration costs decreased by \$39.3 million compared to last year. The decrease was a result of cost reductions associated with store closures, the restructuring of the company's head office workforce, and reductions in discretionary spending. This decrease was furthered by the Canada Emergency Wage Subsidy and negotiated rent concessions recognized in the quarter.

Despite the unprecedented challenges introduced by COVID-19, adjusted EBITDA decreased by only \$7.6 million for the quarter compared to the same period last year. Lower adjusted EBITDA was driven by a decline in top-line revenue as a result of temporary retail store closures.

With the Canada Emergency Wage Subsidy and cost-cutting initiatives taken to better align to the current retail climate generated cost savings, these measures did not completely offset the loss of revenue. Consequently, net loss for the first quarter was \$31.6 million compared to a net loss of \$19.1 million last year.

We ended the quarter with \$110.6 million in cash and short-term investments while having no debt, which bolsters our financial health as we weather the storm.

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

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 star followed by the one on your touchtone phone. You will hear a three-tone prompt acknowledging your request. If you are using a speakerphone, please lift the handset before pressing any keys. One moment please for your first question.

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

David McFadgen — Analyst, Cormark Securities

Hi. A couple questions, if I may. Craig, I think you mentioned that, well, since the stores have reopened you've had several sales days that were on par with last year. So does that just mean that the results in the quarter where it was about 70% of last year is just reflective of that the business is ramping? The business ramping (inaudible)?

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

Correct. Obviously, while stores were closed, we didn't have days above last year, but as stores ramped back up and online continues to be strong we have had days over last year, yes.

David McFadgen — Analyst, Cormark Securities

Okay. And is the business continuing to ramp?

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

Yeah, I mean, I think at the moment retail has stabilized a bit. It's obviously still down to last year, but online continues to be very strong, so we're certainly pleased with what we're seeing. I mean I don't think it's any surprise that the shoppers that are out these days, there are fewer casual shoppers, but shoppers with high intent coming into stores and, as we noted, conversion and average transaction value is up, but there's still fewer people out shopping in general.

David McFadgen — Analyst, Cormark Securities

Yes. And maybe a question for Heather, I mean, Heather, what do you think it takes to get the retail sales back to what it used to be? Do we have to be able to shop without masks? Or what's your kind of view on that?

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

I think our own view is that customers will continue well into the months ahead to make shopping an activity they do when they have something specific to buy. And I think online, you know, we've continued to have exceptional online sales. But what we're seeing in our customers is traffic is still way down, like it's way down, but when the customers come in, our conversion is way up and our average transaction is way up. So that's saying that you've got a deliberate customer and we think that that's going to remain, frankly, until there's a vaccine. People are afraid of this virus, as they should be, and I think what's happening in Canada is everybody watches the news and the US news just washes

over people. And because the US is so bad, even though Canada has been pretty good, people know that the risk is out there.

So, all in all, we predict that the retail consumer will remain a cautious consumer. And what we're doing to buttress that is every single thing to make it easy, safe, to give them that feeling of security, and we have a lot planned for the holiday quarter. But David, I don't see the consumer returning to the kind of behaviour that we were used to before COVID until there's a vaccine or some kind of therapeutic strong enough to blunt the fear.

David McFadgen — Analyst, Cormark Securities

Okay.

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

I mean I think it will be hard to express the extent to which the Indigo customer demonstrated their commitment to us during the quarter that we just completed. Like frankly, we're buoyed by it and their response to a lot of the new things that we're doing. So yeah, it's going to take a bit.

David McFadgen — Analyst, Cormark Securities

Okay.

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

Did you have a second question?

David McFadgen — Analyst, Cormark Securities

Yes. Well, I have many, actually, if I may.

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

Sure. Go ahead.

David McFadgen — Analyst, Cormark Securities

So, obviously online sales in the quarter benefitted from the fact that the retail stores were closed, because it was so strong; everybody moved online. Now that retail is open I was wondering if you can give us an idea of what online is doing now. Obviously it's probably not growing to the same extent it was, but can you give us an idea of what online is doing now in terms of growth?

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

Without doing anything that's considered inappropriate, I would say that we are still experiencing exceptional online sales.

David McFadgen — Analyst, Cormark Securities

Okay. That's very positive.

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

Yeah, it is.

David McFadgen — Analyst, Cormark Securities

So I saw that you had some rent relief in the quarter. I think you're still negotiating with some landlords. I thought the rent relief would be larger than that. So can you give us any insight—?

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

Yeah, I don't believe, and Jim, sorry, Craig can hop in here, I don't believe, and we're doing this live and that's great, but I don't believe that the rent relief was captured in this quarter because we were still negotiating.

But, Craig, do you want to just take that question?

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

Sure. I'll hop in there. Yeah, Heather is quite right there, there was a small amount in the quarter but, frankly, we only recognized where deals were literally signed with amended agreements. So it was a very small portion of what we will see in the year. We're not going to go into specific numbers on that just yet given that we still have a few negotiations to wrap up.

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

But I would say that this was, ah, I think it's fair to say that this was an intense and concerted effort and we feel positive about what was achieved.

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

Yeah. So, David, like if you were to look at the share we expect over the year, there was not a full quarter's worth in this quarter, if that your question. We'll definitely see more next quarter.

David McFadgen — Analyst, Cormark Securities

Yeah, I thought it was that and also that there are probably many more rent concessions to be obtained or you have obtained them and they're just not reflected in the quarter.

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

Exactly.

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

Correct

David McFadgen — Analyst, Cormark Securities

Okay. And then on the Canadian Emergency Wage Subsidy, obviously you recognized about \$16 million in the quarter. Should we expect that number to continue for the next quarter or so?

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

No, not to that extent. We may get a small amount but, obviously, that large amount was reflective of our stores being closed for two months. I think, you know, as much as we're thrilled with

the sales we're seeing, that does also mean that that will put pressure on that benefit, that we will not be eligible for anything near that. In fact, that benefit for us going forward will be very small, if there's any at all.

David McFadgen — Analyst, Cormark Securities

Okay. And so you're talking about Q2 and beyond, right?

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

Correct. And I don't even know, obviously, because it depends specifically on our results every month.

David McFadgen — Analyst, Cormark Securities

Okay. Okay. And just on the gross margin, obviously the gross margin was negatively impacted by online, because online gross margin is lower. Is there any ability to improve that online gross margin?

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

There's two points there to be aware of. One is online shipping, which, of course, was extremely high. And the other is, you realize that with 200 retail stores closed from the end of March through pretty much June and even then at curtailed hours, we had goods in our stores and we were planning for a pretty positive first quarter. This is when we expected to see a nice turn in the business based on a number of things that we had done. So we were sitting on merchandise that we had to and are still having to clear. So we are doing a number of things on margin but, like any other retailer with goods

that were meant for another season, that is also impacting margins. So you have two things which are impacting margin. One is temporal, the cleared goods, although it will last a bit into this quarter. The shipping cost is going to be higher than last year because our online business has grown so much.

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

Yes. So that's spot on and then the only other thing to keep in mind, David, is obviously the sales mix in the first quarter versus what we expect the rest of the year. With the stores now open I think the penetration of online compared to Q1 will be about half going forward, which will still be well above what we've seen in the past, but certainly Q1 was exceptional for that reason in that for two months 100% of our sales were coming from the online channel.

David McFadgen — Analyst, Cormark Securities

Yeah. Okay. So the cash balance at the end of the quarter was higher than what I was looking for, which is obviously positive. Do you think you could actually finish this year with cash being similar to what you started the year with?

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

I don't know if we're allowed to—

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

Yeah, I don't think I'm going to give—

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

Sorry, Craig, do you want to hop in there?

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

Yeah. I don't really want to speculate on that. I mean I guess we're pleased with what is happening right now, David. In the end, like any year, everything is going to come down to holiday and I think, based on our earlier discussion, it's how are people going to behave in a holiday period when the store is usually quite busy and we're in a world of physical distancing. It's very hard to forecast things at the moment, so I'm not going to go way out on that limb.

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

I think what is worth noting though is, and exactly consistent with Craig, this is the reason that we so advanced efforts to ensure a very strong, robust click-and-collect capability. What we were able to MacGyver, frankly, for Q1 was just a small technological change, but the major experience for customers on click and collect will be very positive for the third quarter.

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

Yeah, absolutely.

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

That is, the best thing that we can do is to create every single possible option for the customer. They can shop online, they can shop click and collect, they can shop Instacart, so that they feel as safe as possible. All that said, I fully reinforce Craig's point that we always experience amazing intensity in our stores at holiday so we'll do what we can, but keeping everybody safe will be top of the list.

David McFadgen — Analyst, Cormark Securities

Okay. Okay, well that's it for me. Thanks so much.

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

Thanks, David.

Operator

Thank you. At this time I will now turn the call back over for closing comments.

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

Thank you. Thank you, everyone, 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 5, 2020. Thank you again and have a great day.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and we ask that you please disconnect your lines. Enjoy the rest of your day.