

Indigo Books & Music Inc.

Fiscal 2022 Second Quarter Results

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Indigo Books & Music Inc. — Chief Financial Officer

Heather Reisman

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CONFERENCE CALL PARTICIPANTS

Sid Dilawari

Cormark Securities — Analyst

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Indigo Books & Music Inc. Financial Year 2022 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 Wednesday, November 10, 2021.

I would now like to turn the conference call 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 fiscal 2022 second quarter 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 17, 2021.

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, and thank you for joining us.

Our strong sales performance this quarter, double digit revenue growth, with improvements across both our print and general merchandise businesses, delivered second quarter revenues that exceeded both last year and pre-pandemic levels. Specifically, sales were \$238.8 million, a 16.3% increase over last year and a 17.4% increase over fiscal 2020. This sales momentum is being enabled by the strength of our omnichannel strategy, the continuing strength of the book business, and strong general merchandise growth. It is worth noting that these numbers were achieved despite the reality that capacity restrictions in retail continue to exist in several markets and foot traffic in city centres remains far below historic levels.

Of note, we are particularly pleased with the growth of OUI, our proprietary home brand, and with our newly-introduced sustainable paper brand, Nóta. Nóta resonated extremely well during the back-to-school/back-to-work period and we are pleased to see such strong alignment between our commitment to sustainability and the commitment of our customers. Building quality proprietary product designed in-house is key to our growth strategy.

And while on the subject of sustainability, we were pleased this month with the public launch of our Write the Future sustainability strategy where we formally declared our commitment to being net zero by 2035. We encourage everyone to visit our website at indigo.ca/sustainability.

In addition to our commitment to the planet, we remain steadfast in our commitment to children's literacy in Canada. Over the past year, and advanced this quarter, we provided over \$2.2 million in grants to promote literacy in high-needs communities, an effort which includes a purposeful focus on reaching Indigenous children across nine provinces and the territories.

While Craig will provide a detailed financial perspective, I would just note that we delivered an adjusted EBITDA of \$10.6 million. This was driven by a number of things, including strong sales, a strengthened operating model which included greater sell-through of full-priced goods, a more effective leverage cost structure, and an out of the ordinary benefit, offset by lower government support.

I will now pass 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 October 2, 2021. Comparative figures reference the 13 weeks ended September 26, 2020.

In the second quarter we generated revenue of \$238.8 million, an increase of \$33.5 million or 16.3% from the second quarter last year. This increase in revenue was notably experienced across the Company's print and general merchandise businesses. The print business continued to experience strong demand, driven by a younger demographic and the popularity of reading on social media and, as Heather discussed, the Company's proprietary brands, in particular the home brand, OUI, are meaningfully contributing to the growth of the general merchandise business.

As a result of temporary store closures from COVID-19, the impact of social distancing, and government-mandated capacity constraints in reopened stores, we believe that comparable sales are not currently meaningful to evaluate performance. Instead, we focus on total revenue, as discussed, as well as omnichannel fulfillment trends.

The retail channel, which is inclusive of orders fulfilled through omnichannel store pickup, increased by 16.7% to \$159.6 million for the 13-week period ended October 2, 2021. Retail revenue growth was achieved through improvements in traffic, conversion, and average transaction values as pandemic conditions softened and the Company's retail network performed stronger than in the same period last year.

Online channel revenue decreased by \$8.4 million or 13.3% to \$54.6 million for the 13-week period ended October 2, 2021. This moderated demand reflects the rebound of retail, as discussed. The online channel sustained sales levels at 85% above pre-COVID fiscal 2020 and continues to be a lever of omnichannel growth and investment focus.

To offer greater connectivity to brands doing business on modern e-commerce platforms and to unlock a dropship opportunity to sell on *indigo.ca*, the Company integrated with Convictional as a technology partner in the second quarter. This is only the beginning of the Company's digital transformation agenda and we look forward to sharing our plans around an enhanced digital experience in future quarters.

Cost of sales increased by \$2.9 million to \$128.8 million for the 13-week period ended October 2, 2021. Excluding the impact of online shipping costs, cost of sales increased by \$2.1 million to \$119.2

million for the period. As a percentage of total revenue, this represents a decrease to 49.9% compared to 57.0%. While this was driven by the retail channel rebound, which typically has a higher margin profile, the Company realized merchandise margin improvements in both channels. These improvements more than offset the adverse impacts of higher inbound freight costs triggered by global supply chain constraints.

Online shipping costs increased by \$0.8 million to \$9.6 million for the 13-week period ended October 2, 2021, largely due to increased fuel cost, which reflect the macroeconomic conditions of the commodity market.

Overall operating, selling, and administration cost increased by \$10.9 million to \$84.2 million for the period. Operating costs were offset by the recognition of \$2 million in occupancy abatement and government rent and payroll subsidies, markedly lower than the \$5.3 million the Company was eligible for and recognized in the prior year. Operating costs also increased on the return of higher sales volumes in the retail channel.

Adjusted EBITDA improved by \$21.9 million to \$10.6 million for the 13-week period ended October 2, 2021. Higher adjusted EBITDA was driven by strong sales performance and stronger merchandise margins and achieved against lower external COVID-19 labour support and the corresponding increase in retail operating expenses. Adjusted EBITDA also benefitted from a one-time payment of \$17 million resulting from the renegotiation of the Company's partnership with its primary café vendor.

The Company recognized net earnings of \$3.5 million for the 13-week period ended October 2, 2021 or \$0.13 net earnings per common share compared to a net loss of \$17.5 million or \$0.63 net loss per common share for the same period last year, an improvement of \$21.1 million.

With no outstanding debt, an undrawn \$25 million revolving credit facility and cash of \$71.9 million, the Company is well positioned to see through the remaining COVID-19 uncertainty and the execution of a post-pandemic growth strategy.

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 star followed by one on your touchtone phone. You will hear a three-tone prompt acknowledging your request and your questions will be polled in the order they are received. Should you wish to decline from the polling process, please press star followed by two. If you are using a speakerphone, please lift your handset before pressing any keys. One moment please for your first question.

Your first question comes from Sid Dilawari with Cormark Securities. Please go ahead.

Sid Dilawari — Analyst, Cormark Securities

Oh, hi. Hi, Heather. Hi, Craig. Just a few housekeeping ones for me first and then I'll ask one big-picture one. Just looking at the revenue composition, just excluding the \$17 million Starbucks payment, trade was approximately 59%, merchandizing was 38% of revenue, slightly more weighted towards merchandising, I guess, relative to last year. Are you happy with this composition or would you like it to be more weighted towards either of the categories?

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

Sorry, could you just say that again? You're saying that the—it's Heather speaking. Hi. Good morning. You're saying, you're noting the mix between our general merchandise and lifestyle and books? Is that what you're asking?

Sid Dilawari — Analyst, Cormark Securities

Exactly. Yes. So I was just asking if you're happy with this composition or would you like it to be slightly more weighted towards merchandise or books going forward?

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

We're extremely happy with the mix, because the customer is telling us two things. As the business grows, the customer is telling us they still value, significantly, the role we play in books. So that business is remaining strong and we're really happy with the strength of that business. And at the same time as the business grows, our general merchandise business grows. What we will look at moving

forward, because we see even greater potential for the growth of our lifestyle business, is always to sustain a strong position in books and a strong market share in books. It is the foundation of the business. So we're really happy with where it's at and we see lots of growth potential on both sides.

Sid Dilawari — Analyst, Cormark Securities

Okay, great. Thanks. That's helpful. And just on that point, you know, in the MD&A there was a mention regarding the younger demographic being more interested in reading versus previously. Is there something that drove that or...? Like was it something related to marketing? Or was it just organic?

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

Actually it's organic and it's been supported by TikTok. Young Canadians have said, "We love to read and we love to talk about reading and we're going to talk about reading on TikTok." And it has just blown up.

Sid Dilawari — Analyst, Cormark Securities

Okay. Okay, that makes sense.

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

Which is a great sign, right? It says, as things are evolving, people are speaking about the importance of reading in their life and their joy of books. So, seriously, it's fantastic.

Sid Dilawari — Analyst, Cormark Securities

Yeah, I know, it's good to see that bounce back from digital. Like even personally for myself, like I always like reading like hard copies of books, and I always did that like even now, but that's good to hear.

And then sorry, just one for Craig. You mentioned inflationary pressures on input costs primarily from freight costs. Are you seeing any inflationary pressure just from any other supply chain disruptions that we see worldwide, not just related to freight? Any other input costs on the merchandizing side that you're seeing are rising? And if yes, are you passing these costs on to the consumer or are you just sort of waiting for it to stabilize and just consuming it yourselves for the time being?

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

So the inbound freight cost has definitely been the most significant and I think, you know, I won't go on too much about that. It's been heavily covered in the news. And we've been experiencing that, frankly, since the start of the year. So you already see that in the run rate, but we expect that to continue into next year.

The next largest one would be slightly related, just in that fuel, you know, the cost of commodities has gone up significantly, so all our carriers that do both our inbound, our store distribution network, and then also our direct-to-consumer transportation, we're seeing high fuel surcharges there. So that would probably be the next biggest one.

There are always other commodity pressures in goods, but so far we are fending that off. There's always some design considerations you can make too in product.

As far as passing it on to the consumer goes, although we haven't really changed many of our ticket prices, we definitely have been following a far less promotional selling strategy and that is definitely showing up in significant margin strength. The margins we're seeing are some of the highest we've seen in the Company's history and that's as a result of lower discounting. So that's really helped get around that cost of goods as well.

Sid Dilawari — Analyst, Cormark Securities

Okay. Okay, thanks. That's helpful. And then just quickly on working capital, we obviously saw a massive working capital spike related to inventories during the quarter. Is that largely due to anticipation of a strong holiday season or is there something else happening here?

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

No, that's exactly right. And I think also, you know, it's much smaller compared to historical levels, but you have to keep in mind, when you look year over year, we'd followed a very conservative and prudent approach last year of keeping inventory extremely tight given where COVID was at that point and the risk of stores closing. And it's lucky we did do that last year, because, in fact, we did find ourselves closed for Christmas in Toronto and then subsequently all of Ontario. So inventory was unusually low last year and that's what you're seeing.

Sid Dilawari — Analyst, Cormark Securities

Okay. And then just one last one, a big-picture one for me. Just over the past few years you have renovated your stores, you have rejuvenated or are still rejuvenating your merchandise lineup. Is there anything else that's on your list of things to do from a strategic standpoint?

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

Heather, do you want to take that one or do you want me to?

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

Sorry, you broke just a bit. Can you just ask that one again?

Sid Dilawari — Analyst, Cormark Securities

Sure. I was just asking, you know, over the past few years you have renovated your stores, you have rejuvenated or are still rejuvenating the merchandizing lineup here. Is there anything else that's on your list of things to do from a strategic standpoint?

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

We have lots actually on our plans related to online, related to stores. There's just a significant amount of planning going on for advances and changes that we're planning, a significant amount of work going on for changes we're planning. But we will announce those when they happen. As we always do. But there's lots in the works. Lots.

Sid Dilawari — Analyst, Cormark Securities

I'm sorry, Craig, you were going to say something I think?

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

No, I was just going to say, as we mentioned on the last analyst call too, I think our number-one priority right now is really digital reinvention, and so we've been working on that throughout the pandemic. But that's certainly, as Heather noted, there's a lot going on, but that's certainly number one on the list.

Sid Dilawari — Analyst, Cormark Securities

Okay. Okay, great. Thanks, guys. That's it for me.

Operator

Ladies and gentlemen, as a reminder, should you have any questions, please press star one.

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

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

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 10th. Thank you again for your support and have a great day.

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

Thanks.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines. Have a great day.