Indigo Books & Music Inc.

Financial Year 2021 Year-End Analyst Conference Call

Event Date/Time: June 2, 2021 — 9:00 a.m. E.T.

Length: 19 minutes

"While Cision has used commercially reasonable efforts to produce this transcript, it does not represent or warrant that this transcript is error-free. Cision will not be responsible for any direct, indirect, incidental, special, consequential, loss of profits or other damages or liabilities which may arise out of or result from any use made of this transcript or any error contained therein."

« Bien que Cision ait fait des efforts commercialement raisonnables afin de produire cette transcription, la société ne peut affirmer ou garantir qu'elle ne contient aucune erreur. Cision ne peut être tenue responsable pour toute perte de profits ou autres dommage ou responsabilité causé par ou découlant directement, indirectement, accessoirement ou spécialement de toute erreur liée à l'utilisation de ce texte ou à toute erreur qu'il contiendrait. »

CORPORATE PARTICIPANTS

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

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

CONFERENCE CALL PARTICIPANTS

David McFadgen
Cormark Securities — Analyst

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Indigo Books & Music Inc. Financial Year 2021 Year-End 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 *, 0 for the Operator.

This call is being recorded on Wednesday, June 2, 2021.

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 fiscal 2021 results. My name is Craig Loudon, and I am 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 June 9, 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. It is almost redundant to say that this year will be remembered as a watershed moment in history, a turbulent time that will prove to transform so much of who we are.

I am proud of the ways in which Indigo has demonstrated resilience and resourcefulness throughout the course of this pandemic and pleased to report that our customers adapted with us, embracing *indigo.ca* and our Express Pickup and curbside offerings.

Buoyed by the exceptional triple-digit growth in online, the in-year delivery of enhanced omnichannel capabilities, and a renewed strength in our core book business, net revenue decreased just 5.5 percent from the prior year. Against draconian government-mandated store closures in our largest province, Ontario, and capacity constraints across the country that meaningfully disrupted our business, including during the all-important holiday season, we feel this is a remarkable result.

Online penetration more than doubled, partially offsetting the sales losses from a severely restricted retail business. This performance is a testament to the agility and dedication of the Indigo team who successfully pivoted to capitalize on the consumer shift to full e-commerce shopping, and we delivered transformative growth.

Amidst the complexity of this global health crisis, we also successfully launched our new home brand, OUI, which was well received by our customers, with many items selling out.

In addition to absorbing some COVID-19 downside, this launch demonstrates the success of assortment expansion as a growth lever for our business as we look forward to a post-pandemic recovery. This expansion will be buttressed by further investment in digital and omni experience for our customers initiated this past year and already well underway.

Back to speaking on fiscal ‘21, margin pressure from the need to clear through retail inventory after waves of store closures, paired with unusually elevated shipping costs driven by the channel shift, impacted sales to adjusted EBITDA.

With the addition of Peter Ruis as President and a healthy balance sheet with no outstanding debt, we look forward to a return to profitability in fiscal 2022.

Craig Loudon

Thank you, Heather. The results we are discussing are for the 53 weeks ended April 3, 2021. Comparative figures have been provided for the 52 weeks ended March 28, 2020. We have also provided certain metrics for fiscal 2021 that exclude the impact of the 53rd week to assist you with your analysis.

Revenue for the full year decreased $53 million or 5.5 percent to $904.7 million from $957.7 million in the prior year. On a normalized 52-week basis, total revenue decreased 7.1 percent compared to the same period last year. This decline reflects the financial impact of government-mandated store closures and customer capacity restrictions that impacted all 177 stores in fiscal 2021.

To put this into greater perspective, stores in the Greater Toronto Area, collectively our biggest market, faced closures for approximately six months’ time, including the critical holiday sales period.

As a result of temporary store closures from COVID-19 and strict social distancing requirements limiting capacity in stores and open markets, 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 omnichannel fulfillment trends.

Online channel revenue more than doubled with growth of 127 percent for the 53-week period ended April 3, 2021, sustaining the momentum realized since the beginning of the pandemic. Online revenue still experienced triple-digit growth on a normalized 52-week basis at 124.5 percent.

The Company converted a significant number of existing retail customers to its digital platforms, as well as acquired a new online customer base with over 1 million new customers shopping on *indigo.ca* in fiscal 2021.

The retail channel, which is inclusive of orders fulfilled through omnichannel express pickup, decreased by 34.1 percent for the 53-week period ended April 3, 2021. On a normalized 52-week basis, retail revenue decreased 35.5 percent. This reflects the severe impact of government-mandated store closures, as discussed.

With enhanced click-and-collect services launched ahead of our Q3 holiday peak, the business was able to activate retail inventory in closed markets, satisfying customer demand and alleviating some pressure from the online fulfillment centres. These enhanced omnichannel capabilities peaked at 35 percent of e-commerce demand during a critical holiday period of December sales and will continue to be a pillar of our omnichannel strategy as customer expectations evolve post-pandemic.

Cost of sales increased by $14.3 million to $567.9 million for the 53-week period ended April 3, 2021. As a percentage of total revenue, cost of sales increased 5 percent to 62.8 percent compared to 57.8 percent last year. This was primarily a function of higher shipping costs from the online channel's penetration increasing to 41 percent and included the elevated volume-driven fulfillment costs during store closure periods.

Excluding online shipping costs, cost of sales decreased by $22.1 million for the 53-week year. As a percentage of total revenue, this represents an increase of only 0.8 percent to 55.9 percent compared to 55.1 percent last year.

Retail margin rate performance remained flat to last year, highlighting the Company's ability to generate full-price sell-through despite isolated pressures from mandated store closures. The online

channel delivered the strongest merchandise margin rate to date as a result of disciplined inventory management, lower online promotional activity, and efficiencies realized in the Company's online fulfillment process.

As the online channel has historically experienced lower margins, these efforts lessen the impact of the noted shift to the online channel. This resulted in an increase to cost of sales as a percent of total revenue of less than 1 percent.

Overall, operating, selling, and administration costs decreased by $49.3 million to $296.4 million for the 53-week period ended April 3, 2021. The Company recognized $16.6 million in occupancy expense support and $27.4 million in government payroll subsidies. These reductions were furthered by lower costs throughout the Company's store network in response to the year-over-year decline in traffic, partially offset by increased costs in the Company's online distribution network from the growth of *indigo.ca*.

In line with significant COVID-19 headwinds and the associated adverse revenue impact, adjusted EBITDA decreased by $21.1 million to a loss of $28.3 million for the 53-week period ended April 3, 2021. As a percent of total revenue, adjusted EBITDA declined by only 2.3 percent to a loss of 3.1 percent this year, reflecting our ability to meet customers' demands despite relentless operational challenges, the extraordinary resilience of our Indigo teams, and a deep affinity for the Indigo brand.

The Company recognized a net loss of $57.9 million for the 53-week period ended April 3, 2021, or $2.09 net loss per common share, compared to net loss of $185 million or $6.72 net loss per common share last year. The improvement in earnings was primarily a result of cycling over non-cash impairment losses and the write-down of the Company's deferred tax assets in the prior year.

With no outstanding debt, a clean inventory position, and cash of $84.9 million, the Company is well positioned to see through the remaining COVID-19 uncertainty and the execution of our post-pandemic growth strategy.

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

Q&A

Operator

As a reminder, to ask a question, you will need to press *, 1 on your telephone. To withdraw your question, press the # key. Please stand by while we compile the community roster.

Your first question is from David McFadgen with Cormark Securities. Your line is open.

David McFadgen — Cormark Securities

Thank you. A couple of questions. First of all, just on the store count, is this the new norm for the store count? I saw that there's a reduction in the small-format stores, so I was wondering if you would reconsider expanding again once we're out of this lockdown. Or is this the new norm here?

Heather Reisman

So, for some time now, we've been looking at our small-format strategy. We were serving a number of very small communities. And as long as the business is doing extremely well, even though those were money-losing, we could justify supporting them. But we had to make lots of meaningful decisions this year. And in communities that cannot support a small-format store, we have in fact withdrawn at the moment.

Having said that, we are in the process of looking totally anew at the whole role of retail and what role can stores play in this new truly digital omnichannel world. And so, I wouldn't overread into

that. I would say, yes, non-profitable locations will be closed, but there's all kinds of new potential depending on how this strategy unfolds.

So we are looking to have the right kind of physical coverage to fully support the customers in a rich omnichannel way. And we actually believe that the customer has changed, and in many ways, that will work in the favour of our physical environment. And the more we can use those physical environments for both serving customers who are in for an experience and those who just want to pick up, the more we will do it.

So it's a long answer to say, David, yes, we deliberately withdrew from money-losing stores that we did not believe had a future as they were designed where they were located, but we are fully relooking overall at our retail footprint in light of a whole new model of operating.

David McFadgen

Okay. And just following along that, obviously, the margins were negatively impacted in this quarter and in fiscal '21 just given the shift from retail to online. And I'm just kind of wondering, I don't even know if you guys have a read on it but, what do you think the margins might be like assuming all this lockdown is behind us and then business kind of goes back to the new norm, whatever that is?

Heather Reisman

Right. So, of course, we're not going to comment specifically on the margin unless, following my comment, Craig wants to make a point. But this is what I think you need to understand or what I think would be valuable for you to understand about how we're thinking about the business.

Last year, notwithstanding a bit of support from our landlords, which was very much appreciated, we essentially took a huge chunk of the business and put it into online. Right? And so that had a huge impact on margins.

What we see moving forward because of the lots of new customers that we picked up to the online channel is that online will continue to grow meaningfully but that the in-store experience will also experience a meaningful growth trajectory, particularly because we are an in-store kind of retailer. So we see the opportunity for very much-improved margins.

Retail-level margins have historically been better than online margins, although we are improving on the online side and will continue to look for improvement. So all that to say, without stepping over a line that isn't appropriate, we believe that, as the business emerges into this new world, we fully expect to see meaningful improvement in margin.

Craig Loudon

And, David, I'll just add to that slightly. It's Craig. The real challenge has been more the shift and that our online margins have greatly improved. In fact, contribution in channel was up high single digits compared to where it was historically. So any net-new revenue landing in the online channel is profitable.

The challenge is when you temporarily take a large amount of volume that would have transacted in retail and will likely do so in the future, you move it out of that fixed-cost network and those costs don't go away because you have long-term leases and obligations, and then push it into a channel where there's variable costs. That's really what challenged the business this year.

And we will see it correct just like we did last summer when we opened for a little bit. We saw stores bounce back and online decrease a bit, but it still was well above historical levels.

David McFadgen

So you talked about returning to profitability in fiscal 2022. At least you're optimistic on doing that. So I imagine that's at the EBITDA level, the way you define EBITDA, that you're hopeful that you'll get to positive EBITDA this year. Right?

Craig Loudon

Correct. Yeah. That's correct. And, certainly, starting the year off in Q1, this is publicly known, but over half of our stores are currently closed with the ongoing Ontario shutdown. So we really need to get out of that and get back to business. But we'll do that as soon as we're allowed to.

David McFadgen

Yeah. Okay. And then just on the cash position, I think you were kind of hoping, at least partway through fiscal '21, to finish with a cash position which was somewhat similar to what you started fiscal '21 with. And I was just wondering why or what you would attribute the lower cash position to. Is it just the function that just dealing with this crazy lockdown scenario? Or—

Heather Reisman

Oh, Craig, can you comment on this—

Craig Loudon

Yeah. Yeah. No. I will.

Heather Reisman

—because this is just that strange 53rd week and what it does.

Craig Loudon

Yeah.

Heather Reisman

Do you want to comment on that?

Craig Loudon

Yep.

Heather Reisman

And the equal to equal. I think it's important to understand that point.

Craig Loudon

Mm-hmm.

Heather Reisman

It's very important.

Craig Loudon

Yep. No. That's a great observation, David. So because of the 53rd week, that pushed the end of both the fourth quarter and the year out a week. And consequently, we had two sets of publisher payments within one month, which normally wouldn't happen, and also, rent payments associated with the future quarter as well.

So if I adjust for the 53-week and take it back to like-for-like timing to a 52-week year, the cash balance would have been $111 million, which is about $9 million off last year, which, given everything we faced, we're pretty pleased with.

So we would never have two sets of publisher payments like that in one month. So that was to the tune of $20 million of extra publisher payments in the month and another $7 million of rent payments. So it's really not comparable, the reported number. But that's the way we need to do it, given the 53rd week this year.

David McFadgen

Okay. Yeah. No. That's very helpful. Okay. Thank you very much.

Craig Loudon

Thanks, David.

Operator

Again, if you would like to ask a question press *, 1 on your telephone.

Craig Loudon

Okay.

Operator

There are no further questions at this time. Now I'll turn the call back over to you, Craig Loudon.

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 first quarter results will be announced on or around August 13th. Thank you again and have a good day.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.