

Indigo Books & Music Inc.

Financial Year 2022 Q1 Analyst Conference Call

Event Date/Time: August 13, 2021 — 9:00 a.m. E.T.

Length: 18 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 dommages 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 2022 Q1 Analyst Conference Call.

At this time, all lines are in listen-only mode. Following the presentation, we'll 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 Friday, August 13, 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 2022 first 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 August 20, 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. First quarter sales performance, plus 27 percent revenue rebound over last year, reflects the beginning of a welcomed recovery in retail and was achieved despite protracted COVID-19 store closures in our largest market, Ontario, as well as sporadic closures and occupancy limitations throughout the country. To expand, over 50 percent of the Company's store locations were impacted until late in the quarter.

The double-digit revenue rebound does speak to the continued strength of Indigo's brand, reinforced by advances in digital and phygital experience, as well as an outstanding retail team who have continued to drive our retail store experience despite the endlessly difficult demands of operating in this ever-changing environment.

Our Print and General Merchandise business both delivered solid results. The popularity of reading on TikTok created a whole new level of reading excitement, particularly for teens, adding to already strong performance in books overall.

Our General Merchandise business continues to benefit from the successful expansion of our proprietary lifestyle brand, OUI. These results validate our ability to evolve with the dynamic retail landscape. We remain keenly focused on our customer and our commitment to being a leading omni-channel retailer, all toward delivering a return to full-year adjusted EBITDA profitability.

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

Craig Loudon

Thank you, Heather. The results we are discussing are for the 13 weeks ended July 3, 2021. Comparative figures reference the 13 weeks ended June 27, 2020.

In the first quarter, we generated revenue of \$172.1 million, an increase of \$37 million or 27.4 percent from the first quarter last year. This double-digit rebound in revenue was experienced across the Company's Print and General Merchandise businesses in both core categories and new product assortments.

The Print business experienced strong demand, notably driven by a younger demographic and the popularity of reading on TikTok. This evolution of social commerce in the book space is exciting. Not only does Indigo's market leadership position benefit from the organic user-generated content on BookTok, it sparks a sales resurgence for many previous-released titles.

In addition to introducing a new demand life cycle, the backlist titles tend to be less promotional than recent bestsellers, delivering strong margin dollars.

As Heather discussed, the Company's proprietary lifestyle brand, OUI, drove growth in General Merchandise through successful assortment expansion, lifting its category sales above pre-pandemic levels.

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 focused on total revenue as discussed as well as omni-channel fulfillment trends. The retail channel, which is inclusive of orders fulfilled through omni-channel store pick-up, increased by 114.8 percent to \$90.2 million for the 13-week period ended July 3, 2021. Customers' desire to shop in store drove this triple-digit revenue rebound, supported by the easing of COVID-19 containment measures in regions.

Ontario-wide closures and other localized rolling enclosures and capacity constraints proved less disruptive than nationwide closures last year but delayed an anticipated full recovery.

Now with meaningfully diminished COVID-19 restrictions across the Company's retail network, we are seeing the positive impact of a full retail fleet to the early weeks of the second quarter.

Ontario store locations featuring an external entrance reopened in the 10th week of the quarter, as mentioned, ahead of remaining locations on June 29, 2021. The Company was well positioned to handle this adversity with convenient omni-channel store pick-up capabilities, a product of investments made over the past 12 months.

Revenues generated through omni-channel store pick-up grew nearly five times from the same period last year and will continue to be a pillar of our omni-channel strategy as customer expectations evolve post-pandemic.

Online channel revenue decreased by \$15.8 million, or 17.5 percent, to \$74.5 million for the 13-week period ended July 3, 2021. This moderated demand reflects the healthy rebound of retail, as discussed. The online channel sustained sales levels over three times pre-COVID fiscal 2020 levels and continues to be a lever of growth and investment focus for the Company.

Cost of sales increased by \$4.7 million to \$101.6 million for the 13-week period ended July 3, 2021, compared to the prior year. Excluding the impact of online shipping costs, costs increased by \$9.1 million to \$88.9 million for the period. As a percentage of total revenue, this represents a decrease of 7.4 percent to 51.7 percent compared to 59.1 percent. These improvements were driven by the retail channel rebound, which typically has a higher margin profile, and merchandise margin improvements in both channels. The strength of these assortments and the success of efforts to be less promotional delivered this stronger margin rate.

Online shipping costs decreased by \$4.4 million to \$12.7 million for the 13-week period ended July 3, 2021, largely in response to tempered demand in the online channel as discussed, but the Company

also realized improvements in online shipping unit economics year over year, a result of final-mile carrier diversification and less disruption from COVID-19 at its distribution centres.

Overall, operating, selling, and administration costs increased by \$23 million to \$86.4 million for the period. Operating costs were offset by the recognition of \$6.5 million in government rent and payroll subsidies, markedly lower than the \$16.8 million the Company was eligible for and recognized in the prior year. Operating costs also increased on the return of higher sale volumes in the retail channel.

Adjusted EBITDA improved by \$8.8 million to a loss of \$14.9 million for the 13-week period ended July 3, 2021. As a percent of total revenue, adjusted EBITDA improved 8.8 percent to a loss of 8.7 percent this year, reflecting a strong product assortment and an early retail recovery.

The Company recognized a net loss of \$21.9 million for the 13-week period ended July 3, 2021, or a \$0.79 net loss per common share, compared to a net loss of \$31.6 million, or \$1.15 net loss per common share, for the same period last year, an improvement of \$9.7 million.

With no outstanding debt, a clean inventory position, and cash of \$81.4 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

Thank you. Ladies and gentlemen, we'll now begin the question-and-answer session. Should you have a question, please press *, followed by 1 on your touch-tone phone. You'll 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 *, followed by 2. If you're using a speakerphone, please lift the handset before pressing any keys. One moment for your first question.

Okay. And your first question comes from David McFadgen from Cormark Securities. David, please go ahead.

David McFadgen — Cormark Securities

Thank you. So a couple questions. So just wondering how the business is trending so far in this quarter now that all the stores are open. Just kind of wondering how the mix is going to be going forward between online and in-store. If you could provide any commentary there.

Heather Reisman

Hi, David. How are you?

David McFadgen

I'm doing well. How are you?

Heather Reisman

Good. Craig, just within the context of what we are allowed to say, do you want to take that, just so I don't cross any lines here?

Craig Loudon

Sure. David, we're certainly seeing strength since the stores reopened. It's actually exceeding our expectations overall from an omni-channel revenue perspective. And I would say we don't know if it's going to continue, but we're certainly seeing revenue slightly ahead of two years ago. But again, it's early days. I don't want to speculate that that will continue or not. Obviously, we don't know because the Ontario reopening's pretty fresh.

And as far as your question regarding online, in the quarter with the Ontario stores closed, obviously, online was still very, very high compared to historical levels and then also our expectations. But even with the stores reopened, it's still holding ground and we really think it's going to be our path to growth in the future. And as we noted, the order online and pick up in store capability, even though we had it last year, the volumes through that have grown by 5 times, so we think people have really enjoyed that service and latched onto it and will continue to use it. So yeah, we see online being a very big part of the portfolio going forward.

David McFadgen

Okay. I mean, obviously, online benefitted significantly from COVID in fiscal '21, and I was just wondering, do you think it could hold this line? Or do you think it's probably going to drop a bit just because it had such a positive benefit from COVID?

Craig Loudon

Yeah. Well, certainly Q1, it's probably a little higher than it will end up being given that Ontario was closed, but certainly it will be well beyond historic levels. There's no question. So, I mean, to be honest, I can't give you a straight answer because I'd be speculating, and I think everyone's finding their way through this, but it's certainly going to be well beyond historic levels, no question.

David McFadgen

Yeah.

Heather Reisman

If I would just ... of course, 100 percent agree with everything that Craig is saying here and would just add it's clear that the consumer, this protracted COVID experience has changed the consumer – people's comfort with buy online, pick up in store, be in store, ship to home. So what we're seeing is an

evolution of the customer, and you're reading this everywhere. You'll read this in the food retail sector, everywhere, and we see huge opportunity in the route that we're going and the business we're in to continue for both channels to evolve.

Craig Loudon

Yeah. Absolutely and actually, one—

Heather Reisman

That's where we're putting our effort, and we're feeling like, yeah.

Craig Loudon

Yeah. And one final point, Dave, because we did talk about this at year-end, but we have seen a new younger customer emerging in the online channel, so I think it's important to think about it also that it's not just that retail customer that's going to shift back. We have seen new customers in the online channel that will likely stay there. So it's important to keep that in mind too.

David McFadgen

Okay. And then just following along on your comment you mentioned earlier. I mean, obviously it's early in Q2, and things could change quite a bit, so no one's going to hold you to anything. But you said it was, at this point, slightly ahead versus 2019. Are you talking total revenue? Or in store?

Craig Loudon

Yeah. No, I'm talking total. Yeah. Omni-channel. Yeah.

David McFadgen

Right, okay. Omni-channel, okay. And then just on margins. Obviously, your gross margin improved quite a bit as in-store sales picked up. And so I'm just wondering if the mix tilts more to be in-store, shouldn't we expect to see more improvement in your gross margin?

Craig Loudon

Yes. You're right. We will benefit from the channel economics when the shipping costs come out of cost of sales. But also a huge benefit here has been being less promotional, and our intent is to continue with that, so. But you're right. There will be that channel effect as well. Yes.

David McFadgen

Okay. And then maybe just a question on investment this year. If you could give us an idea of what you expect in terms of CapEx this year versus, say, fiscal '21?

Craig Loudon

Sure. Our planned CapEx this year is in the \$15 million to \$17 million range. That will really just vary, depending on how many projects get executed. But, by far, the focus of that investment is in our digital capabilities given that's the growth engine, has been so important in this environment and will be going forward. That's certainly the focus of the investment.

David McFadgen

Okay. And then, Heather, where do you stand on your store count? Are you happy with the total number of large format stores?

Heather Reisman

Right now, we have no plans to expand the store count or to make it smaller. I mean, the odd Coles store may close or not, but we see a stable base right now. We have a huge focus, as Craig has just said, in expanding digital capability, and so we've put a lot of money into the stores where we thought there's real opportunity. For now, we're just focusing all of our effort on digital investment.

David McFadgen

Okay. All right. Okay. Well, that's it for me. Thank you.

Heather Reisman

We have good coverage here, and at some point we're going to go back to our original plan, which was to see expansion outside of Canada, but obviously, the whole COVID thing put a bit of a sort of slowdown on any further expansion there. But to the extent that we look at it in the future, that will be the approach we take.

David McFadgen

Well maybe if I may, just following up on that comment. I thought that the New Jersey store, the performance pre-COVID was just kind of mediocre, but maybe I'm mistaken.

Heather Reisman

We obviously don't report by store, but it's taken a little bit of time for it to establish in the market because it was one. We originally thought we were going to do a cluster. But I will just say that right now, we are seeing wonderful improvement in the performance in that store.

David McFadgen

Okay. All right. Okay. Thank you.

Craig Loudon

Thanks, David.

Operator

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

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 9th.

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

Operator

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