

Indigo Books & Music Inc.

Third Quarter Fiscal Year 2024 Analyst Conference Call

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CORPORATE PARTICIPANTS

Craig Loudon

Indigo Books & Music Inc. — Chief Operating Officer and 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. Q3 FY24 Analyst Conference Call.

(Operator Instructions)

This call is being recorded on Friday, February 9, 2024.

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

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

Good morning and thank you for joining us to review Indigo's fiscal 2024 third quarter results. My name is Craig Loudon and I'm the Chief Financial Officer and Chief Operating Officer of Indigo.

Regarding the materials for this conference call, we issued the press release yesterday. It can be found at *indigo.ca* and on the SEDAR+ website. 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 February 16th.

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 our Chief Executive Officer, Heather Reisman.

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

Good morning, everyone and thank you for joining us.

It has been a challenging year in many ways, both within Indigo and around the world. At Indigo, disruptions throughout 2023, including a ransomware attack, some significant general merchandise over-buys, and a premature launch of our new ecommerce platform in August, combined with the challenging economic environment impacted our all important third quarter on both the top and bottom line.

During the quarter, we made the decision to right-size and right-shape our general merchandise inventory. This strategic decision to clear unnecessary inventory had a significant impact on margins and therefore profitability, but it was the right decision. At the same time, we reinvested in our book inventory, consistent with our long-term brand mission to inspire reading and enrich the lives of our customers. We also made the decision during the quarter to simplify elements of our operation and streamline our home office organization – again, a difficult decision, but the right one.

Most important during the quarter, we moved to stabilize our ecommerce operation. As I noted just shortly after my return late in September, we are confident in the underlying strength of our brand, built carefully over 25 years. We are also confident in the clarity of our transformation plan and our ability to connect meaningfully with booklovers. That said, it will take time before we begin seeing our full potential show up in the numbers.

Lastly, as it was announced last week, Indigo received a non-binding proposal from Trilogy Retail Holdings Inc. and Trilogy Investments L.P. to acquire all of the approximately 40% issued and outstanding common shares, the ones it does not already own. The Board of Directors has established a special committee of independent directors that will evaluate the proposal and make recommendations to the Board.

I would now like to ask Craig Loudon to provide a more detailed financial perspective on the quarter.

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

Thank you, Heather. The results we are discussing are for the 13 weeks ended December 30, 2023 and comparative figures reference the 13 weeks ended December 31, 2022.

In the third quarter, the Company generated revenue of \$371 million compared to \$423 million for the same period last year, a change of \$52 million. Revenue from the online channel decreased by \$31 million or 29% to \$77 million for the quarter, compared to \$107 million for the same period last year.

As Heather mentioned, disruptions throughout 2023, including the ransomware attack and premature launch of a new ecommerce platform, negatively impacted our ability to serve our customers. This translated to a decrease in online traffic compared to the prior year and underperformance in the channel that was disproportionate compared to the retail network.

Sales in the retail channel, which is inclusive of orders fulfilled through omnichannel store pick-up, decreased by \$25 million or 8% to \$281 million for the quarter, compared to \$306 million for the same period last year. The retail channel continued to feel the effects of the challenging macroeconomic environment with an overall decline in customer demand, as well as lower full-priced sell through. Sales were also negatively impacted by a more mature general merchandise product assortment. In order to right-size this assortment, the Company undertook wider discounting, which also impacted sales.

We have once again begun reporting on comparable sales. These measures are key performance indicators for the Company but have no standardized meaning prescribed by IFRS and may not be comparable to similar measures presented by other companies. For more information, please refer to the Management's Discussion and Analysis for the quarter. Total comparable sales, which includes online sales, decreased 14%. Comparable retail store sales for the quarter decreased 10% at superstores and 5% in small format stores.

The Company recognized decreased revenue in both its general merchandise and print product lines. The print business showed more resilience in the retail channel with the decline in sales being skewed by overall weakened online channel performance. The top selling releases for the quarter were also not comparable to those of the prior year. The general merchandise business suffered from a less successful product assortment which was missing key top-selling holiday products.

Cost of sales for the third quarter decreased by \$26 million to \$230 million, compared to \$256 million for the same period last year. Excluding the impact of online shipping cost, cost of sales decreased by \$17 million to \$216 million for the quarter compared to \$233 million for the same period

last year, impacted by the discussed overall reduced sales volumes in the quarter. As a percent of total revenue, this represents an increase to 58% compared to 55% in the prior year. The Company engaged in higher promotional activity to right-size product assortment. This along with customers' greater price sensitivity in light of the current macroeconomic environment led to an increased penetration of promotions and discount.

Total online shipping costs decreased by \$9 million to \$14 million for the quarter, compared to \$23 million in the same period last year. This was driven by the discussed reduction in online sales, furthered by improvements in online shipping unit economics from the consolidation with carriers offering more favourable terms.

Operating, selling and administrative costs decreased by \$7 million to \$102 million for the quarter, compared to \$109 million for the same period last year. Variable selling costs decreased in line with the reduction in sales volume. The Company was focused on cost containment, realizing cost savings in the retail network from a new store operating model, in warehousing and distribution cost centre efficiencies, and from a temporary reduction to the Company's marketing programs. In an overall effort to streamline operations, the Company also made the difficult decision to rationalize part of its head office workforce.

Adjusted EBITDA for the quarter was \$22.3 million compared to \$40.8 million for the same period last year. As discussed, Adjusted EBITDA was impacted by reduced sales volume, reflecting the lingering impacts of various consumer disruptions, the pressures of the challenging macroeconomic environment, and a less successful product assortment throughout the holiday sales season. Profitability

was also negatively impacted by reduced full-priced sell through. These impacts were partially offset by the noted cost containment initiatives undertaken by the Company.

Net income for the quarter was \$10.0 million, or \$0.36 net income per common share, compared to net income of \$34.3 million, or \$1.23 net income per common share, for the same period last year.

Subsequent to quarter end, the Company amended and extended its revolving line of credit facility with Trilogy. The amended facility is for an aggregate principal amount of up to \$70 million and, with the consent of Trilogy, the amount may be increased by up to \$10 million. The facility, which expires on December 31, 2024 and has an interest rate of the Royal Bank of Canada prime rate +2.5%, will continue to be used to finance the seasonal working capital and operational needs of the Company.

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

Q & A

Operator

Thank you. Ladies and gentlemen, we will begin the question-and-answer session. (Operator instructions.)

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

David McFadgen – Analyst, Cormark Securities

Okay, great. Thank you. Heather, I was wondering if you could just give us an idea of what your priorities are, now that you're back at the Company.

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

Well, as we noted in the press release, I'm currently working on a transformation plan with the Executive Team, which will essentially bring the business back closer to the core of what our ambition is, and as I said in my note, I feel very confident that it's the right direction.

David McFadgen – Analyst, Cormark Securities

Okay, and I guess part of that would also be a renewed focus on EBITDA or profitability, is that correct?

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

Sorry, what—it would be—sorry, say that again?

David McFadgen – Analyst, Cormark Securities

A renewed focus on EBITDA or profitability?

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

It's actually a focus at all levels, a focus on our overall brand commitment to our customers, a focus on the way that we show up in stores with assortment, and of course the implication of what we have in mind is we'll show a result in the bottom line. As I noted, it will take a bit of time.

David McFadgen – Analyst, Cormark Securities

Okay, okay. Just a couple questions on the business, then. There were media reports, and you talked about right-sizing your head office. I was wondering, is that done in terms of restructuring? Is there more potentially to come?

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

Yes, it is.

David McFadgen – Analyst, Cormark Securities

Okay, so you're done?

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

Now, it's just normal course business. We're looking at processes throughout the Company, but it's normal course business. Yes, it is done.

David McFadgen – Analyst, Cormark Securities

Okay, and can you comment on the amount of cost savings from that?

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

I can't really...

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

Heather, I could probably give a number, just on the home office – I think we can share that. It's in the neighbourhood, related to home office, of \$10 million, David, on an annualized basis, and then as we noted in previous calls, we have also been working on operating costs and had committed to getting about \$15 million out in the year, which with what we achieved in Q3, we believe we're on track for.

David McFadgen – Analyst, Cormark Securities

Okay, and then you talked about how the quarter was negatively impacted by the discounting; you wanted to right-size your general merchandise inventory. You said it was a significant impact. Can you share with us what the impact—what your estimated impact was on sales and cost of sales?

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

Well, I can give you a sense of the impact to margin rates. It probably had an impact in our GM business of about five points of margin, so it was significant. I think it even shows up in some of the GM top line – I think we've disclosed in the materials, but the print business was down about 8 points and

the GM business was down 18.5 points, and I think — you know, it's hard to isolate these items exactly, but some of that is discounting hitting the top line and margin, but it was also — we do have new merchant leadership in place now, but we don't believe in the home stretch of Christmas, that we had the right GM assortment that people were looking for in those final few weeks, so there's a bit of both actions in there. There's the clearing of undesired inventory, but also just not having, on that side of the business, what people were looking for at the last moment.

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

Not consistent with our brand, right?

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

Yes, yes.

David McFadgen — Analyst, Cormark Securities

Sorry, I missed that comment, Heather?

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

I was just adding to Craig and saying that we don't feel the assortment was consistent with our brand.

David McFadgen — Analyst, Cormark Securities

Oh, okay. Okay.

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

In some cases.

David McFadgen — Analyst, Cormark Securities

Okay, and then—you know, you talked about the online business being negatively impacted by the premature launch of the online platform due to the lingering effects from the cyber breach. Do you think now it's running smoothly as we speak?

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

Sorry - Craig, you want me to take that one?

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

Sure, if you want to. Yes.

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

Okay. We feel that it is certainly stabilized, but we still have things that we are working on to get it to the full potential of what we want.

David McFadgen – Analyst, Cormark Securities

Okay, okay. You outlined the impact on the costs from the cyber-attack. You've received, I think it's \$1.3 million in proceeds. Do you have an idea when you will have to settle with the insurer and what the total amount might be?

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

Yes, David, as you noted, we have received the amount you stated. Our policy limit was in the \$10 million range, and we're working through the process, particularly on some of the aspects, such as business interruption. We're told these can take a considerable amount of time, somewhere in the 12-to-18-month range, although we have heard from some other organizations, it's taken even longer than that. But certainly, we have submitted the claims and we're working through that presently.

David McFadgen – Analyst, Cormark Securities

Just to follow up on your comment, is the maximum amount that you might receive \$10 million? Is that correct?

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

Yes, I believe it's \$10 million, it might be \$11 million. Sorry, I need to double-check that, but it's in that magnitude, yes.

David McFadgen – Analyst, Cormark Securities

So, you've got \$1.3 million and then you might get another \$8.7 million, something like that?

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

Yes, that's a fair assumption.

David McFadgen – Analyst, Cormark Securities

Okay, and sorry – I meant to ask one other question just on the new ecommerce platform. What exactly were the problems with that new platform?

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

I don't think that this is appropriate for us to go into the full details here.

David McFadgen – Analyst, Cormark Securities

Okay, okay. All right. Okay, that's it for my questions. Thanks so much.

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

Okay, thanks, David.

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

Thank you, David.

Operator

(Operator Instructions)

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

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

Thank you for your time and attention today. We appreciate you calling in and look forward to reconnecting on a quarterly basis. Our fourth quarter results will be announced on or around May 30th.

Thank you again for your support, and have a good 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.