Don’t Write Off Indigo Books and Music Inc. Just Yet

Description

When investing in the stock market, it a real treat to find an interesting, financially sound company with little investor interest. This is what we have with **Indigo Books & Music Inc.** (TSX:IDG). The company’s recent fiscal third-quarter conference call lasted 19 minutes, and Indigo’s CEO, Heather Reisman, received questions from three individuals: two analysts and one private investor. With results like we are seeing out of Indigo recently, it seems to me that it is only a matter of time before investors take notice, more analysts start covering the name, liquidity rises, and demand for the shares increases.

Turning a corner

The latest quarter was another quarter of very solid results, pointing to the success of the company’s turnaround efforts. Back in November 2013, the company was in dire straits. Losses were mounting and costs were rising amid declining book sales and increasing competition from discount U.S. retailers. This precipitated the decision to refocus, revamp stores, and shift the strategy to turn the retailer into a “lifestyle company” with less focus on books and more focus on gifts, toys, and general merchandise. And in order to fund the increased capital expenditure that goes along with such an effort, Indigo’s dividend was cancelled. This sent the shares tumbling to a low of $7.43 on November 18, 2003.

Yesterday, the stock closed at $11.82 on significantly higher volume (55,863 shares traded versus the three-month average volume of 3,324 shares), a 12.46% rise on the heels of the company’s third-quarter fiscal 2015 results release. Revenue increased 2.1% year over year, despite the fact that there were five fewer superstores and one less small format store. Same-store sales increased 5.5% at the superstores (69% of total revenue) and were marginally lower at the small format stores (15% of total revenue). The online channel, which accounts for 13.5% of total revenue, increased 10.6%.

Product changes driving sales

Indigo is continuing to leverage its retail space by introducing new and exciting products to drive sales and margins. As evidence of its progress on this front, we can see that in the latest quarter, revenues from print (books, calendars, magazines, newspapers) represented 61.3% of revenue versus 63.6% of revenue last year, and the general merchandise category (lifestyle, paper goods, toys, music, DVDs, electronics) increased as a percentage of revenue to 34.8% from 31.7%. The company saw double-digit growth in the general merchandise category during the quarter as well as growth in books.

The American Girl boutiques have been a profitable addition to the mix, along with other new products that complement the store. During the quarter, American Girl far surpassed expectations, and as such, the company is planning at least three new American Girl stores this year.

How is Indigo financing this growth?

Given that the company is focused on growth and investing cash back into the business, one naturally wonders how the company is funding this growth. In fact, Indigo is in a good position in this regard as all growth initiatives are being financed with internal cash flow generation. There is even a good amount of cash left over after accounting for investments back into the business. Cash flow from operations increased 27% in the quarter, and free cash flow was $138.4 million, an increase of 33.7%.

In addition, margins continue to rise as a result of continued cost savings initiatives. Gross margin came in at 43.5% this quarter versus 42.4% in the same quarter last year, and EBITDA margins came in at 12% versus 9.9% in the same quarter last year.

The icing on the cake

To top it all off, the company’s balance sheet remains pristine, with $287 million in cash and no debt. A dividend is not coming in the short-term though as the company is still in the growth phase of its turnaround. But with the recent track record of success, investors can have renewed faith in the company and its strategic plan going forward.

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1. Investing

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1. Editor's Choice

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