



Indigo Books & Music Inc. (TSX:IDG): You Have to Spend Money to Make Money

Description

The biggest problem with investing, as I see it, is that stock prices don't always cooperate.

I've been very [impressed](#) with **Indigo Books & Music Inc.** ([TSX:IDG](#)) over the past year, as it continues to build for the future — a job that includes expanding into the intensely competitive U.S. market — and that costs real money.

Expenses, as a result, go up while profits go down. It's this reality that's seen many investors dart for the exits over the past month — it's down more than 12% through August 21 — with existing shareholders left wondering how long the spending can continue.

For as long as it takes

Indigo CEO Heather Reisman is a lot of things, but impetuous isn't one of them, so the fact the retailer is opening its first store in the U.S. in September suggests a lot of preparation went into its decision to take the “cultural department store” on the road.

By the end of September, Indigo will open for business at the Short Hills Mall in New Jersey in a 30,000-square-foot location that used to house a Saks Fifth Ave.

“We have pretty simple, but straightforward goals for sales per square foot, bottom-line contribution, customer retention and obviously customer affection for the brand, and as we do here for any store we do a reinvest in, and as soon as we see that that's happening, then we'll know that our experience resonates,” Reisman recently stated. “We've had so many developers come to see us from the US expressing their belief in the concept, so we're cautious but we're optimistic.”

Reisman figured out a few years ago how to sell books in an inviting atmosphere that would keep people coming back, and that's got mall owners excited about the retailer's potential south of the border.

The fact is, Indigo is no longer about books, but rather it's about providing a customer experience that's welcoming and enjoyable. Her management team has figured out the ideal mix between books, gifts,

technology, online sales, a coffee with friends, and that experiential *joie de vivre* will be just as successful in the U.S. as it is in Canada, maybe more so.

The glass is half full

In the first quarter ended June 30, Indigo's same-store sales increased by 2.4%, most of the increase was from online revenue, which rose by 12.7% to \$33.8 million, representing 16.5% of the company's overall sales.

Meanwhile, its superstores and small-format stores grew same-store sales in the quarter by just 0.2% and 0.8%, respectively.

Now, at first glance, the brick-and-mortar-store results might seem a bit anemic, but when you're trying to achieve an omni-channel retail experience, there's going to be an ebb and flow from one quarter to the next.

What you don't want to happen is a slowdown in online sales when you're investing heavily in that area, as is the case with Indigo.

"Operating costs increased primarily due to increased sales volumes in the Online channel, expansion of the company's Online facility in Ontario in fiscal 2018, and investment in a new distribution facility in Western Canada to support growth," Indigo's Q1 2019 report stated. "The company will continue to incur disproportionate costs in these distribution centres until both facilities are fully utilized and optimized for efficiencies."

As the headline suggests, you've got to spend money to make money.

A second point that jumps out at me from the first quarter is the breakdown of revenue by product line. Its general merchandise category experienced a 260-basis-point increase in its contribution to revenue during the quarter, accounting for 39.8% of Indigo's overall revenue.

Its print segment, which includes books, magazines, newspapers, and shipping revenue, currently accounts for 57.6% of its overall sales. Four years ago, print accounted for 68.1% of the company's overall sales.

If Indigo keeps up the same pace, print (low margins) will drop below 50% by Q1 2022, making this second point extremely important to the stock's future appreciation.

The bottom line on Indigo stock

Investing is all about understanding risk.

As I see it, the rewards for investing in Indigo stock at this point far outweigh the risks.

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