WestPeak Research

February 12, 2017

Indigo Books & Music Inc. (TSE:IDG)

Retail

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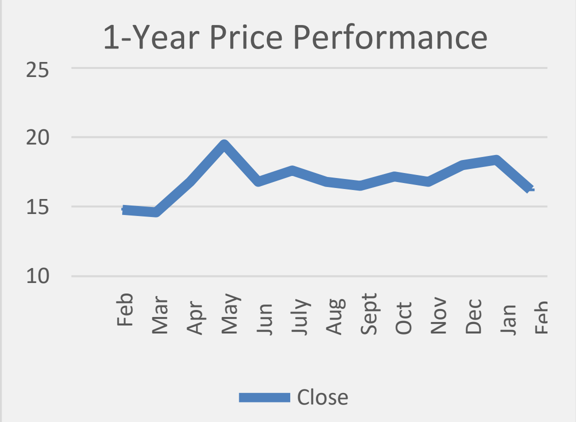
Bachelor of Commerce 2020

Equity Research	Canada
Price Target	**CAD $20.10**
Rating	**BUY**
Current Share Price, close	CAD$ 16.29
Total Return	23.4%

Key Statistics	
52 week H/L	$19.50/$14.50
Market Capitalization	$430M
Net Debt	$0.1M
Enterprise Value	$111M
Net Debt/Enterprise Value	0%
Diluted Shares Outstanding	26M
Free Float %	41%
Dividend Yield	0%
LTM P/E	14.4x
LTM EV/EBITDA	2.5x

WestPeak's Forecast

	2016A	2017E	2018E
Revenue	$994M	$1.01B	$1.07B
EBITDA	-$5M	$20M	$0M
EBIT	$20M	$50M	$12M
Net Income	$29M	$38M	$9M
P/E	6.4x	10.0x	15.0x
EV/EBITDA	15.9x	10.0x	15.0x



Source: Bloomberg, CapIQ, WestPeak Research

Company Profile

Indigo has been operating in Canada since 1997, as their first store was opened in Burlington, Ontario. However, the company as it is known today, Indigo Books & Music, has been in business since 2001, following a merger with Chapters. They are a Canadian based retailer that sells a variety of products including books, toys, and even home decorations. Their products are sold in stores that operate all across Canada, and on their online website. There are 88 large-format stores operating under the banner "Chapters" or "Indigo" and an additional 123 stores operating under the banners Coles, Indigospirit, SmithBooks, and The Book Company.

Thesis

Although it is much more convenient to click "add to cart" and have your favourite book or toy delivered to your doorstep, Indigo has proven that they provide an in-store experience like none other, warranting a visit to the store by customers.

In this new era of online shopping, Indigo has consistently grown brick and mortar sales, while operating fewer stores. Their superstores in particular, aren't just a place to shop, they offer an experience for people of all ages. While parents shop or simply want to read a book in the in-store café, kids can enjoy themselves in a play-area. This unique in-store experience will enable them to succeed in the US, as they explore a possible expansion.

Valuation & Recommendation

The valuation of Indigo Books & Music was done by using a comparable analysis, and a discounted cash flow. The DCF has implied a value of $20.72, well above the current trading price. The possible expansion into new markets, growing general merchandise sales, and in-store experience Indigo provides, are just some of the reasons to be excited about Indigo's future. We recommend a Buy rating for Indigo Books & Music.

Business Overview/Fundamentals

The Company

Indigo (TSE: IDG) is Canada's largest book, gift and specialty toy retailer, operating in all 10 provinces and 1 territory. They sell their products both in-store, and through their online website. Due to the technological shift, demand for physical books has declined as consumers are moving towards online shopping and eReaders. Physical books accounts for more than half of Indigo's business, so in order to keep up with the new trend, the company implemented a transformation strategy to shift certain aspects of the business away from physical books, and to open up the world's first cultural department store. Essentially, a cultural department store is one which offers a cross section of shops, within a single shop. Aside from testing out concept stores, the company was able to expand their online website, optimize their loyalty programs, and increase the variety of products offered. This strategy has proven to be successful as general merchandise is growing, and will eventually be more important to the business than the sale of physical books. While providing high quality products and developing lasting relationships with customers, Indigo has also put a focus on giving back to the community through their own foundation: Indigo Love of Reading. The foundation helps elementary schools that are in need of books and other learning materials, all across Canada.

Kobo

In 2009 Indigo founded Kobo, the company which makes the second most popular eReader in the world, only trailing Amazon's Kindle. Indigo sold just under half of Kobo in 2011 to Japanese e-commerce company Rakuten for $315 million. It is worth noting that while Indigo has earned millions from the increase in worldwide ownership of eReaders, the revenues earned from their physical book sales are being reduced by eReaders. This cannibalization was very concerning to many in the bookstore sector. Indigo was able to combat it by shifting their focus from being just a bookstore, to offering a variety of products, or "General Merchandise." In their Q3 earnings report for fiscal year 2017, Indigo reported that 43.2% of sales came from general merchandise. This is quite encouraging as it shows their shift of strategy is working.

Customer Relations

One of the reasons Indigo has been able to grow such a large customer base is because the values of the company are aligned with those of consumers. Whether it be Indigo led initiatives, the in-store experience, or even the loyalty programs, the company is the top Canadian retail employer brand, according to Randstand Corporation. This progress can be attributed to a few factors including:

1. Indigo Love of Reading - this foundation is the vessel the company uses to give back to the community. Indigo Love of Reading has been operating since 2004 and has helped 900,000 students to date. They have also funded a 3-year research study at McGill University, to help understand the impact that comes with reading from a young age.

2. In-store Experience - the brand image of Indigo is very well thought of among consumers because of the experience they provide. This can be seen especially within the superstores, where parents can shop while kids can enjoy playing in the toy section/play area. This is also seen with in-store cafés that allow customers to enjoy a book with a beverage and/or food. Many of the in-store cafés are a Starbucks, as the coffee chain formed an alliance with Chapters, prior to the Indigo-Chapters merger, in 1995. Indigo is continuously trying to improve the experience they provide, as seen by the cultural department store that they just opened.

3. Reco - Reco is a mobile app that follows the model of a social media company, as it allows you to follow people and post recommendations of books. When someone you follow makes a post, or a "Reco" of a book, it shows up in your feed. When you start using the app, it asks you to highlight your book interests, and then matches you with other people who have similar reading interests. Reco connects booklovers from all over the world, and helps to make the search for a next book much easier.

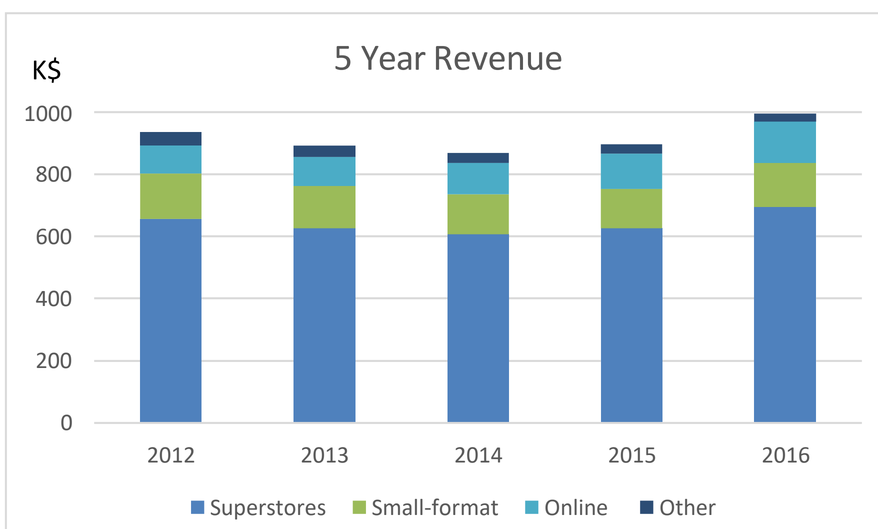
4. CEO Heather Reisman – While she has had her critics, Reisman has proven on numerous occasions that her vision for the business is one that can help Indigo be successful. She is not only a capable CEO, she has a passion for reading. In fact, she has created "Heather's Picks" which is a list of books recommended by her. Many customers even choose their next book from this list, which can be found online and in-stores. She also has 5800 followers on Reco, who watch their newsfeeds for an instant update of Heather's picks.

Subsidiaries

There are 2 subsidiaries that Indigo has an interest in: its wholly owned subsidiary Soho Studios, Inc and the Calendar Club, which it owns 50% of. The Calendar Club operates kiosks in malls all across Canada, which contributes revenue included in the online portion of revenue breakdown.

Growth and Segmentation Breakdown of Revenue

In 2001, Indigo merged with Chapters to form the largest book retailer in Canada. Since then, the company has grown organically, through opening more stores and by increasing brand awareness. They have managed to withstand many attacks from competitors, their biggest to date coming from Amazon, who's efforts managed to put Borders Group out of business. The American company was a book retailer that had been operating since 1971 and employed nearly 19,500



people. The rise of Amazon and eReading forced Indigo to re-shape their identity - to offer more than just books. This can be seen by the wide variety of products offered online, and in-store. This was mentioned before as the “transformation period.” An increase in cost was incurred during that period due to reinvesting in the company. Indigo’s CEO also indicated recently that the company is going to continue to grow organically.

Superstores

As of April 2, 2016, the Company is operating 88 superstores under the banners Chapters and Indigo. These stores contributed a total of $695.3 million of 2016’s revenue, which is up from 2014’s $607.2 million and 2015’s $625.2 million. Despite closing down 7 superstores over the period of 2014-16, Indigo was still able to increase revenue. This is a result of growth in general merchandise, books, and a new trend of adult colouring books. Although store closures may have a negative connotation, increasing revenue while operating fewer stores is impressive. Furthermore, it is possible that certain locations in the coming years will be closed down if the company believes they will be able to continue to grow revenue with fewer stores.

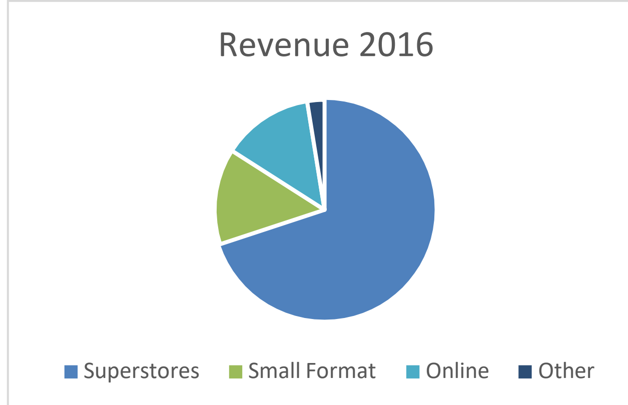
Year	2012	2013	2014	2015	2016
Ending Number of Superstores	97	97	95	91	88
Revenue (Millions)	656.5	615.2	607.2	625.2	695.3

Small Format Stores

As of April 2, 2016, the Company is operating 123 small format stores under the banners Coles, Indigospirit, SmithBooks, and The Book Company. Since 2014, 12 small format stores were closed, and one was opened up in 2016. Similar to the superstores, an increase in revenue was seen in both 2015 and 2016 despite operating fewer stores. Small format stores accounted for $140.2 million of total revenue for 2016. As with superstores, if Indigo believes certain locations can be closed while continuing to grow revenues, it is possible that more small format stores will be closed in the near future.

Year	2012	2013	2014	2015	2016
Ending Number of Small Stores	143	134	131	127	123
Revenue (Millions)	145.2	137.6	127.4	127.8	140.2

Online – Including Kiosks



Indigo recently expanded its website indigo.ca, and with a higher conversion rate and more traffic on the site, 2015 and 2016 online sales saw growth of 11.8% and 16.9%, respectively. Indigo also owns 50% in Calendar Club of Canada Limited Partnership, which operates seasonal kiosks and year-round stores in shopping malls across Canada. Indigo recognized earnings of $0.7 million in 2015 and $1.4 million in 2016. Indigo doesn't put as much of a focus on the online aspect of their business as the profit margin is quite poor. Selling an item online puts Indigo at a disadvantage as it requires them to match the prices listed by Amazon, and other online shopping websites. With that being said, an increase in both online and brick and mortar sales is an indication that the company's customer base is growing.

Other

This includes revenue earned from cafés, irewards card sales, revenue from unredeemed gift cards, and revenue-sharing with Kobo. This accounted for $25.4 million of total 2016 revenue, which is lower than previous years due to a drop in the worldwide sales of eReaders.

Dividends

Indigo had been consistently paying a dividend from the years 2009-13 on a quarterly basis. The company started with $0.10 per quarter until it increased the dividend to $0.11 in 2010. The company cited a need to maintain sufficient capital as a justification for the suspension of the dividend payments. Shareholders were not in favour of this decision as Indigo's stock plummeted by 18%. The capital retained by Indigo following the suspension of dividend payments was invested into the transformation of the brand. Since much of the growth and success they are experiencing today can be attributed to rebranding themselves, suspending dividends was a smart decision. Renovations of all the stores in the fleet, and a possible expansion to international markets suggest that it will be quite some time before dividend payments are made again.

Macro Environment

Retail Industry

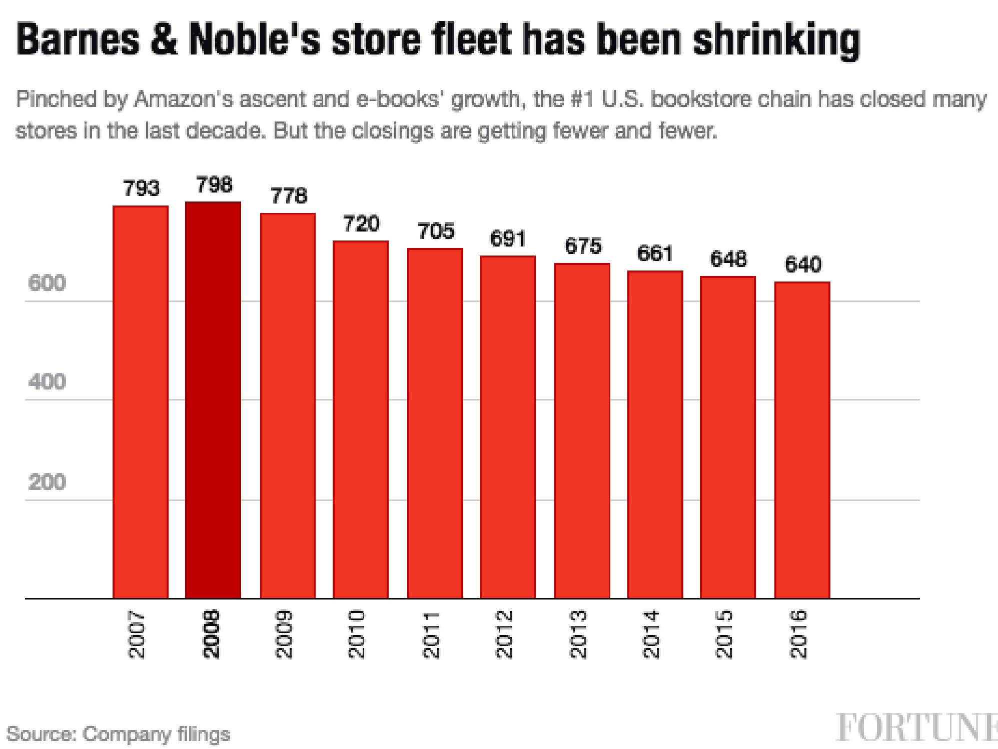
Indigo doesn't have any proprietary technology or intellectual property that gives it a clear, sustainable advantage. However, the company has continued to grow revenue and market share through a growing loyal customer base. Although there are no restrictions prohibiting other companies from entering the marketplace, there are barriers to entry that have helped Indigo in recent years:

1. Capital Requirements – Over the course of 20 years, Indigo has built an infrastructure that includes 211 brick and mortar stores across Canada. The threat of a new entrant building a nationwide brand which will compete with Indigo is minimal. Currently, the company's total money owed for contractual obligations of operating leases is $172.2 million. Of this amount, $54.2 million is owed within this year. Indigo has been able to establish themselves as one of the preeminent Canadian retailers in a continuously changing, highly competitive industry.

2. High Supplier Power– New entrants in the market place are at a disadvantage because of the highly competitive nature of the market. For this reason, suppliers have more bargaining power over prices of merchandise. This is favourable for Indigo as they have longstanding relationships with suppliers.

Competition

The retail industry is continuing to get more competitive with new companies opening up, and existing companies expanding operations. While Indigo is continuing to grow revenue, other retail companies, particularly their competitors in the US, are struggling. Barnes and Noble, the largest book retailer in the US, has closed more than 100 stores in the past 7 years, and reported losses of $14.4 million in their quarter which ended July 30/16, an improvement from their loss of $34.9 million one year earlier. In the era of ecommerce, these losses can be attributed to the company's failure to take advantage of online shopping, as it is currently their brick and mortar stores which have saved them. Their lack of online sales is due, in part, to a botched relaunch of their website, and the rising popularity of shopping on Amazon.



Catalysts

Expansion into New Markets

The CEO recently indicated that the company is exploring the possibility of an expansion into the US, and other markets, as they want to continue to grow organically. Although expanding operations into the US seems like a fairly straightforward decision, there are many risks involved. The competitive landscape is much different, as there are established specialty book retailers in the US. This is different from Canada, as the competition Indigo faces is almost entirely from general retailers who sell books. With that being said, the US is a huge market with untapped potential. Indigo can mitigate a large portion of the risk involved by strategically placing their stores, and by learning from the mistakes of other retailers. In the past, retailers have tried entering new markets by opening up hundreds of stores within a short period of time. Target for example, failed miserably in a full fled expansion into the Canadian market.

The US has never looked better for an Indigo expansion. Borders Group recently exited the market, and Barnes and Noble, the largest book retailer in the US, is struggling. This is an opportunity for Indigo to test their ability to compete in the US market. Borders Group failed to stay in business because of rising debt, and poor management decisions. For example, they made a deal with Amazon to run their online website, which was detrimental for them because it didn't allow them to truly compete in the ecommerce space. Their customers would purchase their products through Amazon, and this disconnect between consumers and the brand resulted in declining sales. Also, they hadn't been able to make a profit in 5 consecutive years leading up to when they decided to shut down. Similarly, Barnes and Noble has little cash, and lots of debt. They have been unable to distinguish themselves from being anything but a bookstore. This is a huge advantage for Indigo, which will be discussed further in the competitive advantage section.

Renovation of 20 Stores

Many of Indigo's stores have been open since the early 2000s, and the CEO believes renovations will help to improve the experience received by customers. It has been said that all the stores in the fleet will be receiving an upgrade, and the goal is for 20 stores to be completed during the 2017 calendar year.

General Merchandise Becomes 50% of Sales

The book retail industry looks very different now than it did as recently as 10 years ago. The emergence of online shopping destinations like Amazon, and the technological shift moving towards eReaders/tablets and away from physical books forced existing retailers to expand their services. By reinvesting into the business, Indigo has managed to reshape the company such that customers now shop at the stores, or online, not just for books, but for the wide variety of products offered. The rise in revenues while being able to shift the product variety away from physical books is promising, as this is solidifying the business in this new era. Indigo has put their focus on increasing general merchandise sales. When the company is able to reach 50% general merchandise sales, it will be a strong measure of the company's durability against an increasingly technology dependant society. Indigo general merchandise sales accounted for 34.1% of total sales in 2016. In their Q3 financials for fiscal 2017, they reported 42.1% of sales being accounted for by general merchandise.

Competitive Advantage

Unique Target Market

Given that Indigo is cash rich with almost no debt, an experimental trial of Indigo in international markets would be a decision which could prove to be very successful for the company. The US is the perfect environment for Indigo to thrive in, as they offer something that other retailers have stopped putting an emphasis on – in-store experience. Consumers no longer feel the need to go to a store and buy a product when they can have anything they want delivered right to their doorstep. Indigo puts this focus on making customers happy because their customers feel attached to the company. From the loyalty programs customers take part in, to the toy section they have for children, customers go to the store because it's a place they can spend time. No convenience factor from online shopping will ever be able to replace this. Indigo has created an environment such that the store is a place kids drag their parents to go to, so that they can play with toys. Parents are willing and even encouraging because it is also place where they are able to enjoy reading a book in the in-store café.

Essentially, Indigo is operating in a league of its own because they do not target the same consumers that online shopping channels and other bookstores target. Indigo's concept store has been well received, and would fit well in the American marketplace. Wharton published an article discussing how Barnes and Noble can avoid the same fate as Borders Group, citing a need to be more than a just bookstore, and to "do [something] like a store within a store." Indigo, having achieved what Wharton deems enough to turn Barnes and Noble around, suggests that the Canadian retailer would be able to succeed in the US.

Fewer eReaders – More Books

Many were skeptical of the decision to sell Kobo in 2011, as eReaders were said to be the replacement of physical books. Since then, bookstores have been put out of business because they were unable to compete with the new technology. Then there's Indigo, who is actually selling fewer and fewer eReaders on a yearly basis, yet outgrew market sales for print books in 2016, increasing their overall market share for physical books. The decrease in eReader sales that Indigo is experiencing can be attributed to a decline in worldwide eReader sales.

Lack of Online Focus

Unlike other bookstores, Indigo recognized that Amazon was targeting a different kind of customer. Instead of trying to revolutionize the digital platform, they deviated from the course they had been on for more than a decade, and defied the norm of bookstores. This first started with their increased product selection, and now the emphasis of bringing consumers into their stores. This is why only 13.4% percent of their nearly $1B in fiscal year 2016 revenue came from their online website. They don't focus on the website because they have to match the prices offered by Amazon and other online shopping websites, which doesn't allow them to make as much money as selling products in-store. It is worth noting, that while they aren't focusing on website sales, the past 3 years have seen double digit growth, with 2016 online revenue growing by 16.9%. While this doesn't help the net income as much as growth from brick and mortar stores, it shows Indigo has been effective in growing their customer base.

Management Team

Heather Reisman – Chair and Chief Executive Officer

Heather Reisman founded the company and has been Chief Executive Officer of Indigo since February 4, 2001. Reisman has proved to be an effective leader as the company has seen enormous growth under her leadership. Many were skeptical of her decisions about strategy in the past, particularly the decision to transform the identity of the business. However, the recent success of the company has shown that she truly understands the business and her vision is one that can help the company succeed.

Robert Haft – Director

Robert Haft is the Managing Partner of Morgan Noble Healthcare Partners, with over 20 years of experience as an investor, founder, and CEO. He is a very important member of the board due to the nature of his experience. Throughout his career, he has opened and managed more than 800 retail stores including drug store Phar-Mor, vitamin stores, book stores, automotive parts store Trak Auto, and supermarkets. He also founded Vitamins.com. It was recently mentioned by the CEO that Indigo is looking at options of expanding into the US, a move that Robert Haft could be very helpful in executing.

Risks

Economic Environment

Indigo's financial performance heavily relies on their fiscal Q3 results, as their business is highly seasonal. This year they reported strong Q3 earnings, but for years to come there will always be the risk that a slow economy would have a strong negative impact on yearly earnings. A decrease in consumer spending during the Christmas season could heavily impact Indigo, along with other seasonal retailers. Other economic conditions such as an unexpected increase in the cost of labor, merchandise, lease agreements, or less general disposable income would also negatively affect the company's finances.

Substitution Risk

In an industry that is constantly changing, Indigo is at risk of losing revenue due to an increase of physical books being sold through new channels. Their competition doesn't consist of simply specialty bookstores that sell physical books, regional multi-store operators, supermarkets, drug stores, warehouse clubs, mail order clubs, Internet booksellers, mass merchandisers, and other retailers also sell physical books. There is also the technological factor to consider, as more people are reading books on eReaders and online through their tablets. It should also be noted that there is no guarantee that Indigo will be able to continue to gain market share of physical books like they were able to in 2016.

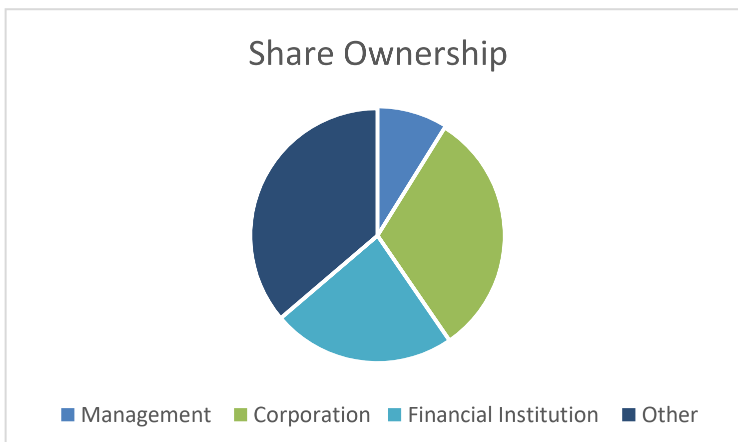
Supply Chain Risk

Indigo relies on suppliers to provide them with the physical books and general merchandise, as the company sells third party manufactured products. If the suppliers are unable to deliver product on time, or items delivered pose quality and safety issues, Indigo could face liability as the retailer and face legal action. This could hinder their ability to compete in the marketplace.

Shareholder Base, Liquidity, Market Depth

Shareholder Base

There are currently 25,949,068 weighted average number of shares outstanding in the company. The company is split between individual shareholders, financial institutions, banks, management, and an unclassified source denoted as "other." One thing to note is that management owns 8.68% of the company, which is split between 6 insiders.



Low Liquidity

Indigo's liquidity can be of concern to some investors, as the average daily volume traded is 4068 shares. This is on the low end of a company with a 400+ million market cap.

Valuation

Discounted Cash Flow – Assumptions

Revenue – we are assuming that revenue will grow in the next 5 years. Given that Indigo is looking to expand operations in new markets, we believe that exposure to new customers will be able to increase revenue. Also, over the past 2 years, Indigo has been able to grow revenue while operating fewer stores due to an increase in online shopping and growth in brick and mortal sales. We believe this trend will continue to grow, as Indigo is putting efforts towards becoming a preeminent gifting destination.

Capital Expenditure – the increase in spending of capital expenditure, in order to open new stores and renovate existing ones, will result in an increased cost to run the business in the next 5 years. There are no specific numbers regarding the cost to renovate stores at this time, but we are projecting that CAPEX will increase to 30 million in 2018, 35 million in 2019 and 2020, and fall back to 30 million in 2021. These projected numbers also take into account the possible expansion to the US and/or other markets.

Dividends – Indigo paid dividends until 2014, but suspended these payments in order to reinvest in the business. Due to the projected increase in Capex over the next few years, we believe they will continue to not pay any dividends.

WACC Calculation – we decided to calculate the weighted average cost of capital for the discounted cash flow analysis. Indigo currently holds less than $100,000 in debt so the calculation used a 100% equity weight. Employing reasonable growth assumptions, the DCF produced an implied share value of $20.72.

Share Capital – We also assumed that the share structure of the company will be the same for the next 5 years. They have issued a small number of shares each year, historically, so we do not anticipate any major share issuances in the near future prompting a dramatic increase in the number shares outstanding.

Comparable Company Analysis

As there are fewer public Canadian retailers the size of Indigo's than there are American, the comparable analysis used more American companies than Canadian. Of the 8 used, 7 companies are American, all are in the retail sector. One of the companies is a specialty bookstore – Barnes and Noble. This analysis gives an implied target price of $22.04 for EV/EBITDA ratios, and an implied target price of $16.36 for P/E ratios. We decided to exclude the P/E ratio for both Barnes and Noble and Build a Bear Workshop from the calculation used to determine Indigo's implied target price based on P/E ratios. We believe their P/E ratios are anomalies in the retail industry, which would inflate Indigo's implied target price based on comparable P/E ratios. Indigo is currently trading at $16.29.

DCF Analysis

For our target price we will be weighing the DCF valuation more heavily than the comparable analysis in terms of coming to a valuation. This is because almost all of companies used as comparable to Indigo operate in the United States, and only one is a book store like Indigo. The DCF gave an implied share price of $20.72.

Recommendation

We have placed Indigo Books & Music as a Buy. The company just reported strong Q3 earnings, which is consistent with the thesis of this report. Perhaps most impressively, 43.2% of total revenue came from general merchandise, a strong indication that Indigo's efforts to move towards being more than just a book store are paying off. They have been able to stave off shifts towards online shopping channels, as their brick and mortar stores have continued to see growth in revenue. The renovations of existing stores, and opening of concept stores, is all part of a plan to continue to expand their loyal customer-base. Expansions into new markets is an exciting opportunity, especially with Indigo's proven track record of being able to keep their customers happy, and the fact that they are targeting a different kind of consumer than their competitors. Due to Indigo's consistent organic growth, strong management, and future growth opportunities, we place Indigo as a buy with a target share price of $20.10.

Appendix 1: Pro Forma Income Statement

WESTPEAK RESEARCH

Income Statement

	2012	2013	2014	2015	2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017	2017	2018	2019	2020	2021
Revenue	**934.0**	**892.5**	**867.7**	**895.4**	**994.2**	**193.1**	**216.9**	**400.3**	**197.2**	**1007.6**	**1071.3**	**1108.0**	**1162.0**	**1212.7**
Cost of Goods Sold	518.3	472.8	466.5	476.4	527.4	101.2	113.2	216.6	112.4	543.5	589.2	609.4	621.7	645.2
Gross Profit	**415.7**	**419.7**	**401.2**	**419.0**	**466.8**	**91.9**	**103.8**	**183.7**	**84.8**	**464.1**	**482.1**	**498.6**	**540.3**	**567.6**
SG&A	417.7	389.3	402.5	397.1	421.8	97.5	98.8	125.8	82.8	404.9	450.0	465.4	488.0	509.4
EBITDA	**-1.9**	**30.3**	**-1.3**	**21.9**	**45.0**	**-5.6**	**5.0**	**57.9**	**2.0**	**59.2**	**32.1**	**33.2**	**52.3**	**58.2**
D&A	26.7	27.9	27.5	26.7	23.8	6.0	6.0	6.5	8.2	26.8	32.3	31.1	33.1	34.1
SBC	1.0	0.7	1.2	0.9	1.2	0.4	0.4	0.5	2.3	3.5	3.5	3.5	3.5	3.5
EBIT	**-29.6**	**1.7**	**-30.0**	**-5.7**	**20.0**	**-12.0**	**-1.4**	**50.9**	**-8.6**	**28.9**	**-3.6**	**-1.3**	**15.7**	**20.6**
Interest expense	-0.2	-0.1	-0.1	-0.1	-1.0	0.0	0.0	0.6	-1.0	-0.4	0.0	0.0	0.0	0.0
Other items	0.5	2.6	3.2	2.6	3.2	0.0	0.0	2.9	0.0	2.9	0.0	0.0	0.0	0.0
Income Before Income Tax	**-29.3**	**4.2**	**-26.9**	**-3.2**	**22.1**	**-12.1**	**-1.4**	**54.4**	**-9.6**	**31.4**	**-3.6**	**-1.3**	**15.7**	**20.6**
Income Tax	1.5	0.1	-4.1	-0.3	6.5	3.1	0.2	-14.5	2.9	-8.3	0.7	0.3	-3.1	-4.1
Net Income	**-27.8**	**4.3**	**-31.0**	**-3.5**	**28.6**	**-9.0**	**-1.2**	**40.0**	**-6.7**	**23.1**	**-2.9**	**-1.1**	**12.5**	**16.5**
Shares Outstanding, Basic	25.2	25.3	25.6	25.7	25.9	25.9	25.9	26.4	26.4	26.4	26.4	26.4	26.4	26.4
Shares Outstanding, Diluted	25.5	25.6	25.6	25.8	26.2	26.2	26.2	26.9	26.9	26.9	26.9	26.9	26.9	26.9
Earnings Per Share, Basic	-$ 1.10	$ 0.17	-$ 1.21	-$ 0.14	$ 1.10	-$ 0.35	-$ 0.05	$ 1.51	-$ 0.25	$ 0.87	-$ 0.11	-$ 0.04	$ 0.47	$ 0.62
Earnings Per Share, Diluted	-$ 1.09	$ 0.17	-$ 1.21	-$ 0.14	$ 1.09	-$ 0.34	-$ 0.05	$ 1.48	-$ 0.25	$ 0.86	-$ 0.11	-$ 0.04	$ 0.47	$ 0.61

Appendix 2: Pro Forma Cash Flow Statement

WESTPEAK RESEARCH

Cashflow Statement

	2012	2013	2014	2015	2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017	2017	2018	2019	2020	2021
Net Income	**-27.8**	**4.3**	**-31.0**	**-3.5**	**28.6**	**-9.0**	**-1.2**	**40.0**	**-6.7**	**23.1**	**-2.9**	**-1.1**	**12.5**	**16.5**
Depreciation and Amortization	26.7	27.9	27.5	26.7	23.8	6.0	6.0	6.5	8.2	26.8	32.3	31.1	33.1	34.1
Net Impairment of capital assets	4.0	0.3	2.6	-0.5	-1.6	0.0	0.0	-1.0		-1.0				
Impairment of goodwill	25.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0		0.0				
Loss on disposal of capital assets	0.1	0.1	0.3	0.1	1.0	0.0	0.0	0.0		0.0				
Stock based compensation	1.0	0.7	1.2	0.9	1.2	0.4	0.4	0.5	2.3	3.5	3.5	3.5	3.5	3.5
Director's compensation	0.5	0.4	0.4	0.3	0.4	0.1	0.1	0.1		0.3				
Deferred income taxes	-1.6	-0.1	4.1	0.4	-7.6	-3.1	-0.2	14.5		11.2				
Other	-0.2	-0.5	-0.2	-2.0	-0.1	0.3	-0.7	0.0		-0.3				
Cash Flows before Working Capital	**28.1**	**33.1**	**5.0**	**22.5**	**45.8**	**-5.3**	**4.4**	**60.6**	**3.8**	**63.5**	**32.9**	**33.5**	**49.2**	**54.1**
Accounts receivable	-4.65	5.49	1.54	0.69	-2.77	-4.14	-6.50	0.0	7.4	-3.2	-9.7	-0.7	-1.0	-1.0
Inventory	2.75	12.67	-2.45	10.58	-9.39	0.56	-47.04	20.8	169.3	143.7	-103.5	-6.1	-3.7	-7.1
Prepaid expenses and other assets	2.12	-0.46	-1.03	-0.29	-5.81	-1.14	7.39	1.2	1.9	9.3	-3.4	-0.2	-0.3	-0.3
Deferred revenue	-0.05	2.50	-0.87	0.44	-0.07	0.44	-0.10	-0.6		-0.3				
Accounts payable, accrued and other liabilities	14.59	-25.04	-14.86	25.16	11.11	-24.97	60.61	39.7	-189.4	-114.1	262.2	11.0	16.2	15.2
Unredeemed gift card liability	1.72	4.46	-0.34	1.38	2.76	0.58	-6.57	21.0		15.0				
Income taxes recoverable	-0.25	-0.09	-0.04	-0.05	-0.05	0.00	0.00	0.0		0.0				
Provisions	0.69	1.55	-1.15	-0.07	-0.88	-0.01	-0.01	0.0		0.0				
Net change in non-cash working capital balances related to continuing operations	16.93	1.09	-19.20	37.84	-5.10	-28.69	7.79	82.2	-10.8	50.5	145.7	4.0	11.2	6.9
Interest on long-term debt and financing charges	0.15	0.10	0.10	0.07	1.00	0.02	0.01	0.0		0.0				
Interest income on cash and cash equivalents	-0.46	-2.61	-2.38	-1.91	-1.75	-0.50	-0.42	-0.6		-1.6				
Income taxes received	-0.33	0.03	0.03	0.03	0.05	0.00	0.00	0.1		0.1				
Share of earnings from equity investment	0.00	0.00	-0.79	-0.66	-1.40	0.51	0.41	-2.9		-2.0				
Operating cash flows of discontinued operations	-56.88	0.00	0.00	0.00	0.00	0.00	0.00	0.0		0.0				
Cash Provided By Operating Activities	**-12.49**	**31.71**	**-17.26**	**57.83**	**38.55**	**-33.91**	**12.19**	**139.2**	**-7.0**	**110.6**	**178.5**	**37.6**	**60.3**	**61.0**
Acquisition of non-capital tax losses	-10.6	0.0	0.0	0.0	0.0	-5.4	-3.6			-9.0				
Purchase of property, plant, and equipment	-12.1	-9.4	-18.7	-10.8	-20.2	-2.0	-3.1	-6.9	-4.0	-15.9	-30.0	-35.0	-35.0	-30.0
Addition of intagible assets	-8.6	-9.6	-10.5	-6.9	-9.0	0.1	0.4	-3.6		-3.1				
Interest Received	0.5	2.7	2.5	1.9	1.5	0.4	0.0	0.4		0.9				
Distributions from equity investments	0.0	0.0	1.2	0.5	0.7	0.0	0.0	0.0		0.0				
Cash disposal resulting from sale of subsidiary	-33.0							0.0		0.0				
Proceeds from disposal of capital assets	0.0				0.0			0.0	2.0	2.0	0.0	0.0	0.0	0.0
Proceeds from sale of subsidiary	148.9							0.0		0.0				
Investing cash flows of discontinued operations	-8.9							0.0		0.0				
Acquisitions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-5.0	-5.0	0.0	0.0	0.0	0.0
Cash Used in Investing Activities	**76.3**	**-16.4**	**-25.6**	**-15.3**	**-27.0**	**-6.8**	**-6.3**	**-10.1**	**-7.0**	**-30.2**	**-30.0**	**-35.0**	**-35.0**	**-30.0**
Repayment of long-term debt	-1.4	-1.2	-0.8	-0.6	-0.2		0.0	0.0		0.0				
Interest received/paid	-0.2	-0.2	-0.1	-0.1	-1.0	0.0	0.0	0.0		0.0				
Proceeds from share issuances	0.6	0.3	0.0	1.8	2.7	0.0	0.5	3.0		3.5				
Repurchase of options			*-2.0*			1.0				1.0				
Purchase of shares in subsidiary	-3.0									0.0				
Financing cash flows of discontinued operations	74.8									0.0				
Dividends paid	-11.1	-11.1	-8.3					0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cash Provided By (Used In) Financing Activities	**59.7**	**-12.1**	**-10.2**	**1.1**	**1.5**	**1.0**	**0.5**	**3.0**	**0.0**	**4.5**	**0.0**	**0.0**	**0.0**	**0.0**
Foreign Exchange Impact	**0.4**	**0.4**	**0.1**	**2.0**	**0.3**	**0.1**	**0.7**	**0.2**	0.0	**0.9**	0.0	0.0	0.0	0.0
Beginning Cash Balance	83.7	207.6	210.6	157.6	203.2	216.5	176.8	183.9	316.3	216.5	302.3	450.8	453.4	478.7
Net Change in Cash	**123.9**	**3.6**	**-53.0**	**45.6**	**13.3**	**-39.7**	**7.1**	**132.4**	**-14.0**	**85.8**	**148.5**	**2.6**	**25.3**	**31.0**
Ending Cash Balance	207.6	210.6	157.6	203.2	216.5	176.8	183.9	316.3	302.3	302.3	450.8	453.4	478.7	509.7

Note:
Company changed accounting practices in 2014, impacting the numbers in the 2013 report.

Appendix 3: Pro Forma Balance Sheet

WESTPEAK RESEARCH

Balance Sheet

	2012	2013	2014	2015	2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017	2017	2018	2019	2020	2021
ASSETS														
Cash and Cash Equivalents	207.6	210.6	157.6	203.2	216.5	176.8	183.9	316.3	302.3	302.3	450.8	453.4	478.7	509.7
Accounts receivable	12.6	7.1	5.6	4.9	7.7	11.8	18.3	18.3	10.8	10.8	20.5	21.2	22.3	23.3
Inventory	229.7	216.5	219.0	208.4	217.8	217.2	264.3	243.4	74.1	74.1	177.6	183.7	187.4	194.4
Income taxes recoverable	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Prepaid expenses and other current assets	3.7	4.2	5.2	5.5	11.3	12.4	5.0	3.8	2.0	2.0	5.4	5.5	5.8	6.1
Derivative Financial Instruments	0.0	0.0	0.0	0.0	0.0	0.2	0.4	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Total Current Assets	**453.6**	**438.4**	**387.3**	**422.0**	**453.3**	**418.5**	**471.9**	**582.8**	**390.3**	**390.3**	**655.4**	**664.9**	**695.2**	**734.6**
Long term investments	0.0	1.0	0.6	0.7	1.4	0.5	0.1	2.9	2.9	2.9	2.9	2.9	2.9	2.9
Property and equipment	67.5	58.9	58.5	54.9	61.0	62.5	62.2	65.8	64.6	64.6	62.3	66.2	68.1	64.0
Intangible assets	22.8	22.2	21.6	16.6	16.5	16.3	17.3	18.6	18.6	18.6	18.6	18.6	18.6	18.6
Long term deferred tax assets	48.6	48.7	44.6	44.2	51.8	54.8	55.0	40.4	40.4	40.4	40.4	40.4	40.4	40.4
Total Non-Current Assets	**138.9**	**130.8**	**125.3**	**116.4**	**130.7**	**134.2**	**134.6**	**127.8**	**126.5**	**126.5**	**124.3**	**128.2**	**130.1**	**126.0**
Total Assets	**592.5**	**569.1**	**512.6**	**538.4**	**584.0**	**552.7**	**606.5**	**710.6**	**516.8**	**516.8**	**779.6**	**793.1**	**825.3**	**860.5**
LIABILITIES														
Accounts payable and accrued liabilities	174.2	150.2	136.4	160.6	171.1	147.7	208.4	248.5	59.2	59.2	321.4	332.4	348.6	363.8
Unredeemed gift card liability	42.7	47.2	46.8	48.2	51.0	51.5	45.0	66.0	66.0	66.0	66.0	66.0	66.0	66.0
Provisions	0.2	2.2	0.9	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Deferred revenue	11.2	13.7	12.9	13.3	13.2	13.7	13.6	12.9	12.9	12.9	12.9	12.9	12.9	12.9
Income taxes recoverable	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current portion of capital lease obligations	1.1	0.8	0.6	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Current Liabilities	**229.5**	**214.0**	**197.6**	**223.2**	**235.4**	**213.0**	**267.0**	**327.6**	**138.2**	**138.2**	**400.4**	**411.4**	**427.6**	**442.8**
Long term accrued liabilities	5.8	4.0	2.9	3.8	4.5	2.9	2.8	2.4	2.4	2.4	2.4	2.4	2.4	2.4
Long term provisions	0.5	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Long term debt	1.1	0.7	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Non-Current Liabilities	**7.4**	**4.8**	**3.3**	**4.0**	**4.6**	**3.0**	**2.9**	**2.4**	**2.4**	**2.4**	**2.4**	**2.4**	**2.4**	**2.4**
Total Liabilities	**236.9**	**218.8**	**200.9**	**227.2**	**240.0**	**216.0**	**269.9**	**330.0**	**140.6**	**140.6**	**402.9**	**413.9**	**430.0**	**445.3**
SHAREHOLDER'S EQUITY														
Common equity	203.4	203.8	203.8	205.9	209.3	210.5	211.2	215.5	217.8	217.8	221.3	224.8	228.3	231.8
Additional paid-in capital	7.0	8.1	8.8	9.8	10.6	10.9	11.2	10.5	10.5	10.5	10.5	10.5	10.5	10.5
Retained Earnings	145.2	138.4	99.0	95.5	124.1	115.1	113.9	153.9	147.2	147.2	144.3	143.2	155.7	172.2
Accumulated other comprehensive loss	0.0	0.0	0.0	0.0	0.0	0.2	0.3	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Total Shareholder's Equity	**355.6**	**350.3**	**311.7**	**311.1**	**344.0**	**336.7**	**336.6**	**380.6**	**376.2**	**376.2**	**376.8**	**379.2**	**395.3**	**415.2**

Appendix 4: Revenue Analysis

WestPeak Research

Revenue Analysis

	2012	2013	2014	2015	2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017	2017	2018	2019	2020	2021
Superstores Growth		-6.3%	-1.3%	3.0%	11.2%					0.5%	0.7%	2.8%	4.4%	3.7%
Small Format Stores Growth		-5.3%	-7.4%	0.3%	9.7%					0.9%	33.6%	3.2%	5.4%	5.1%
Online (including kiosks) Growth		-1.4%	11.0%	11.8%	16.9%					6.2%	8.0%	7.0%	7.0%	7.0%
Other Growth		-12.5%	-8.8%	-8.7%	-10.6%					0.0%	0.0%	0.0%	0.0%	0.0%
Revenue Growth, YoY		**-5.9%**	**-1.3%**	**3.2%**	**11.0%**					**1.3%**	**6.3%**	**3.4%**	**4.9%**	**4.4%**
Superstores Revenue	656.5	615.2	607.2	625.2	695.3	137.4	151.6	275.1	135.0	699.1	704.0	724.0	756.0	784.0
Small Format Stores Revenue	145.2	137.6	127.4	127.8	140.2	26.2	30.5	56.5	28.2	141.4	189.0	195.0	205.5	216.0
Online (including kiosks) Revenue	93.2	91.9	102.0	114.0	133.3	24.9	27.2	60.5	29.0	141.6	152.9	163.6	175.1	187.3
Other Revenue	39.0	34.1	31.1	28.4	25.4	4.6	7.6	8.2	5.0	25.4	25.4	25.4	25.4	25.4
Total Revenue	**934.0**	**878.8**	**867.7**	**895.4**	**994.2**	**193.1**	**216.9**	**400.3**	**197.2**	**1007.5**	**1071.3**	**1108.0**	**1162.0**	**1212.7**
Beginning Number of Superstores	97	97	97	95	91	88	88	88	88	88	88	88	93	96
Additions to stores	0	0	0	0	0	0	0	0	0	0	0	5	3	4
Closures	0	0	2	4	3	0	0	0	0	0	0	0	0	0
Ending Superstores	**97**	**97**	**95**	**91**	**88**	**88**	**88**	**88**	**88**	**88**	**88**	**93**	**96**	**100**
Average Ending Superstores	97	97	96	93	89.5	88	88	88	88	88	88	91	95	98
Average Revenue per Superstore, mm$/store	6.8	6.3	6.3	6.7	7.8	1.6	1.7	3.1	1.5	7.9	8.0	8.0	8.0	8.0
Beginning Number of Small Format Stores	150	143	134	131	127	123	123	123	123	123	125	127	133	141
Addition to Stores	0	0	0	0	0	0	0	0	2	2	0	5	5	4
Closures	-7	-9	-3	-4	-4	0	0	0	0	0	2	1	3	2
Ending Small Format Stores	**143**	**134**	**131**	**127**	**123**	**123**	**123**	**123**	**125**	**125**	**127**	**133**	**141**	**147**
Average Ending Small Format Stores	147	139	133	129	125	123	123	123	124	124	126	130	137	144
Average Revenue per Small Format Store, mm$	0.99	0.99	0.96	0.99	1.12	0.21	0.25	0.46	0.23	1.14	1.50	1.50	1.50	1.50

Appendix 5: Discounted Cash Flow Statement

WESTPEAK RESEARCH

DCF Analysis

WACC Calculation

Market Value of Debt	0.009
Market Value of Equity	456
Totel Capitalization	456.009
Debt	**0.009**
Pre-Tax Cost of Debt	3%
Effective Tax Rate	27.0%
After-Tax Cost of Debt	**2.2%**
Capital Asset Pricing Model	
Risk-Free Rate	2%
Equity Market Risk Premium	5%
Beta	1.14
Cost of Equity	**7.7%**
Debt Weight	0.0%
Equity Weight	100.0%
WACC	**7.70%**

Growth Rate 2.0%

Free Cash Flow Analysis	**2012**	**2013**	**2014**	**2015**	**2016**	Q1 2017	Q2 2017	Q3 2017	Q4 2017	**2017**	**2018**	**2019**	**2020**	**2021**
EBIT	-29.6	1.7	-30.0	-5.7	20.0	-11.0	-1.4	50.9	-8.6	28.9	-3.6	-1.3	15.7	20.6
Tax Rate	-5.1%	2.3%	15.2%	9.7%	29.3%	-25.4%	-16.4%	-26.6%	-30.0%	-26.5%	-20.0%	-20.0%	-20.0%	-20.0%
D&A	26.7	27.9	27.5	26.7	23.8	6.0	6.0	6.5	8.2	26.8	32.3	31.1	33.1	34.1
Change in NWC	-19.2	37.8	-5.1	-28.7	7.8	82.2	-10.8	50.5	145.7	4.0	11.2	6.9	0.0	0.0
Capital Expenditures	-12.1	-9.4	-18.7	-10.8	-20.2	-2.0	-3.1	-6.9	-4.0	-15.9	-30.0	-35.0	-35.0	-30.0
Free Cash Flow	**2.6**	**-17.7**	**-11.5**	**39.4**	**9.9**	**-93.2**	**12.1**	**13.6**	**-152.6**	**43.4**	**-13.3**	**-12.4**	**16.9**	**28.8**
Discount Period								*0.25*	*0.25*		*1.25*	*2.25*	*3.25*	*4.25*
Discounted Free Cash Flow								**13.4**	**-149.8**		**-12.1**	**-10.5**	**13.3**	**21.0**

Share Price Calculation

Free Cash Flow Sum		-138.1
Terminal Value		368.8
Enterprise Value		**230.7**
Less: Debt		0.1
Add Cash		316.3
Equity		**546.9**
Shares Outstanding		26.4
Implied Share Value	$	**20.72**

		WACC				
		6.5%	**7.0%**	**7.5%**	**8.0%**	**8.5%**
	1.0%	$ 21.97	$ 20.42	$ 19.11	$ 17.99	$ 17.03
	1.5%	$ 23.49	$ 21.66	$ 20.14	$ 18.86	$ 17.77
GROWTH	**2.0%**	$ 25.35	$ 23.15	$ 21.36	$ 19.87	$ 18.61
	2.5%	$ 27.67	$ 24.97	$ 22.82	$ 21.06	$ 19.60
	3.0%	$ 30.66	$ 27.25	$ 24.60	$ 22.49	$ 20.77

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Appendix 6: Comparable Company Analysis

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Comparables Analysis

	Cash	Debt	Market Capitalization	EV	TTM EBITDA	Share Price	TTM EPS		EV/EBITDA	P/E
Barnes & Noble Inc.	15.3	24.6	880	890	213.7	$12.15	$0.07		4.2 x	180.0 x
Build A Bear Workshop Inc.	43.9	0.0	182	139	46.6	$11.75	$0.12		3.0 x	96.7 x
Hibbett Sports, Inc.	54.4	4.3	836	786	168.8	$38.07	$3.96		4.7 x	9.6 x
Sportsman's Warehouse Hol	3.6	314.6	256	567	102.2	$6.06	$0.97		5.5 x	6.2 x
Big 5 Sporting Goods Corpor	10.7	18.0	452	460	64.1	$20.52	$1.04		7.2 x	19.7 x
Dick's Sporting Goods	222.5	7.2	7,451	7,235	996.2	$66.15	$3.46		7.3 x	19.1 x
Footlocker	1412.1	171.5	13,806	12,565	1570.1	$104.30	$6.63		8.0 x	15.7 x
Canadian Tire	945.0	6397.7	10,895	16,347	1431.0	$151.20	$9.21		11.4 x	16.4 x
Indigo Books & Music	319.2	0.1	430	111	44.0	$16.29	$1.13		2.5 x	14.4 x

	HIGH	AVERAGE	LOW	IMPLIED TARGET EV		IMPLIED TARGET SHARE PRICE
EV/EBITDA	11.4 x	6.0 x	2.5 x	262.62		$ 22.04
				502.64	HIGH	$ 31.13
				110.93	LOW	$ 16.29
	HIGH	**AVERAGE**	**LOW**	**IMPLIED P/E**		**IMPLIED TARGET SHARE PRICE**
P/E	19.7 x	14.5 x	6.2 x	14.5 x		$ 16.36
				19.7 x	HIGH	$ 22.31
				6.2 x	LOW	$ 7.05

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